

TAX FLASH NEWS

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Provisions of Section 56(2)(vii)(c) are not applicable to the issue of bonus shares

Background

The Delhi Tribunal in the case of Smt. Mamta Bhandari¹ (the taxpayer) held that provisions of Section 56(2)(vii)(c) of the Income-tax Act, 1961 (the Act) are not applicable to the issue of bonus shares. The Tribunal relied on its own decision in the case of Sudhir Menon (HUF) where it was held that in the case of bonus shares, there is neither any increase nor decrease in the wealth of the shareholder, and therefore, the provisions of Section 56(2)(vii)(c) would not apply to bonus shares.

Facts of the case

- Search was conducted in the case of the taxpayer at the residential as well as business premises of Bestech Group.
- The Assessing Officer (AO) issued notice under Section 153A, in response to which, the taxpayer filed return of income. On perusal of the seized material and submissions filed by the taxpayer, it was noticed that the taxpayer had invested in the shares of Bestech India Pvt. Ltd.
- During the Assessment Year (AY) under appeal, the taxpayer was allotted 10,000 equity shares at INR400 on 18 March 2010 and 6.29 lakh bonus shares on 31 March 2010 without taking any consideration. Further 1.47 lakh right shares were also allotted to the taxpayer on 23 March 2010 at the face value of INR10 by Bestech India Pvt. Ltd.

- For arriving out of Fair Market Value (FMV) of the shares of Bestech India Pvt. Ltd., the AO applied Rule 11UA of the Income-tax Rules, 1962 (the Rules) and value of equity share was calculated as INR22.63
- The AO noted that there was net accretion of wealth as per book value in the hands of the taxpayer due to receipt of bonus shares. Thus the provisions of Section 56(2)(vii)(c) were attracted in the case of the taxpayer.
- The taxpayer contended that bonus shares does not come under the ambit of Section 56(2)(vii)(c) of the Act and relied upon explanatory memorandum to the Finance Bill 2010 and the decision of the Mumbai Tribunal in the case of Sudhir Menon (HUF)².
- However, the AO did not accept the contentions of the taxpayer and held that provisions of Section 56(2)(vii)(c) were applicable to the taxpayer's transaction and thus made the addition.
- The CIT(A) considered the explanation of the taxpayer and in the light of decision in the case of Sudhir Menon (HUF), deleted the addition made by the AO.

² Sudhir Menon (HUF) v. ACIT [2014] 45 taxmann.com 176/148 ITD 260 (Mum)

¹ DCIT v. Smt. Mamta Bhandari [2019] 108 taxmann.com 207 (Del)

Tribunal's decision

- In case Section 56(2)(vii)/56(2)(viiia) is made applicable on issue of bonus/right shares, various other sections of the Act would become contradictory. This is because if for the sake of discussion it is presumed that the provisions of Section 56(2)(vii) are made applicable to the allotment of bonus/Right shares, then for the purpose of calculating capital gains under Section 48 and 49 on the sale of such shares, the cost of acquisition shall be taken as per Section 49(4) which will be the value of bonus/right shares considered while applying the provisions of Section 56(2)(vii). It is contradicting the provisions of Section 55(2)(aa)(iiiia)³. If the legislature really intended to bring allotment of bonus/right shares within the ambit of section 56(2)(vii), it would have amended section 55(2)(aa)(iiiia) simultaneously.
- The Mumbai Tribunal in the case of Sudhir Menon (HUF) in respect of applicability of Section 56(2)(vii) to bonus/right shares observed as follows:
 - Issue of bonus shares by definition is capitalisation of its profit by the issuing company. There is neither any increase nor decrease in the wealth of the shareholder (or of the issuing company) on account of a bonus issue, and his percentage holding therein remains constant. What in effect transpires is that a share gets split (in the same proportion for all the shareholders), as for example by a factor of two in case of a 1:1 bonus issue.
 - In other words, there is no receipt of any property by the shareholder, and what stand received by him is the split shares out of his own holding. It would be akin to somebody exchanging the one thousand rupee note for two five hundred or ten hundred rupee notes.
 - There is, accordingly, no question of any gift of or accretion to property. The shareholder getting only the value of his existing shares, which stands reduced to the same extent. The same has the effect of reducing the value per share, increasing its mobility and, thus liquidity, in the sense that the shares become more accessible for transactions and, thus, trading.

³ Provisions relating to cost of acquisition – cost of acquisition shall be taken as nil in relation to any financial asset allotted to the taxpayer without any payment and on the basis of holding of any other financial asset

- Further the sum and substance of the decision of the Supreme Court in the case of Khoday Distilleries Ltd., is that, no properties being conveyed to a shareholder by issue of bonus/right shares inasmuch as the property therein is comprised in the existing shareholding of the allottee.
- Similarly no property is being passed on to the taxpayer in the instant case on allotment of bonus/right shares and thus no addition could be made by applying provisions of Section 56(2)(vii).
- The Delhi Tribunal in the case of Meenu Satija⁴, on identical facts quashed the proceedings under Section 263. Therefore, ratio of the decision of the Tribunal in the case of Meenu Satija, squarely apply to the facts and circumstances of the case. Whether this order have been passed under section 263 or merit would not make any difference. The principle of law have been clearly decided in favour of the taxpayer on the identical facts. The Tribunal has also relied upon the decision of Mumbai Bench in the case of Sudhir Menon (HUF), which was relied upon by the CIT(A) as well. No infirmity have been pointed out in the order of CIT(A). The tax department's had no merit and the same was accordingly dismissed.

Our comments

The issue with respect to applicability of provisions of Section 56(2)(vii)(c) on the issue of bonus shares has been a matter of debate before Courts/Tribunal.

The Bangalore Tribunal in the case of Dr. Rajan Pai⁵ relied on the case of Sudhir Menon (HUF) and held that when bonus shares are issued by capitalising a portion of the reserves and surplus, there is no increase in the asset value of a company, in any manner. Consequently, for every bonus share issued, there is a corresponding reduction in the actual fair market value of the equity share originally held. The taxpayer who receives bonus shares could never be considered as having received something without consideration or for a consideration less than the FMV of the property. Accordingly, the FMV of the bonus shares cannot be taxed as income from other sources.

On similar lines, the Tribunal in the instant case has held that provisions of Section 56(2)(vii)(c) are not applicable to issue of bonus shares.

⁴ Meenu Satija v. Pr. CIT (Central) [IT Appeal No. 3215 (Del) of 2016, dated 27 January 2017]

⁵ DCIT v. Dr. Rajan Pai [ITA.1290/Bang/2015, (Assessment Year: 2012-13)]

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