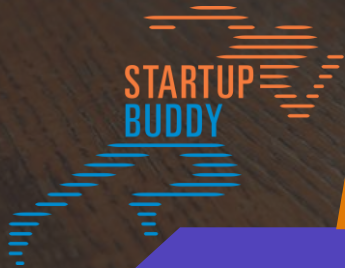


Innovation Ambassador Training by

Legal Structures and Ethical Steps in Establishing Startups

23rd July, 2021



How to Start?

Create

Business Plan

Long term as well as short Term

Identify

Key Metrics

For your business

Select Correct

Legal Structure

For your business

Various Structure available in India

Unregistered Structure

Sole Proprietor

Partnership Firm

Registered Structure

Limited Liability
Partnership (LLP)

Company
(Private/ Public Limited)

Deciding Factors

- ▶ Tax Benefits
- ▶ Team Structure
- ▶ Future Plan
- ▶ Potential Liabilities
- ▶ Residential Status (because of FEMA Rules and Regulations)

Why to Incorporate?

- ▶ For Branding of Business, incorporation of legal entity is important.
- ▶ To separate out income and expenditure of business from personal
- ▶ For addition of Co-founders
- ▶ Team is key to run business so sharing of Profits with team in the form of ESOP is important aspect
- ▶ For Investment/ Exit, legal entity is must

When to Incorporate?

- ▶ Purely depending upon business requirements
- ▶ How much funds and which kind of funds will be required
- ▶ Revenue expectation

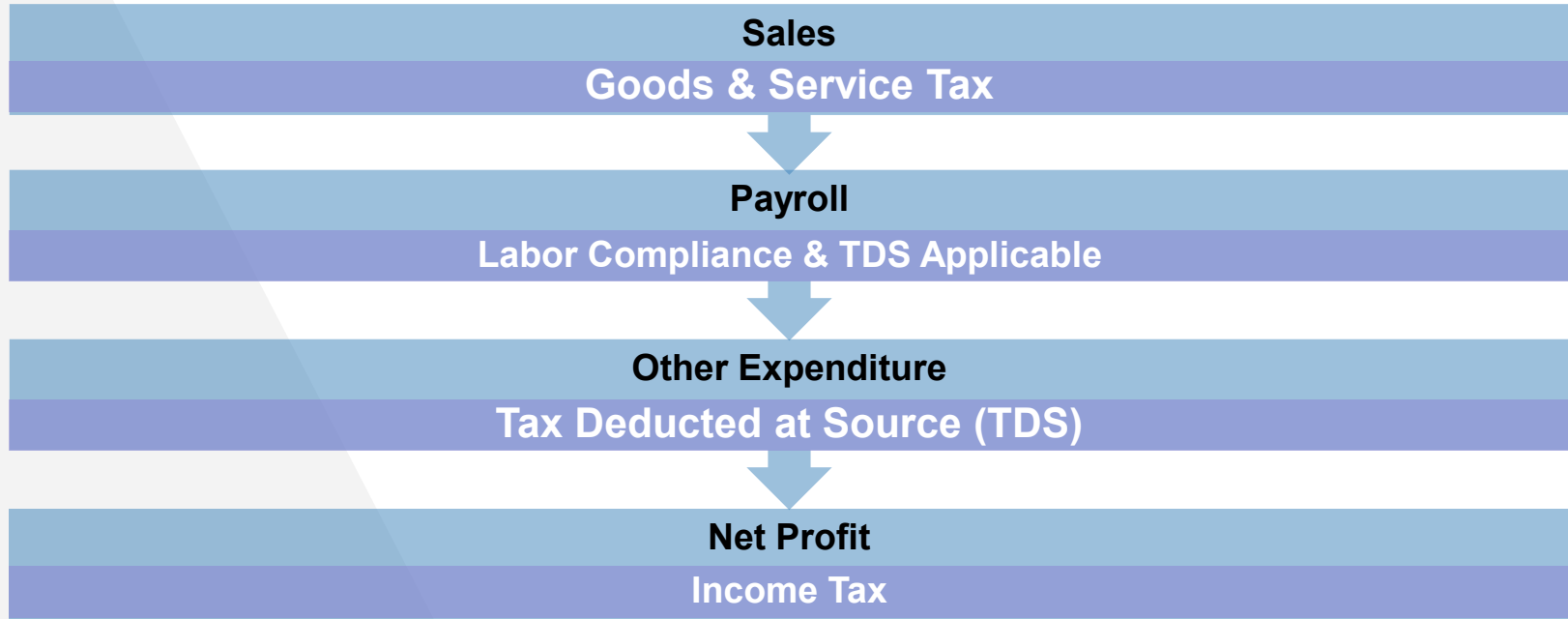
My Suggestion:

- ▶ Best is to incorporate just after Proof of Concept

How to Incorporate?

- ✓ Identify Brand Name & Legal Entity Name
 - This may be same or may be different.
 - Single Entity may have multiple Brands as well
- ✓ Check Trademark for Brand Name and Legal Name
- ✓ Document roles and responsibilities of founding team
- ✓ Select the right Entity according to your business

Compliances Applicable on Business



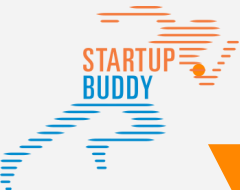
Sole Proprietorship

Advantage

- Ownership is solely owned by an individual.
- Business owner has a power to control the business operations.
- Owner will receive all the profits and bear all the losses.
- Easy to setup

Disadvantage

- Owners and business is referred to as one of the same entity (No separation)
- Unlimited Liability (Not restricted to the capital of the legal entity)
- Can not add another founder in business



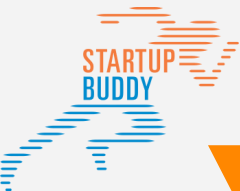
Sole Proprietorship- Compliance

Compliance Applicable

| | |
|--|---|
| Separate Income Tax Return | : No |
| TDS Compliance | : No (Upto Certain Limits) |
| GST Compliance | : Same rules in all structure (except Reverse Charge) |
| Payroll Compliance | : Same rules in all structure |
| Books of Accounts required to Maintain | : No (Presumptive Tax upto Certain limit) |
| Secretarial Compliance | : No |

Sole Proprietorship- Process

- ▶ Decide the Trade Name
- ▶ Do one Registration like Shop & Establishment, GST, etc.
- ▶ Open a Bank Account
 - ▶ No Separate PAN required
 - ▶ Easiest way to setup & Least compliance



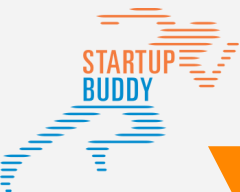
Partnership Firm

Advantage

- Two and more individuals share cost and responsibilities
- Terms of partnership recorded in partnership agreement.
- “Silent partner” concept is possible
- Easy to setup

Disadvantage

- Liable for the action of other partner.
- Unlimited Liability (Not restricted to the capital of the legal entity)
- Benefit of Slab Rate Taxation is not applicable



Partnership Firm - Compliance

Compliance Applicable

| | |
|--|---|
| Separate Income Tax Return | : Yes |
| TDS Compliance | : No (Upto Certain Limits) |
| GST Compliance | : Same rules in all structure (except Reverse Charge) |
| Payroll Compliance | : Same rules in all structure |
| Books of Accounts required to Maintain | : No (Presumptive Tax upto Certain limit) |
| Secretarial Compliance | : No |

Partnership Firm- Process

- ▶ Draft a Partnership Deed
- ▶ Print on Stamp Paper to execute by Partners
- ▶ Apply for PAN
- ▶ Open a Bank Account in the name of Partnership Firm

Limited Liability Partnership (LLP)

Advantage

- Two and more individuals share cost and responsibilities
- Terms of partnership recorded in partnership agreement.
- Registered with Ministry of Corporate Affairs (MCA)
- Perpetual Succession

Disadvantage

- Benefit of Slab Rate Taxation is not applicable
- More legal compliances required than simple partnership Firm
- Regular and Annual filings with MCA applicable same as body corporate.
- Audit under MCA will be required after some milestone.

Limited Liability Partnership (LLP) - Compliance

Compliance Applicable

| | |
|--|---|
| Separate Income Tax Return | : Yes |
| TDS Compliance | : Yes |
| GST Compliance | : Same rules in all structure (except Reverse Charge) |
| Payroll Compliance | : Same rules in all structure |
| Books of Accounts required to Maintain | : Yes |
| Secretarial Compliance | : Yes |

LLP- Process

- ▶ Reserve the name of LLP with Ministry of Corporate Affairs (MCA)
- ▶ Apply for Digital Signatures of Partners
- ▶ Draft a Partnership Deed
- ▶ Print on Stamp Paper to execute by Partners
- ▶ File documents with MCA and wait for Registration Certificate
- ▶ Apply for PAN
- ▶ Open a Bank Account in the name of Partnership Firm

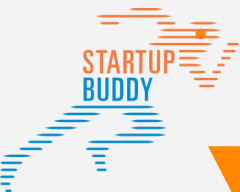
Private Limited Company

Advantage

- A Separate legal entity.
- A Company is ruled by its charter documents MOA and AOA.
- Can be as small as one person, or multinational
- Ownership often broken into small units, **SHARES**.
- Those who buy shares – Shareholders
- Since there are many owners, a Board of Directors runs the corporation.
- Shareholders have limited liability, not responsible for debts.
- Get profit as **DIVIDENDS**
- Each share is equivalent to one Vote

Disadvantage

- Double Taxation on Net Profit if distributed as Dividend.
- Various restriction like taking loan or giving loan from unrelated person is prohibited.
- Regular and Annual filings with MCA applicable
- Audit under MCA will be required from very first day.
- Winding up is not easy.



Private Limited Company

Compliance Applicable

| | |
|--|---|
| Separate Income Tax Return | : Yes |
| TDS Compliance | : Yes |
| GST Compliance | : Same rules in all structure (except Reverse Charge) |
| Payroll Compliance | : Same rules in all structure |
| Books of Accounts required to Maintain | : Yes |
| Secretarial Compliance | : Yes |

Type of Shares

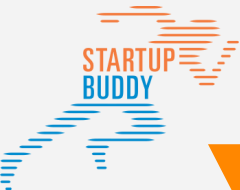
- ▶ **Equity Shares**
 - ▶ Called as Common Stocks in some Countries
 - ▶ Having Voting Power
 - ▶ No Preference

- ▶ **Preference Shares**
 - ▶ Should be Compulsorily Convertible
 - ▶ Preference Rights
 - ▶ Part of Cap Table



Company Incorporation- Process

- ▶ Check Trade Mark
- ▶ Reserve the name of the Company with Ministry of Corporate Affairs (MCA)
- ▶ Apply for Digital Signatures of all shareholders
- ▶ File the application with MCA including MOA, AOA, ID, Address Proof, etc.
- ▶ MCA will issue the Certification Of Incorporation
- ▶ PAN and TAN will automatically allotted along with Certificate of Incorporation

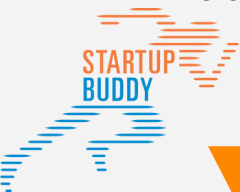


Next Few Steps after Incorporation

- ▶ Open Bank Account
- ▶ Transfer Initial Capital as per commitment in Memorandum of Association (MOA)
- ▶ File Business Commencement Certificate with MCA
- ▶ Now the business can be initiated.
- ▶ Directors can bring more funds to the company as Directors Loan

Next Few Steps (In case of all entity)

- ▶ Apply for Udyam Registration (Also known as MSME Registration)
- ▶ Register the entity with Startup India
- ▶ File Form 2 with startup India for Angel Tax Exemption
 - ▶ Can be filed at the time of fund raise as well
- ▶ In case you expect lots of GST on Vendor's payment, apply GST immediately instead of waiting for threshold limit to claim the input credit.
- ▶ Labour Law Registration, as and when applicable



Capitalization Table (Example 1)

Assumption: Mr. C (Investor) is investing INR 2 Crores for 20% Equity where Mr. A and Mr. B are cofounders:

| Name of Shareholder | Current Shareholding | | Fresh Issues | Revised Shareholding | |
|---------------------|----------------------|----------------|--------------|----------------------|----------------|
| | No. of Shares | % | | No. of Shares | % |
| Mr. A (Founder) | 5,000 | 50.00% | | 5,000 | 40.00% |
| Mr. B (Founder) | 5,000 | 50.00% | | 5,000 | 40.00% |
| Mr. C (Investor) | | | 2,500 | 2,500 | 20.00% |
| Total | 10,000 | 100.00% | 2,500 | 12,500 | 100.00% |

Pre-Money Valuation

8,00,00,000

Investment Amount Post Money Valuation

2,00,00,000

10,00,00,000

Price Per Share

8,000

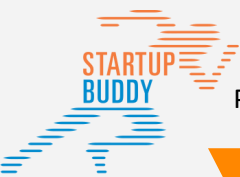
8,000

8,000

Capitalization Table (Example 2)

Assumption: Mr. C (Investor) is investing INR 2 Crores for 20% Equity with a condition to keep Provision of 2000 shares for Employees as ESOP

| Name of Shareholder | Current Shareholding | | Fresh Issues | Revised Shareholding | |
|---------------------|----------------------|----------------|--------------|----------------------|----------------|
| | No. of Shares | % | | No. of Shares | % |
| Mr. A (Founder) | 5,000 | 41.67% | | 5,000 | 33.33% |
| Mr. B (Founder) | 5,000 | 41.67% | | 5,000 | 33.33% |
| ESOP Pool | 2,000 | 16.67% | | 2,000 | 13.33% |
| Mr. C (Investor) | | | 3,000 | 3,000 | 20.00% |
| Total | 12,000 | 100.00% | 3,000 | 15,000 | 100.00% |



Pre-Money Valuation

8,00,00,000

Price Per Share

6,667

Investment Amount

2,00,00,000

6,667

Post Money Valuation

10,00,00,000

6,667



Important Agreements

| S. No. | Agreements |
|--------|--|
| 1 | Founder Agreements |
| 2 | Contract with Clients/ Vendors |
| 3 | Contract with Employees |
| 4 | Non Disclosure Agreements with Employees & Vendors |
| 5 | Privacy Policy for website |
| 6 | Terms of use for website |
| 7 | Software Development Agreement |
| 8 | Software Licensing Agreement |

THANKS!

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