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Expenses for increase in authorised share capital attributable to bonus shares is revenue expenditure

Deduction available to taxpayer for expenses incurred for increase in authorised share capital pertaining to issue of bonus shares

The Mumbai Income Tax Appellate Tribunal in M/s Empower India Ltd.[1] *vide* order dated 23 October 2019, held that expenses for increase in authorised share capital attributable to issue of bonus shares is revenue expenditure as there is no expansion of capital base nor any benefit of enduring nature on account of such bonus issue.

Facts of the case

- M/s Empower India Ltd. (the taxpayer) was incorporated on 20 February 1981 to carry out the business of reselling in IT products and providing manpower supply services.
- The taxpayer filed application to ROC for increase of its authorised share capital and paid expenses aggregating to Rs. 86,80,163 comprising of ROC fee of Rs. 71,60,163 and stamp duty of Rs. 15,20,000.
- The taxpayer increased its issued share capital which consisted of issue of bonus share capital of Rs. 80,42,11,445.
- The total expenses of Rs.86,80,163 for increase of authorised share capital was claimed as deduction in the return of income for AY 2011-12.
- The AO disallowed the expense of Rs. 86,80,163 being capital in nature under section 37(1) of the Act.
- The Commissioner of Income Tax (Appeals) [CIT(A)] confirmed the addition of Rs. 86,80,163 on the grounds that the expenses incurred for increasing the capital base of the company are capital in nature and hence cannot be allowed as revenue expenditure under section 37(1) of the Income Tax Act, 1961 (the Act).

  The CIT(A) relied on the Supreme Court (SC) decisions in the case of Punjab State Industrial Development Corpn. Ltd vs. CIT[2] and Brooke Bond India Ltd vs. CIT[3] 91 Taxman 26.

Issue under consideration

Whether the taxpayer is entitled to deduction under the Act for payment of ROC fees and stamp duty attributable to issue of bonus shares?

Ruling of the Mumbai Income Tax Appellate Tribunal (ITAT)

- The ITAT noted that out of the total expense of Rs. 86,80,163 incurred for increase in authorised share capital, an amount of Rs. 56,52,580 was attributable to the issue of bonus

[1] ITA No.5207/Mum/2017
[2] (1997) 93 Taxman 5
[3] (1997) 91 Taxman 26

share capital. The sum of Rs. 56,52,580 comprised of Rs. 40,44,157 for ROC fees and Rs. 16,08,423 for stamp duty.

- The ITAT held that the expenditure of Rs. 56,52,580 attributable to issue of bonus shares is allowable as revenue expenditure under section 37(1) of the Act on account of the following:
  - Bonus share capital is mere capitalisation of reserve by reallocation of companies' funds. Accordingly, it does not involve inflow of fresh funds or increase in capital employed.
  - The taxpayer has not acquired benefit or advantage of enduring nature on account of the issue of the bonus shares.
  - The issue of bonus share will not result in expansion of capital base as there will not be any change in the total funds available with the taxpayer.
- The ITAT, however, held that the balance amount of Rs. 30,27,583 was not allowable as it is on account of increase in share capital.

Our comments

The decision of the Mumbai ITAT is consistent with recent judicial precedents that for the purpose of disallowance of an expenditure as capital expenditure, it should result in the expansion of capital base of the company, by fresh inflow of capital. The Karnataka High Court (HC) in the case of M/s Motor Industries Co. Ltd.[4], in connection with the expenditure incurred on buyback of shares, held that there is no flow of funds or increase in capital employed and it is not of enduring effect. SC[5] has dismissed the Department's appeal against the Karnataka HC decision. Further, the Bombay HC in the case of Bramha Bazar Hotels Ltd.[6] had also held that premium on share buyback is revenue expenditure since there is no increase in capital base.

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[4] ITA No.1064/2008
[5] SLP No. (C)…….CC 17909/2015
[6] ITA No.1721 of 2013