Assignment – Form of Organisation

Q1. A and B want to start a business. They have two options for selecting a form of organization, partnership firm or a private company. The estimated profits of which, before the following deductions, are expected at Rs.3,72,000:

(a) Remuneration Rs.6,000 p.m. each.

(b) Medical facility of Rs.10,000 p.a. each.

(c) Car facility from residence to office and back, estimated cost Rs.10,000 p.a. each.

(d) Rent-free house valued at Rs.15,000 each.

(e) Each will give a loan to the business of Rs.1,00,000 @ 24% p.a.

(f) Contribution as capital Rs.1,00,000 each. On this, interest will be paid @ 24% p.a. However, the company cannot pay any interest on it.

(g) The profits after tax will be distributed equally as profits or dividends.

Suggest whether they should form a partnership firm or a private company.

Q2. A, B and C have decided to set up a business. For this purpose A, B and C are having Rs.3,00,000 Rs.1,50,000 and Rs.1,50,000 respectively. They wish to charge interest on their capital/loan @ 20% p.a., salary A Rs.7,500 B Rs.3,750 and C Rs.3,750 p.m. and share profits in the ratio 2:1:1 or B and C to receive half the income as salary nominating A as the sole owner of the business. They expect the income of Rs.3,00,000 (before charging interest on capital/loan) during the relevant year.
As an income tax expert your are approached by A, B and C for considered opinion as to whether they should have a firm or a sole proprietary concern of A, while B and C becoming employees and money-lenders to the concern so that they can reduce their tax liability? What is your advice and what arguments would you give in support of your advice?

Q3. Ravi and Mohan propose to set up a business, either as a partnership or as a private limited company, with capital contribution of Rs.10,00,000 each. Profits of the business, before charging interest @ 18% on their capital and remuneration at Rs.5,000 p.m. each, are estimated at Rs.5,00,000. Profits after tax are proposed to be distributed equally as profits/dividend. Advise them, with appropriate workings, about the firm or organization they should choose from the point of view of tax implications involved in each case, assuming that they have no income other than that from the proposed business.

Q4. X and Co., a partnership firm with two equal working partners A and B is engaged in the business of carriage of goods. As on 1st April 08, it owns 10 trucks, out of which seven are heavy-duty vehicles and the remaining 3, light-duty vehicles. On 13th October, it sold three heavy-duty vehicles for Rs.4,50,000 and used the proceeds to buy 2 light-duty vehicles on 30th December and put them to use in business on 22nd February 2009. Compute total income and tax ability of the firm, based on the following particulars:

	(Rs.)		(Rs.)
Operating expenses	7,30,000	Gross freight receipts	12,50,000
Depreciation	1,50,000	Non-business receipts	2,50,000
Salary to partners at Rs.70,000 each	1,40,000		
Interest on Capital	1,20,000		
Net Profit	3,60,000		
	15,00,000		

As per deed, partners are entitled to salary Rs.70,000 each and interest @ 20% on capital of Rs.3,00,000 each.

Will it make any difference if X and Co. were a private limited company and the salary and interest payment was to its two directors?

Q5. A partnership firm is engaged in the business of retail trade. It has two partners, X and Y, who share business profits equally. In previous year 2008-09 its annual turnover is Rs.40 lakh and it has opted to be assesses in terms of Section 44AF. During the year, it has paid salary to each partner @ Rs.5,000 per month in accordance with terms of the partnership deed. Compute tax liability of the partnership firm and its partners, assuming that X has other income of Rs.25,000 by way of interest on debentures of a company, and Y has paid Rs.5,000 as contribution to his public provident fund account.