



CBDT issues final notification for exemption of acquisitions of equity shares from long-term capital gain tax under Section 10(38) of the Income-tax Act

Background

Section 10(38) of the Income-tax Act, 1961 (the Act), prior to its amendment by the Finance Act, 2017, provided that the income arising by way of a transfer of long-term capital asset, being equity share in a company, shall be exempt from tax if such transfer is undertaken after 1 October 2004 and chargeable to Securities Transaction Tax (STT) under Chapter VII of the Finance (No. 2) Act, 2004.

In order to curb the practice of declaring unaccounted income as exempt long-term capital gain by entering into sham transactions, the Finance Act, 2017 amended the provisions of Section 10(38) of the Act to provide that exemption under this section for income arising on transfer of equity share acquired or on after 1 October 2004 shall be available only if the acquisition of share is chargeable to STT.

However, to protect the exemption for genuine cases where the STT could not have been paid, it was provided that the central government was to notify the acquisition for which the condition of chargeability to STT shall not apply. Accordingly, the Central Board of Direct Taxes (CBDT) has issued a press release and the draft notification under Section 10(38) of the Act. The draft notification proposed a negative list. It stated that all transactions will be eligible for benefit under Section 10(38) of the Act except for the specified transactions.

Recently, the CBDT has notified¹ final rules for exemption of acquisitions of equity shares from long term capital gain tax under Section 10(38) of the Act. The CBDT notified all

transactions of acquisition of equity share entered into on or after the 1 October 2004 which are not chargeable to STT under Chapter VII of the Finance (No. 2) Act, 2004 (23 of 2004), other than certain specified transactions. The final Notification has provided relief to certain additional transaction. The key difference between the draft Notification and final Notification are as under:

- Exemption from condition of STT would not be available where acquisition of existing listed equity share in a company whose equity shares are not frequently traded in a recognised stock exchange of India is made through a preferential issue. Draft Notification provided exemption to preferential issues to which the provisions of chapter VII of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 does not apply. The final Notification extended this relief to 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.

¹ Notification No.43/2017, dated 5 June 2017

- By an investment fund² or a Venture Capital Fund (VCF) referred to in Section 10(23FB) of the Act or a Qualified Institutional Buyer (QIB).
- The draft notification provided that exemption of STT would not be available where transaction for the acquisition of existing listed equity share in a company is not entered through a recognised stock exchange of India. The final Notification provided exception to the following transactions:
 - Acquisition through an issue of share by a company other than issues referred above.
 - Acquisition by scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business.
 - Acquisition which has been approved by the Supreme Court, High Courts, NCLT, SEBI or RBI.
 - Acquisition under employee stock option scheme (ESOPs) or employee stock purchase scheme (ESPS) framed under the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999
 - Acquisition by any non-resident in accordance with FDI guidelines of the government of India.
 - Where acquisition of shares of company is made under SEBI (Substantial Acquisition of Shares and Takeovers) Regulation, 2011.
 - Acquisition from the government.
 - Acquisition by an investment fund or a VCF or a QIB.
- Acquisition by mode of specified transfer which are exempt under Section 47) and transfer by way of slump sale under Section 50B of the Act, if the previous owner of such shares has not acquired them by any specified mode³.
- The draft Notification provided that exemption from the condition of STT would not be available to 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 Securities and Exchange Board of India Act, 1992 (15 of 1992) and the rules made thereunder. There is no change in this clause in the final Notification.
- The final notification has amended the definition of the term 'frequently traded shares'. Further, certain new terms like preferential issue, QIB, public financial institution and scheduled bank, reconstruction company, securitisation company, etc. have also been defined.

The final notification shall come into effect from 1 April 2018 and will accordingly apply from assessment year 2018-19 onwards.

Our comments

Today, the Central Board Direct Taxes (CBDT) has issued the final notification providing that the condition of chargeability to Securities Transaction Tax (STT) shall not apply to all transactions of acquisitions of equity shares entered into on or after the 1 October 2004 other than the specified transactions. The CBDT has provided much needed clarity by way of this notification. The CBDT has accepted various representations made by the stakeholders to provide relief to certain transaction from the

² Clause (a) of Explanation 1 to Section 115UB of the Act - 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

³ Modes referred to in clause (a) or clause (b) or clause (c) of the final notification [other than the transactions referred to in the proviso to clause (a) or clause (b)]

condition of STT. Accordingly, certain acquisitions like acquisition by way issue of share by a company, acquisition under employee stock option scheme or employee stock purchase scheme, acquisition by any non-resident in accordance with FDI guidelines of the government of India, acquisition by an investment fund or a VCF or a QIB, acquisition by mode of specified transfer which are exempt under Section 47 and transfer by way of slump sale under Section 50B of the Act, etc. have been exempted.

However, certain transaction have still not been considered for e.g. issue of shares against warrants, issue of shares on settlement of dues under a scheme of debt restructuring, inter-se transfer of equity shares between promoters, strategic acquisitions by private investors, etc.



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