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# ***Central Board of Direct Taxes releases draft notification to be issued under section 10(38) of the Income-tax Act, 1961***

April 5, 2017

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## ***In brief***

Finance Act, 2017 amended section 10(38) of the Income-tax Act, 1961 (the Act) stating that long term capital gains from transfer of listed equity shares acquired on or after 01 October, 2004, would be exempt from tax under section 10(38) of the Act only if the Securities Transaction Tax (STT) was paid at the time of acquisition of such shares. However, to protect the exemption in respect of genuine cases, it was proposed to notify transfers for which the pre-condition of chargeability to STT on acquisition would not be applicable.

In light of the above, the Central Board of Direct Taxes (CBDT) has issued a press release along with draft notification under section 10(38) of the Act seeking comments/ suggestions from the stakeholders by 11 April, 2017.

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## ***In detail***

### ***Background***

- Under the existing provisions of section 10(38) of the Act, the income arising from a transfer of long term capital asset, being equity share of a company, or a unit of an equity oriented fund, is exempt from tax if the transaction of sale is undertaken on or after 01 October, 2004 and is chargeable to STT under Chapter VII of the Finance (No.2) Act, 2004 (exemption).
- It was noticed by the revenue authorities that the aforesaid exemption was being misused to declare unaccounted income as exempt long-term capital gains by entering into sham transactions.
- To curb such malpractice, the Finance Act, 2017 amended the provisions of section 10(38) of the Act. By virtue of this amendment, the exemption available under this section would be restricted in case of transfer of those listed equity shares, only for which STT was paid at the time of acquisition of the shares.
- However, this amendment would also disadvantage certain genuine cases. Therefore, the memorandum to the Finance Bill, 2017 mentioned that transactions in which the STT could not have been paid, such as acquisition of shares in IPOs, FPOs, bonus or rights issue by a listed company, acquisition by non-resident in accordance with the foreign direct investment policy of the government, etc., would be carved out by issuance of separate notification. The Central Government would notify the transfers for which the condition of chargeability to STT shall not apply.
- The CBDT has now issued a draft notification proposed to be codified into section 10(38) of the Act. The CBDT has requested for comments/ suggestion of the stakeholders by 11 April, 2017.

### **Draft notification**

- CBDT's move to provide a restricted negative list instead of providing exhaustive list is a rather positive approach, not limiting the exemption to the specified transactions only.
- The draft notification provides negative list suggesting the following transactions of acquisitions of equity shares for which condition of chargeability to STT would not be requisite for availing the exemption:
  - a) The exemption will not be available in case of acquisition by way of preferential issue of listed equity share in a company whose equity shares are not frequently traded in a recognised stock exchange of India. However, the exemption would be available to those preferential issues to which the provisions of chapter VII of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements), 2009 does not apply.
  - b) Purchase of listed equity shares in a company, not entered through a recognised stock exchange would not be eligible for exemption.
  - c) The equity shares acquired during the intermediary period starting from the date on which the company is delisted and ending on the date on which the company is re-listed on a recognised stock exchange,

in accordance with the Securities Contracts (Regulation) Act, 1956, read with Securities and Exchange Board of India Act, 1992 and any rules made there under.

Explanation – For the purpose of this notification:

- i) “Frequently traded shares” means shares of a company, in which the traded turnover on a recognised stock exchange during the twelve calendar months preceding the calendar month in which the transfer is made is at least 10% of the total number of shares of such class of the company.  
  
Provided the share capital of a particular class of shares of the company is not identical throughout such period, the weighted average number of total shares of such class of the company shall represent the total number of shares.
- ii) “Listed” means listed in a recognised stock exchange in India, in accordance with the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and any rule made thereunder.
- iii) “Recognised stock exchange” shall have the same meaning as in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956).

### **The takeaways**

The restriction to the exemption

concerned various stakeholders who awaited clarity on the exceptions to the amendment. The draft notification may not have answered all the questions of the stakeholders; however, it does indicate the thought process of the authorities concerning transactions they deem are genuine in availing the exemption.

The relaxation under point a) of the draft notification covers preferential issue by companies, specified therein, in cases such as acquisitions of equity shares pursuant to scheme approved by a High Court (now National Company Law Tribunal), conversion of loan or debt instrument. However, point b) of the draft notification takes away the exemption in cases of off-market purchases of listed equity shares.

It seems that the CBDT has taken away the exemption for strategic buy-outs in off-market transactions. This may impede the interest of the private equity players and strategic investors with the increased burden of tax on long-term capital gains at the time of exit.

In addition, in our view, clarity on whether the exemption would be available on the transfer of listed equity shares acquired through employee stock options is likely to be sought by stakeholders, in the next phase.

### **Let's talk**

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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