

CASE NO.:
Appeal (civil) 4422 of 2001

PETITIONER:
Commissioner of Income Tax, Mumbai

RESPONDENT:
M/s General Insurance Corporation

DATE OF JUDGMENT: 25/09/2006

BENCH:
ASHOK BHAN & Markandey Katju

JUDGMENT:
J U D G M E N T

Bhan, J.

The question which arises for consideration in this appeal is, as to whether the expenditure incurred in connection with the issuance of bonus shares is a capital expenditure or revenue expenditure. The question of law framed in the High Court was:

(i) Whether on the facts and in the circumstances of the case and in law the Tribunal was right in holding that the expenditure incurred on account of share issue is allowable expenditure?

The Assessee is an Insurance Company which has four subsidiaries. For the assessment year 1991-92 the assessee filed a return of income of Rs. 58,52,80,850/- along with the audit report. The assessing Officer disallowed a few expenses incurred as revenue expenditure, one of them being in the sum of Rs. 1,04,28,500/- incurred towards the stamp duty and registration fees paid in connection with the increase in authorized share capital. The respondent-assessee had during the accounting year, incurred expenditure separately for:

- (i) The increase of its authorized share capital and
- (ii) The issue of bonus shares.

The Assessing Officer disallowed both the items of expenditure as revenue expenditure. According to him, the expenses incurred were towards a capital asset of a durable nature for the acquisition of a capital asset and, therefore, the expenses could only be attributable towards the capital expenditure.

The assessee being aggrieved filed an appeal under Section 143 (3) before the CIT (Appeals). Disallowance of Rs. 1,04,28,500/- in respect of stamp duty and registration fees incurred in connection with the increase in the authorized share capital were bifurcated by the CIT (Appeals) into two categories, one relating to the increase in authorized share capital from Rs. 75 crores to Rs. 250 crores and second relating to issue of bonus shares. In respect of the first category of expenditure it was held that the same was not allowable in terms of the judgments of the Bombay High Court in the case of Bombay Burmah Trading Corporation, vs. CIT, (1984) 145 ITR 793 and Richardson Hindustan Limited

Vs. CIT, (1988)169 ITR 516. The expenditure falling under second category was allowed as revenue expenditure being directly covered by the decision in Bombay Burmah Trading Corporation's case (supra).

The revenue being aggrieved challenged the order passed by the CIT (Appeals) before the Income Tax Appellate Tribunal (for short "the Tribunal"). The Tribunal upheld the decision of the CIT (Appeals) treating the expenses incurred towards the issue of bonus shares as revenue expenditure by observing inter alia as under:

"We have carefully considered the rival submissions. The basis for the judgment by Hon'ble Supreme Court in the case of Brooke Bond India Limited vs. CIT, (1997) 225 ITR 798 (SC), has been that the expenditure was connected with the expansion of the capital base of the Company and therefore such expenditure was capital expenditure. However, in the case of issue of bonus shares there does not take place an expansion of the capital base of the company but only re-allocation of the existing funds. We, therefore, hold that the Learned CIT (Appeals) rightly decided this issue in favour of the assessee. This ground of appeal is therefore rejected."

The revenue thereafter filed an appeal under Section 260-A of the Income tax Act (for short "the Act") before the High Court of Bombay, raising two questions of law. The High Court in its judgment has affirmed the Tribunal's judgment by following its earlier decision in the case of Bombay Burmah Trading Corporation (supra). This Court granted leave qua the question of law as reproduced in para 1 of this judgment.

On the question, as to whether the expenses incurred in connection with the issue of bonus shares is a revenue expenditure or a capital expenditure, there is a conflict of opinion between the High Courts of Bombay and Calcutta on the one hand and Gujarat and Andhra Pradesh on the other. Bombay and Calcutta High Courts have taken the view that the expenses incurred in connection with the issue of bonus shares is a revenue expenditure whereas Gujarat and Andhra Pradesh High Courts have taken the view that the expenses incurred in connection with the bonus shares is in the nature of capital expenditure.

Learned counsel for the appellant relying upon the commentary to the Companies Act by A Ramaiya, Sixteenth Edition 2004, which occurs in the commentary to Section 81 of the Indian Companies Act, - "When a company prospers and accumulates a large surplus it converts this surplus into capital and divides the capital among its members in proportion to their rights. This is done by issuing fully paid shares representing the increased capital. The shareholders to whom the shares are allotted have to pay nothing. The purpose is to capitalize the gains which may be available for division or utilize quasi-capital gains. Bonus shares go by the modern name "capitalization of shares". AND the judgments of the Gujarat High Court in Ahmedabad Manufacturing and Calico Pvt. Ltd. Vs. Commissioner of Income-Tax, (1986) 162 ITR 800, CIT Vs. Mihir Textiles Limited, (1994) 206 ITR 112 (Gujarat), Gujarat Steel Tubes Limited Vs. CIT, (1994) 210 ITR 358, CIT Vs. Ajit Mills Limited, (1994) 210 ITR 658

and the two judgments of the Andhra Pradesh High Court in Vazir Sultan Tobacco Co. Ltd. Vs. CIT, (1990) 184 ITR 70 and Vazir Sultan Tobacco Co. Ltd. Vs. CIT, (1988) 174 ITR 689 wherein it has been held that the issuance of bonus shares increases the issued and paid up capital of the company and the bonus shares of the company are directly connected with the acquisition of capital and an advantage of enduring nature. CONTENTS that the expenses incurred towards issue of bonus shares confers an enduring benefit to the company which has a resultant impact on the capital structure of the company and therefore, it should be regarded as the capital expenditure. Reliance has also been placed upon the judgments of this Court in Punjab State Industrial Development Corporation Ltd. Vs. CIT, (1997) 225 ITR 792 (SC) and Brooke Bond India Ltd. Vs. CIT, (1997) 225 ITR 798 (SC). He also relied upon in CIT vs. Motor Industries Co. Ltd., (1998) 229 ITR 137 of Karnataka High Court, in CIT vs. Ajit Mills Limited, (1994) 210 ITR 658, Gujrat Steel Tubes Ltd., vs. CIT, (1994) 210 ITR 358 of Gujarat High Court & Union Carbide India Ltd., vs. CIT, (1993) 203 ITR 584 of Calcutta High Court.

As against this, learned senior counsel appearing for the respondent contends that undoubtedly increase in share capital by the issue of fresh shares leads to an inflow of fresh funds into the company expands or adds to, its capital employed resulting in expending its profit making apparatus, but THE ISSUE OF BONUS SHARES by capitalization of reserves is merely a reallocation of a company's funds. There is no inflow of fresh funds or increase in the capital employed, which remains the same. The issue of bonus shares leaves the capital employed unchanged and therefore, does not result in conferring an enduring benefit to the company and the same has to be regarded as revenue expenditure. He has relied upon the judgment of this Court in CIT vs. Dalmia Investment Co. Ltd., (1964) 52 ITR 567 (SC), Bombay Burmah Trading Corporation Ltd. Vs. CIT, (1984) 145 ITR 793, Richardson Hindustan Limited Vs. CIT, (1988) 169 ITR 516 (Bombay) and the subsequent judgments of the same Court taking the same view and the judgment of the Calcutta High Court in Wood Craft Products Limited Vs. Commissioner of Income-Tax, (1993) 204 ITR 545.

We may at the outset indicate that this Court has laid down the test for determining whether a particular expenditure is revenue or capital expenditure in the case of Empire Jute Co. Ltd. Vs. CIT, 1980 (4) SCC 25. This Court after considering the law on the subject in detail observed at page 8 as under:

"The decided cases have, from time to time, evolved various tests for distinguishing between capital and revenue expenditure but no test is paramount or conclusive. There is no all embracing formula which can provide a ready solution to the problem; no touchstone has been devised. Every case has to be decided on its own facts keeping in mind the broad picture of the whole operation in respect of which the expenditure has been incurred. But a few tests formulated by the courts may be referred to as they might help to arrive at a correct decision of the controversy

between the parties. One celebrated test is that laid down by Lord Cave, L.C. in *Atherton vs. British Insulated and Helsby Cables Ltd.*, 10 TC 155, where the learned Law Lord stated :

When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.''

[Emphasis supplied]

In short, what has been held in this case is that if the expenditure is made once and for all with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade then there is a good reason for treating such an expenditure as properly attributable not to revenue but to capital. This is so, in the absence of special circumstances leading to an opposite conclusion.

Decisions of this Court in *Punjab State Industrial Development Corporation Ltd.* (supra) and *Brooke Bond India Ltd.* (supra) and *CIT Vs. Motor Industries Co. Ltd.*, (1998) 229 ITR 137 of Karnataka High Court, *CIT Vs. Ajit Mills Limited*, (1994) 210 ITR 658, *Gujrat Steel Tubes Ltd., vs. CIT*, (1994) 210 ITR 358 & *Union Carbide India Ltd., vs. CIT*, (1993) 203 ITR 584 of Calcutta High Court are of not much assistance to us. All these cases relate to the issue of fresh shares which lead to an inflow of fresh funds into the company which expands, or adds to its capital employed in the company resulting in the expansion of its profit making apparatus. Expenditure incurred for the purpose of increasing company's share capital by the issue of fresh shares would certainly be a capital expenditure as has been held by this Court in the cases cited above.

Effect of issuance of bonus share has been explained by this Court in *Dalmia Investment Co. Ltd.*, (supra) where the question of valuation of bonus share was considered. After quoting the decision in the case of *Eisner Vs. Macomber*, (1920) 252 U.S. 189, of the Supreme Court of United States of America, Mr. Justice Hidayatullah explained the consequences of issue of bonus shares by observing thus:

"\005. In other words, by the issue of bonus shares pro rata, which ranked pari passu with the existing shares, the market price was exactly halved, and divided between the old and the bonus shares. This will ordinarily be the case but not when the shares do not rank pari passu and we shall deal with that case separately. When the shares rank pari passu the result may be stated by saying that what the shareholder held as a whole rupee coin is held by him, after the issue of bonus shares, in two 50 nP. coins. The total value remains the same, but the evidence of that value is not in one certificate but in two."

It is further observed at pages 577-578:

"It follows that though profits are profits in the hands of the company, when they are disposed of by converting them into capital instead of paying them over to the shareholders, no income can be said to accrue to the shareholders because the new shares confer a title to a larger proportion of the surplus assets at a general distribution. The floating capital used in the company which formerly consisted of subscribed capital and the reserves now becomes the subscribed capital."

[Emphasis supplied]

The Gujarat High Court in Ahmedabad Manufacturing and Calico Pvt. Ltd. Vs. Commissioner of Income-Tax, (1986) 162 ITR 800 has held, that the expenses incurred towards the issuance of bonus shares is a capital expenditure. Bonus shares issued by the assessee company also constitute its capital bonus shares, as right shares are an integral part of the permanent structure of the company and are not in any way connected with the working capital of the company which is utilized to carry on day to day operations of the business. Negating the contention of the assessee that no benefit whatsoever is derived by the assessee company when its profits and/or reserves are converted into paid-up shares, it was held that as a result of the increase in the paid up share capital the creditworthiness of the assessee-company would increase which would be a benefit or advantage of enduring nature. That the bonus shares are an integral part of the permanent structure of the assessee-company. The bonus shares are not different from rights shares as, according to it, in the case of bonus shares a bonus is first paid to the shareholders who pay it back to the company to get their bonus shares. This reasoning of the Gujarat High Court was evident from the following extracts from its judgment:

At page 808:

"It is clear that when bonus shares are issued, two things take place: (i) bonus is paid to the shareholders; and (ii) wholly or partly paid-up shares are issued against the bonus payable to the shareholders. The shareholders invest the bonus paid to them in the shares and that is how the bonus shares are issued to them.

In our opinion, therefore, it would not make any difference whether paid-up share capital is augmented by issuance of right shares or bonus shares to the shareholders.

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As already pointed out above, bonus shares are not different from rights shares\005\005\005.."

The above observation is completely contrary to the observation of this Court in Dalmia Investment Co. Ltd.,

(supra), which judgment had not been referred to by the Gujarat High Court. In the case of Dalmia Investment Co. Ltd., (supra) this Court has held that floating capital used in the company which formerly consisted of subscribed capital and the reserves now becomes the subscribed capital. The conversion of the reserves into capital did not involve the release of the profits to the shareholder; the money remains where it was, that is to say, employed in the business. In the face of these observations the reasoning given by the Gujarat High Court cannot be upheld.

We do not agree with the view taken by the Gujarat High Court that increase in the paid up share capital by issuing bonus shares may increase the creditworthiness of the company but that does not mean that increase in the credit worthiness would be a benefit or advantage of enduring nature resulting in creating a capital asset.

The Andhra Pradesh High Court has in Vazir Sultan Tobacco Co. Ltd. Vs. CIT, (1990) 184 ITR 70 (AP), taken the view that the expenditure incurred on the issue of bonus shares was capital in nature because the issue of bonus shares led to an increase in the company's capital base.

The observations and conclusions are erroneous as they run contrary to the observation made by this Court in Dalmia Investment Co. Ltd., (supra). The capital base of the company prior to or after the issuance of bonus shares remains unchanged.

Issuance of bonus shares does not result in any inflow of fresh funds or increase in the capital employed, the capital employed remains the same. Issuance of bonus shares by capitalization of reserves is merely a reallocation of company's fund. This is illustrated by the following hypothetical tabulation which establishes that bonus shares leaves the capital employed untouched, because in the hypothetical example, the capital employed remains the same (i.e. Rs. 600) both pre and post issuance of bonus shares.

Sl.No.	
Particulars	
Pre-Bonus	
Issue	
Rs.	
On Bonus Issue	
Rs.	
Post Bonus	
shares	
Rs.	
1.	
Pre-paid share	
capital	
100	
100+100=200	
200	
2.	
Reserve	
500	
500-100=400	

400
3.
Total
600
600
600

As observed earlier, the issue of bonus shares by capitalization of reserves is merely a reallocation of company's funds. There is no inflow of fresh funds or increase in the capital employed, which remains the same. If that be so, then it cannot be held that the Company has acquired a benefit or advantage of enduring nature. The total funds available with the company will remain the same and the issue of bonus shares will not result in any change in the capital structure of the company. Issue of bonus shares does not result in the expansion of capital base of the company.

The case Wood Craft Products Limited (supra) of the Calcutta High Court is similar to the case of the respondent. In that case as well there was increase of authorized share capital by the issue of fresh shares and a separate issue of bonus shares. The Calcutta High Court drew a distinction between the raising of fresh capital and the issue of bonus shares and held that expenditure on the former was capital in nature as it changed the capital base. On the other hand, in the case of bonus shares, was held to be revenue expenditure following the decision of the Supreme Court in Dalmia Investment Co. Ltd., (supra) on the ground that there was no change in the capital structure at all.

In our considered opinion, the view taken by the Bombay and Calcutta High Courts is correct to the effect that the expenditure on issuance of bonus shares is revenue expenditure. The contrary judgments of Gujarat and Andhra Pradesh High Courts are erroneous and do not lay down the correct law.

For the reasons stated above, the question referred to us, is answered in the affirmative, i.e., in favour of the assessee and against the revenue.