Buyback of shares - Tax implications

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Introduction

1. Buyback of shares (including specified securities) by a company is one of the popular methods by which it distributes its profits or reserves to its shareholders. Some of the recent instances of successful buybacks include ₹ 13,000 crores by IT major Infosys, buyback of shares by TCS another IT major, etc.

The regulatory conditions of buyback are governed by the provisions of the Companies Act, 2013.

What is buyback of shares?

2. Section 68 of the Companies Act, 2013 deals with buyback of shares. The relevant provisions are as under:

68. Power of company to purchase its own securities.—(1) Notwithstanding anything contained in this Act, but subject to the provisions of sub-section (2), a company may purchase its own shares or other specified securities (hereinafter referred to as buy-back) out of—

(*a*) its free reserves;

(*b*) the securities premium account; or

(*c*) the proceeds of the issue of any shares or other specified securities:

Provided that no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

Further, *Explanation* to section 115QA of the Income tax Act (ITA) (discussed in detail later) also defines buyback as under:

"*Explanation*.—For the purposes of this section,—

(*i*) "buy-back" means purchase by a company of its own shares in accordance with the provisions of any law for the time being in force relating to companies"

From the above it would be observed that buyback means purchase of its own shares by a company.

Certain other relevant regulatory aspects of buyback are discussed below:

- Buyback of shares can be made out of either free reserves/securities premium account/from proceeds of issue of any shares or other specified securities. However, no buyback can be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities which are proposed to be bought back.
- Buyback requires authorization in articles of the company and passing of special resolution in general meeting of the company. No special resolution is, however, required where buyback is 10% or less than paid-up capital and same is authorized by passing of resolution in the Board meeting;
- Buyback can be 25% or less of the aggregate of paid-up capital and free reserves of the company:
- Notice of general meeting for passing of special resolution authorizing buyback must contain prescribed particulars.
- Buyback of listed shares has to be as per prescribed SEBI buyback regulations
- All shares proposed to bought back must be fully paid-up
- Every buyback process must be completed within 1 year from date of passing of board resolution/special resolution.
- The term 'specified securities' includes employee stock options or other securities as may be notified by the Central Government

Tax implications of buyback of shares where shares have been held as investments

3. The tax implications of buyback can be categorised into tax implications in respect of buyback of listed shares and that of unlisted shares. The same have been discussed below:

- Tax implications of buyback of unlisted shares
- Tax implications in the hands of company

The domestic company proposing to buyback its shares from shareholders is required to pay a buyback tax to the government u/s 115QA of the ITA. The section was inserted by the Finance Act, 2013.

The section provides that any amount of 'distributed income' by a domestic company on buyback of unlisted shares from shareholder is chargeable to additional income-tax @ 20% (plus 12% surcharge and 4% health cess). The effective rate of buyback tax is 23.296%.

The term 'distributed income' has been defined to mean the consideration paid by the company on buy-back of shares as reduced by the amount received by it for issue of such shares to be determined in the prescribed manner.

The amount received on issue of shares has to be determined as per Rule 40BB of the Income Tax Rules. Some of the methodologies relevant for determining amount received on issue of shares are as under:

Situation	*Amount received on issue of shares*
Shares issued by way of subscription	Amount actually received in respect of such share, including any amount actually received as securities premium.
Where any amount out of amount received on issue of shares has been returned to shareholders prior to buyback (for instance, any previous buyback, or reduction of share capital)	Amount received in respect of shares less sum so returned. However, no deduction is allowed in respect of dividend distribution tax paid u/s 115O.