CHAPTER FIVE

FORMS OF BUSINESS ORGANISATION

5.1 Sole proprietorship
5.2 Partnership
5.2.1 Partnership firms - tax liability
5.2.2 Recent tax legislations
5.3 Joint stock company

Private & Public limited companies
Portion of a limited company
CHAPTER 5
FORMS OF BUSINESS ORGANISATION

We have already considered the various avenues available to the NRI for investing his funds in India. The qualified and/or experienced NRI may want to try his hand at business in his home country. How does he go about achieving this objective?

5.1 Sole proprietorship
The simplest form of business organisation would be sole proprietorship of any business. The NRI could take a suitable premises on lease, to start with, and do business as a wholesaler or retailer of any commodity or product. He has to get himself registered as a businessman with the local authority, say the Municipality or Corporation of the town/city where he resides and observe the Shops and Establishment Act relative to the State in which he operates. He will also have to register himself with the Sales Tax Authority of the State concerned. He will be assessed to income tax on his business in accordance with the provisions of the Income Tax Law.

5.2 Partnership
The second alternative is to enter into partnership with relatives/friends and do business in the name of the firm which may or may not be registered under the Indian Partnership Act, 1932. The minimum strength required for constituting a partnership firm is two, the maximum being twenty. A partnership may be at will or for a specified period mentioned in the Partnership Deed. The

12/
gets dissolved and may be renewed on the same or different terms, upon the death, removal or retirement of any partner. The firm name may continue to be the same or may be changed (with the approval of the Registrar of Firms if it is a Registered Firm) upon any such dissolution. Liability is unlimited in the partnership type of business — even the personal estates of the partners are liable to be attached to satisfy the firm's liabilities to creditors. This, therefore, is a major deterrent to the growth of the partnership firm as a form of business organisation.

5.2.1 Partnership firms - tax liability

It would be prudent to get the firm registered under the I.T. Law irrespective of its registration under the Partnership Act. Registration of the firm under the I.T. Law ensures tax advantage in the form of a lower overall assessment of the firm and its partners. An unregistered firm is assessed on its total income, like an individual. Partners are, therefore, not taxed separately on their respective shares in the income of the firm. However, such shares are included in their respective total incomes for the purpose of determining the rates of tax applicable to their personal incomes. Such shares are initially included in their total income and if the unregistered firm has paid tax on its total income, the partners are allowed tax rebate on their respective shares of the firm's income. If the total income of the firm is below the taxable limit, no tax would be payable by the firm and the partners' respective
shares in the firm's income would be taxable in their hands. The question of tax rebate in this case does not arise. If there is a loss in an unregistered firm, this would not be apportioned among its partners, but would be carried forward by the firm and set off against its future profits in accordance with the I.T. Law. In other words, personal right of set off is denied to the partners of an unregistered firm.

A registered firm is taxed on its total income but the substantive levy is made on the partners. The share of profit of each partner would be taxed in his hands along with his other income. There is admittedly an element of double taxation in the case of a registered firm in as much as the firm is taxed on its total income which, when distributed among its partners, falls to be taxed again in the partners' respective hands as well. Despite this double taxation the aggregate or overall liability of a registered firm and its partners respecting the firm's income is still normally lower than that of an unregistered firm. If the partners' personal incomes are not substantially high, the slab rates of tax applicable on their respective incomes would be lower than those applicable to the unregistered firm. Since the levy on unregistered firms is made on the total undistributed income rather than on the distributed income, as in the case of a registered firm, the tax incidence on the latter firm and its partners is, generally, comparatively lower.
The Direct Taxes (Amendment) Act, 1987 sought to introduce far reaching changes in the tax provisions relating to partnership firms. The very concept of unregistered firm was to be done away with, effective 1/4/89, and all firms were to be taxed at the maximum marginal rate with effect from 1/4/89. Fortunately, following representations from a wide cross section of business and industry all these harsh provisions have been withdrawn and the original law restored by the Direct Taxes (Amendment) Act, 1989, which came into force on April 1, 1989.

5.3 The Joint Stock Company

By far the best and most stable of business organisations is the Joint Stock company which, as held by the Supreme Court in Tata Engineering and Locomotive company Ltd., v State of Bihar "is equal to a 'natural person and has a legal entity of its own. The entity of the corporation is entirely separate from that of its shareholders; it bears its own name and has a seal of its own; its assets are separate and distinct from those of its members; it can sue and be sued exclusively for its own purposes; its creditors cannot obtain satisfaction from the assets of its members; the liability of the members or shareholders is limited to the capital invested by them; similarly the creditors or the members have no right to the assets of the corporation." The
company is thus a legal person and as such is capable of assuming rights, duties and liabilities distinct from those of its own members.

5.3.1 Private and Public Limited Companies

A private limited company can be formed with just two individuals. Its membership is restricted to 50 excluding past and present members who are employees. It cannot invite the public to subscribe for its shares or debentures. Transferability of shares is also restricted in the case of a private limited company.

The minimum membership in the case of a public limited company is seven. There is no upper limit on its membership. Indeed there are huge corporations like Hindustan Lever Ltd., which boast of a membership of nearly a lakh of shareholders. All companies are governed by the provisions of the Companies Act, 1956.

5.3.2 Incorporation of a Limited Company

The first step in the incorporation of a company is the selection and availability of a name for which purpose an application has to be made in a prescribed form (Form 1A) to the Registrar of Companies. Once the name has been approved, the promoters have to submit the following documents to the Registrar:

a. Memorandum of Association of the company which is the very constitution of the company, detailing the objects for which the company has been formed, duly stamped;
b. Articles of Association of the company which are byelaws interse of the members, duly stamped;
c. a declaration in form I signed by a person named in the Articles as a Director or Secretary of the company to the effect that all requirements of the Companies Act in relation to the incorporation of the company have been duly complied with;
d. notice of the situation of the Registered Office of the company in form 18

e. consents in Form no. 29 from the proposed Directors in the case of a public limited company and
f. form no. 32 giving certain particulars of the Directors of the company.

On the incorporation of the company the Registrar issues a certificate of incorporation which is conclusive proof that all the requirements of the Companies Act, 1956 in regard to the incorporation of the company have been fulfilled. A private limited company can start its business immediately on receipt of the certificate of incorporation. A public limited company will have to obtain a certificate of commencement of business before it commences its operations. For this purpose, it will have to file a statement in lieu of prospectus in the prescribed form with the Registrar.