

Primer

Companies registered under Section 25 of the Companies Act, 1956 ('Not for Profit' Companies): A Primer



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Primer

The Companies Act, 1956 (the Act) provides for regulatory environment for the companies incorporated under the Act. With the growing times and the complex business structures, various forms of entities have been formulated to suit specific needs and accordingly regulations have developed to monitor such entities. The regulatory structure, regulations and the control aspects gives rise to devising to various forms of companies. The corporate form can take many shapes based on various aspects such as a) on the basis of size b) on the basis of members c) on the basis of control d) on the basis of liability e) on the basis of manner of access to capital and so on. One such classification under the Act is a 'not for profit company' or a company registered u/s 25 of the Act.

Whenever a company is formed as a not for profit organization, we understand that the same is registered under section 25 of the Act which provides for registration of such companies that are being formed in order to promote religion, charity, art etc. and intends or aims to use its profit/income in promoting such objects. Thus, we use the word *not for profit organization*. In this primer we mainly discuss on the various aspects connected with the companies registered under sec 25 of the Act.

1. What do we mean by “not for profit” organization?

Does it mean that the company so formed under the section will not be making any profit? If not, then why it is at all formed and how will it promote its object or run its business in absence of any profits?

Many often the above questions arise when we think of a 'not for profit' companies. The answer is that such companies can and do generate profits, however, the profits/income so generated out of its activities is not available for distribution to its members as dividends, as in case of other companies, but will be used *solely* to encourage and sponsor its object.

2. What are the types of not for profit organizations?

- a) Society (registered under the Society Registration Act, 1860)
- b) Trusts
- c) Cooperative Societies
- d) Companies registered under sec 25 of the Act



Primer

3. Why would one prefer a sec 25 company over other forms of not for profit organizations?

- a) Independent corporate entity
- b) Perpetual succession
- c) Limited liability
- d) Greater privileges under the Act
- e) Regulated by uniform law across the country (i.e. the Act) unlike in case of societies and trusts which have state-wise laws as well

4. What are the key features of a sec 25 company?

- a) Company which has its objects that of promoting art, science, religion, charity etc.
- b) Uses its profits solely towards promoting its objects
- c) Does not distribute dividends to members
- d) Does not have the word “limited” or words “private limited” to its name

5. What are the various forms of a sec 25 company?

A section 25 company can be formed for following purposes:

- a) Chamber
- b) Clubs
- c) Trade associations
- d) Charitable institutions
- e) Educational and training institutions
- f) Research centres

6. What are the types of a section 25 company?

On the basis of the share capital/nature of the company, a section 25 company can be:

- a) Limited by shares
- b) Limited by guarantee and not having share capital
- c) Limited by guarantee and having share capital



Primer

On the basis of members/subscribers, a section 25 company can be (though not using the words 'private limited' or 'limited' within its name):

- a) Private company (if members are less than 49)
- b) Public company (if members are more than 49)

7. If on the basis of number of members, a section 25 company is classified as a public company, will it require obtaining a certificate of commencement of business before initiating its objects/business?

Yes, if a section 25 company is a public company and is limited by share capital or limited by share capital and guarantee, it will be required to file the statement in lieu of prospectus and obtain a certificate of commencement of business.

If the section 25 company is limited by guarantee only, such formality is not required.

8. If a section 25 company is a public company in nature, will it require complying with the conditions of minimum paid up capital and minimum directors as mandatory for other public companies?

In terms of section 3(6) of the Companies Act, 1956, there is no need to maintain the minimum capital requirements. However, a public section 25 company (whether limited by guarantee, or by share capital or by both), will require to have at least 3 directors on its board and if such companies do not have a board, 3 persons on its management committee as the case may be.

9. What are the rules and regulations to be complied with at the time of incorporation of a sec 25 company?

- a) The Companies Act, 1956
- b) The Companies Regulations 1956 (the Regulations)
- c) The Companies (Central Government's) General Rules and Forms, 1956

Primer

10. What is the procedure to incorporate a sec 25 company? What are the e-forms to be filed at the time of incorporation?

- a) Eform 1A of the Companies (Central Government's) General Rules and Forms, 1956 for the purpose of name application to the Registrar of Companies¹ (RoC)². Attachments required:
 - i. Board Resolution in case the proposed company is using name of an existing company
 - ii. Trademark or authorisation to use trade mark, if the name of the company is based on trade mark or application for deed of assignment
 - iii. Any other attachment
- b) Application to the RoC in eform 24A for the purpose of grant of license with the following documents:
 - i. Draft of MoA/AoA
 - ii. Names, Address and occupation of the promoters alongwith DIN
 - iii. List of companies, associations in which the promoters are directors or hold responsible position with the description of the position held.
 - iv. List of the proposed members of the Board of Directors.
 - v. Declaration signed by an Advocate / Chartered Accountant / Company Secretary on non-judicial stamp paper of appropriate value.[Reg 4 (ii) of the Regulation]
 - vi. The proposed sources of income and the expenditures thereof for upcoming five years [Reg 4 (vi)]
 - vii. A note on the proposed activities and also the past activities, if any. [Reg 4 (vii)]
 - viii. A statement of the grounds for making an application under section 25. In this statement a reference to the relevant clause in the Memorandum of Association regarding the Vision and Mission of the proposed company should be made. [Reg 4 (viii)]
 - ix. Declaration as referred in Annexure V of the Regulations signed by all the promoters on non-judicial Stamp Paper of appropriate value [Reg 4(ix) and 8(viii) of the Regulation]

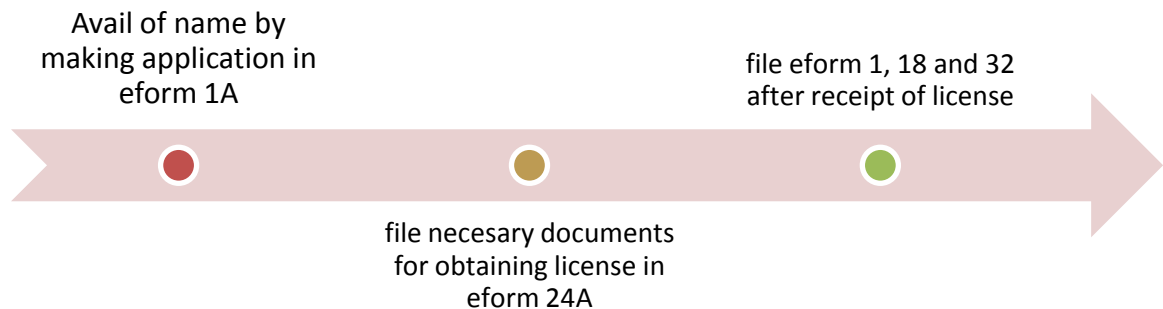
¹ The powers have been delegated from Regional director to RoC vide notification No. F. No. 5/7/201 1-C.L-V dated March 17, 2011

² It is to be ensured that all the proposed directors have a valid DIN and at least one of them has digital signature.



Primer

- c) On receipt of license with conditions as laid down by RoC, to file eforms 1, 18 and 32 for registration of MoA/AoA, intimation of registered office and directorship details. Attachments required:
- A copy of MoA and AoA along with subscription sheets
 - Consent letters from proposed directors
 - Proof of premises proposed to be the registered office of the company
 - No Objection Certificate from director [if registered office is owned by director (not taken on lease by company)]
 - A proof that the Company is permitted to use the address as the registered office of the Company [if registered office is owned by any other entity/ person (not taken on lease by company)]
 - Lease deed (if taken on lease by the company)
- d) In case the company to be formed is a public company, Statement in lieu of prospectus (SLP) to be filed in eform 20 alongwith declaration u/s 149 (2) (b) of the Act. Attachments required:
- Statement in lieu of prospectus prepared under sec 149 of the Act



11. What is the estimated time frame for incorporation of a section 25 company?

The name usually gets approved within a period of 2-3 days. However, grant of license may take a time of 10-15 days. Thereafter, eforms 1, 18 and 32 are approved within 4-5 days. Overall, within a span of maximum 30 days one can get the company incorporated subject to queries raised by RoC, if any and approval.



Primer

12. Does a sec 25 company have Board of Directors (BoD)?

Yes, it operates very much like any other company except that it enjoys certain benefits and exemptions under the Act.

In case of clubs, chambers etc. they have a management committee equivalent to that of BoD having the same rights, obligations and fiduciary duties as that of a director.

13. Can a sec 25 company also become a holding company?

Yes. There is nothing in the section or under the law debarring such companies to become holding companies and accordingly surplus funds, if any, of such companies may be utilized by investing in other companies.

However, the investments as standing in the books of a sec 25 company should not be substantial and making it a investment company as the main object of such companies is to promote art, commerce etc and not to invest for profits. In addition, these companies can promote only such companies having objects similar to the investor company.

14. Are the provisions of section 372A applicable to a sec 25 company?

Yes. Sub section (2) of sec 25 states that the companies will be subject to all the obligations of limited companies imposed by the various provisions of the Act.

As far as granting of loans, guarantees are concerned, the same is dependent on the lending company's capital. A sec 25 company may or may not have capital. In case of a company having share capital the provisions of sec 372A becomes applicable and in the event it is limited by guarantee only, it might have reserves which qualify for computation u/s 372A. As regards giving guarantee or providing security by a company, the existence of share capital or free reserves is not relevant and as such in these cases, the provisions of section 372A are also attracted.



Primer

15. Can an existing company get a license u/s 25?

Yes. An existing company can avail the privileges under section 25 by restricting its objects for non-profit making purposes as specified in sub-section (1).

Special resolution will have to be passed and the Company shall have to seek the approval of the Central Government for change of its name, including for deletion of the words “Limited” or “Private Limited”, as the case may be. For alteration of Memorandum and Articles of Association, a special resolution will be necessary.

16. Under what circumstances can the license be revoked and what are the consequences?

- a) RoC can revoke the license in event of contravention of any terms of the license subject to natural justice. Any accumulated benefit should be surrendered;
- b) In case of addition of the word “limited” it ceases to enjoy all the benefits and privileges

In the event of a *mala fide* or arbitrary action to cancel the license, the aggrieved association may challenge the order of the Central Government under Article 226 of the Constitution.

17. What are the advantages and benefits enjoyed by a company registered u/s 25 under Companies Act, 1956?

Under the Companies Act, 1956

- a) The requirement of minimum paid-up capital is not applicable to such companies [sec 3 (6)]
- b) No stamp duty/minimum stamp duty is attracted on MoA/AoA.
- c) Registration fees payable on share capital is lower as compared to companies not having a license under section 25. The fee payable is fixed irrespective of the amount of authorized share capital.
- d) License to drop the word ‘limited’ as the last word and yet enjoy the protection of limited liability
- e) A partnership firm may become a member of any association or company licensed under sec 25 [Sec 25 (4); Department clarification vide *Circular No. 4/72*, dated 9-3-1972]



Primer

- f) Officers and members enjoy immunity from personal liability

Benefits of company not having share capital

- a) There is no upfront capital contribution
- b) Non-applicability of section 297 of the Act
- c) In the event of winding up the members are liable only to the extent of the guaranteed amount;
- d) Name guidelines require a minimum authorised capital on use of prescribed word(s) in name of the company. Such capital requirement is not applicable in case of guarantee companies.

Other exemptions and benefits

In exercise of the powers conferred by sub-section (6) of section 25 of the Act, Central Government has provided following benefits to section 25 companies which will be available unless otherwise provided in the AoA of these companies:

<i>Provisions of Act</i>	<i>Extent of exemption</i>
Section 2(45)	² In so far as it required the appointment of an individual to perform the duties which may be performed by a secretary under the said Act and any other ministerial or administrative duties only if he possesses the prescribed qualifications.
Section 147	The whole.
Section 160(1)(aa)	The whole.
Section 166(2)	The whole, provided that the time, date and place of each annual general meeting are decided upon before-hand by the Board of Directors having regard to the directions, if any, given in this regard by the company in general meeting.
Section 171(1)	A general meeting may be called by giving a notice in writing of not less than 14 days.
³ Section 193	Minutes may be recorded within 30 days of the conclusion of

²Vide Notification No. SO 35(E), dated January 9, 1976.

³Vide Notification No. SO 2767, dated 5-8-1964.

Primer

	every meeting in case of companies where the articles of association provide for confirmation of minutes by circulation.
Section 209(4A)	Books of account relating to a period of not less than four years immediately preceding the current year shall be preserved.
⁴ Section 219	Documents referred to in sub-clause (1) may be sent to members not less than fourteen days before the date of the general meeting instead of 21 days.
Section 257	Shall not apply to companies whose articles provide for election of directors by ballot.
⁵ Section 259	The whole.
Section 264(1)	The whole.
⁶ Section 280	The whole.
Section 282	The whole.
Section 285	Shall apply only to the extent that the Board of Directors, Executive Committee or Governing Committee of such companies shall hold at least one meeting within every six calendar months.
Section 287	Shall apply only to the extent that the quorum for the Board Meeting shall be either eight members or $\frac{1}{4}$ th of its total strength whichever is less provided the quorum shall not be less than two members in any case.
⁷ Section 292	Matters referred to in clauses (c), (d) and (e) of sub-section (1) may be decided by Board by circulation instead of at a meeting.
Section 299	Shall apply only to cases to which sub-sections (1) and (3) of section 297 apply.
Section 301	A register shall be maintained only of contracts to which sub-sections (1) and (3) of section 297 apply.

⁴Vide Notification No. GSR 73, dated 30-12-1965.

⁵Vide Notification No. SO 2767, dated 5-8-1964

⁶Since omitted by the Amendment Act, 1965

⁷Added vide Notification No. SO 2767, dated 5-8-1964

Primer

18. What are the advantages and benefits enjoyed by a company registered u/s 25 under Income Tax Act, 1961?

To qualify for exemption under the Income Tax Act, 1961 it is necessary that there should be in its MoA or AoA a prohibition of distribution of profits among its members [*Delhi Stock Exchange Assn. Ltd. v. CIT* (1997) 12 SCL 133 (SC)]. To claim exemption from income-tax, the operations of an organization should be covered under the definition of 'charitable purpose' as defined in the said Act. Section 2(15) defines the expression "charitable purpose" in an inclusive manner to include, - (i) relief of the poor, (ii) education, (iii) medical relief, (iv) preservation of environment, (v) preservation of monuments or objects or places of artistic or historic interest and (iv) advancement of any other object of general public utility. The aforesaid definition is not exhaustive and, therefore, purposes similar to the purposes mentioned in the aforesaid definition will also constitute charitable purposes.

Electoral Trust Scheme, 2013

A sec 25 company is eligible for making an application for approval of electoral trust under Clause 2(22AAA) of the Income Tax Act, 1961. Such trust shall receive voluntary contributions and distribute the same to political parties. The conditions for such approval are:

- a) The company is registered on or after 1st day of April, 2012 for the purpose of section 25 of the Companies Act, 1956
- b) The name of the company shall include the phrase "electoral trust"
- c) The sole object of the electoral trust should be to distribute the contributions to political parties registered u/s 29 of the Registration of People Act, 1951, i.e. no object should not be to pass any direct/indirect benefits to its members
- d) The electoral trust shall have a PAN
- e) Adequate arrangements should be made for recording the receipts from the contributors in accordance with Rule 17CA;



Primer

Deductions in respect of contributions given by any person to political parties [u/s 80GGC]

Any amount advanced by way of contribution by any assessee to a political party or an electoral trust will be deducted in computing the total income. Therefore, any amount advanced by an assessee for the purpose of donations to political parties will be eligible for deduction. Since, such donation can be done also through an electoral trust which needs to be a sec 25 company; the same is the benefit to an assessee.

19. What are the advantages and benefits enjoyed by a company registered u/s 25 under Foreign Exchange Regulations?

External Commercial Borrowings (ECB)

- a) Section 25 companies engaged in micro finance (NBFC-MFIs) are eligible to avail ECB under automatic route up to USD 10 million or its equivalent during a financial year;
- b) Companies registered under Section 25 of the Companies Act, 1956 and engaged in micro finance will be permitted to avail ECBs from individuals also apart from other lenders like international banks, multilateral financial institutions, export credit agencies, foreign equity holders and overseas organizations

Foreign Contribution Regulation Act, 1976 (FCRA)

FCRA provides that persons having definite cultural, economic, educational, religious and social programmes should get themselves registered with the Government of India before accepting any 'foreign contribution'. In case a person falling in the above category is not registered with the Central Government, it can accept foreign contribution only after obtaining prior permission of the Central Government. Therefore, there is no prior permission required in case of accepting foreign contributions by a company registered u/s 25 of the Act.



Primer

20. What are the advantages and benefits enjoyed by a company registered u/s 25 under National Housing Bank (NHB) Directions?

Micro-mortgage Housing Finance Companies (MMHFC) has been introduced in the year 2010 vide NHB's notification dated March 29, 2010.³ MMHFC are companies registered under section 25 of the Companies Act, 1956 and can extend housing loans upto Rs. 1,50,000/- to poor people. MMHFCs enjoy certain advantages which are listed below:

- a) They are exempted from NHB registration
- b) The requirement of a minimum net owned fund is done away with.
- c) They need not comply with any of the regulations of the National Housing Bank
- d) They will not be treated as housing finance companies for any regulatory purposes

21. What are the advantages and benefits enjoyed by a company registered u/s 25 under SEBI Regulations?

Under the SEBI (Self-Regulatory Organizations) Regulations, 2004, only a company registered u/s 25 of the Act can make an application to SEBI for grant of certificate of recognition as a Self-regulatory Organization. (Notification F. No. SEBI/LAD/DOP/3348/2004 dated 19/02/2004⁴)

22. What are the advantages and benefits enjoyed by a company registered u/s 25 under Reserve Bank of India Act, 1934?

Under the Master Circular issued on Exemptions from RBI Act, 1943⁵ it is stated that an NBFC engaged in micro-financing activity licensed under section 25 shall not have to comply with sections 45-IA, 45-IB and 45-IC of the Reserve Bank of India Act, 1934 requiring registration, maintaining percentage of assets and creating a mandatory reserve fund.

³ Notification No. NHB.HFC. REG-3/CMD/2010 (See: <http://www.nhb.org.in/Regulation/Amendment%20in%20Directions.pdf>)

⁴ <http://www.sebi.gov.in/acts/sroregu.html>

⁵ http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=7390

Primer

23. Whether CARO, 2003 applies to section 25 companies?

Company registered u/s 25 is exempted from compliance of reporting under CARO, 2003.

24. What are the drawbacks of having a section 25 company?

- a) Obtaining license at times may involve complexities
- b) No alteration in MoA without the prior approval of Central Government [Sec 25 (8)]
- c) No dividend benefits to its members
- d) Since, its regulated by the Act hence number of compliances are to be ensured
- e) The license granted has number of conditions therefore, the company needs to ensure that it adequately complies with all and does not contravene any of it.
- f) Section 25 company is regarded as “company” within the meaning of Income Tax Act, 1961 and as such the income is taxable as per the applicable rates.
- g) U/s 12A of the Income Tax Act. The investment by such companies must be made in approved forms and modes of investment as specified in Section 11(5) of the Income Tax Act. All voluntary donations received by such a company are treated as income.
- h) The members cannot prefer to complain against the company alleging an offence under the Companies Act, 1956 as the members are not shareholder. [*Madras Cricket Club v. M. Subbiah* (2010) 154 Com Cases 353 (Mad)]

25. What are the restrictions/conditions imposed while grant of license?

Few important usual conditions/restrictions in the license are:

- a) income and property of the company *shall* be applied solely for the promotion of the objects as set forth in its MoA and that no portion thereof shall be paid or transferred, directly or indirectly by way of dividend, bonus, or otherwise by way of profit, to persons who at any time are or have been members of the said company or to any of them or to any person claiming through any one or more of them;
- b) no remuneration or other benefit in money or money's worth shall be given by the company to any of its members, whether officers or servants



Primer

- of the company or not, except payment of out-of pocket expenses, reasonable and proper interest on money lent, or reasonable and proper rent on premises let to the company; however, the company can pay the same in good faith after taking necessary Central Government approval
- c) no member shall be appointed to any office under the company which is remunerated by the salary, fees, or in any other manner; however, company may take Central Government approval for the same;
 - d) no alteration shall be made to the Memorandum of Association or to the articles of Association of the company, which are for the time being in force unless the alteration have been submitted to and approved by the Central Government;

26. Can a section 25 company get merged into other companies?

Yes, a sec 25 company can get merged into another company having similar business or activities.

27. Can other companies be merged into a section 25 company?

Yes, other section 25 companies having similar objects can be merged into another registered sec 25 company.

28. How can a section 25 company alter its charter documents (Memorandum and Articles of Association)?

In addition to compliances required under Companies Act, 1956, prior approval of Central Government (presently, power delegated to RoC) shall also be required for alteration.

29. Are shares/memberships of a section 25 freely transferable?

If the company is a private company in nature, shares/membership cannot be transferred to outsiders. Maximum number of members is to be limited to 49.

If the company is a public company in nature, shares/memberships are freely transferable in accordance with Articles of Association of the company.

Primer

30. Will payment of salary to officers who are members of the company also amount to division of profits?

A section 25 company is allowed to pay remuneration/salary to its officers in the manner as prescribed by its Articles of Association or as agreed upon between the members.

However, the license granted by the Regional Director in the usual course imposes a restriction on remunerating its members, officers and/or servants.

31. Is there any specific format for drafting Memorandum and Articles of Association of such special companies?

Yes, the Memorandum and Articles of Association are to be drawn in conformity with the Regulations, Table A, B (for companies limited by shares only), Table C (for companies limited by guarantee and not having share capital) and Table D (for companies limited by guarantee and having a share capital) to the Schedule I of Companies Act, 1956.

32. Can a section 25 company provide several other charitable objects in its 'Other Object' clause in the Memorandum and later on make the other objects as one of its main object?

A section 25 company is not allowed to insert any object as 'Other Object'. In other words, the 'Other Objects' of such companies are NIL and hence, no question of altering main objects. In any case, any amendment in charter documents will require prior approval of the Central Government.

33. Like the incorporation process, do section 25 companies have different processes for mergers/amalgamations/winding ups also?

No, for the purposes of mergers/winding ups etc, section 25 companies are treated at par with all other companies. However, the court may at its own discretion require approvals/ no objections from all concerned persons/authorities.



Primer

34. Is it required to obtain prior approval of Central Government before making alteration in Memorandum and Articles of Association of a section 25 company?

Section 25(8) requires prior approval of Central Government only where the amendment is in object clause of the Memorandum of Association. However, in practice, the Central Government does take undertakings from the promoters and/or directors to not to make any amendment in any of the charter documents without prior approval of the Central Government.

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