
Sanatkumar Jayantilal Vs Commissioner of Income Tax

Income-tax Reference No. 304 of 1981

Court: Gujarat High Court

Date of Decision: Dec. 22, 1993

Acts Referred:

Income Tax Act, 1961 " Section 143(3), 147, 2(42A), 45

Citation: (1994) 117 CTR 249 : (1995) 211 ITR 755

Hon'ble Judges: M.B. Shah, J; J.M. Panchal, J

Bench: Division Bench

Advocate: J.P. Shah, for the Appellant; B.J. Shelat, for the Respondent

Judgement

M.B. Shah, J.

For the assessment year 1968-69, the assessee - Sanatkumar Jayantilal - filed a return of income which included capital

gains on long-term basis in respect of the sale of 10,000 shares of Indian Iron and Steel Company Limited and 324 shares of Kohinoor Mills

Limited. The net capital gains declared as on long-term was Rs. 31,941. The Income Tax Officer accepted the working of capital gains on long-

term while passing the assessment order u/s 143(3) of the Income Tax Act, 1961.

2. For the assessment year 1969-70, the assessee submitted a return of income mentioning therein that there were long-term capital gains in

respect of 120 shares of Belapur Company Limited. The Income Tax Officer passed an assessment order accepting the contention of the assessee

that there were long-term capital gains of Rs. 2,643 as disclosed by the assessee.

3. Thereafter, the Income Tax Officer issued notice u/s 147(a) of the Act on the ground that out of 10,000 shares of Indian Iron Steel and

Company Limited sold, 5,000 shares were bonus shares received by the assessee in the same accounting year. As these shares were sold within

the period of 12 months of their acquisition, they gave rise to short-term capital gains. In the assessment year 1969-70, similar notice was given by

stating that 60 bonus shares of Belapur Company Limited were sold within 24 months of their receipt.

4. After considering the objections including the objection with regard to the jurisdiction u/s 147(a) of the Act raised by the assessee, the Income

Tax Officer decided that on sale of the bonus shares, tax is required to be worked out on the basis of short-term capital gains. The appeals against

the reassessment orders were dismissed by the Commissioner of Income Tax (Appeals). In the appeal filed by the assessee, the Tribunal arrived at

the conclusion that primary or material facts omitted from the Income Tax returns were that the shares which were sold were bonus shares which

were acquired within the period of 12 months or 24 months before the sale. The Tribunal, therefore, held that the Income Tax Officer was well

within his jurisdiction to reopen the two assessments. On the merits, the Tribunal relied upon the decision of this court in the case of Commissioner

of Income Tax, Gujarat-I Vs. Chunilal Khushaldas, and dismissed the appeal filed by the assessee.

5. Hence, at the instance of the assessee, the following questions are referred u/s 256(1) of the Income Tax Act, 1961, for our opinion :

1. Whether in view of the facts and circumstances of the case, the Tribunal was right in holding that the jurisdiction of the Income Tax Officer u/s

147(a) was valid for (a) assessment year 1968-69, and (b) assessment year 1969-70 ?

2. Whether, in view of the facts and circumstances of the case, the Tribunal was right in holding that the sale of bonus shares during the previous

year yielded short-term capital gains for (a) assessment year 1968-69, (b) assessment year 1969-70 ?

6. Re. : Question No. 1 :

Learned counsel for the assessee does not press question No. 1 in view of the finding given by the Tribunal on the said question. Hence, it is not

required to be answered.

7. Re. : Question No. 2 :

Learned counsel for the assessee vehemently submitted that the decision rendered by this court in Commissioner of Income Tax, Gujarat-I Vs.

Chunilal Khushaldas, requires to be reconsidered. It is his contention that the court has materially erred in laying down whether the bonus shares

are short-term capital assets or long-term capital assets would depend upon the point of time when the bonus shares are acquired and not on the

date of acquisition of the original shares on the basis of which the bonus shares are issued. It is his contention that this court has not considered the

law laid down by the Supreme Court in the case of Miss Dhun Dadabhoy Kapadia Vs. Commissioner of Income Tax, Bombay, . He also referred

to the following observations from the ""Books of Accountancy"" :

(i) "Intermediate Accounting" by Davidson at page 23, paragraph 30 -

"Shareholders should not celebrate upon receiving a stock dividend. If the shares are of the same type as those held before, each shareholders

proportionate interest in the owners equity of the corporation and proportionate voting power will not have changed....." Stock dividend is

bonus share.

(ii) "Accounting. The Basis for Business Decisions" by Meigs and Johnson, at pages 541 and 542 :

"An example may make this fundamental point clear. Assume that a corporation with 800 shares of stock is owned equally by James Adams and

Frank Barnes, each owning 400 shares of stock. The corporation pays a stock dividend of 25 per cent. and distributes 200 additional shares (25

per cent. of 800 shares), with 100 shares going to each of the two stockholders. Adams and Barnes now hold 500 shares apiece, but each still

owns one-half of the business. The corporation has not changed; its assets and liabilities and its total capital are exactly the same as before he

dividend. From the stockholder's view point, the ownership of 500 shares out of a total of 1,000 outstanding shares represents no more than did

the ownership of 400 shares out of a total of 800 shares previously outstanding.

Assume that the market value of this stock was \$ 10 per share prior to the stock dividend. The total market value of all the outstanding shares was,

therefore, 800 times \$ 10, or \$ 8,000. What would be the market value per share and in total after the additional 200 dividend shares were issued

? The 1,000 shares now outstanding should have the same total market value as the previously outstanding 800 shares, because the ""pie"" has

merely been divided into more but smaller pieces....."

(iii) "Book-Keeping and Accounts" by W. W. Bigg and R. E. G. Perrins, at pages 271 and 272 :

"A bonus issue of shares adds nothing to the net assets of the company; it divides the capital employed in the business into a larger number of

shares. This can be explained by an illustration.

Illustration (1) :

A company's summarised balance-sheet is as follows :

Share capital in Pound 1 shares Sundry assets, less creditors

Pound 100,000 Pound 150,000

Reserves 50,000

If the assets and goodwill are fully valued, each Pound 1 share is worth Pound 1.50 cum dividend. On the profits being capitalised, if the bonus

shares are issued at par, the share capital becomes Pound 150,000 in Pound 1 shares. Each share is now worth Pound 1, but each shareholder

has 50 per cent. more shares. The shareholders are no better off."

(iv) "Modern Financial Accounting" by G. A. Lee, (third edition), at page 257 :

". . . . It is decided to capitalise all the reserves, except \$ 10,000 of the profit and loss account, by means of a 3 for 1 bonus issue of ordinary

shares. . . ."

"It is apparent that the total owners' equity remains unaltered, except that the share issue expenses fall to be written off in due course; nor have the

company's expectations as to future profits been changed in any way. The new 200,000 shares are worth, on that basis, just the same as the old

50,000 ones and the stock market will react accordingly, by reducing the price to one-fourth of its old level. Each member's holding is thus

unchanged in total value. Hence, the "bonus" is illusory, and the term "scrip issue" (not the same as a scrip dividend - See Chapter 12, sub-section

12.2.2.) is more realistic."

8. In our view, it would be difficult to accept the contention of learned counsel for the assessee. In the case of Commissioner of Income Tax,

Gujarat-I Vs. Chunilal Khushaldas, the Division Bench of this court had dealt with in detail similar contentions raised by the assessee and arrived at

the conclusion that the bonus shares were short-term capital assets within the meaning of section 2(42A) as they were not held by the assessee for

more than twelve months. The gains arising from the sale of the bonus shares were, therefore, liable to be taxed as capital gains arising out of the

transfer of short-term capital assets. For this purpose, the court referred to the definition of short-term capital assets as defined in section 2(42A)

and observed as under (at page 373) :

It is, therefore, necessary to know what is a short-term capital asset. That is defined in section 2(42A) to mean "a capital asset held by an

assessee for not more than twelve months immediately preceding the date of its transfer...." Clause (ii) of the Explanation to section 2(42A)

provides that :

"in respect of capital assets other than those mentioned in clause (i), the period for which any capital asset is held by the assessee shall be

determined subject to any rules which the Board may make in this behalf."

There are admittedly no rules made by the Board under this clause and, therefore, the question as to what is the period for which any capital asset

is held by the assessee has to be determined on first principle. If the bonus shares were held by the assessee for not more than twelve months

immediately preceding the date of their transfer, they would be short-term capital assets; otherwise, they would be long-term capital assets.

(emphasis (Here printed in italics) supplied).

9. Thereafter, the court dealt with the similar contentions, which are raised in this matter, that the bonus shares add nothing to the interest of the

shareholders and take nothing out of the pocket of the company and what is owned by the shareholders previously by virtue of original share

certificates is after the bonus shares held on the basis of more certificates. After considering various decisions cited on the point and regulation 96

of Table A to the Companies Act, 1956, the court held that bonus shares come into existence on their allotment and till such allotment the shares

do not exist. The relevant observations are as under (at page 377) :

The bonus shares would then come into existence and the capitalised accumulated profits would constitute additional share capital issued to and

contributed by the shareholders. Till then it cannot be said that the bonus shares are in existence. That is very clear from the observations of the

Supreme Court in *Sri Gopal Jalan and Co. v. Calcutta Stock Exchange Association* [1963] 33 Comp Cas 862 where Sarkar J. said, though in a

slightly different context : "in company law ""allotment"" means the appropriation out of the previously unappropriated capital of a company, of a

certain number of shares to a person. Till such allotment the shares do not exist as such. It is on allotment in this sense that the shares come into

existence".

10. The court also referred to the decision of the Supreme Court in the case of *Commissioner of Income Tax, Bihar Vs. Dalmia Investment Co.*

Ltd., and observed that the bonus shares, as pointed out by Hidayatullah J., entitle the shareholders ""to an additional share in the increased capital

and again, they are ""property from which income in the shape of money may be derived in the future"". The court finally held that the bonus shares

plainly and indubitably confer a right on the shareholder to an additional share in the increased capital of the company and also entitle him to an

additional right to vote as also to obtain income in the shape of money out of the profits of the company and they must, therefore, be held to be

acquired when they are issued by the company and that the bonus shares issued by a company are acquired by a shareholder when they are issued

and they must be taken to be held by the shareholder from the date of their issue and not from the date when the original shares in respect of which

they are issued were acquired by the shareholders.

11. Learned counsel for the assessee further pointed out that the court has considered numerous decisions, which were cited at the time of hearing

of the matter but the attention of the court was not drawn to the decision rendered by the Supreme Court in the case of *Miss Dhun Dadabhoy*

Kapadia Vs. Commissioner of Income Tax, Bombay, wherein it is held that in working out the capital gain or loss, the principles that have to be

applied are those which are a part of commercial practice or which an ordinary man of business will resort to when making a computation for his

business purposes. Relying upon this, he submitted that suppose the price of share cum bonus is Rs. 30 on a particular date, say August 31, 1992,

then price of the ex-bonus shares on September 1, 1992, would be Rs. 15. Presuming that A sells 10,000 shares at Rs. 30, he will earn Rs. 3

lakhs and his long-term capital gains will be Rs. 2 lakhs. As against this, B sells 10,000 ex-bonus shares and 10,000 bonus shares at Rs. 15 and

gets the price of Rs. 1,50,000 plus Rs. 1,50,000, respectively, and on the basis of the decision of this court in the case of *Commissioner of Income*

Tax, Gujarat-I Vs. Chunilal Khushaldas, he would be required to pay capital gain tax on Rs. 1 lakh as short-term capital gain and Rs. 1 lakh as

long-term capital gain. He, therefore, contended that this would lead to absurd results.

12. With regard to the aforesaid submission, there cannot be any dispute that, in working out the capital gain or loss, the principles that have to be

applied are those which are part of commercial practice. But it would be for the Legislature to define in which case it can be stated that capital

assets were held on long-term basis or short-term basis. The Legislature has provided it u/s 2(42A) of the Act. It is true that the bonus shares

would be issued out of the accumulated profits but it cannot be doubted that the said accumulated profits reach the hands of the shareholders only

on the date when the bonus shares are issued. It is not necessary that, because there is accumulation of profits, the company should issue bonus

shares. Therefore, the relevant date for determination of the capital asset, as provided u/s 2(42A) of the Act, would be the date on which the

bonus shares are issued to the shareholders. Further, in working out the definition provided by the Legislature, it may in some cases cause some

hardship, but that would hardly be a ground for holding that the definition given in section 2(42A) for short-term capital asset should be interpreted

in a manner which is inconsistent with the language used in the said definition clause. Hence, the phrase ""capital asset"" held by the assessee cannot

be given a meaning that even though as a matter of fact the assessee was not holding the bonus shares prior to their issue or say prior to their birth,

yet, as bonus shares are issued from the profits accumulated, their issue would relate back to the date of holding of the original shares. This aspect

is also considered in the case of Commissioner of Income Tax, Gujarat-I Vs. Chunilal Khushaldas, and it is observed that the word ""held"" ,

according to its plain natural sense, means ""belong to"" or ""of the ownership of"". Thereafter, the court held that the requirement that the capital

assets must be held by the assessee for not more than twelve months immediately preceding the date of its transfer does indicate that the capital

asset must exist as an identifiable capital asset during the period it is claimed that it is held by the assessee. If the capital asset consists of bonus

shares, the bonus shares must exist as bonus shares throughout the period for which they are supposed to be held by the assessee and obviously

there would be no bonus shares prior to the date of their issue.

13. Hence, in our view, the court has considered all the aspects in proper perspective and after taking into consideration all the relevant decisions

and dealing with all the arguments which are advanced in this matter and, therefore, the judgment rendered by this court in Commissioner of

Income Tax, Gujarat-I Vs. Chunilal Khushaldas, does not call for any reconsideration. Hence, question No. 2 is answered in the affirmative, i.e., in

favour of the Revenue and against the assessee.

14. In the result, the reference stands disposed of accordingly with no order as to costs.