

BUYBACK TAXATION IN INDIA

EVOLUTION AND CURRENT FRAMEWORK

Corporate Context: Indian law permits companies to repurchase (buy back) their own shares under safeguards Under Section 68 Companies Act, 2013. These reforms (e.g. Section 68 of Companies Act 2013) recognize buybacks as a valid capital distribution, subject to limits (e.g. 25% of capital and reserves, solvency declaration) and procedures (special resolution, regulatory filings). SEBI's Buy-Back Regulations, 2018 also prescribe additional rules and define "promoter" status for listed firms.

Taxation Overview: The tax treatment of buybacks has changed repeatedly due to misuse and abuse of the provisions and even assuming this to be tax neutral in various situations due to ingenious planning. Broadly, the pre-2013 regime treated buybacks as capital gains for shareholders, whereas post-2013 Parliament imposed tax at the company level on the distribution (to mirror dividend taxation). In FY 2024-25 this was flipped so shareholders were taxed on the full buyback value as dividend income (with cost as an allowable loss). The Union Budget 2026 proposes reverting (for most shareholders) to a capital gains basis, with differentiated rates for promoters. Below we discuss each phase, statutory basis, and stakeholder impact, with references.

Historical Tax Regimes Governing Share Buybacks in India

- **Pre-2013 (Capital Gains Regime):**

Share buyback proceeds were taxed in shareholders' hands as capital gains under Section 46A of the Income-tax Act, 1961. A shareholder's taxable gain equaled "consideration received" minus "cost of acquisition". This aligned with normal capital-gains rules (with concessional rates and indexation), making buybacks potentially more tax-efficient than dividends.



- **2013–2024 (Section 115QA Regime – Anti-Arbitrage Phase):** Finance Act 2013 introduced Section 115QA to curb perceived tax avoidance. Under Section 115QA, a company undertaking a buyback must pay 20% income-tax on the “distributed income” (essentially the buyback consideration minus the original issue price of the shares). Initially this applied only to unlisted companies, but Finance Act 2019 (No.2) extended u/s 115QA to listed companies (w.e.f. 5 July 2019).
- Correspondingly, shareholders became exempt: Section 10(34A) rendered buyback proceeds tax-free in their hands. This company-level tax produced predictability but also inequities: shareholders who had paid more than issue price received no relief, and non-resident investors struggled to claim foreign tax credits. For example, under section 115QA a company paid tax at 20% (plus surcharge/cess) on the excess buyback price over issue price, while shareholders declared no income (exempt u/s 10(34A)).
- **FY 2024–25 (Dividend Characterization Phase):** The Finance Act (No.2) 2024 fundamentally altered this: it treated any buyback receipt as deemed dividend under Section 2(22)(f) of Income tax Act, 1961. Concretely, shareholders were taxed on the entire buyback amount at dividend rates (up to 30% for high-income individuals), without deducting acquisition cost. To mitigate this shift, the Finance Act allowed the original share cost to be recognized as a capital loss (via a deemed nil sale under section 46A). Thus the “two-part” mechanism made shareholders taxable up front on full proceeds as dividends, while enabling them to carry forward equivalent capital losses under normal set-off rules. In effect, while aiming for parity with dividend taxation, this approach often increased tax for high-bracket investors (who lost preferential capital gains treatment) and created compliance complexity (e.g. tracking carry-forward losses).

Proposed Regime (Budget 2026)

The 2026 Budget proposes another shift: buybacks (from 1 April 2026) will again be taxed on a net capital gain basis, subject to differentiated treatment for promoters. Key features:

- **Capital Gains Basis:** Shareholders (other than specified “promoters”) will pay tax on net gains (buyback price minus cost), akin to a sale of shares. Long-term and short-term capital gains rules would apply. Crucially, this restores immediate deduction of share cost in computing gain (unlike FY25, where cost was deferred as a capital loss).

- **Differential Rates for Promoters:** To discourage use by insiders, the Budget imposes an extra levy on promoters. Under the proposed law, promoters will pay capital gains plus additional tax, effectively raising their total rate.

The proposed tax rates applicable to promoters are summarized below:

Category	Nature of Gains	Domestic Company	Other than Domestic Company
Listed Shares	STCG	20%+2%=22%	20%+10%=30%
Listed/Unlisted Securities	LTCG	12.50%+9.5%=22%	12.50%+17.50%=30%

- **Definition of “Promoter”:**

Listed Companies: In the case of listed companies, the term “promoter” derives its meaning from SEBI (Buy-Back of Securities) Regulations, 2018. It includes persons exercising control over the company as well as entities forming part of the promoter group as disclosed under SEBI regulations. Accordingly, shareholders classified as promoters or promoter group members under the securities law framework are treated as promoters for the purposes of the proposed buyback taxation provisions.

Unlisted Companies: For unlisted companies, promoter identification is based on Section 2(69) of the Companies Act, 2013 and is further expanded to include any person holding, directly or indirectly, more than 10 percent of the share capital. Consequently, even significant minority shareholders may fall within the promoter category based solely on shareholding thresholds, reflecting an anti-avoidance approach similar to that adopted under the deemed dividend provisions of Section 2(22)(e) of the Income-tax Act, 1961. The language indicates that for the purpose of computing 10% threshold even preference capital may be included.

Aggregation of 10% Shareholding – Direct and Indirect Holding

The proposed provisions require aggregation of shareholding held directly or indirectly for determining the 10 percent threshold; however, the scope of “indirect holding” has not been specifically defined. The absence of clear attribution guidelines may therefore create interpretational uncertainty while determining promoter status, particularly in closely held entities.

- **Legislative Basis:** The Finance Bill, 2026 proposes the insertion of a specific provision under the Income-tax Act, 2025 (Section 69, corresponding to erstwhile Section 46A), to expressly provide that consideration received on buyback shall be taxable as capital gains. The Budget Speech clarifies that buyback proceeds will no longer be characterized as dividend income and that promoters will be subject to an additional levy. The Memorandum to the Finance Bill states that the objective of the amendment is to rationalize the taxation framework by restoring capital gains treatment for buybacks with effect from FY 2026–27.

Promoter vs. Non-Promoter Implications

- **Promoters:** Under the proposed regime, the overall tax impact for promoters is largely neutral. Although the shift from gross dividend taxation to a net capital gains basis allows deduction of acquisition cost, the benefit is substantially offset by the additional levy imposed on promoters. Consequently, the effective tax rate for individual promoters in listed company buybacks is expected to be approximately 30%, broadly comparable to the earlier dividend taxation framework. In the case of promoter entities (domestic companies), the effective rate is estimated at around 22%. While the mechanism transitions from dividend to capital gains taxation, promoters effectively bear a higher rate than that applicable to ordinary capital gains. Notably, shareholders holding more than 10% equity—irrespective of formal promoter classification—may also fall within the higher tax bracket, potentially influencing exit structuring and investment planning for founders and private equity investors. The change from promoter to non promoter category may again be a subject matter of ingenious planning.

Comparative Overview

The table below summarizes the tax incidence and base under each regime:

Phase / Period	Taxpayer	Tax Base	Applicable Provision / Mechanism
Pre-2013 (Capital Gains)	Shareholder	Net gain = (Buyback price – Cost of acquisition)	Taxed as capital gains under ITA u/s 46A (introduced FA 1999)
2013–2024 (Sec.115QA Regime)	Issuing Company	Distributed income = (Buyback price – Issue price)	Company-level tax @20% (+ surcharge/cess) under ITA u/s 115QA; shareholders exempt u/s 10(34A)
FY2024–FY2025 (Dividend Phase)	Shareholder	Gross proceeds (full buyback consideration)	Taxed as deemed dividend under ITA u/s 2(22)(f); cost of shares allowed as capital loss u/s 46A
FY2026+ (Proposed Capital Gains)	Shareholder (net)	Net gain = (Buyback price – Cost)	Capital gains treatment for all; CG rates apply (12.5% LTCG / 20% STCG etc.) with additional levy for promoters

Key Considerations for Stakeholders

The proposed amendments raise several practical and interpretational considerations that may require legislative clarification or administrative guidance.

- **Documentation and Withholding:** The differentiated treatment mean companies must identify promoters (by SEBI/Co. Act tests) and potentially deduct/provide statements accordingly. Ensuring compliance (forms, disclosures, tax certificates) will be important, especially in contexts of foreign shareholders claiming treaty relief.

- **Treaty and Tax Credit Issues:** For non-residents, the reclassification of buyback proceeds as capital gains (with an implicit source in India) may or may not align with treaty definitions. If classified as dividends under a treaty, shareholders could lose the benefit of their basis in shares. Conversely, if classified as capital gains, India typically has broad taxing rights (often with credit relief to limit double-taxation). Absent treaty changes, foreign investors should map the new rules against each relevant DTAA, as noted by tax advisers.
- **Applicability of Surcharge Cap:** An interpretational issue may arise regarding the applicable surcharge rate on additional income-tax under Section 69. While the surcharge for individuals can go up to 37% where total income exceeds INR 5 crore, the surcharge on dividend and capital gains under Sections 196, 197 and 198 is capped at 15%. Since the income arising on buyback continues to retain the character of capital gains, it may be argued that the 15% surcharge cap should apply, instead of the higher surcharge rate.
- **Applicability of Surcharge on Additional Income-tax under Section 69:** Another interpretational issue arises regarding the applicability of surcharge on the additional income-tax proposed under Section 69. The surcharge provisions under Clause 3(4) of the Finance Bill, 2026 apply only to income-tax levied under specified sections of the 2025 Act, while Paragraph F of the First Schedule governs surcharge on income-tax computed under the normal slab rate regime. Since neither of these provisions specifically refers to the additional income-tax under Section 69, it may be argued that surcharge may not automatically apply to such levy. Given that tax can be imposed only with clear statutory authority, the absence of an explicit provision imposing surcharge on the additional income-tax under Section 69 may lead to interpretational disputes unless the legislative framework is suitably clarified.
- **Availability of De Minimis Exemption:** It remains unclear whether the de minimis exemption of ₹1,25,000 under Section 198 of the Income-tax Act, 2025 would be available while computing the additional income tax payable by promoters under the proposed buy-back provisions.
- **Exemption under Section 86:** Exemption under Section 86 of the Income-tax Act, 2025 in respect of long-term capital gains arising from buy-back of shares, particularly where promoter-level additional tax is triggered can again be a subject matter of dispute.

- **Redemption of Preference Shares:** Since redemption of preference shares is treated as purchase of own shares in view of a Supreme Court Ruling, an issue may arise whether such transactions would also attract the promoter-level additional income tax under the proposed framework.
- **Dividend Characterisation Post-Omission of Clause (f):** With the proposed omission of clause (f) under Section 2(40) by the Finance Bill, 2026, and in the absence of an explicit exclusion, it requires examination whether amounts distributed on buy-back could still be regarded as “dividend” for tax purposes in certain circumstances. Legislative intent suggests a shift toward capital gains treatment; however, interpretational clarity would be necessary to avoid potential re-characterisation disputes.
- **Characterisation of Buyback Proceeds as Income:** Since the amount arising on buyback of shares is deemed to be capital gains under Section 69, an issue arises whether such amount would qualify as “income” under Section 2(49)(k), which includes capital gains chargeable under Section 67.
- **Applicability of Statutory Exemptions (Sections 82–86):** A significant interpretational issue arises because the proposed Section 69 which deems buyback proceeds as capital gains does not contain an express cross-reference to the exemption framework provided in Sections 82 to 86 of the Income-tax Act, 2025. This is in contrast to Section 67, which explicitly incorporates these exemptions for standard capital gains. Consequently, it remains unclear whether shareholders, particularly promoters subject to the additional tax levy, can validly claim exemptions such as Section 86. Legislative clarification is required to ensure these benefits extend to gains characterized under Section 69.
- **Taxability under the New Regime:** Since the new regime under Sections 202/201 operates with a non-obstante clause (“notwithstanding anything contained in this Act”), an issue arises whether income arising to a promoter on buyback would be taxable at normal slab rates under the new regime instead of being subject to the additional tax provisions applicable to promoters.
- **Applicability of Section 79:** Section 79 provides that where unquoted shares are transferred for the purposes of Section 72 at a value lower than FMV, such FMV shall be deemed to be the full value of consideration. An issue arises whether this deeming provision would apply to buyback of shares, which is governed by a specific buyback taxation provision.

- **Set-off of Capital Losses against Buyback gains:** Where additional tax is levied on promoters on capital gains arising from buyback of shares, an interpretational issue arises as to whether such tax should be computed on the gross capital gains from the buyback transaction or on the net capital gains after allowing set-off of brought forward or current year capital losses or current business losses. While the Income-tax Act generally permits set-off of capital losses against capital gains, it remains unclear whether such adjustment would be available in the case of a specific transaction-based levy such as additional tax on buyback gains.
- **Statutory Backing for Additional Income-tax under Section 69(2):** The proposed levy of additional income-tax on buyback-related income under Section 69(2) raises a legislative concern. Under the framework of the 2025 Act, Section 4(1) provides that income-tax shall be charged at the rates specified in the relevant Central Act (Finance Act). However, a review of the Finance Bill, 2026 indicates that there is no explicit reference to the additional income-tax under Section 69(2) or the rates prescribed therein in the First Schedule or related provisions. This creates uncertainty as to whether the levy can be validly enforced without being incorporated into the Finance Act's rate structure. Accordingly, it may be argued that, in the absence of such statutory integration, the proposed levy under Section 69(2) may lack adequate legislative support and could give rise to interpretational issues unless appropriate amendments are made.
- **Comparability to Dividends:** Even with capital gains treatment, for promoters the ultimate tax cost remains similar to dividends. Thus, buybacks by closely-held or promoter-driven companies may not yield meaningful tax savings over dividends. For widely-held firms, however, buybacks may now become a more neutral way to distribute retained earnings without disadvantaging minority shareholders.

Conclusion

The taxation of share buybacks in India has undergone significant shifts, moving between capital gains and dividend-based frameworks in response to evolving fiscal and anti-avoidance objectives. The proposals under Budget 2026 seek to restore capital gains treatment while introducing targeted safeguards for promoters to prevent potential misuse. This calibrated approach aims to balance equity among shareholders, revenue protection, and tax neutrality.

In light of the proposed changes, companies and investors should reassess their capital distribution strategies and evaluate the implications for promoter holdings, exit planning, and cross-border investments. Legal, tax, and finance teams will need to align internal policies, financial models, and compliance processes with the revised framework to ensure accurate implementation and risk mitigation.