CHOICE OF BUSINESS STRUCTURE

Choosing a business structure for executing your vision for profit, is one of the most crucial first steps to start a business. Every business entity has legal, financial, and administrative implications, so it is important to get started with the most suited form of entity.

Parameters that enable deciding on a Business Structure

Choice of business structure essentially is based on various aspects of executing your vision for profit. Some of the questions that needs to be answered before you choose a structure is:

- Are you the sole beneficiary out of your venture?
- Are you looking at partnering with someone or having an Investor?
- Are you only looking at a small scale for the initial years?
- Will you be employing minimal manpower and may be on a need basis?
- Are you looking at minimal compliances?
- What will be your expected earnings and deductions?
- Do you have a pre requisite of a company structure as part of a tender or similar process?

What would be the registration and administrative costs to set up and maintain a business structure?

- Will there be a need to seek external funding? Debt or equity.

To help you gain a basic understanding of the differences between entity types, below is a guide to the most common business structures entrepreneurs choose.

Before selecting, though, you should talk with a Company Secretary to determine which will best serve your needs.

Types of Business Structures

Sole Proprietorship

In a Sole proprietorship, there is no legal separation between the business owner and the business. Property and liabilities, of both the business as well as in the personal ones, are held in the owner's name. Usually, the owner is an individual. Income tax, clubbing both business and personal income, are filed in the individual name.

Home businesses often select to operate in Sole Proprietorship structure, because it is the most simple and inexpensive type of entity to establish and maintain.

One drawback in operating a business as a sole proprietor is that usually the owner is personally liable legally and financially for the losses arising out of the business. In a situation where one files a lawsuit against the Sole proprietorship or if the proprietor cannot repay the business debts, the proprietor's personal assets (bank accounts, home, car, retirement savings, etc.) are at risk.

Starting a Sole Proprietorship is fairly simple and straightforward, as only a PAN is a pre requisite. Apart from income tax return filing there will be no other ongoing compliances, unless the business grows big with employees, at which point in time, labour laws related compliance kicks in.

When is a Sole Proprietorship a preferable proposition?

• When it's a home-based business

• When a business has only one owner

• When a business has no employees

• When a business provides products and services that have minimal legal risks associated with them

Partnership

Partnership structure mirrors a Sole Proprietorship albeit with more than one owner.

In a Partnership, owners share legal, financial, and management responsibilities for the business. In fact, the actions of one partner could impose liability on the personal assets of another partner.

Partnership is governed by a partnership agreement to spell out the division of ownership and duties. Tax obligations pass through to the individual owners.

Partnership can be registered or unregistered. Unregistered partnership stops with the execution of a Partnership agreement whereas a registered partnership involves a registration with the Registrar of firms and annual renewal of the same. Registered partnerships are only eligible to file a suit in a court of law in the event of a litigation between the partners or third parties arising out of a contract.

Other types of partnerships exist, as well including:

Limited Liability Partnership

LLP is a type of partnership which is governed under the LLP Act 2008. LLP structure offers more flexibility and liability protection. They also come with more formation and ongoing compliance requirements. Filings are to be made with the Ministry of Corporate Affairs. Recurring compliance requires filing of Form 8 and Form 11 annually. Event based compliances require form filing depending on events like change in agreement, cessation of addition of partners, change of registered office etc.

When might operating as a Partnership Firm (Not an LLP) be preferable?

• When owners do not intend to reinvest money back into the business

• When business partners seek minimal compliance formalities and associated costs

• When a multi-owner business has no employees

• When a business provides products and services that have minimal legal risks associated with them

Company

A company is a legal entity separate from its owners, and it provides a significant degree of personal liability protection for its owners (shareholders). Ownership is through holding shares in the company, which may be held privately or publicly. The ability to sell shares in the company offers an opportunity to raise capital to fund initiatives and fuel growth. Status as a Company makes a business more attractive to outside investors, as well.

A Company must file its own income tax return and the company receives deductions for business expenses, which reduces its tax liability when it earns revenue. Dividend paid to shareholders is not deductible as an expense.

Incorporating a company involves filing of Memorandum and Articles of Incorporation with the Registrar of Companies, and it comes with higher startup costs and more administrative complexity than running a business as a Sole Proprietorship, Partnership, or LLP. A Company must have governing rules by way of Articles of Association, a board of directors, hold meetings on a regular basis, and abide by the Companies Act, 2013 to maintain its status.

When is a Company structure a preferable option?

- When a company's profits are expected and will be reinvested
- When a company wants to seek external funding, debt or equity
- When a company wants to have a large number of shareholders
- When the owners intend to limit their personal liability