₹1.9 trn share sales via IPOs over six years in LTCG tax crosshairs

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Secondary share sales worth ₹1.9 trillion mobilised via initial public offerings (IPOs) since April 2018 could now be assessed for potential evasion of long-term capital gains (LTCG) tax.

Due to ambiguity over the applicability of LTCG — which was reintroduced in 2018 — several promoters and private equity (PE) firms have refrained from tax payments. However, the latest Budget not only clarifies the applicability of LTCG but also states that this will be enforced retrospectively from April 1, 2018.

Almost two-thirds of the ₹3 trillion raised through IPOs since FY19 has been secondary or offer-for-sale (OFS) transactions. This figure also encompasses proceeds from the IPOs of public sector undertakings (PSUs). "A slew of IPOs had seen a technical position being adopted wherein OFS shares were being transacted at zero tax," said Vivek Gupta, partner at Deloitte India.

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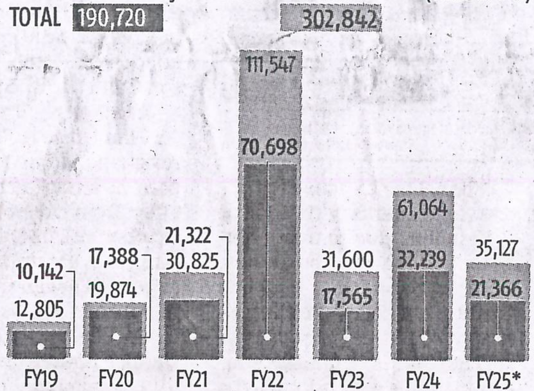

Tax officials may scrutinise all IPO mobilisations since FY19

"Given this was against the intent of the law and the increased number of IPOs underway, the government has sought to clarify this retroactively. That means founders or investors who adopted this position will need to effectively pay the back taxes along with interest now," added Gupta.

In the Union Budget presented in 2018, the government had instituted a 10 per cent LTCG tax on equity assets sold after a minimum holding period of 12 months. However, the law's draft specified that tax would apply to transactions where the securities transaction tax (STT) was paid during the sale of shares. For IPOs, since the sale of shares does not occur on the exchange platform, STT is not paid. Furthermore, ambiguity prevailed over the LTCG taxable amount due to the absence of a fair market value (FMV) framework for unlisted companies.

The latest Finance Bill, by amending Section 55 of the Income-tax Act, has cleared the air over this issue, providing a framework for FMV to determine the cost of acquisition. "The amendment plugs a gap in the computation mechanism which was introduced by the Finance Act 2018," explained Ritesh Kumar, partner at M&A Tax & Regulatory Services, BDO India, emphasising that the tax confusion stemmed not from an interpretational loophole but from a legislative drafting oversight.

Amit Baid, head of tax, BTG Advaya, observed: "An aggressive approach was adopted by a few promoters to claim exemption from capital gains tax on shares offered through an OFS in IPOs." Some, he said, relied on principles established in related Supreme Court judgments to justify their claims.

The government has yet to estimate the amount of tax that will be recovered, but experts believe tax officials may scrutinise all IPO mobilisations since FY19. "This amendment is designed to be applied retrospectively. As a result, there may arise instances of reassessment for taxpayers who previously adopted a stance of nil capital gains on the transfer of such shares," noted Rajarshi Dasgupta, executive director-tax, Aquilaw. This could also set the tone for LTCG tax payments on future IPO proceeds. The clarification comes at a time when over ₹1 trillion is anticipated to be raised via IPOs in the next 12 months. A significant portion of this is expected to be secondary share sales, including the ₹25,000-crore Hyundai Motor India IPO.