Foundations of Entrepreneurship

Forms of Legal Entities

- Different legal forms of ownership
- Comparative analysis of their types and features.
- Which legal form is suitable to your business?

Forms of Legal Entities

- Sole Proprietorship
- Partnership
- One Person Company (OPC)
- Limited liability partnership (LLP)
- Private limited company

Sole Proprietorship Firm – Single Owner

- Sole proprietorship or simply proprietorship - a single individual is the sole owner of the business.
- It is the simplest form of business entity.
- The firm has no legal existence separate from its owner.
- The sole owner and the business are the same as regards, ownership of assets, income tax and legal liabilities.
- The proprietor has UNLIMITED LIABILITIES.

Sole Proprietorship firm – other features

- Owner has complete control over all the aspects of the business.
- Owner alone enjoys the benefits or profits of the business and bears all the losses.
- The capital required by the firm is supplied wholly by the owner and from the profits of the business.
- Lack of continuity i.e. the existence of a sole proprietorship business is dependent on the life and death of the proprietor.

Income Tax

- The income of the sole proprietor/owner is added to the profit of the business to arrive at taxable income. No separate IT for the business.

Income tax - Example

- Suppose the owner earns ₹0.6 million in a year from sources other than the business.
- And the profit from the business is ₹1.5 M in the same year.
- The owner has to pay income tax on ₹2.1 M: (0.6 + 1.5 = ₹2.1 M)
- Both will use the same PAN number.

Proprietorship - Unlimited Liabilities

Since the business and its owner are one and the same, any legal claimant can recover dues from the personal assets of the owner. The liability of the proprietor is unlimited.

Unlimited liability - Example

- **Suppose the business borrows money from bank and default amount is ₹1.0 million. The bank can recover their dues by liquidating the assets of both the business and of the proprietor.**
- **Suppose that by selling all the assets of the business the bank can recover only ₹0.6 million. The bank will now recover the remaining ₹0.4 M by selling the personal assets of the owner.**

Proprietorship - Unlimited Liabilities

Unlimited liability - Example

- **Suppose the business borrows money from bank and the default amount is ₹1.3 million. The bank can recover their dues by liquidating the assets of both the business and the personal properties of the proprietor.**

Proprietorship - Unlimited Liabilities

Unlimited liability - Example

01 Company assets

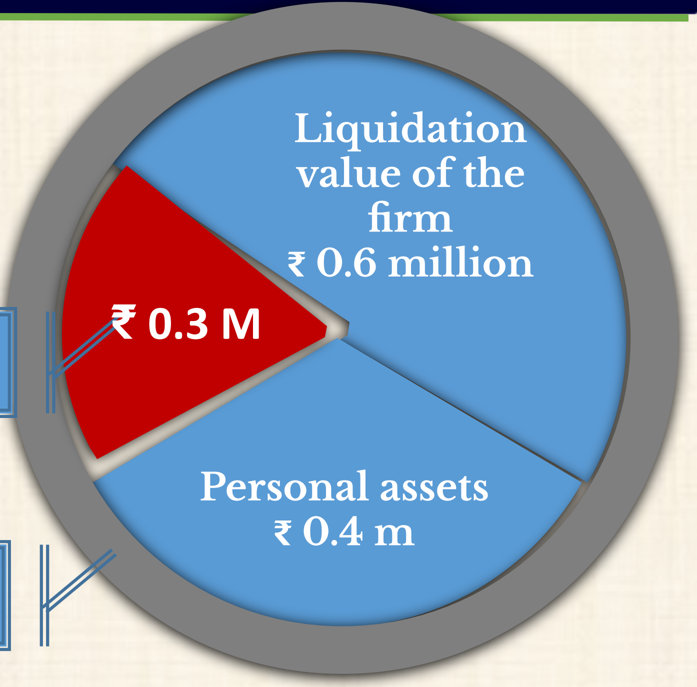
₹0.6 million

02 Personal assets

₹0.4 million

Bank loses ₹ 0.3 million

Total Bank Loan Outstanding: ₹ 1.3 million



Sole Proprietorship Firm – other features

- The primary legal formality is to obtain a trade license, PAN (for the proprietor) and GST.
- Trade license is issued by the panchayat within the panchayat area and by Municipal Corporation in corporation area.
- For obtaining a trade license one needs the proof of an address for the business.
- For own premises for the business, a copy of the title deed of the premises can be submitted as proof of business premises.
- For rented premises, the rent agreement is to be provided.
- GST registration has now become simple. One can initiate the process online at www.gst.gov.in.

Sole Proprietorship – other features

- For special businesses, specific licenses may be necessary.
- For example, for restaurant ‘Food Safety and Standards Authority of India license (FSSAI)’ is required.
- For running a shop, one should register under the Shops & Establishments Act. This process can also be done online.

Proprietorship

Advantages

- Ease of formation: trade license, business premises, GST registration
- Maximum incentive for hard work.
- Secrecy of business.
- Quick decisions and flexibility of operations.

Proprietorship

Disadvantages

- Limited capital depending on the capability of the owner.
- Managerial ability limited to sole proprietor. [Of course, they can engage professionals to manage the activities.]
- Limited life – the business is automatically dissolved on death of the proprietor.
- Unlimited liability.
- Clubbing of income may lead to higher income tax. (Above Rs. 10 lakh, LLP or company income tax rate is lower than that of proprietor)
- In the present context, proprietorship business is disadvantaged as the personal tax rate is much higher at 30% compared to corporate tax of 17 to 22%.

- **Many of the small businesses such as retailer, grocers, stationary shops, small manufacturing units are proprietorship firms.**

- **Ankur is a Senior Vice President at Nirvana Venture Advisors.**
- **Abishek is an Associate Vice President at Nirvana Venture Advisors.**
- **The session is scheduled at 9.00 p.m. tomorrow (06.02.2021)**

Partnership – multiple owners

- A partnership is formed between two or more persons.
- Partnership is formed by an agreement – either written or oral.
- Partnership is formed to carry on business by all partners or by any of them on others’ behalf.
- When the written agreement is duly stamped and registered, the document is called "Partnership Deed".
- Ordinarily, the rights, duties, contribution to equity capital and liabilities of partners are laid down in the deed. But if there is no such deed or where the deed does not specify the rights and obligations, the provisions of the Indian Partnership Act, 1932 apply.

Registration of Partnership Deed

- One may decide to get the partnership deed registered.
- Done at the Office of the Registrar of Firms.
- Every state has an office

Advantages of Partnership Form

- Ease of formation compared to limited liability companies.
- Greater capital and credit resources compared to proprietorship.
- Better judgement and more managerial abilities.
- Income tax of the firm is treated independent of the partners.

Disadvantages of Partnership Form

- Absence of ultimate authority
- Liability for the actions of other partners
- Limited life. Usually the firm is dissolved when any of the partners expires.
- Unlimited liability

- Partnership is an appropriate form of ownership for small and medium sized businesses owned by more than one persons involving limited own capital.
- This may include small scale industries, wholesale and retail trade, small services firms like transport agencies, real estate brokers, professional firms like chartered accountants, doctors' clinic, attorney or law firms.

Partnership - Unlimited Liabilities

Legal claimant such as banks and creditors can recover dues from the personal assets of the owners. The liability of the partners are unlimited.

Unlimited liability - Example

Suppose the firm borrows ₹1.0 M from a bank and defaults in repayment. The bank can recover the dues by liquidating the business as also by selling personal assets of the partners.

Now suppose that by selling all the assets of the business the bank can recover only ₹0.6 M. The bank will now recover the remaining ₹0.4 M by selling the personal assets of the partners. Assets of which partners would be liquidated first would be decided as per the terms in the partnership deed or mutually decided later.

Income Tax

- Partnership firms are not separate legal entities.
- However, for the purpose of income tax, firm is different from the partners and the firm has separate PAN number.
- The firm pays income tax independently of the partners and the present income tax rate is approximately @ 20% of profit.
- The firm can pay salary to partners and interest on borrowing from partners, which are deductible expenses in profit & loss account.

Limited Liability Company

- Limited liability form of legal entities are those where the members or owners of the company are not PERSONALLY liable for the liabilities of the company.
- The creditors and lenders to such companies can recover their dues only to the extent possible by liquidating the company and they can not claim anything from the personal assets of the owners.

Limited liability - Example

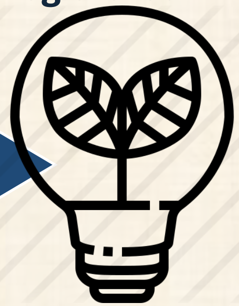
- Suppose the company borrows ₹1.0 M from a bank and defaults in repayment. The bank can recover the dues by liquidating the business as also by selling personal assets of the partners.
- Now suppose bank can recover only ₹0.6 M by liquidating the company. They will not be able to recover the remaining amount by selling any personal asset of the members.

One Person Company (OPC)
Companies Act 2013

- One person company or OPC is a single person economic entity with features similar to a limited liability company.
  - One Person Company has only one member.
  - There may be a nominee besides the one member.
  - There can be outside directors without shareholding.
- The main advantage of a OPC is that a single individual can register and run a (limited liability) company whereas a minimum of two persons are necessary for private limited company.

Steps to Form OPC

RoC issues certificate of incorporation. Company is registered



STEP 1

DSC

Apply for Digital Signature Certificate

STEP 2

DIN

Apply for Director Identification Number

STEP 3

RUN

Name approval Request for Unique Name

STEP 4

Documents

MoA, AoA and other required documents

STEP 5

MCA

File forms and documents for approval

The Salient features of an OPC include the following:

- An OPC can primarily be of two categories :
  - Company limited by shares.
  - Company limited by guarantee (has shareholders who act as guarantors promising to pay small sum in the event of winding up of the company).
- An OPC limited by shares shall comply with following requirements :
  - Shall have minimum paid up capital of ₹ 1 L and maximum ~~₹ 50 L~~ no maximum limit now.
  - Are not allowed to transfer its shares.
  - Are not allowed to invite public to subscribe to the shares of the company.

Comparison between OPC and Sole Proprietorship

OPC	Sole Proprietorship
• Limited liability • Tax is applicable in the same bracket as of any private company. • Nominee who is a natural born citizen of India becomes the successor in case of death of the sole member/director. • Compliance: Has to submit annual report and audited accounts.	• Unlimited liability • Tax bracket same as individual • Succession through court • Compliance – no annual returns, auditing of account only after reaching a threshold turnover

Conversion of OPC into a Private Limited Company:

- As per the Act, an OPC can be voluntarily converted into a Private Limited Company
- An OPC has to be compulsorily converted itself into a Private Limited Company:
  - ~~If at any time the paid-up capital of the OPC exceeds Rs. 50 Lacs.~~
  - ~~If the average turnover in any of the three consecutive financial years is more than Rs. 2 crores.~~

Voluntary Conversion

- An OPC can be converted into Private Limited after minimum of 2 years of existence as OPC.
- ~~Then it has to increase its paid-up share capital to ₹ 50 Lakhs and an annual turnover should not be less than 2 crores.~~
- ~~If the company fails to comply these provisions it shall convert back itself to an OPC by passing a special resolution.~~

Motivations for registering a One Person Company

- Single Promoter – full ownership and control
- Uninterrupted Existence (nominee becomes new owner in case of death of owner)
- Easy Transferability (Ownership can be transferred easily)
- Borrowing capacity – lenders prefer company over proprietorship or partnership firm.
- Owning property – a company is an artificial person and therefore own assets.

Transfer of Ownership

Ownership of a one person company can be transferred by transferring the shareholding, directorship and nominee director in the registrar of company.

Limited Liability Partnership (LLP)
Limited Liability Partnership Act 2008

- LLP is a corporate structure that combines the flexibility of the partnership and the advantages of limited liability form of ownership but at a lower compliance cost.
- It allows its members the flexibility of organising their internal management on the basis of a mutually arrived agreement, like in a partnership firm.
- small and medium enterprises, in general, and enterprises in services sector, in particular prefer this form owing to the flexibility in its structure and operation.
- Globally, LLPs are the preferred form by service industry or for activities involving professionals

Private Limited Company

- A private limited company is a form of corporate entity that is a voluntary association of not less than TWO and not more than TWO HUNDRED members.
- The liability of each member/owner is limited to the extent of the ownership in the company.
- In the case of default, the creditors or lenders to the company can not lay their hands on the personal assets of the owners.
- Transfer of shares is limited to its members and not allowed to invite the general public to subscribe to its shares.
- They keep control over the business within a limited circle and maintain the privacy of their business.

Limited liability - Example

- Suppose the company borrows ₹1.0 M from a bank and defaults in repayment. The bank can recover the dues by liquidating the business but can't sell personal assets of the directors.
- Now suppose bank can recover only ₹0.6 by liquidating the company. They will not be able to recover the remaining amount by selling any personal asset of the members.

Private Limited Company

Advantages

- Continuity of existence.
- Liabilities of its members are limited to their contributions to equity.
- Shares are transferable with some formalities, and thus, can invite new members as directors/shareholders.
- Less legal restrictions, need not hold statutory general meeting or file statutory report.

Disadvantages

- Shares are not absolutely freely transferable.
- Not allowed to invite public to subscribe to its shares.
- Scope for promotional frauds.
- Undemocratic control (since major decisions are not based on public shareholders).

Private Ltd. Company vs. LLP

Private Limited Company	LLP
Minimum share holders: 2 Minimum directors: 2	Minimum partners: 2 2 designated partners
Maximum shareholders: 200	No maximum number of partners
Memorandum of Association defines the activities.	LLP Agreement or Schedule 1 of the Act
Articles of association: procedure to follow	LLP Agreement or Schedule 1 of the Act
Transfer of shares restricted.	Transfer allowed. Transferee does not become partner automatically.
Management by Board of Directors	Two partners authorized in agreement
Company can be converted into LLP or public limited company	Can be converted into company following complete procedure and LLP is wound up.
Common seal compulsory	Optional
Change of registered office or dissolution of entity involves lot of formalities	Less formalities. Dissolution or windup is easy.

Public Limited Company

Public Limited Company

- An entity with the legal form of public limited company is a legal entity independent of its owners i.e. it is an artificial juridical person.
- It has perpetual existence or successions.
- Unlike private limited company, the shares of a public limited company are easily transferable.
- A company must have a minimum of seven members but there is no limit as regards the maximum number.
- The company collects its capital by the sale of its shares and those who buy the shares are called the members. The amount so collected is called the share capital.

Comparison between Public Limited and Private Limited Company

Feature	Public Limited Company	Private Limited Company
Minimum number of members	7	2
Minimum number of directors	3	2
Maximum number of members	Unlimited	200
Minimum capital	5,00,000	2,00,000
Invitation to public to subscribe to share capital	Yes	No
Managerial remuneration	No restriction	Should not exceed 11% of annual net profit

Joint Hindu Family

Joint Hindu Family or Hindu undivided family (HUF) is a legal form of business entity wherein the members of an undivided family can only be a member of the business. It is governed by Hindu Law.

Subsidiary Company

Subsidiary company is owned by another company or companies or mix of companies and individuals. If it is exclusively owned by one company it is referred to as wholly owned subsidiary. The company that owns the subsidiary is called the parent company or holding company. The subsidiary may be of any legal form. Many foreign companies have subsidiaries in India.

Co-operatives

- Co-operative organisation is a society which has as its objectives the promotion of the interests of its members in accordance with the principles of cooperation.
- It is a voluntary association of ten or more members residing or working in the same locality, who join together on the basis of equality for the fulfilment of their economic or business interest.
- The basic feature which differentiates the co-operatives from other forms of business ownership is that its primary motive is service to the members rather than making profits.

There are different types of cooperatives like consumer co-operatives, producer's co-operatives, marketing co-operatives, housing co-operatives, credit co-operatives, farming co-operatives etc. The aim of all such co-operatives is to promote the welfare of their members. Its main features are:-

- It is a voluntary organisation as a member is free to leave the society and withdraw his capital at any time, after giving a notice.
  The minimum number of members is 10, but there is no limit to the maximum number of members. However, the members must be residing or working in the same locality.
- Registration of a co-operative enterprise is compulsory. A co-operative society may be registered with the Registrar of Co-operatives Societies.
  After registration a co-operative enterprise becomes a body corporate independent of its members i.e. a separate legal entity.
  It is subject to the provisions of the Co-operative Societies Act, 1912 or State Co-operative Societies Acts.
- It has to submit annual reports and accounts to the Registrar of Societies.
  The liability of every member is limited to the extent of his capital contribution.
- The shares of co-operative society cannot be transferred but can be returned to the society in case a member wants to withdraw his membership.
  Being a separate legal entity a co-operative enjoys continuity of existence which is not affected by death, insolvency, retirement, etc. of the members.

Factors Determining Forms of Businesses

- The nature and size of business.
- Scale of operation
- The degree of control desired by the owner(s).
- Amount of capital required for the establishment and operation.
- The degree of risks and liabilities as well as the willingness of the owners to bear it.
- Comparative tax liability.
- Degree of compliance and government formalities.

- **http://www.mca.gov.in/**
- https://en.wikipedia.org/wiki/List_of_legal_entity_types_by_country
- **https://yourstory.com/2015/03/business-legal-entity**
- http://www.mca.gov.in/MinistryV2/classification+and+registration+of+companies.html
- **https://www.flaticon.com/** **for icons**

Thank you