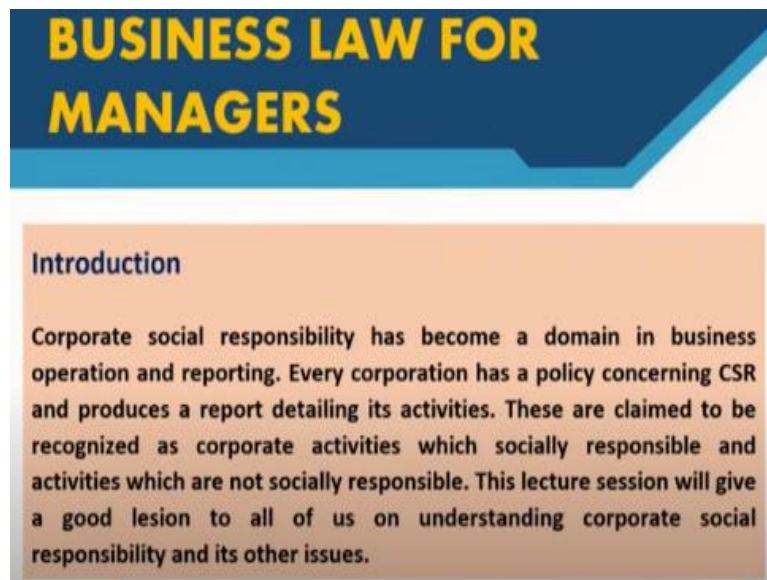


**Business Law for Managers**  
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**Module-1: Corporate Law**

**Lecture - 04**  
**Corporate Social Responsibility (CSR)**

Good evening. This is the module 1 lecture 4 on Corporate Social Responsibility.

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Corporate Social Responsibility, the very word might bring certain ideas in mind as if the corporates need to be again made aware of their responsibility and what is the need for reintroducing this subject in business law. The purpose is clear that the corporates are not socially responsible. It is a debatable issue, but it is correct largely barring exceptions.

Now why is it so? If you ask me as a corporate law practitioner, somebody who has been into this for the last 30 years and more on research and further understanding aspect, I found this topic to be very relevant for all times to come even now because I find social responsibility of corporates sometimes gets diluted totally for the simple reason Indian corporates pay huge rate of income tax.

The corporate tax rate of Indian corporates is one of the highest. If not the highest, almost the highest if you compare with corporate tax rates in any other country. It has been to some extent brought down. However, there is a huge gap even now.

Anybody who is making profit and reducing costs, increasing contribution, taking care of all stakeholders is additionally required over and above the huge income tax that he is paying, the company is paying to take care of corporate social responsibility in a different form. He is already taking care without which a big corporate cannot sustain business.

There is no way one can be socially irresponsible and still continue for long, cannot be sustainable. At the same time, these corporates are being compelled to pay a certain percentage of their profit as CSR. And before that, all that what CSR is, why CSR is needed, what is the legal compulsion, we will all discuss all this. But to me it is still a question that can we enforce CSR on corporates or will it not backfire or has it not already started backfiring?

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It was never in the Companies Act before. Companies Act came in 1956. It was never in the Companies Act till 2013. I still remember it was in a national convention of Institute of Company Secretaries when (()) (04:28) Ministry of Corporate Affairs made an announcement. Then ordinance has been passed CSR is being made mandatory to the thunderous applause of more than 2500 company secretaries present there.

Was it required? Many would say yes absolutely required. Perhaps yes, but not in this form. If somebody is paying tax on declared profits doing business within all parameters of law following ethics code of conduct, huge tax he is already paying. And there are all years not a single year when some kind of phase has not come in, education, higher education.

People were expecting COVID phase also. Something or the other. Some phase is coming in some form and also on the corporates squarely. Over and above that a compulsion of CSR. Will it really see the light or the perspective for which it has been done. Corporates have lot of machineries to use to ensure that law is also followed at the same time the outflow unnecessarily goes up, does not unnecessarily go up.

You are forcing corporates to look at differently ways of compliance. This is not at all required. Rather we should create a business environment where social responsibility will be equal to sustainability. Today we are all talking of ESG environment, societal and governance. If we take care of environmental, societal and governance that is enough CSR itself, more than that, even more than that.

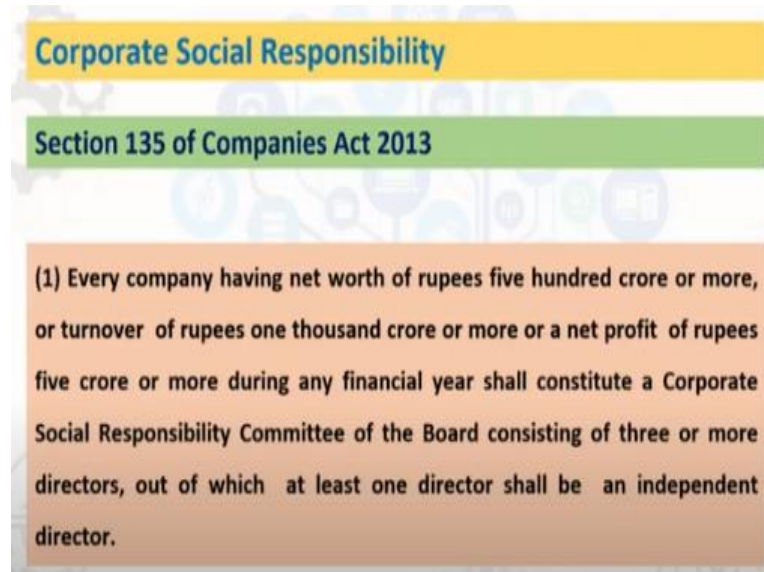
The very first thing is environment E. Then societal, that is the society largely the people related society. And then we talking of governance so that end of the day, it is followed in letter and spirit as well and not only in letter that is governance, precisely.

Whatever you say, whatever all the good talks that you make, all the speeches that you make, are literally and spiritually, what is literally are very well written, but spiritually effectively implementable are you doing it or not? That is governance. If we do that, that is enough CSR for a corporate, more than that. This 2% to me, I will explain this 2% why I am saying again and again.

This 2% compulsion of the average net profits of the company which has been compulsion on the corporates to me for a responsible corporate, which largely all are. Otherwise again I say you cannot sustain and we are seeing people are not able to sustain if they are not responsible. Make it an environment of sustainability.

And then you will see Corporate Social Responsibility actually did not have to be done it will be always followed. But let us see what the law has done. What the law has tried to do in the name of CSR.

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Now it says section 135 of the Companies Act 2013. Every company whose net worth is more than 500 crores or more. Almost all companies having some stake in the market listed companies of doing some worth, even midsize companies, even some small companies, their net worth is more than 500 crores. I am talking of companies of worth. A turnover of 1000 crore or more.

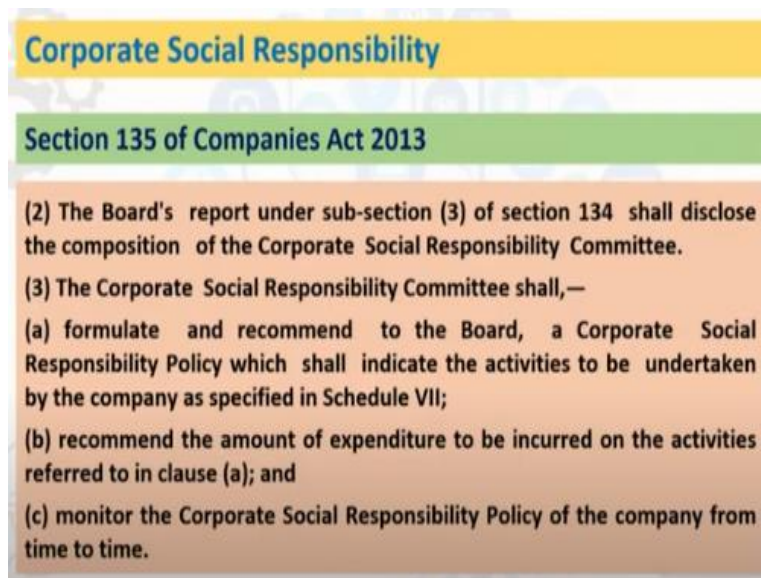
Again, that is not a very big amount. 1000 crore turnover midsize companies almost have. Net profit of rupees five crores or more. Again, net profit is something which in accounting parlance we say it is all in accounts. They are supposed to constitute a corporate social responsibility committee of the board. So, from the board, we take out a committee and name it a Corporate Social Responsibility Committee.

It is nobody else. It is a part of the board only consisting of supposing 12 directors you take out 3 directors and create a committee. And out of which one of the directors shall be an independent director. Why not all three? Let us have all three as independent directors. Good company should have all three as independent directors. Why one? Because if it is one the other two are not independent.

So, their decision would prevail upon the independent director. So, majority wins. On one hand, you create a committee on other hand you create one independent director. You make all independent or you make the chairman independent director. As you have done for another committee like Nomination and Remuneration Committee.

I do not think this has been done in the right I mean, keeping the right objective in mind, keeping one director as the independent director.

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Now second, the board's report under Section 134. The sections are only for reference, but what does it come. Shall disclose the composition of, the Board of Directors give a report to the shareholders every year, we call it the directors report. It is important, it is important for all shareholders, institutional holders, who largely now dominate and dictate. I use the word dictate, the corporate actions today.

They go through this report. Now in that report, you have to give that what is that formulation and recommendation to the board the committee has done, amount of expenditure they will be incurring on the various activities that which are referred to as the activities which will tantamount to CSR. Anything and everything cannot be CSR. They mentioned very clearly these are CSR.

If you do anything else, other than that is not CSR. Corporates are told categorically 1 to 10 CSR. Anything other than that is not CSR. Therefore, they have made so many amendments time and again. When there is a prime minister's this COVID case PF

relief fund immediately comes under CSR. So, it is an enabling CSR provision. As and when something is required urgently put it under CSR.

Why because CSR has got 2% on the net profits. Corporates are bound to spend that money therefore let it be spent here. And they are also going to monitor the Corporate Social Responsibility policy of the company from time to time. So more of a monitoring body created from the same board, nothing new.

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**Corporate Social Responsibility**

**Section 135 of Companies Act 2013**

(4) The Board of every company referred to in sub-section (1) shall —

(a) 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

(b) ensure that the activities as are included in Corporate Social Responsibility Policy of the company are undertaken by the company.

Now the board every committee, board of every company referred to shall after taking into account the recommendations, now the board's action, approve the policy and disclose the contents of this policy in the company's website and the report. If you go to the website of every company, the more or less there is a verbatim the same thing cut and paste which has been given, this is the policy of the Corporate Social Responsibility.

Action on the ground is what is required. Policies are there for posting or hosting in the website. But what is the implementation? That is what is most important required.



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**Corporate Social Responsibility**

**Section 135 of Companies Act 2013**

(5) The Board of every company referred to in subsection (1), 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:

Provided that 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:

Now here I come to the 2%. The board of every company referred to shall ensure that the company spend, ensure the responsibility on the board. If that tomorrow the company does not spend, the board of directors will be taken to court, can be challenged if the company does not spend 2% of the average net profits made during the three immediately preceding financial years.

So basically, a new company is exempted from it. It must have three years profit. So, it must be in existence for three years and it must have made profit for three years. So basically, there is a gap. Every company which is creating a CSR committee and disclosing its policy is not mandatory required to spend in CSR.

He is required to spend in CSR only when over and above creating the policy. He also qualifies with this provision that is in business for three years and had profit for three years. A case a company has lost in one year and profit in two years. It will still qualify because it talks of average net profit. So, a minus 10 in the first year, but a plus 20 and plus 20 in the next two years would make it 40 minus 10 30 divided by 3 10 as the average net profit.

So, it is not saying continuous three years' profit. It is saying average net profits of the company made during the three net profit, average net profit. So, there was a question that we made a loss in one year, we mean any particular company or in between one year I had made a loss. Or maybe even that case, a more striking case is the company made profit of 20 years 2020 in two years and then made a loss of 30 in the last year.

The poor company was in profit for the first two years, then is in loss currently in the last year. But unfortunately, the profits were 20 20 40, last year 35. So, it still had a five year, plus five profit, average net profit. So, three years would be five divided by three. So, he has to mandatorily spend that in spite of the fact that last year he made a whopping loss of 30 crores. Still, you have to pay a CSR, made a CSR expense.

Now again, he says, provided a company shall give preference to the local areas around it, where it operates for spending the amount earmarked for Corporate Social Responsibility activities; important. The company shall give preference to the local area areas around it where it operates. See a company when it operates in an area, in a remote village say it sets up a manufacturing unit.

Can you think of a company operating in a remote area in a manufacturing unit, where the villages maybe under 100 meters or 200 meters. In India you do not find other than in desert Thar or somewhere you do not find anywhere where people are not there within 100 to 200 meters. We have been searching for land.

In our case I personally experienced in the remotest areas in Gujarat anywhere we set up a plant we find within 200 meters there is a basmati, there is a village and there is a panchayat. The village and the panchayat will be always around you and multiple ones with multiple sarpanches. So, no corporate, no house, no industry can be set up without taking the responsibility of the villages around you.

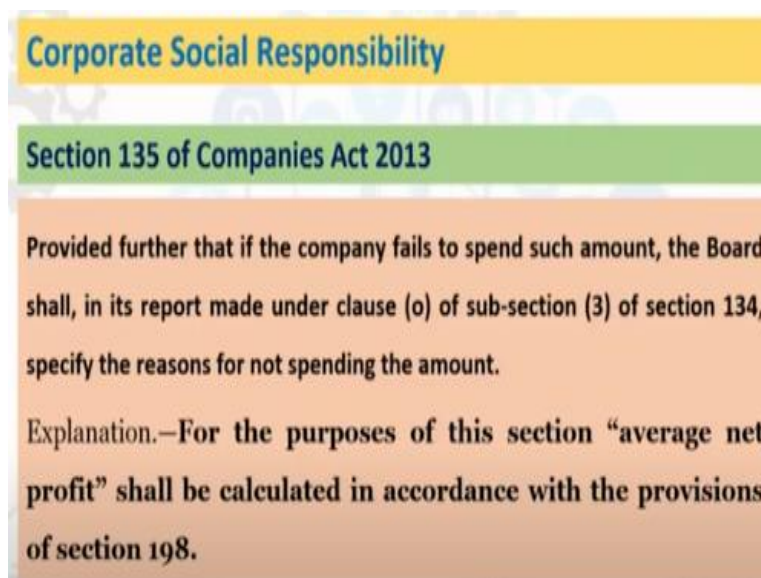
And ensuring they have safe drinking water, safe environment, safe health, safe education, you need to build a social fabric around you. It is all the same Tata Jamshedpur model in a small very small way. Everyone does it. Every unit has to do it provided it wants to be responsible and sustainable business. Because these are the persons around the factory that creates the human bond or the human chain.

So, it invariably has to be taken care of whether you call it a social responsibility or business sustainability, it has to be taken care of. Whatever is required to be spent one has to spend. This is nothing new. The preference has always been given. Why the word preference came?



The preference came because many times it has been seen for reasons best known to many that your factory is in x place, but your CSR is being done at a place 5000 kilometers away or 10,000 kilometers away. Why? For reasons best known. Corporates have to spend 2% of the net profits of the company. Preference to be given. Why preference, why not solely?

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Provided further that if the company fails to spend such amount the board shall in its made clause 0 of 35 whatever reasons for not spending them. Now this is slightly gone changed. Now reasons will not do. You have to do it. Earlier it was reasons. You give the reasons why you have not done it. What will happen to the image of a company? It says I have got net profit but I have not spent.

What can be a reason? Reason can be I am going for further expansion, diversification. I am accruing funds. I am internal accruals. I need funds for internal accruals. I need funds for the expansion diversification. Therefore, I am not spending. But this is not an explanation from a responsible organization.

How can you give an explanation like that that I want to spend this money for my expansion and diversification, I need funds. Again, this is something of a very you know unexplained provision in law where corporates are struggling. I have not yet

seen a corporate very few, very few, rarest of rare who has said that I am unable to do for this reason.

Somewhere or other they have to show they have done it. They have to spend. So, when they have to spend, they have to curtail somewhere. Fund cannot be multiplied like that. Incorporate fund does not generate like that. If I have to do CSR somewhere, I have to spend 2%, somewhere I do have to do a curtailment.

Because end of the day one has to survive in the business. Contribution going down, costs going up, no control on that. But CSR is fixed 2%.

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**Corporate Social Responsibility Rules**

**Under Section 135 of the Companies Act 2013 :: Guiding Principles**

CSR is the process by which an organization thinks about and evolves its relationships with stakeholders for the common good, and demonstrates its commitment in this regard by adoption of appropriate business processes and strategies. Thus CSR is not charity or mere donations. It is a way of conducting business, by which corporate entities visibly contribute to the social good. Socially responsible companies do not limit themselves to using resources to engage in activities that increase only their profits.

They use CSR to integrate economic, environmental and social objectives with the company's operations and growth.

Now the guiding principles, the places where I mentioned about where you can spend CSR. CSR is a process by which an organization thinks about an evolved relationship with stakeholders for the common good. These are good to listen to and hear because it is for the stakeholders. Stakeholders meaning everybody, not only the shareholders.

So, if it is all for the shareholders, if your employees are happy, if the government is getting all the dues, if your vendors are getting the payments, if your customers are happy with your products, if your research and innovation is doing good to the overall good, if your shareholders are happy with your dividend, if you are taking adequate care of the society by taking care of the people around you, your factory.

Then again additionally one of this, you do contribute to CSR to the extent possible, but do not mandate it to 2% under any circumstances. Otherwise, your directors would be questioned. There will be show cause notices. The jailing provision has been removed.

Now the provision for penalty and jail which was discussed and finally because of the corporate uproar, corporates going absolutely against this provision, the jail provisions to the directors for non-fulfillment of 2% CSR, in spite of the fact company complying with all laws, finally it has been removed. But there was a discussion and it was in the policy stage before being implemented.

So, CSR to me, actually is what is very important to understand is, can never be sustainable unless it is seen to be something not a charity or donation. It has to be again a sustainable, we will discuss sustainable CSR in our next slides. What is sustainable CSR? CSR that can be sustained, that can remain, that will be imbibed in the business.

That will go into the DNA of the business. You do not have to spell out and shout and say CSR, CSR, CSR. CSR is automatically done as you do business. Then only CSR will become. Donating few funds for the relief fund or some charity or some donation, some temple building, some road building is one-time donations. Those are not sustainable CSRs.

Now they CSR to integrate economic, environmental and social objective. That is exactly what is called ESG. Environmental, societal, and governance. If you do that, that is more than CSR.

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## Corporate Social Responsibility Rules

### Under Section 135 of the Companies Act 2013 :: Guiding Principles

In exercise of the powers conferred under clause (o) and clause (q) of sub-section 3 of Section 134 read with Section 135 and sub-sections (1) and (2) of section 469 of the Companies Act, 2013 the Central Government hereby makes the following Rules namely:

#### Part I - Short title and commencement :-

1. These rules may be called the Corporate Social Responsibility Rules, 2013.
2. They shall come into force on the date of their publication in the official gazette and shall be applicable from the financial year 2014-15.

Now let us see the guiding principles, short title and commencement of the rules.

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## Corporate Social Responsibility Rules

### Some Important Definitions and Points from Draft Rules:

- **Corporate Social Responsibility** means Corporate Social Responsibility (CSR) as defined in Section 135 of the Companies Act 2013;
- **'Net Profit'** for the section 135 and these rules shall mean, **net profit before tax** as per books of accounts and shall not include profits arising from branches outside India.
- 2% CSR spending would be computed as 2% of the average net profits made by the company during every block of three years. For the purpose of First CSR reporting the **Net Profit** shall mean average of the annual net profit of the preceding three financial years ending on or before 31 March 2014.

Net Profit has been defined before tax. Again, it is not after tax, before tax. PBT we call it. You get a tax fill if CSR is an admissible expenditure. That is, it. But net profit before tax is considered as the net profit, not after tax. 2% CSR spending will be computed 2% of the net profit is made by the company during every block of 3 years. This was the initial stage. Therefore 2014 has been referred to.

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## Corporate Social Responsibility Rules

### Some Important Definitions and Points from Draft Rules:

- Reporting will be done on an annual basis commencing from FY 2014 - 15.
- Tax treatment of CSR spend will be in accordance with the IT Act as may be notified by CBDT.
- Words and expressions used in these Rules and not defined herein but defined in the Act shall have the meaning respectively assigned to them in the Act.

Annual basis of reporting come against 2014-15, Act 2013 effective 2014-15.

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## Corporate Social Responsibility Rules

### PART II – Operating Provisions of the Rules

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.

Now the important thing is the CSR committee shall prepare a list of CSR projects and programs which a company plans to undertake during the year.

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## Corporate Social Responsibility Rules

### PART II – Operating Provisions of the Rules

- 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: a. 2% of the average net profits, b. any income arising there from c. surplus arising out of CSR activities.

Now again there is a guideline which has to be followed. It is saying integrating the business model with social and environmental priorities and processes in order to create shared value. This is exactly should be the purpose of CSR and then only CSR can be strategic. You have to integrate into the business model. Business should run along with CSR. CSR and business should not be separate.

Integration, that is again very important, imbibed in the business. I can give an example here of imbibed in the business. Many companies today are setting up power plants along with the business. This power plant is run from the gas which is generated from the business. Every business has some kind of you know manufacturing process. I am talking of manufacturing companies which throws some gas in the production process.

It can be a low calorific gas. Earlier when the Companies Act 2000 sorry Electricity Act 2003 was not there. No one was allowed to have captive power plants, which could have sold power to the grid, excess power. You can only consume you cannot sell the power to the grid. You have no right to sell power. 2003 Act allowed you to sell power. Sell power to the grid or to private parties.

Because power cannot be stored. There is no power bank kind of thing where electricity power can be stored and then traded. You have to sell it to the grid. Now 2003 Act allowed that. After that many companies came. And today it has become a

business model. Wherever a manufacturing process is set up, there is a power plant coming up next to it, the same company.

It is totally an investment. Whenever somebody is saying I am expanding in this area, I am setting up so much metric ton of power or whatever units of certain commodity, additionally I am setting up a power plant. Now why you are setting a power plant, your business is primarily this? I am setting a power plant, I have changed my Memorandum of Association, I have included there generation of power.

But there is a compliance part of it. But the business part of it is why I am doing it. Because law is allowing me to sell power. And I can see business opportunity. The power that I was incinerating, spending money so that it does not pollute the environment and releasing that gas in the air in spite of incineration, nobody can guarantee that all the GHG has been incinerated and nothing is going out.

Still carbon dioxide is released, GHG gases are released. So it is polluting the environment. After incineration also, incineration means burning, burning means cost. Now with the new business model, they are converting this power, this gas to power and generating a power which is called a green power. Why green power because you are not burning anything more to generate this power.

In any case what was coming out was burnt and released. So now you are getting into this power. So, when you are producing this power and selling to the grid, you are doing two things. One, you are protecting the environment by producing green power. You are stopping the emission of GHG gases by incineration. So, you are taking care of the ESG E environment.

At the same time, you are making good profit because cost of production is almost zero, because the byproduct the gas is an unintended byproduct which comes naturally. So, the raw material cost is almost zero. So, this became a good business model. Almost all companies are doing it. It is also a CSR to be. Why because you are being responsible to ensure that the environment is clean.

For that you are investing in power, in setting up the power plant. You are having a separate segment of power unit. You are recruiting power engineers. You are maintaining a separate system altogether. You are incurring expenses. May not be raw material expenses, but all other expenses, CapEx, regular salaries, maintenance, all other than the raw material cost.

So it is win-win. Business is making profit, legitimate, ethical, strategic profit at the same time environment is being taken care of. These kinds of CSRs will be sustainable. More and more such models are required where business is protected, interest is protected, stakeholders interest is protected overall. Not by one time charity, one time donation, relief funds, floods, earthquakes.

These are okay one time but cannot be sustainable. Cannot be imbibed, cannot be integrated in the business model.

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**Corporate Social Responsibility Rules**

**PART II – Operating Provisions of the Rules**

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 three years in carrying on activities in related areas.

So trust, societies, companies operating in India are not set up by the company. This provision may not be required at all. Why do you want again bring in trust and societies in CSR? Whose objective is served by this? We have seen in the past how trusts have been mis-utilized. Again in the same CSR after taking so much guard, ensuring corporates to go for 2% why is it required to be through trust and societies?

Why not directly? There is a lot of debate on this point, why should CSR be done through trusts, societies?



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**Corporate Social Responsibility Rules**

**PART II – Operating Provisions of the Rules**

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.
9. 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.

CSR activities are undertaken within India, absolutely justifiable. Now there is another question which comes only activities which are not exclusively for the benefit of employees. Of course, if you are doing something which is a benefit of the employees, it is not CSR. But why not exclusively for the benefit of employees?

Supposing one sets up a medicine shop within the factory and supplies free medicine to the employees, the cost will not qualify for CSR. But the moment I open the gate and allow the neighborhood to come and take this medicine, it will qualify for CSR. Because it is not exclusively for the benefit of employees. Debatable, questionable.

What quantum goes to the employees and what quantum goes to the people around?  
Why employees to be included in that?

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These are certain provisions in CSR which are I feel leads lot of understanding as well as further look into introspection, improvisation. First of all, the mindset has to be made clear, what do you want the corporate to do? Do you want them to really comply in letter and in spirit or only in letter? That is the same thing has to be understood.

Because corporates have and I repeat different mechanisms to comply. So it can be both in letter and not in spirit. It can be in both letter and in spirit.

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## CONCLUSION

This lecture session has covered various provisions for CSR in Companies Act 2013, some important definitions and operating provisions of the rules. The learners will be able to understand these and may apply in their professional practice.

Thank you.