

Social Sector Hotline

March 12, 2014

NEW RULES FOR CORPORATE SOCIAL RESPONSIBILITY ANNOUNCED

- Corporate Social Responsibility ("CSR") defined under the CSR Rules
- Applicable to every company including branch and project offices of a foreign company in India
- Dispensed with the requirement of independent director for private limited and unlisted companies
- Social business projects removed from Schedule VII
- CSR expenditure includes 'spending' as well as 'contribution'
- Non clarity on tax treatment for undertaking CSR activities
- Regulatory fault-line between foreign contribution and CSR regime
- Deletion of social business projects whether valid?
- Whether alteration of the Schedule an abdication of legislative power?

The much discussed and awaited CSR provisions have been notified by the Ministry of Corporate Affairs ("MCA") on February 27, 2014¹ giving effect to Section 135 the new Companies Act, 2013 ("Companies Act") dealing with CSR read with Schedule VII² ("Schedule") of the Companies Act and the Companies (Corporate Social Responsibility) Rules, 2014 ("CSR Rules"). This is in furtherance of powers provided to the Central Government under Section 469 and Section 467 the Companies Act to make and alter rules, regulations etc. and any provisions contained in any of the schedule under the Companies Act. Moreover, any such alteration in the rules or schedules needs to be placed before both the houses of the parliament for validity.

The said Section, Schedule and CSR Rules will come into effect from the first day of April, 2014.

The CSR provision will be applicable to companies with an annual turnover of INR 10 billion and more, or a net worth of INR 5 billion and more, or a net profit of INR 0.05 billion or more during any financial year. Companies that trigger any of the aforesaid conditions must spend at least two per cent (2%) of their average net profits made during the three immediately preceding financial years on CSR activities and/or report the reason for spending or non-expenditure. With the notification having been issued almost a month prior to the date of implementation of CSR provision, the companies will have to gear up to formulate their CSR policy; keeping in mind the revised list of activities enlisted under the amended Schedule VII and the CSR Rules.

CSR PROVISIONS AS ENVISAGED UNDER SECTION 135 OF THE COMPANIES ACT

Every qualifying company will be required to constitute a CSR Committee ("Committee") of the Board of Directors ("Board") consisting of three or more directors³. The Committee shall formulate and recommend to the Board, a CSR policy which shall indicate the activities to be undertaken; recommend the amount of expenditure to be incurred on the activities referred and monitor the CSR policy of the company⁴. The Board shall take into account the recommendations made by the CSR Committee and approve the CSR policy of the company⁵.

It will be important to understand the key changes brought in by the CSR Rules and Schedule VII as captured originally under Section 135 of the Companies Act.

INCLUSIVE DEFINITION OF THE TERM CSR

While the Companies Act used CSR as a nomenclature without actually defining it, the notified rules have defined the term 'CSR' to mean and include but not limited to:

- projects or programs relating to activities specified in the Schedule; or
- projects or programs relating to activities undertaken by the Board in pursuance of recommendations of the CSR Committee as per the declared CSR policy subject to the condition that such policy covers subjects enumerated in the Schedule.

By providing the definition of CSR, the scope and application of CSR that can be undertaken by the companies has been further clarified. The definition of CSR assumes significance as it allows companies to engage in projects or programs relating to activities enlisted under the Schedule. It also permits flexibility to companies by allowing them to choose their preferred CSR engagements that are in conformity with the CSR policy.

By keeping the definition of CSR inclusive, MCA acknowledges the urgent need of the industry to be given more freedom in choosing their CSR activities. However, it would be interesting to watch this space and see whether such autonomy (if given) can have any significant multiplier effect - both for the economy and corporates. It also needs to be seen whether such autonomy will allow flexibility to companies in choosing activities from outside the list of Schedule

Research Papers

Structuring Platform Investments in India For Foreign Investors

March 31, 2025

India's Oil & Gas Sector— at a Glance?

March 27, 2025

Artificial Intelligence in Healthcare

March 27, 2025

Research Articles

Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?

February 04, 2025

INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals

January 15, 2025

Key changes to Model Concession Agreements in the Road Sector

January 03, 2025

Audio

CCI's Deal Value Test

February 22, 2025

Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice

December 18, 2024

Digital Lending - Part 1 - What's New with NBFC P2Ps

November 19, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Vyapak Desai speaking on the danger of deepfakes | Legally Speaking with Tarun Nangia | NewsX

INSTITUTIONAL COVERAGE OF CSR

While Section 135 (1) of Companies Act brings under its purview every company which would mean to include a company incorporated in India⁶. The CSR Rules have made an attempt to broaden the definition of the term 'company' to include a foreign company having a branch or project office of a foreign company.⁷ This gives an expansionist scope under the CSR Rules to regulate such companies which prima facie are not included under Section 135. Thus, the CSR Rules which were supposed to be supplementary to the main provision seems to have overreaching effect well beyond the scope of Section 135 as originally contemplated. This is a clear discordance which may be opened to judicial scrutiny as MCA has gone beyond its legislative mandate.

Further, it seems to be an overarching provision and applicability of the same may be perceived by the foreign companies as an additional tax, over and above their corporate taxes for doing business in India.

COMPUTATION OF NET PROFIT

Every company will have to report its standalone net profit during a financial year for the purpose of determining whether or not it triggers the threshold criteria as prescribed under Section 135(1) of the Companies Act.

Indian company: The CSR Rules have clarified the manner in which a company's net worth will be computed to determine if it fits into the 'spending' norm. In order to determine the 'net profit', dividend income received from another Indian company or profits made by the company from its overseas branches have been excluded. Moreover, the 2% CSR is computed as 2% of the average net profits made by the company during the preceding three financial years.

Foreign company: The CSR Rules prescribe that in case of a foreign company that has its branch or a project office in India, CSR provision will be applicable to such offices. CSR Rules further prescribe that the balance sheet and profit and loss account of a foreign company will be prepared in accordance with Section 381(1)(a) and net profit to be computed as per Section 198 of the Companies Act. It is not clear as to how the computation of net worth or turnover would be arrived at in case of a branch or project office of a foreign company.

APPOINTMENT OF INDEPENDENT DIRECTORS ON THE BOARD

The CSR Rules have dispensed with the requirement of appointing an independent director on the CSR Committee of the Board of an unlisted company as well as a private company. It has brought in the much needed clarity, as under the boarder scheme of the Companies Act, there is no requirement regarding appointment of independent director on the board of directors of the unlisted or private company.

Further, the CSR Rules have relaxed the requirement regarding the presence of three or more directors on the CSR Committee of the Board. In case where a private company has only two directors on the Board, the CSR Committee can be constituted with these two directors. The CSR Committee of a foreign company shall comprise of at least two persons wherein one or more persons should be resident in India⁸ and the other person nominated by the foreign company⁹.

The CSR Rules, by including foreign companies within its ambit, have provided latitude to treat persons authorized by the foreign company akin to directors of an Indian company for the purposes of affixing a fiduciary duty and liabilities in the event of any breach in the reporting requirements for CSR provisions. By expanding the scope of CSR Rules, it is apparent that the government has overlooked the limited role (to accept on behalf of company service of process and any notices or other documents) of the authorized persons of the foreign companies in India.

MODALITIES FOR UNDERTAKING CSR ACTIVITIES

Conducting CSR through a third party: CSR activities can be undertaken through a registered society or trust or a Section 8 Company under the Companies Act. In this regard, the CSR Rules have liberalized the participation of a third party to undertake CSR activities on behalf of the spending company provided it fulfills the relevant track record of three years in undertaking similar projects or programs. Such an entity would have to follow the specifications and modalities regarding utilization of funds, monitoring and reporting requirements as provided by the spending company.

Conducting CSR through group entities: Autonomy to the companies to carry out their CSR activities through their own or holding or subsidiary or associate company's registered society or trust or Section 8 Company have been provided.

Collaborating or pooling resources: Collaboration with other companies for undertaking CSR projects or programs is also permitted subject to the condition that the collaborating companies are in a position to report separately as per the reporting requirements under the Companies Act.

CSR EXPENDITURE

Nature of CSR expenditure and geographic limitations

Expenditure incurred on specified activities that are carried out in India will qualify as CSR expenditure. Such expenditure includes contribution to the corpus or on projects or programs relating to CSR activities. Any activity undertaken solely for the benefits of employees and their families will remain outside the purview of CSR activity.

Expenditure incurred in undertaking normal course of business will not form a part of the CSR expenditure. Companies would need to clearly distinguish those activities which are undertaken specifically in pursuance of normal course of business and those that are done incrementally as part of the CSR initiatives.

Any surplus arising out of CSR activities will not be considered as business profit for the spending company. It is unclear whether the surplus will form part of the CSR Fund for the next financial year.

The CSR Rules are unequivocal in stating that any form of direct or indirect contribution made to any political party by company cannot be counted towards CSR activity.

Employees' contribution towards CSR

Companies are permitted to train their employees and/or personnel of their implementing agencies to build CSR capabilities. Any expenditure incurred in providing such training up to a ceiling of five percent in one financial year is permitted under the CSR budget. However, owing to a ceiling on the percentage of amount that can be spent for

April 01, 2025

Vaibhav Parikh, Partner, Nishith Desai Associate on Tech, M&A, and Ease of Doing Business

March 19, 2025

SIAC 2025 Rules: Key changes & Implications

February 18, 2025

training purposes, the idea of including and computing employees' time-value contribution towards CSR has not been factored at all. Allowing companies to train employees subject to a pre-fixed budget while excluding employees' time-contribution will create a dichotomy in allocation of CSR expenditure.

REPORTING

It is mandatory for companies to disclose their CSR Policy, programs/projects undertaken and amount spent in their report and the CSR Rules provide for a separate format. The report containing details of such activities and CSR policies have to be made available on the company's website for informational purposes.

PROVISION FOR CEASE OF APPLICABILITY OF CSR PROVISION

The requirement and compliance under the CSR provision will cease to be applicable to a company which for the three consecutive years falls outside the purview of the threshold requirement of annual turnover or net worth or net profit as envisaged under Section 135(1) of the Companies Act.

SCOPE OF ACTIVITIES UNDER SCHEDULE VII¹⁰

Substantial changes have been made into the activities enlisted in the Schedule. In the present CSR Rules, the scope of activities under the Schedule has been expanded to include preventive healthcare, sanitation, providing safe drinking water, protection of national heritage, rural development projects, measures to benefit armed forces veterans, rural development projects and the like.

Similarly, several new spectrum of activities such as promoting rural sports, nationally recognized sports, setting up homes and hostels for women, orphans and senior citizens, reducing inequalities in socially and economically backward groups and support to technology incubators in academic institutions have also been included in the list of CSR activities under Schedule. However, the most notable absentees are 'social business projects' and residual clause giving power to the government to prescribe other matters on CSR related activities.

DELETION OF SOCIAL BUSINESS PROJECT AS A CSR ACTIVITY- WHETHER VALID?

Section 467 of the Companies Act gives power to the central government to alter the provisions contained in any of the Schedules. The section is similarly worded as Section 641 of the Companies Act, 1956 which gave power to the central government to make changes in the Schedules.

The notification dated February 27, 2014 is a delegated legislation issued under a statutory provision, namely Section 467 of the Companies Act which provides that the Central Government may, by notification, alter any of the regulations, rules, tables, forms and other provisions contained in any of the Schedule to the Act. Since the Schedule forms an integral part of Section 135, the power to alter the Schedule needs to be exercised with an abundant caution. Delegated legislation is a means by which the legislature delegates part of its legislative function to an executive authority. However, there are well-settled constitutional limits on the scope of delegated legislation. The legislature cannot delegate essential legislative functions such as the determination of legislative policy and cannot delegate its power to repeal or modify its essential features.¹¹

Social business projects forms the core philosophy of corporate social responsibility and Schedule VII of the original Companies Act, 2013 contained 'social business projects' among the list of various activities that a company could undertake. The Central Government vide notification dated February 27, 2014 made amendments to the Schedule while deleting 'social business projects' from the list of activities enlisted under the Schedule. Although Section 467 empowers the government to amend the Schedule through delegation, the power to amend under this section is meant to make simple alterations without affecting the legislative policies enshrined in the Companies Act, 2013. Deletion of 'social business projects' through the notification seems to override the CSR policy as envisaged under the Companies Act. By deleting 'social business projects' through the notification, the central government seems to have exceeded its legislative mandate and the same may be subject to judicial review in future.¹²

OPEN-ENDED ISSUES

Absence of reference point to permit further expansion under the Schedule:

Although CSR Rules have expanded the scope of activities that the companies may undertake, it has, at the same time, not expressly permitted the choice of activities outside the Schedule. Thus, the Schedule may seem to be limiting for certain types of companies that engage in the field of social business or entrepreneurship which the CSR provisions intend to address.

Non clarity on tax treatment for undertaking CSR activities:

CSR Rules are silent on the tax treatment of 'contribution' and 'spending' made through CSR fund by the companies. The tax difference between making donations and spending towards activities enumerated under the Schedule may vary vastly. By including PM National Relief Fund into the Schedule, policy-makers have allowed companies to merely write cheques and claim deductions instead of carrying CSR activities on the ground. Therefore, the new CSR provisions have to be aligned with the existing income-tax laws.

Regulatory fault-line between foreign contribution and CSR regime:

It is important to see whether CSR Rules is positioned to allow convergence with foreign contribution regime in India. Any foreign contribution received from any foreign source requires approval under the Foreign Contribution Regulation Act, 2010 ('FCRA'). It is interesting to note that the definition of foreign source is wide enough to include a Indian company wherein one-half or more nominal share capital is held by a citizen of a foreign country or a foreign corporation or a foreign company. Therefore any spending or contribution made by the foreign source falling within the ambit of the CSR provision will come within the purview of FCRA hence no spending/contribution can be made without the express approval or permission by the Ministry of Home Affairs. Allowability of foreign as well as Indian companies' to make contributions through CSR provision may give rise to inter-regulatory fault-lines within the broader context of CSR and foreign contribution regime in India.

Non clarity on computation of financial accounts of foreign companies:

No clarity under the Companies Act is provided towards any mechanism that allows computation of accounts of a foreign company in order to determine the net worth or turnover of a branch or a project office. Ascertaining the

incidence of CSR exposure in the absence of any clear provision for financial computation of branch or project offices of foreign companies may prove problematic and create practical difficulties.

CONCLUSION

While the introduction of CSR provision in the Companies Act is a welcome step, however the current discourse of corporate philanthropy without giving any express autonomy to companies in choosing their CSR activities may not yield the desired outcome. By allowing only selected list of activities within the Schedule in a sectional manner may end up encouraging only a passive participation by corporates towards CSR activities. In order to enable corporates to participate fully in the philanthropy space, the participation must start with a more inclusive management of CSR policies where government and industry work side by side, which does not assume that (social) business and CSR are incompatible. Thus, the policy-makers should frame rules for social business projects instead of eliminating it from the scheme of CSR regime altogether.

Although Section 135 of the Companies Act did not contemplate enlarging the scope of companies to cover foreign companies in the first place, the CSR Rules nonetheless included foreign companies within its scope. It seems the central government is not opposed to the idea of allowing excessive delegated powers to the executive to make such changes in the Companies Act which cannot be brought unless an amendment to the original Act is proposed. The CSR Rules, in essence, exceeds its legislative mandate; and this aspect needs to be considered by the policy makers.

By expanding the scope of CSR to include foreign companies, its impact on such companies may be manifold. In light of the ambiguity surrounding financial computation of foreign companies, it needs to be seen how practical it would be for branch or project offices to participate in CSR activities. In order to retain the advantage of having a CSR provision in the Companies Act, MCA must also facilitate greater convergence with tax and foreign contribution laws in India.

– **Rahul Rishi, Ankita Srivastava & Dr. Milind Antani**

You can direct your queries or comments to the authors

¹ Press Release dated 27th February 2014; <http://pib.nic.in/newsite/erelease.aspx?relid=104293>

² Schedule VII deals with the activities which may be included by companies in their CSR policies

³ Section 135 (1) of the Companies Act

⁴ Section 135 (2) of the Companies Act

⁵ Section 135 (3) of the Companies Act

⁶ Section 2(20) defines the term Company as a company incorporated under this Act or under any previous company law.

⁷ Section 2(42) of the Companies Act, 2013 defines a "foreign company". A "foreign company" means any company or body corporate incorporated outside India which-

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(b) conducts any business activity in India in any other manner.

⁸ One of the person shall be as specified in Section 380 (1) (d) of the Companies Act. The said section provides that one or more persons resident in India authorized to accept on behalf of the company service of process and any notices or other documents required to be serviced on the company.

⁹ Section 380(1) of the Companies Act provides that one or more person resident in India is authorized to accept on behalf of the company service of process and any notices or other documents required to be served on the company.

¹⁰ <http://pib.nic.in/newsite/PrintRelease.aspx?relid=104293>. Website last visited on February 28, 2014.

¹¹ In Re The Delhi Laws Act, 1912 [1951 AIR 332]

¹² J.K. Industries Ltd. v Union of India and Ors [165 TAXMANN 323 (SC)]

DISCLAIMER

The contents of this hotline should not be construed as legal opinion. View detailed disclaimer.

This Hotline provides general information existing at the time of preparation. The Hotline is intended as a news update and Nishith Desai Associates neither assumes nor accepts any responsibility for any loss arising to any person acting or refraining from acting as a result of any material contained in this Hotline. It is recommended that professional advice be taken based on the specific facts and circumstances. This Hotline does not substitute the need to refer to the original pronouncements.

This is not a Spam mail. You have received this mail because you have either requested for it or someone must have suggested your name. Since India has no anti-spamming law, we refer to the US directive, which states that a mail cannot be considered Spam if it contains the sender's contact information, which this mail does. In case this mail doesn't concern you, please unsubscribe from mailing list.