

Factors To Consider Before Choosing a Legal Structure For Business

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What are the considerations one must keep in mind while choosing the right legal structure for business? In the process of establishing a business or an enterprise, its establishers must make a conscious decision pertaining to the choice of the legal structure of a business.

The legal structure of a business determines the business identity, profitability, and stability. Choosing the right business legal structure with a strong, reliant and efficient foundation may ensure great lengths for the business. Let us delve deep into the types of business legal structures and cast light on the factors one must keep in consideration in order to make the right choice.

The Indian Legal framework offers the following types of business legal structures:

Different Types of legal structure for business

Sole Proprietorship

Establishing a sole proprietorship is the least cumbersome form of business organization since it involves least amount of legal documentation. An unincorporated firm that is owned and operated by a single individual is called a sole proprietorship. When it comes to sole proprietorships, obtaining approval from the government is not essential. The owner acts as both their own employer and manager. The proprietor is the owner of the company's assets and is personally responsible for the debts incurred by the firm. As a result, the owners are personally liable for the fulfilment of all corporate commitments. When the proprietor passes away, the business comes to an end.

Partnership

A partnership is an arrangement in which two or more people run a corporation

or other operations for profit as co-owners. Partnership firms may be defined as an arrangement of two or more persons. A partnership exists in the eyes of the law as an independent entity from its individual members. A partnership firm must have a partnership deed in order to be legally recognized. This is a document that must be written by the partners in partnership and attested to by an attorney. The deed details the legal relationship between partners, including profit split, partner duties, and other relevant information. The individual members of a company that are established as a partnership firm do not personally own any of the property that is acquired by the firm. The debts of the partnership are equally and severally the responsibility of the partners. In addition to this, each of them has an equal share of the legal liability for any wrong doings committed by the partnership.

Corporation or Company

A corporation, often known as a company, is an organization of people, who are referred to as shareholders, that is founded as a legal entity for the purpose of doing business. There are several legal conditions that need to be satisfied before a business may be incorporated. Even if one or more of the company's owners passes away, the business will not be dissolved. Companies are considered to be separate entities in the eyes of the law from their individual owners (shareholders).

A company is its own separate legal entity, complete with its own name and corporate seal. It has the ability to own property, have financial obligations, and borrow money. Shareholders are immune from legal responsibility for the activities of the company.

Limited Liability Company

Limited Liability Company (LLC): A flexible business organization that incorporates elements of partnership and corporation forms, a limited liability company, or LLC, is also known as a limited partnership. It is a group of people, often referred to as members, who are associated with one another because they share individual and collective characteristics. It's possible that this is a sole proprietorship, but it might also be a partnership or a corporation. The level of legal protocol is analogous to that of a business. The owners of a limited liability corporation are only partially responsible for the actions of the firm as a whole and the other members of the business.

One Person Company

One Person Company (OPC) is a corporation formed by a single individual. Prior to the implementation of the Companies Act of 2013, an individual could not create a business. A sole proprietorship was the only option available to a person wishing to form a business since a minimum of two directors and two shareholders were required to create a corporation.

According to Section 2(62) of the 2013 Company's Act^[1], a company may be founded with just one director and one member, Director and member may be the same individual. It is a kind of corporation whose compliance standards are less stringent than those of a private corporation. Thus, a one-person company signifies that a single person, who may be a resident or non-resident, may form a firm that combines the characteristics of a corporation with the advantages of a sole proprietorship.

One must examine the following factors before making their choice:

Ease of installation

From a practical standpoint, establishing corporate firms may involve complex

bureaucratic and legal procedures as compared to establishing a sole proprietorship. The process in the Latters case is simple, inexpensive, and involves less amount of time. In addition to registering with HMRC, a limited company must also submit documents to Companies House and provide further documentation. Registration as a corporation also incurs some fees and other expenditures.

Administrative burden and legal requirements

Certain corporate models are subject to significantly greater scrutiny, administrative and regulatory obligations than others. Directors of corporations, for instance, are bound by the Companies Act of 2006 and must conduct commercial operations with reasonable competence, care, and attention. Additionally, corporations are obliged to produce yearly accounts and submit financial reports (which are kept in the public domain). Limited liability businesses are required by law to maintain extensive records of their operations and to pass an annual audit.

Personal risk and liability

It is essential to evaluate the degree of personal accountability and risk when deciding on a company structure. Some organizational models allow for less exposure to personal accountability than others. For instance, a Sole Trader or a Partnership firm implies personal responsibility of the concerned in case of firm losses or obligations.

However, Limited Responsibility Partnerships and Limited Companies form a separate legal structure for the firm, reducing the personal liability of the persons.

Prospects for Scalability

Considering that an organization is still in its infancy, it is prudent to evaluate how the business structure one chooses affects its scalability in the foreseeable future. For example, a Sole Trader, may discover that they lack the desired reputation required to get finance and investment possibilities.

In addition, as a limited company or limited liability partnership, it may be easier to acquire a loan since one has the option to present stock as collateral for the loans required while preserving the option to purchase and sell that stock.

Tax, earnings, and profits

Additionally, one must examine the tax ramifications of the company structure. Sole Traders, Partnerships, and Limited Liability Partnerships, for instance, pay income tax (and National Insurance) on earnings, subject to thresholds, while a Limited Company pays corporation tax.

Conclusion

Business legal structures have many ramifications. It determines the liability that the company faces during lawsuits. It defines the barrier between one's personal and business taxes or ensures that this barrier doesn't exist. With the diverse options available, it is important to weigh all the variables and decide which factors are most significant to your business goals. Not every form is right for every business, therefore it is very crucial to get professional advice from an experienced business attorney for you to understand all the implications of your choice and can succeed in obtaining your business goals.

FAQs

What to consider when deciding on a business structure?

Considerations Before Choosing a Business Structure

1. Existence Durability
2. Complex Procedures
3. Liabilities investment requirements.
4. Business nature
5. Management skills
6. Government controls and restrictions

What are the 4 things that the business structure you choose affects?

Your company structure impacts the amount of taxes you pay, your capacity to acquire capital, the documentation you must file, and your individual accountability.

What is the legal structure of a business?

It is an association of persons, often known as members, who share both individual and corporate features. This might be a sole proprietorship, partnership, or corporation. The legal formality is equivalent to that of a corporation.

[1] <https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf>

<https://www.startupindia.gov.in/content/sih/en/international/go-to-market-guide/types-of-businesses.html>