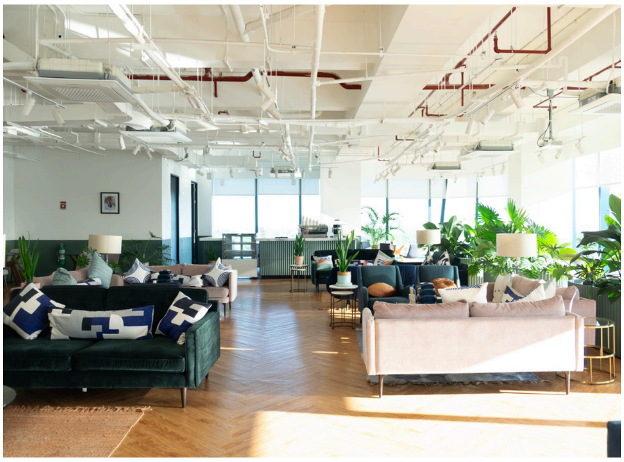
STARTING UP IN INDIA

A FOUNDER'S LEGAL & COMPLIANCE PLAYBOOK



A practical, step-by-step guide informed by what we see go wrong in startups and how to avoid it.

Contents

Starting a business in India is *exciting*. But the real risk is not incorporation -it's early *informality*

This guide is intended for founders, particularly those without a legal or compliance background. It is designed to help you understand:

- what needs to be done;
- the order in which key steps should ideally be undertaken; and
- the areas where legal, regulatory, or compliance risks commonly arise.

While this is not intended to be an exhaustive guide, it is illustrative in nature and should help you navigate some of the practical considerations involved in building and scaling a startup.
That said, every business operates differently, and legal risks often depend on the specific facts, sector, structure, and stage of your startup. Accordingly, this guide should not be treated as a substitute for tailored legal advice or as a one-size-fits-all solution to every legal issue that may arise.

Why Startups Run Into Legal Trouble

Starting a business in India carries genuine legal risk from the earliest day, not from the act of incorporation itself, but from the habits that form before and around it. Founders move fast. Decisions are made verbally. Documentation is deferred. Controls are assumed. Early shortcuts harden into habits.

ROLES UNCLEAR

Undocumented authority creates founder disputes that become expensive to resolve

CASUAL THIRD PARTIES

Informal engagements are where governance risk and corruption exposure first enter

RECORDS WEAK

Missing documentation fails every form of scrutiny tax, investor, or regulatory

01

Choose the Right Structure

The overall structure matters more than speed or cost.

Choose the Right Structure

The structure of your business determines everything that follows: your tax position, your ability to raise capital, your personal liability, and your exit options. Structure your business for where you intend to go, not where you currently are.

STRUCTURE	BEST FOR	KEY ADVANTAGE	KEY LIMITATION
Sole Proprietorship	Solo founder, low risk, services	Simple, minimal cost	Unlimited personal liability
LLP	Bootstrapped services, 2+ founders	Limited liability, flexible structure	Cannot issue equity to investors
Private Limited Company	VC/angel funding, ESOPs, scale	Equity issuance, investor-ready, ESOP eligible	Higher compliance burden from Day One
Section 8 / Trust	Social or charitable purpose	Tax benefits, grant eligibility	Restricted profit distribution

BEFORE DECIDING, ASK:

- Are you testing an idea alone, with limited capital and limited risk?
- Will you raise angel or venture capital at any stage?
- Do you intend to issue equity to early employees or co-founders?
- Is the objective commercial, or social and non-profit?

KEY PRINCIPLE

Structures chosen for speed or cost often create serious friction during diligence, fundraising, or exit. The Private Limited Company is the default for any founder who anticipates external investment or significant scale.

02

Lock Founder Fundamentals Early

The most expensive disputes begin on Day One.

Lock Founder Fundamentals Early

This step is skipped more than any other. Founders who are friends, colleagues, or family assume alignment. That assumption is the risk. A well-drafted Founders Agreement is not a legal formality it is the foundation on which everything else is built.

ALIGN ON THESE IN WRITING

01 Roles, responsibilities and decision-making authority for each founder

02 Equity splits and the rationale behind them. Equal splits are not always optimal

03 Exit scenarios: what happens if a founder leaves or disengages early

04 Ownership of all IP created by founders for the business from Day One

COMMON ORIGINS OF DISPUTE

UNDOCUMENTED OWNERSHIP
Verbal understandings about who owns what become impossible to enforce and easy to dispute.

INFORMAL EQUITY PROMISES
Equity commitments made without documentation are among the most litigated startup disputes.

DECISION-MAKING AMBIGUITY
Unclear authority creates operational paralysis and, eventually, irreparable breakdown.

A Founders Agreement is not optional. Founders who defer it do not avoid the cost; they defer it to a moment when it is far more expensive to resolve.

03

Incorporate and Establish Business Identity

Formality is not bureaucracy- it is protection.

Incorporate and Establish Business Identity

WHAT TO DO

01 Incorporate the entity with the Ministry of Corporate Affairs

02 Obtain PAN for the entity (distinct from personal PAN)

03 Obtain TAN for the entity

04 Register for GST where applicable – based on turnover or business nature

05 Open a dedicated business bank account in the entity name

06 Separate personal and business finances strictly from Day One, no exceptions

RISKS WE SEE

PERSONAL ACCOUNTS

Founders operating through personal accounts create irrecoverable tax and liability exposure.

INFORMAL REVENUE FLOWS

Revenue received outside the entity cannot be properly accounted for or defended in scrutiny.

MISSING RECORDS

Gaps in early documentation resurface – with compounding interest – during diligence or dispute.

Obtain Udyam Registration

Udyam Registration is India's official MSME recognition system administered by the Ministry of Micro, Small and Medium Enterprises. It issues a permanent Udyam Registration Number (URN) and a QR-coded e-certificate. The process is entirely online, free, and self-declaration based – integrated with PAN and GST data. It is not mandatory, but any founder who does not obtain it forfeits significant government support.

MSME ELIGIBILITY CRITERIA

CATEGORY	INVESTMENT	TURNOVER LIMIT
Micro Enterprise	Up to INR 2.5 Crore	Up to INR 10 Crore
Small Enterprise	Up to INR 25 Crore	Up to INR 100 Crore
Medium Enterprise	Up to INR 125 Crore	Up to INR 500 Crore

KEY BENEFITS OF UDYAM REGISTRATION

PRIORITY LENDING
Access to collateral-free credit under government-backed schemes.

GeM TENDERS
Priority status in government procurement and public sector contracts.

SUBSIDIES
Eligibility for power tariff rebates and capital investment schemes.

CREDIBILITY
Formal MSME status strengthens standing with lenders and counterparties.

Register at udyamregistration.gov.in : free ; requires Aadhaar OTP and PAN/GSTIN validation.

04

Permits, Approvals and Licences

Pre-operational compliance is not optional.

Identify Permits, Approvals, and Licences

RELIABLE OFFICIAL PORTALS

startupindia.gov.in – DPIIT recognition, Startup India benefits, and regulatory updates
startupindia.gov.in/content/sih/en/startupgov/regulatory_updates.html – sector-specific regulatory guidance

mca.gov.in – Ministry of Corporate Affairs: incorporation, annual filings, and compliance

gst.gov.in – GST registration, returns, reconciliation, and correspondence

Sector-specific: FSSAI (food & beverage) · DGFT (import/export) · Pollution Control Boards · SEBI (securities) · RBI (NBFC, payments) · IRDAI (insurance)

A RECURRING RISK WE SEE

Founders are relying on informal intermediaries or 'liaison agents' to navigate approvals. This is the point at which governance risk and exposure to corruption most commonly enter a business.
If a payment or arrangement cannot be clearly documented and explained, it is a red flag, not a routine cost of doing business. See the section on Government Touchpoints and Corruption Risk.

Approvals vary by:

- Sector
- Nature of activity
- Location
- Scale of operations

05 Accounting and Record-Keeping Hygiene

Early discipline matters more than sophistication.

Accounting and Record-Keeping Hygiene

DO	NEVER DO
Issue invoices in prescribed GST format with GSTIN, invoice number, tax breakup, and place of supply and maintain basic controls around invoice creation, credit notes, and approvals	Disguise transactions through generic descriptions like 'miscellaneous' or 'sundry'
Maintain a clear invoice trail that matches actual delivery of goods or services	Miscategorise expenses under consulting, marketing, or reimbursements to suppress tax
Separate company and personal funds strictly – no exceptions. Avoid cash transactions unless unavoidable and well supported with documentation	Create same-day or backdated year-end invoices to account for prior expenses
Document approval authority for sensitive payments: advances, reimbursements, commissions	Reconstruct or manufacture vouchers after scrutiny or questions arise
Maintain a central repository of all incorporation docs, licences, contracts, board approvals, and regulatory correspondence. TG Law routinely assists clients in establishing scalable documentation frameworks.	Adjust entries casually at year-end without contemporaneous documentation

If documentation does not exist contemporaneously, attempting to recreate it later almost always worsens exposure. In our experience, acknowledging the gap is nearly always better than reconstructing around it.

06

Hire Carefully, Even at Small Scale

Early hiring decisions have permanent consequences.

Hire Carefully, Even at Small Scale

FOR EVERY ENGAGEMENT : EMPLOYEE OR CONSULTANT

DOCUMENT
Role, scope of work, and authority in writing before engagement commences.

CLASSIFY
Employee versus independent contractor, misclassification creates retrospective liability for PF, ESI, and gratuity.

PROTECT
Confidentiality obligations and IP assignment clauses covering all work product created for the business.

RECORD
Approvals, offer letters, and role changes, every variation in an engagement must be documented.

ESOP DISCIPLINE

Establish a formally approved ESOP plan before making any equity commitments. Maintain board and shareholder approvals, grant letters, vesting schedules, and registers at all times.

Never make informal or verbal equity promises. These are among the most litigated disputes we handle and among the most expensive to resolve.

RISK NOTE
Casual early commitments that were never documented are the source of the majority of hiring-related disputes. The cost of a clear agreement upfront is a fraction of the cost of litigating an ambiguous one.

Labour Codes: What Founders Must Know

CODE	YEAR	KEY ISSUES TO LOOK OUT FOR
Code on Wages	2019	Minimum wage compliance, wage structuring, basic wage thresholds that affect PF and gratuity calculations.
Industrial Relations Code	2020	Employee vs contractor classification, retrenchment rules, collective bargaining thresholds.
Code on Social Security	2020	Expanding PF, gratuity, and ESIC scope – including potential coverage of gig and platform workers.
Occupational Safety, Health & Working Conditions Code	2020	Workplace safety obligations, incident reporting, liability of employers including individual founders.

THE CLASSIFICATION RISK

Employee versus contractor classification is the single most consequential early workforce decision. Misclassification creates retrospective liability for provident fund, ESI, gratuity, and income tax withholding often with penalties and interest. Seek guidance on classification before the first hire, not after the tenth.

Early decisions about workforce structure are difficult and expensive to unwind. Build the right foundation before headcount makes restructuring legally and practically disruptive.

07 Managing Third-Party Relationships

Document everything. Assume nothing.

Managing Third-Party Relationships

FOR EVERY VENDOR, CONSULTANT, OR SERVICE PARTNER:

SCOPE & FEES
Define scope, deliverables, and fees clearly in a written agreement before work commences.

ABAC CLAUSES
Include anti-bribery and anti-corruption (ABAC) clauses in all third-party agreements.

AUDIT RIGHTS
Preserve audit and inspection rights where relevant especially for agents handling approvals or payments.

KYC AT ONBOARDING
Conduct basic KYC and onboarding diligence at the time of engagement not after a problem arises.

DIGITAL AND ONLINE FRAUD RISKS

Phishing and impersonation - Attempts targeting founders and finance teams are increasingly sophisticated. Verify all payment instructions through a second channel before acting.

Payment diversion fraud - Manipulated invoice details redirecting payments to fraudulent accounts. Implement dual authorisation controls for all high-value transfers.

Internal controls -A basic dual-authorisation requirement for payments above a threshold significantly reduces exposure. Implement this before you need it.

KEY PRINCIPLE
If the arrangement cannot be documented and explained to a regulator, investor, or court, reconsider whether it should proceed.

08

Annual Compliances as a Signal of Health

Regulators and investors look here first.

Annual Compliances as a Signal of Health

Annual compliance is the most visible signal of operational discipline. It is where every regulatory inquiry begins and where every investor diligence starts. Penalties accrue quietly on a per-day basis a missed filing today compounds into a significant and growing liability over months, often without any notice.

FILING	FORM	DEADLINE	FILED WITH
Annual Return	**MGT-7**	60 days from AGM	MCA
Financial Statements	**AOC-4**	30 days from AGM	MCA
Income Tax Return	**ITR-6**	31 October (audit cases)	Income Tax Dept.
GST Annual Return	**GSTR-9**	31 December	GST Portal
Statutory Audit	–	Before ITR filing	Auditor (CA)
Director KYC	**DIR-3 KYC**	30 September (annual)	MCA

BASELINE INTERNAL POLICIES

Policies exist to reduce ambiguity – to ensure that when a question arises, there is a documented answer. Every business should maintain, at minimum:

- A written leave and attendance policy
- A documented expense reimbursement policy with clear approval authority
- A conflict of interest and related-party transaction policy

COMPLIANCE IS NOT BOX-TICKING

Annual compliance is the foundation on which investor confidence, regulatory goodwill, and operational continuity are built. It is the first thing a diligencing investor reviews and the first thing a regulator checks.

Fundraising and Diligence Readiness

Investors look at compliance before they look at projections.

What a diligence-ready startup looks like:

- ✓ All statutory filings current – no backlogs with MCA, Income Tax, or GST authorities
- ✓ Cap table clean and accurate – all share allotments and transfers properly documented
- ✓ IP ownership established – all founder IP formally assigned to the company, not retained personally
- ✓ Employment and contractor agreements in place and signed for all current and past engagements
- ✓ A diligence-ready data room: organised, indexed, and accessible to counsel and investors

COMMON DILIGENCE FAILURES WE SEE:

- Shares allotted but MCA filings never made – the cap table exists on paper, not in law
- IP sitting with individual founders rather than the company – a fatal diligence red flag
- Key agreements missing, unsigned, or undated – creates uncertainty about what was agreed
- GST or income tax arrears surfacing during live diligence – often at the worst possible moment

The cost of fixing compliance gaps during a live fundraise in time, money, and negotiating position is significantly higher than addressing them in advance. Diligence readiness is not a pre-raise exercise. It is an ongoing discipline.

Government Touchpoints and Corruption Risk

FACILITATION PAYMENTS

Even small amounts paid to expedite routine approvals carry serious criminal liability under the Prevention of Corruption Act, 1988.

There is no de minimis threshold. The nature of the payment, not its size, determines liability.

Founders who make facilitation payments believing them to be routine costs of business are taking on personal criminal risk.

INFORMAL INTERMEDIARIES

Liaison agents who promise to 'manage' regulatory approvals raise red flags for future investors and regulators alike.

If the arrangement cannot be documented and explained – it should not proceed.

The use of informal intermediaries is often where both governance risk and corruption exposure first enter an early-stage business.

SAFETY AND CRIMINAL EXPOSURE

Labour and workplace safety lapses are among the most common triggers for criminal scrutiny of individual founders. Workplace negligence, safety violations, and labour exploitation can attract personal criminal liability not merely regulatory fines on the entity.

Documentation of safety systems, incident responses, and compliance reviews is essential, not merely advisable. A founder cannot hide behind the corporate form when the breach is one of personal duty of care.

THE GOVERNING PRINCIPLE

A disciplined approach to government interactions is not conservative. It is commercially rational. The costs of a corruption exposure to reputation, to investors, to personal liberty are catastrophic and irreversible.

Compliance as Operational Health

01 ESTABLISH SYSTEMS EARLY

Build compliance systems before scale makes them hard to implement. Avoid reactive approaches; the cost of a good system early is a fraction of the cost of remediation later.

02 DOCUMENT CONTEMPORANEOUSLY

Document decisions at the time they are made, not retrospectively when questions arise. Contemporaneous documentation is always stronger than reconstructed records.

03 TREAT COUNSEL AS PLANNING

Treat legal counsel as a planning function, not a firefighting resource. Early engagement meaningfully reduces enforcement risk.

04 REVIEW PERIODICALLY; NOT ANNUALLY

Run periodic internal reviews of filings, contracts, and records throughout the year. Compliance health is a continuous discipline. Box-ticking at year-end is not a substitute.

Legal health and commercial health are not in tension.
For the founders who build durable businesses, they are the same thing.

Have a specific query in mind? Let's chat.

TG Law Offices

tanya@tglaw.in

+91-8390736278