

Notification issued under section 112A specifying modes of acquisition not covered

October 12, 2018

In brief

The Finance Act, 2018 withdrew the exemption provided under section 10(38) of the Income-tax Act, 1961 (Act) and instead inserted section 112A to tax long-term capital gains arising from transfer of listed equity shares in company or a unit of an equity oriented fund/ business trust at 10%, upon fulfilment of certain conditions.

The Central Government had issued draft notification *vide* a press release dated 24 April, 2018 and requested for comments/ suggestions from various stakeholders. The draft notification specified the acquisitions for which the rate specified in section 112A of the Act would not apply.

On 01 October, 2018 the Central Government issued the final notification¹ under section 112A of the Act. The final notification is in accordance with the draft notification as well as the final notification issued by the Central Board of Direct Taxes under section 10(38). This tax insight summarises the final notification¹ under section 112A.

In detail

Background

Section 10(38) of the Act provided for exemption in respect of gains arising from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust where the transaction is subject to Securities Transaction Tax (STT).

The Finance Act, 2017 amended section 10(38) of the Act, whereby exemption from long-term capital gains arising from transfer of listed equity shares acquired on or after 1 October, 2004 would be

provided only if STT was paid at the time of transfer and acquisition of such shares, subject to exceptions specified in the notification² issued by the Government.

Vide Finance Act, 2018 the exemption under section 10(38) of the Act was withdrawn. A new section 112A was introduced which provided that long-term capital gains exceeding INR 0.1 million will be taxed at a concessional rate of 10% (plus applicable surcharge and cess).

Such long-term capital gains should arise from transfer of the following:

- Equity shares in a company (STT paid on acquisition and transfer);
- Unit of an equity-oriented mutual fund (STT paid on transfer); and
- Unit of a business trust (STT paid on transfer).

However, in some transactions of acquisition of equity shares, STT could not have been paid at the time of acquisition. In order to give the benefits of section 112A to such genuine cases, power was vested in the Central Government to notify such exceptional cases of acquisitions.

¹ Notification No. 60/2018/F. No. 370142/9/2017-TPL dated 1 October 2018

² Notification No F. No. 43/2017/F. No. 370142/09/2017-TPL dated 5 June 2017

In this regard, the Central Government issued the final notification (in accordance with the notification under section 10(38) of the Act). The relevant provisions have been discussed in detail as follows:

Notification

According to the notification the chargeability of STT will not be a condition for equity shares acquired before 01 October, 2004.

Further, the notification provides a negative list of transactions of acquisition in respect of which the condition of STT being paid on acquisition and transfer will have to be satisfied. Certain exclusions (in accordance with the notification under section 10(38)) to this negative list have also been provided.

Negative List

The negative list of transactions from the notification is as follows:

- a) Acquisition of existing listed equity share in a company whose equity shares are not frequently traded on 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 issued on preferential basis (as per the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 [ICDR Regulations]) by an existing listed company (whose equity shares are not frequently traded). Therefore, this clause would not include equity shares issued by existing listed companies whose shares are frequently traded, 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 relisted 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 relisting of a company.]

Exclusions to the above

As mentioned above, the notification also provides a list of exclusions to the above negative list of transactions under points (a) and (b) above. For these transactions, the condition of chargeability to STT would not be applicable for availing the benefits under section 112A of the Act. No exclusions have been notified to transactions under point (c) above.

These exclusions are also in accordance with the notification issued under section 10(38) of the Act. We have tabulated the exclusions in the below table:

| Exclusions to point (a) of the negative list | Exclusions to point (b) of the negative list |
|---|--|
| <ol style="list-style-type: none"> i) Acquisition that 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. ii) Acquisition by any non-resident in accordance with foreign direct investment (FDI) guidelines issued by the Government of India. 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>[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</p> | <ol style="list-style-type: none"> i) Acquisition through an issue of share by a company other than the issue referred to in clause (a) of the negative list. <p>[This clause specifically clarifies that it covers only secondary transactions.]</p> <ol style="list-style-type: none"> ii) Acquisition by scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business. iii) Acquisition that has been approved by the SC, HC, NCLT, SEBI or RBI in this behalf. 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. |

| Exclusions to point (a) of the negative list | Exclusions to point (b) of the negative list |
|--|--|
| <p><i>Investors (FPIs), Foreign Venture Capital Investors (FVCIs), mutual funds, scheduled commercial banks and insurance companies.]</i></p> <p>iv) Acquisition through a preferential issue to which provisions of Chapter VII of the ICDR Regulations do not apply. The 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"> • 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; • 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; • 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 • 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. | <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) or 45(3) (capital contribution in firm/ AOP/ BoI) or 45(4) (distribution on dissolution of firm/ AOP/ BoI) of the Act if the acquisition by the previous owner was not covered under the negative list in this notification.</p> |

Key definitions

Explanations relevant to 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” have the meanings respectively assigned to them in sub-regulation (1) of regulation (2) of the ICDR Regulations.
- iv) “public financial institution”

and “scheduled bank” have the meanings respectively assigned to them in Explanation to clause (viiia) of sub section (1) of section 36 of the 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 mostly as

expected by the industry and is in
accordance with the earlier
notification under section 10(38)
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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