

# ***Buy-back of own shares by a company - Provisions of section 56(2)(viiia) not applicable as such shares do not become its property***

July 23, 2018

## ***In brief***

Recently, the Mumbai bench of the Income-tax Appellate Tribunal (Tribunal) held<sup>1</sup> that for applicability of the provisions of section 56(2)(viiia) of the Income-tax Act, 1961 (Act), the shares should “become property” of the recipient company. The taxpayer repurchased its own shares, which were extinguished by reducing the capital. In the transaction, the shares never became the property of the recipient company, and hence, the transaction did not fall under the provisions of section 56(2)(viiia). Since the test of “becoming property” as per section 56(2)(viiia) failed, the provisions of the aforesaid section could not be invoked.

## ***In detail***

### ***Facts***

- The taxpayer made an offer to its shareholders to buy-back 25% of its existing share capital. The offer for such buy-back was kept open for a period of 15 days.
- One shareholder tendered shares under the buy-back for which the taxpayer discharged consideration to the shareholder.
- The tax officer (TO) computed the book value of the shares at a rate that was higher than the rate at which the company originally repurchased the shares from the shareholder.

Consequently, the TO assessed the difference in the hands of the taxpayer as income from other sources, under the provisions of section 56(2)(viiia) of the Act.

### ***Issue before the Tribunal***

Whether the TO was justified in making addition of the difference, in the book value of shares and the buy-back value, under section 56(2)(viiia) of the Act?

### ***Taxpayer's contentions***

- The specific provisions under the Act that deal with buy-back of shares are as follows:
  - Section 2(22) of the Act, which provides that dividend does not

include payment made by a company on purchase of its own shares; and

- Section 46A of the Act, which provides for taxation of consideration received in the hands of the shareholder.

Accordingly, only the above provisions could be applied in case of buy-back of shares.

The primary conditions for application of the provisions of section 56(2)(viiia) is that the shares should become a “capital asset” and “a property” in the hands of the recipient. The shares

<sup>1</sup> ITA No. 532/ Mum/ 2018

were extinguished on buy-back and the share capital was reduced to that extent. Consequently, such shares did not become the capital asset of the taxpayer.

### ***Revenue's contention***

The difference between the value of the shares as computed by the TO and the buy-back value should be taxed as "income from other sources" under the provisions of section 56(2)(viia) of the Act.

### ***Tribunal's ruling***

- To trigger the implications under section 56(2)(viia), the shares should become the "property" of the recipient company.
- It should be the shares of any other company and not its own shares, because own

shares cannot become the property of the recipient company.

- The taxpayer has purchased its own shares under the buy-back scheme, which were extinguished by reducing the share capital, as per the provisions of the Companies Act, 1956.
- Hence, the test of "becoming a property" and "shares of any other company" failed.
- Accordingly, the provisions of section 56(2)(viia) could not be invoked when the company purchases its own shares under the scheme of buy-back.

### ***The takeaways***

This is an important ruling by the Tribunal in the context of

applicability of the provisions of section 56(2)(viia) in case of buy-back of shares by the company. It clarifies the principle that on buy-back of shares, the shares do not become the property of the recipient company.

It is also important to note that the provisions of section 56(2)(viia) are substituted post 01 April, 2017 under section 56(2)(x) of the Act. Therefore, the principle should squarely be applicable to section 56(2)(x)(c) of the Act. Hence, the transaction of buy-back of shares or other similar restructuring activities should not fall within the ambit of section 56(2)(x)(c) of the Act.

### ***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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