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**ORGANIZATIONAL CHARACTERISTICS FOR GROUPS CONSIDERING
COMMUNITY-BASED HOUSING FINANCE**

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**Organizational Characteristics for Groups Considering Community-Based Housing
Finance**

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Organizational Characteristics for Groups Considering Community-Based Housing Finance

Overview

The purpose of this report is to initiate and support discussion of the various legal forms under which community based groups interested in providing housing finance are presently organized or under which they conceivably might organize in future in India. In addition to the statutory issues relating to the formation, governance and control of these organizations, certain selected Income tax and other regulatory legislative matters relevant to housing finance are also briefly outlined.

This compilation of legal issues under various forms of organization points out gaps in the existing regulatory and legal framework which policy-makers may wish to address. Their attention through appropriate legislative amendments can ensure that the development of community-based financial institutions follows a course which guarantees the safety of public deposits and the solvency of organizations in which shareholders, members and contributors have placed their confidence.

The key points in this report have been selected with the intention to avoid complexities. Each of these summaries, could of course, be expanded into a treatise if all the laws and regulations were fully discussed. Nevertheless, it is hoped that the summaries will be useful as a starting point for discussion and further exploration.

Finally, a word of caution: Though every care has been taken to compile this legal information, these may not be valid sometimes if seen in isolation and entirely a different scenario may arise, if applied to specific facts and circumstances and other legal frame work. This may be treated as a point of indication for further exploration, than as a legal opinion.

V. Nagarajan

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I. NIDHI--MUTUAL BENEFIT ORGANIZATION (MBO)

Under which legislation & section	Companies Act 1956 Sections 12; Sec. 25 optional; Sec. 620A
	Evaluation period min. 3 years is required to ensure bona fide mutual benefit activities.
Definition of "member"	Anyone admitted by the members. A member's control is proportionate to his shareholdings.
Regulating Authority	Registrar of Companies Regional Director of Company Law Board
Registration Document	Memorandum of Association & Articles of Association
Geographical Area?	India; but only one office may be operated.
Any restriction on dividend payment?	No restriction.
Any limit on activity?	Can deal only with members to retain "mutuality of interest."
Capital required	For financial companies, capital must be 8% of risk for entry weighted assets plus off-balance sheet items
Limit on mobilizing deposits?	Borrowings ok. Shares are tradeable between members, but no public quotes. Expedites grassroots ownership. Small man can own shares.
Is housing finance permitted?	Yes
Income tax	Exempt as Mutual Benefit Organization under Section 2(15) or under section 11,12, & 13 Income Tax Act.

Nidhi--Mutual Benefit Organization (MBO)

Any limit on
accepting savings
deposits?

10 times net owned funds for housing finance
companies

Types of deposit
accounts permitted?

Time deposits of 1 year to 7 years, per NHB Directions.

Total loans permitted?

Limited by capital requirement (see above)

Total housing loans?

Minimum 75 percent of HFC loans must be for housing
acquisition or construction per NHB Directions.

Who can borrow?

Anyone.

Can loan guarantees
be given?

Yes, up to the value of unencumbered assets

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2. PUBLIC CHARITABLE TRUST

Under which legislation & section	Indian Trust Act
Definition of "member"	As defined by by-laws.
Regulating	Public Charitable Trusts are not governed by any law. In the event of mismanagement, only members have standing to take action, and that must be by way of civil suit. Except in Gujarat and Maharashtra, recourse for rejected members is limited.
Registration	By-laws.
Limit on Geographical Area?	India
Any restriction on dividend payment?	Not permitted.
Any limit on activity?	As per Trust Deed, otherwise, no restriction. Finance activity OK.
Capital required for entry	No minimum required for entry or operation.
Limit on mobilizing funds other than deposits?	Only charitable donations.
Is housing finance permitted?	Yes.
Income tax	Exemption under Section 11, 12, 13 or 10(23)(c) read with Section 2(15).
Any limit on accepting savings deposits?	None.

Public Charitable Trust

Types of deposit
accounts permitted?

Any type.

Total loans permitted?

No limits.

Total housing loans?

No limits.

Who can borrow?

Anyone meeting trust's criteria as a beneficiary.

/cfi7

3. PUBLIC LIMITED COMPANY

Under which legislation & section	Companies Act, 1956 Sec. 12
Definition of "member"	Anyone holding a share
Regulating Authority	Registrar of Companies
Registration Document	Memorandum of Association & Articles of Association
Limit on Geographical Area?	None
Any restriction on dividend payment?	No restriction
Any limit on activity?	As per Memorandum of Association. Finance activity OK.
Capital required for entry	Nominal, but for operation of financial companies, capital must be 8% of risk-weighted assets plus off-balance sheet items
Limit on mobilizing funds other than deposits?	SEBI requires that promoter must have at least 25% of equity and should offer atleast 25% to the public. Debentures, equity, deposits permitted.
Is housing finance permitted?	Yes
Income tax	Taxable. Housing finance company (HFC) can exempt 40% of income tax liability income under Sec. 36(i)(viii); refer to Appendix.
Any limit on accepting savings deposits?	10 times net owned funds for housing finance companies, per NHB Directions. Deposits from Public Charitable Trusts available only if approved under Sec. 36(i)(viii)
Types of deposit accounts permitted?	Only time deposits of 1 year to 7 years for housing finance companies

Public Limited Company

Total loans permitted?	Limited by capital requirement (see above)
Total housing loans?	Minimum 75 percent of HFC loans must be for housing acquisition or construction, if 36(i)(viii) exemption is sought.
Who can borrow?	Anyone
Can loan guarantees be given?	Yes, up to the value of uncumbered assets

4. SECTION 25 COMPANIES:

Under which legislation & section	Companies Act 1956 Sections 12 & 25
Definition of "member"	Anyone holding a share
Regulating Authority	Registrar of Companies Regional Director of Company Law Board.
Registration Document	Memorandum of Association & Articles of Association
Geographical Area?	India
Any restriction on dividend payment?	No dividend payment permitted. Profits are retained, not distributed. No benefit to promoters/shareholders, even in the event of winding up the company.
Any limit on activity?	Restricted to charitable activities. Finance activity OK.
Capital required for entry	For financial companies, capital must be 8% of risk-weighted assets plus off-balance sheet items
Limit on mobilizing funds other than deposits?	No limit on borrowings. Equity shares are not publicly tradeable.
Is housing finance permitted?	Yes
Income tax	Could be exempt as Mutual Benefit Organization or Charitable under Section 2(15)" and under section 11,12, & 13 of the Income Tax Act". Sec. 36 (i)(viii) exemption is available. Public Charitable Trust deposits <u>and</u> equity are available if Sec. 36 (i)(viii) approval is secured, please refer to Appendix.
Any limit on accepting savings deposits?	10 times net owned funds for housing finance companies

Section 25 Companies:

Types of deposit
accounts permitted?

Time deposits of 1 year to 7 years per NHB Directions.

Total loans permitted?

Limited by capital requirement (see above)

Total housing loans?

Minimum 75 percent of HFC loans must be for housing
acquisition or construction.

Who can borrow?

Anyone.

Can loan guarantees
be given?

Yes, up to the value of unencumbered assets

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5. SOCIETY

Under which legislation & section	Society Registration Act 1860 as amended or as administered by the respective states.
Definition of "member"	As defined in by-laws
Regulating	Societies are subject to no effective regulating authority except in Tamil Nadu, Maharashtra and Gujrat. In the event of mismanagement, only members have standing to take action, and that must be by way of civil suit.
Registration	By-laws. Incorporation certificate.
Limit on Geographical Area?	Can operate throughout India, regardless of place of registration.
Any restriction on dividend payment?	Not permitted.
Any limit on activity?	As per by-laws. Finance activity is permitted RBI non-banking finance company guidelines do not apply. Housing activities could be organized as for-profit division to meet the main charitable purpose of the society.
Capital required for entry	None.
Limit on mobilizing funds other than deposits?	Cannot raise capital from members. Borrowing permitted.
Is housing finance permitted?	Yes.
Income tax	Exemption under Section 11, 12, 13 or 10(23)(c).

Society

Any limit on
accepting savings
deposits?

None.

Types of deposit
accounts permitted?

Any type of deposit, from any person.

Total loans permitted?

No limit.

Total housing loans?

No limit.

Who can borrow?

Anyone meeting the main charitable purpose of the
organization.

/cfi6

6. STATE COOPERATIVE SOCIETY

(Ongoing financial society such as Thrift & Credit Cooperative; NOT a single-project "housing cooperative")

Under which legislation & section	Cooperative Society Act as applicable to each state
Definition of "member"	Any individual admitted as per the institution's by-laws
Regulating Authorities	State Registrar of Cooperative Societies
Registration Document	By-Laws
Geographical Area?	Within the state.
Any restriction on dividend payment?	Maximum dividend 12 %.
Any limit on activity?	Should be organized for a single or narrowly defined common purpose. Otherwise, By-laws govern activity.
Capital required	No effective minimum capital.
Limit on mobilizing funds other than deposits?	Share capital must be raised entirely from members. Borrowing is permitted. Shares are tradeable between members, but no public quotes.
Is housing permitted?	Yes.
Income tax	Restricted exemption under Sec. 80P; lower tax rates than on companies.
Any limit on accepting savings deposits?	None.

State Cooperative Society

Types of deposit
accounts permitted?

Passbook savings and time deposits.

Total loans permitted?

No limit.

Total housing loans?

No minimum limit; Recognition U/S 36(i)(viii) of Income
Tax Act not relevant as tax rates are low. However,
Charitable Institution deposits not permitted.

Who can borrow?

Members only.

Can loan guarantees
be given?

Yes, up to the value of unencumbered assets

/cfi4

7. UNREGISTERED SELF-HELP GROUP

Under which legislation & section	Unregistered.
Definition of "member"	No limitation, but maximum membership is 20 persons.
Regulating Authority	None.
Registration	None. However group by-laws and the governing board mechanism provide status for entering into commercial transactions.
Limit on Geographical Area?	Local, by definition.
Any restriction on dividend payment?	Distribution is possible.
Any limit on activity?	None, as long as membership is limited to 20 persons.
Capital required for entry	None.
Limit on mobilizing funds other than deposits?	Restricted to members.
Is housing finance permitted?	Yes.
Income tax	Applicable, unless Income Tax act provisions regarding mutuality of benefit are met.
Any limit on accepting savings deposits?	Only from members, by definition.

Unregistered Self-Help Group

Types of deposit accounts permitted?	Any deposit from members ok.
Total loans permitted?	No limit.
Total housing loans?	No limit
Who can borrow?	Members of the group only. Members are jointly liable for external liabilities.
Can loan guarantees be given?	Not applicable.

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8. URBAN COOPERATIVE BANK

Under which legislation & section	State Cooperative Society Act 1972 Multi State Coop Society Act 1984, secs 2 or 7 Banking Regulation Act, Section 45
Definition of "member"	As defined by the institution's by-laws; number of members is unlimited.
Regulating Authorities	<ol style="list-style-type: none">1. Central or State Registrar of Cooperative Societies (for incorporation & management issues)2. Reserve Bank of India (re: inspection, maintenance of cash & liquid assets, regulation of loans and advances)3. Deposit Insurance & Credit Guarantee Corp.
Registration Document	By-Laws
Geographical Area?	State or India depending on registration.
Any restriction on dividend payment?	Maximum dividend 12%
Any limit on activity?	60% of loans must go to Priority Sector. Otherwise, By-Laws govern activity.
Capital required	In Metro areas, minimum Rs. 30 lakhs. Some flexibility from RBI in non-metro areas. Capital must be 8% of risk-weighted assets plus off-balance sheet items.
Limit on mobilizing funds other than deposits?	Share capital must be raised entirely from members. Borrowing is permitted.
Is housing finance permitted?	Yes, Max to 15% of the bank's total deposits for loans held in portfolio. No limit on NHB refinanced loans. Maximum repair loan Rs. 75,000. Special RBI Circular governs housing finance.
Income Tax	Exempt under Section 80P.
Any limit on accepting savings deposits?	Governed by capital requirements (see above). Deposits may be accepted from anyone.

Urban Cooperative Bank

Types of deposit accounts permitted?	<ul style="list-style-type: none">- Savings accounts with checking- Time deposits- All individual deposits are insured up to 1 lakh
Total loans permitted?	Limited by capital requirement (see above)
Who can borrow?	Any member.
Can loan guarantees be given?	Yes, up to the value of unencumbered assets
NHB Refinance	Presently available to scheduled urban cooperative banks. Available to non-scheduled banks via State and District Cooperative Banks, but each tier adds costs.

Salient Features of Section 36 (i) (viii) of IT Act 1961

In respect of each housing finance company, which is approved by the Central Government for the purpose, the following tax concession benefits are available:

1. A public company formed and registered in India with the main object of carrying on the business of providing long-term finance for construction or purchase of houses in India for residential purposes, can create a special reserve with an amount not exceeding 40 per cent of the total income and, such a reserve is admissible as a deduction in computing income chargeable to income tax under the head Profits & Gains of Business or Profession vide Section 36-(i)(viii) of the Income Tax Act. This reserve so created shall not exceed twice the amount of equity capital.
2. For a HFC to be approved under Section 36-(i)(viii), at least 75% of loan portfolio should be as prescribed above. (Executive discretion and no CBDT guidelines are available prescribing the above percentage).
3. For deposits placed with housing finance companies:
 - a. Deposits with or investments in any bonds issued by such companies by trusts/societies established wholly for charitable or religious purposes, qualify as an eligible mode of investment under Section 11(5) of the I. T. Act. Deposits of capital gain funds derived from property can also be made till invested in property as permitted under the Income Tax Act.
 - b. For loans taken from housing finance companies:

Repayment towards the principal amount of loan taken from any housing finance company for housing purposes is eligible for a tax rebate under Section 88 of the I. T. Act upto a limit of Rs. 10,000. Subject to the aforesaid ceiling, the rebate- from the tax payable- will be equivalent to 20 per cent of the amount repaid. The interest payable on the housing loan is a deductible expense under income from house property under Section 24 of I. T. Act.
 - c. Interest on deposits by an individual or person with such companies will qualify for deduction of upto Rs. 7,000 per annum under Section 80-L of the I. T. Act(along with other eligible deductions).