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# *Refresh*

## Changing Regulatory Landscape

*Newsletter*

*May - June 2014*



**pwc**

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## The FIPB meeting

Among the matters recently discussed in the FIPB meeting have been classified as under:

- Approval granted for issuance of shares to resident and non-resident Indian shareholders of another Indian entity under a share swap agreement
- Proposal requesting *post facto* approval for issuance of optionally convertible warrants on advice of the RBI was approved by the FIPB
- Proposal for granting *post facto* approval for investee company for issue of shares to the foreign investor one day before the receipt of inward remittance rejected by the FIPB
- FIPB approval not required for incorporation of Indian subsidiary to take over the business of importing and wholesale trading of pharmaceutical products from an existing pharmaceutical company
- Proposal for *post facto* approval for issues of equity shares on partly paid-up basis kept in abeyance
- Proposal requesting for *post facto* approval for foreign investment up to 50.3% amounting to over 5 million INR in its paid-up capital by an entity in the US was rejected by the FIPB



# Corporate regulations

## FDI in LLPs

The RBI has operationalised guidelines in relation to FDI in LLPs permitted by the government of India under the approval route<sup>1</sup> with retrospective effect i.e. from 20 May 2011<sup>2</sup>.

The RBI had directed existing LLPs, which have already received foreign investment, to comply with the applicable reporting requirement within specified days from the date of issuance of these instructions. The RBI has also clarified that the compliance needs to be undertaken within 30 or 60 days, as applicable, from 16 April 2014 (i.e. the date of issue of the RBI circular).

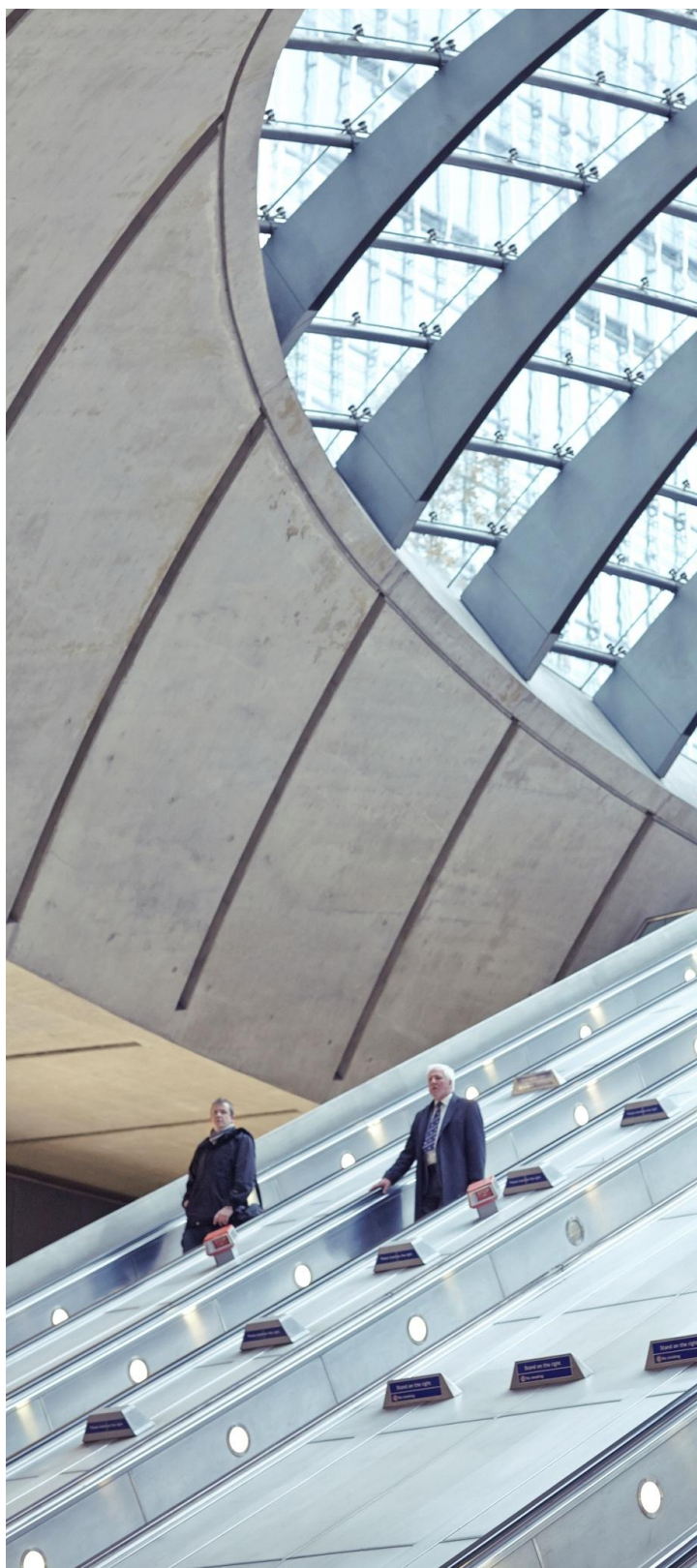
*Source: A.P. (DIR Series) Circular no 123 dated 16 April 2014*

## Reporting requirement: Acquisition of shares on the stock exchanges

The RBI has decided that in cases where the non-resident investor (including a non-resident Indian) acquires shares through a registered broker on stock exchanges under the FDI scheme, the investee company will be required to report the acquisition in Form FC-TRS with the AD category-I bank within 60 days.

Furthermore, it has been decided that in all cases where the Form FC-TRS is submitted beyond the prescribed period of 60 days, approval of the Regional Office may be obtained instead of the Central Office of the RBI.

*Source: A.P. (DIR Series) Circular no 127 dated 2 May 2014*



<sup>1</sup> Press Note 1/2011 dated 20 May 2011

<sup>2</sup> FEMA Notification no 289/2014 dated 13 March 2014 published vide Official Gazette No 190(E) dated 19 March 2014



# Sectoral regulations

## Exchange Control

### Outbound investment

#### *Outbound investment by LLP*

The RBI has now included LLP within the meaning of the term 'Indian party' which would be permitted to make outbound investment.

*Source: Notification no 299/2014-RB dated 24 March 2014 w.e.f. 7 May 2014 and A.P. (DIR Series) Circular no 131 dated 19 May 2014*

## ECB

### *ECB from direct and indirect foreign equity holder and group companies: Liberalisation*

The RBI has now delegated powers to AD banks to permit the following proposals **under the automatic route**.



Sr no	Borrower	Lender	Purpose
1	Companies in manufacturing, infrastructure, hotels, hospitals and software sectors	<ul style="list-style-type: none"><li>Indirect equity holders</li><li>Group companies</li></ul> (ECB from direct equity holders already permitted under automatic route)	Permissible purposes as per RBI directions
2	Companies in manufacturing, infrastructure, hotels, hospitals and software sectors	<ul style="list-style-type: none"><li>Direct equity holders</li></ul>	General corporate purposes (including working capital requirements)
3	Companies in 'miscellaneous service' sectors <sup>3</sup> *	<ul style="list-style-type: none"><li>Direct equity holders</li><li>Indirect equity holders</li><li>Group companies</li></ul>	Permissible purposes as per RBI directions
4	Change of lender when the ECB is from direct / indirect equity holders or group companies		Permissible purposes as per RBI directions

*Source: A.P. (DIR Series) Circular no 130 dated 16 May 2014*

<sup>3</sup> Miscellaneous services mean companies engaged in training activities (but not educational institutes), R&D activities and companies supporting the infrastructure sector. Companies in the trading business, those providing logistics services, financial services and consultancy services are, however, not covered under the facility.

### *Refinance and repayment of rupee loans raised from the domestic banking system*

The RBI has permitted the refinancing and repayment of rupee loans availed from the domestic banking system by raising the ECB under the following windows subject to prescribed conditions:

- Take-out financing scheme
- Repayment of existing rupee loans for companies in infrastructure sector
- Repayment of existing rupee loans for consistent forex earners (10 billion USD window)
- Spectrum allocation

If the ECB is availed from overseas branches and subsidiaries of Indian banks, the risk remains within the Indian banking system. The RBI has now prohibited availing the ECB from overseas branches and subsidiaries of Indian banks for the above purposes.

*Source: A.P. (DIR Series) Circular no 129 dated 9 May 2014*

### *Re-scheduling of ECB: Simplification of procedure*

Earlier, the changes in a draw-down and/or repayment schedule were permitted subject to certain conditions. However, any elongation or rollover in the repayment on the expiry of the original maturity of the ECB required prior approval of the RBI.

The RBI has now delegated the power to AD banks to approve the rescheduling of ECB due to changes in draw-down and/or repayment schedule. This relaxation is also subject to the following key conditions:

- Any changes in AIC will be permitted only if there is a change in the AMP due to re-

scheduling of ECB. There should not be any increase in the rate of interest and no additional cost (in foreign currency / Indian rupees).

- Revised AIC and AMP are in conformity with minimum prescribed limits.
- Such re-scheduling will be allowed only once, before the maturity of the ECB.
- Such changes need to be reported in Form 83.

*Source: A.P. (DIR Series) Circular no 128 dated 9 May 2014*

### **1. Review of AIC ceiling: ECB and trade credits**

The all-in-cost ceiling, ECB and trade credits was due for review after 31 March 2014.

The RBI has now reviewed these rates and decided to keep them unchanged until 30 June 2014. The rates will be subject to review thereafter. Thus, AIC ceiling presently applicable is as below:

Average maturity period	All-in-cost ceilings over six months LIBOR*	
	ECB	Trade credits
Up to one year	350 basis points	350 basis points
More than one year and up to three years		
More than three years and up to five years	500 basis points	

*Source: A.P. (DIR Series) Circular no 121 and 122 dated 10 April 2014*

### **Miscellaneous**

### *Crystallisation of inoperative foreign currency deposits*

The RBI has issued a new notification to promulgate regulations relating to the crystallisation<sup>4</sup> of inoperative foreign currency deposits. The key provisions are as under:

- For deposits having a fixed maturity: If such deposits remain inoperative for a period of three years from the date of maturity of such deposit, the balances will be converted into Indian rupees at the exchange rate prevailing as on that date.
- For deposits having no fixed maturity period: If such deposits remain inoperative for a period of three years (debit of bank charges not to be reckoned as operation), the balance will be converted into Indian rupees at the prevailing exchange rate after giving three-month notice to the depositor.

Thereafter, the depositor can claim either the proceeds in Indian rupees and interest thereon, if any or the foreign currency equivalent (calculated at the rate prevalent as on the date of payment) of the Indian rupee of the original deposit and interest, if any, on such Indian rupee proceeds.

*Source: Notification no FEMA.10A/2014-RB dated 21 March 2014 w.e.f. 7 April 2014*

### *Risk management and inter bank dealings*

The RBI has enhanced the limit for hedging of currency risk of probable exposures based on past performance by resident importers from 25% to 50% of the eligible limit.

The eligible limit is computed as the average of the previous three financial years' import turnover or the previous year's actual import turnover, whichever is higher. It has been clarified that importers, who have already booked contracts up to the previous limit of 25% in the current financial year, shall be eligible for

<sup>4</sup> Crystallisation means conversion of credit balances in any inoperative foreign currency denominated deposit into Indian rupee.

differences arising out of the enhanced limits. All other operational guidelines, terms and conditions shall apply *mutatis mutandis*.

*Source: RBI/2013-14/613, A.P. (DIR Series) Circular no 135 dated 27 May 2014*

### *Export of goods: Long-term export advances*

The RBI has issued liberalised guidelines with respect to the export of goods—long-term advances, where earlier an approval was required to receive export advance beyond the period of one year from the date of receipt of advance payment. Further, AD bankers allowed the receipt of export advance for goods which would take more than one year to manufacture and ship.

With respect to liberalise, the RBI has now permitted banks to allow exporters with a minimum of three years of satisfactory track record to receive long-term export advance up to a maximum tenor of 10 years to be utilised for the execution of long-term supply contracts for the export of goods subject to compliance with the following key conditions:

- The firm irrevocable supply orders should be in place. The contract needs to clearly specify the nature, amount and delivery timelines of products over the years and penalty in the case of non-performance or contract cancellation. Further, product pricing needs to be in consonance with prevailing international prices.
- The company needs to have capacity, systems and processes in place to ensure that orders exceeding duration of the tenure can actually be executed.
- Such export advances shall not be permitted to be used to liquidate rupee loans, classified as net performing assets as per the RBI's asset classification norms.
- Double financing for working capital for execution of export orders should be avoided.

Further, BG / SBLC for export performance can be issued by the banker subject to compliance with the following key conditions:

- Such facility will be extended only for guaranteeing export performance.
- BG / SBLC may be issued for a term not exceeding two years at a time and further rollover of not more than two years at a time may be allowed subject to satisfaction with relative export performance as per the contract.
- BG / SBLC issued from India in favour of the overseas buyer should not be discounted by the overseas branch or subsidiary of bank in India.

*Source: RBI/2013-14/597 A.P. (DIR Series) Circular no 132 dated 21 May 2014*

## **Telecom**

### *The Telecom Commercial Communications Customer Preference (15th Amendment) Regulations, 2014*

The TRAI had issued TCCCP, 2010 (6 of 2010) dated 1 December, 2010 to provide an effective mechanism for curbing UCC. These regulations have been amended from time to time to tighten the regulatory framework. TCCCP (13<sup>th</sup> Amendment) Regulations, 2013, issued on 22 August, 2013, provided disconnection of all telecom resources of entities for which commercial transactions have been solicited, after the second default or notice.

In this regard, entities who have taken measures to comply with the regulations have requested the authority for re-connection. The authority, after considering stakeholder comments streamlined the reconnection procedure.

The TRAI has, therefore, decided to levy administration charges for the reconnection of disconnected telecom resources, other than the telephone connection from which UCC has

originated. The charges would range from 500 INR to 500,000 INR. These charges will help the authority meet administration charges and curb misuse of telecom services.

Accordingly, entities whose telecom resources have been disconnected due to contravention of regulation under consideration, may approach the TRAI within a period of 30 days from the date of disconnection for restoration of such resources. This is provided they substantiate that they have taken reasonable steps to prevent recurrence of such contravention.

*Source: Dated 7 April 2014, No.311-33/2014-QoS*

### *Recommendation on definition of AGR under ISP licence and minimum presumptive AGR*

The TRAI had issued a consultation paper on *Definition of AGR in licence agreements for provision of internet services and minimum presumptive AGR* on 28 December 2012.

Comments were received from various stakeholders and matter was referred to the DoT for its comments also.

Based on the comments received, following are the TRAI's recommendations on the captioned matter:

- A uniform licence fee of 8% of the AGR shall be applicable for all ISP and ISP-IT licences. Revenue for the purpose of licence fee shall include all types of revenue from internet services, allowing only those deductions available for pass-through charges and taxes/levies as in the case of access services, without any set-off for expenses. Revenues from internet services shall also be included in the definition of the AGR.
- Minimum presumptive AGR for the purpose of licence fee shall be applicable on existing ISPs holding the BWA spectrum as applicable to the licensees who obtained access spectrum through competitive bidding.



- For existing ISPs who are holding BWA spectrum from the 2010 auction, the value of presumptive AGR shall be equal to 5% of the sum of the total bid amount by the licensee for the respective service area, as applicable to licensees who obtained spectrum in the auctions conducted in November 2012 and March 2013.
- Based on the TRAI's recommendations relating to the terms and conditions to be applicable on the revenues and licence fees for ISP licences granted under the 1998, 2002 and 2007 guidelines, the DoT may accordingly devise or modify formats of the statement of revenue and licence fee for these three categories of existing ISP licences.

Source: Recommendation dated 1 May 2014

## SEZ

*Deduction under Section 10AA will be available to SEZ units engaged in re-export of imported goods*

The ITAT, Ahmedabad recently held that deduction under Section 10AA of the Act will be available to trading units operating in an SEZ.

In the instant case, the assessee was engaged in the business of trading and manufacturing of precious and semi-precious stones, diamonds and studded gold jewellery and claimed deduction under Section 10AA of the Act.

The AO disallowed the deduction on the following grounds:

- Deduction under section 10AA of the Act is available in case the unit begins to manufacture or produce articles or things or provide service. In this case, the assessee has done only trading and no value addition has been made.
- Further, 'service' has not been anywhere defined in the Act and though trading activity comes under the definition of 'services' in the SEZ Act, the definition appearing in the SEZ Act cannot be applied to the Act.

The ITAT cited an SEZ Instruction issued by the DoC and held that deduction under section 10AA will exclude trading activities *except* in the nature of re-export of imported goods. Hence, deduction under section 10AA of the Act will be available on trading activities in the nature of re-export of imported goods. It also stated that due to the non obstante nature of section 51 of the SEZ Act, SEZ provisions have an overriding effect and anything inconsistent to the provisions of the SEZ Act will not be considered.

## Electronics Policy / M-SIPS Scheme

### *Guidelines on R&D expenditure for M-SIPS subsidy*

Pursuant to the M-SIPS Scheme notified by the government, the DeitY has recently issued guidelines elaborating dealing with capital expenditure relating to R&D activities by potential M-SIPS applicants. The summary of these guidelines are as under:

### *Scope*

- Only those proposals wherein R&D activity results in the manufacture of products will be considered for incentives under the M-SIPS. Standalone R&D units will not be eligible for M-SIPS subsidy.
- R&D expenditure should be related to the product for which M-SIPS application is made. The term 'related' refers to all stages in the value chain of the product proposed to be manufactured, including software integral for functioning of the product.
- All expenditure directly attributable to product development will be considered R&D expenditure. Examples of product development costs include the following:
- Capital equipment, including purchase of design tools, software costs (directly used for R&D) and licence fees, technology,

intellectual property rights, patents and copyrights for R&D

- Expenditure on materials and services used or consumed for prototype development
- Salaries, wages and other employment related costs of personnel directly engaged in product development activities
- Any other expenditure directly attributable to product development, such as fees to register legal rights

#### *Eligibility criteria*

- An applicant claiming subsidy for R&D expenditure should have an eligible proposal under M-SIPS for manufacturing as well.
- R&D expenditure needs to be part of the overall application and should not exceed 50% of the approved project cost.
- In case the expenditure on R&D exceeds 20% of the project cost:
  - The applicant's in-house R&D unit must hold valid recognition by the Department of Scientific and Industrial Research at the time of application. Also, an undertaking will have to be provided that the applicant will provide a valid renewal of recognition of its in-house unit by DSIR for the entire duration of its project under M-SIPS.
  - IPR generated from R&D activities should be in the name of the applicant.

#### *Extent of support for R&D expenditure*

- In case, the project is to be implemented in phases, R&D expenditure eligible for incentives under M-SIPS for any phase needs to be equal to or less than 50% of the cost approved for that particular phase.

- Expenditure related to salaries, wages and other employment related costs of personnel directly engaged in the product development activities should be capped at 15% of the eligible R&D expenditure.

- Further, the Technical Evaluation Committee will evaluate the proposal for expenditure on R&D considering the following:

- Whether the proposed R&D activities relate to manufacturing of products under the project
- Whether P&M, equipment, technology and manpower proposed are commensurate with R&D activities proposed

*Source: Notification no. 27(36)/2013-IPHW dated 17 April 2014*

#### **Company Law**

##### *Delegation of powers to RD and RoC*

The MCA has delegated its powers, pursuant to section 153 (Application for allotment of Director Identification Number), section 154 (Allotment of Director Identification Number) and section 458 (Delegation by Central Government of its powers and functions), to RD and RoC.

- Delegation of powers under section 458 of Companies Act, 2013 to regional directors
- Delegation of powers under sections 153 and 154 of Companies Act, 2013 to the regional director Noida
- Delegation of powers under section 458 of Companies Act, 2013 to the Registrar of Companies

*Source: Notification dated 21 May 2014*

<b>Section</b>	<b>Matters</b>	<b>Delegated to</b>
4(2) – Memorandum	The name stated in the memorandum shall not be as such that its use by the company is undesirable in the opinion of the central government.	RoC
8(1) – Formation of companies with charitable objects, etc.	Grant of licence to company with charitable objects	RoC
8(4)(i) – Formation of companies with charitable objects, etc.	Permission for alteration in the provisions of memorandum or articles except where the alteration is due to conversion into company of other kind	RoC
8(4)(i) – Formation of companies with charitable objects, etc.	Permission for alteration in the provisions of memorandum or articles except where the alteration is due to conversion into company of other kind	RD at Mumbai, Kolkata, Chennai, Noida, Ahmedabad, Hyderabad and Shillong
8(5) – Formation of companies with charitable objects, etc.	Grant of licence to existing companies for registration under this section	RoC
8(6) – Formation of companies with charitable objects, etc.	Power to invoke the licence of company registered under this section	RD at Mumbai, Kolkata, Chennai, Noida, Ahmedabad, Hyderabad and Shillong

*Commencement of provisions of the Companies Act, 2013 with regard to maintenance of books to accounts and preparations, adoption, filing of financial statements, auditors' report, the board's report and attachments to such statements and reports:*

Following the receipt of various requests for clarification, the MCA has clarified that the financial statements, auditors' report and the board's report in respect of the financial year that commenced earlier than 1 April 2014 shall be governed by the relevant provisions, schedules, rules of the Companies Act, 1956 and that in respect of the financial years commencing on or after 1 April 2014, the provisions of the new act shall apply.

*Source: General circular no 8/ 2014 dated 14 April 2014*

*Dissemination of information with regards to the provisions of the Companies Act, 2013 as notified vis-à-vis the corresponding provisions of the Companies Act, 1956:*

The MCA has provided a table mapping the notified provisions of the Companies Act, 2013 with the corresponding provisions of the Companies Act, 1956, and the provisions of the Companies Act, 1956 which shall remain in force.

*Source: Circular no 7/ 2014 dated 1 April 2014*

### *Online payment of stamp duty and court fee stamp for issue of certified copies:*

- The MCA, after review of the process of issue of certified copies of the documents filed with the RoC, has enabled the payment of stamp duty as well as the court fee online through the MCA portal.
- As per the revised process, the amount of court fee shall be added to the MCA fee for getting certified copies. Stamp duty for obtaining the certified true copy shall be paid electronically as per the existing process. It will be calculated based on the number of documents, copies requested and the state in which the registered office of the company is situated.
- Once the application is processed, an acknowledgement for the stamp duty shall be generated. The certified copy of the documents requested shall be sent to the stakeholder by RoC within 15 days by post to the address of applicant mentioned in the *challan*.
- The revised process is effective from 31 March 2014

*Source: Circular no 5/ 2014 dated 28 March 2014*

### **Financial services**

#### *Cash investments in mutual funds:*

The SEBI in partial modification to Para I (1) of the CIR/IMD/DF/21/2012 dated 13 September 2012 has decided to increase the limit of cash transactions in mutual funds from the existing limit of 20,000 INR per investor, per mutual fund, per financial year to 50,000 INR per investor, per mutual fund, per financial year, subject to the following:

- Compliance with the Prevention of Money Laundering Act, 2002 and rules framed there under, the SEBI circular(s) on AML and other applicable AML rules, regulations and guidelines

- Sufficient systems and procedures in place

*Source: Circular no. CIR/IMD/DF/10/2014 dated 22 May 2014*

#### *Disclosures pertaining to AUM:*

The SEBI, in exercise of the powers conferred under section 11 (1) of the SEBI Act 1992, read with the provision of Regulation 77 of the SEBI (mutual funds) Regulation, 1996 and circular no CIR/IMD/DF/05/2014 dated 24 March 2014, has decided that the term 'AUM shall be read as ' (Monthly AAUM)'. Accordingly, data to be disclosed as per the format of Annexure A1 and A2 of the aforesaid circular shall be monthly AAUM instead of AUM.

*Source: Circular no CIR/IMD/DF/07/2014 dated 2 April 2014*

#### *Amendments to Clauses 35B and 49 of the Equity Listing Agreement:*

The SEBI has amended the provisions of the Listing Agreement in relation to corporate governance, in order to align with the provisions of the Companies Act, 2013 in this regard and to adopt best practices on corporate governance and make the existing framework more effective.

The amendments have been carried out in exercise of the powers conferred under section 11 read with section 11A of the SEBI Act, 1992 and the revised listing conditions should form part of the existing Equity Listing Agreement of the stock exchanges.

Given below is a summary of the applicability of the revised listing agreement.

#### *Applicability*

- Revised Clause 49 will be applicable to all listed companies with effect from 1 October 2014.
- Provisions of the Clause 49(VI)(C) shall be applicable to the top 100 listed companies by market capitalisation, as at the end of the immediate previous financial year.



- Provisions of the Clause 49 (VII) shall be applicable to all prospective transactions. All existing material-related party contracts or arrangements as on the date of this circular which are likely to continue beyond 31 March 2015 shall be placed for approval of the shareholders in the first general meeting subsequent to 1 October 1 2014. However, a company may choose to get such contracts approved by the shareholders even before 1 October 2014.
- For other listed entities which are not companies, but body corporate or are subject to regulations under other statutes (e.g. banks, financial institutions, insurance companies etc), Clause 49 will apply to the extent that it does not violate their respective statutes and guidelines or directives issued by the relevant regulatory authorities.
- The Clause 49 is not applicable to mutual funds.
- The revised Clause 35B will be applicable to all listed companies and the modalities will be governed by the provisions of Companies (management and administration) Rules, 2014. Circular no CIR/CFD/DIL/6/2012 dated 13 July 2012 stands amended to that extent.
- The monitoring cell formed by the stock exchanges in terms of circular no CIR/CFD/POLICYCELL /13/2013 dated 18 November 2013 shall also monitor the compliance with the provisions of the revised Clause 49 on corporate governance for all listed companies. The cell shall ascertain the adequacy and accuracy of disclosures in the quarterly compliance reports received from the companies and shall submit a consolidated compliance report to the SEBI within 60 days from the end of each quarter.

*Circular no CIR/CFD/POLICY CELL/2/2014 dated 17 April 2014*

## **Broadcasting**

### *Consultation paper on issues related to CRS*

The TRAI has issued a consultation paper on issues related to CRS. They serve as a local and well-defined community, helping focus on the day-to-day concerns of its audience and satisfy their specific information and entertainment needs. Some of the key issues identified for comments are as follows:

What should be the period of permission for CRS to be prescribed in the guidelines? Is the present five-year period adequate?

- What should be the period of extension on the expiry of the initial period of permission for CRS?
- Should there be any additional terms and conditions of extension or renewal of the permission for CRS?
- Should CRS permission holders be permitted to use the news bulletin of the All India Radio in an unaltered format and community based non-news and current affairs programmes for the categories permitted to the FM radio stations?
- In view of the availability of alternative revenue or funding options, is there any reason to increase the duration of advertisement beyond the five minutes per hour limitation?
- Utilisation of CRS during natural calamities or emergency situations?

*Source: Consultation paper no: 4/2014 dated 2 1May 2014*

### *The PRBP Bill, 2013*

The MIB has proposed to introduce the PRBP Bill, 2013, which on being notified will repeal the existing 'Press and Registration of Books Act, 1867'.

Some of the key amendments proposed under the bill include the following:

- The definition of ‘newspapers’ and ‘publications’ has been expanded to include reproduction in electronic form.
- Publications may lose registration if they carry paid news. Paid news has been defined as, publishing any news or analysis for a price in cash or kind as consideration.
- Specific appellate authority will be constituted for entertaining appeals against the Press Registrar General.

### *The Cinematograph Bill, 2013*

The MIB has introduced The Cinematograph Bill 2013, to provide for the certification of cinematograph films for exhibition and for regulating the exhibition by means of cinematograph and for matters connected therewith or incidental thereto.





# Perspective

## *CSR: Towards a brave new world*

In CSR, a company engages in actions that further social (and environmental) good, beyond the obvious interests of the firm, its business relationships and that which is required by law. The MCA, Government of India has formally notified CSR provisions under section 135 of the Companies Act 2013 and related rules, on 27 February 2014. Along with *National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Businesses* released in 2011, this development is already being considered one of the most forward-looking and futurist frameworks in recent times to help businesses become more responsible.

The provisions dealing with CSR are contained in section 135 of the Companies Act, 2013 (the 2013 Act) effective 1 April 2014. To decide the applicability of section 135, audited accounts of any financial year will be taken into consideration ***with effect from 1 April 2014***. Since the CSR spend amount is based on the average net profit of the last three years, companies can plan its CSR expenditure well in advance.

## *Applicability*

The Companies Act, 2013 mandates a disclosure regarding CSR, than the CSR spend per se. The 2013 Act follows a 'comply or explain' approach. As per the provisions of section 135, a company with a turnover of 1000 crore INR or more or a net worth of 500 crore INR or more or net profit of 5 crore INR or more in any FY shall constitute a CSR Committee and is required to spend at least 2% of their average net profits of the last three years on CSR activities. Further, the 2013 Act provides that if for any reason, a company is unable to spend 2% of their average net profit on CSR, they will be required to explain the reason for not doing so.



### *Computation of net profit*

With respect to computation of net profit, the Rules provide that 'net profit' should be calculated:

- in accordance with section 198 of the 2013 Act (similar to the computation for determining the limit on remuneration of the directors under section 197) for a company (other than foreign company)
- in accordance with clause (a) of sub-section (1) of section 381 read with section 198 for a foreign company

The net profit should exclude any profits from any overseas branch or branches (whether operated as a separate company or otherwise) of the company and any dividend received from other companies in India, which are covered and comply with the provisions of section 135 of the 2013 Act. Further, it clarifies that there is no need to recalculate net profit for the year it has been calculated in accordance with Companies Act, 1956.

### *What are CSR activities?*

Schedule VII (the Schedule) of the 2013 Act states that certain new activities could be classified as CSR activities for instance, protection of national heritage, art and culture, including restoration of buildings and sites for historical importance and works of art, setting-up of public libraries, promotion and development of traditional arts and handicrafts, measures for the benefit of the veterans of the Armed Forces, war widows and their dependents, rural development projects, training to promote sports, funds to technology incubators, etc. The scope of certain existing activities has been enhanced; for instance, the scope of promoting education also includes special education. Further, the Schedule elaborates with respect to certain activities. For example, environment sustainability which includes ecological balance, maintaining air quality, water and soil, conservation of national resources, etc.

Still, **Schedule VII is restrictive in nature** in terms of choice for the company. The government should have permitted companies to have their choice of CSR activities. The contribution of any state set-up funds and social business projects has been removed.

It has been also been clarified in the rules that political contribution and funding won't be considered as CSR expenditure. Further, activities aimed to help only the company's employees or families of the company's employees won't be considered as CSR activities.

Under section 467 of the Companies Act 2013, the government has invoked the power to amend Schedule VII significantly. A 'clause x' in the earlier Schedule VII, which empowered the government to prescribe 'any other matters', has been removed. So, if there is the need to add further activities under Schedule VII, the government needs to propose an amendment by invoking power under section 467 of the said Act.

### *Shared value proposition*

Further, it seems that the concept of shared value proposition has been ruled out. For instance, a company cannot choose a project which also supports their business object. If a water purifier company does CSR in the area of providing safe drinking water and runs a campaign to create awareness regarding safe drinking water, this will have a shared value proposition since the company also derived some value for its business prospects. It would have been better, if this shared value concept had been recognised in the rules.

### *The definition of CSR creates ambiguity*

Companies (CSR Policy) Rules, 2014 were also notified along with section 135. The definition of CSR, as prescribed in Rule 2(c) seems to be an 'inclusive' definition, although at several other places in the Rules, it clearly states that those CSR activities falling under Schedule VII will only qualify as CSR expenditure by a company. This will create ambiguity. If someone takes up a



CSR project, other than those permitted in Schedule VII, but in line with the CSR policy approved by the CSR Committee of the board of directors, CSR spend on such project won't be considered as part of the 2% CSR expenditure under the Companies Act 2013, even if they are well within the inclusive definition of CSR per se. This restricts the choice of the company with many existing CSR schemes and programmes have to reconsider and realign their activities with the newly amended Schedule VII. As indicated by the MCA at several forums, it was expected that the government would permit companies to have their choice of CSR activities.

### *Constitution of CSR Committee: Appointment of an independent director*

There has been concern around the appointment of an independent director by private companies to comply with the provisions of section 135 of the 2013 Act with respect to the constitution of the CSR Committee. The notification clarified that an unlisted public or private company covered under sub-section (1) of section 135 of the 2013 Act, which is not required to appoint an independent director pursuant to sub-section (4) of section 149 of the 2013 Act, shall have its CSR Committee without such director. Though this comes as relief to private companies, the legal question is, can rule-making power under section 469, relax the provision of section 135 of the Companies Act 2013? It would have been better, if the MCA had invoked its power under section 462 to exempt a certain class of companies from compliance with certain provisions of the 2013 Act.

The notification further specified the responsibilities of the CSR Committee to include the following:

- Formulation and recommendation to the board, CSR policy; CSR policy to indicate the activities to be undertaken by the company as specified in Schedule VII

- Recommendation of the amount of expenditure to be incurred on the activities referred to above
- Institution of a transparent monitoring mechanism for implementation
- Monitoring the CSR policy from time to time
- Where a company collaborates with other companies for undertaking projects or programmes, report separately on such projects or programmes

### *CSR reporting, pooling resources, if outsource CSR function, three year track record must*

Thus, companies may also collaborate with other companies for undertaking CSR activities. However, reporting of such CSR activities in the board report has to be done by an individual company. Further, a company may decide to undertake CSR activities through a registered trust, society or a company established under section 8 of the 2013 Act or a company established under section 25 of the Companies Act 1956. However, if a company decided to undertake CSR activities through such trust, society or company, such trust, society or company should have an established track record of three years demonstrating that they have undertaken similar projects in the past.

The notification provides for a specified format of reporting. It requires that the board report of a company covered under the CSR Rules pertaining to a FY commencing on or after 1 April 2014 to include an annual report on CSR containing certain particulars mentioned in the rules related to CSR policy, composition of CSR Committee, net profits, CSR spend, etc. Additionally, companies would be required to display their CSR policy on their corporate website.

An annual report on CSR activities must be included in the board report of a company spending on CSR. Similarly, for foreign companies including a branch or project office,

the CSR spend must be reported as an annexure in the balance sheet.

### *FCs*

**Rules cover FCs, not Cos. Act per se.** The ambit of the Act does not specifically cover foreign companies, but the Rules clearly include foreign companies having their BO or PO in India. As per section 135(1), CSR applies to every 'company' that qualifies as per the mentioned thresholds criteria. As per section 2(20) 'company' means a company incorporated under this Act or under any previous company law. It seems that by this reading, we cannot infer that every 'company' also includes foreign company.

However, as per CSR Rule 3 (1) every 'company' including its holding or subsidiary, and a foreign company defined under clause (42) of section 2 of the Act having its BO or PO in India, which fulfils the criteria specified in sub-section (I) of section 135 of the Act shall comply with the provisions of section 135 of the Act and these rules. Section 2 (42) defines 'foreign company' as any company or body corporate incorporated outside India which has a place of business in India; and conducts any business activity in India in any other manner.

By the combined reading of the above provisions of the section and rules together, it can be said that CSR provisions are also applicable to foreign companies having their BO or PO in India. However, the legal question is, can rule-making power under section 469, relax (exemption for private companies from independent director requirement in CSR Committee) or enhance the scope (CSR provisions applicable to foreign companies) of the provision of section 135?

### *Net worth of foreign companies having BO or PO in India*

The net worth, turnover or net profit of a foreign company of the Act shall be computed in accordance with balance sheet and profit and loss account of such company prepared in

accordance the provision of clause (a) of sub-section (1) of section 381.

Since there are only BO or PO in India, net worth criteria would not be applicable to FCs. Further, for the calculation of turnover or net profit of foreign companies having their branch or project offices in India, turnover or net profit of FCs in India shall only be considered.

CSR spend must be reported as an annexure in the balance sheet. The CSR Committee of a foreign company shall comprise at least two persons of which one person shall be as specified under section 380(1)(d) of the Act and another person shall be nominated by the foreign company.

CSR activities have to be carried out in India only, to be qualified as CSR spend under the Companies Act 2013.

### *Approvals for FCs*

Foreign companies with their BO or PO in India are required to undertake CSR activities need to take approvals under the Foreign Contribution Regulation Act 2010. Such approvals are administered by the Ministry of Home Affairs.

This CSR spend requirement will also trigger an amendment in the FEMA Regulations, as the Indian branch of a foreign company can undertake only eight specific activities and CSR isn't part of those one of the specific activities, requires RBI approval. Also worth noting is that FDI isn't permitted in case of a trust or societies.

### *The Rules are silent over tax treatment*

There is no clarification on the tax treatment of CSR expenditure in the Rules. The request for clarification by the industry was based on the interpretation that if CSR is not the 'normal course of business', such expenses may not be tax deductible.

### *Time value of the company's personnel for CSR activities*

There is a provision in the CSR rule which says that companies may build on CSR capacities from their own personnel, subject to a maximum limit of 5% of the total CSR expenditure of the company in a financial year. It is not clear as to whether the time value of the company's personnel for CSR activities is allowed under this 5% limit.

The concept of CSR is recognised the world over stating that integrating social, environmental and an ethical responsibility into the governance of businesses ensures their long-term success, competitiveness and sustainability. This approach also re-affirms the view that businesses are an integral part of society, and have a critical and active role to play in the

sustenance and improvement of healthy ecosystems, in fostering social inclusion and equity, and in upholding the essentials of ethical practices and good governance. This also makes business sense as companies with effective CSR, develop the image of socially responsible companies and achieve sustainable growth in their operations in the long run. Their products and services are preferred by customers, as a key element in propagating the overall framework for confidence in the social market.

CSR has taken on many guises and names over the years with some companies pursuing it more vigorously and more broadly. With the initiative taken by the Ministry to mandate expenditure on CSR activities, Indian companies will need to now evaluate the way forward.

*Gajendra P Singh (Associate Director, Public policy & Regulatory Affairs)*

# Glossary

AD	Authorised dealer
AGR	Adjusted gross revenue
AIC	All-in-cost
AML	Anti money laundering
AMP	Average maturity period
AO	Assessing officer
AUM	Asset under Management
BG	Bank guarantee
BO	Branch office
BWA	Broadband wireless
CRS	Community radio stations
DeiTY	Department of Electronics and Information Technology
DoC	Department of Commerce
FCs	Foreign companies
FDI	Foreign direct investment
FEMA	Foreign Exchange Management Act
FIPB	Foreign Investment Promotion Board
FY	Financial year
INR	Indian rupee
IT	Information technology
ITAT	Income Tax Appellate Tribunal
MAAUM	Monthly Average Asset under Management
MCA	Ministry of Corporate Affairs
MIB	Ministry of Information and Broadcasting
MoC	Ministry of Commerce
M-SIPS	Modified special incentives package schemes
NRIs	Non-resident Indians
PIB	Press Information Bureau
PO	Project office
PRBP Bill	Press and Registration of Books and Publications Bill, 2013
R&D	Research and development
RBI	Reserve Bank of India
RD	Regional director
SBLC	Stand by letter of credit
SEBI	Securities Exchange Board of India
SEZ Act	Special Economic Zone Act, 2005
SEZ	Special economic zone
TCCCP	The Telecom Commercial Communications Customer Preference Regulation
The Act	Income Tax Act, 1961
TRAI	Telecom Regulatory Authority of India
UCC	Unsolicited commercial communications
USD	United States dollar



# Contacts

## Ahmedabad

President Plaza, 1st Floor Plot No 36  
Opp Muktidham Derasar  
Thaltej Cross Road, SG Highway  
Ahmedabad, Gujarat 380054  
Phone +91-79 3091 7000

## Bangalore

6th Floor, Millenia Tower 'D'  
1 & 2, Murphy Road, Ulsoor,  
Bangalore 560 008  
Phone +91-80 4079 7000

## Chennai

8th Floor, Prestige Palladium Bayan  
129-140 Greams Road,  
Chennai 600 006  
Phone +91 44 4228 5000

## Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th Floor,  
Road No. 10, Banjara Hills,  
Hyderabad – 500034,  
Andhra Pradesh  
Phone +91-40 44246000

## Kolkata

56 & 57, Block DN.  
Ground Floor, A- Wing  
Sector - V, Salt Lake.  
Kolkata - 700 091, West Bengal, India  
Phone +(91) 033 - 2357 9101 / 4400 1111

## Mumbai

PwC House, Plot No. 18A,  
Guru Nanak Road - (Station Road),  
Bandra (West), Mumbai - 400 050  
Phone +91-22 6689 1000

## Gurgaon

Building No. 10, Tower - C  
17th & 18th Floor,  
DLF Cyber City, Gurgaon  
Haryana -122002  
Phone : +91-124 3306 6000

## Pune

GF-02, Tower C,  
Panchshil Tech Park,  
Don Bosco School Road,  
Yerwada, Pune - 411 006  
Phone +91-20 4100 4444

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