ECONOMIC LAWS PRACTICE
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BUDGET BUZZ

Flip-flop on Buy-back

BUDGET PROPOSAL

The Finance Bill, 2026 proposes to treat buy-back proceeds as consideration received on sale of shares under the head "**Capital gains**" as against "**Dividends**". However, in the same breath, it also proposes to subject "Promoters" to an effective tax rate of 30% and promoter companies to 22% on such buy-backs by way of levy of additional tax. These amendments will take effect from 1 April, 2026 and apply for Tax Year 2026-27 onwards.

Historically, the companies undertaking buy-backs were required to pay tax on such buy-back under Section 115QA of Income-tax Act, 1961 and the same was exempt in the hands of recipients. The said tax on buy back was shifted from companies declaring dividend to recipients with effect from 1 April, 2024. Basis this, presently, the gross buy-back proceeds are treated as dividend in the hands of recipients, taxable as "Income from Other Sources" ('**IFOS**'), while the cost of the bought-back shares is recognized separately as a capital loss under "Capital Gains" ('**CG**').

IMPACT

The amendment rationalises the taxation of share buy-backs, which taxed the entire buy-back proceeds as dividend under IFOS, while the cost of acquisition was separately recognised as a capital loss under CG.

Effective from 1 April, 2026, shareholders (including corporate shareholders) will be taxed on the net capital gains arising on buy-back under section 69 of the Income-tax Act, 2025 (IT Act), after providing deduction for cost of acquisition of the said shares.

For "Promoters", which would inter-alia include shareholders holding 10% stake in unlisted companies as well, an additional tax is levied, ensuring an overall effective incidence of 30% tax (22% tax for promoter companies) on such capital gains.

While for non-promoters, the proposed regime should typically be highly efficient and reduce tax exposure considerably, even for Promoters, there could be some efficiency built in given that the taxability would now be on a "net" basis, as against "gross" basis compared to the erstwhile IFOS model. This harmonises the treatment of buy-back with their underlying economic substance of sale of shares.

The dividend paid by the corporates was available as set-off against the buy-back proceeds in case of twin/multi-tiered structures (as buyback proceeds were deemed dividend). The said set-off would not be available under the proposed amendment, as buy-back proceeds would be treated as consideration for sale of shares, and not as dividend received.

ELP's INSIGHTS

The amendment removes the structural mismatch in buy-back taxation by treating buy-backs as a transfer of shares taxable under the head "CG", ensuring tax applies only on the net gain instead of the earlier gross-based dividend model with a separate capital loss.

This rationalization eases the tax burden on buy-backs and is poised to encourage corporates to consider buy-back as a viable capital allocation tool especially for small shareholders.