

REGISTRATION LAWS AND CHALLENGES IN INCORPORATION OF FIRMS

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1. INTRODUCTION

India, as seen today is going through the phase of anomalous economic liberation, opening its base to the vast consumers. It is an enormous country with massive economic potential and is known as one of the fastest growing counties in the world. Registration laws mean the rules and regulations that govern the process of registering. For instance, the process laid down in the registration act provides for all the requisites for the registration of the firms, if the requirements are not duly fulfilled then the firm would not be considered as a registered firm and its registration process would simply be incomplete. But not all firms have to register themselves as the registration laws are different for different firms and certain laws do not make it compulsory for the firms to register them. The incorporation of firms means, the insertion of something as a part of a whole. For example, whenever a company is registered under the companies act it becomes the part of the state and thus there is witnessed an increase in the total number of companies set up in that state. The term firm has a wider connotation as it includes all the forms of business organization which are the partnership firm, limited liability firm, sole proprietorship, Hindu undivided family, statutory bodies, co-operative societies, trusts, companies, non-governmental organizations and so on. Their process of registering and incorporation are different but there are certain common challenges that are faced by all the different kinds of firms.

1. REGISTRATION LAWS

In India the registration laws are different for the different kinds of firms which are in existence. These registration laws are different in respect of every type of firm due to the varied nature of work that is carried out, the capital requirements, the size of the firm, the number of partners and risks involved. Therefore, it is important to know the registration laws of the divergent firms.

1.1 Partnership Firm:

A partnership is the relation between the people who decide who carry out the business together by pooling their resources and to share the profit and losses that arise in the course of such business. The legal definition of a partnership is given the Partnership Act of 1932, it states that a Partnership Firm is the relation between the persons who have agreed to share the profits and losses arising out of the business that is carried on by all of them or any one of them on behalf of all of them.¹ The persons so involved are called “partners” and name under which they carry out their business is called “firm name”.² The registration process of the partnership firm is stated in the Indian Partnership Act, 1932 under Chapter VII, titled as Registration of firms.

Section 56³ declares that it is upon the discretion of the State Governments as to whether the registration in a particular state would be made compulsory or not.

Section 57⁴ states that for the purpose of registration the State Government would provide for a Registrar who will be deemed to be a public servant.

Section 58⁵ states the application for registration. It mentions that any firm who wants to register under the act has to write to the registrar with the partnership deed and the prescribed fee. The deed should be signed by all the partners. The deed should contain the following information regarding the name of the firm, the nature of business, the address of the head office and the branch offices, the name and address of the partners, the duration of the firm, the date on which the partner entered the firm, the ratio in which the partners brought the capital the ratio in which the profits and losses would be shared by the partners and any other information that may be mutually agreed upon by the partners by executing the partnership deed.

¹ Section 4, Indian Partnership Act, 1932, No. 8, Acts of Parliament, 1932 (India)

² *Id.* At 1

³ Indian Partnership Act, 1932, No. 8, Acts of Parliament, 1932 (India)

⁴ *Id.* At 3

⁵ *Id.* At 3

Section 59⁶ declares that if the registrar is satisfied with all the documents, then he would issue a certificate of registration and make an entry in the registrar of books. After such entry is made in the books the firm is deemed to be registered.

Although the registration of the firm is not compulsory but it is advisable to get the firm registered due to certain benefits that can be availed by the firm only when it is registered. Only a registered firm has the right to sue and be sued in the court of law or the partners have the right to sue each other or a partner can sue the firm.⁷ Thus, any subsequent registration after the filing of the suit would be considered void. It is not possible to subscribe to the view that subsequent registration of the firm may cure the initial defect, because the proceedings are void ab initio defective as they could not have been instituted since the firm in whose name the proceedings were instituted was not a registered firm on the date of the institution of the proceedings.⁸

1.2 Limited Liability Partnership Firm:

A limited liability partnership is a partnership in which some or all of the partners have limited liability. It exhibits the elements of a partnership firm as well as a corporate body. In this type of firm each partner is not responsible for the acts of the other partners. According to the Limited Liability Partnership Act of 2008, limited liability partnership means a partnership formed and registered under the Act in question.⁹ The registration process of the LLP is governed by the Limited Liability Partnership Act, 2008 under chapter III, titled as Incorporation of Limited Liability Partnership and incidents thereto.

Section 11¹⁰ states that if two or more persons associated for carrying on a lawful business with the view to earn profit shall subscribe their names to an incorporation document; the document will be filed with the registrar with the requisite information and prescribed fee. The document must be attested by an advocate, a company secretary, chartered accountant or the cost accountant. The document must contain the following information, that is, the name of the limited liability partnership firm, the nature of the

⁶ *Id.* At 3

⁷ Section 69, Indian Partnership Act, 1932, No.8, Acts of parliament, 1932 (India)

⁸ DDA Vs Kochhar Construction Work and Anr., (1998) 8 S.C.C. 559 (India)

⁹ Section 2 (n), Limited Liability Partnership Act, 2008, No. 6, Acts of Parliament, 2009 (India)

¹⁰ Limited Liability Partnership Act, 2008, No. 6, Acts of Parliament, 2009 (India)

firm, the address of the head office and the branch offices, the name and address of the partners and any other information concerning the firm and the partners.

Section 12¹¹ states that the registrar would then retain the document and within a period of fourteen days would investigate and then if satisfied would register the document and provide a certificate for the same.

1.3 Sole Proprietorship:

Sole proprietorship is a form of business in which only one person owns all the assets of the business.¹² Thus, any person who performs business activities without formally creating a business organization is known as a sole proprietor. This type of firm does not possess a separate legal entity and thus while its incorporation no legal formalities are required other than obtaining a license and registering the name of the business. There is no specific act for such firm but the procedure is as follows:

The sole proprietorship business can be established through opening a bank account in the name of the proprietorship firm or obtaining licenses required for conducting the business. The documents required for registering the firm is the proprietor PAN card and the sales and income tax returns.

1.4 One Person Company:

One Person Company is a company in which only one person is the member.¹³ Any person who is a naturally born Indian or any person who is the resident of India for at least 182 days after the commencement of the Companies Act can incorporate a One-Person Company.¹⁴ An OPC must appoint a Nominee in case of any death, incapacity or any other event. The nominee would be deemed to be the member of the firm, be entitled to the shares and must bear the liabilities of the OPC. The nominee has to give a valid consent after his name has been listed to be as a Nominee in the firm. One-person company is different from the Sole Proprietorship because of the following essentials,

¹¹ *Id.* At 10

¹² Definition of Sole Proprietorship; (Sep. 2, 2017, 3:00 PM), <http://www.businessdictionary.com/definition/sole-proprietorship.html>

¹³ Section 2(62), Companies (Amendment) Act, 2013, No. 1, Acts of Parliament, 2013 (India)

¹⁴ Rule 3.1 of Companies (incorporation) Rules, 2014

that is, OPC has a separate legal entity, the liability of the shareholder is limited, the succession in this case is through a Nominee, they are taxed in the same manner as a private company and they have to file annual returns.¹⁵ The registration process of OPC is the same as the private company.

The Requirements to form a OPC are a minimum of one director and member with a share capital of 1 lakh. First, an application for the Director Identification Number (DIN) and Digital Signature certificate (DSC) is made to Ministry of Corporate Affairs with the following documents¹⁶,

- Copy of the PAN Card as identity proof.
- The address proof in the name of the applicant
- Latest passport size photograph
- Email address and mobile number of the applicant
- Education qualification of the applicant along with verification and attestation of documents provided.

After the above verification of documents, the name of the company is approved and then the memorandum of association and the memorandum of articles are drafted. After the drafting process, the filing of e-files with the Registrar of companies takes place. The verification of the forms takes place and then the fees is made for the same. After the aforesaid mentioned steps, if the registrar is satisfied with the documents he issues a certificate of registration and incorporation.

1.5 Company:

Company is a discretionary association that is formed and organized to carry on a business.¹⁷ The legal definition of a company is a association of persons who are interested in a common objective who unite themselves to carry on a lawful business.¹⁸

According to the Companies Act of 2013, a company means a company incorporated

¹⁵Vivek Kumar Verma & Aishwarya Rao, *One Person Company under Companies Act, 2013*, (Sep. 2, 2017, 5:00 PM), <https://indiancaselaws.wordpress.com/2015/09/16/one-person-company-under-companies-act-2013/>

¹⁶ CS Meenal Abhyankar, *Procedure of One Person Company formation, in India*, (Sep.3, 2017, 1:00 PM), blog.abhyankarcs.com/company-formation-in-india/procedure-of-opc-one-person-company-formation-in-india/

¹⁷ Definition of Company, (Sep. 3, 2017, 4:00 PM), <http://www.businessdictionary.com/definition/company.html>

¹⁸ Black's Law Dictionary

under this Act or under any previous company act. ¹⁹A company is suitable where large number of resources is required and the business has to be carried out on a large scale. The registration of a company is compulsory under the Companies Act, 2013. The procedure is covered under section 7²⁰ of the act, which is as follows:

Firstly, all the required documents like the memorandum signed by the subscribers, an affidavit by an advocate or a company secretary or a chartered accountant or a cost accountant along with the prescribed fee to the registrar. Secondly, if the registrar is satisfied then he would provide the company with a corporate identity number which will be the distinct identity of the company. Then he would make an entry in the register and issue the certificate for the same.

1.6 Co-operative:

A co-operative society is the association of people who voluntarily united to achieve their economic, social and cultural needs. The procedure for registration is provided under the Co-operative Societies Act, 1912. The procedure is as follows:

An application is to be made to the registrar which is to be duly signed by the competent persons who would be forming a part of the society. The application should be accompanied by a letter stating the name of the society. Subsequently, a bank account has to be opened on the name of the society. The application for registration of the society should be submitted to the Registrar of Societies of the concerned municipal ward. The documents to be submitted for registration are as follows:

- Required form to be signed by 90% of the promoter members.
- Bank Certificate
- Detailed explanation of working of the society
- Proof of payment of registration charges
- Affidavits, indemnity bonds, any documents specified by the Registrar also have to be submitted.

¹⁹ Section 2(20), Companies (Amendment) Act, 2013, No. 1, Acts of Parliament, 2013 (India)

²⁰ Companies (Amendment) Act, 2013, No. 1, Acts of Parliament, 2013 (India)

Then if satisfied, the registrar would make an entry in the register and will also notify the registration of the co-operative society in the official gazette and issue a certificate of registration.

1.7 Trust:

Trust is an arrangement wherein one person (trustee) holds the property as its nominal owner for the benefit of the other people (beneficiaries) whose names are mentioned in the Trust instrument. The procedure for the registration of the trust is given under The Trust Property Control Act 57 of 1988. Section 11²¹ states that the trustee firstly has to show in his book keeping the property that he holds as a trustee. Secondly, he is required to register the trust property, if required and then open an account in any financial institution, such account should be identifiable as a trust account. After this, the trustee is given a period of 12 months to take such steps so as to bring the property into identification.

1.8 Joint Venture:

It is a commercial enterprise that is undertaken jointly by two or more parties. Such parties distinctly have their own identity before they enter into such a venture. A joint venture can be organized as a partnership firm, cooperation, company or any other business organization which the merging firms choose to select. The incorporation and registration procedure for the joint venture is the same as that of a private or public company. Therefore, its registration process is the same as for the companies and is guarded by the Companies Act, 2013.

2. INCORPORATION OF FIRMS

Incorporation is the legal process that is used to form a corporate entity.²² The process of incorporation involves the drafting of Articles of Incorporation that is the primary tasks in the setting up of a firm that is followed by the registration process. The process of incorporation gives the firm a separate legal entity from that of its owners and is responsible for its own debts, incorporation held in increasing the creditability of the business as an incorporated and registered firm is trusted by the people and it is easier for the incorporated firm to raise the capital.

²¹ Trust Property Control Act, 1988, No.57, Acts of Parliament, 1988 (India)

²² Investopedia, (Sep.5, 2017, 7:00 PM), <http://www.investopedia.com/terms/i/incorporate.asp>

3. CHALLENGES IN THE INCORPORATION OF FIRMS

3.1 Starting a business

In India, the cost of starting a business is astronomical and also the process is formidable. There are almost 12 procedures in the initial starting of the business some of which are raising capital, collecting people, find a property, think about the name and registering the firm. These procedures almost cost for half of the capital raised for the firm due to the documentation and registration process. Also, setting up of a business would take around a month due to the cumbersome formalities.

3.2 Registration process

The registration process of all the firms as seen above is tiresome and also it takes a lot of time and effort to prepare all the documents. A lot of fees are to be paid to an advocate, a company secretary, accountant etc. for getting the required documents organized.

3.3 Capital formation

The capital has to be gathered to initiate the business in the market. The capital is accumulated by the partners or through shares. The people who buy shares are known as the shareholders and they invest in the firm which helps in forming the capital. But, generally when a new firm is started, the people do not wish to invest in such firms as they do not have trust on new companies, their ideologies and working nature.

3.4 Staffing

The term 'Staffing' relates to the recruitment and training of the managerial personnel, in a newly created enterprise.²³ The firms have this major problem of staffing; the recruitment process itself takes a lot of time. The people have to be selected on the basis of the objectives of the firms, as they should hire people diligently so that a lot of capital is not wasted initially in the training of the employees. Therefore, a firm should have a qualified staff at all the levels and they should be competent enough to help the firm achieve its objectives.

²³ Smriti Chand, *Staffing: its meaning, Nature and Importance*, (Sep 6, 2017, 4:00 PM), <http://www.yourarticlelibrary.com/business-management/staffing-its-meaning-nature-and-importance-business-management>.

3.5 Bringing in clients

The new firms have to put in an extra effort to bring in the clients because there are already well settled firms who have a number of clients. The clients already in a business with a successful firm would not initiate to form ties with the new firms. Thus, the policies and plans of the new firm should be innovative so that they attract customers.

3.6 Formation of a long-term plan

A exercise that is aimed at formulating a long-term plan, to meet the future needs on the basis of the current status. It begins with the current status and charts out a path to the projected status, and generally includes short-term (operational or tactical plans) for achieving interim goals.²⁴ The firms while their incorporation process should not formulate plans for short term periods but they should look into the long-term policies otherwise they would be more prone to risk, leading to losses and winding up of the firm.

3.7 Risk management strategy

Risk management refers to the practice of identifying potential risks in advance, analyzing them and taking precautionary steps to reduce/curb the risk.²⁵ The firms have to face challenges due to a lot of competition from the existing firms in the market. This forms a risk factor initially only for the firm and therefore, they should have the plan for managing such a risk whether caused by other firms or by the business environment.

3.8 Keeping up with tax reforms

Tax reforms is the process of changing the way of collecting taxes, this process is generally handled by the government to improve the tax administration. The firms have to keep up to date with the taxation policies and file taxes on time otherwise the non-payment of taxes would also harm the goodwill of the firm in the coming years.

3.9 Economic Factors

The economic factors should be taken into consideration while determining the current and expected future value of the business. The economic factors would include the labor costs, interest rates, government regulation etc.

²⁴ Definition of Long Term Plans, *Supra Note 12*, at 4

²⁵ Definition of Risk Management, (Sep. 8, 2017, 10:00 PM), <http://economictimes.indiatimes.com/definition/risk-management>

3.10 Social Factors

The social factors are the once that affect the lifestyle such as religion, family, health, environment of the people. These factors keep on changing overtime and therefore, the firms also have to be up to date to regulate their activities in regard to such social factors. For example, if a firm builds up a factory next to the residential area and it causes a lot of pollution in the air and the water bodies nearby. In such a condition, the people would not accept such a firm and its goodwill would be affected severely.

3.11 Governmental Intervention

Government intervention is an action by the government in the economy that leads to restrictions upon the working of the firms. This also reduced the growth rate of a particular firm and an economy as a whole. If in an area there is a lot of government intervention in the functioning of the firms that the owners would obviously not like to set up their firms in that area.

4. SUGGESTIONS

“Every problem has a creative solution”

- Donna Karan

In the research paper the registration laws and the challenges in incorporation of firms are discussed and now it is essential to discuss the suggestions as well. As said by Donna Karan that every problem has a creative solution and therefore, I would like to suggest some measures to reduce the challenges mentioned above. Some of the workable solutions to the challenges are:

4.1 Banking Sector

The firms at its inception have the problem of accumulating the capital for running its business smoothly. Thus, if the banks would provide the firms loans at low interest rate then it would be beneficial for the firms to grasp this opportunity to build up their capital. But the firms should keep a balance between the debt capital and the equity capital. Infact, there should be more of equity capital so that they are less burdened by the return of debts.

4.2 Benefits for Employees

There is a problem of staffing in the newly formed firm and therefore, the firms should try and build a good working environment for the employees. They should also provide them with incentives like bonus or promotion. They must be given certain job security and additional perks like the medical facilities and transportation facilities.

4.3 Reduction in Documentation

For the registration of the firm there is an elongated process with a lot of documentation. Thus, the government should reform the policies and reduce the paperwork for the firms. This would make the registration process simpler.

4.4 Online Registration

The registration for the small firms like the Partnership firm, sole proprietorship firm or the LLP firm should be made online so that they do not have to spend their capital on paperwork.

4.5 Knowledge

The new firms should be well equipped with the knowledge of the process of registration and the incidents thereto. This would reduce the time and efforts that are spent on the registration process by the members of the firms.

4.6 Qualified managers

As discussed above, risk management is an essential feature for the firms to safeguard themselves from the externalities. Therefore, the firms should hire in advance well qualified managers for the formulating of strategies to curb the risk.

5. CONCLUSION

The registration and incorporation is a widespread stumbling block in the growth of the economy. It decreases the gross domestic product and per capita income of the people and thus of the economy as a whole. Due to this problem, many firms at its inception have to incur losses because of the initial spending of the capital, some firms have to wind up their business within a short span of two to three years or they choose to work without registering themselves which in turn renders the whole process inefficacious. The registration laws are rigid and

cumbersome and therefore the firms hesitate to initially set up due to the prolonged procedure. There is a lot of documentation and a long attestation process along with it. Also, the firms have to face a number of obstacles in its incorporation process like the building up of capital, employing the qualified members, getting clearances from the government and so on. These hurdles in setting up of a firm initially, demotivates the people who wish to set up a firm of their own. Thus, there are legislations and several other bodies who are working towards this problem, to make it easier for the firms as well as the government. In lieu to this, some suggestions have been provided which may prove successful when implemented.