(1996) 12 MAD CK 0028

In the Madras High Court

Case No : Tax Case No. 249 of 1980 & Tax Case No. 249 of 1980 (Reference No. 160 of 1980)

S. Ram APPELLANT

Vs

Commissioner of Income Tax RESPONDENT

Date of Decision : 12-12-1996

Acts Referred:
Income Tax Act, 1961 — Section 45, 55(2)

Citation : (1998) 230 ITR 353

Hon'ble Judges : N.V. Balasubramanian, J;K.A. Thanikkachalam, J

Bench : Division Bench

Advocate : S.A. Balasubramaniam, for the Appellant; S.V. Subramanian and C.V. Rajan, for the Respondent

Judgement

K.A. Thanikkachalam, J.—In pursuance of the direction given by this court, the Tribunal referred the following question, for the opinion of

this court u/s 256(2) of the Income Tax Act, 1961 (hereinafter referred to as ""the Act"") :

Whether, on the facts and in the circumstances of the case, the method adopted by the Tribunal for valuing the cost of the shares in the hands of

the respective assessees for the purpose of arriving at the taxable capital gains is correct in law ?

2. The assessee is an investor in shares. The assessee acquired on various dates prior to July 4, 1966, 87 original shares of Southern Roadways

Private Ltd. On July 4, 1966, bonus shares were issued by the company. The bonus shares rank pari passu with the old shares. As a result of this

bonus issue, the assessee received 174 shares. There was a further bonus issue when the assessee received 94 shares. The total shareholding of the assessee as on December 31, 1972, was 355 shares. On March 28, 1973, the assessee sold all the 355 shares for Rs. 56,900. The question

of assessment of capital gains from the sale of these shares arose. As per the calculation submitted by the assessee, the capital gain was Rs.

22,109. The capital gain, according to the Income Tax Officer, was Rs. 40,892. The assessee appealed to the Appellate Assistant Commissioner.

The Appellate Assistant Commissioner gave a direction to the Assessing Officer in the matter of ascertaining the cost of bonus shares. According

to the Appellate Assistant Commissioner, the cost of the bonus shares should be fixed by finding out the average price of all the shares in

accordance with the ratio of the judgment of the Supreme Court in Commissioner of Income Tax, Bihar Vs. Dalmia Investment Co. Ltd., . On

receipt of this order, the Income Tax Officer reworked the capital gains. He arrived at the same figure of Rs. 40,892. What he did was to start

with the cost of 87 shares, i.e., 58 shares on partition and 29 by way of gift at Rs. 16,008 and thereafter he worked out the average cost of all the

shares, i.e., original shares and the various bonus shares with the result that arithmetically the aggregate figure remained at Rs. 16,008.

3. As against this order of the Income Tax Officer, dated June 17, 1974, the assessee appealed to the Appellate Assistant Commissioner. The

Appellate Assistant Commissioner by his order, dated June 28, 1975, held that there was no appealable order before him and if the order of the

predecessor Appellate Assistant Commissioner was not given effect to correctly, the assessee, it was stated, could have approached the Appellate

Assistant Commissioner for amending the same. The assessee contested this finding of the Appellate Assistant Commissioner before the Tribunal.

It seems that as against the order passed by the Appellate Assistant Commissioner, the Department also went in appeal before the Appellate

Tribunal. The Appellate Tribunal took into consideration the appeal filed by the Department, which involved the question of valuation of shares

consequent to the issue of bonus shares. The Tribunal proceeded to value the bonus shares. While determining the value of bonus shares, it is

necessary to determine the cost of acquisition of the bonus shares. According to the Tribunal, the shares received on partition on June 25, 1957,

would have to be taken at a particular book value in the assessee''s books. So also regarding the shares received by way of gift, a particular cost would have been recorded in the assessee''s books as on the date of gift. These values would have to be taken as the cost of the aforesaid 87

original shares. If no value has been recorded in the books in respect of the gifted shares, then the market price as on the date of gift should be

taken as the cost of 29 gifted shares. Thus, the Tribunal directed to aggregate the cost of 87 original shares.

4. Subsequently, there was an issue of bonus shares. For ascertaining the cost of value of the bonus shares issued subsequently as well as the

revised value of the partitioned and gifted shares, the Income Tax Officer was directed to adopt the method of working as detailed by the Tribunal

in their order in I.T.A. No. 25 (Mad) of 1974-75, dated March 17, 1977.

5. As far as the bonus shares are concerned, the Tribunal held that the figures so obtained will be substituted as the cost of acquisition. The revised

figures obtained for the shares got on partition (58 shares) and the shares got by way of gift (29 shares) will be ignored as far as the cost of

acquisition is concerned, because the pegged value as on January 1, 1954, of Rs. 184 per share shall have to be adopted in lieu thereof as already

directed. The Income Tax Officer was directed to rework the cost of acquisition in terms of the order passed by the Tribunal. Subject to the above

observations, the appeal filed by the Department in I.T.A. No. 857 (Mds.) of 1974-75 was treated as allowed. In view of the order passed in the

Departmental appeal, the appeal filed by the assessee in I.T.A. No. 1130 (Mds.) of 1975-76 was dismissed.

6. Before us, learned counsel appearing for the assessee submitted that in so far as the original shares are concerned, which were acquired prior to

January 1, 1954, they should be valued as per the provisions of Section 55(2) of the Income Tax Act, 1961, by taking into consideration the fair

market value as was prevalent on January 1, 1954. Learned counsel further submitted that in order to ascertain the cost of acquisition of the bonus

shares obtained subsequent to January 1, 1954, the market value as obtaining on January 1, 1954, with regard to the original shares should be

spread over both the original shares and the bonus shares. According to learned counsel, the actual cost price of the original shares should not be

spread over the original shares and the bonus shares in order to find out the cost of acquisition of the bonus shares. It is also the submission of learned counsel appearing for the assessee that while valuing the bonus shares, which were issued periodically, the value as it stood on the date of

each issue should be taken into consideration and not the fair market value as it was prevalent on January 1, 1954, in the case of valuing the

original shares. In order to support these submissions, learned counsel appearing for the assessee relied upon the decision of this court in

Commissioner of Income Tax Vs. Prema Ramannujam, and another decision of the Supreme Court in Escorts Farms (Ramgarh) Ltd. Vs.

Commissioner of Income Tax, New Delhi, . Reliance was also placed upon another decision of the Supreme Court in Shekhawati General Traders

Ltd. etc. Vs. Income Tax Officer, Company Circle-1, Jaipur, . Lastly, learned counsel appearing for the assessee relied upon yet another decision

of the Supreme Court in Commissioner of Income Tax, Bihar Vs. Dalmia Investment Co. Ltd., .

7. On the other hand, both learned senior and junior standing counsel appearing for the Department, submitted that inasmuch as the bonus shares

were obtained after January 1, 1954, it is not possible to value the bonus shares on the basis of the value of the original shares, which were

determined as per Section 55(2) of the Income Tax Act, 1961, viz., the fair market value as prevalent on January 1, 1954. According to learned

standing counsel, in so far as the original shares are concerned, they are to be valued on the basis of the value prevalent on January 1, 1954, and in

so far as the bonus shares are concerned, they are to be valued on the basis of the cost price of the original shares. Learned standing counsel

submitted that any other method would contravene a plain reading of Section 55(2)(ii) of the Income Tax Act, 1961.

8. In short, learned standing counsel appearing for the Department, made the following three submissions :

1. In the present case, the assessee sold the entire shares, both the original and bonus. Hence, the question of valuing the bonus shares separately

does not arise. Reliance was placed upon the decision of this court in COMMISSIONER OF Income Tax, MADRAS Vs. T.V.S. and SONS

LTD., and a decision of the Calcutta High Court in Goodricke Group Ltd. (No. 2) (Successors-in-interest to Leesh River Tea Co. Ltd.) Vs.

Commissioner of Income Tax, ,

2. So far as the original shares are concerned, the assessee exercised his option to value the original shares as per the fair market value prevalent

on January 1, 1954. The bonus shares were obtained after January 1, 1954. Hence, the option given u/s 55(2) of the Act will not be applicable to

the assessee in so far as the bonus shares are concerned.

3. In order to ascertain the cost of bonus shares, the cost price of the original share should be spread over both original shares as well as bonus

shares.

9. Learned standing counsel for the Department submitted that the assessee is not entitled to ask for valuing the bonus shares on the basis of the

fair market value, prevalent on January 1, 1954, of the original shares.

10. We have heard both learned counsel appearing for the assessee as well as learned standing counsel appearing for the Department. There is no

dispute that in so far as the original shares are concerned, which were acquired prior to January 1, 1954, they should be valued as per the fair

market value prevalent on January 1, 1954, since the option was exercised by the assessee as contemplated u/s 55(2) of the Act. The dispute is

while determining the value of the bonus shares, whether the value of the original shares as determined on January 1, 1954, should be taken into

consideration or the cost price of the original shares should be considered. A similar question came up for consideration before this court in the

case of Commissioner of Income Tax Vs. G.N. Venkatapathy, in T. C. No. 784 of 1984 wherein by a judgment, dated June 24, 1996, this court,

after considering the decisions of the Supreme Court in Commissioner of Income Tax, Bihar Vs. Dalmia Investment Co. Ltd., , Shekhawati

General Traders Ltd. etc. Vs. Income Tax Officer, Company Circle-1, Jaipur, and Commissioner of Income Tax Vs. Prema Ramannujam, of this

court cited supra, held that while ascertaining the value of bonus shares, we have to take into account the value of the shares as opted by the

assessee as on January 1, 1964 as per the provisions of Section 55(2)(b)(i) of the Act, and both the original shares and the bonus shares should be

clubbed together and the average value of each share found out by dividing the total number of shares by the original cost opted as on January 1,

1964. In that case also, learned standing counsel appearing for the Department contended that the value of the original shares should be taken as the cost price, viz., Rs. 100 per share instead of the fair market value opted by the assessee as on January 1, 1954. That contention was not

accepted by this court since the privilege given to the assessee for adopting the fair market value as on January 1, 1964, when shares are obtained

earlier to that date, would be abrogated.

11. The Supreme Court in Escorts Farms (Ramgarh) Ltd. Vs. Commissioner of Income Tax, New Delhi, , while considering the decisions of the

Supreme Court in Shekhawati General Traders Ltd. etc. Vs. Income Tax Officer, Company Circle-1, Jaipur, and Commissioner of Income Tax,

Bihar Vs. Dalmia Investment Co. Ltd., observed as under (headnote):

In Shekhawati General Traders Ltd. etc. Vs. Income Tax Officer, Company Circle-1, Jaipur, , the court laid stress on the fact that the assessee

had opted to take the cost of acquisition as provided by the relevant statute, i.e., the statutory cost of acquisition and thus substituting the market

value as on January 1, 1954, in place of the actual cost of acquisition, and only in such a case, the subsequent issue of bonus shares cannot affect

the issue. It is implicit from the above decision that the principle of averaging by spreading the cost over the old shares and the new bonus shares

as enunciated by the Supreme Court in Commissioner of Income Tax, Bihar Vs. Dalmia Investment Co. Ltd., , and other cases, will apply as a

general rule in cases where the assessee claims to deduct the actual cost of acquisition, instead of the statutory cost of acquisition. It also stands to

reason since the fair market value as per the ''statutory cost of acquisition'' will be a notional or fictional figure--mostly inflated--having no

connection with the original or actual cost. It is after discussing the effect or impact of the issue of the bonus shares, on the value of the original

shares generally and also the various possible methods for determining the cost of the bonus shares, that the Supreme Court in Commissioner of

Income Tax, Bihar Vs. Dalmia Investment Co. Ltd., stated that the real cost to the assessee of the bonus shares cannot be taken to be nil or their

face value and they have to be valued by spreading the cost of the old shares over the old shares and the new issue (bonus shares), taken together,

etc. The principle so laid down is one of general application.

12. According to the facts arising in Escorts Farms (Ramgarh) Ltd. Vs. Commissioner of Income Tax, New Delhi, , the assessee had purchased

the original shares after 1954. Hence, the Supreme Court held that the principles laid down in Shekhawati General Traders Ltd. etc. Vs. Income

Tax Officer, Company Circle-1, Jaipur, cannot be applied to a case where the assessee did not and could not exercise the option of the statutory

cost of acquisition in the place of the actual cost of acquisition. In that view, the Supreme Court distinguished the decision in Shekhawati General

Traders Ltd. etc. Vs. Income Tax Officer, Company Circle-1, Jaipur, .

13. In Commissioner of Income Tax Vs. Prema Ramannujam, , this court held (headnote) : ""that to ascertain the cost of acquisition of 300 bonus

shares sold by the assessee, the cost of 2,875 shares at the rate of Rs. 184 per share as opted by the assessee had to be taken into account and

that cost spread over the original shareholding of the assessee, viz., 2,875 shares as well as the bonus shares issued on July 4, 1966 (during the

year ended March 31, 1967), viz., 5,750 shares, in order to ascertain the cost of acquisition of the bonus shares issued during the year ended

March 31, 1967, out of which 300 shares had been disposed of by the assessee"". In order to come to this conclusion, this court followed the

decisions of the Supreme Court in Shekhawati General Traders Ltd. etc. Vs. Income Tax Officer, Company Circle-1, Jaipur, and Commissioner

of Income Tax, Bihar Vs. Dalmia Investment Co. Ltd., .

14. Relying upon the decision in Commissioner of Income Tax Vs. Prema Ramannujam, , learned counsel appearing for the assessee submitted

that the cost of acquisition of bonus shares should be ascertained on the dates when these shares were issued. If this method is adopted, in a case

where the assessee obtained original shares before January 1, 1954, and the bonus shares after January 1, 1954, that would go against the

decisions of the Supreme Court in Commissioner of Income Tax, Bihar Vs. Dalmia Investment Co. Ltd., and Shekhawati General Traders Ltd.

etc. Vs. Income Tax Officer, Company Circle-1, Jaipur, . Further, it was clearly held that when the original shares and the bonus shares were sold

in their entirety, there will be no cost of acquisition for the bonus shares. If the method suggested by learned counsel for the assessee for the

purpose of valuing the bonus shares as on the dates when they were issued (is adopted), that would also go against the principle that the bonus

shares cannot be valued separately in a case where the original shares and the bonus shares were sold in one block. Therefore, the method

adopted by the assessee in valuing the bonus shares separately as on the dates when they were issued is not acceptable in view of the decisions of

the Supreme Court cited supra. Further, in Commissioner of Income Tax Vs. Prema Ramannujam, , this court never said the bonus shares should

be valued separately as on the dates when they were issued.

15. In COMMISSIONER OF Income Tax, MADRAS Vs. T.V.S. and SONS LTD., this court has clearly held that the Tribunal was not justified

in valuing the cost of the bonus shares and including it for the purpose of determining the cost of acquisition to determine the capital gains. Similarly,

the Calcutta High Court in Goodricke Group Ltd. (No. 2) (Successors-in-interest to Leesh River Tea Co. Ltd.) Vs. Commissioner of Income

Tax, held (headnote) : ""that where an assessee sells the entire block of his shares, original shares as well as bonus shares, the appropriate method

of computing the value of the shares would be to spread the cost of the original shares over the original shares and bonus shares collectively and to

ascertain the average price of all shares"".

16. A combined reading of the decisions cited supra would go to show that in a case where the original shares were obtained before January 1,

1954, and the bonus shares were obtained after January 1, 1954, and where the assessee exercised his option as per the provisions of Section

55(2) of the Act to adopt the fair market value as prevalent on January 1, 1954, while ascertaining the cost of acquisition of bonus shares, it is not

possible to adopt one value for the original shares, viz., the value as on January 1, 1954, and another value for the bonus shares, which was

prevalent after January 1, 1954. If once the value of the original shares is determined in accordance with the statutory provisions, thereafter the

said value is unalterable. The said value should be adopted for the purpose of dividing the same by bonus shares as well as the original shares. Any

alteration to the abovesaid method would be hit by the provisions contained in Section 55(2) of the Act as well as the decisions of the Supreme

Court and the High Court cited supra. Under such circumstances, it is also not possible for the assessee to take the value of the bonus shares,

which were obtained after January 1, 1954, as on the dates when they were issued. Thus, considering the facts arising in this case, in the light of the judicial pronouncements cited supra, we hold that the Tribunal was not correct in coming to the conclusion that for valuing the bonus shares, only

the book value of the original shares should be taken into consideration and not the fair market value as prevalent on January 1, 1954, as opted by

the assessee. Accordingly, we answer the question referred to us in the negative and in favour of the assessee. Consequently, the Tribunal is

directed to redetermine the cost of acquisition and value of the bonus shares while ascertaining the capital gains tax to be levied in the case of the

assessee. No costs.

