

# AccountAble™

AccountAble 1: Trust, Society or Company?

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### TRUST, SOCIETY OR COMPANY?

Generally speaking, any organisation that devotes its funds for public welfare is a not-for-profit organisation (NPO). This includes schools, colleges, hospitals, religious organisations, etc. It also includes non-governmental organisations (NGOs). There are three common forms of not-for-profit organisations: Trusts, Societies and Sec. 8 Companies. Which one should you choose?

#### Trusts

Trusts are the oldest form of charitable organisations. These may be private or public. Private Trusts are formed for the benefit of family members, or a very small set of known persons. A private trust is not a charitable trust. Private trusts are governed by Indian Trusts Act, 1882. This Act does not apply to public trusts.<sup>1</sup>

In Maharashtra and Gujarat, public charitable trusts must be formed and registered under the Bombay Public Trusts Act, 1950. In other states, public trusts are mostly governed by common law.<sup>2</sup> This means that you can form a public trust by preparing a trust deed and registering it under Registration Act, 1908.<sup>3</sup> You just need a settlor and two or more trustees, who may be Indian or foreign citizens.<sup>4</sup> Trustees can also be paid employees of the Trust. A



charitable trust formed anywhere in India can operate in all the states.<sup>5</sup>

In general, trusts are the easiest to form and run. However, as there is no regulatory oversight,<sup>6</sup> disputes have to go to court. The trust deed can also be modified only by the settlor making a supplementary trust deed.<sup>7</sup> If the settlor is not available, you need to go to court for modifying the trust deed.<sup>8</sup> There are no regulatory requirements for governance or public filing of accounts.

<sup>1</sup> Trusts and charities are under the Concurrent List in the Constitution of India. Each state is free to frame its own laws with regard to trusts. The Centre can also frame an all-India law, which will prevail wherever a state law has not been passed. However, the Centre has not passed any law on charitable trusts so far.

<sup>2</sup> Some other states, such as Rajasthan, Andhra Pradesh (now Telangana and Seemandhra), also have laws to govern public trusts. However, even in these states, a charitable trust may be formed under common law.

<sup>3</sup> This Act provides for registration of various legal documents, property transfers, etc. The registration is done by Court Registrar, and a copy of the trust deed taken on court record. The original deed is stamped and returned to the trustees. No registration cer-

tificate is issued.

<sup>4</sup> A trust can also have just one trustee, though it is usual to have at least two. This ensures continuity, in case one trustee becomes incapable. The settlor can also be a trustee.

<sup>5</sup> Trusts formed outside Gujarat or Maharashtra may need to register themselves under Bombay Public Trusts Act, 1950 also - if they want to raise funds (or have any assets situated) in either of these states.

<sup>6</sup> Except in Maharashtra and Gujarat

<sup>7</sup> Supreme Court's observations in Commissioner of Income Tax vs. Kamla Town Trust, 217 ITR 699 (SC) 1996

<sup>8</sup> Under sec. 26 of the Specific Relief Act, 1963

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A public trust is ideal when a person wants to dedicate their own property to a specific cause for all times to come. It is not so suitable<sup>9</sup> when you want to raise funds from the public for the trust's activities.<sup>10</sup>

A trust is a bit like a castle, complete with a moat and drawbridge. You lay in supplies for a couple of hundred years, post archers (or lawyers) on the battlements, and get on with your work. But a trust doesn't work well in a fluid situation. And if you don't have enough funds of your own, you need to allow tourists (read donors) to pay for the upkeep - just as so many former princes and dukes are doing these days.

## Societies

Societies are a relatively modern form. These are formed when about seven persons come together for a common purpose in a general body.<sup>11</sup> These may be Indians or foreigners.<sup>12</sup> You can add more members. Each general body member has one vote. The general body then elects a governing board (usually 5-7 persons) from among the members. The governing board manages the organisation directly or through executive employees.

Societies in many states are governed by the Societies Registration Act, 1860 in its original or amended form. However, a number of states have passed their own laws for regulating societies - these laws have replaced the original Societies Registration Act, 1860.

A society formed in one state can usually operate in other states, if its Memorandum says so.<sup>13</sup> However, in many states, the registrars may refuse to register such a society. Or they may impose additional conditions. For instance, you can register an all-India society in Delhi, only if you have members from several different states.

Governance and public filing requirements vary from one state to another. In general, every society has to file a list of governing body members annually. Many states ask for filing of audited accounts as well. However, there are as many which do not. The main Societies Registration Act, 1860 itself does not have any provision for filing of audited accounts. In most states (except Tamil Nadu)<sup>14</sup>, members and office bearers can also be paid employees of the society.

Formation and governance of a society is more difficult than a trust, but easier than a company. However, finding and corraling seven members can sometimes be difficult. This form works best for people with state-level objectives, who want to focus on their activities, and cannot be bothered with too many formalities.

A society is somewhat like a bus full of pilgrims, driven by



one of the passengers. Arguments may break out over who pays for the fuel and for repairs. There might be quarrels about where to go and how long to stop at each shrine. The driver may be impeached every now and then. To avoid this, most societies restrict membership to the minimum, and raise funds from outsiders.

## Sec. 8 Companies

These are limited companies formed under the Companies Act. The Government grants them a special license under sec. 8 to drop the words 'Private Limited' or 'Limited' from their name.<sup>15</sup> There are three conditions for this:

1. The Company must be formed for charitable objects.<sup>16</sup>
2. Income and profits should be applied towards these objects.
3. It should not pay any dividend to its members.

Such a company can operate in any state without additional formalities. It can be formed with just two persons.<sup>17</sup>

<sup>9</sup> Except in Maharashtra and Gujarat where public trusts are regulated

<sup>10</sup> Such trusts are often formed due to ease and low cost of formation. However, these are nominal trusts, in the sense that the property entrusted is a very small amount, usually just a thousand rupees.

<sup>11</sup> In some states, five persons can form a society.

<sup>12</sup> There is no legal restriction on foreigners being members. However, in some states, registrars may be reluctant to register such societies. People often form the society with Indians, and admit the foreigners as members later on.

<sup>13</sup> The Government is working on a bill to regulate societies which operate across state-borders, or have donors from outside the state or country.

<sup>14</sup> Sec. 25(3) of the Tamil Nadu Societies Registration Act, 1975. Office bearers can not be paid any salary or honorarium.

<sup>15</sup> Same as sec. 25 companies under the Companies Act, 1956

<sup>16</sup> Promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object

<sup>17</sup> Both Private Limited and Public Limited companies can get this license. However, One Person Companies (OPC) can not get a license under this section (rule 3(5), Companies (Incorporation) Rules, 2014).

Members may be Indian or foreigners.<sup>18</sup> It should have at least two directors, who need not be members. The company can be formed with shares - each member gets votes in proportion to their shares. If the company is formed with guarantee, then each member gets one vote.

Can directors and members be paid for their services? This is now easier. You can pay prudent remuneration for actual services - without getting government approval.<sup>19</sup> However, there are severe penalties<sup>20</sup> for violation of any provisions of the Act. And unlike the previous Act, charitable companies now enjoy no relaxation in fees or other



formalities. Whether the company is big or small, it must comply with all requirements of the Companies Act.<sup>21</sup>

Forming a sec. 8 company is more complicated than a trust or a society. It costs you more and takes more time. There are a number of complex formalities in running the company, and it is easy to make a costly mistake. Even so, a sec. 8 company is more robust, transparent and accountable than a trust or a society. If you are not afraid of paperwork, and can afford to spend the extra money, then this is the best form to choose for publicly supported development work.

Using a company for non-profit work is like flying a plane. It costs more money to buy and to maintain. You need a trained pilot and a good crew. You are also heavily regulated. However, if you can afford it and have a long journey ahead, you might find this safer and more comfortable than taking a bus.

### Which is Better?

All three forms can be used for non-profit work, just as a truck can be used to carry passengers, and a bicycle for carrying almost anything! However, each form has its own advantages and handicaps. Which form should you choose?

- Trusts are easy to form and run - but unwieldy when it comes to changing objects or settling disputes. You can choose a trust if you are dedicating your own property to public good. A trust is designed to protect the settlor's wishes - this helps prevent unintended changes when you are no longer involved.
- Societies are designed as democratic structures, and tend to suit collaborative activities. This form is ideal if your work calls for consultation and equal participation of large number of people. However, societies can also be difficult to govern unless you pack the membership with trusted people.
- A non-profit company is the most difficult and expensive to form. However, once formed, it is also the easiest to control. Firstly, you can form a company with just two persons. Secondly, if you choose a share-capital based company, you can exercise control by keeping a majority of shares with you. Management and control can be separated, as the directors need not be shareholders.

<sup>18</sup> Having foreigners on Governing Board, or in control, usually makes it difficult to get FCRA permission.

<sup>19</sup> Clause 6, Form INC 16

<sup>20</sup> Rs.10 lakh to one crore on company; Rs. 25,000 to 25 lakh for officers, as well as imprisonment upto three years. In case of fraud, the fine may be three times to amount involved, as well as imprisonment ranging from 6 months to 10 years.

<sup>21</sup> Sec. 8 companies can not get small company status, and must pay fees applicable to large private companies and public companies.

The following table gives a comparative analysis:

	Public Trust	Registered Society	Sec. 8 Company
Formation	One week	One month	3-6 months
Formation Costs	Rs. 1,000 - 5,000	Rs. 3,000 - 10,000	Rs. 30,000 - 75,000
Annual Costs	Rs. 5,000 +	Rs. 10,000 +	Rs. 30,000 +
Members	Two +	Seven +	Two +
Foreigners as members / Directors	No restriction	Not prohibited by law	Allowed
Payments to members and directors	Allowed	Allowed in most states for actual services	Allowed for actual services
Control	Easy	Difficult	Easy
Public Transparency	Low	Moderate	High
Modifications	Very difficult	Moderate difficulty	Moderate difficulty
Area of Operation	Most of India	Usually restricted to state boundaries	All of India
Tax and FCRA approvals	Eligible	Eligible	Eligible
Governing Law	Common law in most states	Societies Registration Act or equivalent state law	Companies Act, 2013
Regulation	Very little	Moderate	High
Paperwork	Very little	Moderate	High
Penalties under governing law	None in most states	Few	Large number

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