



Buy Back Tax Rules & Distributed Income

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Background

The Authority of Advance Ruling held that where a Mauritian shareholder of Indian company, accepted offer of buy-back of shares given by Indian company, the amount received would be taxable in India as dividend which is liable to withholding tax under section 195 of the Income Tax Act, 1961 (the Act) since the tax payers were taking benefit of some tax treaties and avoiding payment of Capital Gains Tax.

In the light of the above case, The Finance Act, 2013 brought a prospective amendment in the Act to tax the distributed income of domestic company on account of buy back of shares by inserting a new Chapter XII-DA comprising of sections 115QA to 115QC with effect from 1st June 2013 in order to negate the avoidance of payment of tax by way of DDT particularly where the capital gains arising to the shareholders are either not chargeable to tax or are taxable at a lower rate.

Section 115QA of the Act, provides for payment of additional income tax by the company at the rate of 20% on the distributed income on buy-back of unlisted shares.

Scope and Coverage

The Indian Tax Laws (ITL) provide for a levy of buy back tax (BBT) @ 20% of the distributed income arising on buy-back of unlisted shares by a domestic company. "Distributed income" is defined as the difference between the consideration paid by domestic company on buy-back of shares and the amount received by such company on issue of such shares bought back. There was a lack of clarity about determination of the amount received by a domestic company in different circumstances viz. where shares may have been issued by the company

- in tranches,
- for different considerations, or
- May have been issued in lieu of existing shares of another company under a corporate reorganization involving merger, demerger, conversion, succession etc.

To clarify the issues, CBDT had issued draft rules (Draft BBT Rules) on 25th July 2016 to provide for determination of the amount received by the company for issue of shares bought back. Based on the comments received by stakeholders and the public on the Draft BBT Rules, the CBDT has released Final BBT Rules on 17th October 2016. The Final BBT Rules provide for the methodology for determining the amount received by a domestic company on issue of shares under different circumstances. The Final BBT Rules comes into force with effect from 1st June 2016.

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Key highlights

What is Buy Back Tax?

Buy Back Tax is an additional tax in the hands of the domestic company as the distributed income is not taxed again in the hands of the shareholders. BBT is levied @ 20% of the distributed income arising on buy-back of unlisted shares by a domestic company.

What is the meaning of “distributed income”?

For computation of BBT, “distributed income” is defined as the difference between the consideration paid by the domestic company on buy-back of shares and the amount received by the company for issue of such shares.

The methodology of determining ‘amount received by the company’ in specific cases is detailed below:

1) Shares issued upon subscription by any person

The amount, including premium, actually received by the company.

2) Where the company has, prior to the buy-back of shares, returned any sum out of the sum received on issue of shares

The amount received by the company as reduced by the sum so returned. It is clarified that tax, if any, paid under section 115-O of the Act shall not be reduced to arrive at the amount received.

3) Shares issued under ESOP or as sweat equity shares

The fair market value (FMV) of the share as determined by the merchant banker on the date of exercising the option or any other earlier date not being more than 180 days earlier, to the extent credited to the share capital and share premium account by the company.

4) Shares are issued under a scheme of amalgamation, in lieu of the share or shares of an amalgamating company

The amount received by the amalgamating company in respect of such shares issued shall be deemed to be the amount received by the amalgamated company in respect of the shares so issued.

5) Shares issued under a scheme of demerger

The amount which bears to the amount received by the demerged company in respect of the original shares, determined in accordance with this rule, the same proportion as the net book value of the assets transferred in a demerger bears to the net worth of the demerged company immediately before such demerger.

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6) In respect of original shares of a demerged company

The amount received by such demerged company in respect of the original shares, as reduced by the amount derived under Sr. No. 5 above.

7) Share issued or allotted as part of consideration for acquisition of any asset or settlement of any liability

Amount received = A / B

Where A is an amount being lower of the following:

- the amount which bears to the FMV of the asset or liability, as determined by a merchant banker, the same proportion as the part of consideration being paid by issue of shares bears the total consideration
- the amount of consideration for acquisition of the asset or settlement of liability to be paid in the form of shares, to the extent credited to the share capital and share premium account by the company

Where B is the number of shares issued by the company as part of consideration

8) Shares issued or allotted on succession or conversion, as the case may be, of a firm into the company or succession of sole proprietary concern by the company

Amount received = (A-B) / C

Where A is Book Value of the assets in the balance sheet less amount of tax paid as TDS/ TCS/ Advance tax payment as reduced by tax refunds and amount shown in the balance-sheet as asset including the unamortized amount of deferred expenditure which does not represent the value of any asset (Revaluation reserve, if any needs to be ignored).

Where B is the Book Value of liabilities shown in the balance sheet excluding:

- capital, by whatever name called, of the proprietor or partners of the firm;
- Reserves & surpluses, by whatever name called, including balance in P&L account;
- Provision for taxation (other than amount of tax paid as TDS/ TCS/ Advance tax payment, as reduced by tax refunds if any, to the extent of the excess over the tax payable with reference to the book profits, in accordance with the law applicable thereto);
- Amount representing provisions made for meeting liabilities, other than ascertained liabilities; and
- Amount representing contingent liabilities.

Where C is the number of shares issued on conversion / succession.

9) Shares are issued or allotted without any consideration on the basis of existing shareholding

Amount received would be considered as NIL

10) Shares issued pursuant to conversion of preference shares or bond or debenture, debenture-stock or deposit certificate in any form or warrants or any other security issued by the company

The amount received in respect of such instrument so converted.

11) Shares held in dematerialized form

The amount received by the company, determined in accordance with this rule on the basis of first-in-first-out method.

12) In any other case

Face value of the shares

Conclusion

The much awaited final rules have now been notified by the CBDT which provide clarity on some more situations of issue of shares as compared to the draft rules. However, practical issues in implementation of the rules may need further guidance. Since the rule is applicable from 1st June, 2016, the taxability of buy-back of shares executed between 1st June, 2016 upto the date of notification could be a challenge. However, the criticism still continues on as technically, on buy-back there is no transfer as the shares would be cancelled on buy-back and no asset would continue to exist. In Larger interest, the government intends to provide clarity, plug loopholes and provide a non-controversial tax regime, which is well appreciated.

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