STARTUP
Legal STAIRCASE

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Prologue

There is a paradigm shift in our philosophy as a nation of "job seekers" to "job creators" and India is the now the fastest-ever growing Start-up hub in the world. Entrepreneurship has become a mainstream career choice and some of the best young minds of the country are Starting-up, rather than a settled Job.

Today, the access to capital is no longer an issue for talented minds. Funding in available in the form of Angel Investors, Venture Capitalist and Equity Investors. To put the ice on the cake, the government of India has started its flagship programme, known as the "Start-up India scheme", in order to provide the Start-ups with the initial handholding.

This is indeed a golden era for the Indian Start-ups. However, if you are planning to begin your Start-up journey, begin with a right legal advice about your business model and other legalities involved therein.

Why Legal is the Show Stopper?

Usually Start-ups overlook the legal compliance, documentation and advisory simply because they are focused on their core business and ideally a founder should focus on business and should have right advisors to help them with key legal & regulatory aspects of business.

For a founder getting investments for their startup is the key and if there are legal defaults and non-compliance then it badly affects the viability and attractiveness to a potential investor. Now investors are getting experts to check businesses they have invested in to identify regulatory & legal compliances and challenges. Therefore, if a Start-up with all the legal compliances in place, wins the trust of the investor, by assuring the potential investors that the Start-up they are investing in, is in safe hands.

Legal costs should be seen as an investment for a clean image & hassle free operations and it also saves business and its founders from paying exemplary cost in the long run. If you do not focus on legal nuances, there are chances that these small issues will blow out of the proportion at a later stage forcing you to pay huge penalties. Such incidents also put a dent on the Start-up's credibility in the eyes of the Authorities and customers. It hinders the progress of the Start-up. What's worse is that it could even land you into jail and lead to shut-down your Start-up even before it gets off the ground.

LegalKart is delighted to share this STARTUP LEGAL STAIRCASE with you and www.legalkart will be the destination to address all your legal worries. We have discussed some of the most important questions that the Start-up entrepreneurs have in mind.

How should I structure my business?

There are many ways in which you can structure your business. You have the liberty to structure it in the simplest form of Sole Proprietorship, or you may run the business along with a partner and may go for Partnership Firm, or if you want to limit your liability, you can structure the business as an LLP or a Company, besides other structures. Each structure comes with its own set of advantages and disadvantages in terms of cost, tax, complexity, compliances etc.

Some of the most popular ways to structure your business:-

Sole Partnership Firm

Meaning

The sole proprietorship is the simplest business structure under which one can operate a business. Under sole proprietorship, only one person owns the business and he/she is personally responsible for its debts.

Advantages

- High level of autonomy/control
- Least compliances
- No splitting of profit

Disadvantages

- Personal liability (in paying off debts)
- No separate legal identity
- More responsibility

Partnership Firm

A partnership firm is an organization which is constituted by two or more persons to run a business with a goal of earning profit. Each member of such firm is known as a partner and collectively the firm is known as a partnership firm.

Minimum and Maximum Partners

- Minimum – 2
- Maximum – 50 (as per Rule 10 of Companies (Miscellaneous) Rules, 2014)

Advantages

- Sharing of responsibility and liability
- Sharing of losses
- More capital can be contributed
- Less compliances
- Profit has to be divided amongst the partners

Disadvantages

Personal liability (in paying off debts)
One partner is also liable for the negligent act of another partner

Limited Lability Partnership

Meaning

In India, LLP is constituted and governed by Limited Liability Partnership Act, 2008.

Under limited liability partnership (LLP), some or all the partners have limited liabilities. An LLP is like a hybrid model, as it exhibits the elements of both, partnership and company. In LLP, partners are not liable for the misconduct or negligence of one another. This is an important difference from the traditional partnership firm.

Minimum and Maximum number of Partners

- Minimum – 2
- Maximum – No limit

Additionally, there should be at least two number of designated partners who shall be individuals, and at least one of them should be resident in India.

Advantages

- Limited liability
- Separate legal entity
- Cost of forming an LLP is low
- No requirement of minimum capital contribution
- Its not mandatory to conduct statutory annual meetings
- Lesser compliances and regulations than a Company structure
- Profit can be shared regardless of stake held by partners

Disadvantages

- Two foreign partners cannot form an LLP without having one resident Indian partner along with them
- Transfer of ownership by one partner requires consent of all the partners
- Non-compliance of statutory obligations can lead to huge penalties

1. **Private Limited Company**

A Private Limited Company is a business entity held by small group of people (i.e. between 2 and 200), called the shareholders or members. It has a separate legal identity and in case things go bad, member's person liability is limited to the extent of a private limited company has to be registered with the Registrar of Companies (RoC).

Usually, Startups and businesses with high growth aspirations choose this kind of structure as it is the most suitable structure for receiving investments, and more specifically, foreign investments.

Governing Statute

In India, a private limited company is governed by the Companies Act, 2013, and by the various rules made thereunder.

Minimum and Maximum number of Members

- Minimum – 2
- Maximum – 200

Additionally, there should be at least two number of directors, out of whom, one has to be an Indian Citizen and Indian Resident.

Advantages

- Separate legal entity
- Perpetual succession (uninterrupted existence)
- Limited liability of members
- No minimum capital is required. A Private Limited Company can be registered with a mere sum of INR 10,000 as total Authorized Share capital
- A Private Limited Company in India is the only form of business except Public Limited Companies, that can raise funds from the Venture Capitalists (VC) or Angel investors.
- Raising foreign funds is also easier
- Shares of Company can be easily and freely be transferred
- A private company is eligible to take benefit of registration under 'Startup India' scheme of the Government of India, which offers multiple benefits, including tax exemptions, to the recognised Start-ups.

Disadvantages

- Two foreign directors cannot form a Company, without having one resident Indian director along with them
- Registration process can take some time
- Registration process is little costly
- Company is fully liable for its debts and has unlimited liability (However, its members have limited liability)
- Compliance obligation is more
- Non-compliance of statutory obligations can lead to huge penalties
- The procedure for winding up of a company can be complicated, time consuming and costly

What is the right time to incorporate or register my business?

Before we jump on to discuss when is the right time to incorporate a company, let us quickly look at some of the advantages associated with it.

Benefits of Incorporation:-

- **Presenting a professional image to customers, suppliers, and investors** – Becoming incorporated enhances your credibility and status. As you are trying to establish and build relationships with the customers, suppliers and investors, having the company tag attached to your name gives you an edge when competing for the business. Another consideration is to own the web domain in the name of the company.
- **Greater ease in obtaining financing and funding** – Lenders generally prefer an incorporated business and may hesitate to provide a loan to a sole proprietor. Sole proprietorships are often considered riskier because there is no separation between the owner's personal assets and the business (meaning the owner can spend his or her money on him or herself instead of the business). And some investors want a share of the business, which cannot be done in a sole proprietorship, but can certainly be done in a corporation.
- **Possible tax advantages** – Incorporating your business may help lower your tax liability, depending upon a number of issues, such as your personal income tax rate, whether you will reinvest your income, and whether you will be drawing a salary.
- **Limited liability protection** – Operating as a sole proprietorship invites risk. In the eyes of the law, there is no difference between your personal assets and those of your business. If your business incurs debts (if you can't pay your suppliers or commercial lease, for example) or an accident occurs, then you are personally liable for them. If a corporation or LLC owns the business, that corporation or LLC is liable for its debts, not its shareholders or members.

When should I incorporate?

Let us get down to address the elephant in the room:-

You should incorporate early

Incorporating early has a lot of benefits, such as incorporating before you enter into contracts would ensure that you enjoy limited liability protection, the Intellectual Property Rights (IPRs) for the work done by the co-founders or employees could be easily assigned to the company, in case your any of your employee makes a blunder, you again enjoy the shield of limited liability. Besides this, you become eligible for Start-up Programs launched by the respective governments, and can enjoy certain benefits associated with that.

But you should not incorporate way too early

However, you should also not make the mistake of incorporating way too early, considering the downside associated with that, such as it becomes much more expensive to operate the business as a company, than operating it as a sole proprietorship or unregistered partnership. There are fees for incorporating and then annual fees as well.

Also, there are other compliance requirements – such as having to maintain certain records, appoint and maintain a registered agent, file annual reports, hold shareholder meetings, etc., that sole proprietorships do not have to deal with. In addition, if the owner decides to discontinue the business, as a sole proprietorship, the owner just has to stop doing business. Corporations have to go through a formal dissolution and winding up process.

So, if you are only in the planning stages of starting a business, you may wish to focus on the implementation of your ideas, building a prototype and hold off incorporating until you have more concrete plans for important matters such as contract relationships, hiring employees, taking on partners, receiving funding, etc.

Trademark: What is it?
Is it important for you to register your trademark?

Before jumping on to answering this question, we have to first understand what a trademark actually means.

Meaning of Trademark

A trademark can be defined as a type of intellectual property consisting of a recognizable sign, design, or expression which identifies the products or services of a particular organisation and distinguishes it from those of the competitors. A trademark could be a name, word, phrase, logo, symbol, design, image or a combination of these elements. *For example, the brand name "Samsung" and its logo is a trademark.*

Importance of Trademark

- Makes your brand stand apart from the other brands
- Communicates effectively with the customers
- Makes it's easy for the customers to find you
- Helps in marketing and promotion of product
- The value of trademark improves over time
- Good brand name makes hiring easy
- Expresses people what the business is all about
- Intrinsic to the success of the business

Therefore, it becomes extremely pertinent to protect one's trademark.

Is registration important to protect a Trademark?

Instead of answering this question straightforwardly, why don't we rather discuss the benefits of trademark registration, and then leave the rest up to you to decide whether you should go for trademark registration or not.

6 most popular benefits offered by a registered Trademark

1. **Exclusivity:** Once you register your trademark, you get an exclusive right to use that trademark. This essentially means that no one else can use your trademark or deceptively similar trademark without your consent. And in case someone else tries to replicate your trademark, you can seek injunction from the court of law and restrain such unauthorized use.
2. **Using ® Symbol:** Once your trademark is registered, you can use the ® symbol along with your brand name or logo intimating that it is a registered trademark and no one can use the same trademark. Thus it is a direct intimation to the third parties regarding the ownership of the trademark.
3. **Assignment:** Once your trademark is registered, you can either use it for your own exclusive use, or you can transfer, sale or assign it to a third party for the exchange of money.
4. **License:** A registered trademark is your property, and you may also license it to the third parties, either for their exclusive or non-exclusive use. In such case, the ownership of the trademark remains with you, but the third parties only get a license to use it in certain pre-determined manner.
5. **Franchise:** Once you've created a good brand name, you may decide to exclusively enjoy your brand name (*the way Pepsi does),* or you can give license to third parties in different jurisdictions, to run franchise stores using your brand name, in which case you earn Franchise Fee as well as royalty *(for example, McDonalds)*.
6. **Protection against Infringement:** If you find that someone else is unauthorisedly using your registered trademark, without your approval, or is making any deceptive use of the same, you can get the legal protection under the Trademark Act, 1999, and stop the person doing so.

Registering a trademark should be a top priority when a startup is being established. It will protect a business from the get-go, enabling its success in the long run. It is important to secure a startup at the very beginning in order to gain an advantageous position and to prevent any financial loss in the future. Once registered, your trademark is valid for 10 years, after which it can be registered again.

So, what do you think? Should you go for trademark registration?

What licenses do I need to operate my business?

The process of obtaining license changes from one type of business to the other, based on various determining factors like the number of employees, sector, the type of business, the place of business etc. In this little article, we look at some of the most commonly obtained licenses or registrations for a business.

Company or LLP Registration

If you operate your business as sole proprietorship or as a partnership firm, registration is not mandatory for you (even though you can still opt for one). However, if you structure your business as an LLP or a company, you need registration. A company needs to be registered with the Registrar of Companies (RoC) and an LLP can be registered with Registrar of Firms (RoF). There are many benefits of structuring your business as LLP or as a company. Please refer to our discussions in question no.1 to learn the benefits.

GST Registration

GST Act and rules prescribe the criterion and the entities or individuals who fall within that criterion have to avail GST registration. One of such criterion is that the entities and individuals who have an aggregate annual turnover of more than INR 20 lakhs in most State (and INR 10 lakhs in Special Category States) are required to obtain GST Registration. The businesses and individuals falling with such criterion have to obtain the GST registration within 30 days of starting the business.

Udyog Aadhar Registration

This is a registration available for entrepreneurs who want to start and operate a small business, i.e. micro, small or medium enterprise. The eligibility criteria for obtaining Udyog Aadhaar registration is based on the investment in the plant & machinery made by a manufacturing concern or investment in equipment made by a service provider.

Once, Udyog Aadhaar registration is obtained, the business can enjoy various subsidies and schemes provided by the Government to such small businesses.

FSSAI License or Registration

Every food business operator involved in the manufacturing, processing, storage distribution and sale of food products must compulsorily obtain FSSAI Registration or License.

FSSAI Registration is different from FSSAI License in the sense that depending on the size and nature of the business, FBO should obtain the necessary registration or license.

It is a 14-digit registration or a license number which is printed on all the food packages and it gives details about the assembling state, producer's permit. The licensing and registration procedure and requirements are regulated by Food Safety & Standards (Licensing and Registration of food Business) Regulations, 2011.

Import Export Code

Any person involved in import or export of goods/services from India must obtain Import Export Code from the Director General of Foreign Trade (DGFT) department. To obtain Import Export Code, it is mandatory for the business to have a PAN and a current account in a bank.

Shop and Establishment Act License

Shops and Commercial Establishment Acts, which are state-wise legislations regulate the employment of employees working at Shops and Commercial Establishments, across the country. It is applicable on all the commercial establishments, such as the hotels, and eateries, amusement parks, theatres, and other entertainment houses, as well as any other such public amusement places, come under the purview of the Act.

The objective is to secure uniform benefits for employees working in different establishments, from shops, commercial establishments and residential hotels to restaurants, theatres and other places of public amusement or entertainment. This registration is mandatory and the license under the Shops and Establishment Act forms a basic license and a proof of your business to apply for other registrations required to run a business in India. You will also require this license if you want open a current account in a bank. If you are starting a commercial establishment or a shop, you need to file for registration under the Act, within 30 days of commencement of your establishment.

MSME Registration

MSME Registration can be obtained by micro, small and medium enterprises in India to enjoy various subsidies and benefits in terms of loans, taxation, and other schemes. There are multiple benefits laid down by the MSMED Act, 2006 for micro, small and medium enterprises for their machinery and raw material which can be purchased at a subsidised rate.

The eligibility criterion for registration is also provided for in the act and is based on the investment in plant and machinery as well as annual turnover.

Sectoral Licenses

Apart from the licenses and registrations discussed above, there are many sector specific licenses and registrations that a business requires. For example, if you dealing with insurance business, you require approval from IRDAI, if you are engaged into non-banking financial institutions or fin-tech companies, you require NBFC registration, if you are engaged in multimedia broadcasting platforms then you require broadcasting licenses, etc.

Other Licenses and Registrations

Further, a business may also have to obtain permits from the fire department, or the air or water pollution control board, or maybe the local healthcare system, etc.

What is ‘Start-up India scheme’ of the government of India? What are the its benefits?What is Start-up India scheme?

Start-up India Scheme is implemented through the Department of Industrial Policy & Promotions (DIPP), Government of India and is an initiative of the Government of India, which is intended to build a strong eco-system for nurturing innovation and in order to help the recognized Start-ups in reducing their regulatory and financial burden.

A business will be recognised as a ‘Start-up’ under this scheme only after obtaining a Certificate of Registration from Start-up India Hub. The eligibility criterion for getting recognized as a Start-up is listed below.

When will a business be considered as a Start-up?

- If it is incorporated as a private limited company, or registered as a partnership firm, or as a limited liability partnership (LLP) in India.
- 10 years have not elapsed since the date of its incorporation/registration.
- If its turnover for any of the financial years since incorporation/registration has not exceeded INR 100 Crore.
- If it is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation.

Note:- If any such entity is formed by splitting up or reconstruction of a business that was already in existence, shall not be considered a 'Startup'.

Benefits of registering under Start-up India scheme?

- **IPR benefits:** In order to promote awareness and adoption of IPRs by Startups and facilitate them in protecting and commercialising the IPRs, Startup India provides access to high quality Intellectual Property services and resources. It provides advisory services, fast-tracking of Patent applications, 80% rebate in filing of Patent application and 50% rebate in filing of Trademark application.
- **Public Procurement:** The recognized Start-ups enjoy relaxation in public procurement norms, in terms of prior turnover, prior experience and earnest money deposit (EMD).
- **Self-certification under Labour and Environment Laws:** In order to reduce the regulatory and financial burden on Startups, they are allowed to self-certify themselves in terms of the compliance requirement under various labour and environment laws, for a period of 3 to 5 years, from the date of their incorporation/registration.
- **Faster exit:** Ministry of Corporate Affairs (MCA) has notified Start-ups as 'fast track firms' enabling them to wind up their operations within 90 days (whereby this period is 180 days for other companies).
- **Tax exemptions:** The recognized Start-ups are exempted from paying income tax for a period of 3 years out of the years, from the date of its incorporation/registration. Likewise, there are many other taxation benefits available for such Start-ups.

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