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TAX FLASH NEWS

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CBDT final notification clarifying the nature of acquisitions of equity shares where the requirement of payment of STT shall not apply to avail concessional tax rate on long-term capital gains

The Finance Act, 2018 withdrew the exemption of Section 10(38) of the Income-tax Act, 1961 (the Act) and introduced a new Section 112A in the Act, to provide that long-term capital gains (LTCG) arising from 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 shall be taxed at 10 per cent of such capital gains exceeding INR one lakh. The said section, *inter alia*, shall apply to the capital gains arising from a transfer of long-term capital asset being an equity share in a company, only if Securities Transaction Tax (STT) has been paid on acquisition and transfer of such a capital asset.

However, to provide the applicability of the tax regime under Section 112A of the Act to genuine cases where the STT could not have been paid, it has also been provided in Section 112A(4) of the Act that the central government may specify, by notification, the nature of acquisitions in respect of which the requirement of payment of STT shall not apply in the case of acquisition of equity share in a company.

On 24 April 2018, the Central Board of Direct Taxes (CBDT) issued a press release[1] and draft notification[2] proposing to specify the nature of acquisitions in respect of which requirement of payment of STT would not apply to avail concessional tax rate on LTCG.

Recently, the CBDT has issued final Notification[3] under Section 112A(4) of the Act.

CBDT Final Notification

The final Notification prescribes transactions in the nature of acquisition of equity shares entered into (i) before 1 October 2004 or (ii) on or after the 1 October 2004 which are not chargeable to STT, other than the following –

a. Where the acquisition of existing listed equity shares in a company whose equity shares are not frequently traded in a recognised stock exchange of India is made through a preferential issue.

   However, the above provision shall not apply to the acquisition of listed equity shares in a company –

   - Which has been approved by the Supreme Court, High Court, National Company Law Tribunal (NCLT), Securities and Exchange Board of India (SEBI) or Reserve Bank of India (RBI)
   - By any non-resident in accordance with Foreign Direct Investment (FDI) guidelines issued by the government of India
   - By an investment fund[4] referred to in Explanation 1(a) to Section 115UB of the Act or a venture capital fund referred to in Section 10(23FB) of the Act or a Qualified Institutional Buyer (QIB); and

[1] CBDT press release, dated 24 April 2018 (Source: https://www.incometaxindia.gov.in)
[2] Draft Notification, 24 April 2018 (Source: https://www.incometaxindia.gov.in)
[3] CBDT Notification No. 60/2018, dated 1 October 2018

[4] 'Investment fund' means any fund established or incorporated in India in the form of a trust or a company or a limited liability partnership or a body corporate which has been granted a certificate of registration as a Category I or a Category II Alternative Investment Fund and is regulated under the SEBI (Alternative Investment Fund) Regulations, 2012, made under the SEBI Act, 1992

- Through preferential issue to which the provisions of chapter VII of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 does not apply.

b. Where transaction for the acquisition of existing listed equity share in a company is not entered through a recognised stock exchange of India.

However, the above provision shall not apply to the acquisition of listed equity shares in a company made in accordance with the provisions of the Securities Contracts (Regulation) Act, 1956, and is

- Through an issue of share by a company other than issues referred above.
- By scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business
- Approved by the Supreme Court, High Courts, NCLT, SEBI or RBI in this behalf
- Under employee stock option scheme or employee stock purchase scheme framed under the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines,1999
- By any non-resident in accordance with FDI guidelines of the government of India
- In accordance with SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 2011
- From the government
- By an investment fund referred to in clause (a) to Explanation 1 to section 115UB of the Act or a venture capital fund referred to in Section 10(23FB) of the Act or a QIB and
- The draft notification provided the acquisition by mode of transfer referred to in Sections 47 or 50B of the Act, if the previous owner of such shares has not acquired them by any mode referred to in point (a) or (b) or (c) [other than the transactions referred to in the proviso to point (a) or (b)]. The final notification additionally provides the acquisition by mode of transfer referred to in Section 45(3)[5] or 45(4)[6] of the Act.

c. Acquisition of equity share of a company during the period beginning from the date on which the company is delisted from a recognised stock exchange and ending on the date immediately preceding the date on which the company is again listed on a recognised stock exchange in accordance with the Securities Contracts (Regulation) Act, 1956 read with SEBI Act, 1992 (15 of 1992) and the rules made there under.

The notification shall come into effect from 1 April 2019 and accordingly apply to the assessment year 2019-20 and subsequent assessment years.

Our comments

The final notification has addressed few issues that arose out of the draft notification. The final notification has extended the exemption to acquisition by following modes of transfer:

- Transfer of capital asset by a person to a firm or other association of persons (AOP) or body of individuals[7] (BOI) in which he is or becomes a partner or member, by way of capital contribution or otherwise
- Transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other AOP or BOI[7] or otherwise.

However, since the final notification provides a list of exclusions, there are various off-market transactions (which are not sham transactions) that may not get exemption under Section 112A of the Act for example a private equity investor or a strategic investor, who generally purchases a large quantity of listed company's shares outside the stock exchange.

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[5] Section 45(3) of the Act provides that transfer of capital asset by a person to a firm or other association of persons or body of individuals (not being a company or co-operative society) in which he is or becomes a partner or member, by way of capital contribution or otherwise, shall be chargeable to tax as his income of the previous year in which such transfer takes place and for the purpose of Section 48, the amount recorded in the books of account of the firm, association or body as the value of the capital asset shall be deemed to be the full value of the consideration received or accruing as a result of the transfer of the capital asset

[6] Section 45(4) of the Act provides that the profits and gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or co-operative society) or otherwise, shall be chargeable to tax as the income of the firm, association or body, of the previous year in which the said transfer takes place and for the purpose of Section 48, the fair market value of the asset on the date of such transfer shall be deemed to be the full value of the consideration received or accruing as a result of the transfer

[7] Not being a company or co-operative society

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