

A M/S. SHRI GOPAL PAPER MILLS CO. LTD.

v.

COMMISSIONER OF INCOME TAX, CENTRAL CALCUTTA

April 21, 1970

B [J. C. SHAH, K. S. HEGDE AND A. N. GROVER, JJ.]

Finance Act, 1956 Sub-cl. (a) and (b) cl. (1) Second Proviso Paragraph D Part II—Resolution by company capitalising undivided profits in the form of fully paid up bonus shares—Whether the bonus shares could be included in the paid up capital of the assessee—Share-holders entitled to dividends from January 1, 1955—Whether bonus shares can be said to have been issued on the date of resolution i.e. December 30, 1954—If can be said to have been issued within the meaning of Second Proviso to Para D of Part II—‘Allot’ ‘distribute’, meaning.

C The appellant company—assessee—at a general meeting on December 30, 1954 passed a resolution to the effect that a portion of the accumulated undivided profits “be capitalised and distributed amongst the holders of the ordinary shares in the company on the footing that they became entitled thereto as capital and the capital was to be divided into bonus shares and allotted to the ordinary shareholders on the basis of their shareholdings and by clause (b) of the resolution the directors of the company were directed to “issue allot and distribute” the new shares, credited as fully paid up amongst the persons whose names are registered as such in the books of the company on 1st January 1955. The shareholders were entitled to get dividends on those shares only as from 1st January 1955. **E** For the assessment year 1956-57 the relevant accounting period ending on December 31, 1955, the Income-tax Officer determined the total income of the company and in computing the Corporation tax due in respect of the income reduced the rebate to which the appellant company was entitled on two counts; first under sub-cl. (a) and secondly under sub-cl. (b) of cl. (1) to the second proviso to paragraph D of Part II of the Finance Act 1956. As a result of proceedings before authorities under the Act, the following questions were referred to the High Court :

F (i) Whether on the facts and in the circumstances of the case the bonus shares of the face value of Rs. 50,07,500 should be included in the paid up capital of the assessee within the meaning of that term in pursuance of sub-section (1) of the explanation and paragraph D of Part II of the Finance Act 1956 for the relevant year and;

G (ii) Whether on the facts and in the circumstances of the case the bonus shares in question can be said to have been issued within the meaning of the second proviso to paragraph D of Part II of the Finance Act 1956, to the shareholders by the assessee during the accounting year ended 31st December 1955 relevant for the assessment year 1956-57.

The High Court answered both the questions in favour of the department. In appeal to this Court,

H **HELD :** (i) The company had full powers to convert its accumulated undivided profits into bonus shares and it was not open to the ordinary shareholders to refuse to accept those shares when allotted. Under the resolution a portion of the accumulated undivided profits were converted

into capital: that capital was divided into fully paid up bonus shares and allotted to the ordinary shareholders on the basis of their share-holdings. The shares so allotted became the property of the shareholders as from the date of the resolution, namely, December 30, 1954 subject to the qualification that they were entitled to get dividends on those shares only from 1st January 1955. The expression "be capitalised and distributed" in the resolution only means "is hereby capitalised and distributed". The authorities under the Act and the High Court have placed undue emphasis on those clauses of the resolution which lay down the procedure to be adopted in the matter of carrying into effect the decision of the general meeting. They do not in any manner cut down the ambit of that resolution. The High Court as well as the Tribunal were under the erroneous impression that a share cannot be said to have been issued to a person until a share certificate is given to him. Merely because in cl. (b) of the resolution the Directors of the Company were directed to issue bonus shares it cannot be said that the bonus shares had not passed to the shareholders on December 30, 1954. The meaning of the words "allot" and "distribute" should be gathered from the context in which they were used. "Allotment" means the appropriation out of the previously unappropriated capital of a company of a certain number of shares to a person. The word "distribute" found in cl. (b) of the resolution in the context means to record the distribution of the shares in the books of the company. [330 H: 331 A-F; 332 G-H; 333 G]

There was therefore no justification in reducing the rebate firstly under sub-cl. (a) of cl. (1) of the second proviso of paragraph D of Part II and secondly under sub-cl. (b) of cl. (1) of the first proviso to paragraph D of Part II, of the Finance Act. [334 B-C]

Sri Gopal Jalan and Co. v. Calcutta Stock Exchange Association Ltd. [1964] 3 S.C.R. 698, *Bush's case*, L.R. 1X Ch. D. 554, *Re : Heaton's Steel and Iron Company*, [1876-77] 4 Ch. D. 140 *Dalton Time Lock Company v. Dalton*, 66 L.T. 704, *Re : Florence Land and Public Works Company*, (1885) L.R. 29, Ch. D. 421 and *Mosley v. Koffysfontain Mines Ltd.* (1911) L.R. Ch. 73, referred to.

CIVIL APPELLATE JURISDICTION : Civil Appeal No. 1669 of 1966.

Appeal from the judgment and order dated February 5, 1965 of the Calcutta High Court in Income-tax Reference No. 32 of 1961.

A. K. Sen, T. A. Ramachandran and D. N. Gupta, for the appellant.

B. Sen, S. K. Aiyar, B. D. Sharma and R. N. Sachthey, for the respondent.

The Judgment of the Court was delivered by

Hegde, J. This appeal is by a certificate under s. 66A(2) of the Indian Income Tax Act, 1922 (which will hereinafter be called 'the Act') issued by the High Court of Calcutta. It arises out of the judgment and order of that High Court dated February 5, 1965

A in a reference under s. 66(1) of the Act. In the reference mentioned earlier, two questions of law were referred to the High Court for its opinion. They are :

- B “(1) Whether on the facts and in the circumstances of the case the bonus shares of the face value of Rs. 50,07,500/- should be included in the paid up capital of the assessee within the meaning of that term in pursuance of sub-section (1) of the explanation to paragraph (D) of Part II of the Finance Act, 1956 for the relevant assessment year ?
- C (2) Whether on the facts and in the circumstances of the case the bonus shares in question can be said to have been issued within the meaning of the second proviso to paragraph (D) of Part II of the Finance Act, 1956 to the shareholders by the assessee during the accounting year ended 31st December, 1955 relevant for the assessment year 1956-57 ”
- D

E The facts relevant for the purpose of deciding this appeal may now be stated : The appellant is a company incorporated under the Indian Companies Act. It carries on business of manufacture of paper. On December 30, 1954, it passed the following resolution unanimously at a General Meeting held on that date :

- F (a) That a sum of Rs. 50,07,500/- (Rupees fifty lakhs seven thousand and five hundred) being part of the undivided profits of the Company standing to the credit of General Reserve as on 30th June, 1954, be capitalised and distributed amongst the holders of the ordinary shares in the Company on the footing that they became entitled thereto as capital and that the said capital be applied on behalf of such Ordinary Shareholders in payment in full for 5,00,750 Ordinary shares of Rs. 10/- each, in the Company and that such 5,00,750 New Ordinary Shares of Rs. 10/- each, credited as fully paid up shall rank in all respects pari passu with the existing Ordinary Shares, save and except that the holders thereof will not participate in any dividend in respect of any period ending on or before 31st December 1954 and that the same shall be treated for all purposes as an increase of the nominal amount of the capital of the Company held by
- G
- H

each of such Ordinary shareholders and not as income.

- (b) That pursuant to the above resolution and in satisfaction of the interest of the said Ordinary Shareholders in the capitalised sum, the Directors be and they are hereby directed to issue, allot and distribute the said 5,00,750 New Ordinary Shares of Rs. 10/- each, credited as fully paid up amongst the persons whose names are registered as such in the books of the Company as on 1st day of January 1955, in proportion of one such new ordinary share for each ordinary share already held by them on that date, provided that no allotment of shares issued as aforesaid shall be made to non-resident shareholders till approval of the Reserve Bank of India is obtained for the same.
- (c) That the Draft of the Agreement providing for the allotment of said New Ordinary shares in satisfaction of the said capital bonus and submitted to this meeting and signed in the margin by the Chairman, by way of identification, be and the same is hereby approved and that the Director be authorised to affix the Company's seal to duplicate endorsement of such Agreement as and when the same shall have been signed on behalf of the members holding Ordinary shares in the company on 1st January, 1955, by some person to be appointed by the Directors in that behalf, which the Directors be and are hereby authorised to do."

There is no dispute as regards the validity of that resolution. It was passed in accordance with the Articles of Association of the Company. For the assessment year 1956-67, the relevant accounting period ending on December 31, 1955, the Income-tax Officer had determined by his order dated September 29, 1958, the total income of the company at Rs. 42,73,176/-. In computing the Corporation Tax due in respect of the said income, the Income-tax Officer reduced the rebate to which the appellant-company was entitled on two counts; firstly in accordance with sub-cl. (a) of cl. (1) to second proviso to s. D of Pt. II of the Finance Act, 1956, he reduced the rebate at the rate of 2 annas a rupee on Rs. 50,07,500 which according to him represented the face value of the bonus shares issued by the appellant company to its share-holders during the previous year with a view to increasing its paid up capital. Secondly he excluded those bonus

- A shares from the paid up capital of the company as on 1st January, 1955 for the purpose of determining the excess dividends over 6 per cent of the paid up capital on which the rebate was to be reduced at the rate of 2 annas in a rupee according to sub-cl. (b) of cl. (1) of the second proviso to s. D of Pt. II of the Finance Act, 1956. The reduction of the rebate on the first count was
- B Rs. 6,25,937/50 P. and on the second count it was Rs. 1,48,127/31 P. The company appealed to the Appellate Assistant Commissioner and claimed that the bonus shares were in fact issued in the year preceding the previous year relevant to the assessment year 1956-57, therefore, did not come within the mischief of sub-cl. (a) of cl. (1) of the second proviso to s. D of Pt. II. It also contended that the bonus shares were part of the
- C paid up capital of the company as on January 1, 1955 and, therefore, its case came within the scope of sub-cl. (b) of the second proviso to s. D of Pt. II of the Finance Act, 1956. The Appellate Assistant Commissioner rejected the first contention of the company but accepted the second contention. According to him, as the bonus shares were to be credited as fully paid up amongst persons
- D whose names were registered as such in the books of the company as on January 1, 1955, the issue could not possibly take place before that date. But at the same time he took the view that the shareholders have been put into possession of the bonus shares on January 1, 1955 and that the shares were actually issued on January 1, 1955. Hence he held that from that date the ordinary
- E shareholders became the owners of the bonus shares. He, therefore, included the face value of the bonus shares in the paid up capital of the company as on 1st day of the accounting year for the purpose of sub-cl. (b) of cl. (1) of the 2nd proviso to s. D of Part II of the Finance Act, 1956. Both the company as well as the department appealed against the order of the Appellate Assistant Commissioner to the extent it went against them. The Tribunal rejected the contention of the assessee and accepted that of the
- F department. Thereafter at the instance of the assessee, it stated a case to the High Court. The High Court answered both the questions referred to it in favour of the department.

- G The Finance Act, 1956 prescribed the rate of super tax in Part II Paragraph 'D'. That part reads :

Rate

"D. In the case of every company.—

On the whole of total income Six annas and nine pies in the rupee.

- H Provided that—

(i) a rebate at the rate of five annas per rupee of the

total income shall be allowed in the case of any company which—

A

(a) in respect of its profits liable to tax under the Income-tax Act for the year ending on the 31st day of March, 1957, has made the prescribed arrangements for the declaration and payment within the territory of India, of the dividends payable out of such profits and for the deduction of super-tax from dividends in accordance with the provisions of sub-section (3D) of section 18 of that Act, and

B

(b) is a public company with total income not exceeding Rs. 25,000/- to which the provisions of section 23A cannot be made applicable;

C

(ii) a rebate at the rate of four annas per rupee of the total income shall be allowed in the case of any company which satisfies condition (a) but not condition (b) of the preceding clause; and

D

(iii) a rebate at the rate of three annas and six pies per rupee on so much of the total income as consists of dividends from a subsidiary Indian company, and a rebate at the rate of one anna per rupee on any other income included in the total income shall be allowed in the case of any company not entitled to a rebate under either of the preceding clauses :

E

Provided further that—

(i) if the amount of the rebate under clause (i) or clause (ii), as the case may be, of the preceding proviso shall be reduced by the sum, if any, equal to the amount or the aggregate of the amounts, as the case be, computed as hereunder :—

F

(a) on the amount representing the face value of any bonus shares or the amount of any bonus issued to its shareholders during the previous year with a view to increasing the paid-up capital, except to the extent to which such bonus shares or bonus have been issued out of premiums received in cash on the issue of its shares; and

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at the rate of two annas per rupee.

A (b) in addition, in the case of a
company referred to in clause (ii)
of the preceding proviso which has
distributed to its shareholders during
the previous year dividends in excess
of six per cent of its paid up capital,
not being dividends payable at a
fixed rate—

C on that part of the said dividends
which exceeds 6 per cent, but does
not exceed 10 per cent of the paid
up capital; .. at the rate of two
annas per rupee.

D on that part of the said dividends
which exceeds 10 per cent of the
paid up capital; .. at the rate of three
annas per rupee.

E (ii) where the sum arrived at in accordance with sub-
clause (b) or both the sub-clause of clause (i)
of this proviso exceeds the amount of the rebate
arrived at in accordance with clause (i) or
clause (ii) as the case may be, of the preceding
proviso, only so much of the amounts—

(a) issued as bonus shares or as bonus, and

(b) distributed as dividends,

F as is sufficient, in that order, in accordance with the rates
specified in clause (i) of this proviso, to reduce the rebate
to nil, shall be deemed to have been taken into account
for the purpose :

G Provided further that the super-tax payable by a
company the total income of which exceeds Rs. 25,000
shall not exceed the aggregate of—

(a) the super-tax which would have been payable
by the company if its total income had been
Rs. 25,000, and

H (b) half of the amount by which its total income
exceeds Rs. 25,000.

Explanation.—For the purposes of paragraph D of this Part—

- (i) the expression 'paid up capital' means the paid-up capital (other than capital entitled to a dividend at a fixed rate) of the company as on the first day of the previous year relevant to the assessment for the year ending on the 31st day of March, 1957, increased by any premiums received in cash by the company on the issue of its shares, standing to the credit of the share premium account as on the first day of the previous year aforesaid;
- (ii) the expression 'dividend' shall be deemed to include any distribution included in the expression 'dividend' as defined in clause (6A) of section 2 of the Income-tax Act;
- (iii) where any portion of the profits and gains of the company is not included in its total income by reason of such portion being exempt from tax under any provision of the Income-tax Act, the amount of the 'paid-up capital' of the company, the amount distributed as dividends (not being dividends payable at a fixed rate), the amount representing the face value of any bonus shares and the amount of any bonus issued to the shareholders, shall each be deemed to be such proportion thereof as the total income of the company for the previous year bears to its total profits and gains for that year other than capital gains or capital receipts reduced by such allowances as may be admissible under the Income-tax Act which have not been taken into account by the company in its profit and loss account for that year."

In the Finance Act, 1957, also a similar scheme of according rebate and reduction thereof in conditions set out in 1956 Act was adopted.

The first question that arises for decision is as to when the bonus shares became the property of the shareholders? Is it on the date of the resolution of the General Meeting of the company namely December 30, 1954 or on any later date? It may be remembered that for the allotment of the bonus shares, there was no question of calling for applications. Under the Articles of Association of the Company it was not open to the ordinary shareholders to refuse to accept those shares when allotted. The company had full powers to convert its accumulated undivided profits.

- A into bonus shares. The resolution passed at the General Meeting specifically says that those accumulated undivided profits of the company standing to the credit of the general reserve as on June 30, 1954 "be capitalised and distributed amongst the holders of the ordinary shares in the Company on the footing that they had become entitled thereto as capital and that the said capital be applied on behalf of such Ordinary shareholders in payment in full for 5,00,750 Ordinary shares of Rs. 10/- each, in the Company and that such 5,00,750 New Ordinary shares of Rs. 10/- each, credited as fully paid up shall rank in all respects *pari passu* with the existing Ordinary shares...."

- C From this part of the resolution it is clear that the ordinary shareholders became owners of the bonus shares to which they were entitled under the resolution as from the date of the resolution. The expression "be capitalised and distributed" in the resolution means "is hereby capitalised and distributed". In fact the whole tenor of the resolution shows that the distribution of the bonus shares became effective as from 30th December, 1954. If the ordinary shareholders became the owners of the bonus shares on January 1, 1955 or on some later date, the statement in the resolution "save and except that the holders thereof will not participate in any dividend in respect of any period ending on or before 31st December, 1954" becomes meaningless. The authorities under the Act and the High Court placed undue emphasis on
- D the ordinary shareholders became the owners of the bonus shares on January 1, 1955 or on some later date, the statement in the resolution "save and except that the holders thereof will not participate in any dividend in respect of any period ending on or before 31st December, 1954" becomes meaningless. The authorities under the Act and the High Court placed undue emphasis on
- E cls. (b) and (c) of the resolution. Those clauses lay down the procedure to be adopted in the matter of carrying into effect the decision of the General Meeting embodied in cl. (a). They do not in any manner cut down the ambit of that resolution.

- F The High Court as well as the Tribunal were under the erroneous impression that a share cannot be held to have been issued to a person until a share certificate is given to him. This misconception appears to have resulted from the decision in *Bush's* case⁽¹⁾. In Buckley 'On the Companies Acts' 13th Edn. p. 129, the law on the point is stated thus :

- G "It was supposed to have been decided in *Bush's* case that by the 'issue' of shares was meant the issue of the certificates for the shares. But this is a misapprehension. The expression 'issue' with regard to shares may bear various meanings according to the context. It is not necessarily either the allotment of the share or the issue of the certificate that constitutes the issue of the share. The question may be whether the shareholder has or has not been put completely in possession of his share, and this may be so, although some formal act may not

have been completed. Thus shares may have been issued which have been allotted, but for which no certificates have ever been issued, and on the other hand shares as to which a resolution to allot has been made may not have been issued.

Shares for which the memorandum of association has been subscribed are 'issued' when the company is registered."

In *re Heaton's Steel and Iron Company*⁽¹⁾, the Court of Appeal held that the issue of certificates is not necessary to the issue of shares within section 25 of the English Companies Act, 1867. In that case Brett J. observed :

"that in *Bush's case*⁽²⁾ the issue of certificate was merely taken as evidence of the time when the shares were issued, but this must not be taken to mean that shares are not issued until the certificates are issued."

James L.J. observed :

"I think it is desirable to say, as the Appellant appears to have been misled by the marginal note to *Bush's case*⁽²⁾ that the notion that shares are only issued when the certificates are issued is a blunder which could hardly be attributed to us."

In *Dalton Time Lock Company v. Dalton*⁽³⁾, the Appeal Court observed that the share for which the defendant had subscribed in the memorandum of association, must be held to have been issued to him upon the registration of the company and hence he must be held liable to pay the share money. We are unable to agree with the contention of the Revenue that merely because in clause (b) of the resolution of the General Meeting, the Directors of the company were directed to issue bonus shares, the property in the bonus shares had not passed to the ordinary shareholders on December 30, 1954. The words 'allot' and 'distribute' found in cl. (b) of the resolution do not carry the matter further. Their meaning should be gathered from the context in which they were used. Clauses (b) and (c) of the resolution must be read harmoniously with cl. (a). The word "allotment" has not been defined in the Companies Act. The meaning of the word "allot" or "allotment" will have to be gathered from the context in which those words are used. This Court considered the meaning of the word "allotment" in *Sri Gopal Jalan and Co. v. Calcutta Stock Exchange Association Ltd.*⁽⁴⁾ Therein it referred to a large number of

(1) (1876-77) 4, Ch. D.4. 140.

(3) 66, L.T. 704.

(2) L.R. IX Ch. D. 554

(4) [1964] 3, S.C.R. p. 698.

- A English decisions which have considered the meaning of that word. In that decision this Court referred to the observations of Chitty J in *Re Florence Land and Public Works Company*⁽¹⁾ :

B “To my mind there is no magic whatever in the term allotment’ as used in these circumstances. It is said that the allotment is an appropriation of a specific number of shares. It is an appropriation, not of specific shares, but of a certain number of shares”.

- C In *Gopal Jalan's* case⁽²⁾ (supra) Sarkar J. (as he then was) quoted with approval the following passage from Farwell L.J. in *Mosley v. Koffyfontain Mines Ltd.*⁽³⁾

D “As regards the construction of these particular articles, it is plain that the words ‘creation’, ‘issue’ and ‘allotment’ are used with the three different meanings familiar to business people as well as to lawyers. There are three steps with regard to new capital; first, it is created; till it is created the capital does not exist at all. When it is created it may remain unissued for years, as indeed it was here; the market did not allow of a favourable opportunity of placing it. When it is issued it may be issued on such terms as appear for the moment expedient. Next comes allotment. To take the words of Stirling J. in *Splizel v. Chinese Corporation*, 80 L.T. 347, 351, he says: ‘What is an allotment of shares? Broadly speaking, it is an appropriation by the directors or the managing body of the company of shares to a particular person’.”

- F After examining the various decisions, Sarkar J. observed :

G “It is beyond doubt from the authorities to which we have earlier referred, and there are many more which could be cited to show the same position, that 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.”

- H The word “distribute” found in cl. (b) of the resolution in the context means to record the distribution of the shares in the books of the company. If the resolution passed at the General Meeting

(1) (1885) 2 L.R. 29, Ch. D. 421.

(2) [1964] 3 S.C.R. 698

(3) (1911) L.R. Ch. 73, 84.

of the company on December 30, 1954 is read as a whole, there is no doubt that on that day a portion of the accumulated undivided profits were converted into capital; that capital was divided into bonus shares and allotted to the ordinary shareholders on the basis of their share holdings. The shares so allotted became the property of the shareholders as from that date subject to the qualification that they are entitled to get dividends on those shares only as from 1st January 1955: Under cls. (b) and (c) of the resolution, certain directions were given to the Directors in the matter of implementation of that resolution. Hence there was no justification in reducing the rebate firstly under sub-cl. (a) of cl. (1) of the second proviso to Section D of Part II of the Finance Act, 1956 and secondly under sub-cl. (b) of cl. (1) of the second proviso to Section D of Part II of the Finance Act, 1956.

For the reasons mentioned above, we allow this appeal and answer the questions referred to the High Court in favour of the assessee. Revenue shall pay the costs of the assessee both in this Court and in the High Court.

R.K.P.S.

Appeal allowed.