

# **kcmSpark**

Transaction Advisory

**Bye bye Buy-back Tax!**

End of the buy-back era?

August 2024



## Background & Context

[Coverage](#)

As an alternative to simply declaring dividends, buybacks are one of the most common methods to repatriate surplus funds lying in companies to the shareholders of such companies. In India, buybacks were the preferred mode of repatriation for Indian shareholders of domestic companies due to the favourable tax rates (explained later) when compared to that of dividend simpliciter. This was especially true for closely held companies. Alas, the Finance Act (No. 2), 2024 (the "Finance Act") has amended the Income-Tax Act, 1961 (the "Act") such that the tax arbitrage of buybacks over dividends is eliminated. However, all is not lost. **The amendment made by the Finance Act comes into effect from October 1, 2024. Thus, any buyback completed prior to 01.10.2024 shall be subject to the older, more favourable buyback tax!**

In this brief note we attempt to highlight how shareholders can leverage this opportunity and repatriate funds at a more favourable rate of tax. Note that this holds true for a purely domestic case, i.e., shareholders are Indian tax residents, and they hold shares in a company which is a domestic Indian company. For cross-border cases, there are other considerations involved like tax treaties, credit availability and foreign exchange regulations.



## Comparing buyback-tax regimes: Old v. New

[Coverage](#)


### Old Regime

Under the old regime, buyback income is exempt in the hands of the shareholders whereas the company buying back its shares is responsible to pay the buyback-tax on the amount of difference between the buyback consideration and the amount received<sup>1</sup> by the company for the shares bought back. Such buyback-tax was calculated at the rate of 23.296%<sup>2</sup>. However, for the shareholders the tax rate effectively comes to 18.89%<sup>3</sup>. This is the rate which applies irrespective of the amount of buyback consideration or identity of the shareholder (corporate/non-corporate/individual). As opposed to this in case of dividend income, practically no expenses are tax deductible against it and it is subject to tax at the normal slab rates which adds up to 35.88% (i.e., the highest tax rates for individual shareholders).

As mentioned earlier, this old regime of buyback-tax shall be applicable for any buybacks completed prior to 01.10.2024.

### New Regime

For payments under a buyback taking place on or after 01.10.2024, the entire amount paid for buyback of shares shall be deemed as dividends and thus, the whole of buyback consideration shall be subject to the same tax treatment as that of a dividend simpliciter i.e., no deduction shall be allowed from such dividend income and then it will be taxed at slab rates (highest rate being 35.88%). As a result, the tax arbitrage is lost. Thus, one would appreciate that the old regime is beneficial over the new regime by 16.99% [i.e., 35.88% - 18.89%].

At the same time, the shareholder would also get a capital loss equal to the cost of acquisition which they had paid for his shares which are bought back. He may offset such capital loss from any future capital gains income subject to the normal rules of carry forward & set-off of tax losses. But this is little consolation, if at all.

<sup>1</sup> Amount received by the company is the issue price at the time of primary infusion. Rule 40B of Income-Tax Rules, 1962 provides how to determine this amount in various scenarios.

<sup>2</sup> 20% + 12% (surcharge) + 4% (H&E Cess) = 23.296%

<sup>3</sup> Ex: Total outflow for the company under buyback is 100 [this includes buyback-tax (23.296%) + buyback price]; So, Effective buyback tax =  $100 \times (23.296/123.296) = 18.89$



### Some special cases and whether to use the old regime benefit

[Coverage](#)

The aforementioned explanation holds true in cases where the shareholders are Indian tax residents, and the company is a domestic Indian company. However, in a case where such Indian company was acquired in a distressed sale, an interesting situation may arise where the original promoters would have invested a high amount for their shares in the company but thereafter, they sold these shares at a cheaper price to the acquirer. If such shares of the acquirer are then bought back under the old regime, then the acquirer can enjoy a deduction (from the buyback proceeds) of the higher value invested by the original promoters instead of the lower price the acquirer had paid under the acquisition. This can allow a higher repatriation to the acquirer at practically no tax! This is not possible in the new regime.

Then there can be another situation where an Indian company is receiving dividends from another company and intends to further pass on the benefit to its own shareholders. Should the company declare a dividend or consider a buyback under old regime? In such a case, the company should consider declaring a simple dividend since it can claim the pass-through benefit<sup>4</sup> under which the Indian company will not be subject to any tax on the dividend it has received. If, in this case, the company opts for a buyback under the old regime, it will end up paying tax on its dividend income as well as buyback-tax. However, the company can

consider a buyback under the new regime in such cases because the company will not only get the pass-through benefit, but its shareholders will also obtain capital loss.

Lastly, in a case where most of the shareholders of the domestic Indian company are non-residents, the company should evaluate declaring dividend instead of buybacks under old regime. This is because the dividend tax rate for non-resident shareholders is 23.92%, and this would be further reduced by availing double tax avoidance treaty ("treaty") benefit, if any. There may be no treaty benefit available for buybacks under the old regime which would lead to economic double taxation of the buyback proceeds. There are interesting treaty implications for buyback of shares under the new regime but that is beyond the scope of this write-up.

---

<sup>4</sup> Refer Section 80M of the Act



## FAQs relating to the buyback process

[Coverage](#)


### 1 What are the conditions which need to be kept in mind prior to executing a buyback under the corporate law?

A company is eligible to execute a buyback if the following conditions are met –

- The buy-back should be authorized by the Articles of Association of the company.
- The shares which are proposed to be bought back should be fully paid up.
- Maximum amount which can be paid as consideration for a buyback cannot exceed – 25% x (paid up share capital of the company + free reserves of the company).
- Debt-equity ratio of the company after the proposed buyback should not exceed 2:1.
- Where a company has done a buyback earlier, it cannot make another offer for buyback until the completion of 1 year (this is to be reckoned from the date of closure of the earlier buyback offer).

### 2 What are the sources of funds from which shares can be bought back?

Company can buy-back shares only out of the balances appearing in free reserves, securities premium and/or out of proceeds of an earlier fresh issue of shares.

<sup>5</sup> There are broadly two “kinds” of shares – preference shares and equity shares

<sup>6</sup> The buyback offer should remain open for at least 15 days from when it was made (can be reduced subject to shareholders resolution).

<sup>7</sup> Requires the company to open a separate bank account to deposit the buyback consideration prior to payment.

### 3 Are there any restrictions on fresh issue of shares once a buyback is completed?

Once a company has completed a buyback of its shares, it cannot make a further issue (including rights issue) of same kind of shares<sup>5</sup> for the next 6 months.

### 4 What is the process for buying back shares and what is the estimated time it takes for completion?

Broadly, the process of buyback (for listed as well unlisted companies) consists of – (i) passing a special resolution in a shareholders’ meeting (ii) making an offer<sup>6</sup> to buyback to the shareholders (buyback offer letter) (iii) shareholders would tender their shares for buyback to the company based on the buyback offer letter. (iv) company buys back the shares and makes payment<sup>7</sup> to the shareholders (v) company to make requisite reporting to the Registrar and updating the shareholders’ register.

Subject to proper availability of all documents and other practical considerations, it is possible to complete the entire process mentioned above in less than one (1) month.

### 5 What are the documents which need to be in place for a buyback?

These are some critical documents which become the cause of delay in executing a buyback in the middle of a financial year –





## FAQs relating to the buyback process

Coverage



- a. Latest audited financial statements which are not older than 6 months<sup>8</sup>. If latest audited financial statements are older than 6 months, then the company can get a limited review report from its auditor for a more recent set of financial statements (since conducting a new audit is time consuming).
- b. The company also needs a report from its auditor which is addressed to the company's board, stating<sup>9</sup> that the corporate law requirements/conditions for the buyback are met.
- c. The company needs to disclose the 'basis of arriving at the buyback price'. Generally, a valuation report is used for this purpose.

#### 6 Is dematerializing the shares to be bought back essential?

As per the recent amendments in corporate laws, all private companies are required to dematerialize their shares on or before 30.09.2024<sup>10</sup>. These amendments mandate dematerialization of shares prior to making any offer for buyback of shares. In case of contravention, penalty is levied to regularize the same.

<sup>8</sup> 6 months to be reckoned from the date of offer document

<sup>9</sup> For details on what the report needs to state, refer Rule 17(n) of Companies (Share Capital & Debentures) Rules, 2014

<sup>10</sup> There are cases where the deadline for dematerialization maybe longer than 30.09.2024 – for details refer Companies (Prospectus and Allotment of Securities) Second Amendment Rules, 2023 [MCA Notification G.S.R. 802(E). dated 28.07.2023]



## FAQs for some critical tax questions

Coverage



*In leveraging this benefit in such limited time, the company should be aware of the boundaries within which it must execute the buyback to be sure of its tax position –*

**7 In order to take advantage of the old regime without inviting litigation, till what stage should the buyback be completed prior to 01.10.2024?**

Of course, the safest position would be if the entire buyback process is completed prior to 01.10.2024. If not, then the taxpayer should at least strive to make the payment of buyback consideration prior to 01.10.2024 because buyback-tax under the new regime is triggered on “payment”. So, if payment is made prior to 01.10.2024, it would still continue to be a very strong and defensible position in case there is litigation. However, any payment after 01.10.2024 would give rise to difficulties.

**8 Does the Act provide any valuation requirements for buyback of shares?**

No. The Act does not provide any cap/floor valuation for a buyback. Further there are Tribunal rulings<sup>11</sup> to the effect that section 56(2)(x) (i.e., provision which taxes deemed gifts) of the Act are not applicable to buyback of own shares. Hence, it

<sup>11</sup> Vora Financial Services (P.) Ltd. v. ACIT [2018] 96 taxmann.com 88; DCIT v. Globe Capital Market Ltd. [2023] 156 taxmann.com 620 (Delhi - Trib.); DCIT v. Venture Lighting India Ltd. [2023] 150 taxmann.com 523 (Chennai - Trib.); VITP (P.) Ltd. v. DCIT [2022] 143 taxmann.com 304 (Hyderabad - Trib.)

is possible to say that buyback at any value whatsoever will not affect its taxability. (Note: Please bear in mind that there is a requirement to provide basis of buyback price as per corporate law)

**9 Can there be a case where the buyback transaction is not taxed at all – since the tax triggers for old regime and new regime differ?**

Buyback tax is triggered on completion of “purchase” in the old regime, whereas it is triggered at the time of “payment” in the new regime. Consider a case where purchase (technically) is completed after 01.10.2024 but the payment of buyback consideration is done prior to 01.10.2024. This would result in neither of the regimes being triggered and thus, no buyback tax at all!

There are extremely strong grounds<sup>12</sup> to say that under a buyback, the purchase of own shares by the company is completed when the shareholders have tendered their shares for buyback and the company has accepted the shares so offered. Payment can happen only after offer and acceptance. Thus, the case of purchase completing after payment is an impossibility.

Hence, there cannot be a case of complete non-taxation of a buyback since there are no gaps emerging due to the different tax triggers.

**10 Can there be a case where the buyback transaction is doubly taxed – since the tax triggers for old regime and new regime differ?**

Consider a case where purchase is completed prior to 01.10.2024 but the payment of buyback consideration is made after 01.10.2024. In such a case, both the mechanisms are triggered, and one can possibly contend that the

<sup>12</sup> T.N. Aravinda Reddy [1979] 2 Taxman 541 (SC); Relevant provisions of Indian Contract Act, 1872



## FAQs for some critical tax questions

[Coverage](#)


buyback transaction should be taxed under both the regimes – in the hands of the company under the old regime, and in the hands of shareholders in the new regime.

It is a fundamental principle of law that the same income cannot be taxed twice<sup>13</sup>. Further, once we conclude that the buyback (i.e., purchase) of shares relates to period which is prior to 01.10.2024, the proviso inserted in section 10(34A) by the Finance Act should apply, and the dividend income arising on payment of buyback consideration under the new regime should be exempt from tax in the hands of the shareholders.

Thus, there should be no possibility of double taxation of income in such cases and only the tax under the old regime should apply. Nevertheless, to avoid unwarranted litigation, the taxpayers must tread with caution and make sure that the payment of buyback consideration is done prior to 01.10.2024 as mentioned earlier.

### 11 Is there a risk of application of General Anti-Avoidance Rules (GAAR)?

As long as there is a commercial rationale for the buyback transaction, GAAR should have no application at all.

However, a remote yet interesting possibility which can arise is – whether the tax authorities can invoke GAAR based on the taxpayer's choice of timing for executing the transaction? This question requires an in-depth technical analysis which is not within scope of this write-up. However, at the risk of being a subject

matter of controversies, below are some thoughts which can help the taxpayer's case –

- a. The most fundamental requirement for applying GAAR is the existence of an "arrangement". Based on the definition of this term, one can argue that the decision to prepone or postpone a transaction cannot be regarded as an arrangement altogether and hence, not subject to GAAR.
- b. The CBDT<sup>14</sup> has clarified that GAAR shall not interfere with the right of the taxpayer to choose from the available methods of implementing a transaction<sup>15</sup>. Since buyback is a commercially valid repatriation alternative to a simple dividend, GAAR should not interfere with the taxpayer's choice of not opting for a simple dividend instead. And continuing with the same logic, one may also be able to argue that this concept of GAAR's inability to interfere with the taxpayer's right to choose from available methods can also be extended to the contention that GAAR cannot interfere with the taxpayer's right to decide the timing of the transaction.

Irrespective of the above, it is always advisable to have proper documentation in place which helps in justifying the commercial rationale of the buyback (e.g., mentioning rationale for buyback in the board minutes, various resolutions, notice for meetings etc.)

<sup>13</sup> Laxmipat Singhania v. CIT [1969] 72 ITR 291 (SC)

<sup>14</sup> The Central Board of Direct Taxes (CBDT)

<sup>15</sup> Question 3, CBDT Circular No. 7/2017 dated 27.01.2017 ("GAAR Circular")



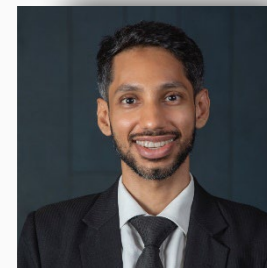


## Conclusion

There is a dramatic shift in the buyback tax provisions which is not conducive to the taxpayer's pockets. There are many alternative methods of repatriation of funds and tax consultants are always there to guide businesses and business-owners on the best-suited alternative available. Although such alternatives result in significant benefits, they usually warrant a lot of time and efforts from the businesses/owners. The old buyback-tax regime was beneficial to the shareholders since it was a reasonable trade-off between the tax cost and the time/effort involved. The old regime will become defunct soon, and considering the new regime, it seems that buybacks will soon become a thing of the past as far as repatriation is concerned. Thus, if you are a shareholder of a closely held company and you were anyways looking to repatriate surplus funds from the company, it would be a good idea to evaluate leveraging the old regime while it lasts!

[Coverage](#)

Should you need more information, kindly reach out to



**Suril Mehta**  
*Partner*

[Suril.mehta@kcmehta.com](mailto:Suril.mehta@kcmehta.com)  
+91 265 2440 446 (Direct)  
+91 85111 85339 (Handheld)

## About **kcmSpark**

**kcmSpark** is a periodic, highly research-oriented publication which covers research and analysis on specific topics by our subject matter experts. As the name suggests, our endeavour is to present to you, interesting and thought-provoking aspects about a particular topic, in each edition of **kcmSpark**.

This publication is prepared exclusively for the benefit and use of member firms of KCM Network and their clients. This should not be used as a substitute for professional advice. Reasonable care has been taken for ensuring the accuracy and the authenticity of the contents of this publication. However, we do not take any responsibility for any error or omission contained therein on any account. It is recommended that the readers should take professional advice before acting on the same. No part of this document may be reproduced in whole or in part in any manner without prior written permission from K C Mehta & Co LLP.

## Locations

### Ahmedabad

#### Arpit Jain

Level 11, Tower B,  
Ratnaakar Nine Square,  
Vastrapur,  
Ahmedabad - 380 015

Phone: + 91 79 4910 2200  
[arpit.jain@kcmehta.com](mailto:arpit.jain@kcmehta.com)

### Bengaluru

#### Dhaval Trivedi

4/1, Rudra Chambers, First  
Floor, 4<sup>th</sup> Main, B/W 8<sup>th</sup> & 9<sup>th</sup>  
Cross Road, Malleshwaram,  
Bengaluru - 560 003

Phone: +91 99983 24622  
[dhaval.trivedi@kcmehta.com](mailto:dhaval.trivedi@kcmehta.com)

### Mumbai

#### Bhadresh Vyas

315, The Summit Business Bay,  
Nr. WEH Metro Station,  
Gundavali, Andheri East,  
Mumbai - 400 069

Phone: +91 22 2612 5834  
[bhadresh.vyas@kcmehta.com](mailto:bhadresh.vyas@kcmehta.com)

### Vadodara

#### Milin Mehta

Meghdhanush,  
Race Course,  
Vadodara - 390 007

Phone: +91 265 2440 400  
[milin.mehta@kcmehta.com](mailto:milin.mehta@kcmehta.com)

Independent Member

**kcm**  
NETWORK