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# Central Government issues notification under section 10(38) of the Income-tax Act, 1961

June 07, 2017

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## ***In brief***

The Finance Act, 2017 amended section 10(38) of the Income-tax Act, 1961 (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 Securities Transaction Tax (STT) was paid at the time of acquisition of such shares. However, with the intent to continue the exemption in respect of genuine cases, it was proposed to notify transactions of acquisition, for which the pre-condition of chargeability to STT on acquisition would not be applicable.

Towards this end, the Central Board of Direct Taxes had issued a press release on 03 April 2017, along with a draft notification to be issued under section 10(38) of the Act, seeking comments/suggestions from various stakeholders. The draft notification contained a “negative list” of transactions of acquisition in respect of which the exemption under section 10(38) would not be available.

On 05 June 2017, the Central Government has issued the final notification under section 10(38) of the Act in this regard. While the final notification is similar to the draft notification in terms of prescribing a negative list of transactions, further relaxation has been provided in respect of select transactions of acquisition. This notification applies to all transactions on or after 01 April, 2017.

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## ***In detail***

### ***Background***

- Under the erstwhile provisions of section 10(38) of the Act, the income arising from 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).
- With an intent to curb malpractices, 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 has been restricted only to those listed equity shares, for which STT was also paid at the time of acquisition of the shares.
- 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 Initial Public Offers (IPOs), Follow-on Public Offers (FPOs), bonus or rights issue by a listed company, acquisition by non-resident in accordance with the Foreign Direct Investment (FDI) policy of the government, etc., would be carved out by issuance of separate notification.
- In this regard, the Central Government has issued a notification. We have discussed the provisions of the notification in detail as follows:

## Notification

- The notification prescribes a negative list of transactions of acquisition in respect of which exemption under section 10(38) of the Act would not be available.
- The negative list of transactions prescribed in the notification has been iterated below:

- (a) Acquisition of existing listed equity share in a company whose equity shares are not frequently traded in a recognised stock exchange of India by way of a preferential issue (for definition of “frequently traded share” refer segment “Key Definitions”).

**[Key takeaway:** This clause covers only fresh issue of equity shares by a listed company under the preferential issuance route. Definition of “preferential issue” is as per the SEBI (Issue of Capital and Disclosure

Requirements) Regulations, 2009 (ICDR Regulations). Therefore, this clause would not include equity shares issued under public issue, rights issue, bonus issue, ESOP schemes, issue of depository receipts issued outside India, etc.]

- (b) Acquisition of existing listed equity share in a company, not entered through a recognised stock exchange of India.

**[Key takeaway:** This clause covers secondary acquisition of listed equity shares, regardless of whether they are frequently traded outside stock exchange.]

- (c) Acquisition of equity share of a company during the intervening 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.

**[Key takeaway:** This clause covers both primary as well as secondary transactions undertaken during the intervening period between delisting and re-listing of a company.]

## Exceptions to the above

- However, the notification also prescribes a list of exclusions to the above negative list of transactions under clause (a) and (b) above. For these transactions, the condition of chargeability to STT would not be applicable for availing the Exemption. No exclusions have been prescribed in respect of point (c) above.
- We have tabulated below the exclusions to the negative list of transactions of acquisition prescribed by the notification:

Exclusions to clause (a) of the negative list	Exclusions to clause (b) of the negative list
<p>(i) Acquisition which has been approved by Supreme Court (SC), High Court (HC), National Company Law Tribunal (NCLT), Securities and Exchange Board of India (SEBI) or Reserve Bank of India (RBI) in this behalf.</p> <p>(ii) Acquisition by any non-resident in accordance with FDI guidelines issued by the Government of India.</p> <p>(iii) Acquisition by a Category I or Category II Alternate Investment Fund (AIF) or a Venture Capital Fund (VCF) or a Qualified Institutional Buyer (QIB).</p> <p><b>[Definition of QIB is as per ICDR Regulations. Per the ICDR Regulations, QIB includes, inter-alia, AIFs (all categories), Category I and II Foreign Portfolio Investors (FPIs), Foreign Venture Capital Investors (FVCIs), mutual</b></p>	<p>(i) Acquisition through an issue of share by a company other than the issue referred to in clause (a) of the negative list.</p> <p><b>[This clause specifically clarifies that it covers only secondary transactions.]</b></p> <p>(ii) Acquisition by scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business.</p> <p>(iii) Acquisition which has been approved by the SC, HC, NCLT, SEBI or RBI in this behalf.</p> <p>(iv) Acquisition under employees stock option scheme or employee stock purchase scheme framed under the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.</p>

<p><b><i>funds, scheduled commercial banks and insurance companies.]</i></b></p> <p>(iv) Acquisition through a preferential issue to which provisions of Chapter VII of the ICDR Regulations do not apply. Following is the list of transactions to which Chapter VII of ICDR Regulations do not apply subject to conditions stated therein:</p> <ul style="list-style-type: none"> <li>○ Conversion of loan or option attached to convertible debt instruments in terms of sub-sections (3) and (4) of section 81 of the Companies Act, 1956 or sub-section (3) and (4) of section 62 of the Companies Act, 2013, whichever applicable;</li> <li>○ Scheme approved by a HC under section 391 to 394 of the Companies Act, 1956 or a Tribunal under section 230 to 234 of the Companies Act, 2013, whichever applicable;</li> <li>○ Rehabilitation scheme approved by Board of Industrial and Financial Reconstruction under the Sick Industrial Companies (Special Provisions) Act, 1985 or the Tribunal under the Insolvency and Bankruptcy Code, 2016, whichever applicable; and</li> <li>○ Acquisition by secured lenders pursuant to conversion of their debt into equity shares under the strategic debt restructuring scheme in accordance with the guidelines specified by the RBI.</li> </ul>	<p>(v) Acquisition by any non-resident in accordance with FDI guidelines of the Government of India.</p> <p>(vi) Acquisition of shares of company under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011.</p> <p>(vii) Acquisition from the Government.</p> <p>(viii) Acquisition by a Category I or II AIF or a VCF or a QIB.</p> <p>(ix) Acquisition by mode of transfer referred to in section 47 (transactions not regarded as “transfers”) or section 50B (slump sale) of the Act if the acquisition by the previous owner was not covered under the negative list under this notification.</p>
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### Key definitions

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 that where 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) “preferential issue” and “Qualified Institutional Buyer” shall have the meanings respectively assigned to them in sub-regulation (1) of regulation (2) of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009.

- (iv) “public financial institution” and “scheduled bank” shall have the meanings respectively assigned to them in Explanation to clause (viia) of sub section (1) of section 36 of Income-tax Act.
- (v) “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).
- (vi) “reconstruction company” and “securitisation company” shall have the meanings respectively assigned to them in sub-section (1) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of

Security Interest Act, 2002  
(54 of 2002).

### ***The takeaways***

The notification is a welcome step in terms of notifying a restricted negative list of acquisitions in

respect of which exemption under section 10(38) of the Act would not be available. The Central Government has taken due note of representations received by it on the draft notification by prescribing further relaxations to

the negative list.

### ***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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