



NET PROFIT & CSR EXPENDITURES

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CSR EXPENDITURE & MODES OF IMPLEMENTATION

2.1.1 CSR expenditure shall include all expenditure including contribution to corpus or contribution towards projects or programs relating to CSR activities, approved by the Board on the recommendation of its CSR Committee. However, CSR expenditure will not include any expenditure on any item not in conformity or not in line with activities which fall within the purview of Schedule VII of the Act.

2.1.2 It may be noted that CSR expenditures are subject to the following conditions:

- The CSR activities have to be confined to the activities described in the Schedule VII of the Act.
- The CSR expenditure can be made directly by the company.
- The CSR expenditure can be made through registered organisations having at least 3 years' experience in similar programmes.
- The CSR expenditure can also be made through registered organisation promoted by the company. In such cases, the condition of having at least 3 years' experience in similar programmes, will not apply.
 1. The company cannot make any contribution to any political party or political purpose as defined under section 182.
 2. The company should give priority to the local area and the areas around it where it operates.
 3. The company should spend at least 2% of the average Net Profit made during the three immediately preceding financial years.
 4. The expenditure on employees shall not be permissible, unless it is upto 5% on capacity building pertaining to CSR. Further upto 5% on capacity building pertaining to CSR shall also be permissible for the implementing NPOs.
 5. Activities undertaken in pursuance of the normal course of business of the company is not CSR. For instance, a company engaged in plantation cannot claim that the plantation is made as a part of its activity is CSR.
 6. Only CSR activities within India will be taken into consideration. Any activity outside India will not be considered even if it complies with all other conditions.
 7. If the company is unable to spend CSR funds as per provisions then it will have to report under section 134(3)(o) specifying the reasons for not spending.

CSR EXPENDITURE WHETHER CHARGE AGAINST INCOME OR APPROPRIATION

2.2.1 Whether CSR is a charge to the income or appropriation of income has not been clarified. Expenditures of various natures have been allowed as permissible under CSR. For instance, the following type of CSR expenditures is permissible:

1. Direct expenditure on charitable activities as per Schedule VII
2. Direct expenditure on charitable activities in local area
3. Direct expenditure on capacity building of employees

4. Grant to Trust or Society
5. Transfer to other corporates under pooling of expenditure
6. Donation to Govt. recognised funds where 100% tax relief is available

2.2.2 All the above types of expenditures require different types of accounting and tax treatment. For instance, 5% expenditure on capacity building of employees or local area development are judicially/legally considered as a charge against the income. Therefore, they can be directly claimed as expenditure. If that is true then it is not clear whether the 'average income' for CSR should be determined before or after charging such expenditure.

2.2.3 On the other hand, grant, donations, etc. are voluntary appropriation of income and cannot be charged as expenditure against the income. The CSR law allows all these various type of applications as CSR expenditures. Therefore, there is a lot of ambiguity with regard to the accounting and legal treatment.

2.2.4 The problem is that CSR law allows both chargeable and voluntary nature of expenditure. For instance expenditure on local area development have been held as business expenditure, therefore, a company can claim such expenditure even without the CSR laws. On the other hand, charitable activity in other areas is not chargeable expenditures and therefore, can be claimed as expenditure only under CSR laws. However, all the above issues are more relevant from a taxation angle.

CSR EXPENDITURE BEFORE OR AFTER DETERMINING NET INCOME

2.3.1 The computation of average net income shall be made under section 198. For the purpose of CSR, irrespective of the nature of expenditure, the company has to apply 2% of the Net Profit computed under 198.

2.3.2 From a finance planning point of view, a company may distinguish between the chargeable expenditure and the voluntary expenditure, because the chargeable expenditure can be deducted during computation of Net Profit under section 198.

2.3.3 For example, a company spends Rs. 4 lakh on CSR including Rs. 2 lakh on local area issues which are directly incidental to the business. Therefore, the company can claim Rs. 2 lakh on local area issues as business expenditures, which will reduce its Net Profit as well as the CSR spends. The question which needs to be clarified is that whether such overlapping expenditures (which can be claimed both as business as well as CSR expenditures) be treated as CSR expenditure and if so should they be deducted during computation of Net Profit under section 198.

LACK OF CLARITY REGARDING ADMINISTRATIVE EXPENSES

2.4.1 There is no accounting standard or mechanism to determine administrative expenses. The judicial precedence is confusing as most of the administrative expenses have been treated as programme expenses. This will result in use of discretionary norms in determining the administrative expenses, affecting the uniformity in reporting under CSR Rules. This issue has been discussed in detail in the next chapter.

TREATMENT OF SHORT FALL OR EXCESS IN CSR EXPENDITURE

2.5.1 Under Section 134(3)(o) the Board of the company is required to report the short fall in CSR expenditure, however, there is no such requirement of reporting the short fall of CSR expenditure, in the audited financial statements.

- 2.5.2** A short fall in expenditure is a financial issue with a legal accountability of the board. Such shortfall should be formally computed in the audited statement and the company should be required to apply such short fall in future years based on Rules as may be determined.
- 2.5.3** Similarly, there is lack of clarity in reporting and off setting of surplus in CSR expenditures. For example, if a company spends more than 2% of the average profit in any year towards CSR, then will it be allowed to spend less in subsequent years. Ideally, such off set should be permissible.

CAN COMPANIES AVERAGE OUT CSR EXPENDITURE IN CASE OF POOLING

- 2.6.1** Under Rule 4(3) a company may also collaborate with other companies for undertaking projects or programs or CSR activities in such a manner that the CSR Committees of respective companies are in a position to report separately on such projects or programs in accordance with the Rules. In other words, a group of companies can jointly execute CSR programmes, such companies can be holding and subsidiary companies also. The modalities of such joint execution have not been explained in the Act or the Rules.
- 2.6.2** However, it is not clear, in case of pooling of expenses, whether one company can spend less than the other more. In other words, can companies' average out CSR expenditure? Normally each company should be required to spend the requisite amount under CSR with or without pooling of expenses.

POLITICAL CONTRIBUTIONS CANNOT BE GIVEN

- 2.7.1** Under Rule 4(7) it is provided that the CSR expenditure shall not include any contribution, directly or indirectly to any political party under section 182 of the Act. It may be noted that under the Act, companies are permitted to make contributions to political parties upto 7.5% of the average Net Profit during the three immediately preceding financial years subject to the conditions specified in section 182. The text of the section 182 is as under:

Prohibitions and restrictions regarding political contributions.

182.(1) notwithstanding anything contained in any other provision of this Act, a company, other than a Government company and a company which has been in existence for less than three financial years, may contribute any amount directly or indirectly to any political party:

Provided that the amount referred to in sub-section (1) or, as the case may be, the aggregate of the amount which may be so contributed by the company in any financial year shall not exceed seven and a half per cent of its average net profits during the three immediately preceding financial years:

Provided further that no such contribution shall be made by a company unless a resolution authorising the making of such contribution is passed at a meeting of the Board of Directors and such resolution shall, subject to the other provisions of this section, be deemed to be justification in law for the making and the acceptance of the contribution authorised by it.

(2) Without prejudice to the generality of the provisions of sub-section (1),—

- (a) a donation or subscription or payment caused to be given by a company on its behalf or on its account to a person who, to its knowledge, is carrying on any activity which, at the time at which such donation or subscription or



payment was given or made, can reasonably be regarded as likely to affect public support for a political party shall also be deemed to be contribution of the amount of such donation, subscription or payment to such person for a political purpose;

- (b) the amount of expenditure incurred, directly or indirectly, by a company on an advertisement in any publication, being a publication in the nature of a souvenir, brochure, tract, pamphlet or the like, shall also be deemed —
 - (i) where such publication is by or on behalf of a political party, to be a contribution of such amount to such political party, and
 - (ii) where such publication is not by or on behalf of, but for the advantage of a political party, to be a contribution for a political purpose.

(3) Every company shall disclose in its profit and loss account any amount or amounts contributed by it to any political party during the financial year to which that account relates, giving particulars of the total amount contributed and the name of the party to which such amount has been contributed.

(4) If a company makes any contribution in contravention of the provisions of this section, the company shall be punishable with fine which may extend to five times the amount so contributed and every officer of the company who is in default shall be punishable with imprisonment for a term which may extend to six months and with fine which may extend to five times the amount so contributed.

Explanation —For the purposes of this section, “political party” means a political party registered under section 29A of the Representation of the People Act, 1951 (43 of 1951).