

CHAPTER - III

ASSESSMENT OF COMPANIES

3.1 DEFINITION OF A COMPANY

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Section 2(31) of the Income-tax Act, 1961, includes a 'company' within the definition of a "Person" and section 2(17) defines 'company'. Section 2(17) says that a 'company' means -

- (i) Any Indian company; or
- (ii) Any body corporate incorporated or under the laws of a country outside India; or
- (iii) Any institution, association or body, which is or was assessable or was assessed as a company for any assessment year under the Income-tax Act 1922 or which is or was assessable or was assessed under the Income-tax Act, 1961, as a company for any assessment year commencing on or before the first day of April 1970; or
- (iv) Any institution, association or body, whether incorporated or not and whether Indian or non-Indian which is declared by general or special order of the Board to be a company;

PROVIDED that such institution, association or body shall be deemed to be a company only for such assessment year or assessment years (whether commencing before the 1st

day of April 1971 or on or after that date) as may be specified in the declaration.

3.1.1 "Indian Company":

The expression 'Indian Company' has been defined in Section 2(26) to mean a company formed and registered under the Companies Act, 1956 (Act 1 of 1956), including:

- (i) a company formed and registered under any law relating to companies formerly in force in any part of India other than the State of Jammu and Kashmir, and the Union Territories specified in (iii) below;
- (ia) a corporate body established by or under a central, state or provincial Act;
- (ib) a corporate body established by or under a central, state or provincial Act;
- (ib) any institution, association or body, which is declared by the Board to be a company under section 2(17);
- (ii) in the case of the State of Jammu and Kashmir, a company formed and registered under any law for the time being in force in the State;
- (iii) in the case of any of the Union Territories of Dadra and Nagar Haveli, Goa, Daman and Diu and Pondicherry, a company formed and registered under any law for the time being in force in that Union Territory.

There is a proviso in section 2(26), which also requires

that in each of the above cases, the registered, or as the case may be, the principal office of the company, corporation, institution, association or body must be situated in India.

Therefore, now all foreign bodies corporate, irrespective of their places of incorporation, are 'companies' for the purpose of the Income-tax Act, 1961. Even for income-tax purposes, if one or more of the following conditions are satisfied:

- (1) It was assessed under the Income-tax Act as a 'company' for any assessment year for and upto the assessment year 1969-70;
- (2) Although not actually assessed under the Indian Income-tax Act for any assessment year as aforesaid, it was liable to such an assessment as a company for any assessment year prior to the assessment year 1970-71;
- (3) Whether Indian or non-Indian and whether incorporated or not, it is declared by general or special order of the Board to be a 'company'. Such a declaration, however, would hold good only for such assessment year or years, as may be specified by the Board.

Such declaration may be necessary since non-company assesseees having a large income pay more tax than what an assessee company with the same income is required to pay.

It should be noted here that the Central Board of Direct Taxes (CBDT) can suo-motu declare a foreign association as a company for the purposes of an assessment under the Indian income-tax though the association does not make an application therefor. Furthermore, it is necessary to remember that the question of declaring a foreign assessee to be a company would arise only where the assessee is an association, whether incorporated or not. An individual, or a firm, or a family, can never be declared as a 'company'.

2.1.2 Types of Companies:

(i) Domestic Company:

A 'Domestic Company' means an Indian company or any other company which, in respect of its income, is liable to tax under the Act, has made prescribe arrangements for the declaration and payment of dividends in accordance with section 194. To comply with section 194:

- (i) The share register of the company for all shareholders should be regularly maintained at its principal place of business in India in respect of any assessment year atleast from 1st April of the relevant assessment year;
- (ii) The General Body meeting for passing of accounts of the relevant previous year and for declaring dividends in respect thereof should be held only at a place within India; and
- (iii) The dividends declared, if any, should be payable only

within India to all shareholders.

(ii) Foreign Company:

It means a company that is not a domestic company.

(iii) Industrial Company:

Section 2(8)(c) of the Finance Act, 1984, defines an 'industrial company' as a company which is mainly engaged in the business of generation or redistribution of electricity or any form of power or in the carriage by road or inland waterways of passengers or goods or in the manufacture or processing of goods or in mining. A company is deemed to be engaged in the above activity, if the income attributable to any one or more of the above activities, included in the total income of the previous year before allowing family deductions (section 80) is not less than 51 per cent of such noted, which expresses that the requirement of 51 per cent, etc., is not necessary if the company is mainly engaged in such activities. Cochin Company v. CIT (1978) 114 ITR 822 approves this. 'Project' means a project for the construction of a building, road, dam, bridge or other structure or assembly or installation of any machinery or plant. But the Finance Act, 1985, makes this definition, more or less, irrelevant for computing tax rates.

(iv) Investment Company:

An 'Investment Company' means a company whose gross

total income (as under section 80-B) consists mainly of the income which is chargeable under the heads 'Interest on securities', 'Income from house property', 'Capital gains' and 'Income from other sources'.

(v) Trading Company:

A 'Trading company' means a company whose business consists wholly in the provision of technical know-how or in the rendering of services in that connection to other persons.

(vii) Widely-held Company:

This is also known as "a company in which public are substantially interested" and means any of the following:

- (1) It is a company owned by the Government or the Reserve Bank of India or in which not less than 40 per cent shares (value) are held by the Government or the Reserve Bank of India or by a corporation owned by the Reserve Bank of India;
- (2) It is a company having no share-capital and it is declared by the CBDT as such;
- (3) It is a company registered under section 25 of the Companies' Act, 1956, namely, the companies for the promotion of commerce, art, science, religion, charity, prohibiting the payment of any dividend to its members;
- (4) It is a company which is not a private company and its

equity shares are, as on the last day of the previous year, listed in a recognized stock exchange in India;

- (5) It is a company (not a private company) and its shares carrying 50 per cent of voting power (40 per cent in the case of industrial companies) have been allotted to or acquired unconditionally by and were throughout the previous year, beneficially held by -

- (a) the government, or
- (b) a statutory corporation, or
- (c) a widely-held company or its subsidiary.

But the Finance Act, 1985, provides that a company which carries on, as its principal business, the business of acceptance of deposits from its members and which is declared by the central government under section 620A of the Companies' ActA to be a Nidhi or a mutual benefit society, shall be regarded as widely-held company.

(viii) Public Sector Company:

A 'Public sector company' means any corporation established by or under any central, state or provincial Act or a Government company as defined in section 617 of the Companies' Act, 1956.

Section 104 is now withdrawn. Section 80M provides for a deduction of inter-corporate dividends in the case of domestic companies. This is specially important in the case

of an existing company considering expansion of its activities. The definition of dividend is now enlarged and includes any payment by a company, not being a widely-held company, made after 31.5.1987, by way of advance or loan to a shareholder, being a person who is a beneficial owner of share (not being preference shares) holding not less than 10% of the voting power or to any concern in which he is a member or partner and in which he has a substantial interest.

(ix) Closely-held company:

A company which is not a widely-held company is called 'closely-held company'.

3.1.3 Classification of Companies:

The companies may be classified as under:

- (a) Widely-held company, i.e. the company in which the public is substantially interested; and
- (b) Closely-held company.

This classification academically influences the tax liabilities of both Indian and foreign companies. But practically, this classification is effective only in respect of the Indian companies. In the framework of the Income-tax Act, some disincentives are associated with a closely-held form of a company. The following may be noted in this connection:

- (i) Section 2(22)(e): Any payment made by a closely held company for the individual benefit of a shareholder

having substantial interest in the company is generally treated as a dividend, depending upon the extent of accumulated profits possessed by this company.

- (ii) Section 79: This section restricts the carrying forward and adjustment of losses of closely-held companies, where there is a change in shareholding, which is intended with a view to avoiding or reducing any tax liability.
- (iii) Section 104: This section imposes additional income-tax on these companies unless they declare atleast a minimum dividend as prescribed under that section. But some companies do have certain exemptions in this regard. This is not applicable to a foreign company.

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