Messrs. Shri Gopal Paper Mills Co. Ltd.

Vs

Commissioner of Income-Tax, Central, Calcutta

Civil Appeal No. 1569 of 1966

(J. C. Shah, K. S. Hegde, A. N. Grover JJ)

21.04.1970

JUDGMENT

HEGDE, J. -

1. This appeal is by a certificate under section 66-A(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 3, 1965 in a reference under section 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 :

> "(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 ?
>
> (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 ?"

2. 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 :

> "(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 he 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 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."

3. There is no dispute as regards the validity of that resolution. It was passed in accordance with the Article of Association of the company. For the assessment year 1966-67, 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-clause (a) of clause (1) to second proviso to S.D. of Part 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 shareholders during the previous year with a view to increasing its paid-up capital. Secondly he excluded these bonus 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-clause (b) of clause (1) of the second proviso to S.D. of Part II of the Finance Act, 1956. The reduction of the rebate on the first count was 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, it did not come within the mischief of sub-clause (a) of clause (1) of the second proviso to S.D. of Part II. It also contended that the bonus shares were part of the paid-up capital of the company as on January 1, 1955 and, therefore, it did not come within the mischief of sub-clause (b) of the second proviso to S.D. of Part 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 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 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 the 1st day of the accounting year for the purpose of sub-clause (b) of clause (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 assistance Commissioner to the extent it went against them. The Tribunal rejected the contention of the assessee and accepted that of the 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.

4. The Finance Act, 1956 prescribed the rate of super tax in Part II paragraph 'D'. That part read :

> #"D. In the case of every company - RateOn the whole of total income .. .. Six annas and nine pies in the rupee;##

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

> (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 satisfied condition (a) but not Condition (b) of the preceding clause; and
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> (iii) a rebate at the rate of three annas and six pies per rupees on so much of the total income as consists of dividends from a subsidiary Indian Company, and a rebate at the rate of one annas 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 clause :

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 amounts, as the case may be, computed as hereunder :
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> #(a) on the amount representing the face value at the rate ofof any bonus shares or the amount of any bonus two annas perissued to it shareholders during the previous rupee.year with a view to increasing the paid-upcapital, except to the extent to which suchbonus shares or bonus have been issued out ofpremiums received in cash on the issue of itsshares; and(b) in addition, in the case of a companyreferred to in clause (ii) of the precedingproviso which has distributed to itsshareholders during the previous yeardividends in excess of six per cent, of itspaid-up capital, not being

dividendspayable at a fixed rate -on that part of the said dividends which at the rate ofexceeds 6 per cent, but does not exceed two annas per10 per cent of the paid-up capital; rupee.on that part of the said dividends which at the rate ofexceeds 10 per cent, of the paid-up three annascapital; per rupee.##

(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 the 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,

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 :

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

(b) half 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 (6-A) 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 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."

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

6. 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 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 at fully paid-up shall rank in all respects pari passu with the existing ordinary shares .....".

7. From this part of the resolution it is clear that the ordinary share-holders became owners of the bonus shares to which they were entitled to 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 share-holders became the owners of the bonus shares on and after 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 have placed undue emphasis on clauses (b) and (c) of the resolution. Those clauses by down the procedure to be adopted in the matter of carrying into effect the decision of the General Meeting embodied in clause (a). They do not in any manner cut down the ambit of that resolution.

8. 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. (LR IX Ch D 554) In Buckley 'On the Companies Acts 13th Edn., p. 129, the law, on the point is stated thus :

> "It was supposed to have been decided in Bush's case (supra) 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 where 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.
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> Shares for which the memorandum of association has been subscribed are 'issued' when the company is registered."

9. In re Heaton's Steel and Iron Company, ((1876-77) 4 Ch D 140) 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 (supra) the issue of certificates 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 not to Bush's case (supra) that the notion that shares are only issued when the certificates are issued is a blunder which could hardly be attributed to us."

10. In Dalton Time Lock Company v. Dalton, (66 LT 704) the Appeal Court observed that the share for which the defendant had subscribed in the memorandum 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 clause (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 clause (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 Shri Gopal Jalan and Co. v. Calcutta Stock Exchange Association Ltd. ((1964) 3 SCR 698). Therein it refereed to a large number of 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 ((1885) LR 29 Ch D 421) :

"To my mind there is no magic whatever in the term "allotment" as used in these circumstance. 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."

In Gopal Jalan's case (supra) Sarkar, J. (as he then was), quoted with approval the following passage from Farewell, L.J., in Noaley v. Koffyfontain Mines Ltd. ((1911) 1 LR Ch 73, 84) :

> "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 issue don such terms as appear for the moment expedient. Next comes allotment. To take the words of Sterling. J., in Spitzel 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'."

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

> "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 come into existence."

11. The word "distribute" found in clause (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 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 clauses (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-clause (a) of clause (1) of the second proviso to Section D of Part II of the Finance Act, 1956 and secondly under sub-clause (b) of clause (1) of the second proviso to Section D of Part II of the Finance Act, 1956.

12. 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.

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