

PRIVATE COMPANIES LIMITED BY GUARANTEE:  
THE BEST VEHICLE FOR NON-GOVERNMENTAL  
ORGANIZATIONS

A THESIS SUBMITTED IN PARTIAL FULFILMENT  
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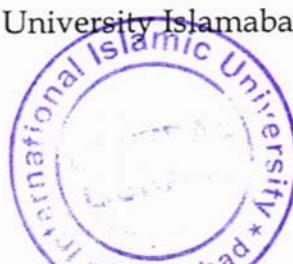
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**PRIVATE COMPANIES LIMITED BY GUARANTEE:**

**THE BEST VEHICLE FOR NON-GOVERNMENTAL ORGANIZATIONS**

By

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Accepted by the Faculty of Shariah and Law, International Islamic University Islamabad (I.I.U.I.) in partial fulfilment of the requirements for the award of the degree of LL.M (Corporate Law)

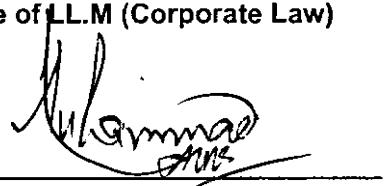
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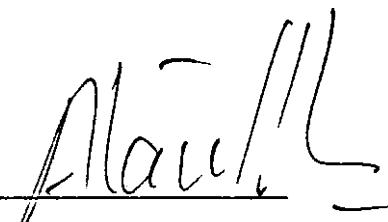


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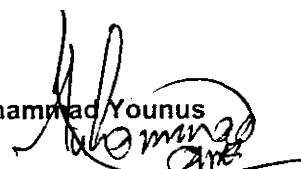
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**DEDICATED TO MY BELOVED FATHER**

## **ACRONYMS**

AKRSP	Agha Khan Rural Support Program
CPLC	Citizen Police Liaison Committee
CRO	Company Registrar Office
CSO	Civil Society Organizations
CBOs	Community Based Organizations
FBR	Federal Board of Revenue
HRCP	Human Rights Commission of Pakistan
ITO	Income Tax Ordinance
IUCN	International Union for Conservation of Nature
MOA	Memorandum of Association
NGOs	Non-Governmental Organizations
NPOs	Non-Profit Organizations
PMN	Pakistan Microfinance Network
RSPs	Rural Support Programs
SAP PK	South Asian Partnership Pakistan

SECP	Security and Exchange Commission of Pakistan
SPDC	Social policy and Development Canter
SRSP	Sarhad Rural Support Program
TRDP	Thardeep Rural Development Programme
WHO	World Health Organization
WWF	World Wide Fund

## TABLE OF CASES

1. *Salmon v. Salmon and Company*, 1987 AC 22.
2. *United Liner Agencies of Pakistan (Pvt) Ltd Karachi v. Mahenau Agha*, 2003 SCMR 132.
3. *The Bolivar Case*, AIR 1961 PC 85.
4. *Mohammad Irfan Azad v. Sultana Begum*, PLD 1971 Kar 91.
5. *Mrs. Bacha. F. Guzdar v. Commissioner of Income Tax*, AIR 1955 SC 74.
6. *Heavy Engineering Mazdoor Union v. State of Bihar*, AIR 1970 SC 82.
7. *Rustum Cavasjee Cooper v. Union of India*, AIR 1970 SC 564.
8. *Turner Morrison and Co. Ltd v. Hungerfond Investment Trust Ltd*, AIR 1972 SC 131.
9. *Chartered Insurance Institute v. London Corporation*, 1957 1WLR 867
10. *Thomas v. R. L. Godeok*, AIR 1970 Pat 163.
11. *The Sakharkheda Education Society v. State of Maharashtra*, AIR 1968 Bom 91.
12. *The Commissioner for Special Purposes of Income Tax v. John Fredrick Pemsel*, 1891 AC 531.
13. *Nadir Pvt Ltd v. FC of T*, (1937) 47 ALJR 303.

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## TABLE OF CONTENTS

INTRODUCTION .....	3
CHAPTER 1 .....	10
PRIVATE COMPANY LIMITED BY GUARANTEE AND NON PROFIT ORGANIZATIONS .....	10
1.1 The Concept of Private Companies .....	10
1.2 Main Features of A Private Company .....	11
1.2.1 Membership .....	11
1.2.2 Restriction on Transfer of Shares .....	12
1.2.3. Public Invitations in Respect of Shares/Debenture Issues .....	12
1.2.4 Limited Liability by Guarantee .....	14
1.2.5 Legal Entities .....	14
1.2.6 Perpetual Succession .....	15
1.2.7 Common Seal .....	16
1.2.8 The Powers and Scope of Business .....	16
1.3 Incorporation of A Private Company .....	17
1.3.1 Steps for Incorporation .....	17
1.3.2 Kinds of Private Company .....	21
1.3.4 Comparison with Companies Limited by Shares and Companies Limited by Guarantee .....	25
1.4 Privileges and Exemptions of A Private Company Limited by Guarantee .....	27
1.5 Relationship of Non-governmental Organizations with Private Companies Limited by Guarantee .....	29
CHAPTER 2 .....	33
ROLE AND THE REGULATORY FRAME WORK OF NGO'S IN PAKISTAN .....	33
2.1 The Role of NGO's in Pakistan .....	33
2.2 The Role of NGOs .....	39
2.3 The Regulatory Framework of NGOs in Pakistan .....	41
2.3.1 Enabling Statutes .....	42
2.3.2 Controlling Legislation .....	49
2.4 The Constitutional Framework .....	53

3.5 Taxation .....	55
CHAPTER # 3.....	61
BENEFITS OF INCORPORATION FOR NGOS.....	61
3.1 Legal Status at the Official Level and among Donors .....	62
3.2 Continued Existence .....	63
3.3 Limited Liability by Guarantee .....	63
3.4 Public Invitation in Respect of Shares and Debenture Issues .....	64
3.5 Operate as Joint Stock Company .....	65
3.6 Book Keeping, Accounts and Audit.....	66
3.7 Good Corporate Governance.....	67
3.8 Public Accountability and Transparency.....	68
3.9 Common Seal.....	68
3.10 The Powers and Scope of Business .....	69
3.11 Restriction on Transfer of Issues.....	70
3.12 Exemptions and Privileges under the Companies Ordinance, 1984 .....	70
3.13 Tax Exemption .....	72
CONCLUSIONS.....	75
BIBLIOGRAPHY .....	87

## INTRODUCTION

Non-governmental organizations are formed voluntarily by citizens with an element of voluntarily participation in the organization. They are independent within the laws of society, and controlled by those whose have formed or by elected or appointed boards. They are not for private personal profit or gain. Their aims are to improve the circumstances and prospects of people and to act on concerns and issues detrimental to the well-being circumstances or prospects of society as a whole. NGOs contribute to a civil society by providing a means for expressing and actively addressing the varied and complex needs of society.

Non-governmental organizations address a variety of people's needs and interests. People participate voluntarily in these organizations. Boards of directors, staff, and volunteers, who give their time, manage these organizations. The organization fundraises or solicits donations from people and other organizations that care about the NGOs mission. Each organization provides targeted program and services to focus on its constituent's needs, or interests. The organizations are independent and are generally known for the good work they do.

In recent years the presence and number of NGOs has grown. However, the influence and importance of NGOs differ depending on the national context in which they operate. The organization's goal is not to make a profit for the benefit of organizations, but can earn money to achieve the organization's mission.

NGOs have become increasingly influential in world affairs. They often impact the social, economic and, political activities of communities. NGOs are not for private or for personal profit. In many countries, NGOs engage in many activities such as health care, youth and women's issues, education, environmental preservation, culture, ethics, revenue generating activities, economic, over population, water, sanitation, employment opportunities, and other identities. The international covenant on Civil and Political Rights, developed by the United Nations in 1966, and since ratified by 135 countries, grants the right to assemble. The number of international operating NGOs are estimated at 40, 4000. National numbers are even higher.

What follows are a few examples of the focus, and scale of NGOs in countries, where voluntaries have served or are serving. In Jordon, local NGOs enjoy royal patronage, and many work with youth women's issues. Kenya has more than 600 NGOs, many working in grass-roots community development. In the Philippines, 500,000 registered Philippine NGOs try to make a difference in a variety of sectors, including AIDS, education and environmental presentation. In Russia, NGOs deliver business services assist battered women, and work an environment education. Russia has 277, 000 NGOs. India is estimated to have around 3.3 million NGOs. In Slovakia, there are more than 350 NGOs, many working in the development of an effective civil society.

In Pakistan NGOs are playing very important role for over all development segment of society through providing right base approach and service delivery. Pakistan is estimated 45,000 NGOs. They are working in the field of education, health, women development, youth issues, economic development, and capacity building of civil society organizations. Moreover, NGOs are playing pivotal role to create awareness among community about their rights and responsibility. People have blind faith in these organizations such as Edhi Foundation, Shaukat Khanum Trust, Khwaja Ghareeb Nawaz welfare Trust, Rural Support Program, fukar and Sahara Trust etc.

Non-governmental organizations (NGOs) can perform their functions in a better way if they get incorporated and form a Company. This will give them manifold benefits of incorporation, such as the right to sue in the name of the company, the right to own property in its own name, the benefit of continued existence irrespective of the change of its members and so forth. Incorporation will also help the government to have a check on the functions of the NGOs through the tools of corporate governance. It will, thus, answer the allegations levelled against some NGOs by different circles.

As these organizations are supposed to be, and generally are, non-profit organizations the best tool for them is a "private company limited by guarantee". This is because such a company does not have a share capital, but has members who are guarantors instead of shareholders. The members of the

company do not own the company, but are the decision makers of the company. This means that the profits of the company cannot be distributed to the members through dividends and that they do not have any claim upon the assets of the company. The members of the company may appoint Directors often called 'Trustees', who are given the responsibility for creating and implementing policies for the company. The Directors also enjoy limited liability, provided that they have not acted negligently, or fraudulently, and have not allowed the guarantee company to continue trading when it was insolvent. The liability of the members is limited. Limitation of liability takes the form of a guarantee from its members to pay a nominal sum in the event of the company being wound up to the extent of their guarantee. The amount of money is guaranteed. Such companies being private companies need not issue prospectus and invite public subscription. Such a company has a legal entity distinct from the members who own shares in that company. Therefore the member of the company who are running it cannot be made personally liable for the debt of the company, and a compromise signed by a majority of shareholders of the company does not bind the company. Guarantee companies are useful for non-profit organizations that require corporate status. This means that its profits are not distributed to its members but are retained to be used for the objects of the guarantee company. This does not mean that the guarantee company cannot make a profit, as indeed it is almost paramount that it can and does so. Where an organization is likely to enter into contracts, it may need the benefit of limited liability to protect its board of trustees

and members, who may be involved in a voluntary basis. These contracts may be include employment contracts, purchasing lands, buildings or property, contracting with services or product providers, and contracts with fund raisers. A guarantee company provides a clear legal identity. This provides the ability for the company to own property in its own name and a democratic structure where its participants are required to adhere to the strict laws and regulations governing limited companies generally. The constitution of the company limited by guarantee is the Memorandum & Articles of Association. The Memorandum sets out the objects of the company and the powers of the company. The Memorandum will also state how much money the members of the company will guarantee to pay in the event of the company being wound up. The Articles of Association state meetings of the company, proceedings of the meetings, the voting rights of members, number of trustees, the powers of the trustee, and procedures for appointing and retirement of members and trustees. So, this is considered the best vehicle for NGOs and non-profit organizations throughout the world.

In Pakistan, the NGOs generally do not adopt this mechanism. Most of them work within constrains of trust and registration, although some have been incorporated as well. It will be a beneficial exercise to collect data on this issue and find out the exact ratio of the incorporated and unincorporated NGOs, and then, look for the NGOs that have adopted the mechanism of private company limited by guarantee. An analysis of this data will help verify our assessment that

the best vehicle for NGOs is that of private company limited by guarantee. For this purpose, the study will be divided into three chapters. Chapter # 1 will form the theoretical framework for the study. It is divided in to two sections; section # 1 will briefly explain the concept of private limited companies, its main features and briefly explain the three kinds of private company, the exemptions given under the companies' ordinance, 1984, to private companies. section # 2 will briefly explain the concept of non-profit organizations and its relationship with private companies, and conclude it that the best vehicle for NGOs are the private companies limited by guarantee. Chapter 2 will analyse the data regarding NGOs operating in Pakistan. It will explain the legal framework of NGOs operating in Pakistan. There are two types of legislation, one is called enabling legislation, and the other is called controlling legislation. The enabling legislation facilitates formation of associations of person specified purposes and to provide a regime for their regulation such as internal management and accounting controls. The controlling legislation does not provide a means to form association, but they recognizing their assistance, seeks to regulate their conduct such as internal management and accounting controls. The law of Trust, The Societies Registration Act, 1860, and The Companies Ordinance, 1984, are enabling legislations, and The Religious Societies Act, 1880, The Charitable Endowment Act, 1890, The Charitable and Religious Trusts Act, 1920, The Charitable Funds Act, 1953, The Voluntary Social Welfare Agencies Ordinance, 1961, and the proposed Nonprofit Benefit Organization Act, 2003 are in the nature of controlling

legislation. It will explain that no corporate status is conveyed by these legislations, except the companies' ordinance, 1984. It will also analyse the hypothesis that the best mechanism for NGOs is a private company limited by guarantee. Chapter # 3 will give the benefits of incorporated NGOs under the companies' ordinance, 1984.

## CHAPTER 1

# PRIVATE COMPANY LIMITED BY GUARANTEE AND NON-PROFIT ORGANIZATIONS

### 1.1 The Concept of Private Companies

The private company is a company<sup>1</sup>, which is not a public company. It may be a private Company limited by shares, or a company limited by guarantee or an unlimited company. The popular conception of a private company is of a small concern with few shareholders, most of whom are actively engaged in managing the company's business, and who regard their shares not merely as an investment but as the source of their livelihood. In other words a private company is often visualized simply as an incorporated partnership.<sup>2</sup> Private companies are numerous than public ones, but their total paid up share capital is little more than half of that of the public companies, but it does not mean that private limited companies have small share capital and possess assets of only small value. There is no legal limit on the amount of share capital which a private company may issue; some of them have a large share capital than many public

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<sup>1</sup> Separate legal entity as distinguished from persons who own it. Such persons, held, cannot be liable for debts of company., salmon v. salmon and company.1987 AC 22

<sup>2</sup> Robert R Pennington LLD, Pennington's company Law, fifth ed, 811(Butterworth & co publishers ltd,1985)

companies. The choice whether a company shall be a public or private one, is determined only in part by the amount of capital. If it can be raised from a small group of persons, the company will be a private one, but if it will be necessary to invite the public to subscribe for the company's securities, it will have to be a public company. According to Companies' Ordinance, 1984 the private company is a company, which by its articles;

- 1---restricts the right to transfer its shares, if any;
- 2---limits the number of its members to fifty not including persons who are in the employment of the company; and
- 3---prohibits any invitation to the public to subscribe for the shares, any, or debentures of the Company.<sup>3</sup>

## **1.2 Main Features of A Private Company**

The main features of a private company are as follows:

### **1.2.1 Membership**

Minimum number of members required is two whereas maximum number is limited to fifty excluding the present and past employed members. The provisions regarding the number

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<sup>3</sup> *The Companies Ordinance, 1984* , sec # 2 (28)<http://www.helplinelaw.com>(Last accessed on 31-07-2009)

of members are contained in the Articles of Association.<sup>4</sup> On the other hand, the Articles may impose whatever restrictions is desired on the number of its members, and also may impose any qualifications and disqualifications for membership.<sup>5</sup>

### **1.2.2 Restriction on Transfer of Shares**

In terms of the very definition of a private company there must be restrictions of member's rights to transfer their shares. However, the shares are always transferable subject to the restriction. The provisions related to the transfer of shares are inserted in the Articles of Association, but it does not require any particular restrictions, and so the restrictions imposed can be as severe or trivial as the framers of the articles choose <sup>6</sup>

### **1.2.3. Public Invitations in Respect of Shares/Debenture Issues**

A private company is prohibited from making any invitation to public to subscribe for its shares and debentures.<sup>7</sup> For the purpose of the statutory prohibition the

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<sup>4</sup> Articles of association of a company are terms of contract between the members and the terms are legally binding upon the members. Such right is enforceable in law provided the terms are not forbidden by law. ] United Liner Agencies of Pakistan (pvt) Ltd Karachi v. Mahenau Agha ,2003 SCMR 132(a)]

<sup>5</sup>Robert R Pennington, *Pennington's Company Law*, fifth ed, at 818(Butterworth & Co Publishers, 1985).

<sup>6</sup> Ibid.

public includes any section of the public, in the same way as in the definition of a prospectus, and an allotment or agreement to allot shares or debentures, with a view to them being offered for sale to the public is deemed to be made in the same circumstances as in connection with the definition of a prospectus. consequently, a private company may not issue a prospectus, nor may it have its shares or debentures offered for sale or placed on a stock exchange by an issuing house or sponsoring brokers, nor may it have its shares or debentures placed on the "over the counter" market by arrangement with dealers. But a private company is not deemed to offer its shares or debentures to the public if it has issued an invitation to its members or debenture holders which is not calculated to result in shares or debentures becoming available for subscription by persons other than those members or debenture holders, nor when the invitation can properly be regarded as domestic concern of the company and the persons to whom it is addressed. Thus, a private company may issue unrenounceable letters of right and even renounceable letters of right if the class of persons to whom the rights may be renounced is limited so as to make the transactions a domestic one. In particular, a private company may invite its existing members or employees, or members of the families of such persons, to subscribe for shares or debentures of the company, and the right to subscribe may be made renounceable to any such persons.<sup>8</sup>

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<sup>8</sup>Robert R Pennington LLD, Pennington's company Law, fifth ed, at 282(Butterworth & co publishers ltd,1985)

#### **1.2.4 Limited Liability by Guarantee**

Being a limited Company the liability of the members of a private company is limited to the amount unpaid on shares held or to the amount guaranteed by members. This amount is called the amount of guarantee<sup>9</sup>.

#### **1.2.5 Legal Entities**

A company whether public or private has a separate legal existence in the eyes of law. It is regarded as a separate person quite distinct from its members. It can own and transfer properties, employ people, make loans, can sue and be sued in its own name.

A "legal entity" distinct from its members or shareholders,<sup>10</sup> Compromise decree passed on basis of compromise of some shareholders and without notice to company. It was held, that not sustainable against assets of company and set aside.<sup>11</sup>

A company incorporated under the companies Act is a legal entity distinct from the members who own shares in that company. Therefore the member of

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<sup>8</sup> ibid

<sup>9</sup> Ibid

<sup>10</sup> S. Sharifuddin pirzada, Salman Aslam Butt, and Saeeda Siddiqui, *Company Law Digest* , 1947-2005: *company, Pakistan, India and U.K*, vol 2,at 890( Asia Law house Karachi)

<sup>11</sup> the Bolivar case AIR 1961 PC 85, salmon V. salmon & co, 1987 AC 22rel. mohd irfan azad v. sultana begum PLD 1971 kar.91

the company who are running it cannot be made personally liable for the debt of the company, and a compromise signed by a majority of shareholders of the company does not bind the company.<sup>12</sup>

An incorporated company has a separate existence and the law recognizes it as a juristic person separate and distinct from its members.<sup>13</sup> This new personality emerges from the moment of its incorporation and from the date the persons subscribing to its memorandum of association and others joining it as members are regarded as a body incorporate aggregate and the new person begins to function as an entity.<sup>14</sup>

### **1.2.6 Perpetual Succession**

A company registered under the companies Act is a legal person, separate and distinct from <sup>15</sup>its individual members. Property of the company is not the property of the shareholders. a share holder has merely an interest in the company arising under its Articles of association measured by a sum of money for the purpose of liability, and by a share in the profit. Again a director of a

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<sup>12</sup> PLD 1971 kar.91

<sup>13</sup> S. Sharifuddin pirzada, Salman Aslam Butt, and Saeeda Siddiqui, *Company Law Digest* , 1947-2005: *company, the companies Act, 1956, sec # 34, Pakistan, India and U.K*, vol 2,( Asia Law house Karachi)1085

<sup>14</sup> Mrs. Bacha.F. guzdar v. commissioner of income tax, AIR 1955 SC 74. and heavy engineering mazdoor union v. state of bihar, AIR 1970 SC 82

<sup>15</sup> Rustam Casvajee Cooper v. Union of India, AIR 1970 SC 564

company is merely its agent for the purpose of management. The holder of a deposit account in a company is its creditor; he is not the owner of any specific fund lying with the company.

All companies whether public or private have perpetual existence and are not affected by the death and bankruptcy of its members.<sup>16</sup>

### **1.2.7 Common Seal**

A private company limited by guarantee has a common seal which denotes the signature of the company. The seal is affixed on all important documents and contracts that require the company's signature.<sup>17</sup>

### **1.2.8 The Powers and Scope of Business**

A private limited company cannot exceed its powers conferred on it under the memorandum of association.<sup>18</sup> Where the relevant clauses of the memorandum

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<sup>16</sup> 7Robert R Pennington LLD, Pennington's company Law, fifth ed, at 282(Butterworth & co publishers ltd,1985)

<sup>17</sup> ibid

<sup>18</sup> S. Sharifuddin pirzada, Salman Aslam Butt, and Saeeda Siddiqui, *Company Law Digest* , 1947-2005: *company, the companies Act, 1956, sec # 34, Pakistan, India and U.K*, vol 2, at 1043( Asia Law house Karachi)

of the company empowered to carry on business in India and elsewhere as merchants, general merchants, agents and traders etc, to receive money on deposit at interest or otherwise and lend money to such persons with or without security and on such terms as may seem expedient and in particular to customers of the persons having dealing with the company and to give any guarantee or indemnity as may seem expedient to distribute amongst members of the company in specie any property of the company, but distributing amounting to a reduction of capital shall be made without the sanction, if any, for the time being required by law and to do all such other things as are incidental or conductive to the attainment of objects mentioned in the memorandum.<sup>19</sup>

### **1.3 Incorporation of A Private Company**

The promoters have to consider and decide certain factors before taking steps for incorporations of a private company.

#### **1.3.1 Steps for Incorporation**

These steps are as follows;<sup>20</sup>

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<sup>19</sup> Turner Morrison and co. ltd v. hungerfond investment trust ltd, AIR, 1972, S.C.131

<sup>20</sup> Chinmoy Charerjee, *Guide to Private Companies Practice Precedents at 17* (Bombay: N. M. Tripath Private limited, 1989)

The promoters have to choose a suitable name for the proposed company but the name should not be such which, in the opinion of the Central Government, is undesirable. A name should not be identical with the name of an existing company.

The objects of the proposed company should be spelt out clearly or at least the broad outlines thereof should be decided so that the objects may be adequately elaborated for the purpose of the company's memorandum of association.

The capital requirements of the proposed company should not be ascertained having regard to the fixed assets to be acquired, expenses to be incurred, working capital needs and future requirements. The authorized capital <sup>21</sup>of the company is required to be mentioned in the capital clause of the memorandum of association. It may be noted that the company can raise capital only up to the amount permitted by the memorandum unless it is altered and the limit is increased from time to time.

Every company must have a registered office and it is to be considered by the promoters beforehand the place where the registered office of the company will be situated.

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<sup>21</sup> The limit is the authorized capital. The company can not go beyond that, unless there is change in the memorandum.

A private company may be formed by two or more persons who are required to subscribe their names to the memorandum of association. Any person may be a subscriber but since a partnership firm is not a person it cannot be a subscriber. A company may also be a subscriber. A few persons jointly also may be subscribers to the memorandum of association.<sup>22</sup>

The first directors of beforehand the company are normally appointed by the Articles of Association and as such, it is to be decided the names of the persons who shall act as the first directors of the company.

A company must have a common seal from the time of its incorporation. The seal denotes the signature of the company and is required to be affixer on all important documents where the signature of the company is required to be affixed. The seal is usually adopted at the first Board meeting of the company and for the purpose; the design and form of the seal should be decided beforehand so that the same is ready immediately after the incorporation of the company.<sup>23</sup>

For the purpose of incorporation of private company few documents are required to be prepared and filed with the Registrar of companies. These are;

**(a) Memorandum of association**

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<sup>22</sup> ibid

<sup>23</sup>ibid

- (b) Articles of agreement association
- (c) The, if any, which the company proposes to, enter into with any individual for appointment as its managing or whole time director or manager.
- (d) A declaration in Form No.1 by an advocate of the Supreme Court or of a High Court, or an attorney or a pleader entitled to appear before a High Court, or a Secretary, or a Chartered Accountant in whole time practice of the country.

The draft Memorandum and Articles of Association are normally informally cleared by the Registrar's office before the final printing is done. The Memorandum and Articles of Association are finally printed and are required to be stamped as per provisions of the Stamp Act. Thereafter, these are signed by the Subscribers who have to add up in their own hand-writing their names, father's name, full residential address, occupation and number of shares agreed to be taken by them. An agent may sign the memorandum on behalf of a Subscriber if he is authorized by a power of attorney to do so.<sup>24</sup>

The documents submitted to the Registrar of Companies are scrutinized at the Registrar's office. If, however, any corrections are required to be done in any of the documents, the person in whose favour authority has been given by the subscribers will be required to call at the Registrar's office and make the necessary alterations or corrections. Thereafter the Registrar will register the Company and issue the Certificate of Incorporation. The Certificate of

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<sup>24</sup> ibid

Incorporation issued by the Registrar is the conclusive evidence that all the requirements of Act in respect of registration and matters precedent and incidental thereto have been fully complied with.

### **1.3.2 Kinds of Private Company**

A private limited company may be in three kinds,

1. A private company limited by shares
2. A private company limited by guarantee
3. An unlimited company.

#### **1.3.1.1 A Private Company Limited by Shares**

A private company limited by shares is the common type of private company. Private Company limited by shares in its articles restricts the right to transfer its shares; and with certain exceptions, limit the number of its members to fifty; and prohibit it from invitation to the public to subscribe for its shares or debentures.

#### **1.3.1.2 A Private Company Limited By Guarantee**

A company limited by guarantee is one whose memorandum of association contains an understanding by its member to contribute a specified amount

toward the payment of its debts and the expenses of winding up if it is wound up while he was a member within one year after he ceases to be a member. The rest of the company's memorandum is similar to that of a company limited by shares, and in particular it states that the liability of its members is limited. A company limited by guarantee must have its own special articles of association, and cannot dispense with them as a company limited by shares may do. If a company limited by guarantee was registered with a share capital, its members are under the double liability of having to pay the issue price of their shares and to honor their guarantee in the event of the company being wound up. The guarantee undertaken by members of a company limited by guarantee differs from the liability of shareholders for unpaid share capital in that it is not an asset of the company, but merely a contingent liability of the members to contribute in the event of the company being wound up. Consequently, the amount of the guarantee cannot be mortgaged by the company, nor can it be increased or reduced by an alteration of the company's memorandum, or by agreement with the members, or by any process similar to an increase or reduction of share capital<sup>25</sup>

A private company limited by guarantee is a type of incorporation used primarily for non-profit organizations that requires corporate status. Such a

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<sup>25</sup> Robert R Pennington LLD, Pennington's company Law, fifth ed, at 828,829(Butterworth & co publishers ltd,1985)

company has no share capital, and the liability of the members is limited to the extent of their given guarantee, and it accrues in the event of its being wound up. Such companies are widely used for charitable purposes<sup>26</sup>.

A company limited by guarantee is generally a non-profit making association and such a company is an alternative to a Company limited by shares. Under the scheme of the Companies Act, 1913, a company cannot be created in which the members are free from any liability whatsoever. Therefore, ordinarily companies created under the companies Act is limited by shares, that is, the members of the company are made liable as contributories to the extent of the shares they have taken or they have agreed to take in the company. But such a company is not suitable for non-profit making association, and therefore as an alternative to such a company, the companies Act permits the incorporation of a company in which the members agree that, in the event of liquidation of the company, they will subscribe an agreed amount. As regards the working capital of such a company it generally comes from other sources, that is, endowments, grants, fees, subscriptions, etc.<sup>27</sup>

The mode of formation of a private company limited by guarantee is similar to that of other companies. The memorandum and articles of association must be in the prescribed form. Guarantee companies are suited to associations for mutual insurance, association for trade protection, mutual information, pooling shares

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<sup>26</sup> <http://www.google.com> (Last accessed on 6-8-2008)

<sup>27</sup> *sindh industrial trading Estate Ltd v. Central Board of Revenue*; PLD 1975 kar.128,

and debentures, and clubs. This form is also suited to associations intended to be supported by annual subscriptions and funds<sup>28</sup>

### **1.3.1.3 Unlimited Companies**

An unlimited company, like a limited one, is a corporation, and is therefore subject to the same rules as to its capacity to enter into transactions and incur liabilities, but unlike a limited company, its members are liable to contribute the last penny of their fortunes in order to satisfy its debts and liabilities when it's wound up. The company must have its own special article of association, which must state the amount of its share capital if it has one.<sup>29</sup> If such a company have a share capital, the memorandum of the company must, so far as possible, follow the form specified in regulations made by the Secretary of State for Trade and Industry, and if have no share capital, the memorandum of the company must, so far as possible, follow the from specified in regulations made by the Secretary of State for Trade and Industry, and if have no share capital, then there is no standard from of memorandum and articles of association to which its own must adhere. The personal liability of members of an unlimited company to contribute toward payment of its debts is not an asset of the company, but, like the

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<sup>28</sup> Awtar singh, Law relating to private companies, 4th ed, at 235(Eastern book company,1983)

<sup>29</sup> Robert R Pennington LL.D, Pennington's company Law, fifth ed, at 830(Butterworth & co publishers ltd,1985)

guarantee undertaken by members of a company limited by guarantee, is a contingent liability of the members which will become effective only when the company is wound up. Consequently, while the company is a going concern, its members cannot be called upon to contribute anything beyond the capital unpaid on their shares and the company cannot mortgage or charge their personal liability for its debts so as to give any of its creditor's priority for payment out of their contributions when the company is wound up. The only way by which the company's creditors may compel the members to contribute toward payment of its debts is by petitioning for the company to be wound up by the court. As the winding up order made, the liquidator may make calls on members to raise sufficient money to pay the company's debts and liabilities in full and also meet the expenses of the liquidation.<sup>30</sup>

#### **1.3.4 Comparison with Companies Limited by Shares and Companies Limited by Guarantee**

The companies Act 1985(U.K),and the Companies Ordinance 1984(Pakistan), and the rules of company law generally apply to companies limited by guarantee and unlimited companies in the same way as they apply to private companies limited by shares with some statutory exceptions arising from their constitution. The principal difference between such companies is that companies limited by

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<sup>30</sup> ibid at p. 831,832

guarantee and unlimited companies need not have a share capital whereas private companies limited by shares obviously must. In applying the company law, to a company limited by guarantee or an unlimited company, it must be remembered that reference to a "company" include all kinds of company registered under the law, whether public or private, whether limited or unlimited and whether with or without a share capital. Furthermore, a company limited by guarantee with a share capital is treated by the companies Act 1985, in the same way as a company limited by shares; the same rules apply to it and they are merely supplemented by the special rules relating to the members additional liability arising under the guarantee clause in its memorandum. On the other hand, the provisions of the companies Act, 1985, which apply to a company limited by shares but not to all companies, do not apply to an unlimited company with a share capital. The difference between the various kinds of companies can be best illustrated by setting out first, the statutory privileges which are enjoyed only by companies limited by shares and companies limited by guarantee with no share capital and to unlimited companies, whether they have a share capital or not, and finally the peculiar rules applicable to companies which have no share capital. An account of these privileges and rules is bound to appear something of a catalogue, and is intelligible only by reference to the provisions of company law.<sup>31</sup>

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<sup>31</sup>ibid

## **1.4 Privileges and Exemptions of A Private Company Limited by Guarantee**

A Company limited by guarantee having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the Company in the event of winding up<sup>32</sup>.

A guarantee Company in its pure form is always a private company; as it has no share capital, it can not satisfy the requirements of a public limited company<sup>33</sup>.

An independent private company limited by guarantee enjoys certain privileges and exemptions from compliance of a number of statutory requirements, which are denied to public companies. These privileges and exemptions are as follows:

1. A private company limited by guarantee is not required to deliver a statement in lieu of prospectus to the Registrar of companies before allotment of shares.
2. The restrictions on providing financial assistance to a party for purchasing the shares in a company do not apply to the private company limited by guarantee.

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<sup>32</sup> <http://www.yahoo.com> (Last accessed on 7-8-2008)

<sup>33</sup> Imran Ahsan Khan Nyazee, *Company Law (includes Companies Ordinance, 1984)* at 45, Federal Law House, 2008, Islamabad

3. The provisions relating to further issue of shares to the existing shareholders are not applicable<sup>34</sup>.
4. An aggrieved person cannot except under certain circumstances appeal to the Central Government against refusal by the Company to register a transfer or transmission of shares.
5. Such a company is not required to hold a statutory meeting and to forward a statutory report to its members or deliver a copy to the Registrar.
6. Ceiling on overall managerial remuneration do not apply to a private company unless it is a subsidiary of a public company.
7. A private company limited by guarantee can appoint any firm or body corporate an office or place of profit for any duration of time, if necessary.<sup>35</sup>
8. Copies of balance sheet and profit and loss account are filed with the Registrar separately and the copies of profit and loss account are not open for inspection at the Registrar's office by a person other than a member of the company.

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<sup>34</sup> Chinmoy Chatterjee, *Guide to Private Companies Practice Precedents* (Bombay: N. M. Tripathi Private limited, 1989), 4.

<sup>35</sup> Ibid.

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9. Restrictions on appointment of a person as director by the Articles unless he has signed and filed with the Registrar his consent in writing to act as such director do not apply to a private company.
10. A person can become a director of more than twenty independent private companies.<sup>36</sup>
11. There are no restrictions on loan to a director of a private company limited by guarantee<sup>37</sup>
12. No restrictions are imposed on a private company from giving loans or guarantee to other companies or making investments in the shares of other companies.

Provisions relating to the company Law Board's power to prevent change in Board of Directors are not applicable to the private company limited by guarantee.

## **1.5 Relationship of Non-governmental Organizations with Private Companied Limited by Guarantee**

The general rule, the name of every public limited company must end with the word "Limited" and that of a private company with the words "Private Limited". But there are some organizations which are for promoting commerce, art,

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<sup>36</sup>Ibid at 5

<sup>37</sup> Ibid.

science, religion, charity or any other useful objects, if the Central Government is satisfied from that association the Central Government may, direct that Association may be registered as a company with the limited liability, without the addition of the word "Limited" or the words "private Limited" to its name.<sup>38</sup>

The non-governmental organizations (NGOs)<sup>39</sup> are conducted to achieve a wide variety of objectives, encompassing ideological, political, religious as well as secular aspirations of the people, and it is promoted, sponsored or managed by domestic as well as foreign, individuals, small and large groups of like-minded citizens, corporations and governmental instrumentalities<sup>40</sup>.

The non-governmental organizations are broadly divided in to two main categories, the one is domestic nonprofits and the other is foreign nonprofits. The domestic non-profit organizations are conducted for non-governmental independent citizen organizations, government sponsored initiatives, and private and public sector partnership. The foreign non-profit organizations are conducted by foreign resident missions, and international organizations having headquarters or country agreements with the government<sup>41</sup>.

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<sup>38</sup> *The Companies Ordinance, 1984, section 42* <http://www.helplinelaw.com>(Last accessed on 28-07-2009)

<sup>39</sup> Non-governmental organization, social service organization, voluntary organization, non-profit organization all are synonymous, meaning a body which renders a non-profit service to the society. It can be formed as a limited company under the company's ordinance, 1984, as a society under the societies Registration Act, 1860, and as a trust under the Trust Act, 1882.

<sup>40</sup> Syed Ahmad Hassan Shah, "Regulation of Civil Society Organizations: A Pakistan Case Study", *Islamabad Law Review*, 3 & 4 (2003), at p. 302.

<sup>41</sup> Ibid

The non-governmental organization generally works within the constants of trusts or for other charitable purposes.<sup>42</sup> A plethora of case law precedents of the various courts have examined what is and what is not an objective of "charitable nature". The case of commissioner for special purposes of income tax v. Jhon Fredrick Pemsel<sup>43</sup> outlined 4 heads of charitable purposes viz;

1. for the relief of poverty;
2. for the advancement of education;
3. for the advancement of religion; and
4. For other purposes beneficial to the community not falling under any of the preceding heads.

The public nature of a charitable purpose is necessary for legal recognition i.e. the benefit should be for the public and not for personal benefits.<sup>44</sup> If the main object is the benefit of members of a profession to practice their profession to greater advantage, this does not amount to a charitable purpose.<sup>45</sup>

In the case of Nadir pvt Ltd v. FC of T,<sup>46</sup> the assessor was considered carrying on activities for the purpose of profit or gain to its individual members because if a distribution of profits or gains were to be take place upon a winding

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<sup>42</sup> Philanthropy, altruism, humanitarianisms are similar concepts.

<sup>43</sup> 1891 AC 531

<sup>44</sup> ibid

<sup>45</sup> Chartered Insurance Institute v. London Corporation, 1957, 1WLR 867

<sup>46</sup> (1973)47 ALJR 303

up it would be within the power of the shareholders to direct the application of those profits or gains for their own benefit.

The NGOs are mostly not registered, and have no legal entity. They have no right to take legal action as a legal personality, even government have no control on these organizations. These non-profit organizations can perform their functions in a better way if they get incorporated and form a company. So they can get the right to sue in the name of the company, the right to own property in its own name, the perpetual succession and a separate legal entity. It will also help the Government to have a check on the functioning of the non-profit organizations. The best tool for non-profit organizations is that of "private company limited by guarantee". Because such a company is a type of incorporation used primarily for non-profit organizations that require corporate status. A company limited by guarantee does not have a share capital; instead it has members who are guarantors instead of shareholders. The liability of its members may respectively undertake to contribute to the assets of the company in the event of its being wound up. Such companies are widely used for schools, professional and trade associations, clubs and charities.

## CHAPTER 2

### ROLE AND THE REGULATORY FRAME WORK OF NGO'S IN PAKISTAN

#### 2.1 The Role of NGO's in Pakistan

In Pakistan, there is a tradition of local organizations led and run by welfare organizations or community activities, both in rural and urban areas. These organizations have predominantly concentrated on social welfare activities, such as seldom challenged social inequalities. NGOs have made favourable indents to needy sections of Pakistani society at par with a constantly changing socio-economic climate. NGOs have reached out all the sections of society including women, children, pavement dwellers, unorganized workers, youth, and slum-dwellers, and landless labourers. They are viewed as vehicles of legitimization of civil society.

In Pakistan, NGOs have existed since independence in 1947. Initially the State was unable to provide the emergency relief to refugees, and to needy section, that resulted from Pakistan's creation, so NGOs played a role as an assistance of government, and, steeped into fill the gaps in assistance, and,

service delivery. Generally, they have worked for rehabilitation, and, social welfare, and, to serve the poor and migrated people.

Non-governmental organization created by natural or legal persons with no participation or representation of any government. NGOs are funded totally or partially by governments, they maintains its non-governmental status and excludes government representatives from membership in the organization.<sup>47</sup> NGOs have four characteristics according to the commonwealth foundation, a London based NGO study group. These are as follows;<sup>48</sup>

Firstly, NGOs are formed voluntarily by citizens with an element of voluntary participation in the organization, whether in the form of small numbers of board members or large number of members or time given by volunteers.

Secondly, NGOs are independent within the laws of society, and controlled by those who have formed them or by elected or appointed boards. The legal status of NGOs is based on freedom of association, one of the most basic human rights, developed by the United Nations in 1996, and since ratified by 135 countries, grants the rights to assemble.

Thirdly, NGOs are not private personal profit or gain. NGOs may, in many countries engage in revenue-generating activities, but must use the revenue solely in pursuit of the organization's mission. Like other enterprises, NGOs have

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<sup>47</sup> <http://www.wikipedia.com> (Last accessed on 12-08-2009)

<sup>48</sup> <http://www.commonwealthfoundation.com> (Last accessed on 12-9-2009)

employees who are paid for what they perform, but may be reimbursed for expenses they incur in the course of performing their board duties.

Lastly, the aims of NGOs are to improve the circumstances and prospects the people and to act on concerns and issues detrimental to the well-being circumstances or prospects of people or society as a whole.

NGOs have played an important role in creating awareness of issues such as social, cultural, economic, educational, religion, human and legal rights, women in development, and, over population, health care, water, and sanitation, and employment opportunities to under-developed areas. NGOs have become increasingly influential in world affairs. They often impact the social, economic and political activities of communities and the country as a whole. NGOs address a host of issues, including, but not limited to, women's rights, environmental protection, human rights, economic development, political rights, or health care. In numerous countries, NGOs have led the way in democratization, in battling diseases and illnesses, in promoting and enforcing human rights, and in increasing standards of living.<sup>48</sup>

NGOs vary in their methods. Some act primarily as lobbyists, while others conduct programs and activities primarily. For instance, an NGO such as Oxfams concerned with poverty alleviation, might provide needy people with the equipment and skills to find food and clean drinking water. Others, such as

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<sup>48</sup> <http://www.docs.lib.duke.edu/igo/guides/ngo/define.htm> (Last accessed on 12-08-2009)

Afghanistan information Management Services, provide specialised technical products and services to support development activities implemented on the ground by other organization.<sup>49</sup>

Registrations of NGOs are not mandatory. However in view of the legal effects of registration vis-à-vis the ill-effects of non-registration; NGOs are registered as a matter of course. Registered NGOs can open its own accounts, lawfully vest, purchase, and hold properties,<sup>50</sup> and also can get tax exemption on its income under the Income Tax Ordinance, 2001. The liabilities of the registered NGOs are limited to the assets of members or governing body under section 8 of the Societies Registration Act 1860.<sup>51</sup>

A person is the member of NGO according to the terms and conditions enumerated in the memorandum of association. In case of dissolution, or winding up of NGO, the members are required to vacate their membership, although, that their membership has not expired.<sup>52</sup>

NGOs can be formed only with a lawful object. Thus, there can be no society, trust, or company for the trading, and, promotion of communal disagreements,

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<sup>49</sup> What is NGOs? Professor Peter Willets, city University London,<http://www.staff.city.ac.uk.com> (Last accessed on 12-09-2009)

<sup>50</sup> Anita Abraham, *Formation and Management of NGOs*: ed 2003 at p. 60-61 Universal Law Publisher Co. Pvt .ltd. Delhi,

<sup>51</sup> Thomas v. R.L.Godeok, AIR 1970 Pat 163

<sup>52</sup> see *supra* management of NGOs

armed robbery, and, prostitution. It will not be constituted as a criminal group, in particular it will be non-violent<sup>53</sup>.

The governing body of, and, the board of directors are personally responsible for the control and management of the affairs of NGOs.<sup>54</sup>

NGOs are obligated to spend the monies raised, received, accumulated only for the objects of its mission, and not for personal benefits. They can make, negotiate, and conclude contracts with third parties for sale, supply, distribution, hire-lease and other matters with an aim to achieve their objectives. They have power to contract, and power to acquire, hold, and dispose off property both movable, and immovable.<sup>55</sup> NGOs can transfer their Undertakings<sup>56</sup> in relation to title, right and interest according to its memorandum of association.

Registered NGOs have a right of legal action; it can sue and be sued for a legal injury. A case, appeal, and other proceedings are instituted by or against NGOs. The liabilities of members are limited.

NGOs are required to furnish statutory returns, particulars, and statements from time to time. The governing board is duty bound to maintain proper

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<sup>53</sup> ibid

<sup>54</sup> ibid

<sup>55</sup> ibid

<sup>56</sup> The undertakings vested may include all the assets, rights, leaseholds, powers, authorities, and privileges, and all movable and immovable properties including lands, buildings, works, workshops, projects, stores, instruments, machinery automobiles and other vehicles, cash balances, funds, including reserve funds, investments and book debts of the NGOs.

accounts, records, annual statement of accounts, income, and expenditure account, and balance sheet. The governing board has the authority on the security of the properties or any other asset for achieving the objectives.<sup>57</sup>

NGOs are conducting to archive a wide Variety of objectives, encompassing ideological, political, religious as well as secular aspirations of people. They can be divided into four broad categories.<sup>58</sup> The first is the national level capacity building, research, advocacy, and, funding organizations. These include organizations such as the International Union for Conservation of Nature (IUCN), World Wide Fund(WFF), Sustainable Development Policy Institute (SDPI), Social Policy and Development Centre (SPDC), Human Rights Commission of Pakistan ( HRCP), and, Citizen Police Liaison Committee(CPLC).

The second category is implementing and support organizations such as Strengthening Participatory Organizations (SOP) and South Asia Partnership Pakistan (SAP Pak). They are working directiy with communities to establish community-based organizations in specific regions, helping them to shift from welfare orientation to participatory development, and supporting their development projects.<sup>59</sup>

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<sup>57</sup> ibid

<sup>58</sup> Humaria Bano, *Effective Regulation of Non-profit organizations in Pakistan*, ed: 2008 at p.13-14, International Islamic University, Islamabad

<sup>59</sup> ibid

The third category is umbrella non-profit organizations. These are working as the Family Planning Association of Pakistan, the Population Council, and the Trust for Voluntary Organizations and National Rural Support Program. The fourth category is related to social service delivery such as basic education, health and family planning.

## **2.2 The Role of NGOs**

Pakistan is an underdeveloped country, which has many internal and external problems. After 63 years of independence Pakistan is facing different problems such as unemployment, fluctuation in state's economic conditions, water and power crises, violence, illiteracy, poverty, health, child labour and rapid population increase. These problems should be solved by exploring new facts and figures and solutions through research.

A non-Governmental Organization (NGOs) is any non-profit, voluntary citizen's group, which is organized on a local, national or international level. NGOs perform a verity of services and humanitarian functions, bring citizen's concerns to Government, monitor polices and encourage political participation at the community level. They provide analysis and expertise. Serve as early warning mechanisms and help monitor and implement international agreements. Some are organized around specific issues, such as human rights, the environment or health. Their relationship with offices and agencies of the United

Nations System differs depending on their goals, their venue and their mandate.<sup>60</sup>

NGOs have grown considerably in the recent past, in its size as well as scope of work. It now enjoys an influence that is fundamentally different from what it exercised during the last few decades. This new power emanates from its ability to generate additional resources, and to use the media, information technology, judicial system and professional research to mobilize public opinion for its causes. In terms of scope of work, NGOs are now engaged in many spheres of life ranging from basic service delivery to lobbying for legal and fiscal reforms. They also take a more pro-active approach, and, are often defining issues for national agenda.<sup>61</sup>

NGOs are playing an important role in creating awareness of issues such as human and legal rights, women in development and over population. They are providing badly needed services such as basic health care, water and sanitation and employment opportunities to under-developed areas. NGOs called the Network in one example, which lobbies the government on the rational use of drugs along WHO guidelines<sup>62</sup>. Some NGOs concentrate on advocacy and lobbying. Many direct their activities at the government, and, policy making bodies,

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<sup>60</sup> <http://www.nonprofit.about.com> (Last accessed on 5-5-2009)

<sup>61</sup> <http://www.lead.org.pk> (Last accessed on 31-7-2009)

<sup>62</sup> Khawar Mumtaz, Yameema Mithal, and, *Bilquis Tabira, Pakistan Tradition and Change*, ed 2003, <http://www.books.google.com> (Last accessed on 31-07-2009)

with little involvement at the grassroots. The Agha Khan Rural Support Programme has pioneered an approach of building up village organizations, separately for men and women, launching development activities through groups<sup>63</sup>. Here the brief description is given that what the NGOs are doing for the solutions of problems in Pakistan.

## **2.3 The Regulatory Framework of NGOs in Pakistan**

The regulatory framework for setting up, organizing, governing, and managing CSOs in Pakistan is both old and confusing. These laws are inherited from the United Kingdom, date back to just after the war of Independence in 1857. The most recent specific legislation was issued as a Presidential Ordinance 1961. some laws cover the registration, internal governance, and accountability of organizations, some gives the procedure, how they are financed and managed, and some cover the relationship between the State and these organization. There are two broad kinds of legislation<sup>64</sup> dealing the non-governmental organizations, one is "enabling legislation" and the other is "controlling legislation". The Law of Trust, the Societies Registration Act 1860, and the Companies Ordinance 1984 are enabling legislation, and the Religious Societies Act 1880, the Charitable Endowment Act 1890, the Charitable and Religious

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<sup>63</sup> ibid

<sup>64</sup> Syed Ahmad Hassan Shah, "Regulation of Civil Society Organizations: at p.334 A Pakistan Case Study", *Islamabad Law Review*, Vol. 1, Nos. 3 & 4, Autumn & Winter 2003

Trusts Act 1920, the Charitable Funds Act 1953, The Voluntary Social Welfare Agencies Ordinance 1961, and the proposed Nonprofit public Benefit Organizations Act 2003 are in the nature of Controlling legislation.

The “enabling legislation” facilitates formation of associations of persons for specified purposes and to provide a regime for their regulation such as internal management and accounting controls, the “controlling legislation” does not provide a means to form associations, but by recognizing their existence, seek to regulate their conduct such as internal management and accounting controls.

### **2.3.1 Enabling Statutes**

#### **2.3.1.1 Societies Registration Act, 1860**

This is the oldest statute of registration laws. The Act was made only for the regulation of professional, scientific and fine arts activities, and was later extended to include charitable and social organizations as well. Society may be formed for any literary, scientific or charitable purpose, and for the promotion of fine arts, for instruction, the diffusion of useful knowledge, the diffusion of political education, the foundation or maintenance of libraries or reading-rooms for members of the public, public museums and galleries of paintings and other works of art, collections of natural, history, mechanical and philosophical inventions, instruments or designs.

Seven or more persons associated for specified purpose,<sup>65</sup> may form a society upon payment of prescribed fees and by and subscribing to a memorandum of association and filing it along with a copy of the rules and regulations entrusting management of the affairs to the governing body and certified by at least three governors with the designated authority. The form of the memorandum is prescribed, which requires nominal disclosures as to the name, address and objects of the society along with the particulars of the governors.

A society registered under the Societies Registration Act, 1860, is not a legal person, as it cannot sue and be sued in its own name. The Act gives provisions for suits by or against societies;<sup>66</sup> however it does not make a society a legal person as required by law. A registered society is not a body corporate but is like a joint stock company or a club.<sup>67</sup>

A society is required to maintain a roll or list of its member, and if the rules do not or otherwise provide for holding general meetings, a list of names, addresses and occupations of the governing body to whom the management is entrusted is to be filed with the designated authority in January each year.<sup>68</sup>

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<sup>65</sup> Societies Registration Act, 1860, section 1 <http://www.helplinelaw.com> (Last accessed on 11-08-2009)

<sup>66</sup> Societies Registration Act, 1860, section 6 <http://www.helplinelaw.com> (Last accessed on 11-08-2009)

<sup>67</sup> The Sakharkheda Education Society v. State of Maharashtra, AIR 1968 Bom 91

<sup>68</sup> Societies Registration Act, 1860, section 4 <http://www.helplinelaw.com> (Last accessed on 11-08-2009)

The object for which a society is formed may be altered, extended or abridged<sup>69</sup> or the society may wholly or partially amalgamate with another society as the governing body so considers advisable. If so, the governing body is required to submit a proposal to the members in form of a written report and may call a meeting for this purpose. In order for the members to act upon this proposition, three conditions have to be met:

The regime for the dissolution requires that members not less than three-fifths may determine dissolution forthwith, or at such time and in such manner as may be resolved, at a general meeting convened for this purpose. The societies where the government is a member or a contributor or otherwise interested such societies cannot be dissolved without the consent of the government.<sup>70</sup>

### **2.3.1.2 The Indian Trusts Act, 1882**

Trusts in the strict sense in which that term is used by English lawyers, that is to say, confidence to the existence of which a "legal" and an "equitable" estate are necessary, are unknown to Hindu and Mohammedan Law. But trusts in the wider

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<sup>69</sup> Societies Registration Act, 1860, section 12 <http://www.helplinelaw.com> (Last accessed on 11-08-2009)

<sup>70</sup> section 13

sense of the word, that to say, obligations annexed to the ownership of property which arise out of a confidence reposed in, and accepted by the owner for the benefit of another, are constantly created by the natives of Pakistan, and are frequently enforced by the Pakistani Courts.

Trust is an arrangement<sup>71</sup> whereby an owner of the property settles in writing such property either to him alone or with other persons for benefit of another. It may private or public, where beneficiaries are not private parties but the public at large, it is a public trust. Consequently, most CSOs claiming status of a trust are public trusts. Contrary to common perception, the Trusts Act, 1882 only deals with private trusts such as Muslim waqfs, undivided family relations under customary or personal law<sup>72</sup>, and public, private religious and charitable endowments.

Whether a trust is required to be in writing, and registered, depends upon its nature. Trusts settling immovable property only require mandatory registration<sup>73</sup>, and must, therefore, be in writing. An instrument of trust is registered with the Registrar of Assurances within whose jurisdiction the trust property is situated or the settler resides. No corporate legal personality is conveyed to a trust upon creation or registration. It may not therefore act, sue or be sued in its own name and instead must act through its designated trustees.

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<sup>71</sup> The Indian Trusts Act, 1882 section 1 [http://www.ngosinfo.gov.pk/user/the\\_Trust\\_Act\\_1882.doc](http://www.ngosinfo.gov.pk/user/the_Trust_Act_1882.doc) (Last accessed on 11-08-2009)

<sup>72</sup> Generally, Hindu undivided family structures

<sup>73</sup> section 5

A trust may be created for any lawful object or such objects that are not forbidden by law or would defeat any law, or is fraudulent or injures a person or property or, is not immoral or opposed to public policy.<sup>74</sup> A trust property cannot be used for any other purpose except that for which it is settled. Treatment of the proceeds of a trust is also so regulated; however, the author may allocate a portion for administrative affairs.

The instrument of trust would govern the extent to which the deed of trust may be altered or if there may be an amalgamation. In the absence, the trustee may seek these options through court under the provisions of the controlling legislation.

Trusts are dissolved,<sup>75</sup> when it fulfils the purpose, or the purpose becomes unlawful, or its fulfilment becomes impossible, or where revocable, is expressly revoked in the manner prescribed or through court or by permission of the beneficiary.

The general principles of trust law do not impose any duties or powers on the government. However, several controlling legislation vest in the government to take action in public interest, including taking over the management and assets of the trust.

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<sup>74</sup> section 4

<sup>75</sup> section 77

### **2.3.1.3 The Companies Ordinance, 1984**

The companies' ordinance is one of the principal legislations governing the conduct of companies formed for commercial purposes. It also facilitates registration of associations of persons, existing or to be set up in future, as limited liability companies under section 42 that apply or intend to apply their profits, if any or income for the promotion of their objects and prohibit dividends to members. CSOs are called "non-profit companies" or "section 42 companies".

Any five or more persons intending to form an association or an existing association, may upon payment of prescribed fee, by subscribing to a memorandum of association and the articles of association, by submitting prescribed documents to the company registration office having jurisdiction, having the prior approval of the Securities and Exchange Commission of Pakistan (SECP) register as section 42 company.<sup>76</sup>

The memorandum describes disclosures such as the name, address, objects, liability and restriction on dividends to members and particulars of the board of directors and other conditions, if any, set out by the SECP. The articles elaborate the manner in which the administration and day to day management

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<sup>76</sup> the companies ordinance,1984

shall be conducted, including provisions as to members, meetings, voting, quorum and the like.<sup>77</sup>

The registration of section 42 companies entails a two-fold process; one is, procuring a license from the SECP, and the other is subsequent registration with the relevant CRO. The procurement of the license requires a written application accompanied by particulars of the promoters with list of common directorships or governorships in other associations; a declaration that the documents are in conformity with the companies ordinance, audited accounts and annual report, an estimate of future annual income and expenditure, including source of income and expenditure, including source of income and head of expenditure, a brief statement of work done or to be done. The SECP may in public interest grant the license, and also prescribe additional conditions such as, that the association fulfil the requirements for incorporation for public companies, prohibition on payment of remuneration to members for service rendered, prior approval of SECP to change the charter documents, limits of liability, and consent of relevant government agency if any patronage is claimed. All associations registered under the Ordinance are bodies corporate, having the ability to sue and be sued

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<sup>77</sup> Syed Ahmad Hassan Shah, "Regulation of Civil Society Organizations: A Pakistan Case Study", *Islamabad Law Review*, Vol. 1, Nos. 3 & 4, (Autumn & Winter 2003) 341

in their name with their corporate identifiers, such as “Limited” or “Guarantee Limited” in its name.<sup>78</sup>

The charter of the association cannot be amended except with the permission of the SECP. There is no provision for the amalgamation and dissolution of non-profit companies under the Ordinance, and this would be as per the general laws, which may entail recourse to the High Court.<sup>79</sup>

All documents and reporting requirements are public documents, and available with the CRO with whom a section 42 company is registered. The SEC/CRO maintains a systematized record of these documents and any person may inspect or receive certified copies upon payment of prescribed fee.

Section 42 companies are incorporated as companies not having a share capital; therefore, the question of member claiming proprietary rights in the company property on such basis does not arise.

### **2.3.2 Controlling Legislation**

#### **2.3.2.1 The Religious Societies Act, 1880**

The application of this Act does not only apply to societies registered under the Act of 1860, but also extends to other “bodies of persons” associate for purposes

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<sup>78</sup> ibid

<sup>79</sup> see supra note at p. 343

of maintaining properties for religious worship as well. This law appears to be an effort toward the documentation of unregistered associations or trusts of public nature.

The Act requires, that associations of persons must be recorded in writing by a memorandum with all particulars of all its previous, continuing and incoming trustees, must be executed by the Chairman of such association and also be duly witnessed by at least two credible witness in a meeting to be held for such purpose, and must be registered under the Registration Act, 1908. The Act lays down the criteria for the appointment of trustees, by a majority vote of not less than two thirds of the members actually present at a meeting for this purpose. Three-fifth majority of members are required for the dissolution of association, in such a manner as may be resolved, including disposal and settlement of property, claims and liabilities. The Civil Courts have power to adjudicate their disputes. However, this law makes provision for an opinion from High Court on matters covered by it on petition by an interested person, and accords such opinion the force of a declaratory decree.

### **2.3.2.2 The Charitable Endowments Act, 1890.**

This is the only sector specific legislation that defines the term charitable purpose as including relief of poor, education, medical; relief and the advancement of any

other object of general public utility, but specifically excludes a purpose which relates exclusively to religious teaching or worship.

This Act empowers the Federal Government and each of the provincial governments to designate one of their officers as the "Treasurer of Charitable Endowments" for Pakistan in case of the Federal government or by the name of the provinces, in case of the provincial governments, and declares that the Treasurer shall be, for the purposes of taking, holding and transferring movable property under this Act a corporate sole. Under this law, existing as well as proposed trusts for charitable purposes may be vested in the Treasurer on application made by interested persons. The Treasurer appoints a committee of administration, and notifies the same in the official Gazette by way of a scheme of administration that provides for scope, powers, functions and responsibilities of the committee and all matters pertaining to its administration.

### **2.3.2.3 The Charitable and Religious Trusts Act, 1920**

It vests in every person "having an interest" the right to move the appropriate court where "substantial" part of the subject matter of a charitable or religious trust is situated to obtain an order directing trustees to furnish particulars as to; the nature and objects of the trust, the value, condition, management and application of the subject matter of the trust, and Income belonging thereto, and that the account of the trust be audited. it provides a three-month grace period for

people to deny the existence of a trust by initiating a suit for declaration to this effect, failing which; the court is to decide the case on merits.<sup>80</sup>

#### **2.3.2.4 The Charitable Funds Act, 1953**

This Act embodies a scheme of regulation, administration and accounting of collection of funds. It defines two very important terms, "collection" and "charitable funds". The former means and includes an appeal for, receipt, collection or an attempt to collect, directly, any donation in cash or kind from the public or individuals for a charitable fund, while the latter, means "any" fund consisting of donation given by way of charity for the benefit of any institution, association, society, or undertaking having the sole or principal object of establishing or maintaining or benefiting of a mosque, dargah, orphanage, widow's home, educational institution and the like, or the relief of the poor, sick or distressed or any other educational, religious, benevolent or philanthropic purpose.

#### **2.3.2.5 The voluntarily social welfare Agencies Ordinance 1961**

The Ordinance defines agency as a voluntary social welfare agency, which is defined as any organization, association or undertaking established by persons

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<sup>80</sup> Syed Ahmad Hassan Shah, "Regulation of Civil Society Organizations: A Pakistan Case Study", at p.346 *Islamabad Law Review*, Vol. 1, Nos. 3 & 4, Autumn & Winter 2003

of their own free will for the purpose of rendering welfare services in one or more fields mentioned in the schedule and depending for its resources on public subscription, donations or government aid. The schedule specifies welfare of children, youth, women, the physically and mentally handicapped, juvenile delinquents, socially handicapped, beggars and destitute, and the aged and the infirm, family planning, recreational programs intended to keep people away from anti-social activities, social education, welfare and rehabilitation of released prisoners and patients, training in social work and the coordination of social welfare agencies.

## 2.4 The Constitutional Framework

The constitution of Islamic Republic of Pakistan, 1973, acknowledges fundamental rights of its citizens ranging from the security of the individual to the right to free speech and expression, from freedom to associate to the right to be treated equally before, and the entitlement to equal protection of the law.<sup>81</sup> Every citizen has the right to form associations or unions, subject to any law in the interest of sovereignty or integrity of Pakistan, public order or morality.<sup>82</sup>

The constitution demarcates exercise of legislative authority between the Federal Government and each of the four provincial governments by providing a

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<sup>81</sup> see supra note at p.327

<sup>82</sup> Justice Ehsan-ul-haq chaudhory, *The Constitution of the Islamic Republic of Pakistan, 1973*: (Punjab law book house, Lahore)Art#17,9

subject-wise Legislative Lists. The federal government has exclusive power to legislate with respect to matters enumerated in the Federal Legislative List, while it has concurrent power with each of the provinces to legislate upon matters enumerated in the Concurrent Legislative List. All residuary legislative power vests in provincial governments.<sup>83</sup> Regarding concurrent powers of legislation, Art # 143 provides that in the event of an inconsistency between a federal and a provincial law, the provincial law shall be void to the extent of the repugnancy, regardless of the time of passing of the federal law, that is, before or after the promulgation or enactment of provincial law in conflict<sup>84</sup>. A perusal of the two lists reveals the following;

- (1) Legislation regarding incorporation, regulation and winding up of non-trading corporations and cooperative societies having objects not confined to a province, falling within the exclusive legislative domain of the federal government, and accordingly, the federal government has the exclusive power to legislate in matters of taxation, offences relating thereto, enquiries and statistics and all matters incidental or ancillary to the foregoing.<sup>85</sup>
- (2) Regarding legislation on trusts and trustees, mentally ill and retarded, environment, population and social welfare, trade, unions, labour employment information bureaus and training establishments, ancient and

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<sup>83</sup>distribution of legislative powers: see *supra* note at p.73, Art# 141,142

<sup>84</sup> *ibid*

<sup>85</sup> Pakistan constitution, 1973; fourth schedule, Fed, Legislative list, pt. item 31,48,56,57, and 59

historical monuments, archaeological sites and remains, education, and auqaf, and in matters of offences, enquiries and statistics relating thereto along with all matters incidental or ancillary to the foregoing, both the federal government and the provincial governments have concurrent jurisdiction.<sup>86</sup>

(3) The federal government cannot legislate upon activities of CSOs if it can be shown that a particular area of activity is not contemplated within the subjects enumerated in either of the legislative lists, these being residuary matters, fall within the exclusive scope of the provincial governments.<sup>87</sup>

### 3.5 Taxation

The principle regulatory body for tax matters is the Federal Board of Revenue (FBR), which through its designated officers regulates the regime for tax exemptions. The governing legislation is the Income Tax Ordinance, 2001(ITO) and the rules framed there under, Income Tax Rules, 2002. importantly, the sought after tax-exempt status is not granted on ipso facto upon registration as a non-profit organization, and neither, when granted upon application in prescribed from, is it on a perpetual basis; it is liable to scrutiny and renewal annually, in some cases where good ratings are confirmed up to three years.

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<sup>86</sup> Pakistan constitution,1973, fourth schedule, Fed, legislative list, pt. item 10, 24, 25, 28, 38, 39, 43, 45, 46, and 48.

<sup>87</sup> Syed Ahmad Hassan Shah, "Regulation of Civil Society Organizations: A Pakistan Case Study", *Islamabad Law Review*, Vol. 1, Nos. 3 & 4, (Autumn & Winter 2003) 329.

Section 61 of the ITO and Rules 211 through 220 of the 2002 Rules are particularly pertinent for exemption for civil society organizations.<sup>88</sup>

The ITO entitles every person to a tax credit in a financial year in respect of amounts paid or property given as donation to a non-profit organization. The formula assumes 15% of taxable income in case of companies and 30% in case of individuals or association of persons.<sup>89</sup>

A non-profit organization is defined as any person, other than an individual, which is

- (a) Established for religious, educational, charitable, welfare or development purposes, or for the promotion of any amateur spot;
- (b) Formed and registered under any law as a non-profit organization;
- (c) approved by the Commissioner for specified period, on an application made by such person in the prescribed documents and, on requisition, such other documents as may be required by the Commissioner;

and none of the assets of such person confers, or may confer, a private benefit to any other person.<sup>90</sup>

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<sup>88</sup> see supra note at p. 354

<sup>89</sup> ibid

<sup>90</sup> Syed Ashar Ali Shah bukhari: *Income Tax Ordinance, 2001*, sec # 2(36), Mansoor book house, katchery road Lahore, 26

The term “person” as used in the ITO includes; an individual; a company or association of persons incorporated, formed, organized or established in Pakistan or elsewhere; the Federal Government, a foreign government, a political subdivision of a foreign government, or public international organization.<sup>91</sup>

A “company” for the purposes of the ITO includes companies incorporated under the Companies Ordinance, a body corporate under any other law in Pakistan, and a trust. Importantly, “association of persons” includes a firm and any artificial juridical person.<sup>92</sup>

As indicated earlier, the definitions of the ITO are for the purposes of the ITO only. If the ITO, for instance, classifies a “trust” within the meaning and scope of a “company”, the former does not in terms of general law become a corporation sole like the company. Likewise, an association of persons treated as a distinct entity for the purposes of tax, does not imply that it is a corporation sole having legal personality.

“Income” of non-profit organizations forms donations, voluntary contributions, subscriptions, house property, investments in securities of the federal government and all income charge under the head “income from business” under the ITO expended in Pakistan is also exempt to the extent it is actually spent on

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<sup>91</sup> see *supra* note at p. 85, sec # 80

<sup>92</sup> *ibid*

non-commercial purposes. Income from business is exempt pro rata to the aggregate income.<sup>93</sup>

An application for the tax exempt status to the FBR must be on the prescribed form,<sup>94</sup> which requires detailed information as to the objects, membership and financial matters, and is also required to be accompanied by certified copies of charter documents identifying the objects, the certificate of registration, and, audited balance sheet and revenue accounts audited by a chartered accountant, and also be accompanied by names of the promoters and office bearers, and a detailed report regarding the performance in pursuit of its objects.<sup>95</sup> Additionally, a non-governmental organization desirous of acquiring benefits under the ITO is required to include in its charter documents specific information such as; audit to be undertaken by a chartered accountant; minimum quorum requirements of one-third or one-fourth, depending upon the enabling legislation under which it is registered, and transfer of assets, in the event of dissolution, to be intimated to the commissioner concerned within three months of dissolution, utilization of monies, property or income shall be for the advancement of its objectives, distribution of dividends or property to members or their relatives is prohibited,

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<sup>93</sup> see *supra* note at p.213-214, cl.58, 2<sup>nd</sup> Schedule- exemptions and tax concessions pt-I, exemption from total income

<sup>94</sup> Huzaima Bukhari & Dr. Ikramul Haq, *Tax Laws of Pakistan: Income Tax Rules, 2002*, Rule # 211c & 213, 2<sup>nd</sup> ed (Lahore law publications Lahore) 384, 388

<sup>95</sup> *ibid*

and not more than 25%<sup>96</sup> of total income including donations shall be set apart or remain unutilized;

(a) bank accounts shall only be maintained with scheduled bank, that is banks approved by the State bank of Pakistan, and

(b) Charter documents shall not be altered except with the prior approval of the FBR.<sup>97</sup>

Specific rights to refuse tax-exempt status have also been provided and these include using the organization for,<sup>98</sup> Personal gain or that particular of a group, Propagation of political views, Personal benefit to their families, and has not met its objectives as certified by an independent rating agency on the basis of defined criteria including, meeting legal prerequisites, and standards of internal governance financial management and program effectiveness.<sup>99</sup>

Renewal is granted to organizations that continue their work and can prove so to the satisfaction of the commissioner concerned. A period of two months is prescribed for the commissioner to grant this renewal. With respect to filings, in addition to the one tome filings mentioned above, an organization enjoying the tax-exempt status or wishing to continue with it, must make annual filings to the

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<sup>96</sup> This can be enhanced up to 50% provided certain prescribed conditions are met.

<sup>97</sup> Syed Ahmad Hassan Shah, "Regulation of Civil Society Organizations: A Pakistan Case Study", *Islamabad Law Review*, Vol. 1, Nos. 3 & 4, (Autumn & Winter 2003) 355

<sup>98</sup> Huzaima Bukhari & Dr. Ikramul Haq, *Tax Laws of Pakistan: Income Tax Rules, 2002*, Rule # 213(2), 2<sup>nd</sup> ed (Lahore law publications Lahore) 387-388

<sup>99</sup> *ibid*

commissioner concerned of, statement of audited accounts, statement of income donations received and moneys paid, list of donees and beneficiaries, and Statement showing money kept aside or unutilized with reasons for doing so.<sup>100</sup>

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<sup>100</sup> <http://www.fbr.com.pk> (Last accessed on 12-8-2010)

## CHAPTER # 3

### BENEFITS OF INCORPORATION FOR NGOS

NGOs promote pluralism, diversity, and tolerance in society, while protecting and strengthens cultural, ethic, religious, linguistic and other identities. The most important function of NGOs is a facilitator of citizen's participation in their societies.<sup>101</sup> NGOs enable all voices to be heard, when individual from a group with others, who have similar values and interests. NGOs often aim to promote understanding between citizens and the state. NGOs contribute to civil society by providing a means for expressing and actively addressing the varied and complex needs of society. They are seen as serving several essential functions. NGOs advance science and thought, develop culture and art, protect the environment and support all activities and concerns that make a vibrant civil society.<sup>102</sup> NGOs motivate citizens in all aspects of society to act, rather than depend on state power and benefit. It creates an alternative to centralized state agencies and provides services with greater independence and flexibility. The NGOs may not therefore act, sue or be sued in its own name and instead must act though its designated trustees. The general principal for non-profit organizations that they are not required showing any periodic reports to the

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<sup>101</sup> <http://www.non-profitexpert.com> (Last accessed on 8-10-2010)

<sup>102</sup> <http://www.Britannica.com> (Last accessed on 10-10-2010)

general public. Government has no power to check and inspect the work of NGOs. The property cannot be used for any other purpose except that for which it is related. NGOs need a helping hand to fulfil people's requirements. They can perform their functions in a better way if they incorporate and form a private company limited by guarantee under the companies' ordinance, 1984. This will give them manifold benefits of incorporation, these are following:

### **3.1 Legal Status at the Official Level and among Donors**

If NGOs are incorporate in the form of private company limited by guarantee under the Companies Ordinance, 1984, it will get legal status or a separate legal entity at the official level and among donors. The registration under the Ordinance gives it the status of artificial juridical person. It can be owned and transfer properties, employ people, make loans, and can sue and be sued in the name of a company. A company incorporated under the companies Act is a legal entity distinct from the members who own shares in that company. Therefore the member of the company who are running it cannot be made personally liable for the debt of the company, and a compromise signed by a majority of shareholders of the company does not bind the company.<sup>103</sup> A company registered under the companies Act is a legal person, separate and distinct from its individual members. Property of the company is not the property of the shareholders. A

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<sup>103</sup> PLD 1971, Karachi

shareholder has merely an interest in the company arising under its Articles of association measured by a sum of money for the purpose of liability, and by a share in the profit. Again a director of a company is merely its agent for the purpose of management. The holder of a deposit account in a company is its creditor; he is not the owner of any specific fund lying with the company.

### **3.2 Continued Existence**

The incorporation in the form of private limited company will grant a perpetual succession to NGOs, and will not be effected by the death, and bankruptcy of the members. A guarantee company provides legal identity. This provides the ability for the company to own property in its own name, and a democratic structure where its participants are required to adhere to the strict laws and regulations governing limited companies generally. They will also get the ability to enforce bye-laws.<sup>104</sup>

### **3.3 Limited Liability by Guarantee**

Guarantee companies are useful for non-governmental organization that requires corporate status. This means that its profits are not distributed to its members, but are retained to be used for the purposes of the guarantee company. Of

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<sup>104</sup> <http://www.SFSgo.com> (Last accessed on 10-10-2010)

course this does not mean that the guarantee company cannot make a profit as indeed it is almost paramount that it can and does so. Where an organization is likely to enter into contracts, it may need the benefit of limited liability to protect its board of trustees, and its members, who may be involved in a voluntary basis, such as employment contracts, purchasing land, buildings or property, contracting with services or fund raises. Being a limited company the liability of the members of these NGOs will be limited to the amount guaranteed by members.<sup>105</sup> This amount is called the amount of guarantee. A limited liability company offers protection or personal assets from business risks and liabilities and is a separate legal entity.

### **3.4 Public Invitation in Respect of Shares and Debenture**

#### **Issues**

Such a company will be prohibited from making any invitation to public to subscribe for its shares and debentures. For the purpose of the statutory prohibition the public includes any section of the public, in the same way as in the definition of a prospectus, and an allotment or agreement to allot shares or debentures, with a view to them being offered for sale to the public is deemed to be made in the same circumstances as in connection with the definition of a

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<sup>105</sup> <http://www.SFSgo.com/gurantee company.asp> (Last accessed on 10-10-2010)

prospectus.<sup>106</sup> consequently, such a company will not be bound to issue a prospectus, or to have its shares or debentures offered for sale or placed on a stock exchange by an issuing house or sponsoring brokers, or offer its shares or debentures placed on the “over the counter” market by arrangement with dealers.

### **3.5 Operate as Joint Stock Company**

The registration of NGOs Under this ordinance allows an NGO to operate much like any other profit making company, except that it is limited by guarantee and not by share capital. Therefore, any profits made by the NGO is solely utilised for the development and promotion of the NGOs objectives and could not be share by the members.<sup>107</sup> NGOs registered under this law are almost indistinguishable from commercial organizations. The corporate structure combines the professional setup of a commercial organization with the development objectives of the NGO and therefore, is able to operate more effectively and efficiently. Leading successful NGOs in Pakistan are registered under this law e.g. Islamic Relief, Pakistan.

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<sup>106</sup> Robert R Pennington LLD, Pennington's company Law, fifth ed, at 282(Butterworth & co publishers ltd, 1985)

<sup>107</sup> <http://www.yahoo.com> (Last accessed on 8-10-2010)

### **3.6 Book Keeping, Accounts and Audit**

Each law under which a charitable organisation can be established in Pakistan requires in some form or the other, that accounts be maintained. The form and manner is specified in all but the various statutes. Audit requirements are also stated. However, the stringency for both the maintenance of accounts and its subsequent audit differs in each case. However, the rigour is not stringent and thus only rudimentary accounting and auditing is required under the various trusts acts. It is only the Companies Ordinance that requires the accounts to be maintained using the International Accounting Standards which are used by the Chartered Accountants for auditing the books of accounts. Being a body corporate registered under the Companies Ordinance, NGOs registered under the Companies Ordinance are required to keep books of accounts with respect to, all sums of money received and disbursed by the Company; all assets and liabilities of the Company; and all other transactions.

Additionally, the Company is required to perform annual audit of its books of accounts. This requirement and the related exactitude with which it is imposed augment the transparency in the operations and lend credibility to the NGO's activities. Some International Donors require a thorough check and balance system to ensure the proper utilisation of funds, and this is often set as a precondition for continuity in monetary support. The audit of the affairs of the

NGO certainly enhances the Public image. Bookkeeping and audit standards are at an internationally comparable level.<sup>108</sup>

### **3.7 Good Corporate Governance**

Good corporate governance requires that organizations are transparent in their operations, are held accountable for their actions and are cost-effective in the services that they provide. The stakeholders obtain this trust through the existence, implementation of effective legislative framework. It also helps to ensure that minimum standards of corporate behaviour are observed. The NGOs are entitled to and responsible for the powers and responsibilities of the relevant statute under which it is registered. Those rules and regulations cover not only its internal governance but also vis a vis the registration authority.<sup>109</sup>

No corporate legal personality is conveyed to NGOs upon creation or registration. The companies' ordinance gives them the status of artificial juristic personality. Corporate governance, then, is essentially about the responsible leadership of institutions. This is leadership, that is transparent, answerable, and accountable towards the company's identified stakeholders. It aims at achieving a balance between economic, social, individual and collective goals. Seeking to

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<sup>108</sup> <http://www.yahoo.com> (8-10-2010)

<sup>109</sup> BMSF NGO institute, good governance, <http://www.securethefuture.com/ngo/governance1.p>  
(Last accessed on 6-8-2010)

align as closely as possible the interests of individuals, the institution and society as a whole.

### **3.8 Public Accountability and Transparency**

Accountability and transparency are important because they help to define a non-governmental organizations purpose, functions, and status, NGOs service providers, especially social services, and medical institutions, have been criticized for their lack of financial transparency, and unethical business conduct.<sup>110</sup>

Charitable companies under Section 42 of the Ordinance of 1984 exist in a regulatory framework that is primarily geared towards protection of the investment expectations of corporate stakeholders. This results in a degree of regulation and compliance with regulatory procedures. All documents filed with the Registrar of Joint Stock Companies are available for public scrutiny on payment of fees.

### **3.9 Common Seal**

If the NGO is registered under the Companies Ordinance, it can be used a common seal. The seal is of some legal significance because the affixing of the

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<sup>110</sup> <http://www.google.com> (Last accessed on 13-9-201

seal signifies that the document is the act and deed of the company, whereas when a document is merely signed by a director, then that is deemed to be an act carried out on behalf of the company.<sup>111</sup>

### **3.10 The Powers and Scope of Business**

If NGOs are registered under the companies Ordinance, 1984, as a private company limited by guarantee, it cannot exceed its powers and scope of business than given in its memorandum of association.<sup>112</sup> If the memorandum of the company empowered to carry on business in country and elsewhere as merchants, general merchants, agents and traders etc., to receive money on deposit at interest or otherwise and lend money to such persons with or without security and on such terms as may seem expedient and in particular to customers of the persons having dealing with the company and to give any guarantee or indemnity as may seem expedient to distribute amongst members of the company in specie any property of the company, but distributing amounting to a reduction of capital shall be made without the sanction, if any, for the time being required by law and to do all such other things as are incidental or conducive to the attainment of objects mentioned in the memorandum.

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<sup>111</sup> Robert R Pennington LLD, Pennington's company Law, fifth ed, at 282(Butterworth & co publishers ltd, 1985)

<sup>112</sup> S. Sharifuddin pirzada, Salman Aslam Butt, and Saeeda Siddiqui, *Company Law Digest* . 1947. 2005: *company, the companies Act, 1956, sec # 34, Pakistan, India and U.K*, vol 2, at 1043( Asia Law house Karachi)

### **3.11 Restriction on Transfer of Issues**

In terms of the very definition of a private company there must be restrictions of member's rights to transfer their shares. However, the shares are always transferable subject to the restriction. The provisions related to the transfer of shares are inserted in the Articles of Association, but it does not require any particular restrictions, and so the restrictions imposed can be as severe or trivial as the framers of the articles choose <sup>113</sup><sup>3</sup>. If the NGOs are incorporated under the companies' ordinance, 1984, they will be restricted to transfer their issues to the general public.

### **3.12 Exemptions and Privileges under the Companies Ordinance, 1984**

A guarantee Company in its pure form is always a private company; as it has no share capital, it cannot satisfy the requirements of a public limited company. <sup>14</sup> An independent NGOs as a private company limited by guarantee enjoys certain privileges and exemptions from compliance of a number of statutory

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<sup>113</sup><sup>3</sup>Robert R Pennington LLD, Pennington's company Law, fifth ed, at 818(Butterworth & co publishers ltd,1985)

14. Imran Ahsan Khan Nyazee, *Company Law (includes Companies Ordinance,1984)* at 45, Federal Law House, 2008, Islamabad

15 Chinmoy Chatterjee, *Guide to Private Companies Practice Precedents* (Bombay: N. M. Tripathi Private limited, 1989),4

requirements, which are denied to public companies. These privileges and exemptions are as following;

1. They will not be required to deliver a statement in lieu of prospectus to the Registrar of companies before allotment of shares.
2. The restrictions on providing financial assistance to a party for purchasing the shares in a company will not be applied on these NGOs.
3. The provisions relating to further issue of shares to the existing shareholders are not applicable.<sup>15</sup>
4. An aggrieved person cannot be except under certain circumstances appeal to the Central Government against refusal by the Company to register a transfer or transmission of shares.
5. Such a company is not required to hold a statutory meeting and to forward a statutory report to its members or deliver a copy to the Registrar.
6. Ceiling on overall managerial remuneration will not be applied on these NGOs.
7. These NGOs can be able to appoint any firm or body corporate an office or place of profit for any duration of time, if necessary.
8. Copies of balance sheet and profit and loss account are filed with the Registrar separately and the copies of profit and loss account are not

open for inspection at the Registrar's office by a person other than a member of the company.<sup>114</sup>

9. There are no restrictions on loan to a director of NGOs as a private company limited by guarantee.

### **3.13 Tax Exemption**

The income tax obligations of NGOs are governed by the Income Tax Ordinance 2001 and the Income Tax Rules 2002. There are also additional provincial tax laws that apply to NGOs. Tax benefits depend on the type of NGO and the type of income. NGOs may be eligible for income tax exemption under the Income Tax Ordinance. Only registered NGOs may apply for an income tax exemption to the Federal Board of Revenue (FBR) the federal tax authority in Pakistan.<sup>115</sup> The FBR recognizes three categories of charity: informal, trusts and other legal obligations, which include waqfs, societies, agencies and non-profit companies, and organizations approved by the Commissioner of Income Tax or the FBR. Exempt Income. Tax exemptions for NGOs apply to certain types of income and only the amount of income spent in Pakistan will be exempt. Any income of a trust, welfare institute, or non-profit organization from donations, contributions, subscriptions, property, investments in securities, and "income from business" is

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<sup>114</sup> <http://www.ngoinfo.gov.com> (Last accessed on 14-9-2010)

<sup>115</sup> <http://www.fbr.com.pk> (Last accessed on 12-9-2010)

exempt from tax if the income was spent towards the objectives of the organization. In addition, income from investments, grants received from the federal or provincial government or property held under trust or other legal obligations for religious or charitable purposes is exempt. Further, income received by a religious or charitable institution from voluntary contributions which apply solely to the religious or charitable purposes of the organization is exempt. Moreover, the income of non-profit educational institutes established solely for educational purposes is also exempt if the income is applied to its educational purposes and not given to any of its members.<sup>18</sup> NGOs may apply for tax-exempt status to the Commissioner of Income Tax of the province or jurisdiction in which the NGO resides if it has been operating in Pakistan for three years. Under the Ordinance, the Commissioner first recognizes the organization as a non-profit organization and then the exemption accrues automatically. Recognition not only exempts the income of the organizations, but also the donation given to such organizations.<sup>19</sup> The application for registration provides; the name of the NG, the address of the NGO, its aims and objects, the law under which the NGO was registered, its registration number, the date of registration, details of the intended beneficiaries, the number of members, the start and end date of the NGO's fiscal year; and that books of accounts are regularly maintained. Upon receipt of the application the Commissioner may make such

inquiries as necessary. If the Commissioner grants approval, the approval will be published in the official gazette.<sup>116</sup>

Private companies limited by guarantee are normally registered for non-profit making functions. The company has no share capital. A company limited by guarantee has members, rather than shareholders, the members of the company undertake to contribute a predetermined sum to the liabilities of the company which becomes due in the event of the company being wound up. It cannot distribute its profits to its members, and is therefore eligible to apply for charitable status if necessary. Guarantee companies are useful for non-profit organisations that require corporate status.<sup>117</sup> This means that its profits are not distributed to its members but are retained to be used for the purposes of the guarantee company.<sup>118</sup> So, being a private company limited by guarantee, NGOs will be enjoying a corporate status, and as a charitable organization they will be able to get tax exemption.<sup>119</sup>

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<sup>116</sup> Syed Ashar Ali Shah bukhari: *Income Tax Ordinance, 2001*, cl.58, 2<sup>nd</sup> Schedule- exemptions and tax concessions pt-1, exemption from total income, Mansoor book hose, katchery road Lahore, 213-214

<sup>117</sup> <http://www.fbr.com.pk> (Last accessed on 12-9-2010)

<sup>118</sup> Huzaima Bukhari & Dr. Ikramul Haq, *Tax Laws of Pakistan: Income Tax Rules, 2002*, Rule # 211 & 213, 2<sup>nd</sup> ed (Lahore law publications Lahore) 384,388

<sup>119</sup> <http://www.ngoinfo.gov.com> (Last accessed on 14-9-2010)

## CONCLUSIONS

"NGOs are defined by the World Bank as private organizations that pursue activities to relieve Suffering, promote the interests of the poor, protect the environment, provide basic social services, or undertake community development. The most common name used internationally for an organization formed only to help others. NGOs are not governmental organizations or for profit businesses. NGOs are recognized as important players in the formulation, design, and application of development strategies".

"NGOs establish the mechanisms by which governments and the market can be held accountable by the public. They usually belong to one of three sectors of society, the government sector, for private business sector, and NGO third sector. For a society to achieve its full potential and for citizens to fulfill their goals, all three sectors must cooperate with one another. Each sector has strengths and weakness in providing, what citizens need and want. The business sector most effectively delivers goods. The government sector drafts and enforces laws, and defends the country's borders. The third sector, which consists of NGOs, provides services that the business and government sectors are unwilling or unable to provide, and they provide a venue for citizens to come together and be heard on issues that they feel are important. NGOs are strengthening the fabric of civil societies in still fragile, emerging democracies. They are essential partners for Government, the private sector, and development organizations in meeting

people's needs."

Pakistani NGOs are very vibrant to watch the progress of overall development and played very important role to the restoration of democracy, and reinstating of the judiciary. They provide a unique platform to work collectively for helping poor people to upgrade of living, health, and educational standers, and to cope up with the Natural Disasters. .

The NGOs sector emerged as an important player on the development of Pakistan. Welfare Ordinated NGOs are primarily philanthropic institutions working with vulnerable groups, such as Edhi welfare Trust, and AnsarBarni welfare trusts. Most NGOs are engaged in direct services as was facilitating services delivery through linkages with government line agencies. A number of NGOs are implementing integral rural and urban development programs indifferent parts of the country and provide a participatory approach and work closely with local communities. The most prominent development NGOs are the RSPs, Sungi development Foundation, the Orangi pilot project, the RSPs includes the AKRSP, NRSP, PRSP, Sarhad Rural Support Program, and the Baluchistan Rural Support Program. A number of advocacy groups became active in Pakistan; they broadly deal with human rights, women's and child rights, and environmental issues. Many NGOs mobilize communities in order to channel their interventions through a participatory method. Several leading international NGOs have operations in Pakistan, of which some focus more on direct implementation, other in capacity

building of local institutions, while some attain to balance the two approaches. Key International NGOs active in Pakistan, include the two major environment and conservation NGOs, world conservation unit and world wide Fund for Natural development NGOs, such as Action Aid, and Save the Children Foundation.

The constitution of Islamic Republic of Pakistan, 1973, under article # 17, recognized the fundamental rights of citizens ranging from the security of the individual the right of free speech and expression, freedom of association, and equality before law. The legal frame work for setting up, organizing, and managing NGOs in Pakistan, it is proposed to first, states the governing legislation dealing with it. There are two broad kinds, one is "enabling legislation" and the other is "controlling legislation". The law of Trust, The Societies Registration Act, 1860, and The Companies Ordinance, 1984, are enabling legislations, and The Religious Societies Act, 1880, The Charitable Endowment Act, 1890, The Charitable and Religious Trusts Act, 1920, The Charitable Funds Act, 1953, The Voluntary Social Welfare Agencies Ordinance, 1961, and the proposed Nonprofit Benefit Organization Act, 2003 are in the nature of controlling legislation. The enabling legislation facilitates formation of associations of person specified purposes and to provide a regime for their regulation such as internal management and accounting controls. The controlling legislation does not provide a means to form association, but they recognizing their assistance, seeks to regulate their conduct such as internal management and accounting controls.

A society registered under The Societies Registration Act, 1860, is not a legal person as it cannot sue and be sued in its own name. The Act gives provisions for suits by or against societies; however it does not make a society a legal person as required by law. The object for which societies are formed may be altered, extended, or abridged, or the society may wholly or partly amalgamate with another society as the governing body so considers advisable after fulfillment of conditions given under the Act, 1860. The Indian Trust Act, 1882, gives the arrangement whereby an owner of the property settles in writing such as property either himself or with other property. It may be private or public, where beneficiaries are not private parties, but the public at large, it is a public trust. It only deals with private trusts, musalmanwaqfs, and undivided family relations under customary or personal law, and public, private, religious, and charitable endowments. It may be created for any lawful object, or such objects that are not forbidden by law or would defeat any laws, or fraudulent or injures a person or property or immoral or opposed to public policy. No corporate legal personality is conveyed to a trust upon creation or registration. It may not therefore act, sue or be sued in its own name, and instead must act through its designated trustees. The Companies Ordinance, 1984, is one of the principal legislation governing the conduct of CSOs formed for commercial purposes. It also facilitates registration of association of persons, existing or to be set up in future, as limited liability Company under section # 42, that apply or intended to apply their profits, if any or income for the promotion of their objects, and prohibit dividends to members.

CSOs are called non-profit companies or section # 42 companies. Section # 42 companies are incorporated as companies not having a share capital. All associations registered under The Companies Ordinance, 1984, are bodies corporate, having the liability to sue, and be sued as limited, or guarantee limited, or private limited in its name.

The Religious Societies Act, 1860, does not only apply to societies registered under the Act of 1860, but also extend to other bodies of persons associated for purposes of maintaining properties for religious worship as well. This law appears to be an effort towards the documentation of unregistered associations of trust of public nature. The Charitable Endowment Act, 1890, is the only sector specifies legislation that defines the term charitable purposes as including relief of proof, education, medical relief, and the advancement of any other of general public utility, but specifically excludes a purpose which relates exclusively to religious teaching and worship. The Charitable and Religious Act, 1920, deals with associations having charitable and religious purposes. The Charitable Funds Act, 1953, embodies a scheme of regulation, administration, and accounting of collection funds. It defines two very important terms, collection and charitable funds. Collection includes an appeal for receipt, collection or ant attempt to collect any donation in cash or in kind from the public or individuals for charitable funds, while charitable includes any fund consisting of donation given by way of charity for the benefit of any institute, association, or society having the principal object of charitable purposes. The Ordinance, 1961, defines organizations, associations, or

under established by persons of their own free will for the purposes of charitable nature. No corporate legal status is alienated upon their creation or registration under these controlling statutes. It cannot sue or be sued in their own name.

NGOs are an expression of people's belief, that through their own initiative, they can better fulfill potential, and can perform their functions in a better way if they get incorporated a form of company under the Companies Ordinance, 1984. The private company is a company, which by its articles, restricts the right to transfer its shares, if any, limits the number of members to fifty not including persons, who are in the employment of the companies, and prohibits any invitation to the public to subscribe for the shares, or debentures of the company. It may be a company limited by shares, or a company limited by guarantee, or an unlimited company. The popular conception of a private company is of small concern with few shareholders, most of whom are actively engaged in managing the company's business, and who regard their shares not merely as an investment but as the source of their livelihood. Private companies are numerous than public one, but their share capital is little more than half of that of the public companies, but it does not mean that private limited companies have small share capital, and possess assets of any small value. There is no legal requirement, or legal limit on the amount of share capital, which a private company may issue. Some of them have a large share capital than many public companies. A company incorporated under the Ordinance, 1984, is a legal entity distinct from the members, who own shares in that company. Therefore, the member of the company, who are running

it, cannot be made personally liable for the debt of the company, and a compromise signed but the majority of shareholders of the company. The provisions regarding the number of members, and provisions related to the transfer of shares are contained in the Articles of Association. The number of the member is limited to fifty excluding the present and past employed members. A private company is prohibited from making any invitation to public to subscribe for its shares and debentures. A company may not issue a prospectus, nor may it have its shares or debentures offered for sale or places in a stock exchange by issuing house or sponsoring brokers, nor may it have its shares or debentures placed in over the counter market by arrangement with dealers. Being a limited company a liability of the members are limited to the amount guaranteed by members. This amount is called the amount of guarantee. All companies whether public or private have perpetual existence, and are not affected by the death and bankruptcy of its members.

Private companies are of three in kinds, a private company limited by shares, an unlimited company, and a private company limited by guarantee. A private company limited by shares in its articles restricts the right to transfer its shares, and with certain exceptions limit the number of members to fifty, prohibit it from invitation to the public to subscribe for its shares or debentures. An unlimited company, like a limited one, is a corporation, and is therefore subject to the same rules as to its capacity to enter into transactions and incur liabilities, but unlike a limited company, its members are liable to contribute the last penny of their

fortunes in order to satisfy its debts and liabilities when it's wound up. The company must have its own special article of association, which must state the amount of its share capital if it has one. The personal liability of members of an unlimited company to contribute toward payment of its debts is not an asset of the company, but, like the guarantee undertaken by members of a company limited by guarantee, is a contingent liability of the members which will become effective only when the company is wound up. A private company limited by guarantee is one whose memorandum of association contains an understanding by its member to contribute a specified amount toward the payment of its debts and the expenses of winding up. The rest of the company's memorandum is similar to that of a company limited by shares, and in particular it states that the liability of its members is limited. A company limited by guarantee must have its own special articles of association, and cannot dispense with them as a company limited by shares may do. A private company limited by guarantee has a common seal, which denotes the signature of the company. If a company limited by guarantee was registered with a share capital, its members are under the double liability of having to pay the issue price of their shares and to honour their guarantee in the event of the company being wound up. The amount of the guarantee cannot be mortgaged by the company, nor can it be increased or reduced by an alteration of the company's memorandum, or by agreement with the members, or by any process similar to an increase or reduction of share capital. A private company limited by guarantee is a type of incorporation used primarily for non-profit

organizations that requires corporate status. Such a company has no share capital, and the liability of the members is limited to the extent of their given guarantee, and it accrues in the event of its being wound up. Such companies are widely used for charitable purposes. The mode of formation of a private company limited by guarantee is similar to that of other companies. The memorandum and articles of association must be in the prescribed form. Guarantee companies are suited to associations for mutual insurance, association for trade protection, mutual information, pooling shares and debentures, and clubs. This form is also suited to associations intended to be supported by annual subscriptions and funds. The companies Act 1985(U.K),and the Companies Ordinance 1984(Pakistan), and the rules of company law generally apply to companies limited by guarantee and unlimited companies in the same way as they apply to private companies limited by shares with some statutory exceptions arising from their constitution. The principal difference between such companies is that companies limited by guarantee and unlimited companies need not have a share capital whereas private companies limited by shares obviously must.

The NGOs may not therefore act, sue or be sued in its own name and instead must act through its designated trustees. The general principal for non-profit organizations that they are not required showing any periodic reports to the general public. Government has no power to check and inspect the work of NGOs. The property cannot be used for any other purpose except that for which it is related. NGOs need a helping hand to fulfil people's requirements. Non-

governmental organizations can perform their function in a better way, if they get incorporated and form a company under the Companies Ordinance, 1984. As these organizations are supposed to be, and generally are non-governmental, the best tool for them is a private company limited by guarantee. This will give them manifold benefits of incorporation, such as the right to sue in the name of the company, the benefits of continued existence irrespective of the its members, it will get legal status or a separate legal entity. The registration under the Ordinance gives it the status of artificial juridical person. It can be owned and transfer properties, employ people, make loans, and can sue and be sued in the name of a company. The incorporation in the form of private limited company will grant a perpetual succession to NGOs, and will not be effected by the death, and bankruptcy of the members. Being a limited company the liability of the members will be limited to the amount guaranteed by members. Such a company will be prohibited from making any invitation to public to subscribe for its shares and debentures. Incorporated NGOs can be used a common seal. The seal is of some legal significance because the affixing of the seal signifies that the document is the act and deed of the company, whereas when a document is merely signed by a director, then that is deemed to be an act carried out on behalf of the company.

**Incorporation of NGOs** Under this ordinance give them the right to operate much like any other profit making company, except that it is limited by guarantee and not by share capital. Therefore, any profits made by the NGO is solely utilised for the development and promotion of the NGOs purposes and could not be utilised by

the members. NGOs registered under this law are almost indistinguishable from commercial organizations. The corporate structure combines the professional setup of a commercial organization with the development objectives of the NGO and therefore, is able to operate more effectively and efficiently. Being a body corporate under the Companies Ordinance, NGOs are required to keep books of accounts with respect to all sums of money received and disbursed by the Company, all assets and liabilities of the Company, and all other transactions. Additionally, the Company is required to perform annual audit of its books of accounts. Incorporation will help them in a regulatory framework that is primarily geared towards protection of the investment expectations of corporate stakeholders. This results in a degree of regulation and compliance with regulatory procedures. All documents filed with the Registrar of Joint Stock Companies are available for public scrutiny on payment of fees. Incorporation will also help the government to have a check on the functions of these organizations through the tools of corporate governance. It will thus insure the allegations levelled against some NGOs by different circles. The NGOs are mostly not registered, and have no legal entity. They have no right to take legal action as a legal personality, even government have no control on these organizations. It will also help the Government to have a check on the functioning of the non-profit organizations. The best tool for non-profit organizations is that of "private company limited by guarantee". Because such a company is a type of incorporation used primarily for non-profit organizations that require corporate status. A company limited by

guarantee enjoys certain privileges and exemptions from compliance of a number of statutory requirements, such as have no share capital; instead it has members who are guarantors instead of shareholders. The liability of its members may respectively undertake to contribute to the assets of the company in the event of its being wound up. Such companies are widely used for schools, professional and trade associations, clubs and charities. A private company limited by guarantee is not required to deliver a statement in lieu of prospectus to the Registrar of companies before allotment of shares. Such a company is not required to hold a statutory meeting and to forward a statutory report to its members or deliver a copy to the Registrar. Moreover, the liability of the members accrues in the event of winding up, and therefore, and only to the extent of their guarantee. NGOs are the expression of people's belief, that through their own initiative, they can better fulfil their potential, if they get incorporation as a private company limited by guarantee under the Companies Ordinance, 1984, and so doing reduce the opportunity gap, that exists between the advantaged and disadvantaged society. So, this is considered the best vehicle for NGOs throughout the world.

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