

August 04, 2017

Legal Note: Existing Laws on Corporate Social Responsibility

1. Introduction:

- 1.1 Following set of rules have specifically provided for legal obligations of business to allocate certain fund for corporate social responsibility (the "**CSR**"): (a) in cases of industries, Industrial Enterprise Act 2016 (2073) ("**IEA**" or the "**Act**") and, (b) in cases of banks and financial institutions ("**BFI**s"), Circular no. 11/073/74 dated January 25, 2017 (2073/10/12) issued by Nepal *Rastra* Bank, the Central Bank of Nepal ("**NRB**") (the "**NRB Circular**").
- 1.2 No such CSR requirement has been prescribed for insurance businesses and other non-industrial sectors (for example, trading businesses).

2. CSR Requirement for Industries:

2.1 Applicability:

- (a) The mandatory requirement of the CSR has been made applicable to only certain industries on the basis of (a) investments in the fixed capital, or (b) annual turnover.
- (b) The CSR requirement is applicable to (i) medium industries; i.e. industries having investment in fixed capital exceeding NPR 100,000,000 but less than NPR 250,000,000; (ii) large industries i.e. industries having investment in fixed capital exceeding of NPR 250,000,000 and (iii) cottage industries (i.e. industries based on traditional skill or technology, local raw materials and resources etc.) and small industries (i.e. industries having investment in fixed capital of less than NPR 10,000,0000 except micro and cottage industries) whose annual turnover is more than NPR 150,000,000.
- (c) Fixed capital for the purpose of IEA is calculated on the basis of assets such as land, buildings, factory, storage house, machineries, vehicles, furniture etc.

2.2 Amount for the CSR:

- (a) The IEA makes it mandatory to allocate at least one percent (1%) of the *annual profit* to be utilized for CSR. The IEA refers to the wording "annual profit". The IEA, however, has not defined "annual profit".
- (b) From the implementation point of view, this issue warrants clarity from the Government as to whether the amount is to be calculated on the profit -before tax or after tax.

2.3 Sectors specified for utilization of the amount of CSR:

Prior approval from the Government authorities is not required for the annual plans and programs prepared for the utilization of the amount of the CSR. However, the fund created

for the CSR is to be utilized in the prescribed sector on the basis of annual plans and programs. However, such sectors are yet to be specified in the Regulations.

2.4 *Reporting requirement:*

The transaction amount for a financial year and progress report of the utilization of the fund collected for the CSR is required to be submitted to the relevant government authorities registered within three months from the end of the financial year.

2.5 *Sanction for Non-compliance:*

The IEA penalizes the industries at the rate of 0.75% of the annual revenue for failure to comply with the CSR obligation. Further, the language in the law does not use the wording “up to” which means that the risk of even minor non-compliance may trigger a huge financial impact for the industry.

2.6 *Allocation of amount for FY 2016/17:*

The IEA came into implementation during the financial year of 2016/17 and it there is some level of uncertainty as to whether the funds should be calculated for the entire year or only on proportionate basis. Given that the requirement is imposed to allocate on annual basis, the allocation may have to be made for the entire year.

3. CSR Requirement for BFIs:

3.1 *Applicability:*

The NRB Circular has required BFIs to allocate at least one percent (1%) of *net profit* and deposit the same in a separate CSR fund. The fund allocated is to be utilized in the subsequent fiscal year.

3.2 *Amount for the CSR:*

Whilst the NRB Circular has provided that allocation is to be done out of net profit it has not clarified whether allocation is to be done before or after profit.

3.3 *Area of Utilization:*

The area of utilization has been categorized in the following manner;

- i. *Utilization for social projects:* Direct and indirect utilization in programs related to education, health, disaster management, environment protection, cultural promotion, infrastructural development in remote areas, and improvement in earning capabilities of socially backward groups, financial literacy and customer protection. Projects should be selected through proposal with public notice by highly recognized organizations working in the related field.
- ii. *Direct grant expenditure:* Direct expenditure towards providing grant for education and health of backward classes or expenditure in construction of infrastructures, buying of vehicles and cost of operating them, etc. for organizations working towards the same cause.

- iii. *Sustainable development goals:* Sustainable development goals of Nepal, direct and indirect expenditure towards achievement of goals set in the 17 areas recognized by the 2016-2030 (Sustainable Development Goals, 2016-2030).
- iv. The cost borne by BFIs while setting up a Child Day Care Centre for their employees.

3.3 *Limitation on use for marketing purpose:*

Pursuant to the NRB Circular, the BFIs cannot utilize the funds for branding purpose but it can use its name as "reference". Also, the BFIs must not restrict its utilization of funds targeting a specific geographical area and subject matter. Further, the utilization must not be made so as to acquire personal or political gain in any manner. The BFIs are required to implement internal procedure for implementation of CSR fund.

3.4 *Sanctions for non-compliance:*

Nepal Rastra Bank Act 2002 (2058) has provided for both fine and imprisonment sanctions for non-compliance to the NRB Circulars.

3.5 *Allocation of amount for FY 2016/17:*

Unlike IEA, NRB Circular has prescribed specific sectors for utilization of allocated CSR amount with certain conditions and restrictions. Thus, the BFIs are required to comply with this provision allocating profit amount of the FY 2016/17 and utilizing the same in the next financial year.

4. Decision making Capacity:

The minimum amount to be allocated for the CSR activities is a legal requirement for industries and BFIs. Both IEA and NRB Circular have not clarified as to whether the decision to invest in CSR activities and its amount is to be resolved through the Board of the Directors or the General Meeting of the company. Generally, the requirement is to prepare the internal procedure for utilization of the CSR fund. This can define the internal authorities and would at least require approval at the Board level.

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