



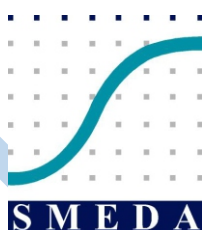
Information Booklet

## Business Regulations

# 4

# BUSINESS STRUCTURES AND TYPES

for SMEs



## Introduction

**Small and Medium Enterprises Development Authority (SMEDA)** works under the Ministry of Industries and Production, Government of Pakistan and was established in 1998 with the objective to propel economic growth through development of SMEs. SMEDA serves as an SME strategy-advisory body for the Government of Pakistan and facilitates partners in meeting their SME development agendas.

SMEDA envisions growth of a globally competitive SME sector (in Pakistan), through creating an enabling environment and support services for increase in the national economy. SMEDA strives to achieve this vision by providing assistance in employment generation and value addition to the national income, through development of the SME Sector, by helping increase the number, scale and competitiveness of SMEs.

National Business Development Program for SMEs (NBDP) is a project of SMEDA which intends to provide hands-on support services to SMEs. The aim of this business development support provided by NBDP is to advance new businesses and improve efficiencies in existing SME value chains to empower them to contend in global market. NBDP expects to facilitate around 314,000 SME beneficiaries over the period of five years.

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## Objective

- To increase the understanding and knowledge of entrepreneurs on the various types of business structure, their merit and demerit and basis for opting right structure for the business

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## a

# Introduction to Business, its Types and Structures

A business is an organization that strives for profit by providing goods and services desired by its customers. Goods are tangible items manufactured by businesses, such as shoes, garments and cars etc. Services are intangible offerings of businesses that cannot be touched or stored. Medical care, legal advice, hairstylists, car washes, and airlines all provide services.

Businesses also serve other organizations, such as machinery manufacturers, wholesalers, computer hardware and medical supplies etc. by providing machinery, goods for resale, computers, hospital supplies and scores of other items.

A large number of businesses are micro and small while others are medium and very few are large. Micro businesses are mostly informal, whereas, medium and large businesses have formal structures with different levels of informality in their structure.

The size and structure of the business depends largely upon the sponsor's vision and resource base, perceived customer base and the complexity of the business. Some of the factors that decide the choice of business structure are nature of the business, Control level, The level of risk profile of the business, the implication of tax, profit (or loss) of the business.



## b

# Types of Businesses

Businesses are classified in four categories:



Service  
Business

Merchandising/  
Trading Business

Manufacturing  
Business

Hybrid  
Business

### i

## Service Business

The business in which intangible products and offerings are rendered or provided, such as information, care, advice or some type of facilitation by professionals with expertise and experience for advice and care and other skills for similar intangible products. For example, beauty and hair salons, repair shops, banks, insurance and transportation etc.

### ii

## Merchandising and Trading Business

The business in which the goods are purchased in bulk or brought in from a distance and sold with a margin. Thus, the profit is generated by purchasing the product at lower cost and then selling it to the market at the wholesale or retail price.

### iii

## Manufacturing Business

A manufacturing business buys the raw materials and components with the intention of using them for making a new product. The manufactured goods will then be sold to the customers. The examples include, garment factories, flour mills, and other product manufacturers.

## iv Hybrid Business

Hybrid businesses are companies that may be classified into more than one type of business. A restaurant, for example, combines ingredients in making a fine meal (manufacturing), sells a cold bottle of smoothie (merchandising), and fills customer orders (service).

## C Business Structures

The size and structure of the business depends largely upon the sponsor's vision and resource base, perceived customer base and the complexity of business. High degree of complexity, large customer base and business people with vision and resources would have medium and large businesses. Simple business model, local customer base and flat or low vision businesses are normally micro and small.

Some of the factors that decide the choice of business structure are:



Nature of the business

Desired level of control

Level of risk profile of the business

Implication of tax

Profit (or loss) of the business

The business structures are also defined by the level of their formality from sole proprietorship to partnership and company limited by shares or limited by guarantee and cooperatives.

## i Sole Proprietorship

A sole proprietorship is a business owned by one person only. There is no legal distinction between the owner and the business entity. The owner is in direct control of all elements and is legally accountable for the finances of such business, the owner enjoys the profit and bear the losses. The owner also enjoys unlimited authority and responsibility.

## ii Partnership



Some businesses are governed by more than one person who contribute resources to the entity and share the responsibility and authority, as per their agreement. The partners share the profit and loss on a pre-decided percentage of share of the business among themselves. Every partner is principal, as well as, an agent of the firm. The partnership does not continue to exist when members come and go. Generally, all partners in partnership have unlimited liability.

Partnerships come in two varieties:

### General Partnerships

In a general partnership, the partners manage the company and assume responsibility for the partnership's debts and other obligations. The general partners own and operate the business and assume liability for the partnership.

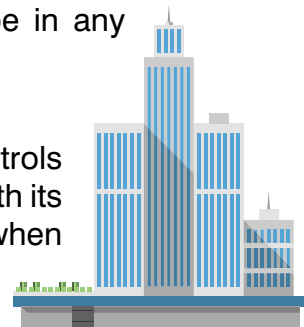
### Limited Partnerships

A limited partnership has both general and limited partners. The limited partners serve as investors only; they have no control over the operations of the company and are not subject to the same liabilities as the general partners.

A company is a business organization consisting of two sets of individuals, one organized as a group of investors and the other to conduct the business. The investors can be in any predefined proportions. Companies come in two distinct forms:

### Public Limited Company

The share of stock represents the ownership in company. The board of directors controls the activities of the company or corporation. A company is a separate legal entity with its own identity and it exists independent of its members. It will only cease to exist when winding up of the company is done legally. The company continues to exist even when members come and go. The liability of the members is limited.



The co-operative society is a voluntary association of members who come together with the motive of mutual welfare. As it is a voluntary association, the membership is also voluntary. Members can come and go more conveniently than a private limited company. All the members have limited liability. An elected managing committee has the powers to take decisions. Functionally, it operates similar to or same as a private limited company.

## Legal Framework for Business Structures

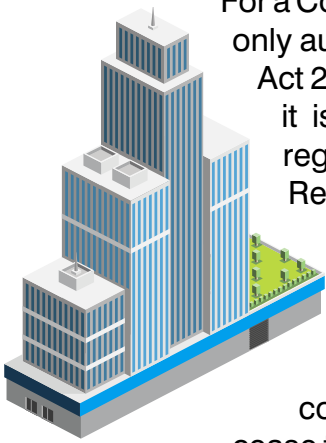
Sole proprietorship is not considered to be a formal structure for doing business in Pakistan and has a very simple business registration procedure. A person can start his/her business as a sole proprietor and then apply for a business name in the NTN certificate from the Federal Bureau of Revenue (FBR). The governing body and registering authority for sole proprietor business is the Federal Board of Revenue (FBR) in addition to an optional registration with Provincial Industries Department, particularly for the purpose of excise and taxation. There is no cost associated with applying for NTN for sole proprietorship (other than the lawyer's fee). The estimated time of NTN registration is 7-10 days.



In a Partnership; Legal regime for establishment and regulation of partnerships in Pakistan is stated in the Partnership Act, 1932. Two or more partners' up to a maximum of twenty persons desiring to carry out a lawful commercial activity or a profession may form a partnership except in certain cases. For example, where twenty or more persons may form partnership to undertake practice as lawyers or accountants or any other practice which cannot be carried out as a limited liability company under the provisions of law.

In all other cases, where the number of intended partners increases beyond the figure of twenty, a company should be incorporated. A partnership may be registered with the Registrar of Firms of an area where the office of the firm is situated or proposed to be situated. The partnership does not continue to exist when members come and go. Generally, all partners in partnership have unlimited liability.

## ii Company



For a Company in Pakistan, Securities and Exchange Commission of Pakistan (SECP) is the only authority for registration and regulating the companies in Pakistan under Companies Act 2017. A company may be registered online or manually, and the fee structure differs, it is subject to change, with nature of company. The estimated time of company registration is 20-30 days. The filled form with all documents is submitted to the Registrar of Companies of SECP within 90 days from the date of issuance of certificate of availability of name. If all requirements are fulfilled, the registrar issues the Certificate of Incorporation.

The business entity and its owners' identity are different and separate in a company/corporation. The share of stock represents the ownership in a company. The board of directors controls the activities of the corporation. It will only cease to exist when winding up of the company is done legally. The company continues to exist even when members come & go. The liability of the members is limited. Certain licenses may be required for a business subject to the nature of your business (Annexure A).

## iii Co-operative Societies

The co-operative societies are formed and registered in Pakistan under the Cooperative Societies Act, 1925. This Act extends to the [Punjab/Sindh/Khyber Pakhtunkhwa/Baluchistan]. The cooperative society must consist of at least ten persons above the age of eighteen years. A person is free to join a cooperative society, and can also leave anytime, as per his/ her desire. The co-operative society is not affected by the entry or exit of its members. Members have the right to vote, by which they elect the executives who will constitute the managing committee.

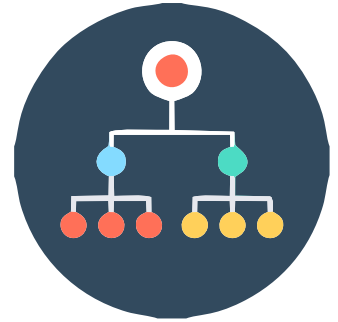
No amendment of the by-law of a society shall be valid until it is duly passed by a simple majority of members. No person shall exercise the rights of a member of a society unless or until he has made such payment to the society in respect of membership. On the death of a member of a society such society may within a period one year from the death of such member transfer the share of interest of the deceased member to a person or persons nominated in accordance with the bye laws of the society.



## Sole Proprietorship

In Pakistan, Income Tax Ordinance 2001 handles taxation related issues for sole proprietorship. A person can request for starting his/her business name in the NTN certificate. By doing so, the person will be liable for personal and business tax under the same NTN and the entrepreneur's status will be as individual. The business individual is taxed for the profits only unless turnover exceed 10 million rupees. In case it exceeds 10 million rupees, 1.25% of total turnover is payable. Slab rates are applied (Annexure B).

All sole proprietors and partnerships fall within the category of Business Individuals. The minimum slab for individual and association of persons, taxable income is more than Rs. 400,000. (for the year 2018-2019) Further, number of slabs have been increased to 8 slabs. Highest tax rate is Rs. 1,220,000 plus 35% where income exceeds Rs. 6,000,000 per annum (Annexure B).



## Partnership

In a registered partnership, NTN is issued in name of the partnership and the individual partners are not taxed separately. However, in an unregistered partnership, each partner has to file his/her own personal tax returns, taxed for the profits only. The partnership firm is taxed for the profits only, unless turnover exceeds 10 million rupees. In case, the profit exceeds 10 million rupees, 1.25% tax of total turnover is payable. Slab rates are applied (Annexure B).



## Company

The Corporate tax is restricted to 29% for Tax Year 2019 and onwards, as compared gradual reduction of 1% each year till the rate reached 25% by tax year 2023.

## Selecting the Right Business Structure

Structure of the business entity needs to be a well-considered aspect of any business. It is very important to wisely choose the structure for business entity, make changes when necessary, and take advantage of the business structure. The following factors can have a major impact on the decision for structure:

Owner's vision	Tax rates	Business risk	Partners
Investors	Business goals	Marketing plans	Costs of the business

The simplest structure is the sole proprietorship, which usually involves just one individual who owns and operates the enterprise. For those who intend to work alone, this model works well. However, banks and other financing sources are often reluctant to make business loans to sole proprietorships. In such cases,

the more regulated option of single director company is effective. Otherwise, one is dependent on their own financing sources, such as savings, home equity or family loans. Sole proprietorships are common in a variety of industries, but the typical sole proprietorship owns a small service or retail operation, such as a dry cleaner, accounting services, insurance services, a roadside vendor's stand, a bakery, a repair shop, a gift shop, painters, plumbers, electricians, and landscaping services.

The partnerships are more expensive to establish than sole proprietorships because they require more extensive legal and accounting services. Like the sole proprietorship, partnership does not distinguish between the business and its owners. Limited partnerships are usually found in professional firms, such as dentists, lawyers, and physicians, as well as in oil and gas, motion-picture, and real-estate companies.

Using the corporate or company structure is more complex and expensive than most other business structures. A corporation is an independent legal entity, separate from its owners, and as such, it requires complying with more regulations and tax requirements. On the benefit side, some of its expenses are allowed tax benefit. The biggest benefit for a small-business owner who decides to incorporate is the liability protection he or she receives. A corporation's debt is not considered that of its owners. If a business is organized as a corporation, personal assets are not at risk. A corporation also can retain some of its profits, without the owner paying tax on them. Another plus is the ability of a corporation to raise money. A corporation can sell stock, either common or preferred, to raise funds. Corporations also continue indefinitely, even if one of the shareholders dies, sells the shares or becomes disabled.

## 9

### Changing the Business Structure

Changing business structure depends on the current structure of business. Businesses typically change their legal structure because of a change in business need. The reorganization of a business structure is generally done to become more organized, improve processes and adapt to the changing needs of the business and mostly, due to regulatory requirements. A restructure may include changing ownership, adding partners, increasing the number of employees, protection from unlimited liability, need for greater bank financing, potential growth, introduction of new offerings or changing the legal, operational or other aspects of the business. The easiest change to make is from a sole proprietorship to simple partnership or from sole proprietorship to a more complex business structure of single director private limited company and so on.

Once the business owner decides that it is time to change structure of business entity, the process can be initiated with the following four steps that help to learn how to change type of business structure:

#### 1

**Research business structure options:** Understand the requirements for other forms of business like liability, taxation, and ownership.

#### 2

**Consult an expert:** When changing business structure, consult with a business advisor/consultant or a corporate lawyer. If restructuring impacts other parties, (including business collaborators, suppliers and customers etc.) they must be notified formally by the business and the business should get them to sign off on the change.

#### 3

**File Paperwork:** When a business is changing its structure, paperwork needs to be filed. Changing business structures is quite similar to choosing business entity profile for the first time.

#### 4

**Updating the contacts:** One must not leave the bank, vendors, insurance company, and customers in the dark when the business structure is changed. The business management must update the contacts as soon as possible, especially if the restructuring impacts them.

## ANNEXURE A

- National Tax Number (NTN)
- Sales Tax Number (STN)
- Intellectual Property Rights (Trade Mark, copy right, patent etc.):
- Professional Tax
- Employees Social Security Institution
- Employees Old Age Benefits Institution
- Certificate of Environment Protection
- Council Permits and Certificates from Concerning Professional Body
  - Pakistan Medical and Dental Council. (PMDC)
  - The Pakistan Council of Architects and Town Planners
  - Pakistan Engineering Council (PEC)
  - National Council for Tib
  - National Council for Homeopathy
  - Pakistan Veterinary Medical Council
  - Bar Councils

## ANNEXURE B

### ***Tax Slabs for Unsalaries Income***

As per income tax ordinance 2001, The rates of tax imposed on the income of every individual and association of persons, except a salaried individual, are as follows (these are subject to change by the FBR)

#	Taxable Income	Rate of Tax
1	Where the taxable income does not exceed Rs. 400,000	0%
2	Where the taxable income exceeds Rs. 400,000 but does not exceed Rs. 600,000	5% of the amount exceeding Rs. 400,000
3	Where the taxable income exceeds Rs. 600,000 but does not exceed Rs. 1,200,000	Rs. 10,000 plus 10% of the amount exceeding Rs. 600,000
4	Where the taxable income exceeds Rs. 1,200,000 but does not exceed Rs. 2,400,000	Rs. 70,000 plus 15% of the amount exceeding Rs. 1,200,000
5	Where taxable income exceeds Rs. 2,400,000 but does not exceed Rs. 3,000,000	Rs. 250,000 plus 20% of the amount exceeding Rs. 2,400,000
6	Where taxable income exceeds Rs. 3,000,000 but does not exceed Rs. 4,000,000	Rs. 370,000 plus 25% of the amount exceeding Rs. 3,000,000
7	Where the taxable income exceeds Rs. 4,000,000 but does not exceed Rs. 6,000,000	Rs. 620,000 plus 30% of the amount exceeding Rs. 4,000,000
8	Where the taxable income exceeds Rs. 6,000,000	Rs. 1,220,000 plus 35% of the amount exceeding Rs. 6,000,000

## Conclusion



A business is an organization that offers products and services wanted by its customers. The size and structure of the business relies to a great extent on the sponsors, vision and asset base, perceived customer base and the intricacy of business. This additionally incorporates nature and kind of business, the implication of tax, legitimate structure, ownership and partnership. It is important for SMEs to develop an understanding of types of business structures, their merit and demerit as it provides the basis for selecting the appropriate business structure.



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