BUY-BACK OF SHARES

BUY-BACK OF SHARES (AS PER PROVISIONS OF COMPANIES ACT,2013)

- **Buy-Back** is one of the important provisions in **the Companies Act, 2013**, which enables a company to purchase its own shares. Amongst other host of reasons, a program of buy-back is resorted to by a company to distribute surplus cash to its shareholders or to even provide investors an opportunity to exit from their investment, especially in case of unlisted/private companies.

- Provisions governing the buy back under **Companies Act, 2013** are contained in **Section 68 to Section 70 and also Rule 17 of the Companies (Share Capital and Debenture) Rules, 2014.**
- **From the next slide onwards, we will brief you about the buyback of shares:**

1. <u>Sources of Buy-Back [S. 68(1)]:</u> A company may purchase its shares out of:
its
a) free reserves;
b) the securities premium account; or
c) the proceeds of the issue of any shares or other specified securities.
However, no buy-back of any kind of shares can be made out of the proceeds of an earlier issue of the same kind of shares.

2. <u>Prohibitions on Buy-Back [S. 70]:</u>
No company shall directly or indirectly purchase its own shares:-
- through any ***subsidiary company*** including its own subsidiary companies;
- through any ***investment company*** or group of investment companies; or
- if a default, is made by the company, in the repayment of deposits accepted, interest payment thereon, redemption of debentures or preference shares or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company, however, the buy-back is not prohibited, if the default is remedied and a period of *three years* has lapsed after such default ceased to subsist.
- if the company has ***not complied*** with the provisions of *S. 92 (Annual Return), S. 123 (Declaration of Dividend), S. 127 (punishment for failure to distribute dividend) and S. 129 (Financial Statement)*

PROVISIONS FOR BUYBACK OF SHARES

1. Must be authorized by **its articles.**
2. The Buy-back can be made with the approval of the Board of directors at a board meeting, if quantum- ***up to 10% of the total paid-up equity capital and free reserves*** *of the company.*
3. The Buy-back can be made with the a special resolution (SR) passed by shareholders in general meeting, if quantum- ***up to 25% of the aggregate of paid-up capital and free reserves*** *of the company*.
4. The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement.
5. The Buy-back of shares of private & unlisted public companies may be:
   - ✓ from the existing shareholders on a proportionate basis;
   - ✓ by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

6. **Before the buy-back**, the company shall file with the ROC a Letter of Offer in **<u>e-form SH-8</u>** and the Letter of Offer shall be dispatched to the shareholders immediately after filing the same with the Registrar of Companies but not later than 20 days from its filing with the Registrar of Companies ensuring the matters as prescribed in the Sub-rule 10 of Rule 17 of ***The Companies (Share Capital and Debentures) Rules,2014*** .
7. The company shall file with the ROC, along with the letter of offer, a declaration of solvency in **<u>e-Form SH-9.</u>**
8. The offer for buy back shall remain open for a minimum period of 15 days but not more than 30 days from the date of dispatch of letter of offer.
9. The ratio of the ***aggregate of secured and unsecured debts*** owed by the company after buy-back shall not be more than twice the paid-up capital and its free reserves ***(2:1)***
10. Shares to be bought back must be ***fully paid up.***
11. Buy-back shall be completed within a period of 1 year from the date of passing of SR or BR, as the case may be. No offer of buy-back shall be made within a period of one year from the date of the closure of the preceding offer of buy-back, if any.

12. In case the number of shares offered by the shareholders is more than the total number of shares to be bought back by the company, the acceptance shall be on **proportionate basis.**

13. The company shall complete the **verifications** of the offers received within **fifteen days** from the date of closure of the offer.

14. After the closure of the buy-back offer, the company shall immediately open a **separate bank account** and deposit the amount therein.

15. Within **7 days** from the date of verification of the offers:

- Make payment of consideration in cash to those shareholders whose shares have been accepted.
- Return the share certificates to those shareholders whose shares are not accepted at all or the balance of shares, if partly accepted.

16. The company shall Extinguish and physically destroy the shares bought back within 7 days of the last date of completion of buy back.
17. The company shall not make a further issue of the same kind of shares including allotment of new shares within a period of **six months** **except** by way of a bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.
18. The Company shall maintain a register of shares which has been bought back in **Form SH-10.**
19. The Return of Buy back with the Registrar in **Form SH-11** on completion of buy back along with the certificate in **Form SH-15** certifying that the buy-back of shares has been made in compliance with the provisions of the Act and rules within 30 days of such completion.
20. If the buy-back of shares is made out of free reserves or securities premium account a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account .
21. If a company makes any default in complying with the provisions of **Section 68**, then the punishment shall be as follows:

- Company Fine ***not less than Rupees One Lakh but which may extend to Rupees Three Lakh.***
- Every officer ***Imprisonment*** for a term which ***may extend to three years or with fine which shall not be less than Rupees One Lakh, but which may extend to Rupees Three Lakh, or with both.***

TAXATION ON BUY-BACK OF SHARES

- **Finance Act, 2013,** inserted **Section 115QA**, which provides for the levy of tax, on account of buy-back of shares, at an ***effective rate of 23.296%*** (20% + 12% Surcharge + 4% Health & Education cess), in case of a **domestic unlisted company.**

- Buy-Back Tax has to be paid by the company on the **distributed income** which is nothing but the ***consideration paid by the company on buy back of shares, as reduced by the amount received by the company on issue of such shares, determined in the manner prescribed under Rule 40BB of the Income Tax Rules, 1962 (ITR)***. Also, such Buy Back Tax has to be paid by the company ***over and above the tax paid by it***, if any, on its total income. The value determined should not be higher than the **Fair Market Value** of the shares of the company, as otherwise, the differential amount can be charged to tax as **deemed dividend u/s 2(22)(e),** if relationship between the shareholder and company, as provided under that section is satisfied.

- Buy Back Tax is levied at the level of company, the consequential income arising in the ***hands of shareholders is exempt from tax,*** as per **Section 10(34A)** of the Income Tax Act,1961.

- Later on, **Finance (No.2) Act, 2019** extended the **scope of Section 115QA** by including **listed companies** within its ambit. Correspondingly, investors will not have to pay any tax on capital gains on buyback as this is now exempted.

- For the purpose of **Section 115QA, 'Buy-Back'** means *purchase by the company of its own shares, in accordance with the provisions of Section 68 of the Companies Act, 2013.*

- Since, income arising in the hands of the shareholders, on account of buy back, on which "Buy Back Tax" has been paid, is exempt under Section 10(34A), there is no tax outflow in their hands, on account of buy back. Even for shareholders, ***which are companies, on whom provisions of Section 115JB are applicable, need not include such income for calculating MAT, as being exempt under Section 10.***

- The tax is payable **within a period of 14 days** from the date of payment of any amount to the shareholders on the buy-back of shares. The tax on distributed income **(i.e. buy-back) is payable by the company even if such company is not liable/ required to pay income tax.**

- The tax on distributed income paid/ payable by the company shall be treated as **final payment of tax.** No further credit shall be claimed either by the company or any other person in respect of the amount of tax so paid.

- Income charged under ***section 115QA shall not be allowed any deduction under any other provisions of the Act either to the company or shareholders.***

Example :

Suppose M/s. XYZ originally issued shares for INR 10. The shareholder bought the shares at INR 400. The company M/s. XYZ buy-back the shares at INR 600.

In such cases, as per provisions of section 115QA of the Income Tax Act, the tax is payable on INR 590 (INR 600 – INR 10).

SO WHICH ONE IS MORE TAX EFFECTIVE, DIVIDEND DISTRIBUTION OR BUYBACK OF SHARES?

- A company having distributable reserves has two options to distribute the same to its shareholders: (i) declares dividend to shareholders; or (ii) purchases its own shares (i.e. buy-back of shares) at a consideration fixed by it.

- The shareholders falling in the higher income group, having income levels of more than INR 50 Lacs, or corporate shareholders, the effective rate at which tax is paid, when dividend is received by them is between ***34.32% to 42.744%.*** Whereas, if in case surplus is distributed to such shareholders, by way of buy-back of shares, then the effective tax rate on ***such distribution is 23.296%.***

- <u>***Thus, buy back of shares by unlisted companies is a tax efficient mechanism for distributing surplus to its shareholders.***</u>