DETERMINING THE BETTER FORM OF ORGANISATION FOR STARTUPS: LLP OR PRIVATE LIMITED COMPANY

Shailaja Mishra* Shailendra Singh*

ABSTRACT

One of the best ways to gain financial independence and improve the image in society is by carving your path on your terms in running a business entity. For starting a business, you need to take certain decisions which affect the overall life of an entity. These decisions are regarding the name of the company, nature of the business, size of the business, ways to arrange the funds and most importantly the form of business organisation. A passionate entrepreneur looking to initiate a startup is in the dilemma of choosing between a limited liability partnership which is registered under the limited liability partnership act 2008, or a private limited company which is registered under the companies act 2013. Both of them have certain similarities i.e., registration of both is done on the MCA portal but there are also certain differences. This article deals with the advantages and disadvantages of both forms of business over each other. There will also be a detailed analysis based on the registration process, ownership and membership, funding and compliance, taxation and penalties which would give a brief idea to select the appropriate one.

Keywords: Startup, Agreement, Partners, Shareholders, Capital requirement, Registration, Perpetual Succession.

INTRODUCTION

Every business is governed by certain rules and regulations which are defined by the governing body. This framework forms the basis of entrepreneurship and determines the business's growth and prosperity. Whenever a new entrepreneur wants to start a business, the first and foremost thing which comes to his mind is which form of business will suit his necessity. A startup in India also faces such a challenge where the best form of company is to be decided. Though the most popular and well-known form of organization is a private limited company, nowadays limited liability partnership is also becoming desirable for budget-oriented startups. In India starting a new business is quite easy. However, when it

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comes to the transformation of one form of business to another it requires a lot of legal compliance and certain expenses. Therefore, utmost care should be taken in deciding the form of business which has to be chosen.

Private limited companies have existed for a very long time but LLPs (limited liability partnerships) is a new concept in India that was introduced in India in 2008[1].

LIMITED LIABILITY PARTNERSHIP AND ITS CHARACTERISTICS

A limited liability partnership is a firm with two or more partners bearing limited liabilities towards the firm. No partner is accountable for the illegal activities of any other partners. Each partner is only responsible for his acts and therefore, an LLP is a legal entity separate from its partners having perpetual succession[2].

The minimum capital required to start an LLP is not specified. The partners are only liable to the extent of their compositions which they have employed in the business. LLP is generally suitable for startups small and medium-sized businesses, traders and businesses which do not require huge funding.

PRIVATE LIMITED COMPANY AND ITS CHARACTERISTICS

A private limited company is owned and managed by a group of shareholders where a minimum of two and a maximum of 200 members can be there. The members of the private limited company are only accountable to the extent of shares held by them in case of losses faced by the company. There is generally a restriction on the transferability of shares which means that shares can only be transferred to the existing members of the company and the general public cannot be invited to subscribe to its shares. This form of business is suitable for enterprises that need huge funds.

MERITS AND DEMERITS OF LIMITED LIABILITY PARTNERSHIP

THE FOLLOWING ARE THE MERITS OF REGISTERING BUSINESS AS AN LIMITED LIABILITY PARTNERSHIP:

[1] https://cleartax.in/s/private-limited-company-versus-llp accessed on 12-07-23
[2] https://www.zeebiz.com/small-business/in-depth-whats-better-for-startups-a-private-limited-company-or-an-llp-2769 accessed on 12-07-23

1. The first and foremost advantage is that an LLP (limited liability partnership) is easier to incorporate and also contains lesser formalities.
2. The registration cost of an LLP (limited liability partnership) is comparatively less than the registration cost of a company.
3. A limited liability partnership (LLP) has separate legal existence because it is a corporate body that can sue and can be sued in its name.
4. The limited liability partnership (LLP) has perpetual succession as its existence is not affected by the death or exit of any partner.
5. There is no minimum limit specified for the starting of an LLP (limited liability partnership) it can be started with any amount.
6. The partners of an LLP (limited liability partnership) are only liable to the extent of the capital invested by them. They cannot be held accountable for compensating the losses incurred by the unethical activities of their partners[3].

THE DEMERITS OF AN LLP ARE AS FOLLOWS:

1. The minimum requirement for an LLP to continue is 2 partners, i.e., if one of the partners exits the business the LLP is automatically dissolved.
2. If any compliance is not met regarding an LLP the penalties are very high.
3. For the expansion of any business external funding or angel investors are needed. But in the case of LLP, procurement of funds is harder since the investors can't become the shareholder of the LLP.

MERITS AND DEMERITS OF PRIVATE LIMITED COMPANY

THE FOLLOWING ARE THE MERITS OF PRIVATE LIMITED COMPANY:

1. The minimum paid-up capital is not specified for a private limited company. Therefore, it can be started with any sum of money.
2. A private limited company has perpetual succession i.e., it is not dissolved with the exit of any members or any other uncertainty.
3. The members of a private limited company are only responsible to the extent of shares held by them, so they have limited liability.

[3] https://cleartx.in/s/private-limited-company-versus-llp (n-1) accessed on 13-07-23

4. A private limited company is a separate legal entity from its members. Therefore, it can sue or be sued in its name.
5. If the company aspires to expand its business it can easily issue shares and raise funds from external sources[4].

THE FOLLOWING ARE THE DEMERITS OF PRIVATE LIMITED COMPANY:

1. The maximum membership of a private limited company is limited to 200. Therefore, it needs to take care before issuing shares in small quantities.
2. The shares which are held by the members cannot be transferred outside the existing shareholders. Therefore, the transfer of shares is limited.
3. A private limited company cannot issue a prospectus inviting the general public to subscribe to the shares of the company. So, no fresh issue of shares is possible.

DIFFERENCE BETWEEN A LIMITED LIABILITY PARTNERSHIP AND A PRIVATE LIMITED COMPANY

Any new entrepreneur who wants to choose a form of company between an LLP and a private limited company has to know the differences between both of them, without which the entrepreneur cannot take the correct decision. The following is the point of difference which will give a clear perspective.

Ownership – In a limited liability partnership, the partners are the owners as well as manage the day-to-day business. There is no clear difference between the management and the ownership. There are no additional shareholders and therefore, a partner can be a manager or the owner of the business. On the other hand, in a private limited company, there is a clear distinction between the management and the ownership. The shareholders of the company do not participate in the management and day-to-day functioning of the business. The board of directors has the managerial authority. There is also a limitation on the transfer of shares outside the existing members of the company therefore, no one can be added to ownership through the issue of fresh shares[5].

Registration process – A private limited company is registered under the companies act 2013, while a limited liability partnership is registered under the limited liability partnership

[4]Ibid
[5]https://business.paytm.com/blog/pvt-ltd-limited-company-vs-llp-kb/ accessed on 14-07-23

act 2008, both of them are registered with the Ministry of Corporate Affairs (MCA). The registration process of a limited liability partnership and a private limited company is almost similar with only a few differences. The registration application is filed with the registrar of the companies on the MCA portal.

The designated partners have to obtain the designated partner identification number (DPIN) in case of a limited liability partnership for registration. The directors of a company have to obtain a director identification number (DIN) to register a private limited company. The LLP must file the FILLIP form to register itself while in the case of a private limited company the SPICe+ form to register the company. The name of an LLP must contain the word '**LLP**' at the end while the name of the private limited company should end with '**Pvt. Ltd'.**

The document which governs the internal working of an LLP is called the LLP agreement signed by all the partners and it is filed with the MCA, but it is not a public document. On the other hand, the documents which govern a company are AOA (Articles of Association) and MOA (Memorandum of Association). Since these are public documents, any outsider can obtain them from the MCA portal by paying a prescribed fee. The registration fee for the incorporation of an LLP is comparatively less and also the documents that must be printed and notarised on stamp paper are lesser for an LLP. While the registration fee and the documents are comparatively more in the case of private limited company registration[6].

Membership and Directors – In an LLP the minimum number of partners is 2 and the maximum number is not specified, also there is no compulsion of having a minimum of 2 directors. On the other hand, the private limited company needs to have a minimum of 2 members and a maximum of 200, also a minimum of two directors to be appointed at the time of incorporation.

Compliance – For an LLP conducting board meetings or annual general meetings is not a compulsion because the partners who are also the owners manage the business. In a private limited company, a minimum of 4 board meetings every year and an annual general meeting within six months before the end of the financial year is compulsory because the directors manage the business on behalf of shareholders. These meetings result in transparency and better policy formulation. The statutory audit for an LLP is not compulsory, but if the annual turnover exceeds 40 lakhs and the capital contribution exceeds 25 lakhs, it should get its

[6] https://cleartax.in/s/private-limited-company-versus-llp (n1,n3) accessed on 14-07-2023

account audited. The statutory audit in the case of a private limited company is mandatory irrespective of its annual turnover[7].

Foreign Investment – For foreign investment in an LLP, prior approval of the Reserve Bank of India and the foreign promotion investment board is required. Foreigners can invest in a private limited company by FDI and FPI under the automatic approval route in most sectors[8].

Fines and Penalties – The penalty for non-compliance or late filing of documents is most of the time higher for the LLPs as compared to the private limited company. Therefore, the promoters of an LLP must be compliant and follow the due dates for filing the documents to avoid excess fines[9].

Taxation – An LLP must pay a fixed 30% tax on its earnings. But if the income exceeds the 1 crore limit, the tax is increased by a 12% surcharge. On the other hand, a private limited company has to pay a tax of 25% if its earning is less than 400 crores and ifearning is more than 400 crores the tax rate increase to 30%. Private limited companies can also choose the new tax rates.

Statement of accounts – A private limited company must file with the Registrar of Companies its annual financial statement and annual return in Form AOC-4 and Form MGT-7 respectively. While an LLP has to file with the Registrar of Companies the statement of accounts and solvency and annual returns in Form-8 LLP and Form-11 LLP, respectively[10].

CONCLUSION AND SUGGESTION

Based on the above differences we can conclude that the purpose and the size of the business are the two important factors along with the long-term objectives of the company which help us decide the form of business to be adopted. The concept of a private limited company is quite old and has been prevalent in India for more than 100 years, therefore it has people's acceptability, reliability and credibility. LLP on the other hand is a new concept and people are not much familiar with it. So, a business that has to attract more members and needs more funds should go for a private limited company as it can issue shares and procure the required

[7]https://thestartuplab.in/difference-between-llp-and-private-limited-company-in-india/ accessed on 14-07-23
[8]Ibid
[9]https://www.indiafilings.com/learn/private-limited-company-vs-llp/accessed on 14-07-23
[10]https://cleartax.in/s/private-limited-company-vs-llp (n1,n3,n6) accessed on 14-07-23

capital which is needed to run the business. But a person should opt for an LLP if the partners are fewer and the capital employed is not a huge amount.

The private limited company gives the option of inviting foreign investments which can help diversify and expand the business and finance various other growth projects which might not be fulfilled by the shareholder's fund. FDI in LLP needs to go through approvals from financial institutions so it is hard to attract.

LLP is suitable for a business in which the owners want to supervise and manage the business themselves because they don't want any external interference also a small business is easily manageable by two to three persons. On the other hand, a private limited company can have a maximum of 200 shareholders and therefore, need a board of directors to manage the affairs of a company.

An LLP also has fewer compliances i.e., auditing is mandatory only after a certain turnover is exceeded and also less, number of documents need to be filed. While the private limited company needs to be compulsorily audited and documentation is also more in its case. Therefore, an LLP has an upper hand in small-scale businesses and a private limited company is suitable for a large and expanding business.