Decoding the Legalities of Starting a Business: Legal Support for Start-ups

written by Sweta Sampath | November 22, 2022

In the era of globalization, India as a developing country is giving rise to various new businesses and start-ups across the country. In furtherance of this, the Government has also introduced several schemes such as Make in India, Start-up India and Execute India to further increase India's standing in the global market by encouraging new businesses. To establish a start-up and run it safely, several legal compliances are required, which often call for legal support for start-ups.

There are several kinds of business entities that must be chosen per the aims and objectives of a business idea. Once a form of business entity is decided, the next important step is raising investments and funding. Furthermore, there is also a requirement to enter into various agreements with different parties to run a start-up or business. To identify, decide and utilize resources to ensure the smooth functioning of a business, it is often advisable to seek start-up legal services.

This article will aid the reader in making crucial choices about starting a business and also the legalities of starting a business :

- Selecting the right Business Entity
- Employee Agreements
- Raising Investments and Funding
- Government Initiatives

Selecting the Right Business Entity

There are various kinds of business entities ranging from a sole proprietorship, partnership, and limited partnership to private companies, public companies, limited liability companies, statutory corporations, and even non-profit organizations. This article deals with the most prominent kinds of business entities recognized in India.

Sole Proprietorship

The simplest type of company entity under which one can operate is a sole proprietorship. However, the sole proprietorship is not considered a distinct legal entity. The business owner is held personally responsible for the company's financial obligations. The owner and the business are the same for tax and legal liability purposes. This form is best suited for individuals wanting complete control of ownership and minimal legal compliances.

There is no specific registration required for a sole proprietorship, however, certain basic registrations are required as follows:

- A Registration Certificate under the Shops and Establishment Act of the state in which the business is established.
- Goods & Services Tax (GST) Registration is required in case the turnover is more than Rs. 20 lakhs.
- There is also an option to register as a Small and Medium Enterprise under the Micro, Small and Medium Enterprises Development Act, 2006.[1]
- There is a requirement of filing an annual Income Tax Return as well.

Partnership

According to Section 4[2] of the Indian Partnership Act of 1932, a partnership is a relation between individuals who have decided to share the profits accruing from a business that all of them carry on or any of them acting on behalf of all of them. Without a separate legal personality from its partners, it cannot be sued in its name, own property, or incur debt. In addition, the partners of a partnership firm are jointly and severally responsible for the firm's debts.

There may also be limited liability partnerships (LLPs), which are such where the liability of the partners is limited to their contribution. This also means that an LLP has a separate legal existence. LLPs are governed by the Limited Liability Partnership Act, of 2008.[3] LLPs are better suited for start-ups while also having a restriction on the liability of partners because it gives the benefits of both a partnership and a company. Furthermore, there are fewer statutory compliances involved despite the limited liability.

The following are the requirements to commence a partnership firm:

- A Partnership Deed is to be created on a judicial stamp paper and signed by all the partners. This includes the rights and duties of the partners and the firm.
- Although it is not mandatory to register a Partnership firm, however, generally any corporate lawyer for start-ups commencing as a partnership firm would advise registering as per the Partnership Act, of 1932.[4] This is to ensure that all legal benefits can be availed.
- The firm must register with the details involving the name of the firm, the place of business, other locations, details of the partners, and so on. If the Registrar is satisfied, a Certificate of Registration is issued.
- A GST Registration is also required.

Private Limited Company

A private ownership structure characterizes a private limited company. A private limited corporation can be incorporated with as few as 2 members and as many as 200. It is not permitted to publish a prospectus on the open market or to solicit or accept public deposits. Private company shares cannot be freely transferred. This entity is well suited for start-ups and is also very credible due to the compliance requirements

One Person Company (OPC) is a type of this company, as defined under Section 2(62)[5] of the Companies Act. There are comparatively lesser compliances for OPCs and the single owner has complete control of the company. This entity is best suited for start-ups and is preferred the most for funding.

The following is the registration process for a private limited company in India:

- The first step is the Digital Signature Certificate (DSC), which is mandatory for all proposed Directors and the subscribers of the Memorandum of Association (MoA) and Articles of Association (AoA). This is because the registration process is completely online.
- The second step is obtaining the Director Identification Number (DIN), which is to be obtained by anyone who wishes to be a director in a company.
- The third step is registering the company on the Portal of the Ministry of Corporate Affairs (MCA). This involves filling out the SPICe+ form and submitting the relevant documents.
- Once the application is verified by the Registrar of Companies, the Certificate of Incorporation is issued.
- The other documents required for registration of a company involve Address proof such as tenancy/rental agreement, etc., MoA which contains the objective of the company, and AoA, which are the by-laws of the company.
- The minimum number of members required for a Private Company is 2 and the maximum is 200. A minimum of 2 directors are required to run the company. Furthermore, the minimum paid-up capital is Rs. 1 lakh.

Public Company

A form of a company whose securities are traded on a stock exchange is a public limited company. At least seven members are required to start a Public Limited Company. The transferability of shares is unrestricted. These companies must make more public disclosures and comply with additional regulations from the government and other regulatory bodies like the Securities and Exchange Board of India (SEBI), Reserve Bank of India (RBI), etc. The primary reasons for choosing a public company are to raise capital for business and obtain more visibility and credibility in the market.

The basic process for registering a Public Company remains the same as that of a Private Limited Company. Additionally, the following points are also to be kept in mind:

- It is necessary that all the requirements such as the number of directors, shareholders, minimum paid-up share capital, etc. be fulfilled. The minimum number of directors is 3 and the minimum number of shareholders is 7. Furthermore, the minimum share capital required is Rs. 5 lakhs.
- After this, the DSC and the DIN must be obtained.
- It is necessary to have a properly registered address for the Company. The Registrar must approve the name of the company; it must end with ‘Limited’.
- This is followed by the execution of the MoA and AoA, which are then submitted for verification.
- Once verified, the Certificate of Incorporation is issued. Before starting the business, a Certificate of Commencement also needs to be obtained within 180 days of the Incorporate Certificate. This certificate mentions that all the subscription money has been received.

Documents Required

Several agreements and documents are essential for upcoming businesses to secure their interests and achieve their objective. The essential nature of these agreements requires that legal support for start-ups be sought from start-up law firms in India.

Some of the common essential agreements, which are governed by the principles of the Indian contract law and other required documents include:

- *Employment Agreements*: A contract between the business organization and its employee to avoid any misunderstanding with the employee which could lead to legal liability for the organization. It includes the terms of employment, compensation, termination, etc.
- *Confidentiality Agreements*: These are also called Non-Disclosure Agreements (NDAs). The parties signing such a contract, especially the employees of the business, undertake that they will not share any confidential and/ or sensitive information with anyone.
- *Certificate of Incorporation*: A certificate of incorporation is a legally enforceable document that certifies the formation of a company. All corporations must have this document, often known as the corporate charter, to conduct business. This is under the Companies Act, 2013[6].
- *Shareholders Agreement (SHA)*: A Shareholders Agreement describes the internal management structure of the company and outlines the rights and obligations of the shareholders to successfully safeguard their interests in general. This is a private document that is primarily a contract between some or all the shareholders of the company.
- *Founders Agreement*: A Founder's agreement is a contract signed by the co-founders of a company that describes the equity participation goals and levels of each founder. It includes the obligations, benefits, positions, and remuneration for each founder.
- *Lease*: These are agreements between the organization and the party leasing the space/ building to conduct business.
- *Loan Agreements*: Start-ups require funding to commence with business. For this, start-ups may take loans from banks and other Non-Banking Financial Corporations (NBFCs). To obtain this loan and agree to the terms, loan agreements are signed.

Government Initiatives

The Government has been very active in supporting start-ups and upcoming businesses so that they can prosper and contribute well to the nation's economy. Some of the initiatives undertaken by the government are as follows:

- *Start-up India*: This is a flagship initiative of the Indian Government. It aims to build a strong ecosystem to nurture innovation and start-ups in the country so that there is sustainable economic growth and several employment opportunities are created.[7]
- *Start-up India Seed Fund*: This fund was launched in 2021 and is worth ten thousand crores. This is to be utilized to support start-ups and business ideas from aspiring entrepreneurs so that they do not face a capital shortage.[8]
- *Digital India GENESIS*: This stands for "*Gen-next Support for Innovative Start-ups*". This scheme aims to empower national deep-tech start-ups.[9]
- *Pradhan Mantri Mudra Yojana*: Under this scheme, Micro Units Development Refinance Agency (MUDRA) banks have been established to improve lending opportunities and spur the expansion of small businesses in rural areas.[10]

There is a multitude of other schemes to support innovation and start-ups like the Multiplier Grants Scheme, ATAL Innovation Mission, Digital India Bhashini, The Venture Capital Assistance Scheme, and so on.

Conclusion

Establishing a start-up is risky, however, it can also be greatly rewarding. The start-ups need to ensure that they do not make common mistakes such as not catering to the market need with the products or services, contacting investors indirectly, etc. In the aftermath of the pandemic, the start-up industry is growing again; however, a significant boost is required to push innovation.

Furthermore, there are several legalities and compliances which need to be fulfilled, to establish a start-up, obtain investments, obtain the benefit of government schemes, and enter into any business transaction. Therefore, it becomes crucial at this stage to seek legal support for start-ups from start-up law firms in India. Several law firms in India specialize in providing legal services to start-ups such as King Stubb & Kasiva.

FAQs

What are the most common essential contracts for start-ups and growing businesses?

There are several essential contracts for start-ups and growing businesses that require help from a corporate lawyer for start-ups. Some of them are as follows:

1. Employment Agreements
2. Confidentiality Agreements
3. Letters of Intent
4. Stock Purchase Agreement
5. Lease
6. Loan Agreements
7. Founders Agreement
8. Shareholders Agreements

What are the different sources of start-up funding?

There are several sources of start-up funding, however, the most common ones are:

1. Bootstrapping and/or borrowing funds from friends and family
2. Small Business Loans from Banks or NBFCs etc.
3. Incubator or Accelerator
4. Government Schemes providing funding
5. Angel Investors and Venture Capitalists

What should the founders know for establishing a start-up?

From a business point of view, start-ups need to know their target audience, conduct market research, target investors, register, develop a unique product, develop a good company culture, and enter into all essential contracts to avoid legal liabilities. Several law firms in India specialize in providing support for start-ups. To establish a start-up, founders can seek the help of such start-up law firms and safeguard their interests.

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[1] Micro, Small and Medium Enterprises Development Act, 2006.
[2] Section 4, The Indian Partnership Act, 1932.
[3] Limited Liability Partnership Act, 2008.
[4] The Partnership Act, 1932.
[5] Section 2(62), The Companies Act, 2013.
[6] The Companies Act, 2013.
[7]https://www.startupindia.gov.in/content/dam/invest-india/Templates/public/Action__Plan.pdf.
[8]https://seedfund.startupindia.gov.in/.

[9]https://pib.gov.in/PressReleaseIframePage.aspx?PRID=1839435.
[10]https://www.mudra.org.in/.