



# TAX FLASH NEWS

## An analysis of the report of the High Level Committee on CSR provisions

### Background

India is the first country to introduce a legal requirement for companies to comply with Corporate Social Responsibility (CSR). The new Companies Act, 2013 (the Act) requires companies with a net worth of greater than or equal to INR500 crore, or a turnover of greater than or equal to INR1,000 crore, or a net profit of greater than or equal to INR5 crore to spend 2 per cent of average net profit of the immediately preceding three years on CSR activities. The Financial Year (FY) 2014-15 was the first year for the companies to comply with the new CSR provisions.

As the law is new and lacks precedents related to CSR requirements, several questions were raised by the stakeholders. The Ministry of Corporate Affairs (MCA) thus constituted a six member High Level Committee (HLC) chaired by Mr. Anil Bajjal. The committee contemplated and commented on compliance, monitoring and evaluation of programmes, the tax treatment of expenses, etc. related to CSR.

The HLC adopted a consultative approach with various industry organisations, not for profit organisations, Public Sector Undertakings (PSUs) and private companies to arrive at the recommendations provided. The recommendations are tabled before the MCA for their approval. The relevant notification/amendments will be issued upon approval.

### Issues and recommendations

#### A. Compliance

The committee discussed compliance related issues pertaining to the applicability of the law to certain class of companies, interpretation of the term 'net profit' and the financial year which companies need to look at for assessing the trigger to spend on CSR.

Sr. No.	Issue	Recommendation
1	<ul style="list-style-type: none"> <li>CSR is restricted to entities under the company law.</li> <li>Other profit making listed entities incorporated through specific statutes are excluded from the CSR requirement.</li> </ul>	<ul style="list-style-type: none"> <li>Extend applicability of CSR provisions to such entities through amendments in respective statutes or SEBI listing agreement.</li> </ul>
2	<ul style="list-style-type: none"> <li>Applicability of CSR provisions to Section 8 companies</li> </ul>	<ul style="list-style-type: none"> <li>Section 8 companies are involved in charitable activities and the surplus generated by them is ploughed back</li> </ul>

		<ul style="list-style-type: none"> <li>• CSR provisions should not be applicable to them.</li> </ul>
3	<ul style="list-style-type: none"> <li>• Feasibility of compliance with CSR provisions for foreign companies: <ul style="list-style-type: none"> <li>➢ No legal requirement to undertake CSR in the home country.</li> <li>➢ Location of some of the Board of Directors of foreign company outside India may hinder their supervision and compliance.</li> </ul> </li> </ul>	Issue to be further examined
4	<ul style="list-style-type: none"> <li>• CSR Rules define net profit as net profit as per financial statements prepared in accordance with applicable provisions of the Act<sup>1</sup></li> <li>• Applicable provisions of the Act do not provide a reference to 'net profit'.</li> <li>• As per CSR rules, Section 198 does not apply for testing the net profit eligibility criteria.</li> </ul>	<ul style="list-style-type: none"> <li>• Net profit to be computed as per Section 198.</li> <li>• Clarifications are required for definition of net profit</li> </ul>
5	<ul style="list-style-type: none"> <li>• Lack of clarity on interpretation of 'any financial year' to assess the trigger</li> <li>• Financial year may refer to any year since incorporation or preceding financial year or same year.</li> <li>• The MCA clarification states that 'any financial year' is to mean any of the three preceding financial years</li> </ul>	<ul style="list-style-type: none"> <li>• Interpretation in Rules considered retrospective, exceeding the provisions of the Act.</li> <li>• The MCA is to examine and make an amendment in Section 135(1) or in the CSR rules</li> </ul>

The committee also concluded that the existing penalty provisions for non-compliance are sufficient reiterating the need for good governance and self-regulation by the board of directors.

## B. Execution and monitoring of CSR programmes

The HLC deliberated on the ease of executing and monitoring CSR for small and large companies. The need for government intervention for monitoring the CSR programme of PSUs and non-PSUs was evaluated and recommendations were made.

Sr. No	Issue	Recommendation
1	Small companies face difficulty in the execution of CSR requirements due to a small CSR budget	<ul style="list-style-type: none"> <li>• Categorise companies into – <ul style="list-style-type: none"> <li>(i) CSR budget less than INR5 crore</li> <li>(ii) CSR budget of greater than or equal to INR5 crore</li> </ul> </li> <li>• Companies with CSR budget greater than or equal to INR5 crore are to comply with all CSR provisions</li> <li>• Companies with CSR budget less than INR5 crore <ul style="list-style-type: none"> <li>➢ Need not undertake CSR in programme mode.</li> <li>➢ Can undertake an activity covered under the omnibus (all including) provision of 'Public Purpose'</li> <li>➢ Pool CSR funds with similar companies</li> </ul> </li> </ul>
2	<ul style="list-style-type: none"> <li>• Unavailability of the list of credible implementing agencies for undertaking CSR.</li> </ul>	<ul style="list-style-type: none"> <li>• Companies are adept at conducting due-diligence of implementing agencies.</li> </ul>

<sup>1</sup> Section 129 of the Companies Act, 2013 governs financial statements

	<ul style="list-style-type: none"> <li>• Need for a template of an MOU between companies and implementing agencies</li> </ul>	<ul style="list-style-type: none"> <li>• The government is not required to hand-hold</li> </ul>
3	<ul style="list-style-type: none"> <li>• Requirement of government appointed external agencies for monitoring and evaluation of CSR programmes</li> </ul>	<ul style="list-style-type: none"> <li>• Boards of companies are accountable to the shareholders for utilisation their CSR fund.</li> <li>• A stringent mechanism for monitoring CSR expenditure is not required.</li> </ul>
4	<ul style="list-style-type: none"> <li>• Stringent CSR compliance for PSUs through the new Department of Public Enterprises guidelines.</li> <li>• All profit making PSUs to spend on CSR activities</li> </ul>	<ul style="list-style-type: none"> <li>• Treat all companies at par for implementing CSR.</li> </ul>
5	<ul style="list-style-type: none"> <li>• Additional monitoring mechanism for the PSUs CSR programmes</li> </ul>	<ul style="list-style-type: none"> <li>• CSR by PSUs are subject to: <ul style="list-style-type: none"> <li>➢ Audit by CAG.</li> <li>➢ Study by COPU<sup>2</sup></li> <li>➢ Signing of an MOU between a PSU and the Administrative Ministry</li> </ul> </li> <li>• No additional monitoring of CSR activities required</li> </ul>

The committee also recommended inclusion of an all including or omnibus clause in the Schedule VII to address programmes which lie outside the purview of the existing schedule but are essential to the object of social good.

### C. Costs related to CSR programmes

The committee deliberated on the restrictiveness of the cap on administrative expenses related to CSR programmes, employee volunteering cost and the need to carry forward unspent CSR funds to the subsequent year.

Sr. No.	Issue	Recommendation
1	<ul style="list-style-type: none"> <li>• A 5 per cent administrative expenses/overheads cap is inadequate to manage administrative expenses related to CSR activities</li> <li>• Unclear whether the cap on overheads is applicable to the implementing agencies, as well</li> </ul>	<ul style="list-style-type: none"> <li>• Increase cap to 10 per cent through amendments</li> <li>• Capacity building cost of implementing agencies is not to be included in the administrative expenses</li> <li>• A clarity is required on the applicability of the admin expenses cap on implementing agencies</li> </ul>
2	<ul style="list-style-type: none"> <li>• Monetisation of employee volunteering in CSR programmes as eligible CSR expense</li> </ul>	<ul style="list-style-type: none"> <li>• Monetisation of employee volunteering is not recommended as allocation of employees' time cost is not easy</li> </ul>
3	<ul style="list-style-type: none"> <li>• Funds allocated to the CSR programme may not be spent fully on account of the long gestation period of the programme</li> </ul>	<ul style="list-style-type: none"> <li>• Carry forward of the unspent CSR amount is mandatory for PSUs.</li> <li>• A clarification is to be issued to extend this to non-PSUs with a five year sunset clause.</li> </ul>

Besides the issues stated above, the HLC discussed whether distribution of goods and services manufactured/rendered by companies should be considered as eligible CSR expenditure. The committee

<sup>2</sup> Parliamentary Committee on Public Sector Undertakings (COPU)

pointed various issues relating to such form of CSR expenditure such as companies in the name of CSR may merely distribute products and services which may not qualify as CSR, distribute sub-standard or near expiry products, valuation of such expenses may be difficult, may use this to circumvent their CSR requirements and the 'normal course of business' rule. However, no recommendations were made.

#### D. Treatment of CSR expenses under the Income- tax Act, 1961

The committee discussed the need for uniform tax treatment for the CSR expenditure undertaken by companies, along with the service tax implications relating to the MOU between companies and the implementation agencies for executing CSR.

Sr. No.	Issue	Recommendation
1	<ul style="list-style-type: none"> <li>PSUs are not allowed to contribute to PMNRF<sup>3</sup> and hence cannot avail a tax exemption under Section 80G</li> </ul>	<ul style="list-style-type: none"> <li>Tax benefit for contribution to PMNRF is a regressive incentive</li> <li>A uniformity in tax treatment of CSR expenditure on all eligible activities</li> </ul>
2	<ul style="list-style-type: none"> <li>Companies outsourcing their CSR activities to implementing agencies face a service tax implication.</li> <li>Contribution made by companies entering into a MOU with implementation agencies is treated as a grant and is not liable to service tax.</li> </ul>	<ul style="list-style-type: none"> <li>A suggestion to examine and correct the discrepancy in service tax treatment.</li> </ul>

#### E. Other recommendations

- The HLC has highlighted the various tax incentives available to companies for undertaking CSR activities under Sections 30 to 36 of the Income-tax Act, 1961 in addition to the general deduction available under Section 80G for contribution to eligible entities.
- The committee also recommended setting up an annual awards for CSR purposes, one each for large and small companies to incentivise undertaking CSR programmes.

#### Our comments

The HLC felt that the initial two to three years would be a learning period for all the companies to comply with the CSR provisions and the government, to observe compliance with the new law. There is thus a need to be lenient with companies for the next two to three years. The objective of the MCA is to encourage companies to understand the need for social intervention and spend on CSR for the social good.

The recommendations by the HLC is to encourage greater autonomy and flexibility to the Board of Directors of a company to undertake CSR programmes, making CSR self-regulatory.

<sup>3</sup> Prime Minister's National Relief Fund (PMNRF)

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