Department of Applied Economics and Commerce

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Selection of form of Business Organisation:-

Comparative study of Partnership Firm and Company in relation to tax liability.

When we have to choose one of the forms of business organizations between a partnership firm and a company from tax point of view, we should consider the following factor and choose that one which attracts minimum tax liability.

1. **Deduction regarding capital expenditure on family planning. :-** U/s 36(1)(ix) a company is entitled to this deduction in five equal annual instalments in which the expenditure is incurred. On the other hand, a firm can claim depreciation on the assets acquired for the purpose u/s 32. The difference between the two sums may increase the tax liability of a firm.
2. **Deduction regarding interest. :-** A company can pay interest on loan taken from its shareholders, at the rate it deems fit. On the other hand, a firm cannot deduct interest on loan taken from its partners, more than 12% p.a. while computing its income. This may increase the tax liability of the firm.
3. **Deduction regarding remuneration. :-** A company can pay remuneration to its employees (including shareholders) as it deems fit and it is deductible in computing its income. On the other hand, a partnership firm is entitled to a deduction for remuneration to its working partners as prescribed u/s 40(b). This increase the tax liability of a firm.
4. **Tax-free income. :-** If the undertaking is entitled to deduction u/ss 80-IA or 80-IB etc., a company cannot reduce its tax liability because it has to pay interest to moneylenders (shareholders) and salary to employees (Directors) before computing its income for deduction.

   On the other hand, a firm may provide in the partnership deed that no interest on loan or capital provided by the partners and remuneration to working partners shall be paid. This will reduce the tax liability of the firm and its partners.

5. **Withdrawals of Capital from the business. :-** If a shareholder does not want to remain a shareholder of the company, he can sell its shares. If he sells these shares after 12 months from the date of acquisition, he will be entitled to the benefits of indexation and liable to pay tax on Long term capital gain at a lesser rate.

   On the other hand If a partner does not want to remain a

Partner in the firm, he can leave the firm but he will not get the benefits of indexation On the amount invested in the firm. This will increase his tax liability.

Conclusion:- In certain cases it is advantageous to form a company and in certain cases to form a partnership firm. Hence we have to consider the various aspects and decide the form of organization which suited us.

Thanks.