

former holder in such a proportion that the bonus on the old shares would just pay the price of the new shares. The actual facts were that the whole amount of the accumulated profits had been expended in new plant and the intention was to capitalize this outlay by the issue of new shares against it, declare the profits as bonus and then set off the bonus against the price of the new shares.

Fry, L.J., in his judgment in the Divisional Court, L.R. 29 C. D. 653, lays down the test as to when new shares created out of accumulated profits are income and when capital. "When a testator or settlor directs or permits the subject of his disposition to remain as shares or stock in a company which has the power either of distributing its profits as dividend or of converting them into capital, and the company validly exercises this power, such exercise of its power is binding on all persons interested under him, the testator or settlor in the shares, and consequently what is paid by the company as dividend goes to the tenant for life and what is paid by the company to the shareholder as capital or appropriated as an increase of the capital stock in the concern, enures to the benefit of all who are interested in the capital. In a word what the company says is income shall be income and what it says is capital shall be capital."

Lord Herschell quotes this statement of the law with approval in his judgment in the House of Lords and draws a clear distinction between companies which can, and companies which cannot, increase their capital, in the following words:—"And it appears to me that where a company has power to increase its capital and to appropriate its profits to such increase, it cannot be considered as having converted any part of its profits into capital when it has made no such increase even if a company having no power to increase its capital may be regarded as having thus converted profits into capital by the accumulation and use of them as such." He then goes on to hold that if a company having power to increase its capital declares a bonus out of accumulated profits without declaring such bonus to be capital it will remain income.

Lord Watson referring to this question says that where, as in this case "the company has power to determine whether profits reserved and temporarily devoted to capital purposes shall be distributed as dividend or permanently added to its capital the interest of the life tenant depends in my opinion upon the decision of the company."