Taxation on Buy Back of Shares by India Companies

What is a Share Buyback?

A share buyback occurs when a company repurchases its own shares from existing shareholders. This reduces the total number of outstanding shares in the market. Companies often undertake buybacks to enhance earnings per share, reward shareholders, or deter hostile takeovers.

Why Change in Buyback Taxation?

Prior to the Finance Act 2020, companies were liable for a Dividend Distribution Tax (DDT) on dividends paid to shareholders. However, the tax burden was shifted to shareholders with the introduction of normal income tax rates on dividends. Despite this change, the tax on buybacks remained unchanged.

The Finance Bill 2024 (2) seeks to align the tax treatment of buybacks with dividends. Consequently, the existing 23.296% buyback tax u/s 115QA will be replaced by a system where shareholders will be taxed on the buyback proceeds at their applicable income tax rates. This move recognizes that both dividends and buybacks are essentially methods for distributing a company's accumulated profits.

The amendment also addresses the extinguishment of shareholder rights upon tendering shares for buyback. The treatment of the acquisition cost of these shares will be detailed in the subsequent section, "Buyback Taxation Post Amendment."

Buy Back Taxation – Pre Amendment

Under the previous tax regime, Indian companies were subject to a 23.296% tax (consisting of 20% tax, 12% surcharge, and 4% cess) on the distributed gain from a buyback (buyback price minus issue price) as per Section 115QA of the Income Tax Act, 1961. Importantly, shareholders were exempt from tax on the buyback proceeds under Section 10(34).

Illustration

Sl No	Particulars (i)	Amount (INR) (ii)	Taxable Income (INR) (iii)	Additional Tax (INR) (iv)	Cash (Outflow) / Inflow (ii+iv)
A	Company issued 100 Shares @INR 1000 per share in year 2018 *(Cost)*	100,000	-	-	1,00,000
B	Company bought back 30 shares in 2023 @1500 per share *(Sec 115QA)*	45,000	15,000 [30*(1500-1000)]	3,494 [15,000*23.296%]	(48,494) [45,000+3,494]
C	Buy-Back consideration received by Shareholder [100*1500] *(Exempt as per Sec 10(34))*	45,000	-	-	45,000

Buy Back Taxation Post Amendment (*with effect from 1st Oct 2024*)

Tax on Buy-Back Consideration: The amount a domestic company pays to repurchase its own shares will be treated as a dividend in the hands of the receiving shareholders. This dividend income will be subject to income tax at the shareholder's applicable tax rate. No deductions for expenses can be claimed against this dividend income when calculating income from other sources.

The cost of acquisition of the shares which have been bought back would generate a capital loss in the hands of the shareholder as these assets have been extinguished.

Treatment of Buy-Back Capital Loss: When a shareholder's shares are bought back by the company, the acquisition cost of those shares becomes a capital loss. This capital loss can be offset against any future capital gains from share sales or other capital gains. The shareholder can carry forward this capital loss to reduce their overall capital gains tax liability.

Essentially, while shareholders will be taxed on the buyback proceeds as dividend income, they will also have the opportunity to claim a capital loss on the shares bought back.

Illustration

SI No	Particulars (i)	Amount (INR) (ii)	Taxable Component (iii)	Tax Amount (iv)	Cash (Outflow) / Inflow (v)
A	Acquired 100 Shares @INR 1000 per share in year 2020 *(Cost)*	100,000	-	-	(1,00,000)
B	Company bought back 30 shares in 2024 @1500 per share *[Dividend as per sec 2(22)(f)]*	45,000	45,000	13,500 [45,000*30%]*	(58,500)^
C	Capital loss on such buyback *(30 Shares*INR 1000)*	30,000	-	-	-
D	Capital Gian on sale of 40 shares out of remaining 70 acquired in 2020 @INR 2000 per share *(before Capital Loss setoff)*, sold in 2025	80,000 [40*2000]	40,000 [40*(2000-1000)]	5,000 [40,000*12.5%]	75,000
E	Capital Gain on shares above (D) after setting off capital loss on buyback (from C)	80,000 [40*2000]	10,000 [40,000-30,000]	1,250 [10,000*12.5%]	78,750

* *Considered 30% tax rate for buy back consideration taxation being highest tax slab rate of Individual for illustration purpose*

^ *Assumed Company intends to distribute Cash after tax of Rs 45,000 to share holders of bought back shares (ignored grossing-up)*

Implications of Amendment

Given the propensity for high-income individuals to invest in equity shares, the amendment is likely to result in increased tax liability for shareholders. This is due to the taxation of buyback proceeds at ordinary income tax rates and the deferral of the cost of acquisition of bought back shares as a capital loss, which can only be offset against future capital gains arising from equity dispositions again which are taxable at 12.5% (LTCG) or 20% (STCG).

Given the recent amendment, the tax implications of buyback payouts from accumulated reserves, necessitating a comprehensive evaluation of all relevant factors before a company decides how to distribute surplus funds.

Comparative Tax Out Flow Analysis *(for former illustrations)*

Particulars	Pre Amendment			Post Amendment			Tax Outflow difference
	Gross Amount	Tax Outflow	Net Cash Flow	Gross Amount	Tax Outflow	Net Cash Flow	
Share Issue Proceeds	1,00,000	-	1,00,000	1,00,000	-	1,00,000	-
Share Buy Back [30 nos*1500] (Note 1)	45,000	3,494 (Note 2)	(48,494)	45,000	13,500 (Note 3)	(58,500)	(10,006)
Subsequent Share sale [40 nos*2000]	80,000	5,000 (Note 4)	75,000	80,000	1,250 (Note 5)	78,750	3,750
Differential Tax post Amendment (Outflow)							**(6,256)**

***Note 1 –** Assumed Company intends to distribute Cash after tax of Rs 45,000 to share holders of bought back shares (ignored grossing-up)

***Note 2 –** Tax @23.296% on [30*(1500-1000)] = 3,494 [Being 23.296% tax on distributed Gain (Buyback Price- Issue Price)]

***Note 3 –** Tax @30% on [30*1500] = 13,500 [Being 30% on Buy Back consideration]

***Note 4 –** Tax @12.5% on [40*(2000-1000)] = 5,000 [Being Tax @12.5% on long term capital gain (LTCG) on sale of shares]

***Note 5 –** Tax @ 12.5% on [40*(2000-1000)-30,000] = 1,250 [Being Tax @12.5% on LTCG after setting off b/f Buy Back Capital Loss]