

Corporate Social Responsibility (Sec 135) Part-2

(Continued from Geeta Saar 95)

6. Functions of CSR Committee

The functions of the CSR Committee is enumerated in sub-section (3) of section 135 of the Act, which provides that the Committee shall,

- (a) formulate and recommend to the Board, a Corporate Social Responsibility Policy which shall indicate the activities to be undertaken by the company as specified in Schedule VII; (the Companies (Amendment) Bill, 2016 proposes to substitute the words “in areas or subject, specified in Schedule VII” for the words “as specified in Schedule VII”)
- (b) recommend the amount of expenditure to be incurred on the activities referred to in CSR Policy and
- (c) monitor the CSR Policy of the company from time to time.

The functions of the Committee imply that the Committee should meet regularly to conduct the business of formulation, recommendation and monitoring. The function of monitoring is a continuing function of the CSR Committee. The modalities of the frequency of meeting, quorum etc. shall be defined by the Board.

While no procedure has been specified in the Act for modification of CSR Policy, going by the intention of legislature, the modification needs to go through CSR Committee. Rule 5(2) further provides that the CSR Committee shall institute a transparent monitoring mechanism for implementation of the CSR projects or programs or activities undertaken by the company.

7. CSR Policy

Rule 2(1)(e) provides that “CSR Policy” relates to the activities to be undertaken by the company as specified in Schedule VII to the Act and the expenditure thereon, excluding activities undertaken in pursuance of normal course of business of a company. Hence, a company cannot undertake activities which are in normal course of its business (either gratuitously or at reduced prices) and claim such expenditure as CSR expenditure. Such policy is framed by the CSR Committee are recommended to the Board for its adoption.

Rule 6 provides that the CSR Policy of the company shall inter-alia include the following namely:

- a) The list of CSR projects or programs which a company plans to undertake falling within the purview of the Schedule VII of the Act, specifying modalities of execution of such projects or programs and implementation schedule for the same; and
- b) Monitoring the process of such projects or programs.

In terms of rule 6(2), the CSR Policy of the company shall specify that the surplus arising out of the CSR projects or programs or activities shall not form part of the business profit of a company.

8. CSR Expenditure

Sub-section (5) of section 135 provides that the Board of every company which fulfils the criteria in sub-section (1) shall ensure that the company spends, in every financial year, at least two per cent of the average net profits of the company made during the three immediately preceding financial years. Such expenditure needs to be made on activities in pursuance of its CSR Policy. It is to be noted that the net profit needs to be calculated as per the provisions of section 198 as per explanation appended after sub-section (5) of section 135. Hence, such profit shall be profit before tax.

The Companies (Amendment) Bill, 2016 proposes to substitute the explanation with the following:

‘Explanation – For the purposes of this section “net profit” shall not include such sums as may be prescribed, and shall be calculated in accordance with the provisions of section 198.’

Here, ‘net profit’ would include ‘net loss’ as well i.e. credit will be given for the losses incurred during any of the three preceding years which are being considered. To give an illustration, where the net profits of the company for the past three financial years are Rs. 2 Crores, Rs. 1 Crore and a loss of Rs. 60 lacs, the average profit for the three years shall be Rs. 80 lacs.

While conducting the CSR activities, the company shall give preference to the local area and areas around it where it operates, for spending the earmarked amount. The local area could be area around registered office or any other site like factory building, branch office from where the company conducts any business. In case of failure to spend the amount, reasons for the same shall be disclosed in the Board’s report.

The CSR expenditure shall be made on the activities relatable to the specified activities provided in Schedule VII. Rule 7 further provides that CSR expenditure shall include all expenditure including contribution to corpus, or on projects or programs relating to CSR activities approved by the Board on the recommendation of its CSR Committee, but does not include any expenditure on an item not in conformity or not in line with activities which fall within the purview of Schedule VII of the Act. General circular no. 21/2014 dated 18.06.2014 further puts a condition on the contribution to corpus shall qualify as CSR expenditure when the said trust/ section 8 company/ society is created exclusively for undertaking CSR activities or the said corpus is earmarked for purposes covered under Schedule VII.

It is clarified through the said circular that one-off events or statutory obligations under other laws do not qualify for CSR expenditure. Further, expenditure on building CSR capacities of their own personnel as well as those of their Implementing agencies including expenditure on administrative overheads, shall not exceed five percent of total CSR expenditure of the company in one financial year.

The Ministry vide its General Circular No.01/2016 dated 12.01.2016 has clarified that the amount spent by the company towards CSR expenditure cannot be claimed as business expenditure. The Finance Act, 2014 also provides that any expenditure incurred by the assessee on the activities relating to Corporate Social Responsibility referred to in Section 135 of the Companies Act, 2013 shall not be deemed to be an expenditure incurred by the assessee for the purposes of the business or profession. However, spending on activities like contributions to Prime Minister's Relief Fund, rural development projects, skill development etc. as specified under Schedule VII may still enjoy exemptions under different sections of the Income Tax Act, 1961.

Any excess amount spent in excess of the prescribed 2 % cannot be carried forward to the subsequent year and adjusted against that year's CSR expenditure. As regards any shortfall in CSR spend during any year, only disclosure of reason in Board's report is mandated. The Act is silent on the carry forward. However, keeping in mind the overall objective of the section, the Board is free to decide if they wish to carry forward the same to next year and then spend it over and above the CSR spending for that subsequent year.

9. CSR Activities

The scheme of the Act is to undertake CSR activities on continuous basis and not as one-off events. Rule 5 provides that the CSR activities shall be undertaken by the company, as per its stated CSR Policy, as projects or programs or activities (either new or ongoing), excluding activities undertaken in pursuance of its normal course of business. Such activities can be undertaken in India only.

The mode of CSR activities may either be through a registered trust (including a trust registered under the provisions of Income Tax Act, 1961 for states where registration of trusts is not mandatory) or a registered society or a company established under section 8 of the Act by the company. Such implementation agency may be incorporated and expenditure made either by the company singly or along with its holding or subsidiary or associate company, or along with any other company or holding or subsidiary or associate company of such other company, or otherwise.

A company established under section 8 of the Act or a registered trust or a registered society, established by the Central Government or State Government or any entity established under an Act of Parliament or a State legislature.

When the implementation agency is not established by the company in any manner specified above, such entity shall have an established track record of three years in undertaking similar programs or projects. The company shall specify the project or programs to be undertaken through these implementation agencies, the modalities of utilization of funds on such projects and programs and the monitoring and reporting mechanism.

A company established under section 8 of the Act or a registered trust or a registered society, established by the Central Government or State Government or any entity established under an Act of Parliament or a State legislature.

Collaboration with other companies for undertaking projects or programs or CSR activities is allowed when separate reporting as per the provisions of the rules is possible.

The CSR projects or programs or activities of the company that benefit exclusively to the employees of the company and their families shall not be considered as CSR activities in accordance with section 135 of the Act.

Further, contribution of any amount directly or indirectly to any political party under section 182 of the Act, shall not be considered as CSR activity.

The expenditure incurred by Foreign Holding Company for CSR activities in India will qualify as CSR spend of the Indian subsidiary if, the CSR expenditures are routed through Indian subsidiaries and if the Indian subsidiary is required to do so as per section 135 of the Act.

10. CSR Reporting

Sub-section (2) of section 135 provides that the Board's report shall disclose the composition of the CSR Committee. In case of failure to spend the CSR amount, the Board's report shall disclose the reason for not spending the same. Rule 8 further provides that the Board's report of a company covered under these rules pertaining to a financial year commencing on or after the 01.04.2014 shall include an annual report on CSR containing particulars specified in annexure to the Companies (Corporate Social Responsibility) Rules, 2014. In case of a foreign company, the balance sheet filed under sub-clause (b) of sub-section (1) of section 381 shall contain an Annexure regarding report on CSR. The said format includes details like a brief outline of the company's CSR policy, composition of the CSR Committee, average net profit of the company for last three financial years, prescribed CSR expenditure, details of CSR spent during the financial year, total amount to be spent for the financial year, amount unspent, if any, reasons of failure to spend, manner of expenditure, a responsibility statement of the CSR Committee etc.

Rule 9 requires the Board to disclose the contents of such policy in its report and the same shall be displayed on the company's website, if any.

11. Ceasing of applicability of provisions

Rule 3(2) provides that every company which ceases to be a company covered under sub-section (1) of section 135 of the Act for three consecutive financial years shall not be required to - (a) constitute a CSR Committee; and (b) comply with the provisions contained in sub-section (2) to (5) of the said section, till such time it meets the criteria specified in sub-section (1) of section 135 again.

12. Punishment and Compoundability

The concept of CSR is based on the principle of “comply or explain”. Section 135 of the Act does not lay down any penal provisions in case a company fails to spend the specified amount. However, as per the second proviso to sub-section (5) of section 135 in case the company fails to spend such amount, the Board shall in its report specify the reasons for not spending the amount. The Act only provides for disclosure, there is no monetary penalty for non-compliance.

In case the company does not disclose the reasons in the Board’s report, the company and the officer shall be liable to fine provided under sub-section (8) of section 134. For any other non-compliance of this section, the penal provisions under section 450 would apply in case of any non-compliance of this section. Accordingly, for contravention, the company and every officer of the company who is in default shall be punishable with a fine upto Rs.10,000, in case the contravention is a continuing one then the further fine shall be Rs.1,000 every day. The offences under this section are compoundable under section 441 of the Act.

(Concluded)

Contents of Geeta Saar, as extracted from ICSI Premier on Company Law, is as per notified law as on 30th September, 2016.