

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

TAX APPEAL No. 202 of 2000

For Approval and Signature:

**HONOURABLE MR.JUSTICE AKIL KURESHI
HONOURABLE MS.JUSTICE HARSHA DEVANI**

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1 Whether Reporters of Local Papers may be allowed to see the judgment ?

2 To be referred to the Reporter or not ?

3 Whether their Lordships wish to see the fair copy of the judgment ?

4 Whether this case involves a substantial question of law as to the interpretation of the constitution of India, 1950 or any order made thereunder ?

5 Whether it is to be circulated to the civil judge ?

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G.S.F.C. LTD. - Appellant(s)

Versus

DY. C.I.T. (ASSTT) - Opponent(s)

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Appearance :

MR MANISH J. SHAH for MR JP SHAH for Appellant

MR KM PARIKH for Respondent

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CORAM : HONOURABLE MR.JUSTICE AKIL KURESHI

and

HONOURABLE MS.JUSTICE HARSHA DEVANI

Date : 14/08/2012

ORAL JUDGMENT

(Per : HONOURABLE MR.JUSTICE AKIL KURESHI)

1. The appellant – Gujarat State Fertilizers Co. Ltd., the assessee has preferred this appeal under section 260A of the Income Tax Act, 1961 (“the Act” for short) calling in question a judgement of the Income Tax Appellate Tribunal (“the Tribunal” for short) dated 4.5.2000. At the time of admission of the appeal, the following substantial question of law was framed:

“Whether, the expenditure of Rs.4,12,595/- for sub-division of shares of the company is revenue expenditure and therefore allowable?”

2. The issue arises in following factual background. The assessment year concerned is 1987-88. During the period relevant to the assessment year in question, the assessee had incurred expenditure of Rs.3 lakhs by way of payment to the Registrar of Companies for raising the limit of authorized share capital of the company. The assessee had also expended a sum of Rs.4,12,595/- for the purpose of sub-division of its shares. The assessee claimed such expenditure as revenue expenditure. The revenue authorities, however, disallowed both the expenditures holding that the same are capital in nature. The issues reached the Tribunal. The Tribunal by the impugned judgement, treated both the above questions of allowability of both the expenditures separately. With respect to the payment of Rs.3 lakhs made by the assessee to the Registrar of Companies for raising the limit of authorized share capital of the company, the Tribunal was of the opinion that the issue was covered squarely against the assessee by virtue of a decision of the Supreme Court in case of **Punjab State Industrial Development Corporation Ltd. v.**

Commissioner of Income Tax, reported in (1997) 225 ITR 792 (SC).

3. With respect to the payment of Rs.4,12,595/- towards the expenditure incurred by the assessee for the purpose of sub-division of its shares, the Tribunal noted that the same was for the purpose of easy trading of such shares in the market and was essentially for the benefits of the shareholders. The Tribunal was of the opinion that such expenditure incurred was connected with the capital structure of the company and gave the company an advantage of enduring nature. The Tribunal, therefore, held that the revenue authorities rightly disallowed such expenditure treating the same as capital in nature. The Tribunal referred to and relied upon the decision of this Court in case of **Ahmedabad Manufacturing and Calico Pvt. Ltd. v. Commissioner of Income Tax**, reported in (1986) 162 ITR 800 (Guj.).

4. It is this issue which the assessee has carried in appeal before us. Learned counsel for the appellant submitted that by virtue of sub-division of the shares, what the assessee company achieved was to increase its share base. This was solely with the purpose of easy trading of the shares in the market. Such sub-division did not increase the share capital of the company and only benefited the shareholders.

5. Counsel further submitted that the decision of the Division Bench of this Court in case of **Ahmedabad Manufacturing and Calico Pvt. Ltd.** (supra) has been overruled by the Apex Court in case of **Commissioner of Income Tax v. General Insurance Corporation**, reported in

(2006) 286 ITR 232. Counsel submitted that the facts of the present case are even stronger inasmuch as, in the case before this Court in **Ahmedabad Manufacturing and Calico Pvt. Ltd.** (supra) and before the Apex Court in case of **General Insurance Corporation** (supra), involved expenditure which was for issuance of bonus shares, whereas in the present case, expenditure was incurred for the purpose of sub-division of shares which had no element whatsoever of any increase in the share capital of the company.

6. On the other hand, Shri Parikh for the respondent submitted that by sub-division of the shares, the company desired to achieve easy trading of shares in the market. Such arrangement would, therefore, affect the share structure of the company. Shareholders would benefit because of ease with which the shares could be traded. Such arrangement, therefore, would result into enduring benefit to the company. He, therefore, submitted that despite the decision of the Apex Court in case of **General Insurance Corporation** (supra), expenditure in the present case should still be treated as capital in nature.

7. Having thus heard the learned counsel for the parties, we notice that in the present case, the expenditure admittedly was made for the purpose of sub-division of the shares. It is not even the case of the Department that by such arrangement, share capital of the assessee company in any manner increased. Such sub-division was made only for the purpose of easy trading of the shares in the market. Such arrangement, therefore, may result into some benefit for the shareholders of the company, nevertheless we are unable to see how the

revenue can argue that such division of shares resulted into any enduring benefit for the company.

8. The Division Bench of this Court in case of **Ahmedabad Manufacturing and Calico Pvt. Ltd.** (supra) was examining the question of expenditure incurred by the company for the purpose of issuance of bonus shares. The Division Bench opined 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. Thus, the shareholders invest the bonus paid to them in the shares and that is how the bonus shares are issued to them. The Court was of the opinion that these shares are rights shares and are, therefore, 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. The Court was, therefore, of the opinion that it would not be correct to say that no benefit whatsoever is derived by the company when its profits and/or reserves are converted into paid-up shares. The Court was of the opinion that capitalization of profits or reserves by issuance of bonus shares benefits the company inasmuch as the past accumulated profits are permanently retained in the business and this would increase the creditworthiness of the company. On such basis, the Court was of the opinion that issuance of bonus shares would result into enduring benefits of the company. Any expenditure incurred for such purpose should, therefore, be treated as capital in nature.

9. Such issue was examined by the Apex Court in case of

General Insurance Corporation (supra). The Supreme Court was examining the question whether the expenditure incurred in connection with the issuance of bonus shares is a capital expenditure or a revenue expenditure. The Supreme Court noted that there was a conflict of opinion between different High Courts. The Gujarat High Court in case of **Ahmedabad Manufacturing and Calico Pvt. Ltd.** (supra) and certain other High Courts had taken a view that such expenditure would be capital in nature. On the other hand, the Bombay High Court and the Calcutta High Court had taken a contrary view. The Apex Court resolved the controversy holding that the 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. It was held that issuance of bonus shares by capitalization of reserves is merely a reallocation of the company's fund. In terms, the Apex Court held that the decision of the Gujarat High Court in case of **Ahmedabad Manufacturing and Calico Pvt. Ltd.** (supra) was contrary to the observations of the Supreme Court in the case of **Dalmia Investment Co. Ltd.** reported in (1964) 52 ITR 567. The Apex Court approved the decision of the Calcutta High Court in case of **Wood Craft Products Ltd.** reported in (1993) 204 ITR 545, making following observations :

“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."

10. The issue, thus, stands squarely covered by the above decision of the Apex Court. It is, of course, true that in the present case, we are concerned with a slightly different nature of expenditure undertaken by the assessee company. Before the Supreme Court, the issue involved was regarding

expenditure incurred in issuing bonus shares. In the present case, the expenditure is incurred for the purpose of sub-division of the shares. However, we do not see how the observations made by the Apex Court in the ratio laid down in case of **General Insurance Corporation** (supra) can be distinguished in view of such difference in facts. In case of sub-division of the shares also, there is no increase in the share capital of the company. So much is not even seriously disputed by the counsel for the revenue. His contention, however, that by virtue of such sub-division, the company gains enduring benefit is without any support from the record.

11. In the result, we answer the question in favour of the assessee. We allow the appeal to the above extent and reverse the decision of the Tribunal to the above extent. The appeal is disposed of accordingly.

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[AKIL KURESHI, J.]

THE HIGH COURT
OF GUJARAT

[HARSHA DEVANI, J.]

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