LEGAL FORMS OF BUSINESS

A business is a legal entity.

One way of classifying businesses is based on the liabilities of the owners

1. Unlimited liability
2. Limited liability

The personal properties of owners of businesses of the unlimited-liability type are liable to be liquidated to pay creditors or legal claimants. Whereas, no personal assets of the owners of limited liability companies can be attached to recover dues of creditors.

Suppose you have a business. You raise a loan from a bank. You also purchase materials from other businesses or individuals [They (including the bank) are known as creditors]. Now, for some reason, your business defaults in making payment to the creditors their dues who go to court for recovery and receive(s) a DECREE from the court to recover the money from the business/owners. The creditors have the option of selling all assets of the business and also the personal properties of all the owners depending on the type of legal form of the business. If the business is of the ‘Unlimited Liabilities’ kind such as Proprietorship or Partnership, the creditors can sell your personal properties if you own any, such as building, land, investment, etc. But if the business is the ‘Limited Liabilities’ type, such as ‘One Person Company (OPC)’, ‘Limited Liabilities Partnership (LLP)’, ‘Private Limited’, ‘Public Limited’, etc. the creditor has no access to your personal properties to recover their dues. They can recover whatever they can by liquidating the assets of the business only.

Unlimited liabilities businesses may have the following forms:

1. Sole proprietorship – with only one owner
2. Partnership – with multiple owners

The proprietorship business is not different from the proprietor and the profit of the business is clubbed with other personal income(s) to determine income tax liabilities. This kind of business has a limited life span since the business ceases to exist if the proprietor expires. The same is true for partnership businesses, except that the income tax of the partnership firm is to be assessed and paid independent of the income tax of the partners. It is easy to start a business with these type of legal forms. You need a trade license and GST registration to start the business. These types of firms cannot allot shares to investors of any kind to raise money.

Limited liability companies can be of any of the following types:

1. One Person Company (OPC) – only one director. Not permitted to allot shares to others.
2. Limited Liabilities Partnership (LLP) – 2 to any number of partners
3. Private Limited – 2 to 200 shareholders. Not allowed to allot shares to public to raise money, but can allot shares to investors.
4. Public Limited – No upper limit of number of shareholders. Can raise money from the public through Initial Public Offering (IPO) and list shares in stock exchanges.

Except for the OPC type of companies, all other types of businesses have perpetual life, meaning that the life of the companies is not dependent on the life of the owners. If any or all the owners pass away, the business remains as a going concern, and new owners will take the reins of the company. All limited liability companies have to register with the Register of Companies (RoC), which takes some time and has to comply with certain statutory compliances such as Director Identification Number (DIN), Digital signature, submission of audited financial statements, etc.