Deloitte.

India | Tax & Regulatory | For private circulation only | 4 July 2018

Mergers and Acquisition Alert
Delivering Clarity

Buy-back of own shares below fair market value not taxable under section 56(2)(viia), rules Mumbai Bench of Income-tax Appellate Tribunal*

***** ITA No. 532/Mum/2018***

Issue no: M&A/04/2018

In this issue:

Facts of the case

- The taxpayer, Vora Financial Services Pvt Ltd, is a private limited company.
- The taxpayer company bought back its own shares from a particular shareholder under a buy-back scheme at a price of INR 26 per share in May 2013. The book value of the shares on 31 March 2013 was INR 32.80 per share.
- The tax officer, noticing that the book value of shares was greater than their buy-back price, sought to tax the difference in the hands of the taxpayer company under section 56(2)(viia) of the Income-tax Act, 1961 (the Act).
- Section 56(2)(viia) provides that where a closely-held company receives any property (being shares of a closely held company), for inadequate consideration, the difference between the fair market value of the shares (prescribed to be the adjusted book value of the shares as per Rule 11UA of the Income-tax Rules, 1962) and the consideration, shall be taxable in the hands of the recipient of the property under 'Income from other sources'.
- The taxpayer company, on the other hand, argued that a pre-condition for applicability of the provisions of section 56(2)(viia) was that the shares received upon buy-back should become "property" of the recipient, a condition which was not satisfied in the present case since it was a buy-back of its own shares which were subsequently extinguished.

Key issue under consideration

Whether the provisions of section 56(2)(viia) are applicable to a company in case of buy-back of its own shares?

Ruling of the Tribunal

- The Tribunal, taking into account the language of the provisions and the rationale behind introducing such anti-abuse provisions, noted that the key emphasis was on taxation in situations where the prescribed assets had become a "property" of the recipient for inadequate consideration.
- The Tribunal concurred with the taxpayer company's argument that since shares bought back by the taxpayer are compulsorily extinguished under the buy-back, the same cannot become "property" of the taxpayer company so as to attract the provisions of section 56(2)(viia).
- The Tribunal also noted that section 56(2)(viia) contextually contemplates receipt by a company, of shares of another company, and not its own shares, in as much that a company cannot become an owner of its own shares.
- Accordingly, the Tribunal deleted the addition made under section 56(2)(viia) in the hands of the taxpayer company.

Conclusion

The Mumbai Bench of the Income-tax Appellate Tribunal has decided this much-debated issue of taxability under section 56(2)(viia) in the hands of a company upon buy-back of its own shares at a price below the prescribed fair market value.

It is pertinent to note that the provisions of section 56(2)(viia) have been made inapplicable from 1 April 2017 in lieu of much broader provisions under section 56(2)(x). However, given the similarity of the provisions of section 56(2)(viia) and 56(2)(x) as regards "receipt of property", one could argue the applicability of this decision in the context of section 56(2)(x) as well.

Deloitte tax@hand App

Current. Comprehensive. Convenient.
Download tax@hand app, a secure digital platform for timely global and regional news, perspectives, and resources. Do visit the tax@hand webpage here.

Deloitte.

IOS	Android	Website
Download from App Store	Download from Google Play	Add to favorites

Do you know about Dbriefs?

Dbriefs are live webcasts that give valuable insights on important developments affecting your business. To register, visit the Dbriefs page.

Download the report

Deloitte makes an impact that matters