SPECIAL BENCH.

Before Mr. Victor Murray Coutts Trotter, Chief Justice, and Mr. Justice Ramesam.

THE COMMISSIONER OF INCOME-TAX, MADRAS (REFERRING OFFICER),

1924, March 27.

v.

BINNY & CO. (MADRAS), LIMITED (ASSESSEE).*

Income-tax Act (XI of 1922)—Super-tax—Value of income—Company—Surplus accumulation of profits, not distributed among shareholders—Bonus shares issued to shareholders representing their share of profits—Liability of shareholders to income-tax or super-tax on such shares—Bonus shares, whether income.

Where the surplus accumulation of profits of a company, instead of being distributed among its shareholders, was capitalized under a special resolution of the company, and new shares were issued to the shareholders representing their share in the accumulated surplus,

Held, that the new shares were not taxable as income, and that the shareholders were not liable to super-tax on the value of the new shares issued to them.

Inland Revenue Commissioners v. *Blott—Inland Revenue Commissioners* v. *Greenwood* [1921] 2 A.C., 171 (view of the majority of the House of Lords, followed); and *Swan Brewery Company, Limited,* v. *Rex* [1914] A.C., 231, distinguished.

CASE stated under section 66 (2) of the Indian Income-tax Act for decision of the question whether the Assessee, Messrs. Binny & Co. (Madras), Limited, as a shareholder in the Deccan Sugar and Abkāri Co., Limited, was liable to pay super-tax on the value of bonus shares newly issued by the latter in the year 1921.

The material facts appear from the judgment of the learned Chief Justice.

* Referred Case No. 1 of 1924.

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Nugent Grant for the Assessee.—The surplus accumulations of profits of the company were never paid to the shareholders as dividend. They were converted into capital of the company under a special resolution of the company. They were distributed as new shares to the shareholders in addition to their original shares. The case falls within the decision of the majority of the Law Lords in *Inland Revenue Commissioners* v. *Blott—Inland Revenue Commissioners* v. *Greenwood*(1). The decision in *Swan Brewery Company, Limited,* v. *Rex*(2) does not govern this case. It was a decision on the language of a special statute, Dividend Duties Act (1902) of Western Australia, in which the term "dividend" is defined in section 2 as including "any profit or advantage," etc. Reference was also made to *Bouch* v. *Sproule*(3).

Government Pleader (*C. V. Anantakrishna Ayyar*) for the Government.—This case is concluded by the decision of the Privy Council in the *Swan Brewery Company, Limited*, v. *Rex*(2). The decision was delivered by Lord SUMNER and has been explained by himself in *Blott's* case(1). His Lordship says in the latter case, that the decision in the former case was not based on the particular language of the Statute of Western Australia (Dividend Duties Act, 1902), but on principle and on the general scheme of the Company's Act. Whether right or wrong, the decision of the Privy Council in *Swan Brewery Company, Limited*, v. *Rex*(2), accepted by the dissenting minority of the House of Lords in *Blott's* case(1), is binding on this Court.

JUDGMENT.

COUTTS TROTTER, C.J.

COUTTS TROTTER, C.J.—This is a reference by the Commissioner of Income-tax which raises a very simple

(1) [1921] 2 A.C., 171. (2) [1914] A.C., 231.
(3) (1887) 12 App. Cas., 385.

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point in the sense that it can be put within a narrow compass on a very few undisputed facts; in another sense it raises a subtle question of law, for it has given rise to a great variety of judicial opinion in very high quarters.

The facts are these. A company called the Deccan Sugar and Abkāri Co., Limited, was incorporated in 1897 with a share capital of ten lakhs in shares of Rs. 500 face value each. In May 1908 the capital was increased to 22 lakhs by adding 7,000 preference shares of the A class of Rs. 100 face value each and 5,000 preference shares of the B class also of Rs. 100 face value each. In 1908, in pursuance of a resolution passed in June, the ordinary share capital was reduced to Rs. 1,66,672, thus making the total capital of the company something over 13 lakhs. Messrs. Binny & Co., Limited, held 200 ordinary shares of Rs. 125 each in this company. In 1921 the Deccan Company had on its books a surplus accumulation of profits undistributed of practically 5 lakhs of rupees. In July 1921, by a special resolution which was confirmed in the following month, the articles of the company were amended, and the two important amendments were these. The first was a preliminary one enabling the company by a special resolution to subdivide or consolidate its shares or any of them. The other was a new article 133-A by which the company by a special resolution might at any time take to itself the power to capitalize undivided profits or reserve fund; and that is what purported to take place in this case. Each holder of a share of Rs. 125 became the holder of three additional shares. The capital of the company was increased by 1,328 shares of Rs. 375 each; and therefore the result was that Messrs. Binny & Co. for 200 shares of Rs. 125 each got 200 shares of Rs. 500 each,

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and in 1921 scrip carrying out that change of position was issued.

The question we have to decide is whether this issue of new shares to the shareholders representing their share in the accumulated surplus is taxable as income. I propose to say very little about this matter, because, to my mind, it crystallizes for our purposes into two questions. The first is, are we concluded by the decision of the Privy Council in the *Swan Brewery Company, Limited*, v. *Rex*(1)? The next is, is it desirable, if we are not covered by the Privy Council decision, to decide contrary to the majority of the House of Lords in *Inland Revenue Commissioners* v. *Blott—Inland Revenue Commissioners* v. *Greenwood* (2)?

It is best that I should deal with the first contention at the outset. It is suggested that the *Swan Brewery Company, Limited*, v. *Rex*(1) directly covers the present point but with great respect to certain observations of Lord SUMNER in *Blott's* case, I am unable to see that it does cover it. If it does, of course, we as an Indian Court are not at liberty to say, as some of the members of the House of Lords did in *Blott's* case, that it was erroneously decided. If it does not decide the point finally for the House of Lords, it decides it finally and conclusively for this Court. That was a decision on an Act known as the Dividend Duties Act of Western Australia, which, to put it shortly, taxed dividends, and contained a definition of "dividends" which covered "every profit, advantage or gain intended to be paid or credited to or distributed among any members of any company." It is quite obvious that a distribution of what was conveniently called bonus shares is an advantage to the shareholder, and, therefore,

(1) [1914] A.C., 231. (2) [1921] 2 A.C., 171.

one may conclude that, on the words of the Act, their Lordships of the Privy Council had no option but to hold that this was a dividend within the meaning of the Act. Lord SUMNER, in delivering the judgment of the Board, said this :

> "In ordinary language the new shares would not be called a dividend, nor would the allotment of them be a distribution of a dividend,"

(it has to be observed that what is made taxable by the Act is a dividend and nothing more).

> "The question in issue here," his Lordship goes on, "is whether or not the new shares were a dividend under the Act abovementioned."

If that judgment stood alone unexplained by any subsequent utterance of his Lordship, I should infer that not merely was it a decision on the words of the Australian statute but that it was carefully confined to be a decision on the words of that Statute with an intimation that, but for that statute, the word could not be capable of bearing the meaning required to be put upon it before the Crown could succeed. But in *Blott's* case (1), Lord SUMNER undoubtedly said that he had intended to lay down a wider principle, and that principle so far as I can see is this. Ever since the decision in *Trevor* v. *Whitworth*(2) in 1887 it has been accepted law that a company cannot buy its own shares. That is used, as I follow the reasoning of Lord SUMNER and Lord DUNEDIN, to found this contention: that, as a company cannot buy its own shares, that is to say, cannot pay its funds into its own coffers and issue scrip to itself, what must be supposed to have taken place, as Lord SUMNER says notionally, is that, although no such thing in fact happened, the company paid its profits over to the shareholder and that the shareholder

(1) [1921] 2 A.C., 171. (2) (1887) 12 App. Cas., 409.

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repaid them and in return got scrip handed to him, which of course would give him a share in the capital of the company. That reasoning is thus answered by the reasoning of Viscount HALDANE and Viscount FINLAY. I will refer very briefly to one or two passages in Lord FINLAY's judgment at page 192 of the report. He says this :

"The general scope and effect of these transactions is beyond dispute. There was an increase in the capital of the company by the retention of the amounts available for dividends. Though the number of shares was increased by the issue of the new preference shares to the ordinary shareholders, this did not affect the proportions to which they were entitled in the undertaking and in any profits. All the shareholders received these new preference shares, so that the proportion in which they were to share in any profits remained the same. . . . The use of the sums which had been available for dividend to increase capital would enable the company to carry on a larger and more profitable business, which might be expected to yield larger dividends. These dividends, however, were to be in the future. So far as the present was concerned, there was no dividend out of the accumulated profits; these were devoted to increasing the capital of the company."

Then again at page 194,

"The effect of this operation" (that is the one which he described) "was that the amount of the bonus was retained by the company as additional capital, and that the shareholders got the new preference shares. No option was left to any particular shareholder. He was compelled by the action of the company to take the preference shares. He could not have sued for the bonus in money, as the resolution which gave the bonus *uno flatu* declared that it was to be satisfied by the distribution of preference shares. Under these circumstances it seems to be impossible to treat the shareholders for the purpose of super-tax as having received the bonus and paid it back to the company to be retained as capital. They never received it at all. The case appears to stand exactly as ROWLATT, J., put it—*Inland Revenue Commissioners* v. *Blott*—*Inland Revenue Commissioners* v. *Greenwood*(1)."

(1) [1920] 1 K.B., 114, 133.

"Now I do not think that there is a payment of a dividend to a shareholder unless a part of the profits of the company is thereby liberated to him in the sense that the company parts with it and he takes it."

If I may humbly add a word in such distinguished company, I think it might be put in this way. That you cannot say that there is a notional payment of a dividend to a shareholder when the position is that, if he sued for it, his action must be dismissed, that is to say, when the whole conception that he is entitled to the dividend is one that the law refuses to countenance. That being so, it is enough for me to say that I think that this Court, having regard to the fact that the words of the Indian Statute are, for all practical purposes, identical with those of the English Statute, should respectfully follow the opinion of the majority of the highest Court in the Empire, especially when that opinion was one confirming the unanimous decision of a very strong Court of Appeal of three very eminent Lords Justices. I should also like to add this, that I think it extremely improbable that this arrangement about the distribution of these profits and the manner in which the transaction should be carried through was drafted, here, without reference to the English cases. I do not know whether, at the time the resolution was drafted the decision of the House of Lords was published but, at any rate, the decision of the Court of appeal in *Inland Revenue Commissioners* v. *Blott—Inland Revenue Commissioners* v. *Greenwood*(1), was available. I have looked at that decision and it expresses the opinion that the case was concluded by the decision in *Bouch* v. *Sproule* (2), itself a House of Lords decision, and that opinion of the Court of Appeal must have been available to the learned gentleman who drafted these articles and

(1) [1920] 2 K.B., 657. (2) (1887) 12 App. Cas., 385.

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amendments to articles. I also observe that both Viscount HALDANE and Viscount CAVE agreed with the Court of Appeal in thinking that the matter before them in *Blott's* case was concluded by the previous decision of the House of Lords. In these circumstances, although I have treated the matter as one of law, I think that it would be an undesirable and inequitable result if we had to come to any other conclusion than that which we have arrived at.

Our answer to the reference is that the company, Messrs. Binny & Co., is not liable to pay super-tax on the value of shares newly issued by the Deccan Sugar and Abkāri Company, Limited, in the year 1921. The company will have its costs on the Original Side scale.

RAMESAM, J.

RAMESAM, J.—I agree. There are three features in this case as in Blott's case which make it difficult for a Court to say that the additional shares issued amount to income. The first is that there was no option to the shareholders, and it was not open to them, to sue for the additional dividend in the shape of cash or in the shape of other chattels or goods. The resolution of the company compelled them to take it only in the form of additional shares and in no other. This feature was emphasized by all the Law Lords who formed the majority in *Blott's* case(1).

The next feature which perhaps is a corollary from the first is this: The relative situation of each shareholder to the other shareholders in the company remains unaltered. His proportion out of the total earnings that may be set apart for distribution as dividends among the shareholders remains the same after this operation of the company. To explain it further—If, for instance, in any year, the amount of profits that is set apart available for distribution among the shareholders is one lakh,

(1) [1921] A.C., 171.

the proportion which a particular shareholder gets, remains the same after the increase in shares as before. If formerly a shareholder got 32 per cent on shares of Rs. 125 each, now he will be getting Rs. 40 for each share of Rs. 500, i.e., 8 per cent on shares of Rs. 500; the total income would be the same amount.

The third feature which again may be regarded as a corollary from the other two is that the effect is the same as if the company passed a resolution expanding its operations and for increasing its machinery. This has been pointed out by Viscount FINLAY in *Blott's* case(1). It is true that, as Lord SUMNER points out, there was a payment in *Bouch* v. *Sproule*(2), a dividend warrant was sent out in the form of a negotiable instrument, which, had it been presented, payment must have been made. But this fact only served to distinguish *Bouch* v. *Sproule*(2), from the case before the House of Lords, *Blott's* case(1). If that distinction is emphasized, it follows that we ought to agree with the decision of the majority in Blott's case. It may be that the effect of the operations in question by the company is to increase the value of a share and if a particular shareholder sells his enhanced share, he may realize more in the market as pointed out by Viscount CAVE. This amounts to only realizing his assets in the shape of capital and not in the shape of income.

I agree with the answer proposed by my Lord.

L. M. Taylor, Attorney for Assessee.

K.R.

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(1) [1921] 2 A.C., 171 at 196. (2) (1887) 12 App. Cas., 385.