RAMA UNIVERSITY

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FACULTY OF COMMERCE AND MANAGEMENT

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SUBJECT: Corporate Tax Planning

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LECTURE-08

TAXATION OF COMPANIES

In most countries with income taxation, corporate entities are subject to tax on their profits and, in addition, dividends are taxed in the hands of shareholders (subject to exemption up to a point). The base of the corporate income tax, however, is commonly the accounting profits derived with reference to historical costs.

Company is a voluntary association of persons formed for the purpose of doing business having a distinct name and limited liability. It is a juristic person having a separate legal entity distinct from the members who constitute it, capable of rights and duties of its own and endowed with the potential of perpetual succession. The Companies Act, 1956, states that 'company' includes company formed and registered under the Act or an existing company i.e., a company formed or registered under any of the previous company laws.

However, company is not a citizen so as to claim fundamental rights granted to citizens.

Company is a 'juristic person' and it can file a suit as an 'indigent person'

An expression 'person' includes not merely a natural person but also other juridical persons. A company being a juristic person would be represented before a Court of law or any other place by a person competent to represent it. It is enough that the person competent to represent a company presents the application on behalf of the company. Minors, lunatics or person under any disability are also entitled to file a suit either through guardian or the next friend. In such a case it is the guardian or next friend who is competent to represent the petitioner.

Company is a separate legal entity

Company is separate legal entity distinct from its shareholders. The major constituents of a company are its members, who are the ultimate owners and its directors. It is an important feature of the company form of business, that there is a gap between the ownership and control over the affairs of the company. In real sense the members are the owners of a company, but it is being managed by the directors who are elected representatives of its members, because it is absolutely necessary for it to have a human agency called as the Company's board of directors. The Board of Directors comprises the directors.

The tax levied on a company’s income is based on its legal residence. Companies of Indian origin are levied tax in India, while International companies are levied tax on earnings from their

Indian operations. For International companies' royalty, interest, gains from sale of capital assets within India, dividends from Indian companies and fees for technical services are all treated as income arising in India.

Definitions of Company

Company: As per section 2(17), company means: Any Indian company, or Any body corporate incorporated by or under the laws of a country outside India, or

Any institution, association or body which was assessed as a company for any assessment year under the Income Tax Act, 1922 or was assessed under this Act as a company for any assessment year commencing on or before 1.4.1970, or

Any institution, association or body, whether incorporated or not and whether Indian or non-Indian, which is declared by a general or special order of CBDT to be a company.

A company in which the public are substantially interested: Section 2(18) of the Income Tax Act has defined "acompany in which the public are substantially interested" includes:

A company owned by Government or Reserve Bank of India.

A company having Government participation i.e., a company in which not less than 40% of the shares are held by Government or the RBI or a corporation owned by the RBI or a corporation owned by the RBI.

Companies registered under section 25 of the Indian Companies Act, 1956: Companies registered under section 25 of the Companies Act, 1956 are companies which are promoted with special object such as to promote commerce, art, science, charity or religion or any such useful object and these companies do not have profit motive. However, if at any time these companies declare dividend, they would lose the status of a company in which the public are substantially interested.

A company declared by the CBDT: It is a company without share capital and which having regard to its object, nature and composition of its membership or other relevant consideration is declared by the Board to be a company in which public are substantially interested.

Mutual benefit finance company, where principal business of the company is acceptance of deposits from its members and which has been declared by the Central Government to be a Nidhi or a Mutual Benefit Society.

A company having co-operative society participation: It is a company in which at least 50% or more equity shares have been held by one or more co-operative societies.

A public limited company: A company is deemed to be a public limited company if it is not a private company as defined by the Companies Act, 1956 and is fulfilling either of the following two conditions:

- Its equity shares were listed on a recognised stock exchange, as on the last day of the relevant previous year; or Its equity shares carrying at least 50% of the voting power (in the case of an industrial company the limit is 40%) were beneficially held throughout the relevant previous year by government, a statutory corporation, a company in which the public is substantially interested or a wholly owned subsidiary of such a company.

Widely held company: It is a company in which the public are substantially interested.

Closely held company: It is a company in which the public are not substantially interested.

Indian company [Section 2(26)]: Indian Company means a company formed and registered under the Companies Act, 1956 and includes -

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).

A corporation established by or under a Central, State or Provincial Act

Any institution, association or body which is declared by the Board to be a company.

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 that State;

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; Provided that the registered or, as the case may be, principal office of the company, corporation, institution, association or body, in all cases is in India.

Domestic company [Section 2(22A)]: A domestic company means an Indian company or any other company which in respect of its income, liable to tax under the Income Tax Act, has made the prescribed arrangements for the declaration and payment within India, of the dividends (including dividends on preference shares) payable out of such income.

Foreign company [Section 2 (23A)]: Foreign Company means a company which is not a domestic company.

Investment Company: Investment Company means a company whose gross total income consists mainly of income which is chargeable under the heads Income from house property,

Residence of a Company

capital gains and income from other sources.

[Section 6(3)]

A company is said to be a resident in India during the relevant previous year if: it is an Indian company or if it is not an Indian company then, the control and the management of its affairs is situated wholly in India.

The company is said to be non-resident in India, if it is not an Indian company and some part of the control and management of its affairs is situated outside India.

The total income of a company is also computed in the manner in which income of any other assessee is computed.

CARRY FORWARD AND SET OFF OF LOSSES

(Section 79)

In the case of closely held companies, no loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year (unless on the last day of the previous year in which loss is set off and on the last day of the previous year in which the loss was incurred), the shares of the company carrying not less than 51% of the voting power were beneficially held by the same persons.

Where a change in voting power of more than 49% of the shareholding of a closely held company has taken place between two relevant dates (viz.the last day of the previous year in which set off is claimed and the last date of the previous year in which the loss is incurred) the assessee will not be entitled to claim set off of such losses. This provision shall not apply to a change in the voting power consequent upon:

the death of a shareholder; or

on account of transfer of shares by way of gifts to any relative of the shareholder making such gift.

Further, section 79 shall not apply to any change in the shareholding of an Indian company, which is subsidiary of a foreign company arising as a result of amalgamating or demerged foreign company continue to remain the shareholders of the amalgamated or the resulting foreign company.

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