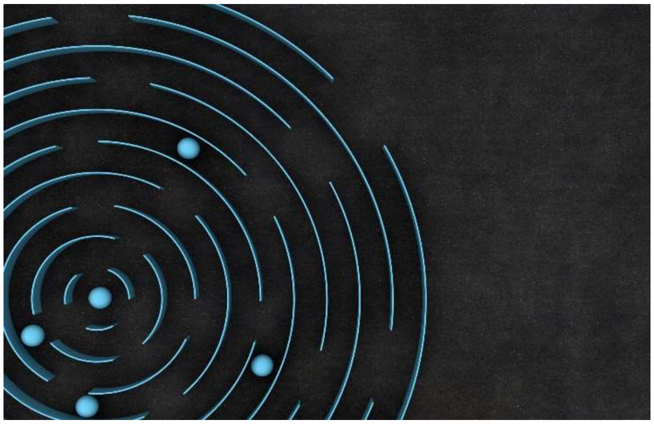
Business Structures you can choose for your Start-up



Want to kick start your venture but not able to decide which Business structure you should choose for your Start-up – Should it be a Sole proprietorship, Partnership, Limited Liability Partnership or a Private Limited Company ? Which one will best work for your business and which one is cheaper to start with and has few legal compliances, does it have limited/unlimited liability, the nature of risk associated with it, whether the same would be tax beneficial, will it will be easier to get funding for further growth of business and many more such issues need to be dealt with before you decide on any particular business structure.

Before dealing with these numerous concerns you need to know about some of the most preferred different forms of Business Structures (under Indian Laws) for commercial enterprises that you can choose for your business venture.

Sole Proprietor

This is the most simplest form of Business Structure where the entrepreneur wholly and solely carries on the business and is personally responsible for the same. This form of structure is apt for the small businesses and requires no formal entity registration except few registrations like tax registrations, shops & establishments, etc. and there is no minimum capital requirement and has very few legal compliances. The entrepreneur is solely and personally liable for his actions and decisions and the business does not have any separate legal existence. Professionals, consultants and individual service providers like CA, CS, CWAs, Advocates, Engineering Consultants normally opt for this form of enterprise. The entity is taxed at the same rate as an individual proprietor.

Partnership

When two or more person decide to conduct the business they can chose to get into Partnership. A formal agreement is entered into between the persons forming partnership and registration is not mandatory. Such partnership firm is not distinct from its partners. Property of the partnership firm is the property of the individuals constituting it. Partners are the agents of the firm and of other partners and are joint and severally liable for the acts of each other; being personally liable, the partner's liability is unlimited. Death/insolvency of partner normally dissolves the partnership firm unless otherwise agreed.

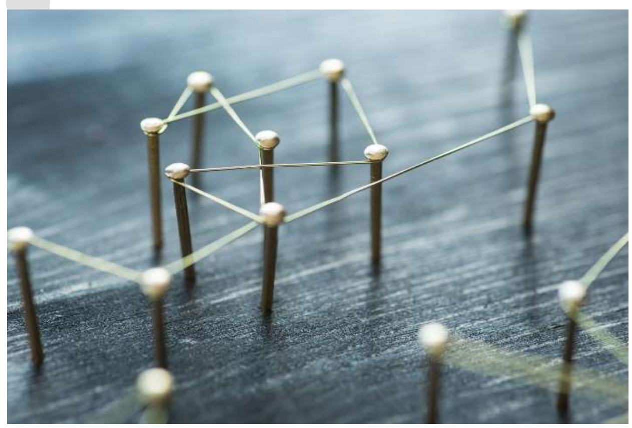
Limited Liability Partnership ("LLP")

As the name suggests, the liability of partners in this form of Partnership is limited to the extent of their agreed contribution in LLP. LLP is an entity separate from its Partners and has perpetual succession and is liable to the extent of its assets owned. Partners are the agents of the firm but not of the other partners and are not personally liable, directly or indirectly. Mutual written agreement governs the rights and liabilities of the Partners and LLP. LLP is to be mandatorily registered with Ministry of Corporate Affairs and some annual filings are mandatory. Audit is mandatory only if in any financial year, the turnover exceeds INR 40lakhs or contribution exceeds INR 25lakhs. It is considered as a cost effective method of doing business with very less legal compliances and limited liability as it is a hybrid form of partnership and company.

Private Limited Company

A Private Limited Company is an entity separate from its shareholders/members constituting it and has a perpetual succession and is capable of owning and holding property, incurring debts, borrowing moneys, employing people, can enter into contracts, sue or being sued in its own name. Shareholders are not liable for the acts of the Company and the liability of shareholders is limited to the extent of the shares they hold in the company. Shareholders are not the agents of the company and cannot bind the company with their acts. Shares are freely transferrable subject to few restrictions. Registration of company is mandatory and is regulated under company laws.

LLP vis a vis Company



There is no minimum capital contribution requirement and a minimum of 2 persons are required to form an LLP and a private limited company, however the basic difference between LLP and Company is of internal governance. The internal affairs of LLP are governed contractually by the agreement mutually entered into between the partners, and need to appoint directors or hold Board meetings while there is separation of ownership and management in the Company and is governed by the statute, MoA & AoA.

Company is required to appoint Directors and constitute the Board and is mandatorily required to hold Board meetings. Also the fact that LLP does not attract tax while distributing the profits among the partners whereas Companies have to pay dividend distribution tax while paying dividend to the shareholders, out of its profits (which stands abolished as per Union Budget 2020-21).

The creditworthiness of a Company when compared to LLP. Banks prefer to grant loans easily to a Company then to an LLP. Further, it is easier for the Company to raise funds as Venture Capitals and other investors prefer to fund the Company over an LLP. Venture Capitalist normally like to hold a stake in the equity of the Company against the investment that they bring in the Company, which is not possible in the LLP form of business.

Further it is easier for a startup company to attract and retain the talent even if it is not able to pay the salary as Company can issue employee stock options (ESOPs) thereby enabling it to compensate the employee without employee having the power to vote while in case of LLP the employee will have to be included in the partners agreement which will in turn give him the power to vote, which every LLP or for that matter every partner in LLP might not be comfortable with.

Every organization structure has its own pros and cons but before taking the crucial and long term decision one needs to dwell upon and consider the cost, legal implications, financial requirements, number of persons involved, audit requirements, tax benefits, industry requirements, alongwith the nature, scope and scale of business, that one would like to conduct and its future prospects. Though the law allows a person to change the organization structure at a later stage however it also needs to be considered that while you may have sought registrations, approvals and licenses for one form of organization structure, changing the business structure at later date in short term would again entail considerable costs and efforts for transferring and/or procuring new approvals, registrations, licenses for the new organization structure that you may choose to adopt.