Tax on Buy-Back of Shares, Charitable Entities and Inter-changeability of PAN & Aadhaar

The present government came to power with a decisive majority. Naturally, the country was looking forward to the first budget of this government by the full-time lady Finance Minister. This article deals with provisions of the Finance (No. 2) Bill, 2019 regarding buy-back of shares by listed companies, power to refuse or cancel registration of charitable organisations and inter-changeability of PAN and Aadhaar number. The amendments with respect to tax on buy-back of shares of Listed Companies has become immediately effective and applies to any buy-back scheme implemented on or after 5th July 2019. Companies that have announced buy-back schemes prior to the introduction of the Finance (No. 2) Bill, 2019 will not have taken into account the new tax. Read on…

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Tax on Buy-back of Shares by Listed Companies

With the introduction of Section 77A in the Companies Act, 1956 buy-back of shares became relatively simple and a company could, without going to the High Court, buy-back its shares. Companies Act, 2013 has a similar provision in Section 68. A company having distributable surplus can either declare dividend or subject to the provisions of the Companies Act, 2013, purchase its own shares making the money available to the shareholders. While dividend was chargeable to Dividend Distribution Tax (DDT), the amount disbursed on buy-back of shares was chargeable as capital gains and taxed at a lower rate. In cases where provisions of Double Tax Avoidance Agreements were applicable, amount received on buy-back of shares in certain cases was completely exempt from Indian taxation. It was felt that unlisted companies, as a part of tax avoidance scheme, were resorting to buy-back of shares instead of payment of dividends. Finance Act, 2013 introduced Chapter XII-D consisting of Sections 115QA to 115QC in the Income Tax Act, 1961 (Act) as an anti-tax avoidance measure to curb this practice. The amount

received by the shareholder on buy-back of shares was exempted by introduction of Section 10(34A) and the company was made liable to pay tax on consideration paid by the company for buy-back of shares as reduced by the amount which the company had received for issue of such shares. The provision, when originally introduced, was applicable only to the buy-back of shares by unlisted companies.

SEBI Regulations permitting buy-back of shares through stock exchange made the process even easier. In case of buy-back of shares by listed companies, till the introduction of Section 112A with effect from assessment year 2019-20, long-term capital gain was exempt if the shares were transferred on the stock market and Securities Transaction Tax was paid. Thus, the amount received on buy-back of shares through stock exchange was completely exempt in the hands of the shareholders.

Dividend income exceeding ₹ 10 lakhs became chargeable in the hands of the shareholders from assessment year 2017-18 under section 115BBDA. It is also subjected to DDT in the hands of the company. Due to tax on dividends, buy-back of shares became an attractive proposition, particularly where promoters' holding in the company was substantial. In the recent years, listed companies including public sector undertakings have been buying back shares with aggregate amounts running in to billions of rupees. Companies implementing buy-back schemes include some of the large tech companies as well. This attracted the attention of the government and the Finance (No. 2) Bill, 2019 proposes to extend provisions of 115QA to buy-back of shares by listed companies as well. Any buy-back of shares by a listed company on or after 5th July 2019 will attract tax under this Section at the rate of 20% plus surcharge at the rate of 12% and applicable cess. As a consequence, any income arising to the shareholder from participating in a buy-back scheme will be exempt under section 10 (34A).

> The Finance (No. 2) Bill, 2019 proposes to extend provisions of 115QA to buy-back of shares by listed companies as well. Any buy-back of shares by a listed company on or after 5th July 2019 will attract tax under this section at the rate of 20% plus surcharge at the rate of 12% and applicable cess.

The proposed amendment has become immediately effective and applies to any buy-back scheme implemented on or after 5th July 2019. Companies that have announced buy-back schemes prior to the introduction of the Finance (No. 2) Bill, 2019 will not have taken into account the new tax. They may have to reconsider proposed buy-back of shares, particularly if the amount sanctioned for the buy-back by the shareholders is not sufficient to cover the new tax or the buy-back amount along with the amount of the tax under section 115QA puts strain on the liquidity of the company. According to press reports, a listed company has already withdrawn its proposal to buy back its shares.

Section 115QA after its proposed amendment will affect a large number of companies and their shareholders. While it is true that the companies used buy-back schemes as a tax-effective option instead of declaring dividend, a buy-back scheme may be implemented for various reasons. A company may buy back the shares when in its opinion the quoted price on the stock exchanges for its shares does not represent the true value of the shares or where the company does not have avenues to invest its accumulated funds profitably and buy-back is implemented with a view to return the capital. The scheme of buy-back of shares may be implemented to increase the shareholding of the promoters. In such a case, the promoters do not participate in the buy-back. In all such cases, the buy-back amount received by the shareholders will suffer tax under section 115QA though buy-back was never intended to be a substitute for dividend.

The tax under section 115QA is levied on the buy-back amount as reduced by the amount received by the company in respect of shares being bought back. This is computed in accordance with the provisions of Rule 40BB. Rule 40BB contemplates twelve different situations. In case of listed companies, the applicability of Section 115QA may adversely impact the shareholders who acquired the shares at a price higher than the amount that the company had received for issue of such shares. Take an example where the company is buying back share for ₹ 600 which the shareholder has bought for ₹ 400 while the company had originally issued the share for ₹ 10. In such a case, the tax under section 115QA will be levied on ₹ 590 and not on the gain of ₹ 200 of the shareholder. Further, Rule 40BB provides that where shares are held in dematerialised form and cannot be distinctly identified, the amount received by the company in respect of the shares being bought back is to be determined in accordance with provisions of the Rule on the basis of 'first in first out' method. All the shareholders may not have dematerialised their shares, the shares may not have been dematerialised in the order in which they were issued. Considering this, there may be practical difficulties in applying this provision of the Rule.

Although the proposed amendment aims to bring tax on dividend and tax on buy-back of shares at par, in certain cases buy-back of shares may still be tax efficient. In cases where shareholders receive dividend in excess of ₹ 10 lakh, the shareholder has to pay tax under section 115BBD at the rate of 10% plus applicable surcharge and cess on such excess. This is in addition to the DDT payable by the company under section 115-O. The aggregate of this would still be higher than the tax under section 115QA. If the promoter shareholders are in the category attracting higher surcharge proposed by the Finance (No. 2) Bill, 2019, the aggregate of DDT, the tax under section 115BBD and the higher surcharge will be substantially higher than the tax under section 115QA. May be, buy-back of shares is not yet a thing of past and companies may still resort to it.

Proposal Relating to Charitable Entities

In India there are a large number of charitable entities carrying on various activities for the benefit of the society or section of the society. The Act exempts income of charitable organisations from taxation. However, over the years provisions of the Act pertaining to charitable entities have become extremely stringent. In the recent past, there have been a large number of cases where registration has been refused to a charitable entity or exemption under section 11 has been refused or existing registration has been cancelled. The Finance (No. 2) Bill, 2019 proposes to add one more provision empowering the tax Administration to refuse registration or cancel the registration under section 12AA. In India, while there is no Central legislation governing charitable entities generally, various states have laws governing charitable trusts or institutions. The Foreign Contribution (Regulation) Rules 2011 is a Central Act dealing with foreign contributions that may be received by charitable entities and others. The provisions of all these laws are different and complex. It is unlikely that the tax authorities will be conversant with these laws and have expert knowledge in the field. It is on this background that the proposed amendments should be viewed.

Presently, while granting registration the Commissioner has to satisfy himself about the objects of the trust or institution and the genuineness of its activities. By substituting Section 12AA(1)(a), it is now proposed that the Commissioner will also satisfy himself about the compliance by the trust or institution of requirements of any other law that are material for the purposes of achieving the objects of the trust or the institution.

While considering the application for the registration to a charitable entity, under the proposed provision, the Commissioner will decide about compliance or otherwise with the requirements of other applicable law. The satisfaction is in respect of requirements *that are material for the achieving the objects*

of the entity. At this stage, the Commissioner has to take an independent decision whether there is a violation of a requirement of other applicable law. While coming to this conclusion, the Commissioner who is not expected to have expert knowledge of the other laws, does not have to wait for any order or decision of the authority under the other law. Further, the Commissioner has to decide if the requirement which has not been complied with is a material requirement for the fulfilment of the objects of the trust or the institution. This is bound to be subjective and will lead to disputes and litigation. A few months delay in filing the audited accounts of the charitable entity with the Charity Commissioner may also be considered as a non-compliance of requirement that is material to the achievement of the objects of the entity.

Further, presently the registration of a trust or an institution can be cancelled if it is noticed that the activities of the entity are being carried out in a manner such that income, either whole or part, of the entity is not exempt on account of operation of Section 13(1) of the Act. It is now proposed to amend Section 12AA(4) and provide that the registration of the charitable entity may be cancelled also on the ground that the entity has violated requirements of other law as are material for the purposes of achieving the objects of the trust or the institution. For cancellation of registration the order, direction or decree holding that such non-compliance has occurred, should either not have been disputed or should have attained finality. It may be noted that while considering the application by a charitable entity for registration, the Commissioner has to decide on his own that there is non-compliance of requirements of other applicable law. On the other hand, for cancellation of registration already granted the Commissioner has to necessarily rely upon order, direction or decree passed under the other applicable law and has to wait till such order, direction or decree has attained finality or has not been disputed. However, as in the case of granting of registration, even while cancelling the registration the Commissioner will decide whether the requirement which was not complied with was material for the fulfilment of the objects of the entity.

It is now proposed to amend section 12AA(4) and provide that the registration of the charitable entity may be cancelled also on the ground that the entity has violated requirements of other law as are material for the purposes of achieving the objects of the trust or the institution.

Cancellation of registration can have disastrous impact on the charitable entities. Under Chapter XXII-EB consisting of Sections 115TD to 115TF, a trust or an institution which converts itself into any form which is not eligible for grant of registration under section 12AA is liable to pay a tax on accreted income i.e. fair market value of the total assets of the entity as reduced by the total liability of the entity. Under section 115TD(3), a trust or an institution whose registration under section 12AA has been cancelled is treated as an entity which has converted itself into a form which is not eligible for grant of registration. Thus, effectively if the registration is cancelled, the charitable entity will have to pay tax on its net worth calculated based on the fair market value of the assets.

A power giving discretion to decide compliance or otherwise under other law and its materiality for achieving the objects is not desirable. The proposed amendment needs reconsideration.

PAN and Aadhaar

In September 2018, the Supreme Court of India upheld the constitutional validity of Aadhaar and held that Aadhaar number was mandatory for applying for PAN and filing of income tax return. As a consequence, the Finance (No. 2) Bill, 2019 proposes to extend the mandatory use of Aadhaar number and PAN and in

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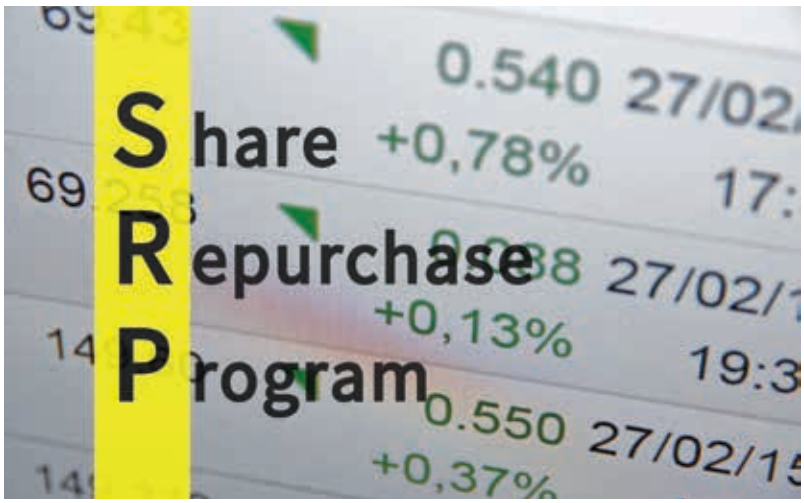
In Section 139A, three new sub-sections are proposed to be inserted. Clause (a) of the new sub-section (5E) provides that if a person who is required to furnish or quote or intimate PAN and does not possess PAN but possesses Aadhaar number, then he may instead of PAN use his Aadhaar number and in such a case he will be allotted a PAN. The manner of allotting the PAN shall be prescribed. Further, clause (b) of the sub-section provides that where a person has been allotted PAN, and if he has intimated his Aadhaar number as provided in 139AA(2), he may use his Aadhaar number in lieu of PAN. Provision of this sub-section starts with non-obstante clause and overrides other provisions of the Act. Two new sub-sections (6A) and (6B) have been introduced. Sub-section (6A) provides that a person entering into transactions to be prescribed shall quote either his PAN or Aadhaar number in the documents pertaining to the transactions and also authenticate the PAN or Aadhaar number, as the case may be. Sub-section (6B) on the other hand, casts a duty on the person receiving any document relating to the prescribed transactions to ensure that PAN or Aadhaar number has been duly quoted and authenticated as prescribed. Failure to quote and authenticate the PAN or Aadhaar number as required under sub-section (6A) will attract penalty of ₹ 10,000 for each instance of the default. Similar penalty has been provided for failure to ensure that PAN or Aadhaar number is quoted and authenticated as required under sub-section (6B). All the three new sub-sections effectively make PAN and Aadhaar number interchangeable. May be in future both the numbers will be merged into one.



Sub-section 139AA(2) makes it mandatory for every person holding PAN to intimate his Aadhaar number to the prescribed authority. The existing proviso to Section 139AA(2) provides that in case the person fails to intimate his Aadhaar number, his PAN will be invalidated. The proviso is proposed be amended to provide that the failure to intimate the Aadhaar number will result in PAN becoming inoperative (as against becoming invalid).

While provisions of the Finance (No. 2) Bill, 2019 are generally reasonable, with every passing year the compliance burden on the assessee is increasing manifold. An effort to reduce this burden is the need of the day. ■

In between goals is a thing called life, that has to be lived and enjoyed. - Sid Caesar