

AccountAble™

By some estimates, there are close to 30 lakh registered charities in India. Most of these are formed as public trusts or societies. On the other hand, just about 11,920 active charities are not-for-profit companies (NPC). This is only partly due to lack of awareness. The main reason has been the difficulties and delays in forming non-profit companies — it used to take 8-12 months to register a non-profit company.

With the coming of Companies Act 2013, this has changed. A non-profit company can often be formed in less than a month. You can also pay salaries and fees to directors and shareholders without getting approval from Central Government.¹ Companies doing CSR also prefer NPCs over societies and trusts. Therefore, an average of 167 NPCs are now being formed every month.

This issue of AccountAble explains how to form a not-for-profit company in India.

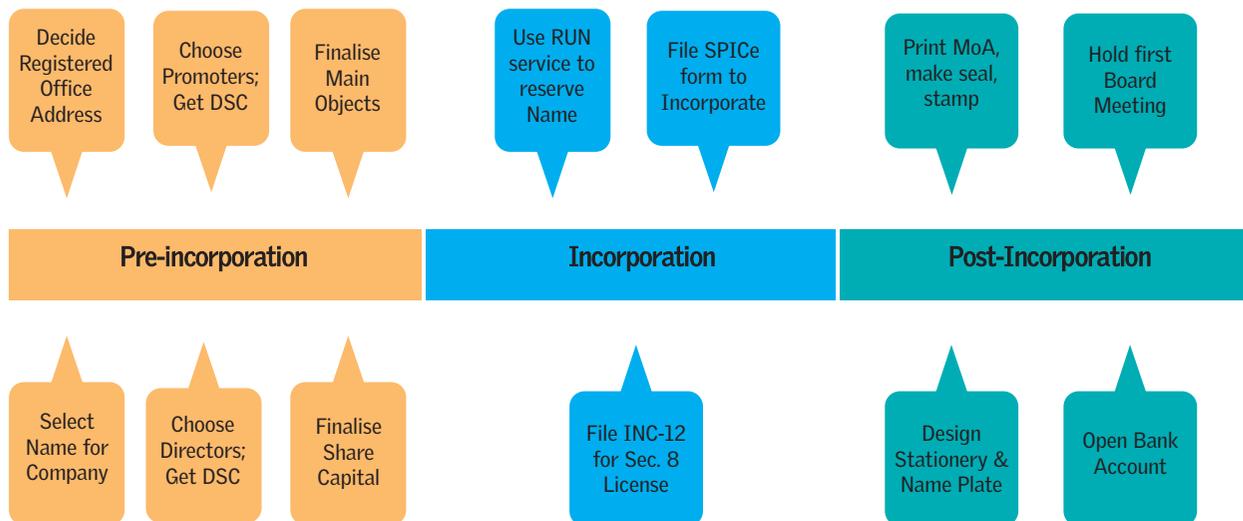
What is a Not-for-Profit Company?

Companies are generally formed to make profits. However, there is a special type of company which is formed to do social good. These companies are known as Not-for-Profit Companies.

These are also called sec. 25 or sec. 8 companies.² Once formed properly, the company can drop the words 'Private Limited' or 'Limited' from its name. This makes it easier for people to recognise its charitable mission.

NPCs can be formed with share capital or by guarantee. These can be public limited (minimum seven members) or private limited companies (minimum two members).³ NPCs must have a minimum of two directors.

NPCs enjoy some privileges under Companies Act. For example, they need not have a minimum paid up capital of Rs. 1 lakh, as for other companies. However, they are also more regulated. For example, their annual returns (forms AOC-4 and MGT-7) must be signed by a practising company secretary. NPCs formed now must include a clause restricting activities on a purely commercial basis.⁴



¹ Amount paid must be reasonable and must be for actual work done for the company.

² NPCs were issued a special license recognising their not-for-profit status under sec. 25 of Companies Act, 1956. This section has been renumbered as sec. 8 under Companies Act 2013.

³ One-Person Companies (with just one member) are not issued a license under sec. 8.

⁴ NPCs can take up activities which result in a profit, if these activities are incidental to their main objects.

Regulation and privileges under other laws are at par with societies and trusts. NPCs can obtain tax registration under sec. 12AA and approval under sec. 80G for fund-raising. Once registered under sec. 12AA, NPCs enjoy the same GST (Goods and Services Tax) exemption as other NPOs (see AccountAble 151: GST Exemption for NGOs). In Maharashtra and Gujarat, NPCs need not register with Charities Commissioner. Unlike societies registered under a state Act, NPCs can operate across India.

Pre-incorporation

Before filing any document with the Registrar, you should make the following preparations:

1. Registered Office Address

Decide on the state where your registered office will be situated. Your registered office can be different from your head office. It can even be in a different state.

Your registrar's choice depends on the state where your registered office is located. Most states have one registrar each, except Maharashtra and Tamil Nadu, which are blessed with two each. Shifting your office later from one state to another or from one registrar to another can be difficult and a bit expensive.

Your Income Tax assessment will be done wherever your registered office is located. This is not an important issue unless your case is picked up for physical scrutiny. In such a case, you will have to either lug your documents to the Income Tax Office or apply for change of jurisdiction.

You will need to provide a rent agreement and an NOC (No Objection Certificate) from the property owner for the office address. Owner's proof of ownership is also required.

2. Name

Most promoters think that the company's name is very important for its identity. However, the registrars are bound by strict guidelines in this matter and often reject the chosen names mercilessly.⁵ The NPC's name should not imply government patronage or connection with an existing company or well known organisation. It should also contain a word like Foundation or Association. If the name contains a coined word, you should explain how you coined the word. If the name is related to the objects of the company, it is easier to justify your selection.

If you are unable to get approval for the name you want — don't lose heart. Go with the name that the Registrar has approved. You can still retain your identity by adding your chosen logo or phrase as a brand on all your stationery and website.

3. Promoters

You need at least two promoters to form a private limited NPC — or seven to form a public limited NPC. Promoters can be individuals or legal persons such as LLPs (Limited Liability Partnerships), companies or other corporate bodies (except societies, which are not considered bodies corporate). If you are forming a company limited by shares, make sure that none of them are a foreign source.⁶ You can issue or transfer shares to foreign sources once you get FCRA registration. This requires additional formalities under FEMA.

You will need ID proof, address proof and PAN card (or passport) for each of the promoters. At least one of the promoters should have a DSC⁷ as well. Some registrars may also ask you to paste a passport size photo of the promoters on subscription sheet in MoA (Memorandum of Association). If any of the promoters are non-residents, then their documents must be notarised and apostilled (countries under Hague Apostille Convention). If the documents are not in English, then they must be translated into English before being notarised and apostilled. Documents from Commonwealth countries can be self-attested and notarised instead of apostilling.

4. Directors

There should be a minimum of two directors for an NPC, whether it is a private or a public company. If you plan to apply for FCRA prior-permission or registration, then the directors should be Indian citizens or Persons of Indian Origin (PIO). Avoid non-residents if possible — FCRA verification is delayed greatly if a director is residing outside India. The first directors are typically named in the Articles of Association - often the promoters become the first directors as well.

Each director should have a unique DIN (Director's Identification Number). If they don't, then a DIN will be allotted at the time of forming the company. The directors should also have a DSC, ID proof, address proof and PAN card or passport.

⁵ See Rule 8 (including sub-rule 7) of Companies (Incorporation) Rules, 2014 for guidelines.

⁶ Initial share subscription must be followed by issue of share certificates within sixty days of formation (sec. 56). Share capital contributed to an NPC by a foreign source is treated as foreign contribution. Therefore, foreigners should not subscribe to the MoA. If you do want a foreign source as a promoter, form a company limited by guarantee.

⁷ Token-based Digital Signature Certificate. Scanned signature images are not DSCs.

5. Objects

A company must have objects saying what it intends to do after formation. For an NPC, the objects must be related to promotion of commerce, art, science, sports, education, research, social welfare, religion, charity, protection of environment or any such other object (sec. 8(1)(a)). The objects should also conform to charitable purpose as defined in sec. 2(15) of Income Tax Act. These should not include any political activities if you intend to apply for FCRA permission. Paradoxically, your main objects should not include fund-raising either, as this is not a charitable object and can result in denial of tax registration u/s 12AA.

Much care should be taken in drafting the objects. You cannot take up activities which are not covered by your objects — these are treated as ultra vires (beyond your powers). Changing the main objects also means that you will have to revalidate your tax registration by filing form 10A again.

6. Share Capital

There is no requirement of minimum paid up capital for NPCs. You can, therefore, have as little as Rs. 10,000 or even Rs. 100. The share capital is divided into a number of equity shares of Rs. 10 or Rs. 100 each. Voting rights depend on the number of shares a person holds. For example, one person holding 51% shares can outvote a hundred persons holding the rest of 49% shares.

When the company is incorporated, the members have to deposit their share of capital in the Company's bank account. The company will issue them share certificates in return. These should be stamped with adhesive stamps or electronic stamps, according to local rules for payment of stamp duty.

If you are forming a guarantee company instead, it will not have a share capital. Each member would guarantee a specified contribution of money in case the company is wound up. Till that time, they do not have to pay anything. This feature makes guarantee companies attractive for some — particularly if a foreigner, a PIO or a foreign company is one of the promoters. However, the flip side is that each member has only one vote — irrespective of how big a guarantee they have provided.

Incorporation

Once you've collected all the papers, the incorporation process is relatively simple. All filings have to be done online at MCA website (mca.gov.in). MCA (Ministry of Corporate Affairs) forms change frequently — please ensure that you are using the latest forms. Detailed guidelines for filling the forms are available with each form.

If there are any queries on your application, then these are

dealt online. In rare cases, you may have to visit the ROC (Registrar of Companies) office for follow-up. There are three stages:

1. Name Approval

List up to two names for approval by ROC, in the order of your preference. This is done through RUN service (Reserve Unique Name) online at MCA's site. You also have to summarise your main objects in 500 characters (including spaces). A fee of Rs. 1,000 should be deposited online.

The ROC will approve one name or reject all. If all are rejected, you get a chance to propose another two names against the same application. In larger cities, the approval may come in 2-5 days — in places with low corporate presence, approval can take a couple of weeks. The approved name remains valid for 20 days from date of approval.

Once you've got the name approved, you should apply for sec. 8 license before your name approval expires.

2. Sec. 8 License

Application for sec. 8 license is filed in form INC-12, along with draft MoA and AoA (Articles of Association). You have to also file a projected Income & Expenditure for three years, showing how much funds you expect to raise and spend. A fee of Rs. 2,000 is required for the license application. The Registrar will check that your main objects clause is in line with sec. 8(1). They will also check that you will apply any profits for promotion of your objects and will not distribute any dividend.

The Registrar may ask you to delete or modify one of the objects. Some registrars do not permit other objects to be included in the MoA. For example, the ROC in Delhi no longer permits any specific activities to be added under furtherance of objects (*the doing of all such other lawful things as considered necessary for the furtherance of the above objects*:). In ROC's view, if the colon is replaced with a period, then this phrase provides sufficient powers for raising funds, opening bank accounts, buying and selling property, etc.

Issue of sec. 8 license may take 1-4 weeks. Once you have received the license, you can proceed to incorporate the company itself.

3. Incorporation

Application for incorporation is filed in form SPICe, along with a number of attachments. The MoA / AoA that were included with sec. 8 license application must be enclosed with this — without any changes. You will also have to deposit filing fees (Rs. 2,975) and stamp duty for MoA and AoA online. The stamp duty varies from one state to another.

If all is in order, the incorporation certificate will be issued in about 1-3 weeks. Your PAN and TAN will be issued automatically when the company is incorporated. Your CIN

(Corporate Identity Number) will be mentioned on your incorporation certificate.

Post-Incorporation

Once the company is incorporated, you have to do several things rather quickly:

1. MoA/ AoA

You should get about 50 sets of these printed at a printing press. The Incorporation Certificate and the sec. 8 license must be included in the printed booklets. These are often sought by various regulators, banks, etc. You should also order a common seal and a couple of rubber stamps for use by the directors (when signing documents, applications, etc.). Some companies order a metal seal for embossing important documents.

2. Stationery and Name Plate

All your publications, letterheads and communications with outsiders should mention the full name of the company, CIN, registered office address, e-mail ID, web-site and phone number. You should also affix a name plate showing the company name, CIN and registered office address at the registered office and all other offices that you open.

3. First Board Meeting

The first Board meeting records several important matters, such as approval of preliminary expenses, adoption of common seal, appointment of auditors, issues of subscription shares, opening of bank account, etc. This should be held within 30 days of

incorporation. Later on the board will meet less frequently — twice a year is enough. Don't pay sitting fees to Board members for attending board meetings — this attracts reverse charge of GST and compulsory registration!

4. Bank Account

You will have to open a bank account in the company's name. If you open one within sixty days of incorporation, the banks will not ask for address proof. Deposit the share subscription cheques in this account as soon as the account is opened.

Timelines and Cost

Registering a sec. 8 company used to take 8-12 months in the past. Now it is possible to get an NPC incorporated in just about four weeks — though some ROCs take longer. This does not include the preparation time, which can take 1-3 months, depending on how quickly the promoters are able to provide documents or take decisions. The entire process is quite transparent and bound by fairly clear rules.

If you incorporate an NPC in-house, it may cost you just about Rs. 8-15,000. However, if you've not done this before, it is a good idea to get professional help from a CA, CS or a lawyer, preferably one who's had experience with sec. 8 companies. Professional fees for NPC incorporation range from Rs. 50-100,000, in addition to the ROC fees, stamp duty, printing, etc.

What is AccountAble: Each issue of 'AccountAble' covers a different topic related to NPO regulation or accounting. It is posted/emailed to about 3,000 persons in NPOs, Agencies, CSR Departments, Corporate Foundations and audit firms.

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Interpretation of law: Law discussed here is valid as of 31-August-2018. However, the interpretation is of general nature. Please consult your advisors before taking any important decision.

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