

April 2014

## Corporate Social Responsibility under the New Companies Act.

### 1 Introduction

The recently enacted Companies Act, 2013 seeks to encourage large companies to invest in developmental activities within India in a structured manner through a mandatory Corporate Social Responsibility (“**CSR**”) commitment. Section 135 of the (Indian) Companies Act, 2013 (the “**New Act**”), read together with the Companies (Corporate Social Responsibility Policy) Rules, 2014 (the “**Rules**”) and the amendment to schedule VII of the New Act sets out the regulatory framework for CSR which would be applicable to companies incorporated, or having a presence, in India. The provisions will take effect from 1 April 2014. Discussed below are some of the key features of the CSR regime.

### 2 Applicability of the CSR provisions

The CSR provisions will be applicable to all companies incorporated in India (private or public) as well as foreign companies having a branch office or project office in India. A company which fulfils any one of the criteria mentioned below in any financial year is required to spend a part of its profits (as discussed below) towards its CSR activities.<sup>1</sup>

**2.1** Companies having a net worth<sup>2</sup> of INR 500 crore or more.

**2.2** Companies having an annual turnover<sup>3</sup> of INR 1000 crore or more.

**2.3** Companies having net profits of INR 5 crore or more.

(Any company fulfilling any one of the above requirements, an “**Eligible Company**”).

<sup>1</sup> Section 135 of the New Act.

<sup>2</sup> Section 2(57) of the New Act defines “net-worth” as the aggregate value of the paid-up share capital and all reserves created out of the profits and securities premium account, after deducting the aggregate value of the accumulated losses, deferred expenditure and miscellaneous expenditure not written off, as per the audited balance sheet, but does not include reserves created out of revaluation of assets, write-back of depreciation and amalgamation.

<sup>3</sup> Section 2(91) of the New Act defines “turnover” of a company as the aggregate value of the realisation of amounts made from the sale, supply or distribution of goods or on account of services rendered, or both, by the company during a financial year.

### Contents

1	Introduction.....	1
2	Applicability of the CSR provisions.....	1
3	Contribution towards CSR .....	2
4	Nature of CSR Activities.....	2
5	Implementation of CSR Obligations .....	3
6	Role of the CSR Committee .....	4
7	Board and implementation of CSR.....	4
8	Employees’ Contribution under CSR ...	5
9	Failure to make CSR contribution .....	5
10	Non-applicability of CSR provisions .....	5

### 3 Contribution towards CSR

**3.1** The minimum monetary threshold for expenditure to be made by an Eligible Company towards CSR, in every financial year, is 2 per cent. of the average net profits made by the Eligible Company in the immediately preceding three financial years.

**3.2** An Eligible Company which does not have an average net profit in the immediately preceding three years will not be required to make any expenditure towards CSR in that financial year. However, it will be under an obligation to publish the reasons for not making CSR expenditure in the manner described in paragraph 7.3 below.

#### **3.3** Computation of Net Profits

- (i) Net profits of an Eligible Company will be as per its financial statements prepared according to the provisions of the New Act<sup>4</sup> but will exclude (i) profits arising from any overseas branch; and (ii) dividends received from other companies in India that comply with their CSR obligations (if applicable).
- (ii) The calculation of net profits for a foreign company will be based on its balance sheets and profit and loss accounts prepared in the form prescribed under the New Act and filed with the Registrar of Companies (the “ROC”).<sup>5</sup> However, the procedure for calculation of turnover or net-worth of a foreign company having a branch or project office in India to determine its eligibility under the CSR regime has not yet been prescribed under the New Act. Hence, the eligibility criteria for foreign companies under the CSR regime is currently unclear.

### 4 Nature of CSR Activities

**4.1** The activities that an Eligible Company can undertake and participate in to fulfil its CSR obligations include projects/activities for the following:

- (i) eradicating poverty, hunger and malnutrition, promoting preventive healthcare and sanitation and making available clean drinking water;
- (ii) promoting education;
- (iii) promoting gender equality, empowering women, orphans and the elderly, and removal of social and economical disparities;
- (iv) ensuring environmental sustainability and ecological balance;
- (v) protecting national heritage, art and culture;

<sup>4</sup> Net profits are to be computed in terms of section 198 of the New Act. However, it has been clarified that if the net profits in respect of a financial year have been computed in accordance with the provisions of the Old Act then they will not be required to be recalculated in accordance with the provisions of the New Act.

<sup>5</sup> Section 381 (a) read together with section 198 of the New Act.

- (vi) taking measures for the benefit of armed forces, war widows and their dependents;
- (vii) promoting sports;
- (viii) contributing to government welfare funds for socio-economic development and reducing social inequalities;
- (ix) contributing to technology incubators set up within academic institutions with the permission of the Central Government; and
- (x) undertaking rural development projects.

**4.2** The definition of CSR is an inclusive definition<sup>6</sup> and an Eligible Company would be able to comply with its obligations by participating in programs and projects directly or indirectly related to the broad headings set out in the amended schedule VII of the New Act (set out in paragraph 4.1 above). However, some of the Rules seem to suggest that the definition is exhaustive and that only expenditure on areas expressly mentioned in schedule VII would qualify towards CSR expenditure. In light of this inconsistency, a clarification regarding the scope of the activities to be undertaken under the CSR regime would be helpful.

**4.3** Contributions or expenditure made (i) directly or indirectly to any political party<sup>7</sup>; (ii) as a part of an Eligible Company's normal course of business; or (iii) for the exclusive benefit of the employees of such an Eligible Company or their family members would not be considered as a CSR activity for the purposes of section 135 of the New Act.

## 5 Implementation of CSR Obligations

**5.1** The activities undertaken as part of an Eligible Company's CSR obligations under the New Act:

- (i) can be conducted as programmes, projects or activities (either new or ongoing), or as contributions to a corpus in relation to sub-paragraph (iv) below;
- (ii) must be undertaken within India;
- (iii) can be undertaken in collaboration with other companies provided that each Eligible Company is able to individually report its CSR projects or programs; and
- (iv) can be undertaken through a registered trust, registered society or charitable company<sup>8</sup> ("**Implementing Agency**") operating within India:

<sup>6</sup> The definition of CSR under the Rules begins as follows: "*Corporate Social Responsibility*" means and includes but is not limited to.

<sup>7</sup> Section 182 of the New Act.

<sup>8</sup> Section 8 of the New Act.

- A. which is set up by the contributing company, its parent, subsidiary or associate company; or
- B. which is not set up by the contributing company, its parent, subsidiary or associate company if it has a track record of at least three years in undertaking similar programs.

## 6 Role of the CSR Committee

6.1 The Act requires an Eligible Company to constitute a Corporate Social Responsibility Committee ("**CSRC**") consisting of:

- (i) three or more directors, out of which at least one director has to be an independent director. The Rules clarify that an unlisted public company or a private company which is not required to appoint an independent director under the New Act will not be required to appoint an independent director as a member of the CSRC;
- (ii) two directors in case of a private company having only two directors; and
- (iii) at least two persons in case of a foreign company, one of whom will be nominated by the foreign company and the other must be the person resident in India authorised under section 380(1)(d) of the New Act to accept service of processes and/or notices on behalf of the company.

6.2 The CSRC is required to formulate, and recommend to the Board of Directors of the Eligible Company ("**Board**"), a Corporate Social Responsibility Policy ("**CSR Policy**"). The CSR Policy must specify (i) the activities to be undertaken by the Eligible Company, (ii) the expenditure limits for the proposed activities mentioned in the CSR Policy, (iii) monitoring and implementation process of the CSR Policy and (iv) that the surplus arising out of the CSR projects will not form part of the business profit of the Eligible Company.

6.3 The CSRC will also be responsible for monitoring the CSR Policy and for developing a monitoring mechanism for the activities undertaken by an Eligible Company under the CSR Policy.

## 7 Board and implementation of CSR

7.1 After considering the recommendation of the CSRC, the Board must then approve and adopt a CSR policy. The CSR Policy is required to be made public and should be published on the Eligible Company's website.

7.2 The Board will be responsible for ensuring the execution of the activities enumerated in the CSR Policy and must ensure that best efforts are made to spend the amount earmarked for CSR activities in accordance with the CSR Policy.

- 7.3** From financial year 2014-15, the Board will have an obligation to include as part of its annual Board report, a CSR report including the details of the CSRC, CSR Policy, reasons for not complying with the CSR expenditure requirements and initiatives taken to comply with its CSR obligations in the format prescribed in the Rules.<sup>9</sup> For a foreign company, such a report must be included in its balance sheet to be filed with the ROC.<sup>10</sup>

## **8 Employees' Contribution under CSR**

- 8.1** The Rules provide that an Eligible Company is permitted to spend only up to 5 per cent. of the total CSR expenditure in a single financial year in training its employees and those of the Implementing Agencies.
- 8.2** Before the notification of the Rules, it was expected that if employees of an Eligible Company worked on a CSR project, then the time-value of the contribution of such employees towards CSR would be included in the definition of CSR expenditure and could be set off against a corresponding monetary expenditure required to be made by the Eligible Company. However, the Rules do not recognise the time-value contribution by the employees of an Eligible Company and hence CSR contribution would be limited to the actual contribution made by such an Eligible Company.

## **9 Failure to make CSR contribution**

An Eligible Company which fails to spend the requisite amount of money on CSR activities must specify the reasons for the same in the annual Board's report circulated to the shareholders and on the Eligible Company's website.<sup>11</sup> The New Act does not include any sanction or penalty otherwise for a failure to fulfil CSR obligations.

## **10 Non-applicability of CSR provisions**

An already Eligible Company which fails to meet any of the eligibility criteria mentioned in paragraph 2.2 above in any financial year does not automatically get discharged of its CSR obligation and is required to make the CSR expenditure for the financial year out of its profits. An Eligible Company would be discharged of its CSR obligations only if it does not satisfy any of the eligibility criteria for a consecutive period of three financial years. This could increase the burden on small companies.

---

<sup>9</sup> Section 134 of the New Act.

<sup>10</sup> Section 381 of the New Act.

<sup>11</sup> Section 134(3)(o) of the New Act.

A copy of the:

- (a) notification in relation to the enforcement of section 135 can be found [here](#);
- (b) amendment to schedule VII of the New Act can be found [here](#);
- (c) Rules can be found [here](#).

This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

The contents of this publication do not constitute any opinion or determination on, or certification in respect of, the application of Indian law, by or from Linklaters LLP or its affiliated firms or entities (together "Linklaters"). All content relating to Indian law and any comments concerning India are based on legal advice from Talwar Thakore & Associates taking into account, where applicable, Linklaters' transactional experience and understanding of the rules and regulations and the practice in India. Like all international law firms, Linklaters is not licensed to undertake Indian legal services.

© Linklaters LLP and Talwar Thakore & Associates. All Rights reserved 2014

Linklaters LLP is a limited liability partnership registered in England and Wales with registered number OC326345. It is a law firm authorised and regulated by the Solicitors Regulation Authority. The term partner in relation to Linklaters LLP is used to refer to a member of Linklaters LLP or an employee or consultant of Linklaters LLP or any of its affiliated firms or entities with equivalent standing and qualifications. A list of the names of the members of Linklaters LLP together with a list of those non-members who are designated as partners and their professional qualifications is open to inspection at its registered office, One Silk Street, London EC2Y 8HQ or on [www.linklaters.com](http://www.linklaters.com) and such persons are either solicitors, registered foreign lawyers or European lawyers.

Please refer to [www.linklaters.com/regulation](http://www.linklaters.com/regulation) for important information on our regulatory position. We currently hold your contact details, which we use to send you newsletters such as this and for other marketing and business communications.

We use your contact details for our own internal purposes only. This information is available to our offices worldwide and to those of our associated firms.

Please refer to [www.linklaters.com/regulation](http://www.linklaters.com/regulation) for important information on our regulatory position.

If any of your details are incorrect or have recently changed, or if you no longer wish to receive this newsletter or other marketing communications, please let us know by emailing us at [marketing.database@linklaters.com](mailto:marketing.database@linklaters.com) or [marketing.database@tta.in](mailto:marketing.database@tta.in).

## Contacts

For further information please contact:

## Linklaters

### Savi Hebbur

Partner, London

(+44) 207 456 3388

[savi.hebbur@linklaters.com](mailto:savi.hebbur@linklaters.com)

One Silk Street  
London EC2Y 8HQ  
United Kingdom  
Telephone (+44) 20 7456 2000

[Linklaters.com](http://Linklaters.com)

## tt&a

### Kunal Thakore

Partner, Mumbai

(+91) 22 6613 6961

[kunal.thakore@tta.in](mailto:kunal.thakore@tta.in)

### Rachita Nadig

Associate, Mumbai

(+91) 22 6613 6986

[rachita.nadig@tta.in](mailto:rachita.nadig@tta.in)

3rd Floor, Kalpataru Heritage  
127, MG Road  
Mumbai, 400 001  
India  
Telephone (+91) 22 6613 6900