

BUY-BACK OF SHARES

◆ PROVISIONS OF BUY BACK OF SHARES ◆

1. Section 115QA and section 10(34A) shall apply when a company buy backs shares from its shareholders. The company shall pay tax @ 23.296% (20% + 12% surcharge + 4% cess) under section 115QA on the amount of distributed income which shall be calculated as under:

Amount paid by the company to its shareholders on buy back of shares

minus

Amount received by the company for issue of shares including share premium, if any. (subject to Rule 40BB)

2. Where a shareholder receives any amount on buy back of shares of a company referred in section 115QA, the amount received by shareholder shall be exempt under section 10(34A). No capital gains shall be computed in hands of shareholders.
3. As per section 2(22), no deemed dividend shall arise on buy back of shares.

ILLUSTRATIONS ON BUY BACK OF SHARES & RULE 40BB

Illustration 1:

A company buys back 10,000 listed equity shares of face value of ₹ 10 each at a price of ₹ 100 per share on 01.01.2023. These shares are held by four shareholders equally (i.e., 2,500 shares each) who have subscribed to these shares on 01.01.2012 for ₹ 10 each by paying a premium of ₹ 20 per share.

There is no deemed dividend under section 2(22) on buy back of shares.

Now in hands of the company distributed income shall be as under:

10,000 equity shares × ₹ 100
[Buy back price]

minus

10,000 equity shares × ₹ 30
[Amount received by company
for issue of shares]

$$10,00,000 \quad - \quad 3,00,000 \quad = \quad 7,00,000$$

Company shall pay tax under section 115QA @ 23.296% on ₹ 7,00,000.

The amount received by shareholders shall be exempt under section 10(34A). No Capital Gains shall arise in hand of shareholders on buy back of shares. If suppose shareholders have shown a profit of ₹ 1,75,000 [2,500 shares × (₹ 100 – ₹ 30)] in their profit and loss account as profit on buy back of shares, then ₹ 1,75,000 shall be subtracted from net profit since the amount received by shareholders is exempt under section 10(34A).

Illustration 2:

A company issued 10,00,000 unlisted equity shares at the face value of ₹ 10 each on 01.01.2012. The company buybacks these equity shares on 01.01.2023 for ₹ 12 each.

There is no deemed dividend under section 2(22) on buy back of equity shares.

Now, distributed income on which company shall pay 23.296% tax under section 115QA shall be:

$$₹ 1,20,00,000 - ₹ 1,00,00,000 = ₹ 20,00,000$$

There will be no capital gains in hands of equity shareholders. The amount received by them is exempt from tax under section 10(34A).

Illustration 3:

A Ltd. issued equity shares of face value of ₹ 10 as under:

Mr. A: 10,00,000 shares @ ₹ 10 each

Mr. B: 10,00,000 shares @ ₹ 10 each

Mr. C: 10,00,000 shares @ ₹ 10 each at premium of ₹ 20 each

Mr. D: 10,00,000 shares @ ₹ 10 each at premium of ₹ 20 each

Balance Sheet of A Ltd.

Liabilities	Amount (₹)	Assets	Amount (₹)
Equity share Capital	4,00,00,000	Non-current Assets	12,00,00,000
40,00,000 shares @ ₹ 10			
Share Premium	4,00,00,000	Current Assets	6,00,00,000
Reserves & Surplus	10,00,00,000		
Total	18,00,00,000	Total	18,00,00,000

If company buy backs 1,00,000 shares @ ₹ 50 per share each from Mr. A, Mr. B, Mr. C & Mr. D. Now distributed income as per section 115QA shall be as under:

Mr. A: (₹ 50 - ₹ 10) × 1,00,000	=	₹ 40,00,000
Mr. B: (₹ 50 - ₹ 10) × 1,00,000	=	₹ 40,00,000
Mr. C: (₹ 50 - ₹ 30) × 1,00,000	=	₹ 20,00,000
Mr. D: (₹ 50 - ₹ 30) × 1,00,000	=	₹ 20,00,000
		<u>₹ 1,20,00,000</u>

Company shall pay additional tax on ₹ 1,20,00,000 @ 20% + (Surcharge @ 12% + Health & Education Cess @ 4%) under section 115QA. Amount received by shareholders is exempt under section 10(34A).

Illustration 4:

Suppose in Illustration 3, in previous year 31.03.2023, the company has reduced face value of shares from ₹ 10 to ₹ 8 and paid ₹ 5 per share in cash to each share holder:

$$\text{Total Distribution on Reduction of share capital under section 2(22)(d)} = 5 \times 40,00,000 = 2,00,00,000$$

Since reserves and surplus are ₹ 10,00,00,000, ₹ 2,00,00,000 is the deemed dividend under section 2(22)(d). The said deemed dividends are taxable in hands of shareholders.

Now suppose in previous year 31.03.2024. Company buy backs 1,00,000 shares each from A, B, C & D @ 50 per share.

Answer will remain same as in Illustration 3.

Illustration 5:

Suppose in above illustration 4, reserves & surplus of the company were NIL. Then, there is no deemed dividend under section 2(22)(d). Now distributed income for section 115QA shall be computed as under:

Mr. A: (₹ 50 - ₹ 5) × 1,00,000	=	₹ 45,00,000
Mr. B: (₹ 50 - ₹ 5) × 1,00,000	=	₹ 45,00,000
Mr. C: (₹ 50 - ₹ 25) × 1,00,000	=	₹ 25,00,000
Mr. D: (₹ 50 - ₹ 25) × 1,00,000	=	₹ 25,00,000
		<u>₹ 1,40,00,000</u>

Company will pay additional tax on ₹ 1,40,00,000 @ 20% + 12% + 4% under section 115QA. Amount received by shareholders are exempt under section 10(34A).

Illustration 6:

Suppose a company issued ESOPS/Sweat Equity shares as under:

- 10,000 shares to Mr. A @ ₹ 100 per share being face value
- Fair Market Value on date of exercise of option: ₹ 1000
- Perquisite in hand of employee 10,000 × 900 = ₹ 90,00,000

CASE I: Company passed following entry:

ESOP Expenditure	Dr.	90,00,000	
Bank A/c	Dr.	10,00,000	
To Share Capital			10,00,000
To Share Premium			90,00,000

CASE II: Company passed following entry:

Bank A/c	Dr.	10,00,000	
To Share Capital			10,00,000

Now, company buy backs the share @ ₹ 1,300 per share.

CASE I: Distributed income under section 115QA

$$(1,300 \times 10,000) - 1,00,00,000 \\ = ₹ 30,00,000$$

Company will pay 20% + 12% + 4% on ₹ 30,00,000 under section 115QA.

CASE II: Distributed income under section 115QA

$$1,300 \times 10,000 - 10,00,000 \\ = ₹ 1,20,00,000$$

Company will pay 20% + 12% + 4% of ₹ 1,20,00,000 under section 115QA.

Illustration 7:

Mr. A acquired 10,000 shares of company X Ltd. @ ₹ 20 per share. Company X Ltd. is amalgamated with company Y Ltd. and Mr. A is allotted 30,000 shares of ₹ 10 each in company Y Ltd. Company Y Ltd. buys back 5,000 shares from Mr. A at ₹ 15 per share.

**Amount received by amalgamated company
from Mr. A for 30,000 shares**

$$\begin{aligned} &= \frac{2,00,000}{30,000} \\ &= ₹ 6.67 \text{ per share} \end{aligned}$$

Now, $(5,000 \times 15) - (5,000 \times 6.67) = \text{Distributed Income under section 115QA}$

Illustration 8:

Mr. A acquired 10,000 shares of company M Ltd. @ 20 per share. Company M demerges one of its business to resulting company Q Ltd. Mr. A is allotted 20,000 shares of company Q Ltd.

Net Book value of assets transferred in demerger	=	₹ 2 crores
Net worth of company M before demerger	=	₹ 5 crores

Now amount received by company Q Ltd. from Mr. A shall be as under for 20,000 shares:

$$\begin{aligned} ₹ 2,00,000 \times 2/5 &= ₹ 80,000 \\ ₹ 80,000/20,000 &= ₹ 4 \text{ per share.} \end{aligned}$$

Amount received by Company M for 10,000 shares

To be reduced by amount as arrived above

2,00,000
- (80,000)
<u>1,20,000</u>

$$₹ 1,20,000/10,000 = ₹ 12 \text{ per share.}$$

According, where Company M or Company Q buy backs shares from Mr. A in future, amount received towards issue of shares by Company M or Company Q shall be ₹ 12 and ₹ 4 respectively.