



ADVANTAGES OF INCORPORATION OF A COMPANY

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INDEX

Introduction.....3

Advantages of Incorporation of a company.....4

 1. Limited Liability Protection4

 2. Tax Benefits5

 3. Access to Capital.....7

 4. Perpetual Existence.....8

 5. Brand Protection10

 6. Management and Ownership Separation11

Conclusion13



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Introduction

The incorporation of a company is the process of creating a legal entity that is separate from its owners. This legal entity has the power to enter into contracts, own assets, and incur liabilities. Incorporation provides several benefits, including limited liability protection, easier access to capital, and increased credibility. This process involves registering the business with the government and completing various legal and regulatory requirements. The benefits of incorporating a company are numerous and significant. In this article, we will explore the need for the incorporation of a company and the advantages it offers.

The incorporation of a company is often seen as a necessary step for entrepreneurs who want to protect their assets from business liabilities. The incorporation process involves the creation of the articles of incorporation, which outline the purpose, structure, and bylaws. The articles of incorporation must be filed with the state in which the corporation is incorporated. Once the articles of incorporation are filed, the corporation is recognized as a legal entity, and it can begin conducting business.¹

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¹ Company Law, Executive program, Module 1, Paper 2 by the Institute of Company Secretaries of India, 2018.

Advantages of Incorporation of a company

1. Limited Liability Protection

One of the most significant advantages of incorporation is the limited liability protection it provides to the owners of the company. When a business is incorporated, it becomes a separate legal entity from its owners. This means that the owners are not personally liable for any debts or obligations incurred by the company. In the event of a lawsuit or bankruptcy, the owner's assets are protected, and they are not at risk of losing everything they own. The only assets that can be used to settle the company's debts are the assets of the company. This is especially important for businesses with high-risk activities or those that operate in industries where lawsuits are common.

Limited liability protection is a legal concept that limits the financial liability of company owners to the amount they have invested in the business. This concept provides a significant advantage for entrepreneurs and investors, as it reduces their risk in case the business is unable to pay its debts or faces legal claims. In simpler terms, limited liability protection means that if a company fails or is sued, the personal assets of its owners, such as their homes, cars, and personal savings, are not at risk of being seized to pay for the company's debts or legal settlements. Instead, the company's assets, such as its cash, investments, and property, are used to settle any outstanding obligations.

Limited liability protection is a critical component of modern business law, and it is one of the main reasons why many entrepreneurs and investors choose to form a corporation or a limited liability company (LLC) instead of operating as a sole proprietorship or a partnership. The following are some of the key benefits of limited liability protection:

- a) **Protection of personal assets:** The primary benefit of limited liability protection is that it shields the personal assets of company owners from business debts and legal claims. This means that even if the company is sued or goes bankrupt, the owner's personal savings, homes, and other assets are not at risk of being seized to pay for the company's obligations.

- b) Encourages investment: Limited liability protection also makes it easier for companies to attract investors because it reduces the investors' risk. If the company fails, the investors' losses are limited to the amount they have invested, and they are not personally liable for the company's debts.
- c) Facilitates business growth: Limited liability protection can also help companies grow by providing a stable legal structure that can survive changes in ownership or management. This stability can help companies obtain financing, enter into contracts, and make long-term investments without the risk of personal liability.
- d) Flexibility in tax treatment: Limited liability companies (LLCs) and S corporations have the advantage of being taxed as pass-through entities, which means that the company's profits and losses are passed through to the owners and reported on their tax returns. This can provide significant tax benefits, such as the ability to deduct business losses against other income.

It is important to note that limited liability protection does not provide absolute protection for company owners. In some cases, courts may "pierce the corporate veil" and hold owners personally liable for the company's obligations. This typically occurs when owners fail to follow corporate formalities, commingle personal and business funds, or engage in fraudulent activities. Additionally, owners may still be held liable for their actions, such as negligence or intentional harm.

In summary, limited liability protection is a critical legal concept that provides significant benefits to entrepreneurs and investors. It protects personal assets, reduces financial risk, and provides a stable legal structure that can facilitate business growth. However, it is important for company owners to understand the limits of this protection and to follow good corporate governance practices to avoid personal liability.²

2. Tax Benefits

Another advantage of incorporating a company is the tax benefits that it provides. Corporations are separate legal entities that pay taxes on their profits. This means that the company's profits are taxed separately from the shareholders' income. In many cases, this results in a lower

² Forbes, Kevin F. 1986. "Limited Liability and the Development of the Business Corporation." *Journal of Law, Economics, and Organization*, 2 (Spring), p. 163-77.

overall tax rate for the shareholders. Additionally, corporations can deduct many expenses from their taxable income, such as employee salaries, rent, and equipment costs. This can further reduce the company's tax liability and increase its profits. Corporations can pay lower tax rates on their income, and they can also retain earnings for future growth without paying personal income taxes on those retained earnings.

Major Tax benefits of incorporating a company:

- a) Lower tax rates for corporations: One of the main tax benefits of incorporating a company is that corporations are subject to lower tax rates than individuals. In most countries, the tax rate for corporations is lower than the tax rate for individuals, which means that incorporating a company can result in significant tax savings.
- b) Deductions for business expenses: Another tax benefit of incorporating a company is that businesses can deduct certain expenses from their taxable income. This includes expenses such as rent, salaries, advertising, and office supplies. By deducting these expenses, companies can reduce their taxable income and ultimately lower their tax liability.
- c) Tax-free fringe benefits: Incorporated companies can provide tax-free fringe benefits to their employees, which can be a significant advantage when it comes to attracting and retaining talent. These benefits can include things like health insurance, life insurance, retirement plans, and other similar benefits. Since these benefits are not taxed as income, employees can enjoy them without incurring additional tax liability.
- d) Capital gains tax advantages: Another tax benefit of incorporating a company is that it can provide capital gains tax advantages. When a business is incorporated, the owners are considered to have sold their ownership stake in the business to the new corporate entity. This means that any appreciation in the value of the business that occurs after incorporation is subject to capital gains tax rather than income tax. Capital gains tax rates are typically lower than income tax rates, which can result in significant tax savings for the owners of the company.
- e) Access to tax incentives and credits: Incorporated companies may also be eligible for various tax incentives and credits. For example, some governments offer tax credits for businesses that invest in research and development or that operate in certain geographic regions. By incorporating a company, businesses may be able to take advantage of these incentives and reduce their overall tax liability.

In conclusion, there are many tax benefits associated with the incorporation of a company. These benefits include lower tax rates, deductions for business expenses, tax-free fringe benefits, limited liability protection, capital gains tax advantages, and access to tax incentives and credits. Incorporation can be a complex process, however, and businesses need to seek professional advice before making any decisions regarding their corporate structure.³

3. Access to Capital

Incorporation can also provide access to capital. A company can issue stock to raise funds from investors, and it can also borrow money from banks or other lenders. Additionally, incorporation can make it easier for a company to attract investment because investors are more likely to invest in a formal, established business with limited liability protection. Corporations can sell shares of stock to raise money from investors. This can be an effective way to raise capital for business expansion, research, and development, or other projects. A corporation can borrow money from banks and other financial institutions.

There are several ways in which incorporation can provide access to capital:

- a) Issuing stocks and bonds: One of the main ways in which a company can raise capital is by issuing stocks and bonds. When a company issues stocks, it is essentially selling ownership of the company to investors. The investors become shareholders and are entitled to a share of the company's profits. When a company issues bonds, it is essentially borrowing money from investors. The investors become bondholders and are entitled to receive interest payments on their investments. Incorporation makes it easier for a company to issue stocks and bonds because it provides a legal framework for doing so. The company can issue stocks and bonds in compliance with the relevant securities laws and regulations, and investors can be assured that their investments are protected by the legal structure of the company.
- b) Bank loans: Incorporation can also make it easier for a company to obtain bank loans. Banks are more likely to lend money to a company that is incorporated because it provides a legal structure that makes the loan more secure. Banks can take a security interest in the assets of the company, which provides additional security for the loan. In addition, banks may be more willing to lend money to a company that is incorporated

³ Bhandari, D., & Pandit, V. "Incorporation of foreign companies in India", *Supremo amicus*, vol. 21.

because it has a separate legal identity from its owners. This means that the company is responsible for its debts and liabilities, which reduces the risk for the bank.

- c) **Venture capital:** Venture capital is a type of financing that is provided by investors who are willing to take on higher risk in exchange for a potentially high return on investment. Venture capitalists typically invest in start-up companies or companies that are in the early stages of development. Incorporation can make it easier for a company to obtain venture capital because it provides a legal structure that is more attractive to investors. Investors are more likely to invest in a company that is incorporated because it provides a legal framework that protects their investment. In addition, incorporation provides a framework for the governance of the company, which can make it more attractive to investors. Investors want to be assured that the company has a clear governance structure in place that will enable it to grow and succeed.
- d) **Crowdfunding:** Crowdfunding is a relatively new way for companies to raise capital. It involves raising small amounts of money from a large number of people, typically through an online platform. Crowdfunding can be a useful way for start-ups and small businesses to raise capital. Incorporation can make it easier for a company to use crowdfunding because it provides a legal structure that is more attractive to investors. Investors are more likely to invest in a company that is incorporated because it provides a legal framework that protects their investment.

In addition, incorporation provides a framework for the governance of the company, which can make it more attractive to investors. Investors want to be assured that the company has a clear governance structure in place that will enable it to grow and succeed.

In conclusion, incorporation provides access to capital in several ways. It makes it easier for a company to issue stocks and bonds, obtain bank loans, obtain venture capital, and use crowdfunding. These sources of capital are essential for businesses to grow and expand, and incorporation provides a legal framework that makes it easier to access them.⁴

4. Perpetual Existence

Another benefit of incorporation is that the company has perpetual existence. The company exists as a separate legal entity, and its existence is not affected by the death or departure of its

⁴ Reasons behind incorporation, HMRC Research Report 317, Ipsos MORI Social Research Institute. June 2014, p. 27-37.

owners. The company can continue to exist even if one or more of its owners decide to sell their shares or leave the company. This provides stability and continuity to the company, which can be essential for businesses that require long-term planning and investment. Unlike sole proprietorships and partnerships, which are dissolved if the owner dies or leaves the business, corporations can continue to exist indefinitely. This can provide peace of mind to the owners of the company, knowing that their business will continue to exist even after they are gone.

Perpetual existence is a concept in business law that means a company will continue to exist indefinitely unless it is dissolved voluntarily or involuntarily. This means that the company will continue to operate, conduct business, enter into contracts, and own property, regardless of changes in ownership or management.⁵

There are several reasons why perpetual existence is important for businesses. Firstly, it allows a company to continue its operations and maintain its brand and reputation, even if there are changes in ownership or management. This is particularly important for businesses that have built up a strong brand or have a loyal customer base.

Secondly, perpetual existence can make it easier for a company to raise capital. Investors are more likely to invest in a business that they believe will continue to exist and grow over the long term. By providing this level of stability, perpetual existence can help businesses attract investors and secure financing.

Thirdly, perpetual existence can help a company to avoid legal and financial liabilities that may arise if it were to dissolve. For example, if a company were to dissolve, its assets would need to be sold off to pay its creditors. If the company had valuable intellectual property or other assets, this could result in significant losses for the owners. By continuing to exist, the company can continue to own and protect its assets, which can help to avoid these types of legal and financial issues.

However, perpetual existence is not without its drawbacks. For example, it can make it more difficult for shareholders to sell their shares, as they may need to find a buyer who is willing to take on the responsibilities of owning a perpetual entity. Additionally, perpetual existence can make it more difficult for the company to change its structure or business model, as any changes may need to be approved by a majority of shareholders.

⁵ Schwartz A.A. "The Perpetual Corporation", *The George Washington Law Review*, vol. 80(2012), p. 773-783.

Despite these potential drawbacks, perpetual existence is an important concept for businesses, particularly those that are looking to grow and succeed over the long term. By providing stability and continuity, perpetual existence can help businesses attract investors, protect their assets, and maintain their brand and reputation.⁶

5. Brand Protection

Incorporation also provides businesses with greater brand protection. When a business is incorporated, it can register its name and logo as a trademark. This provides the company with exclusive rights to use that name and logo in commerce and can help prevent other businesses from using similar names or logos that could confuse the marketplace. Additionally, incorporating can also help protect the company's name and brand by making it easier to register trademarks and patents.

Registering a trademark provides legal protection to the business and prevents others from using similar marks or names. If another business uses a similar mark or name, the trademark owner can take legal action to stop the infringing behaviour and recover damages. Trademarks are essential for building brand recognition and consumer trust, and incorporation provides businesses with the legal framework to protect their trademarks. Incorporation also provides businesses with greater brand protection by enabling them to create a separate brand identity. A business that is not incorporated is often seen as an extension of its owner. This means that any legal issues or negative publicity that the owner experiences can affect the business's brand reputation. By incorporating, the business becomes a separate entity with its own identity and reputation. This means that the business can protect its brand reputation even if the owner experiences legal or personal issues.

In addition, incorporation can also help businesses to protect their brand by allowing them to control their image and reputation. A well-managed brand can create a strong association between a business and its products or services, which can help to differentiate it from competitors and create customer loyalty. By incorporating, businesses can create a legal framework that allows them to control the use of their brand and ensure that it is being used in a way that is consistent with their values and objectives.

For example, a corporation can establish a brand usage policy that outlines how its name and logo can be used by employees, partners, and third-party vendors. This can help to ensure that

⁶ Incorporation of companies, The Institute of Company Secretaries of India, August 2015, p. 1-13.

the brand is being presented consistently and in a way that reflects the company's values and image. Additionally, incorporation allows businesses to take legal action against individuals or entities that engage in activities that could harm their brand or reputation, such as trademark infringement or defamation.⁷

6. Management and Ownership Separation

Incorporation also provides a separation between management and ownership. This means that the company's owners can focus on their core competencies while leaving the company's management to professional managers. This can help ensure that the company is run efficiently and effectively.

The separation of ownership and management gives shareholders greater flexibility in managing their investments. Shareholders can buy and sell shares in the company without affecting the management of the company. This means that they can diversify their investments and manage their portfolio of assets more effectively. They can also vote on important matters such as the election of the board of directors and major strategic decisions, giving them a voice in how the company is run.

Another benefit of separating ownership and management is that it can help to protect the company's reputation. If a company is run by a group of independent managers, it is less likely to be influenced by the personal interests of the shareholders. This can help to prevent situations where the company's reputation is damaged by the actions of a single shareholder or group of shareholders. Additionally, the separation of ownership and management can help to reduce conflicts of interest between the company and its shareholders.

Moreover, the separation of ownership and management allows for the efficient transfer of ownership. In a sole proprietorship or a partnership, the transfer of ownership can be complicated, as the new owner would also have to take on the management responsibilities of the business. However, in an incorporated company, ownership is transferred through the buying and selling of shares, while the management of the company remains the same. This makes it easier for investors to buy and sell shares in the company, which can increase the liquidity of the shares and the value of the company.

⁷ Singh Avtar, *Company Law*, 17th Edition (EBC, Lucknow, 2020) p. 37-48.

In conclusion, the incorporation of a company provides a separation between management and ownership, allowing the company to be run by a group of managers who have the expertise and experience to make informed decisions. This separation of duties ensures that the company is run by individuals with the appropriate skills and knowledge, rather than being influenced by the personal interests of the shareholders. Additionally, the separation of ownership and management allows the company to raise capital by selling shares to the public, provides shareholders with greater flexibility in managing their investments, and helps to protect the company's reputation. These benefits make incorporation a popular choice for companies that want to grow and succeed in today's business environment.⁸



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⁸ Mutreja, P. "Promotion and Formation of Company-Advantages and Disadvantages of Incorporation of a Company", Penacclaims, vol. 14(2021).

Conclusion

In conclusion, incorporating a business can provide numerous advantages, including limited liability protection, increased credibility, access to funding, tax benefits, perpetual existence, the ability to raise capital, and flexibility in ownership. While there are some additional costs and administrative requirements associated with incorporation, the benefits can outweigh these drawbacks, especially for businesses that are looking to grow and expand.



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