New share buyback tax rules may make cos pause

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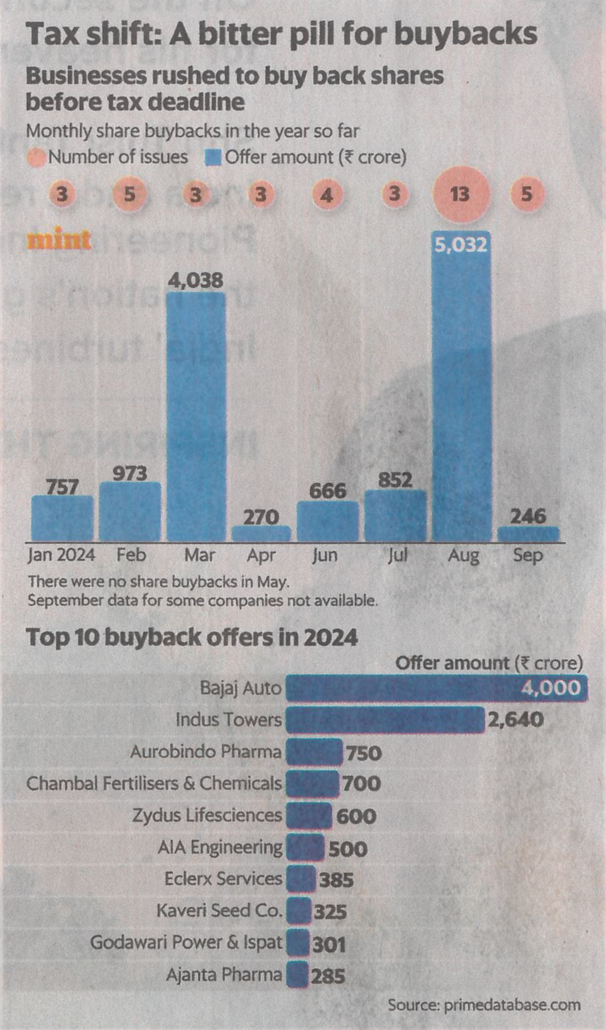

In the Union budget for 2024-25, finance minister Nirmala Sitharaman proposed a shift in the tax burden on share buybacks from companies to shareholders—effective 1 October. How should shareholders navigate this drastic shift in the share buyback landscape? *Mint* explains.

India's tax treatment of share buybacks has evolved significantly, with the latest changes making for a significant milestone. "Pre 2013/2019 amendments, India taxed buybacks as capital gains for the shareholder. This was replaced by a company distribution tax regime in 2013 for unlisted companies and in 2019 for listed companies," said Vivek Gupta, partner, Deloitte India. "The law has now been amended to treat buyback as profit distribution and hence dividend in the hands of the shareholder, shifting the tax burden from the company to the shareholder."

With the latest changes, the entire gross amount received from a share buyback will be taxable, removing the earlier benefit of reducing the cost of acquisition to determine taxable profits, explained S. Sriram, partner at Lakshmikumaran & Sridharan Attorneys.

The tax will be based on a shareholder's income tax slab rate. "Though the loss may be treated as a possible under-the-head capital gain, the tax disadvantages would be disproportionate," Sriram said.

The recent tax overhaul may throw a wrench into the gears of the share buyback market. By shifting the tax burden from companies to shareholders, the government has created a potential disincentive for investors to participate in buybacks.

Sensing this impending change, companies rushed to beat the October deadline, engaging in a frenzied race to complete their buybacks before the new rules took effect. As per the latest data available with primedatabase.com for 39 shares buybacks in the year so far, nearly 46% came following the Union budget announcement.

"Buyback typically is a bear market product when companies see value in repurchasing shares at lower prices," said Pranav Haldea, MD Prime Database Group. Companies implemented 11 buybacks between January and March.

There was a lull following that until August, which saw an extraordinary spike with 13 buybacks totaling ₹5,032 crore. In September, there were five buybacks worth ₹245.65 crore, although data for all companies is still being compiled, according to primedatabase.com.

"The new tax on share buyback aims to bring it at par with dividend taxation. With the new tax regime looming, companies were rushing to complete buyback, resulting in 47 buybacks which have already been completed or announced this calendar year," Haldea said.

Several companies have undertaken significant share buybacks this year. Bajaj Auto Ltd's share buyback that opened in March tops the list with ₹4,000 crore, with Indus Towers and Aurobindo Pharma.

The significant shift in taxation could deter many firms from participating in share buybacks. "The tax treatment of buyback and dividend has been made comparable. Therefore there is no incentive to reptriate cash by way of a buyback as against a dividend, which was previously the case for Indian promoters," said Gouri Puri, partner at law firm Shardul Amarchand Mangaldas.

"A buyback was preferred by an Indian promoter previously since it only attracted a 23.3% tax in the hands of the company undertaking the buyback. On the other hand, dividends could be taxed up to 35.88% in the hands of the promoter shareholder," she added.

With the new tax regime treating proceeds from share buybacks as dividend income, this could diminish the overall benefit for investors, particularly those in higher tax brackets.

However, Puri highlighted that "non-resident shareholders can benefit from the concessional tax rates applicable to dividend income on buybacks under tax treaties".

Different shareholders may have different outcomes in terms of specific impact under the new regime, said Deloitte India's Gupta.

"In generic terms, though, I think it would be fair to say that the attractiveness of a buyback has probably gone down somewhat due to the fact that the gross buyback is now taxed immediately with no offset for cost of the shares."

While the new rule makes buybacks more expensive for investors, Shravan Shetty, managing director, Primus Partners, expects companies to evaluate the exact benefits they will derive from a tax-efficiency perspective.

"Whether shareholders find share buybacks less attractive due to new tax implications will depend on the reasons behind the buybacks," he said, adding that companies aiming to increase ownership may still opt for buyback route. To offset the higher costs that shareholders will incur because of the new tax regime, he expects buyback prices to increase.

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