ECONOMIC LAWS PRACTICE
ADVOCATES & SOLICITORS

BUDGET BUZZ

ABOLITION OF BUY BACK TAX

Budget Proposal

Distribution of surplus profits by a company to its shareholders by way of dividend or buy-back of shares was subjected to Dividend Distribution Tax (**DDT**) and buy-back tax (**BBT**), respectively. Finance Act, 2020 abolished DDT and reverted to the classic way of taxation of dividend whereby the incidence of tax on dividend was shifted back to the shareholder. However, no such amendments were made in respect of BBT.

As a part of measures for widening and deepening the tax base including anti-avoidance, the Finance Bill 2024 has proposed to abolish BBT payable by companies on any amount of income distributed on buy-back of shares. Section 115QA and Section 10(34A) of the IT Act are proposed to be amended to abolish BBT and withdraw exemption available to shareholders on account of buy-back of shares. Further, Section 2(22) and Section 194 of the IT Act are amended to include distribution on buy-back under the ambit of dividend.

The proposed amendment is applicable on buy-back of shares undertaken on or after 1 October 2024 and shall have a twofold impact.

- The full value of distribution received by the shareholders at the time of buy-back would be treated as 'Dividend income' taxable at applicable rates, without any deduction for cost of acquisition/expenses.
- Considering that the buy-back transaction also results in extinguishment of rights, the shareholder shall be eligible to claim capital loss to the extent of cost of acquisition of such shares. Such capital loss can be carried forward and set-off against future capital gains. To effectuate the above, Section 46A of the ITA Act is proposed to be amended to provide that the value of consideration paid at time of buy-back shall be deemed to be Nil.

Impact

With the incidence of tax now being shifted to the shareholders, distribution on buy-back would now be taxable at the rate of tax applicable to shareholders. For non-resident shareholders, this would ensure tax treaty benefits as well as foreign tax credit of the tax paid on dividend income in India.

While this change could lower the tax burden for certain shareholders such as those who do not opt for the buy-back, have effective tax rates below 23.296%, or are non-residents, it may result in higher taxes for other set of shareholders who are subject to higher tax rates.

Post such amendment, while the tax burden on buy-back stands shifted to the shareholders, companies would still be responsible to withhold appropriate taxes under Section 194 and Section 195 of the IT Act.

ELP's Insights

Taxing buy-back in the hands of the company was prejudicial to the shareholders that did not tender their shares for buy-back, as the burden of BBT was borne by them as well.

The Securities and Exchange Board of India (**SEBI**) had issued a consultation paper on review of SEBI (Buyback of Securities) Regulations, 2018. SEBI proposed to the Government to shift the incidence of tax on buyback from the company to the hands of shareholders. In line with the proposal by SEBI and abolishment of DDT, abolishment of BBT aligns with the position existing prior to 2013.

Shifting the tax incidence on buy-back to the shareholder makes the scheme equitable with dividend and serves the purpose of widening and deepening the tax base.