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## **Is Companies Act 2013 forcing corporate to do Charity? : A critical Analysis of CSR regime of new Corporate Legislature of India.**

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### **ABSTRACT**

*On 29<sup>th</sup> August 2013 the President has given its assent to Companies Bill 2013 and the new era of Corporate legislature started in India after 56 years of Companies Act 1956. On 27<sup>th</sup> February 2014 Ministry of Corporate Affairs (MCA) has notified Section 135 of the new Companies Act 2013 relating to Corporate Social Responsibility, Schedule VII and Companies (Corporate Social Responsibility Policy) Rules, 2014. With this Indian corporate are required to follow practice of mandatory Corporate Social Responsibility from Financial Year 2014-15. There is no existing provision on Corporate Social Responsibility in the Companies Act 1956. India is the first country which has made mandatory Corporate Social Responsibility with the notification of above mentioned provisions. With the introduction of mandatory CSR government has legalized the right of society on the corporate duties towards society.*

*In this backdrop I have attempted to conduct a study to examine the provisions relating to CSR in companies Act 2013 and issues and challenges in implementing the same before Indian Corporates. The paper is exploratory research carried out to analysis the provisions of Companies Act 2013 with respect to mandatory Corporate Social Responsibility without formation of any hypothesis. The data is collected mainly from secondary sources the Companies Act 2013, Companies (Corporate Social Responsibility Policy) Rules, 2014 MCA web site etc in the relevant arena.*

*The paper has been divided into six sections, namely: 1. Introduction, 2. Objective of the Study, 3. Research Methodology, 4. Analysis of Provision of Companies Act, Schedule VII and CSR Rule 5. Issue and Challenges before Indian Companies in implementing mandatory CRS and 6. Conclusion*

**Key Words:** *Companies Act 2013, Corporate Social Responsibility, MCA, CSR, Companies (Corporate Social Responsibility Policy) Rules, 2014 JEL Classification: K22, M14*

**“Good people do not need laws to tell them to act responsibly, while bad people will find a way around the laws”-**

**-Plato**

### **1. INTRODUCTION:**

Good Corporate legislature is very important for any economy as its directly and indirectly effects the growth of business in the country. The beginning of era of modern corporate law in England started in 1844 when Joint Stock Companies Act was passed. Following the trend

of England the first corporate legislature in India was passed in 1850. It provides for registration of Companies and transferability of shares but does not give members benefit of limited liability. The Companies Act of 1856 repealed all the previous corporate law of India. This Act dealt with provision relating to incorporation, regulation, and winding up of companies and other associates. The amendment Act of 1857 conferred the right to registration with or without limited liability. This was the first time the concept of limited liability was introduced in India. The same right of registration with or without limited liability was given to Banking and Insurance by the Companies Act of 1860. The then companies Act was recasted in 1882 inserting the amendments made in English Company Law at that time. However, 1913 was landmark year in the History of corporate law as consolidated Act incorporating all provisions was passed. The major amendment to 1913 Act took place in 1936. In 1948 England passed a comprehensive Companies Act. In 1951 Indian Government promulgated the Indian Companies Act (Amendment) Ordinance under which central government and court has been given extensive power to intervene in the affairs of the company and to take necessary action in the Interest of the Company. The Companies Act 1956 was came into force on 1<sup>st</sup> April 1956 to repeal the then existing Companies Act 1913 and extend to whole of the India even to Nagaland subject to such modifications, if any, as the central government may, by notification in the Official Gazette, specify. The Companies Act 1956 was largely based on the recommendation of Bhabha Committee submitted in March 1952 with a view to consolidate and amend the earlier law relating to company and other associate. As the dynamics of the business changes with the passage of time there was need to change the law to support the growth of the business. The Companies Act 1956 was also amended as many as 26 times since 1956. However, the need to replace the existing old Companies Act 1956 was felt for long time to make the existing law and policies at par with international standard and support the growth of Business in the country.

On 4<sup>th</sup> August 2004 Government has brought “Concept paper on new Company Law” on the website of Ministry of Corporate Affairs, with the objective of drafting the new Companies Bill after following a detailed consultative process. On 2<sup>nd</sup> December 2004 the Government has constituted an Expert Committee under the Chairmanship of Dr J.J. Irani comprising the representative from the concerned Departments, Ministries, Professional Institutions, trade bodies and also experts in the field to make recommendations towards the new Company Law. Based on the recommendations of Dr J.J. Irani the Companies Bill 2008 was prepared. The Companies Bill 2008 was introduced in the Lok Sabha on 23<sup>rd</sup> October 2003 but due to dissolution of 14<sup>th</sup> Lok Sabha (UPA-I) the bill was lapsed and could not be passed in the Lok Sabha. After formation of new Government (UPA-2) the Companies Bill 2009 was reintroduced into the Lok Sabha on 3<sup>rd</sup> August 2009 with minor modification in Companies bill 2008. On 9<sup>th</sup> September 2009 the Bill was referred to standing finance committee (the SFC) for examination and report. The Standing Finance Committee submitted its report on 31<sup>st</sup> August 2010 to the parliament. After several rounds of discussion and consultative exercise and after taking into account the report submitted by the Standing Finance Committee the bill was introduced in Lok Sabha on 14<sup>th</sup> December 2011. But bill was again referred to Standing Finance Committee to review certain provision introduced in the Bill. This is first time in the history of parliament a Bill was referred twice to Standing Finance Committee for review and consultation. The revised bill after incorporating certain new suggestions of the Committee was approved by the Cabinet on 4<sup>th</sup> October 2012. The

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Companies Bill 2012 was passed by the Lok Sabha on 18<sup>th</sup> December 2012. The Companies Bill 2013 was passed in the Rajya Sabha on 8<sup>th</sup> August 2013. With the Presidential assent on 29<sup>th</sup> August 2013 the road for the new corporate legislature was clear. When the Bill was passed in Lok Sabha it was Companies Bill 2012 as it was passed in the year 2012 but when Rajya Sabha passed has passed it become Companies Bill 2013 as it was passed in the year 2013. After presidential assent it is known as Companies Act 2013.

The term Corporate Social Responsibility is simply the responsibility of Corporates towards the society and the way how corporate discharges its responsibility towards Society. Corporates are part of society they can't run in isolation with the Society. The concept of doing business is changing with the passage of time and profit is not the sole motive of business. Business has responsibility towards the society also. In most of the countries in the World there is disclosure requirement on CSR but Indian has changed the concept of CSR from disclose to mandatory with the introduction of section 135 in the Companies Act 2013. On 27<sup>th</sup> February 2014 MCA has also notified Section 135 of the new Companies Act 2013 relating to Corporate Social Responsibility, Schedule VII and Companies (Corporate Social Responsibility Policy) Rules, 2014. With this Indian corporate are required to follow practice of mandatory Corporate Social Responsibility from Financial Year 2014-15. There is no existing provision on Corporate Social Responsibility in the Companies Act 1956. India is the first country which has made mandatory Corporate Social Responsibility with the notification of above mentioned provisions.

## **2. OBJECTIVES:**

The study attempt to seek more specially the following objectives:

- a. To analyze the provision of CSR in the Companies Act 2013.
- b. To analyze the provisions of Companies (Corporate Social Responsibility Policy) Rules, 2014 and
- c. To identify the issues and challenges before Indian Corporate in implementation of mandatory CSR.

Considering the above objectives the scope of the study is extended only for analysis of provision of CSR in Companies Act 2013 and the issues and challenges in implementation of same in India before Indian Corporate.

## **3. RESEARCH METHODOLOGY:**

The subject is new and I have not formulated any hypothesis. The research is an exploratory research and research designed employed for the Study is of descriptive type. The data collection is done mainly from the secondary data sources such as bare Companies Act 2013, Companies (Corporate Social Responsibility Policy) Rules, 2014 and MCA official web site.

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#### **4. ANALYSIS OF PROVISIONS OF COMPANIES ACT 2013 :-**

##### **a. Meaning of CSR Activities :**

Section 135 of the Companies Act 2013 does not define CSR Activities .However Rule 2 of CSR Rule 2014 defines CSR Activities in inclusive way and it includes but not limited to :-

- (i) Projects or programs relating to activities specified in the Schedule VII to the Act or
- (ii) Projects or programs relating to activities undertaken by the board of directors of a company in pursuance of recommendation of CSR Committee of the Board subject to condition that such policies will cover subject mentioned in Schedule VII of the Act

The plain reading of above provision give impression that Company can undertake any other activities as CSR Activities even if it is not prescribed in the Schedule VII of the Companies Act 2013.However Rule 7 of CSR Rules clarify that CSR Activity is one falling with Schedule VII of the Act. Hence only activities which fall under schedule VII or are related to the same will be counted as CSR Activities.

The Activities considered as CSR Activities in Schedule VII are as below :-

- a. Eradicating extreme hunger and poverty;
- b. Promotion of education;
- c. Promoting gender equality and empowering women;
- d. Reducing child mortality and improving maternal health;
- e. Combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases;
- f. Ensuring environmental sustainability;
- g. Employment enhancing vocational skills;
- h. Social business projects;
- i. Contribution to the Prime Minister's National Relief Fund or any other fund set up by the Central Government or the State Governments for socio-economic development and relief and funds for the welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women; and such other matters as may be prescribed.

MCA circular dated 18.06.2013 states that the entries in schedule VII must be interpreted liberally so as to capture the essence of the subject enumerated in the schedule. CSR Rule 2014 states that CSR Activities that benefit only the employee and their families are not considered as CSR Activities. Also CSR activity should not be undertaken in normal course of business and must be with respect to any of the activities mentioned in Schedule VII of the Companies Act 2013.The contribution to political party is also outside the scope of CSR Activities of Companies Act 2013.

##### **b. Applicability :**

The CSR Provisions of Companies Act 2013 is applicable for all Companies if they meet any of the below mentioned criteria in any financial year :-

1. Net worth of Rs 500 crs or more ; or

2. Turnover of Rs 1000 crs or more; or
3. Net profit of Rs 5 crs or more

The term any financial year is not defined and clarified in the Act. On 18<sup>th</sup> June 2014 MCA has issued circular clarifying any financial year means any of the three preceding financial year.

Also it is applicable to all types of Company viz: Public, Private, holding, subsidiary, foreign subsidiary etc. The applicable date for CSR Section 135 and CSR Rules 2014 is from 1<sup>st</sup> April 2014

**c. Amount of CSR:**

The All Companies to whom CSR is applicable shall 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, in pursuance of its Corporate Social Responsibility Policy.

The explanation to section 135 states that “average net profit” shall be calculated in accordance with the provisions of section 198. As per CSR Rule 2014 net profit of the Company to mean net profit as per Financial Statement prepared in accordance of Companies Act 2013 and does not include:-

- Any profit arising from any overseas branch or branches of the company' whether operated as a separate company or otherwise
- Any dividend received from other companies in India, which are covered under and complying with the Provisions of section 135 of the Act

**d. Out of CRS Purview :**

Once any one of the applicability criteria mentioned in the applicability clause is met by any company they are required to comply the provision of mandatory CSR every year even in the next year the company cease to be covered under any of the three criteria mentioned in the Act. However Rule 3(2) of CSR Rule 2014 provides that if a company cease to meet any of the three criteria mentioned for applicability of CSR for three consecutive financial it is not required to follow the provision of CSR till such time it again fulfill any of the three applicability criteria mentioned above.

**e. CSR Committee And Its Role :**

If a company fall in any of the three criteria mentioned in applicability clause of CSR during any financial year it shall constitute a Corporate Social Responsibility Committee of the Board consisting of three or more directors, out of which at least one director shall be an independent director.

Rule 5 of CSR Rule 2014 provide that in case of unlisted and private company CSR Committee shall constitute without independent Director and a Private company having two Directors shall constitute its CRS Committee with two Directors.

The Corporate Social Responsibility Committee shall,—

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- (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 of the Companies Act 2013
- (b) Recommend the amount of expenditure to be incurred on the activities referred to in clause (a); and
- (c) Monitor the Corporate Social Responsibility Policy of the company from time to time.

**f. Board Role in CSR:**

It is the responsibility of the board to ensure that the company spends 2% of the Average net profit made during proceeding three financial year in pursuance of CSR Policy. Section 135(4) of the Companies Act 2013 says that the Board of Directors shall approve the CSR policy after considering the recommendation of CSR committee and disclose contents of such Policy in its report and also place it on the company's website, if any. The Board has to ensure that company undertakes the activities mentioned in CSR policy. The report of the Board shall also disclose the composition of CSR Committee.

**g. Mode of Undertaking CSR:**

The CSR Activity should be undertaken in project or Programme model as per CSR policy of the Company. The MCA has issued circular dated 18.06.2014 and clarified one off event such as marathons/advertisement etc would not be qualified as CSR expenditure. The CSR activity in India is only considered. The Board may decide to undertake the CSR activity through below modes:-

1. Registered Trust
2. Registered Society
3. Company established under section 8 of the Companies Act 2013 by the company, either 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.
4. Company can also collaborate with other companies in such manner that CSR committee are in position to report separately on such project or programme to undertake the CSR Activities.

**h. Display of CSR Activity on the Web Site :**

If the Company has website the CSR policy of the Company also need to be disclosed on such website.

**i. Unspent CSR Amount:**

The CSR Rule 2014 has prescribed the format of Annual Report on CSR Activities to be included in the Board Report and in the format the cumulative expenditure is required to be disclosed. This means that the unspent amount on a particular project during particular year need to be carried forward so that cumulative five of the project will be arrives.

**j. Locality for CSR:**

The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities.

**k. Penalty for Non Compliance:**

There is no penalty in the Companies Act 2013 for non-spending the CSR amount. The Companies Act 2013 only provide that if the company fails to spend such amount, the Board shall, in its report specify the reasons for not spending the amount. The approach to CSR in Companies Act 2013 is based on the principal of Comply or Explain. The Section and Rules nowhere describe non-spending as non-compliance but only reason for non-spending is required to be disclosed in the board report. Also auditor can't give qualified report for the same. However failure to explain is punishable with fine from Rs 50000 to Rs 25,00,000. Also officer of the company who default on the reporting provision could be subject to three year in prison and/or fine of not less than Rs 50,000 and upto Rs 5 lacs.

**5. ISSUE AND CHALLENGES BEFORE INDIAN COMPANIES IN IMPLEMENTING MANDATORY CSR:-**

On the basis of analysis of above provision of CSR in Companies Act and CSR Rule 2014 I have identified the below mentioned issue and challenges before Indian Corporate in implementing the CSR:-

**a. Restricted CSR Activities:-**

The activities mentioned in Schedule VII of the Act is only eligible for CSR spending. Although the entries in schedule VII must be interpreted liberally so as to capture the essence of the subject enumerated in the schedule. But it does not permit the choice of activity outside the schedule VII. The CSR activity will be chosen by CSR committee will be one the activity mentioned in Schedule VII. It is not giving company freedom to select from any other critical area not mentioned in Schedule VII.

**b. Restricted preference location:-**

The company shall give preference to the local area and areas around it where it operates, for spending the amount earmarked for Corporate Social Responsibility activities as per provision of section 135 of the Companies Act 2013. Most of the big corporate are located in the developed area of India and they will not do the CSR in undeveloped district or locality. There should be provision that 50% of the CSR amount to be spend in the undeveloped area identified by the government. The regional imbalances are not taken into account and not given due importance while drafting the provision of the Act.

**c. Liquidity Problem:-**

The amount of CSR spending is at least two per cent of the average net profits of the company made during the three immediately preceding financial years. It may be possible that 2% average net profit of the company will be more than liquidity and cash flow position of the company. Many company with tight liquidity position will struggle to comply the provision.

**d. Lower Net Profit Limit:-**

The three threshold mentioned in the Act for applicability of mandatory CSR is networth of Rs 1000 crs or more; or turnover of Rs 1000 crs or more; or net profit of Rs 5 crs or more. The limit of net profit of Rs 5 crs or more is very low compare to net worth criteria of Rs 500 crs and turnover criteria of Rs 1000 crs. Even many small companies will come under the preview of CSR due to threshold of limit of Rs 5 crs net profit.

**e. Additional Burden of Business Responsibility Reporting:-**

SEBI has inserted clause 55 of the listing agreement and top 100 companies in terms of market capitalization in BSE and NSE are required to include Business Responsibility (BR) report with their Annual Report. Now CSR is mandatory but above mentioned company are still required to include BR Report in their Annual Report. In future SEBI may dispense the requirement of BR Reporting if CSR is mandatory for particular company.

**f. First Meeting, Frequency and Quorum of Meeting:-**

The Act is silent on the First Meeting, frequency and quorum for the meeting of CSR Committee. There is need to insert clarity on the same in the CSR Rule, 2014.

**g. Taxation Aspects:-**

The taxation aspects of CSR are not clear. The CBDT has not issued any clarification/circular as on date on whether CSR contribution and/or spending will be treated as business expenses and will be deducted from income of the Company for computation of Tax as business expenses. What is the tax treatment of revenue and capital CSR expenses is still not address by the taxman. Also there is some deduction prescribed by Income Tax for donation U/s 80 G subject to ceiling of 10% of Gross Total income. Some item mentioned in the CSR Activity of Schedule VII is also covered in section 80 G for example contribution to prime minister Relief fund etc. This will promote company not to do any CSR Activity and make contribution to Prime Minister Fund .It will comply the dual law one Companies Act 2013 and second IT Act. The company will take benefit under both the law. This will make the CSR activity as “Cheque Book CSR”. The company instead of doing CSR will simply make contribution to these funds and comply the provision of the Act. The spirit of the Act will be defeated.

**h. Extra Burden:-**

The corporate in India is paying tax @30% plus surcharge plus education and secondary and higher education cess. Corporate are also required to pay wealth tax @1%. This extra amount of 2% net profit of the company for CSR Activity is extra burden for the companies.

**i. No Penalty for Non Compliance:-**

The approach adopted in the Act for implementing CSR is to comply or explain. There is no penalty on company which does not comply the provision of CSR. The Act has adopted easy approach for non-compliance.



**j. Time limit for out of CSR Preview :-**

Once CSR provision is applicable to company it will be continue to apply to company even in the next year the company cease to be covered under any of the three criteria mentioned in the Act for applicability of CSR. To be out of the preview of CSR Provision Company should not fall in any of the three criteria mentioned for applicability of CSR for continuous period of three years. This provision is harsh on small company and company passing from financial trouble. The law should allow company to go out of the preview of CSR provision based on only previous year financials .The period of three year is larger period to qualify to be out of CSR applicability.

**k. Related party spending on CSR:-**

There is no clarity on spending in CSR Activities through related party. The Act should put restriction and control on CSR Activities through related party for example trust promoted by relative of promoter.

**l. Employee outside the preview:-**

Charity begins from home. However, CSR Rule 2014 states that CSR Activities that benefit only the employee and their families are not considered as CSR Activities .There should be provision in the Act that only employees drawing salary in excess of the specified amount will be outside the scope of CSR and not all types of employees and their families.

**m. Treatment of Unspent amount:-**

There is lack of clarity on how long the accumulated unspent amount of CSR can be carry forward. Some time limit should be prescribed for spending the amount and mere giving explanation for no-spending should not be accepted. The Act should impose penalty on the Companies and Directors for non-spending the amount within some specified time.

**6. CONCLUSION:**

India has old tradition of taking care of the society. In earlier days wealth person take care of society by setting of temples, schools, colleges etc. Mahatma Gandhi has introduced the concept "trusteeship". Even when there was no mandatory CSR big corporate houses are involved in some sort of CSR activities. The concept of mandatory CSR is based on the principal that corporates are taking its input and delivering its out to Society. Corporate are part of the society and they can't run in isolation. Discharging responsibility towards society is not charity. Corporate should also be responsible towards society as they get its input and output from society only. Society has right to know how corporate is discharging its social responsibility. With the introduction of mandatory CSR government has legalized the right of society on the corporate duties towards society .There are other forms of business also and in the year to come mandatory CSR should be extended to these forms of business also.

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