Section 135, Companies Act 2013- A Game Changer for Corporate Social Responsibility-Research Article

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Abstract:
India's development sector has evolved substantially over the last few decades and is now witnessing unprecedented interest and investments across the value chain. With the passage of the **Companies Act, 2013** the mandate for **corporate social responsibility (CSR)** has been formally introduced to the dashboard of the Boards of Indian companies. One of the most applauded aspects of the new Company Law regime is the mandatory **social spending requirement**. Faced with innumerable economic and social challenges as our country is, our lawmakers could not have ushered in a more revolutionary change through the new law.
The research paper explores the dimensions and challenges of section 135 of Companies Act 2013.

Key words/phrases: CSR, Facets of Companies Act 2013, Challenges, Revolutionary change.

Introduction:
India is a country of countless challenges, it has grown to be one of the largest economies in the world, and an increasingly important player in the emerging global order, but at the same time, it is still home to the largest number of people living in absolute poverty and the largest number of undernourished children. This gives an impression of uneven distribution of the benefits of growth which many believe, is the root cause of social unrest.

Corporate sector is to be largely responsible for the unevenness. Its contributions to society are now being critically examined. There has been tremendous increase in the understanding of the gap between the haves and the have-nots, this analysis will only increase over time and societal expectations will be on the rise. Many companies have been quick in meeting the needs of an increasingly demanding and socially-aware consumer market while others have done so only when pushed.

Many companies have made CSR as integral part of their corporate strategy. They have specified policies, experts and excellent implementing and monitoring systems in place. In most cases their policies are based on a clearly defined social philosophy or are closely aligned with the companies' business expertise. Many of them are also promoting it as a tool for marketing. Majority of the programs are centered on livelihood, education, environment, health and empowerment of weaker sections of society.

The new Companies Act, 2013, has made it mandatory for companies to be socially responsible by introducing the '**corporate social responsibility'** (CSR) regime. Section 135 of the new Companies Act, read with the CSR Rules, mandates companies meeting certain criteria to set aside two per cent of their net profits for undertaking and promoting socially beneficial activities and projects in India. The Ministry of Corporate Affairs (MCA) recently issued the CSR Rules, 2014, to implement this legislative mandate, which comes into effect on April 1, 2014.

As per the new rules, the expenditures incurred under CSR head will be directly related to the CSR Policy of a company. As a result it becomes crucial to have a well versed and aptly oriented CSR Committee of the Board that develops the CSR Policy. Once the Policy is in place, its implementation, monitoring and evaluation would be critical and company need to keep track record of every rupee spent. Later to enhance transparency and deter the inefficient use of funds, company is required to publish its CSR report of policies and activities in the public domain.

The Concept- Corporate Social Responsibility

The expectations which society has in relation to the environmental, social, and ethical responsibilities of companies have risen. With this development, CSR itself has naturally taken on a number of different meanings. There seems to be infinite number of definitions of CSR, ranging from the simplistic to the complex, and a range of associated terms including 'corporate sustainability', 'corporate citizenship', 'corporate social investment', 'the triple bottom line' among others. Although these terms and definitions are similar, when attempting to identify the essential components of a successful programme for improving CSR it is important to explore the similarities and differences among the definitions used. To that end, some of the more common and generally accepted definitions of CSR are as follows:

- "Corporate social responsibility is about how companies manage the business processes to produce an overall positive impact on society";
- "Corporate citizenship is about business taking a greater account of its social and environmental – as well as financial – footprints";
- Corporate social responsibility is where "a corporation operates in a manner that meets or exceeds the ethical, legal, commercial and public expectations that society has of businesses";
- "Business decision making linked to ethical values, compliance with legal requirements, and respect for people, communities, and the environment around the world";
- "Corporate social responsibility refers to the overall relationship of the corporation with all of its stakeholders. These include customers, employees, communities, owners/investors, government, suppliers and competitors".
- CSR is described as "how business takes account of its economic, social and environmental impacts in the way it operates – maximizing the benefits and minimizing the downsides". In other words, it is about taking responsibility for the impact of our business on all those who are affected by it.
- According to World Business Council for Sustainable Development (WBCSD), CSR is "the continuing commitment by the business to behave ethically and to contribute to economic development while improving the quality of life of the workforce and their families as well as local community and society at large"

Corporate contribution to society, environment and business when guided by enlightened self-interest improves quality of life for all. Effective corporate responsibility requires a good level of commitment from the entire organisation and especially the top management who can ensure that not is CSR practiced but also practiced well.

Objective:

The objective of this research paper is to explore the aspects and challenges rules for CSR under section 135 of Companies Act 2013

Research Methodology:

This study is based on descriptive research design and a structured interview has been used as a tool for taking the response. For the purpose of this study both primary and secondary data has been collected.

Primary Data: The primary data has been collected through a well structured interview schedule from top management officials of 3 corporate houses, who were contacted personally, through e-mail and telephonically. Primary data is focused on identifying the challenges Section 135 hurls in front of corporate sector.
Secondary Data: The secondary data for this paper has been generated from internet resources. Secondary data is used to understand various facets of Section 135.

Companies Act 2013:
Companies Act, 2013 is an Act of the Parliament of India which regulates incorporation of a company, responsibilities of a company, directors, dissolution of a company. The 2013 Act is divided into 29 chapters containing 470 clauses as against 658 Sections in the Companies Act, 1956 and has 7 schedules.The Act has replaced The Companies Act, 1956(in a partial manner) after receiving the assent of the President of India on 29 August 2013. The Act came into force on 12 September 2013 with few changes like earlier private companies maximum number of member was 50 and now it will be 200.a new term of one person company is included in this act that will be a private company and with only 98 provisions of the Act notified. On 27 February 2014, the MCA stated that Section 135 of the Act which deals with corporate social responsibility will come into effect from 1 April 2014. On 26 March 2014, the MCA stated that another 183 sections will be notified from 1 April 2014.

Section 135 of the Companies Act 2013:
As per the Companies Act, 2013, section 135, every company having a net worth of rupees five hundred crore or more, or a turnover of rupees one thousand crore or more or a net profit of rupees five crore or more, during any financial year, 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, in pursuance of its Corporate Social Responsibility policy. The application is to every company, including its holding or subsidiary, and a foreign company having its branch or project office in India.

Facets of Section 135:

❖ **Definition of term CSR**

There is no specified definition of CSR stated in the Act. The notified rules say that 'CSR' means and includes 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.

The meaning specified by MCA clearly indicates the flexibility where companies are free to choose social cause or project it wants to support from list of activities specified in schedule. It also clarifies the scope and application of CSR that can be undertaken by the companies.

It can also be said that MCA very well understands the critical need of corporates to have flexibility in choosing their CSR engagements but it would be interesting to see whether this freedom will allow flexibility to companies in choosing activities from outside the list of Schedule.

❖ **Institutional Coverage of CSR**

Section 135 of the Companies Act, 2013 lays down the requirement for the companies satisfying any of the following criteria to constitute a CSR committee:

- Net worth of Rs 500 crores or more; or
- Turnover of Rs. 1000 crores or more; or
- Net Profit of Rs. 5 crores or more

In addition to the conditions laid down, it also mentions that the same would be applicable to "all" companies. As per expert understanding "all" will include public, private, holding, subsidiary and also foreign companies (doing business in India, whether by themselves, or through an agent or even electronically).
This looks like an attempt to broaden the definition of term "company" by MCA. The new rule do not treat foreign companies differently.

- **Computation of Net Profit**

There is no clear definition of Net profit in the Act itself. Net profit under the rules defined in the Act is interpreted as the net profit of a company as per its financial statement but shall not include following:

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

Moreover, the 2% CSR is computed as 2% of the average net profits made by the company during the preceding three financial years. 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 compan**y.**

- **CSR committee with Independent Director(s)**

The companies mentioned in the rule 3 shall constitute CSR Committee as under.-

- an unlisted public company or a private company which is not required to appoint an independent director shall have its CSR Committee without such director;
- a private company having only two directors on its Board shall constitute its CSR Committee with two such directors;

In case of a foreign company, the CSR Committee shall comprise of at least two persons of which one person shall be as specified under Section 380 (1) (d) of the Act and another person shall be nominated by the foreign company

All companies, as per the rules, have to appoint an independent director on the CSR Committee of the Board of the unlisted or private company, which is not the mandatory requirement under broader scheme of Companies Act. Further, the CSR Rules have relaxed the requirement regarding the presence of three or more directors on the CSR Committee of the Board. The CSR Committee of a foreign company shall comprise of at least two persons wherein one or more persons should be resident in India and the other person nominated by the foreign company.

- **CSR Policy**

The CSR board of company must approve the CSR policy and oversee its implementation. It also must monitor the 2 percent spend. If the spend level is not achieved, the board must explain why.

- **CSR Activities**

CSR Activities as per Schedule VII include:

- eradicating extreme hunger and poverty
- promotion of education
- promoting gender equality and empowering women
- reducing child mortality and improving maternal health
- combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases
- ensuring environmental sustainability
- employment enhancing vocational skills
- social business projects
- 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

Although MCA has prescribed list of CSR activities but they have also kept an open end stating it as *such other matters*. Also the rules have given liberty to companies to conduct CSR activities through a registered society or trust or a Section 8 Company under the Companies Act. In this regard, the CSR Rules have eased up the involvement of a third party to carry out CSR projects /activities on behalf of the company, on condition that third party has experience of minimum three years in implementing similar projects or programs. The expense and funding responsibility would be of the company.

Companies are also allowed 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. Provision for collaborating with other companies for executing CSR projects/ activities is also mentioned in the Act with only condition that the collaborating companies are in a position to report separately as per the reporting requirements under the Companies Act.

- **Reporting of CSR Projects/ Activities**

The new rules have been worked in detail as it also provides a detailed framework for CSR reporting. It should be part of Board's annual report and details as annexure. In case of foreign company; CSR reporting shall be an Annexure to the balance sheet. The report needs to be displayed on the public portal of the company. The Annexure should have following components:

- A brief outline of the CSR Policy (details on public portal)
- The composition of CSR committee

- Average net profit of the company for last three financial years
- Prescribed CSR expenditure
- Details of CSR spent during the financial year
- Reason for not spending the amount (if any)
- A responsibility statement of the CSR committee about implementation and monitoring of CSR policy

❖ Challenges in Implementing CSR Policies Based on Companies Act 2013

The rules prescribed under the new Law are meant to be very effective and increase the partnership between the corporate and societal stakeholders. The law makers firmly believe that new rules will forever change the way CSR is conducted and understood in our country. Although corporate houses have welcomed this game changer Act but have many unanswered and open ended issues related to implementation of these new rules. Few of them are:

- Difference of tax benefits while *contributing* and *spending* for CSR activities. For example, making donation towards the PM's National Relief Fund (PMRNF) will allow the company for total tax benefit on the entire amount donated. Where as if the same company constructs a school building in a village, no tax benefits are favored at least not without long-drawn litigation. But the fact remains that both (donation for PMRNF and school construction, promotion towards education) are CSR activities. The challenge here is to align the new CSR rules with the existing income-tax rules.

- Allowance of Indian as well as foreign companies for CSR project/ activities may give rise to inter – regulatory fault lines within broader context of CSR and foreign contribution system in India. Any foreign contribution in India requires approval under Foreign Contribution Regulation Act, 2010 (FCRA), which means any spending or donation cannot be made without valid approval from Ministry of Home Affairs.

- As per new rules CSR committee should consist of three or more directors. A private limited company only requires two directors. Does it mean that the private company specifically will have to hire and increase the number of board members in addition to the hiring of independent member, to be in agreement with rules? Corporate houses feel this can be too harsh for certain companies.

- There seems to be slight clarity over the monitoring system of government to ensure CSR project/activities. The CSR spending requires a review by the government and which an even bigger challenge.

- 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.

- Calculating average profits in different situations is a challenge in itself. For example, a company has a loss year what will the formula for calculation of average profit in such a case.

- Another bigger challenge is reinvestment of surplus arising out of CSR activities as it may be over and above the 2% figure. At the same time it cannot be considered as profit earned by the company.

- CSR training is also considered as an issue as there is shortage of trained CSR personnel's.

❖ Conclusion

For the first time in Indian history CSR is included in mandatory manner in the Companies Act 2013, which will now created a wealth pool of crores of rupees to be utilized only and only for developmental sector. Section 135 of the Act clearly prescribes what and how of CSR projects/activities to be undertaken by the companies. As per the lawmakers section 135 has evolved over the period of time with discussions with stakeholders- government, corporate houses, civil society, NGO's among others. It is the much needed step as till now CSR in India was looked up as more of philanthropic activity. Experts feel that CSR mandate under the Act is to supplement government initiatives of equitably delivering the benefits of growth and to engage the corporate world with the country's development agenda.

Mandatory social spending requirement is thought to be a game changer as it will boost innovative and effective CSR initiatives. To facilitate skilled manpower Indian Institute of Corporate Affairs (IICA) is planning a series of activities and initiatives to fulfill its mandate. Some of these include – developing a National NGO hub; setting up a data and collaborative projects CSR Portal; taking up CSR trainings and consultancies, developing a Sustainability center, creating a Global gateway for CSR in India; conducting awareness workshops, conferences and seminars nation-wide; developing partnerships with chambers of industry, academic institutions and corporates that can give impetus to the implementation of its mandate; etc.
Amid all the mandates and provisions corporate houses do face certain challenges; at least initial implementation of law will be full of uncertainties and challenges. The new provisions may be viewed as the result of the changing corporate philosophy in India and worldwide which entrusts the responsibilities on giant corporates towards social welfare of the population which comprise of their present or prospective employees, customers or other stakeholders in various roles.

Amongst the entire clarities and conflicts one thing which is true without any doubts is that these provisions under Section 135 of Companies Act 2013 will bring CSR in forefront from back room. It will now be part of strategic planning of all corporate houses.

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