

PETITIONER:
COMMISSIONER OF INCOME-TAX, CENTRAL CALCUTTA

Vs.

RESPONDENT:
GOLD MOHORE, INVESTMENT CO.LTD.

DATE OF JUDGMENT:
03/04/1969

BENCH:
HIDAYATULLAH, M. (CJ)
BENCH:
HIDAYATULLAH, M. (CJ)
SHAH, J.C.
RAMASWAMI, V.
MITTER, G.K.
GROVER, A.N.

CITATION:
1969 AIR 1183 1970 SCR (1) 199
1969 SCC (1) 460

ACT:
Company-Allotment of bonus shares against original holding of shares -Method of calculating profit or loss on sale of original and bonus shares.

HEADNOTE:
The respondent company was a dealer in shares. In respect of each of its holdings of shares in two different companies, it was allotted a set of bonus shares which were to rank pari passu with the old shares. Upon allotment of these bonus shares, the respondent company credited an amount representing the face value of the bonus shares received free of cost to a capital reserve account. Later, both the old as well as the bonus shares were sold and, in, its assessment to income tax for the assessment years 1949-50 and 1950-51, the respondent assessee company showed a loss in respect of the sale of one company's shares and a small profit on the sale of the second company's shares. Both the profit as well as the loss on each transaction was calculated by taking the actual price paid for the 'Old shares together with the face value of the bonus shares as the cost of acquiring all the shares. The Income-tax Officer did not accept this method of calculation and he calculated the profit and the loss on the two transactions by spreading the cost of acquiring the old shares over the total number of shares including the bonus shares acquired free of cost. The Appellate Assistant Commissioner as well as the Tribunal upheld his view but, the High Court, on a reference, held in favour of the respondent assessee. On appeal to this Court,

HELD : The correct method of determining the profit or loss on the sale of bonus shares in cases where bonus shares rank pari passu is to take the cost of the original shares and spread it over all the original as well as the bonus shares and to find out the average price of all the shares. [203 B] Dalmia Investment Company Ltd. v. Commissioner of Income-tax, Bihar 41, I.T.R. 705; Commissioner of Income-tax, Bihar v. Dalmia Investment Co. Ltd. 52 I.T.R. 567; Commissioner of

Income-tax, Central Calcutta v. Gold Mahore Investment Co. Ltd. 68 I.T.R. 213 referred to.
 Emerald & Co. Ltd. v. Commissioner of Income-tax Bombay 36 I.T.R. 257 considered and distinguished.

JUDGMENT:

CIVIL APPELLATE JURISDICTION : Civil Appeals Nos. 1236 and 1237 of 1967.

Appeal from the judgment and order dated April 27, 1963 of the Calcutta High Court in Income-tax Reference No. 65 of 1954.

B. Sen, T. A. Ramachandran and R. N. Sachthey, for the appellant (in both the appeals).

Sachin Chaudhuri, A. N. Mitter and I. N. Shroff, for the respondent (in both the appeals).

The Judgment of the Court was delivered by
 Hidayatullah, C.J These are two appeals by the Commis-
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sioner of Income-Tax, Central, Calcutta against Messrs. Gold Mohore Investment Co. Ltd. and arise out of Income-tax Reference 65/54 decided by the Calcutta High Court on August 27, 1963. The point involved in the appeals is the valuation of bonus shares in the assessment years ending March 31, 1950 and 1951. respectively. The previous years corresponding to the assessment years were the financial years ending 31st March, 1949 and 1950, 1 respectively.

The Assessee Company is a dealer in shares.' Its method of valuation at the opening and closing of the stocks is to value shares at cost. In the Assessment Year 1949-50 the Company held 2,500 shares of the face value of Rs. 10 each in the Howrah Mills Co. Ltd. They had been purchased at Rs. 85 per share and the total cost to the Assessee Company was Rs. 2,12,500. In June, 1948 bonus shares were issued by the Howrah Mills Co. Ltd. in proportion of three shares for every two original shares. The bonus shares were to rank pari passu with the old shares. As a result, the Ass-esse Company obtained 3750 shares of the face value of Rs. 10 each. On August 2, 1948, the Assessee Company sold the original shares for Rs. 72,087/8, i.e. at about Rs. 29 per share. On March 18, 1949 the Assessee Company sold 3,750 shares for Rs. 95,250, that is to say, at Rs. 25 per share. The Assessee Company computed a loss of Rs. 84,041/12. It calculated the loss in the following manner :

"Dr. Sold	CT.	
0-8-2500 shares	2,12,500-0-0	2-8-48(2500) sh.
72,087-8-C		
(old).	(old).	
21-6-48 Cost of	1,379-4-0	18-3-49(3750) sh.
0,125-0-0		
transfer of	(bonus)	
shares.	(1000) sh.	25,125-0-0
bonus.		
2-7-48 By crediting	Loss to P84,041-12-0	
capital reserve a/c	&T a/c	6250
with the face value	6250 sh.	
of bonus shares		
received free of		
cost (3750).	37,500-0-0	
	2,51,379-4-0	2,51,379-4-0"

The bonus shares when they were issued were included in the trading account. According to the Assessee Company the bonus shares had fetched as profit Rs. 95,250 less the face value of the shares, Rs. 37,500. This profit was set off

against the loss on the original shares Rs. 2,12,500 less Rs. 72,087/8, giving the overall loss of Rs. 84,041/12, as stated above.

The Income-tax Officer did not accept this mode of calculation. According to him the loss was Rs. 46,541-12-0 as follows

		201		
"Dr.	Sold		Cr.	
	Rs. a.p.	Rs. a.p.		
O.S. 2500 sh. (sold)		2,12,500-0-0	2-4-48	(2500)
sh. 72,087-8-0				
	old.			
21-6-48	Cost of transfer	1,378-4-0	18-3-49	
(2750)70,125-0-0				
	of shares.	bonus.		
2-7-48 (3700)	sh. bonus (sic.)	Nil	18-3-49	(1000)
25,125-0-0				
	bonus.			
	Loss to P&L a/c	46,541-12-0		
	2,13,879-4-0	2,13,879-4-0"		

On appeal to the Tribunal as to which method was correct, the Tribunal accepted the method of valuation of the Income-tax Officer.

In the Assessment year 1950-51, the account year being 1949-50, the Assessee Company held 122 first preference shares of Fort Gloster Jute Company Ltd. which had cost to the assessee company Rs. 22,883/12/-. In the year of account there was an issue of bonus shares (second preference) and the Assessee Company received 137 shares of the face value of Rs. 100 each. The Assessee Company sold 125 shares (second preference) for Rs. 14,500. It was, therefore, left with 122 shares (first preference) and 12 shares (second preference). The Assessee Company returned a profit of Rs. 1,997 as follows :

"Dr. Rs.	a.p.	Cr. Rs.	a.p.	
O.S. (122)	1 st Pref.	23,883-12-0	18-3-49	(125)
2nd 14,500-0-0				
	Pref			
(137)	2nd Pref. 13,703-0-0	C.S. (122) 1st		
	Profit P&L a/c 1,997-0-0	1st Pref. (12) 23,883-12-0		
(259)	(12) 2nd Pref. 1,200-0-0			
	39,583-12-0	(259) 3 583-12-0-		

It will be seen that the cost of bonus shares was shown at the face value of the shares plus a minor charge of Rs. 3. Rs. 13,703 were credited to capital reserve. The Income-tax Officer spread out the cost of 122 1st preference shares (Rs. 23,883/12) over the 122 shares (first preference) and 137 shares (second preference). He worked out the average cost at Rs. 92/3/6 per share and found the profit to be Rs. 2,973. His method of calculation was as follows

"Dr.	Sold	Cr.	
O.S. 122 1st Pref.	23,833-12-0	14-4-49	125 Pref
14,503-0-0			
	137 2nd Pref. free of cost.	Nil	C.S. 122 1st Pref
	12 2nd Pref		
	@9213/6	12,357-5-0	
	Profit to P&L a/c	2,973-9-0	
(259)	26,857-5-0	(259) 26,857-5-0"	
	L 12 Sup CI/69-14		

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The Tribunal confirmed the assessment as made by the Income-tax Officer. It may be pointed out that the Appellate Assistant Commissioner had in each case confirmed the order of the Income Officer.

The Income-tax Appellate Tribunal then made a reference to

the High Court and referred the following questions for the determination of the High Court:

"1949-50.

"Whether in the facts and circumstances herein stated the assessee carrying on share dealing business, can add Rs. 37,500 being the face value of bonus shares issued to it free of cost on the basis of its old share-holding, as cost of its share holding for the purpose of determining loss in dealing in Howrah Mills Co. Ltd. shares?"

1950-51.

"Whether in the facts and circumstances herein stated, the assessee carrying, on share dealing business, can add Rs. 13,700 being the face value of bonus shares issued to it free of cost on the basis of its old share holdings, as cost of its share holding for the purposes of determining profit in dealing in Fort Gloster Jute Co. shares?"

The High Court, by its judgment dated August 27, 1963, following its decision in Income-tax reference No. 54/1960 (from which Civil Appeal 1239 of 1967 is also being decided today) held in favour of the Assessee Company. The High Court purported to follow a decision of the Patna High Court reported in *Dalmia Investment Company Ltd. v. Commissioner of Incometax, Bihar()*.

Mr. Sen, in dealing with these appeals, points out that the decision of the Patna High Court in 41 I.T.R. 705 was reversed by this Court in *Commissioner of Income-tax, Bihar v. Dalmia Investment Co. Ltd.*(2) and the decision of this Court has further been followed in *Commissioner of Income-tax, Central, Calcutta v. Gold Mohore Investment Co. Ltd.*(3). He contends that the method adopted by the Income-tax Officer in relation to the Fort Gloster Jute shares is the method approved of by this Court, namely, that where the shares are *pari passu* and the valuation is to be made at cost, the price of the original shares must be spread over the old and the new shares and they must be held to liave

(1) 41 I.T.R. 705.

(2) 52 I.T.R. 567.

(3) 68 I.T.R. 213.

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been purchased at the average cost and the profit or loss is to be calculated accordingly. In the decision of this Court in *Dalmia Investment Co. Ltd.*(1) four methods of calculation were considered. The first method is to take the cost as equivalent to the face value of the bonus shares. This method was followed by the Assessee Company. The second method is to take the cost of the bonus shares at Nil, a method adopted by the Income-tax Officer in relation to the Howrah Mills Co. Ltd. A third method is to take the cost of the original shares and to spread it over the original shares and the bonus shares taken collectively, and a fourth method is to find out the fall in the price of the original shares at the stock exchange and to attribute this to the bonus shares. After considering all the four methods, this Court held that the correct method to apply in cases where bonus shares rank *pari passu* is to follow the third method, namely, to take the cost of the original shares and to spread it over all the original as well as the bonus shares and to find out the average price of all the shares.

These cases would normally have been decided on the strength of the ruling of this Court but a doubt arose because in an

earlier decision reported in Emerald & Co. Ltd. v. Commissioner of Income'-tax, Bombay(2), this Courts seemed to have approved of another method. In that case the bonus shares were not sold. In applying different methods, the difference was only Rs. 18 and the Court did not, therefore, express a final view on the matter and accepted the calculation of the Tribunal which was to ignore the bonus shares which were not sold and to calculate the profit and loss on the basis of the original shares, their cost and sale prices. The Court observed as follows :

" The bonus shares are still there, and have not been sold. When they are sold, the question will arise as to what they cost. The books of the assessee's company, as stated in the statement of the case, include the closing stock at cost price. In calculating profit and loss in the manner done by the Tribunal, there is no departure from this system. All the ordinary shares which were bought were sold. Their purchase price is known, as also their sale price. The first assessment is closed, so far as the assessee company is concerned. "

In other words, this Court did not go into the question of the valuation of the bonus shares at all but decided the case on the basis of the original holdings, its cost price and its sale price. The matter was gone into more closely in the Dalmia's case(1) and every method of calculation was considered there. We were

(1) 411.T.R.705.

(2) 36 I.T.R. 257.

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invited to depart from the decision in the Dalmia's case(1) was to take the view which appeared to have been taken in the Emerald's case (2). We have considered the matter once -again and are of opinion that the method followed in the Dalmia's case(1) is the correct method and there seems to be some error in stating that the method of the Tribunal in Emerald's case(2) was finally accepted. Perhaps the Court intended saying that the method of the Income-tax Officer was preferable but by error put down the name of the Income-tax Appellate Tribunal. In any case that case did not decide the matter fully because as the Court itself observed the difference in the two methods only resulted in Rs. 18 being either added to or deducted from the ultimate result. We accordingly accept the third method. The answers recorded by the High Court are discharged and we answer the questions in the negative. The cases will be disposed of in the light of our observations by the Income-Tax Appellate Tribunal by calculating the profit and loss by spreading the cost over the original and the bonus shares and finding out the average cost per share. The appeals are allowed with costs.

R.K.P.S.

Appeal allowed.

(1) 41 I.T.R. 705

(2) 36

I.T.R. 257

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