AccountAble™

107: CSR for NGOs rev. Jan'15

IN THIS ISSUE

The Companies Act, 2013 has introduced 'compulsory' CSR. Starting April'14, large companies must spend some of their profits on socially useful activities. Much of this work may be done through NGOs. This issue of AccountAble gives an overview of CSR and explains how it will work.

CSR?

Corporate Social Responsibility (CSR) is one of the many ways in which societies are asking corporations to behave themselves. In many countries, companies must publish long reports explaining and justifying their behaviour.

In some countries, companies are also expected to use part of their wealth for social good. This is really an evolution of age-old business practices, such as tithing, *zakat* and *dharmada*.[1] Many Indian companies have also been practising CSR in one form or the other. However, most have remained focused on expansion.[2] This might change now.

None of My Business...

Should companies focus on making profits or doing good? This debate has been around ever since the joint-stock company emerged some 400 years ago. The excesses of some companies led Lord Thurlow (1731-1806) to remark: 'Corporations have neither bodies to be punished, nor souls to be condemned; they therefore do as they like.'
Ayn Rand dramatized a different view in her immensely popular *Atlas Shrugged* (1957) - businesses should focus on doing business, and not flounce around doing social work.

Her viewpoint continues to find takers. Beginning 2001, the London-based *Economist* ran a campaign deriding CSR (*Curse of the Ethical Executive*, 15-Nov-01; *Irresponsible*, 21-Nov-02). However, eventually, the editors conceded defeat (*Profit and the Public Good, The Ethics of Business, The Good Company,* 20-Jan-05, *A Change in Climate*, 17-Jan-08).

The *Economist* debate also reflects a social change being brought about by activists around the world. More and more people now subscribe to the view that companies should also consider their impact on society, and relentless pursuit of profit and wealth can't be all that good.

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[1] Tithing is meant primarily to maintain the clergy. The surplus is often used for missionary work around the globe, including running of schools, hospitals, and orphanages. *Zakat* gives back to the community some of the wealth that a person has acquired. Both practices apply to all believers, whether traders or courtiers.

Dharmada (Sanskrit: dharma daay) is more specific to business. It allows business people to set aside part of revenue for charitable work in the local community (p. 110, *'Daan* and Other Giving Traditions in India', www.AccountAid.net).

[2] *Business & Community: The Story of Corporate Social Responsibility in India*, Pushpa Sundar (2013), Sage, New Delhi

PURPOSE

The Companies Act 2013 expects all large companies to spend 2% of their profits on social good. This is a unique provision, the first anywhere in the world. It may well change the relationship between business and society in the decades to come. This legislative innovation achieves several policy objectives with one stroke:

1. Foreign grants are now dwindling away - partly due to changes in Indian economy and partly due to a reinvigorated FCRA. CSR funds will provide the NGO sector with much needed financial support. This means that NGOs will be able to continue bulk of their programs.
2. CSR will bring NGOs and companies together. NGOs can sensitise companies on working with marginalised or rural communities. This will help companies market their products better. Companies can help strengthen management skills of NGOs. This can also get both to shed their mutual distrust.
3. CSR funds are easier to control than FCRA funds. Companies are unlikely to take up social programs which annoy their customers or challenge the Government.
4. The Government can do all this at a very low cost, without levying a tax. At worst, it will lose only the tax revenue on CSR - about 15-30 paise for every rupee donated for CSR.

However, there is a hidden cost for the society. Governments are meant to regulate corporate behaviour. In practice, this mechanism fails quite often. Companies have become very good at co-opting governments and officials in their quest for projects and profits. Governments are also keen to bag industrial projects to generate employment and increase tax revenue. NGOs have provided a counterbalance against this. This bulwark will go once companies and NGOs also start working together.

APPLICABILITY

CSR is required only for very large companies. These can be of three types:

- Those with high net worth of Rs.500 crore or more.
- Those with big turnover of Rs.1,000 crore or more.
- Those with net profit of Rs. 5 crore or more.

Any company, which meets even one of the above conditions in any year, is expected to spend on CSR. It does not matter whether the company is private or public.

Holding Companies

CSR covers holding companies as well. For example, Bigg Family Pvt. Ltd. (BFPL) is a holding company for a number of companies in Bigg group. The net worth of BFPL is 600 crores - most of its assets are shares in the Bigg group. It is therefore covered under CSR requirements. Annual profit of BFPL is Rs. 50 crores, which is mainly dividend from the group companies. All these companies are also covered under CSR.

Does that mean BFPL will have to spend 2% of the entire income? No – dividend received from other group companies (already covered under CSR) will be excluded from the base for calculating 2%.

Foreign Companies?

CSR applies primarily to companies incorporated in India. Therefore, companies incorporated outside India are exempt unless they have a branch office or project office in India. In such cases, CSR provisions will apply to India operations. This will be determined using the Balance Sheet and Profit & Loss Account prepared for the India operations.

Compulsory?

There is much confusion over whether CSR is compulsory or voluntary. Actually it's neither. It is more like a directive, with an implementation framework. This creates the illusion of compulsion.

There is no penalty if you don't actually spend any money on CSR. The penalty kicks in only if you fail to report on CSR or fail to give reasons for not spending.[3] These reasons will be evaluated by the public - if it is interested in the company. The government will not examine or judge the reasons. It will also not check how or where you have spent the money. This reflects very much the spirit with which the Registrar of Companies functions.

Will such a soft law work? Prof. Aneel Karnani thinks it is 'a really bad idea' and 'would be an enforcement nightmare'.[4] However, a tougher law would have been very hard to sell. Also, standard setting bodies have been very successful with similar directives. Therefore, CSR could work fairly well - probably because it is neither perfect nor law!

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[3] second proviso to sec. 135(5)

[4] *Mandatory CSR in India: A Bad Proposal.* 20-May-13, Stanford Social Innovation Review

How Much?

How much should such a company spend? The law says it should spend 2% of the average net profits. This average is calculated by adding net profits of preceding three years and dividing the total by three. The figures should be based on profits before tax.[5] Profit from overseas branches or subsidiaries are excluded.

Should loss-making companies also spend on CSR? Well, they might have to. For example, Alpha company has a turnover of Rs. 1,200 crores this year. It made average profits of Rs.4 crores annually in last three years. This year it has made a loss of Rs.1 crore. Should the company spend on CSR this year? Yes – it should spend at least Rs. 8 lakh this year also.

NUTS & BOLTS

There are a number of rules with regard to spending CSR funds. You need to understand these to tap into CSR funds.

Spending Channels

CSR rules lay down that CSR funds should be spent directly or through a tax-approved NPO. The NPO can be a CSR foundation set up by the company. If the money is spent through an NGO (as a grant), then the NGO should be registered under Income Tax Act. It should also have a track record of three years.

Eligible Activities

Can the companies spend CSR money on whatever they please? No — they can't. Eligible activities are given in Schedule VII to the Companies Act, though the government will interpret the list rather liberally.[6] The listed activities are:

1. eradicating hunger, poverty and malnutrition, promoting preventive health care and sanitation, including contribution to the *Swach Bharat Kosh* set-up by the Central Government for the promotion of sanitation, and making available safe drinking water
2. promoting education, including special education and employment enhancing vocation skills especially among children, women, elderly, and the differently abled and livelihood enhancement projects
3. promoting gender equality, empowering women, setting up homes and hostels for women and orphans; setting up old age homes, day care centres and such other facilities for senior citizens and measures for reducing inequalities faced by socially and economically backward groups
4. ensuring environmental sustainability, ecological balance, protection of flora and fauna, animal welfare, agroforestry, conservation of natural resources and maintaining quality of soil, air and water, including contribution to the Clean Ganga Fund set up by the Central Government for rejuvenation of river Ganga
5. protection of national heritage, art and culture including restoration of buildings and sites of historical importance and works of art; setting up public libraries; promotion and development of traditional arts and handicrafts
6. measures for the benefit of armed forces veterans, war widows and their dependents
7. training to promote rural sports, nationally recognised sports, paralympic sports and Olympic sports
8. contributions or funds provided to technology incubators located within academic institutions which are approved by the Central Government
9. rural development projects

[5] Explanation to Sec. 135, read with sec. 198 of the Companies Act, 2013

[6] General circular No. 36/2014 dated 17-Sep-14: Clarification with regard to provisions of Corporate Social Responsibility under section 135 of the Companies Act, 2013

10. slum area development

A company can also donate CSR funds to the Prime Minister's National Relief Fund or any other fund set up by the Central Government for socio-economic development and relief and welfare of the Scheduled Castes, the Scheduled Tribes, other backward classes, minorities and women.

Apart from the above, upto 5% of the CSR budget can be spent on administration of CSR (including salaries of CSR staff) and training and capacity-building on CSR.

Connecting with CSR

So far, NGOs have found it a challenge to raise CSR funds. What could be the reason for this? Many NGOs approach a company as they would deal with a donor agency: there is a problem in our area - please give us funds to fix it. This approach works well with donor agencies.

However, companies don't think like donor agencies. They need to see how the proposed project connects with their business and their CSR policy. This could be because the project is located close to their factory or market. Or it could be because the project will help address a problem connected with their business activities.

NGOs therefore need to study the business activities and the CSR policies of a company. During CSR discussions with the company, they should show how the proposed project is linked to these.

Tax Deduction

A bit of tax saving will always be welcome! How can NGOs help? Companies can not claim CSR spending as business expenditure under sec. 37 of the Income Tax Act. However, if the CSR money is donated to a tax-approved NGO, then tax deduction can be claimed under section 80G, 35AC, 35(1), etc.

An NGO seeking CSR funds should show how supporting their project will help the company get a tax advantage also.

REPORTING

Large companies should form a CSR committee. The committee has to formulate CSR policy, and monitor how it is implemented. The committee will also recommend how much money should be spent on CSR. The policy should be uploaded on the company website.

Such companies should also give details of their CSR policy and its implementation in the annual Directors' Report. Format for the report is given in CSR Rules 2014. The report should be signed by the CEO or a director. Failure to report attracts penalties.

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