



Tax Flash News



10 May 2024

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Cost of bonus shares allotted prior to 1 April 2001 is nil; option of taking FMV as on that date as cost is not available

Executive summary



In a recent case of *Zash Traders*¹, the dispute arose relating to the determination of the cost of acquisition (CoA) of bonus shares for the purposes of computing the capital gains and it arose due to the interplay of two provisions of the Income-tax Act, 1961.

There is one provision which specifically requires the CoA of the bonus shares to be taken as nil, while there is another provision which gives an option to the taxpayer to take the fair market value (FMV) of a capital asset as on 1 April 2001 as its CoA if that capital asset has been acquired prior to that date.

The issue arose whether the CoA of bonus shares allotted to the taxpayer before 1 April 2001 is to be taken as nil or the FMV as on 1 April 2001.

The Bangalore bench of the Tribunal held that the CoA of bonus shares is to be taken as nil in accordance with the specific provision applicable to the bonus shares. The other provision is applicable to the financial assets acquired by paying a purchase price.

¹ *Zash Traders v. ACIT* (ITA No.747/Bang/2023) (Bang) - Source: Taxsutra

Background



While computing the capital gains arising from the transfer of shares, the taxpayer is entitled to reduce the cost of acquisition of shares.

In the instant case, the dispute related to the determination of CoA of bonus shares, and it arose due to the interplay of the two provisions of the Act i.e.,

- The CoA of bonus shares² allotted to the taxpayer is to be taken as nil [section 55(2)(aa)(iiia)]
- Where a capital asset became the property of the taxpayer before 1 April 2001, the taxpayer has the option to take the FMV of the asset as on 1 April 2001 or the actual cost of the asset as the CoA. [section 55(2)(b)(i)].

The issue arose whether, in the case of bonus shares allotted to the taxpayer before 1 April 2001, the CoA is to be taken as nil or the FMV as on 1 April 2001.

Arguments



The taxpayer argued that the CoA of such bonus shares should be determined under section 55(2)(b)(i) i.e., the FMV as on 1 April 2001 and not nil under section 55(2)(aa)(iiia) based on the following grounds:

- Section 55(2)(aa)(iiia) is subject to the provisions of section 55(2)(b)(i).
- The expression 'subject to' conveys the idea of one provision (section 55(2)(aa)(iiia)) yielding to another provision (section 55(2)(b)(i))³.
- If the conditions of section 55(2)(b)(i) are satisfied, then the CoA must be determined as per that section and not as per the subservient provision of section 55(2)(aa)(iiia).
- The option available under section 55(2)(b)(i) is applicable equally to the original shares as well as the bonus shares.
- The taxpayer relied on the decision in the case of *Heinrich de Fries GmbH*⁴.

The Revenue argued that the CoA of bonus shares was to be taken as nil under section 55(2)(aa)(iiia) of the Act.

² Shares allotted without any payment and based on the holding of the original shares

³ *The South India Corporation (P) Ltd. v. The Secretary, Board of Revenue, Trivandrum & Anr.* [1964 AIR 207] (SC)

⁴ *Heinrich de Fries GmbH v. JCIT* [2006] 98 ITD 292 (Mum)

Tribunal's decision



The Tribunal accepted the Revenue's position and held that the CoA of bonus shares should be determined under section 55(2)(aa)(iiia) being a specific provision i.e., nil.

The Tribunal denied the applicability of section 55(2)(b)(i) on the ground that it is applicable when a purchase price is paid for acquiring the financial assets and not to the bonus shares which are allotted without any payment.

No requirement of the payment on the allotment of bonus shares

For the allotment of bonus shares, a shareholder neither carries any obligation to make payment nor does it make any payment to secure the allotment.

To constitute 'a payment', there should be an obligation to make the payment and that obligation should then be discharged by the payment of money or other valuable things. Further, the payment so made should be accepted by the payee in satisfaction of the obligation⁵.

The allotment of bonus shares accrues to the shareholder, as a matter of right and by way of bonus, based on its shareholding as and when the company decides to issue the bonus shares.

Specific provisions dealing with the determination of the CoA of bonus shares

While section 55(2)(aa)(iiia) specifically deals with the 'bonus shares', section 55(2)(b) deals with 'other capital assets'.

Section 55(2)(b)(i) can be applied to the financial asset where a purchase price is paid for acquiring such asset.

Whereas, in the instant case, the taxpayer had not paid any price for acquiring bonus shares and thus, Section 55(2)(b)(i) is not applicable to the instant case.

If section 55(2)(b)(i) is applied where the financial asset is allotted without any payment, it will make section 55(2)(aa)(iiia) redundant.

There was no scope for importing any rule of interpretation when the words used in the provision were unequivocal.

⁵ P. 1150 in Black's Law Dictionary (Seventh Ed.) and P. Ramanatha Aiyar's 'The Law Lexicon' (Reprint 2002 General Editor: Honourable Justice Y. V. Chandrachud p. 1426),

The date of allotment of bonus shares is irrelevant

The taxpayer also argued that section 55(2)(aa)(iiia) would apply only in those cases where the bonus shares were allotted on or after 1 April 1995 i.e., after the introduction of the section.

The Tribunal held that the plain and natural meaning of the term 'allotted' (a past tense) occurring in section 55(2)(aa)(iiia) is that the factum of allotment of bonus shares should have taken place in the past. The said term is not restricted, qualified, or followed by any date.

The taxpayer's interpretation requires the addition of words or rejection of words which is not permissible in the case of a clear provision.

While introducing the section, the legislative intent was clear that the capital gains arising on the transfer of bonus shares on or after 1 April 1995 should be computed by taking the COA as nil⁶. This suggests that so long as the date of transfer is on or after 1 April 1995, section 55(2)(aa)(iiia) will be applicable even if the bonus shares have been allotted prior to that date.

⁶ CBDT Circular no. 717 dated 14 August 1995

Our comments



The Tribunal did not follow the decision of Mumbai bench of the Tribunal in the case of *Heinrich de Fries GmbH*. In that decision, the Tribunal accepted the taxpayer's position to consider FMV as on 1 April 1981 as the CoA of the bonus shares allotted prior to 1 April 1981⁷. The Tribunal had observed that when the bonus shares were issued, there was a corresponding fall in the market value of original shares because the same valuation of the company got spread over more number of shares. The taxpayer will be at disadvantageous position if the FMV is allowed only for the original shares and denied for the bonus shares.

However, in this case, the Tribunal interpreted the relevant provisions and held that the two provisions deal with different situations. The provision which is specific to the bonus shares should be applicable. The other provision deals with the capital assets other than bonus shares and thus, is not applicable.

⁷ Prior to amendment by the Finance Act, 2017, the relevant date for the purposes of section 55(2)(b)(i) was 1 April 1981 instead of 1 April 2001

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