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Corporate Social Responsibility (CSR) Under Companies Act, 2013

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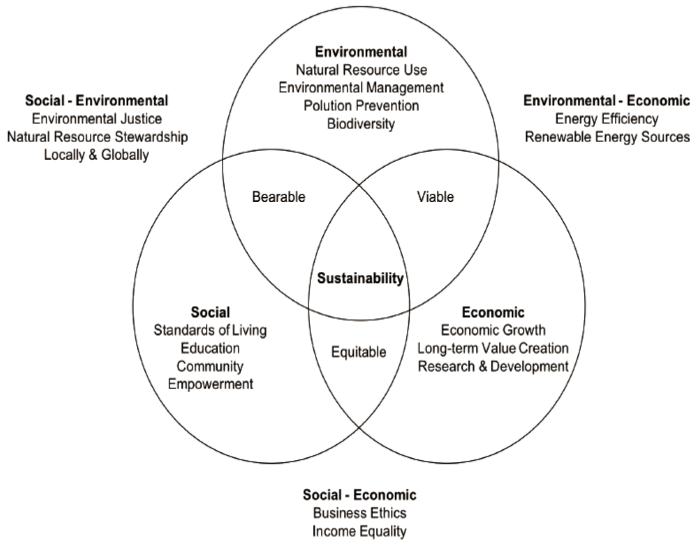
***Abstract*—** This paper examines the concept of the corporate social responsibility (CSR) and its intricate relationship with sustainable development. It is expected of the corporate enterprises to adopt CSR policies that are suited to the economical, social, political, legal and cultural factors of the society, and balance the bargain between sustainable initiatives and profit gaining. The pivotal role of corporate entities in sustainable development due to their huge financial resources, network, etc., is discussed. The UN Global Compact Principles for companies, UN Millennium Development Goals for nations of the world, OECD Guidelines for Multinational Enterprises, which identified the influential factors governing standards for socially and environmentally responsible corporate behaviour are elucidated.

The focus of the paper is centered on the legal position of corporate social responsibility in India, as mandated by the Companies Act, 2013. The rationale employed in the act to select companies for contributing towards CSR and the quantum of funds to be spent by the company is explained. The proposed draft Corporate Social Responsibility Rules under Section 135 of the Companies Act, 2013 specifying the procedures for investing of the funds earmarked for spending on CSR and the relevant report to be prepared by company for maintaining transparency are explained. The lacunae in the Companies Act, 2013 and the draft rules regarding the CSR with respect to the spending, taxability, etc. are analyzed.

Conclusion is drawn signifying the importance of the CSR in the current scenario. The recommendations are made for framing policy for the corporate social responsibility in India considering the specific requirements of the Indian society. The suggestions are also given for filling the lacunae, uncertainties in the Companies Act and CSR Rules.

I. Introduction

During the World Summit on Sustainable Development (WSSD) in Johannesburg in 2002, held on the tenth anniversary of the UN Conference on the Environment and Development (UNCED) in Rio de Janeiro, the then UN Secretary-General Kofi Annan stated that: *"And more and more we are realizing that it is only by mobilizing the corporate sector that we can make significant progress. The corporate sector has the finances, the technology and the management to make this happen."*[1] By 'this' Kofi Annan meant sustainable development and urged to consider the corporate businesses as important and leading actors for making sustainable development happen.



[1] Annan, K. (2002). para. 5-6. *World Summit on Sustainable Development: Summit historic opportunity to further business role in sustainable development says secretary-general in remarks to 'Business Day' event.*

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The classic notion of sustainable development was developed by the WCED, convened by the UNGA in 1983 and chaired by the former Norwegian Prime Minister Gro Harlem Brundtland, and first introduced by its Commission Report (commonly referred to as "Brundtland Report" respectively "Our Common Future") in 1987. The report, which was the first one of its kind, was intended to build on the insights from the earlier Stockholm conference in 1972 and to include the development demands of the countries of the South. Sustainable development was thus defined as: *"Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs. ... in particular the essential needs of the world's poor, to which overriding priority should be given."*

Corporate Social Responsibility

Corporate Social Responsibility and Sustainability is a company's commitment to its stakeholders to conduct business in an environmentally, economically and socially sustainable manner that is transparent and ethical. Businesses can no longer limit themselves to using resources to engage in activities that increase their profits. They have to be socially responsible corporate citizens and also contribute to the social good. Corporate Social Responsibility (CSR) is about integrating economic, environmental and social objectives with a company's operations and growth. The CSR cannot be considered as philanthropy alone, an organization can accomplish sustainable development if CSR becomes an integral part of its business process.

This table below elucidates the various theories of CSR[2]:

Type of theory	Approaches	Short descirption	Authors and references
Instrumental theories (focusing on achieving economic objectives through social activities)	Maximization of shareholder value	Long-term value maximization	Friedman (1970), Jensen (2002)
Integrative theories (focusing on the integration of social demands)	Stakeholder management	Balances the interests of the stakeholders of the firm	Freeman (1984)
	Corporate philanthropy	Searches for social legitimacy and processes to give appropriate responses to social issues	Carroll (1979)
Political theories (focusing on a responsible use of business power in the political arena)	Corporate citizenship	The firm is understood as being like a citizen with certain involvement in the community	Matten and Crane (2005)
Ethical theories (focusing on the right thing to achieve a good society)	Universal rights	Frameworks based on human rights, labor rights and respect for the environment	UN Global Compact (2000)

According to Porter and Kramer [3], who have propounded the concept of "Shared value" suggest that, the solution for CSR lies in a proactive, strategic approach and, which involves the creation of economic value at the same time as societal needs and challenges are addressed. The concept of shared value recognizes that social harms or weaknesses frequently create internal costs for firms—such as wasted energy or raw materials, costly accidents, and need for remedial training to compensate for inadequacies in education. As such, addressing societal harms and constraints does not necessarily raise costs for firms, because they can innovate through using new technologies, operating methods, and management approaches—and as a result, increase their productivity and expand their markets[4]

From a shared value perspective, companies assume a broader set of responsibilities. The companies adopting a shared value approach act because there are huge business opportunities to solve all or part of the societal and environmental problems of our time. Therefore, "shared value is not social responsibility, philanthropy, or even sustainability … it is about expanding the total pool of

[2] Garriga, E., & Melé, D. (2004). Corporate Social Responsibility Theories: Mapping the Territory. *Journal of Business Ethics, 53*(1), 51-71.

[3] Porter, M. E., & Kramer, M. R. (2006). Strategy and Society: The Link Between Competitive Advantage and Corporate Social Responsibility. *Harvard Business Review, 84*(12), 78-92.
[4] Porter, M. E., & Kramer, M. R. (2011). Creating Shared Value. *Harvard Business Review, 89*(1/2), 62-73.

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economic and social value."[5] A shared value perspective suggests that corporations do not deny any social responsibilities, but focus their corporate activities on providing solutions for present and future societal and environmental problems based on their capabilities. The variety of theories and approaches to business ethics and CSR poses an immense challenge for managers to filter out a set of appropriate theories, which take into account a company's present situation and can create future value for both the firm and society.[6]

The UN Global Compact was the first major initiative by the International organisation to lay down a charter of ten principles for all companies globally to respect and follow in their business operations. They are:

- Businesses should support and respect the protection of internationally proclaimed human rights; and
- Make sure that they are not complicit in human rights abuses.
- Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
- The elimination of all forms of forced and compulsory labour;
- The effective abolition of child labour, and
- The elimination of discrimination in respect of employment and occupation.
- Businesses should support a precautionary approach to environmental challenges;
- Undertake initiatives to promote greater environmental responsibility; and
- Encourage the development and diffusion of environmentally friendly technology;
- Businesses should work against corruption in all its forms, including extortion and bribery.

It is the largest voluntary corporate responsibility initiative in the world that forges close linkage between business, society and environment in all development endeavours. Many other international bodies and associations like the OECD countries were quick in coming out with their set of guidelines for multinational corporations, largely in conformity with the principles of the UN Global Compact.

[5] *Ibid.*
[6] Christensen, C. M., & Raynor, M. (2003). Why Hard-nosed Executives Should Care About Management Theory. *Harvard Business Review, 81*(9), 67-74.

At the Millennium Summit in September 2000 the largest gathering of world leaders in history adopted the UN Millennium Declaration, committing their nations to a new global partnership to reduce extreme poverty and setting out a series of time-bound targets, with a deadline of 2015 that have become known as the Millennium Development Goals. The Goals are:

- Eradicate Extreme Hunger and Poverty
- Achieve Universal Primary Education
- Promote Gender Equality and Empower Women
- Reduce Child Mortality
- Improve Maternal Health
- Combat HIV/AIDS, Malaria and other diseases
- Ensure Environmental Sustainability
- Develop a Global Partnership for Development

However, one crucial factor of a competitive economic system is that any privately owned company can only survive if customers buy its products or services. Therefore, not only corporations bear responsibilities but also individual customers. If sustainable development is to come true, customers must change their consumption patterns towards more responsible, sustainable products, and companies have to innovate sustainable business models and contribute to the solutions of problems they have caused by irresponsible activities in the past.

<u>Position in India under Companies Act, 2013</u>:

The Companies Act, 2013 which has been enacted on 29th August, 2013 in India, replacing the nearly 60 year old Companies Act, 1956 provides special provisions for Corporate Social Responsibility (CSR). The Sections 134, 135 of Chapter-IX on Accounts of Companies, Schedule-III and Schedule-VII of the Companies Act, 2013 deal with Corporate Social Responsibility.

As per the Section 134[7], under sub-section 3, clause (o), the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year, shall be mentioned in a report by its Board of Directors, which shall be attached to (financial) statements laid before a company in general meeting.

The Section 135 of Companies Act, 2013 exclusively deals with CSR. It mandates as follows:

[7] Section 134 of Companies Act, 2013

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- Every company having net worth of INR 500 crore or more, or turnover of INR 1000 crore or more or a net profit of INR 5 crore or more during any financial year 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.
- The CSR Committee Board's report under sub-section (*3*) of section 134 shall disclose the composition of the Corporate Social Responsibility Committee.
- The Corporate Social Responsibility Committee shall:
  - 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;
  - recommend the amount of expenditure to be incurred on the activities for CSR;
  - monitor the Corporate Social Responsibility Policy of the company from time to time.
- The CSR Committee Board of every company shall:
  - after taking into account the recommendations made by the Corporate Social Responsibility Committee, approve the Corporate Social Responsibility Policy for the company and disclose contents of such Policy in its report and also place it on the company's website, if any, in such manner as may be prescribed; and
  - ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.
- The CSR Committee Board of every company, shall ensure that the company spends, in every financial year, at least 2%. of the average net profits of the company made during the 3immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy. Further, 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. In case, if the company fails to spend such amount, the Board shall, in its report made under sub-clause (3) of section 134, specify the reasons for not spending the amount.

The Schedule-VII[8] provides the list of activities which may be included by companies in their Corporate Social Responsibility Policies. There are 9 specified and 1 provisional generic categories of activities:

(i) eradicating extreme hunger and poverty;
(ii) promotion of education;
(iii) promoting gender equality and empowering women;
(iv) reducing child mortality and improving maternal health;
(v) combating human immunodeficiency virus, acquired immune deficiency syndrome, malaria and other diseases;
(vi) ensuring environmental sustainability;
(vii) employment enhancing vocational skills;
(viii) social business projects;
(ix) 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;
(x) Such other matters as may be prescribed.

As per the General Instructions for Preparation of Statement of Profit and Loss given in Schedule-III of the Act, the company shall disclose the amount of expenditure incurred on CSR activities by way of notes in the Profit and Loss Statement.

The Draft Rules published by the Ministry of Corporate Affairs on 9th September, 2013 contain the Proposed Draft Corporate Social Responsibility Rules under Section 135 of the Companies Act, 2013. The said CSR Rules shall be applicable from the financial year 2014-15 and the tax treatment of CSR spend will be in accordance with the Income Tax Act as may be notified by the CBDT. The rules mandate as hereunder:

1. CSR activities may generally be conducted as projects or programmes (either new or ongoing) excluding activities undertaken in pursuance of the normal course of business of a company. The CSR Committee constituted under sec. 135(1), shall prepare the CSR Policy of the company which shall include the following:
   a. specify the projects and programmes that are to be undertaken.
   b. prepare a list of CSR projects/programmes which a company plans to undertake during the implementation year, specifying modalities of execution in the areas/sectors chosen and implementation schedules for the same.

[8] Schedule-VII of Companies Act, 2013

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c. CSR projects/programmes of a company may also focus on integrating business models with social and environmental priorities and processes in order to create shared value.
d. CSR Policy of the company should provide that surplus arising out of the CSR activity will not be part of business profits of a company.
e. CSR Policy would specify that the corpus would include the following: (i) 2% of the average net profits, (ii) any income arising there from, (iii) surplus arising out of CSR activities.

2. The CSR Committee shall prepare a transparent monitoring mechanism for ensuring implementation of the projects / programmes / activities proposed to be undertaken by the company.
3. Where a company has set up an organization which is registered as a Trust or Section 8 Company, or Society or Foundation or any other form of entity operating *within India* to facilitate implementation of its CSR activities in accordance with its stated CSR Policy, the following shall apply:
   a. The contributing company would need to specify the projects/programmes to be undertaken by such an organization, for utilizing funds provided by it;
   b. The contributing company shall establish a monitoring mechanism to ensure that the allocation is spent for the intended purpose only;
4. A company may also conduct/implement its CSR programmes through Trusts, Societies, or Section 8 companies *operating* in India, which are not set up by the company itself.
5. Such spends may be included as part of its prescribed CSR spend only if such organizations have an established track record of at least 3 years in carrying on activities in related areas.
6. Companies may collaborate or pool resources with other companies to undertake CSR activities and any expenditure incurred on such collaborative efforts would qualify for computing the CSR spending.
7. Only such CSR activities will be taken into consideration as are undertaken within India.
8. Only activities which are not exclusively for the benefit of employees of the company or their family members shall be considered as CSR activity.

Further, a prescribed format is provided for the Annual Report on CSR initiatives to be included in the Board Report by the qualifying companies and all companies falling under the provision of Section 135 (1) of the Act shall report, in the prescribed format, the details of their CSR initiatives in the Directors' Report and in the company's website.

CONCLUSION

The CSR which has largely been a voluntary contribution by corporate has now been included in law in India. Companies qualifying for CSR also have to report mandatorily about their CSR activities/spending. In case the company fails to spend the earmarked 2% of net profits, it can report the reasons in the prescribed report. However, since the report would be publically available, the companies will be continuously under the scrutiny of various stakeholders and will have to perform. They cannot consistently default, which makes CSR mandatory to a large extent, but, a punitive measure for non-spending of CSR would compel better enforcement. It is expected that, huge amounts of funds will be available for CSR activities from the qualifying companies throughout India, and proper channelling and spending of these funds by establishing an effective administrative and enforcement mechanism is necessary.

There is no definition of CSR given under the Companies Act, 2013. A definition would give direction to the Corporate Sector to prioritize in spending of CSR funds and help in mishandling of the funds. It is not clear as to what constitutes CSR activities as the list specified under Schedule VII of the Act[9] seems like an inclusive list and not exhaustive. So the list does not appear to be binding but suggestive in nature, and the companies are at liberty to spend on CSR activities of their choice, giving opportunity to explore new avenues for sustainable development. Further, permitting the companies to pool funds and take the services of an NGO which is specialised in a specific area is a welcome initiative for undertaking large-scale development projects.

The CSR provisions require a minimum of 3 directors for the constitution of the CSR committee; clarification is needed as to whether qualifying private companies would be required to appoint a third director to comply with the CSR provisions. As, the independent directors under the Company Law are compulsory only for the public listed companies clarity is still needed, whether private companies come under its purview.

[9] The Companies Act, 2013

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The draft CSR rules opine that, the taxability of the funds spent on CSR activities is as per the Income Tax Act, 1961, and also states that such spending does not amount to charity. Under section 37 of the Income Tax Act, an expenditure which is not capital expenditure and is expended "wholly and exclusively" for the purpose of a business is allowed as a business deduction. Further, exemptions are given under section 80G, if a company donates money for charitable purposes, say to Prime Minister’s relief fund. So, there is a dichotomy, and there is nothing in the law to suggest that spending on CSR will be tax-exempt. As such, clarity is need in this regard.

In developing economies like India, where socio-economic disparities are glaring and state social security network, social and environmental concerns tend to assume primacy over immediate business gains. The enactment of the Companies Act, 2013 with exclusive provisions for CSR is a first step in the right direction, and the long path ahead promises a bright future and sustainable development of India.