

[2021] 124 taxmann.com 241 (Karnataka)/[2021] 278 Taxman 138 (Karnataka)/[2021] 431 ITR 250 (Karnataka)[15-12-2020]

JUDGMENT

Alok Aradhe, J. - This appeal under section 260A of the Income Tax Act, 1961 (hereinafter referred to as the Act for short) has been preferred by the revenue. The subject matter of the appeal pertains to the Assessment year 2012-13. The appeal was admitted by a bench of this Court vide order dated 24-10-2017 on the following substantial questions of law:

"Whether under the facts and in the circumstances of the case, the Tribunal was right in law in holding that the assessing authority is not correct in determining the fair market value as per Rule 11A UA of the IT Rules at Rs. 12,49,00,000/- on 1,00,00,000 bonus shares received by assessee and bring the same to tax under the head income from other sources by holding that section 56(2)(v) and (vii) cannot be invoked by assessing authority even when the assessing authority has rightly invoked the said provision as all the ingredients are satisfied to invoke said provision?"

2. The factual background, in which the aforesaid substantial question of law arises for consideration needs mention. The assessee is an individual engaged in the business of medical profession. The assessee filed the return of income for Assessment Year 2012-13 on 28-9-2012 declaring total income of Rs. 3,22,43,330/-. A search and seizure operation under section 132 of the Act was conducted in the premises of the assessee on 12-4-2011 and during the course of the search, some books of accounts, notes and materials were seized. The statement of the assessee was also recorded on 10-6-2011 and after considering the seized material, the assessee admitted an amount of Rs. 12.03 Crores as an undisclosed income for the relevant years. However, the assessee incorporated the additional income disclosed in the return of income for Assessment Year 2011-12. Thereafter notice under section 142(1) of the Act dated 30-7-2013 was issued to the assessee by which he was asked to file the return of income for the Assessment Year 2011-12. The assessee *vide* communication dated 3-9-2013 stated that the original return filed by him under section 139(1) on 28-9-2012 be treated as return. The case was taken up for scrutiny and notice under section 143(2) was served on the assessee on 22-8-2013. The Assessing Officer by an order dated 6-3-2014 *inter alia* held that the assessee had received 1,00,00,000/- bonus shares issued by M/s Manipal Education and Medical Group (India) Pvt. Ltd. The Assessing Officer invoked Section 56(2)(vii) of the Act and treated the receipt of bonus shares as income from other sources and assessed the fair market value of the bonus shares at Rs. 12,49,00,000/-.

3. The assessee thereupon filed an appeal before the Commissioner of Income-tax (Appeals) who by an order dated 4-8-2015 allowed the appeal preferred by the assessee *inter alia* on the ground that conversion of reserve into capital did not involve release of profit and therefore, provisions of section 56(2)(vii) of the Act are not applicable to the assessee and directed deletion of a sum of Rs. 12.49 Crores. The revenue thereupon approached the Income-tax Appellate Tribunal (hereinafter referred to as 'the tribunal' for short) by filing an appeal. The tribunal *vide* order dated 22-10-2016 by placing reliance on the decision of the Supreme Court in *CIT v. Dalmia Investment Co. Ltd.* [\[1964\] 52 ITR 567](#) held that provisions of section 56(2)(vii) of the Act are not attracted to the fact situation of the case and dismissed the appeal preferred by the revenue. In the aforesaid factual background, the revenue has approached this court.

4. Learned Senior counsel for the revenue submitted that the assessee had not paid any consideration for bonus shares and therefore, he was under an obligation in law to offer the market value as income from other sources under section 56(2)(vii)(c) of the Act. It is also submitted that the tribunal erred in relying on the decision of the Supreme Court in *Dalmia Investment Co. Ltd.* (*supra*) which is not applicable to the fact situation of the case. It is also contended that the tribunal erred in law in holding that the assessing authority is not correct in determining the market value as per Rule 11A UA of the Income-tax Rules at Rs. 12,49,00,000/- on 1,00,00,000 bonus shares received by the assessee and bring the same to tax under the head 'income from other sources' by holding that section 56(2)(v) and (vii) of the Act cannot be invoked by the assessing authority.

5. On the other hand, learned Senior counsel for the assessee submitted that there is no receipt in case of allotment of bonus shares and when bonus shares are allotted, they are not received but are created in the hands of the allottees shareholders. It is also submitted that shares do not exist at all until they are allotted and there is a difference between creation of shares and transfer thereof. It is also urged that company cannot be regarded as holding its own shares and when the company issues for the first time, there is no question of property already possessed by the company being thereby transferred to the allottee. It is also argued that if an assessee subscribes to shares there can be no receipt from the company as there is no transfer when an allotment of share is made and in case of allotment of bonus shares, no benefit accrues to the shareholders. It is also argued that section 56(2) of the Act is a part of anti abuse provision and has to be interpreted bearing in mind the object of the provision. It is also urged that the intention of the provision is to tax a benefit received by the shareholder and since, no benefit accrues to the shareholder on issuance of bonus shares, the same cannot be taxed. It is also contended that if interpretation placed by the department is accepted, there would be conflict between section 56(2)(vii) of the Act and section 55 of the Act. In support of aforesaid submissions, reliance has been placed on decisions in *Khoday Distilleries Ltd. v. Commissioner of Income Tax* [2009] 176 Taxman 142/[2008] 307 ITR 312 (SC), *Secretary To The Board of Revenue, Separate Revenue, Madras Referring Officer v. Madura Mills Company Ltd.* ILR 1937 Mad. 559, *Hunsur Plywood Works Ltd. v. CIT* [1997] 95 Taxman 460/[1998] 229 ITR 112 (SC), *Wood Craft Products Ltd. v. CIT* [1993] 204 ITR 545 (Cal.), *CIT v. Athi V. Remachandra Chettiar* [1964] 52 ITR 96 (Mad.), *K.P. Varghese v. ITO* [1981] 7 Taxman 13/131 ITR 597 (SC), as well as CIRCULAR NO.6/2014, CIRCULAR NO.05/2005 DATED 15.07.2005, CIRCULAR NO.1/2011 DATED 6-4-2011.

6. We have considered the submissions made by learned counsel for the parties and have perused the record. The issue which arises for consideration in this appeal is 'as to whether the fair market value of bonus shares computed as per Rule 11U and Rule 11UA of the Income-tax Rules can be considered as income from other sources as per section 56(2)(vii) of the Act. A careful scrutiny of section 56(2)(vii) of the Act contemplates two contingencies firstly, where the property is received without consideration and secondly, where it is received for consideration less than the fair market value. The issue of bonus shares by capitalization of reserves is merely a reallocation of the companies funds. There is no inflow of fresh funds or increase in the capital employed, which remains the same. The total funds available with the company remains the same and issue of bonus shares does not result in any change in respect of capital structure of the company. [See: '*General Insurance Corporation (supra)*']. Thus, there is no addition or alteration to the profit making apparatus and the total funds available with the company remain the same. In substance, when a shareholder gets a bonus shares, the value of the original share held by him goes down and the market value as well as intrinsic value of two shares put together will be the same or nearly the same as per the value of original share before the issue of bonus shares. Thus, any profit derived by the assessee on account of receipt of bonus shares is adjusted by depreciation in the value of equity shares held by him. In the instant case, there is no material on record to infer that bonus shares have been transferred with an intention to evade tax, which is the object of the provision in question. Therefore, the CIT (Appeals) as well as the tribunal have rightly held that when there is an issue of bonus shares, the money remains with the company and nothing comes to the shareholders as there is no transfer of the property and the provisions of section under section 56(2)(vii)(c) of the Act are not attracted to the fact situation of the case.

In view of preceding analysis, the substantial question of law framed by a bench of this court are answered against the revenue and in favour of the assessee. In the result, we do not find any merit in this appeal, the same fails and is hereby dismissed.