CBDT clarifies on taxability of transaction of buyback of shares undertaken prior to 1 June 2013

As per provisions of Section 46A of the Income-tax Act, 1961 (the Act)\(^1\) any consideration received by a shareholder or a holder of other specified securities from any company on purchase of its own shares/other specified securities shall be, subject to the provisions contained in Section 48 of the Act, deemed to be capital gains. Further, sub-clause (iv) of Section 2(22) of the Act excludes any payment made by a company on purchase of its own shares in accordance with the provisions of Section 77A of the Companies Act, 1956 (the Companies Act) from the ambit of ‘dividend’.

The Finance Act, 2013 subsequently introduced Section 115QA\(^2\) to provide that any amount of distributed income by a company on buyback of unlisted shares shall be charged to tax and the company so distributing its income shall be liable to pay additional income-tax at the rate of 20 per cent of the distributed income.

It has been brought to the notice of the Central Board of Direct Taxes (CBDT) that the provisions of buyback of shares since the introduction of Dividend Distribution Tax (DDT) under Section 115-O of the Act\(^3\) are being interpreted in a conflicting manner by the tax authorities as well as the taxpayers, thereby giving rise to disputes on this issue. It has been contended that subsequent to introduction of Section 115QA in the Act and placing reliance on a decision of the Authority for Advance Ruling (AAR No. P of 2010), income-tax authorities, in some cases have sought to recharacterise the purchase consideration received on account of buyback of shares, undertaken prior to 1 June 2013, as dividend and accordingly, subjecting the amounts so distributed by the companies to DDT.

The CBDT has issued a Circular\(^4\) to clarify that consideration received on buyback of shares during the period 1 April 2000 to 31 May 2013 would be taxed as capital gains in the hands of the recipient in accordance with Section 46A of the Act. Further, no such amount shall be treated as a dividend in view of the provisions of sub-clause (iv) of Section 2(22) of the Act.

As a step towards a non-adversarial tax regime, the CBDT has directed that no fresh notice for assessment/reassessment/non-deduction of tax at source shall be issued wherein buyback of shares has taken place prior to 1 June 2013, and the case is covered under Section 46A read with sub-clause (iv) of Section 2(22) of the Act. In cases where notices have already been issued, and assessment proceedings are pending, tax authorities shall complete the assessment keeping in view the above legal position.

\(^1\) With effect from 1 April 2000
\(^2\) With effect from 1 June 2013
\(^3\) With effect from 1 April 2003 till 31 May 2013

\(^4\) Circular No. 3/2016, dated 26 February 2016
Our comments

The issue with respect to taxability of transaction of buyback of shares undertaken prior to 1 June 2013 has been a matter of debate before the courts.

The AAR in the case of XYZ India\(^5\) while dealing with the issue of taxability of consideration received on buyback of shares held that buyback of shares by an Indian company from a Mauritian shareholder is a ‘colourable device’. The scheme was devised to avoid payment of DDT, which is otherwise payable on the distribution of the dividend under Section 115-O of the Act. On the basis of this decision, the tax department has been contending that the consideration of buyback of shares is to be treated as deemed dividend.

Recently, the Mumbai Tribunal\(^6\) held that buyback of shares under Section 77A of the Companies Act cannot be characterised as deemed dividend, and the profits arising out of the buyback scheme should be taxed under the head ‘capital gains’. The provisions of Section 115QA of the Act have been introduced with effect from 1 June 2013, and the profit arising out of buyback of shares is to be taxed at a specified rate. However, the relevant year under consideration was before such an amendment and therefore, the issue was decided as per the law prevailing prior to such an amendment.

The CBDT has clarified that consideration received on buyback of shares between the period 1 April 2000 to 31 May 2013 would be taxed as capital gains in the hands of the recipient in accordance with Section 46A of the Act and no such amount shall be treated as dividend in view of the provisions of sub-clause (iv) of Section 2(22) of the Act.

\(^5\) XYZ India [AAR No. P of 2010 dated 22 March 2012]
\(^6\) TS -72-ITAT-2016(Mum)
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