

AccountAble™

Society, Trust or Company

Issue # 1

If you want to form a voluntary organization, there are three options:

- A company;
- A Registered Society;
- A Registered Trust.

A brief discussion of important features of each of these forms follows:

Non-Profit Company

A company may be Public or Private. Further, a public company may be widely held or closely held. In normal circumstances, a company must append the words 'Ltd.' or 'Pvt. Ltd.' to its name. However, a charitable company, whether public or private, may obtain a license under Sec. 25 of Companies Act, 1956 to drop the reference to limited liability as far as its name is concerned. Such a company is commonly known as a 'Section 25 company' and is eligible for certain exemptions from provisions of law and concessional rate of fees etc. A 'Section 25 Company' can be formed for any nonprofit activity.

Characteristics of a company:

- It is an artificial legal person created by law to achieve the objects for which it is formed. It has a nationality and domicile but can not claim the fundamental rights expressly guaranteed to natural citizens and can not do things that only a natural person can do. However, a company can challenge any law that violates the fundamental rights of citizens.
- It has a distinct legal entity entirely independent of the members constituting it. No member can, either individually or jointly, claim any ownership rights in the assets of the company during its existence. In case of a sec.25 company, this limitation is further extended and members do not receive any part of assets of the company even on its dissolution.
- A company has perpetual succession and is not affected (in a legal sense) by changes in membership or employees, although such changes may affect its actual performance.
- It also has the tremendous advantage of limited liability which means that members and executives are not personally liable to settle

company's dues, unless they give their consent in writing for specific transactions.

- Ownership and management are kept separate in a legal sense although in actual practice the two may be same.
- Membership (ownership) rights are transferable. In case of a private company, certain restrictions are placed on this right to transfer membership.
- A section 25 company can not distribute profits or assets to its members.

Society

A society is essentially an association of persons united together to achieve some common purpose. Such objects are normally charitable, scientific, literary etc. Theoretically, a society need not be registered but registration gives the society legal recognition and is essential for opening of bank accounts, filing of legal suits, obtaining Income Tax approvals, lawful vesting of properties etc. Structurally, it is similar to a company.

Characteristics of a society:

- It is an artificial legal person created to achieve the objects for which it is formed.
- It has a distinct legal entity entirely independent of the members constituting it. Thus, it can sue members and may be sued by its members as strangers. No member can, either individually or jointly, claim any ownership rights in the assets of the society during its existence. *On dissolution the surplus assets of the society are given to some other society with similar objects.*
- A society also has perpetual succession and is not affected in a legal sense by changes in membership or employees.
- It also has the advantage of limited liability which means that members and executives are not personally liable to settle society's dues, except in specific circumstances.



- Membership rights are non-transferable.

Each state has formulated its own regulations for ensuring propriety in functioning of societies, including provision for compulsory division, amalgamation or dissolution (Andhra Pradesh). However,

generally the regulations are enforced with extreme laxity.

A society as registered above is different from a co-operative society.

Trust

There are two statutes¹ relevant to functioning of trusts in India: The Indian Trusts Act, 1882; and, The Charitable and Religious Trusts Act, 1920.

A trust is generally created by annexing an obligation to some property. This obligation, when accepted by the owner/trustee, results in the creation of a trust. The trust has primarily three parties: the donor/s, the trustees and the beneficiaries. It is usually created through a trust deed. After creation of the trust, various registrations and exemptions under Income Tax Act may be sought.

A trust may be private or public, fixed or discretionary (among others). For such activities as proposed, a public discretionary trust is suitable. Such a trust is usually unalterable, and the donor does not have any power to revoke it.

Characteristics of a trust:

- The obligation (created for forming the trust) must relate exclusively to property, the ownership of which vests with the trustees. An obligation, not so related, can not be a trust. Moreover, unlike English law, the Indian law does not recognize duplicate ownership.
- The obligation must arise out of confidence that is reposed in the trustee. Such confidence, in turn, must be accepted for the benefit of the beneficiaries.
- A trust must be created for a lawful purpose.
- The author of the trust must indicate with reasonable certainty the following:
 - Intention to create trust.
 - Purpose of the trust.
 - Beneficiaries of the trust, and
 - The trust property.

Any uncertainty or vagueness concerning the above may invalidate the trust.

Trustees are also subject to certain disabilities. Important amongst these are:

- Disability to renounce trust
- Disability to delegate trust
- Disability to charge for services.

¹ Additionally, the Bombay Public Trust Act is applicable in Maharashtra and Gujarat.

Comparison

A comparative chart of main features of these three organization forms is given in the table on Page 4.

Evaluation

It is felt that for long range planning of organization's future over a time span of, say, five decades, the following aspects of organization form would be crucial to a decision:

- Flexibility with regard to objects and activities (in order to be able to adapt the organization to changing needs of human society);
- Certainty as to legal status and adequate legal protection (in view of proposed international nature of operation).
- Preventing take-over of organization management by non-committed elements.

A detailed comparison of the three alternate forms concerning the above three aspects follows:

□ Flexibility of objects and activities:

To respond to changing environment and needs of the human society, ability to modify objects and undertake new activity is important.

Both the company and the society are equally flexible concerning this. However a company has the disadvantage of having to go through complex legal procedures. On the other hand, a society does not have a wide sphere of activity, this being mainly restricted to charitable, literary, scientific objects etc. A society may not, therefore, undertake (for instance) trading on a "no-profit" basis, unless it can be shown to be directly relevant to its main objects.

A trust, however, is strait-jacketed in this respect. First, the objects (and the beneficiaries) must be explained with reasonable clarity. Second, only the Settlor can modify the objects. In case of his/her death, it may be nearly impossible to modify the objects.

□ Legal Status and Legal Protection:

To operate freely in different countries (with diverse legal frameworks), certainty of legal status and adequate legal protection is crucially important.

Trusts are subject to widely varying statutes in different countries. Some nations do not recognize trusts as a valid form of organization. Similar is the case with society. Even in India itself, different states have enacted their own statutes to deal with societies.

On the other hand, equivalent forms of organization for a company are available across the world. These are governed by similar enactments and offer satisfactory legal protection in almost all the

countries. Further, the company form is governed by a powerful and mature statute which is backed by powerful commercial interests that ensure its sanctity.

□ Preventing takeovers:

A nonprofit organization may grow extremely wealthy over a time, controlling vast properties and assets. It may also grow in terms of influence and prestige. Any of these characteristics may motivate various people to takeover the management of the organization. Such takeovers may also be arranged by Government agencies for their own reasons. Adequate safeguards against such as eventuality are crucial to achievement of an organizations long-term objectives

Companies are taken-over/ merged/ acquired routinely and the event makes public news. However, when societies and trusts are taken over, the fact is rarely brought out. Continuous exposure to the threat of takeover of companies has strengthened the statute and a satisfactory defense mechanism can be built-up around the law.

With regard to societies, statutory provisions which regulate membership and management are very weak. Main defense mechanism is through the Memorandum and bye-laws of Association. Theoretically these can be strictly drafted to prevent takeovers. At the moment, the State of Andhra Pradesh also provides for compulsory division/dissolution of societies by state action.

Trusts are very weakly governed in this respect as they are not subject to democratic functioning. Also, it is difficult to ensure effective and committed perpetual succession without satisfactory provisions for removal of trustees.



- Wide range of activities is possible. Objects can be modified should such a need arise, say fifty years from now. Providing services and trading on no-profit basis is feasible.
- Full legal status and worldwide legal protection is available to a company. Such status and protection are important to facilitate international operations.
- If a private company is formed, prevention of takeovers becomes easy (in view of restricted transferability of shares). Further, a company provides for voting based on number of shares hold. A company can not be, therefore, taken over merely by aligning a majority of members (in numbers) - a majority of shares is required for the purpose.
- A nonprofit company does not suffer from the disability of a commercial image as the words 'Private Limited' can be dropped on obtaining license under Sec. 25.

Recommendation

Considering above, we would award the following ranking to the alternate organizational forms for long range planning where substantial funds are involved:

Nonprofit Private Company	Most suited
Registered Society	Second choice
Registered Public Trust	Unsuitable

Reasons

Company:

A nonprofit private company is recommended for the following reasons:

- Society:**
A society registered under Societies Registration Act, 1860 offers similar advantages, but in a restricted manner. It is therefore recommended as second choice.
- A wide range of activities is possible and objects can be modified. However, a society can not undertake trading or charge fees for services unless it is clearly shown that such activity will promote another object which is charitable or beneficial to public. In certain situations, this may be difficult to prove and may lead to litigation.
 - Societies have full legal status in India. However, different states in India have enacted different laws for governance of societies. In an international context, such variations are even more pronounced. In some countries (in the Southern Parts of the World), societies are not recognized as separate legal entities.
 - As discussed earlier, societies are more vulnerable to takeovers. Extreme care in drafting the memorandum and bye-law is required to overcome this weakness. Even then, it must be clearly understood, that societies do not work on proportional representation basis and any provisions in memorandum or bye-laws can normally be modified by a majority of members present and voting.

Public Trust:

Reasons for finding trust as an unsuitable form of organization are:

- Inability to modify objects/ activities in the event of original settlors being unavailable or unwilling;

- Inadequate legal protection to trusts in many parts of the globe;
- Possibility of mis-management due to non-democratic style of governance.

Table 1: Comparative Chart

Company	Society	Trust
Objects		
Non profit Activities	Charitable, Literary, Scientific etc.	Charitable, Socially Beneficial
Alteration of Objects		
Complex legal procedure	Simple procedure	Bound by covenants of Trust Deed; Normally only Settlor can modify
Formation		
Complex Procedures; Three to six months required	Simple and easy	Simple and easy
Name		
Prior approval required; Authorities have framed narrow Guidelines	Comparatively simple	Comparatively simple
Management		
Formalities of company law to be observed	Few restrictions imposed under the Act	Very few restrictions imposed under the Act
Meetings		
To be held as per provisions of law which are quite extensive	Annual Meeting according to provisions of law. Governing body meetings as prescribed in Rules of the Society	No provisions laid down
Penalties		
Various offenses and lapses attract severe penalties in theory	Few offenses and penalties have been prescribed	Very Negligible
Legal Status		
Full legal status	Legal status with certain limitations	Legal status with certain limitations
Statutory Regulation		
Exhaustive but mature	Very limited	Nominal
Transfer of membership		
Totally free or controlled, as desired	Not possible	Not applicable
Admission of new members		
Controlled by general body or Board through issue of capital	Controlled by Governing Body	Not applicable
Removal of members		
Not possible without consent	Possible without consent	Not applicable
Dissolution or take-over by state		
Very difficult	Possible	Possible
Payment to members		
As approved by company and state	Not restricted	As specified in Trust deed