

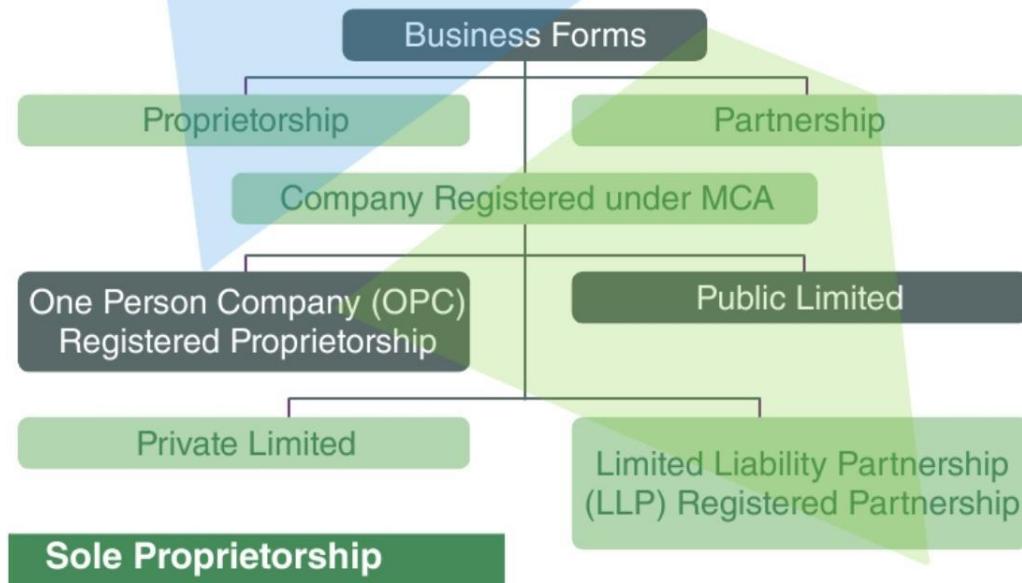
# business STRUCTURE

The entrepreneurial spark is something that hard to suppress. Some people know from an early age they were meant to own their own business while others find themselves starting a business later on in life due to life changes such as parenthood, retirement, losing a job, etc. There are also some who may be employed, but wonder whether the role of business owner/entrepreneur is right for them. **If you have a business idea and want to become an entrepreneur, there's nothing holding you back but yourself. Take the leap, and lead your business with vision and hard work.**

While starting out a business, it is extremely essential to choose a business structure/form that is suitable for you. There is no right or wrong here. What is important is 'you' and 'your' goals, both personal and business. Think of choosing a business form as choosing a vehicle. There are many variants available, but there is one that is best suited to your needs. This literature is aimed at educating you about the different kinds of business entities through which you can start your venture so you can make a well informed decision that will go a long way towards running your business successfully.

## Different types of business incorporations

Every business work under a form of entity which is recognised by law. It may be registered or unregistered depending on the kind of entity. The choice of entity has a huge impact on the running of your business, its control and management as well as its profitability.



The Sole Proprietorship is not a separate legal entity and doesn't require any registration. It simply refers to a person who owns a business as a sole owner. Since there is no distinction between the owner and the sole proprietorship, the owner is personally responsible for all the liabilities of the business and similarly all income from the business is added to the owner's personal tax return. Starting a business as a sole proprietor is relatively simple, and is subject to lesser regulations than other forms of business. Formation of a sole

proprietorship typically takes not more than a couple of days and with almost no costs. All one needs to do is:

- 1) decidethenameunderwhichthebusinesswilloperate,
- 2) have a rubber stamp in the name of the business,
- 3) openabankaccountinthenameofthebusiness

That's all and the sole proprietorship is ready to do business. A sole proprietorship does not need a separate PAN number as it is recognized with Proprietor's personal PAN number.

## Partnership

Partnership is a form of business where two or more individuals jointly own, operate and manage a business. Similar to a sole proprietorship, all the partners are equally and personally liable for the debts from the business. However, a partnership can hold assets independent of its partners. Partnerships are easy to form. There is no minimum capital requirement. Only minimum of two adult persons are required to incorporate a partnership. Partnership firm acts through its partners whose actions are binding on the firm and the other partners. Further, a partnership may or may not be registered.

Although many of the considerations of a sole proprietorship apply to a partnership as well, partnerships are subject to more regulations. A partnership and its operations are governed by The Partnership Act, 1932.

Partnership profits are calculated in a similar manner as for sole proprietorships. However, a separate tax return is required to be filed on behalf of the partnership independent of the personal tax returns of its partners. The partners are required to show the share of post tax profit of the partnership in their personal tax returns although the same is exempt in their hands. This way the profits of the partnership are only taxed once in the hands of the partnership.

It is a good practice for a partnership agreement to be in place from the beginning. The form and nature of such a document may vary greatly depending upon the nature of partnership itself. For example, the partnership deed for a professional partnership would be considerably different from the simple agreement set out for a husband and wife husband and wife partnership. Some important considerations while drafting a partnership deed are:

- 1) objectsofthepartnershipandbusinessactivity,
  - 2) profit sharing ratio,
  - 3) provisionfordrawingsandsalaries,
  - 4) procedures to be followed on retirement or death of a partner, etc.
- However, a partnership deed is not mandatory. Many family partnerships satisfactorily operate without any partnership deed. Although this is legal, it may not be not advisable.

It should be noted that the partners are jointly and severally liable for the debts of the firm. Thus, if one has bound the firm to some expense and is unable to pay, then partners may be required to honour such dues.

A useful application of a husband and wife partnership is with respect to sharing of profits. If a sole trader husband employs his wife, he may have to justify a deduction for her wages in his business accounts as being reasonable for the duties performed. However, in case of a partnership, it may be possible to divide the profits in an agreed profit sharing ratio, irrespective of the work contributed by the partners.

### **Company registered under Ministry of company affairs**

Company differs from a sole proprietorship and a partnership as a company is a body corporate and a separate legal entity distinct from its owners. Consequently, a company can hold assets in its own name and shall be liable for its own debts. The liability of the owners of the company is limited only to the extent of the unpaid share capital due from them. A company enjoys perpetual succession, which means that the life of the company is not dependent upon the life of its owners. A company may be limited by shares or by guarantee, although companies limited by shares are more common. A company is a highly regulated form of business entity, the affairs of which are governed by The Companies Act,2013.

There is a distinction between the ownership and management of a company. The persons who contribute towards the capital of the company are the owners of the company (also known as shareholders) while the directors of the company form the management of the company, responsible for the day to day management of the company. Thus, the ownership and management of a company may or may not lie with the same group of people. Directors are appointed and removed by the shareholders at their discretion. The directors of the company are collectively referred to as the Board of Directors.

### **a company can be of the following three types:**

**1. private limited company:** A private company is one which is owned by a small group of people such as family, friends and relatives. For this reason, private companies are many times also known as closely held companies. Private companies have restrictions on the transferability of their shares and many times shareholders may not be able to transfer their shares without the agreement of the other shareholders. Private company's shares cannot trade on public exchanges and are not issued through an initial public offering.

A private company can be formed with a minimum of two (and maximum of 200) persons as shareholders of the company and an initial capital investment of atleast Rs.100,000. One company may also be a shareholder of another company.

A private company is required to have minimum two directors out of whom at least one director shall be such who has stayed in India for

a total period of not less than one hundred and eighty two (182) days in the previous calendar year. A person can be both the shareholder as well as the director of the company. A private company is prohibited from inviting and accepting deposits from the public.

**2. public limited company:** A public company is company in which the public can become shareholders and hence, it is not a closely held company. A public company requires a minimum of seven shareholders and an initial capital investment of atleast Rs.500,000. It needs to have minimum three directors out of whom at least one director shall be such who has stayed in India for a total period of not less than one hundred and eighty two (182) days in the previous calendar year. There is no restriction on the maximum number of shareholders in a public company. The director and shareholder can be the same person.

Public limited companies enjoy an increased ability to raise capital since they can issue shares to the public. They can also raise additional capital by issuing debentures, bonds and accepting deposits from the public. Debentures and bonds are debt instrument issued by a company for a fixed term. The terms of debentures and bonds may vary for example, they may be redeemable or convertible into equity shares upon maturity.

**3. one person company (opc):** A One Person Company is similar to a private company except that it has only one shareholder. Only a natural adult person, who is a citizen and resident of India can incorporate a One Person Company. A person can be a shareholder of only one OPC at one time. Conversely, an OPC can have only one member at any point of time. There is no minimum capital investment required to form an OPC. An OPC may have only one director/more than one director.

There are certain restrictions that apply to a One Person Company such as it cannot be incorporated as or converted into a company under Section 8 of the Companies Act (Company for Charitable Purposes). It cannot carry out Non-Banking Financial Investment activities including investment in securities of anybody corporate. An OPC cannot voluntarily convert into any other kind of company unless two years have expired from the date of incorporation. However the same does not apply in case its paid up share capital is increased beyond Rs. 50,00,000 or its average annual turnover during the relevant period exceeds Rs.2,00,00,000.

**limited liability partnership (llp):** LLP is a new corporate structure that combines the flexibility of a partnership and the advantages of limited liability of a company at a comparatively low compliance cost. In other words, it is an alternative corporate form of business entity that provides the benefits of limited liability of a company, but allows its members the flexibility of organising their internal management on the basis of a mutually arrived agreement, similar to a partnership firm. An LLP is governed by the provisions of the Limited Liability Partnership Act, 2008.

Owing to flexibility in its structure and operation, it is usually suitable for small and medium enterprises, in general, and for the enterprises in services sector, in particular. LLPs are the preferred choice of business entity particularly for the service industry or for activities involving professionals.

An LLP is a body corporate and a legal entity separate from its partners. Any two or more persons may form an LLP by subscribing their names to an incorporation document and filing the same with the Registrar of Companies. Just like a company, an LLP also enjoys perpetual succession.

The mutual rights and duties of partners of an LLP inter se and those of the LLP and its partners shall be governed by an agreement between partners or between the LLP and the partners subject to the provisions of the LLP Act 2008. The act provides the flexibility to devise the agreement as per mutual understanding between the partner.

Like a company, an LLP can hold assets in its own name and is liable for its own debts to the extent of its assets, the liability of the partners being limited to their agreed contribution in the LLP which may be tangible and intangible in nature. Unlike a partnership, no partner shall be liable on account of the independent or unauthorized actions of other partners or their misconduct.

Every LLP shall have atleast two partners and shall also have atleast two individuals as Designated Partners, of whom at least one shall be resident in India. The duties and obligations of Designated Partners shall be as provided in the law.

## THE IDEAL FORM OF BUSINESS FOR YOU

Choosing a business entity is a technical and complex exercise but also an important one as it can have far - reaching consequences for your business. Your goals and those of the business play an important role in the decision making. However, identifying the most suitable choice of business entity involves balancing a range of factors like nature and objectives of the business, degree of control desired by the owner, amount of capital required, sources of funding, liabilities to be borne, tax borne, tax implications etc.

When you are looking to minimize your personal liability you can generally rule out sole proprietorships and partnerships firms right away because there is lack of liability protection in these two forms. With these two forms, the business is not regarded as a separate legal entity from you, so your personal assets are part of the business. This means that if the business is sued, your personal assets are at stake. In a partnership, your personal assets are at stake even towards any liabilities that may arise due to the actions of your partner.

In an LLP form, your liability is limited to the extent of your contribution towards LLP, except in case of intentional fraud or wrongful act of omission or commission by the partner. What is at stake for you as an

owner is what you have put into the business along with any personal guarantees you have made.

In case of a Company, liability is limited to the amount required to be paid up on each share.

Both LLP and limited company exists as a separate business entity and this creates a fence between your personal assets and the business. Thus your personal property is protected and this gives you the ability to build business credit, get loans and raise capital.

## What next, after you have finalized the business entity?

After finalizing your preferred business structure, you have to also prepare yourself for the compliances that are required under the several laws and regulations prevailing in the country. These laws place the onus of responsibility on the business entity to comply with such laws.

Such Compliances consist of the following:

- Obtaining registration under the various statutes applicable
- Maintenance of statutory records and registers
- Generation of periodic reports and filing the same with the relevant authorities
- Other compliance management services

Some of the registrations to be done after the incorporation are as under:

- Permanent Account Number (PAN): Only in the case of Sole Proprietorship, a separate PAN number is not required. For all other forms of business you need to apply for the PAN in Form 49A. PAN fee is very nominal and It takes around 10-15 days after the submission of duly filled PAN application to obtain a PAN.
- Tax Deduction and Collection Account Number(TAN): Every person liable to deduct tax at source or collect tax at source is required to obtain TAN. An application for allotment of TAN is to be filed in Form 49 Bind duplicate and submitted to any TIN Facilitation Centre. TAN fee is also very nominal and takes additional 10-15 days after the allotment of PAN Number and successful submission of duly filled TAN application to obtain a TAN.
- Value Added Tax Registration(VAT) : VAT is value added tax, a tax levied on the sale of goods in India. Each State in India has unique VAT Regulation and different tax rates apply for different types of products. Therefore the VAT Tax Rate and Exemptions will be unique to each State and type of goods sold. VAT registration is required as per your place of operation of business.
- Service Tax Registration: Service Tax is tax levied on provision of service. There is a threshold for levy of service tax which means that Service Tax is only levied once a service providers' turnover crosses

Rs.10,00,000 in a financial year. However registrations required after crossing a turnover Rs.9,00,000 in a financial year. Taking a Service Tax number is less expensive than VAT and takes around 7-10 days from the date of successful submission of ST application form.

- Importer Exporter Code (IEC): If you wish to import / export the goods, you should have a Import-Export Code i.e IEC. The code will be issued at the office of DGFT and it also takes around 7-10 days for obtaining an IEC.

- Shops & Establishment Registration: Within 30 days of commencing your business you are required to obtain the shops and establishment registration. It again takes around 7 - 10 days for obtaining registration.
- ESI/PF Registration: Employee State Insurance Registration and Provident fund Registrations are required to be obtained depending on the number of employees in your organization.

Business Entity	Sole Proprietorship	Partnership Firm	Company	Limited Liability Partnership
Statue	N.A.	Governed and regulated under Indian Partnership Act, 1932	Governed and regulated under Companies Act, 2013	Governed and regulated under Limited Liability Partnership Act, 2008
Registration	Not Compulsory	Not Compulsory	Compulsory	Compulsory
New PAN required	No	Yes	Yes	Yes
Minimum Number of Directors/ Partners	N.A.	2 Partners	OPC: 1	2 Designated Partners
Private: 2	1	2-20 partners	Private company should have min. 2 members, max. 200 members; public company should have a min. of 7 members, no limit for max. members	LLP should have a minimum of 2 partners. There is no limit on maximum number of partners
Approximate Expenses Involved in formation	NIL	INR 10,000/-	INR 25,000/- to INR 50,000/-	INR 20,000/- to INR 30,000/-
Personal Liability	Unlimited	Unlimited	Limited to the extent of unpaid share capital	Limited to the extent of capital contributed in the LLP
Will the personal assets of owner be under threat if the business goes into debt	Yes	Yes	No, except in the case of fraud on your part	No, except in the case of fraud on your part
Binding Document	N.A.	Partnership Deed	Articles of Association	LLP Agreement
Separate legal Entity	No	No	Yes	Yes
Perpetual Succession	No	No	Yes	Yes
Meeting	Not Required	Not Required	Quarterly Board of Directors meeting, annual shareholders meeting is mandatory	There is no provision for regular meeting of Board and members of LLPs
Dissolution	At will of the Proprietor	By agreement of the partners, insolvency or by court order	Very Procedural, voluntary or by order of National Company Law Tribunal	Less Procedural compared to company, voluntary or by order of National Company Law Tribunal
Dissolution Cost	NIL	INR ,5,000/-	INR 25,000/-	INR 20,000/-
General Annual compliance	No extra compliance	Tax Returns	Tax Return, Audit of Accounts, Company law compliance	Filing of Annual return and annual accounts
Minimum recurring annual cost	NIL	NIL	Rs. 25,000	Rs 10,000

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It is our constant endeavour  
to create effective and useful awareness.



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