Dividends triumph over buybacks

Despite high tax payouts, share of buybacks in reward pool hits lowest in seven years in FY23

SAMIE MODAK
Mumbai, 10 October

Choosing between rewarding shareholders through dividends or share buybacks remains a major dilemma for India Inc. Despite the potential for higher tax payouts, dividends have continued to be the preferred method for returning excess cash to shareholders.

In 2022–23 (FY23), the share of buybacks in India Inc's overall reward pool (total dividends paid and total amount spent on buybacks) fell to 4.85 per cent, the lowest since 2015-16 (FY16).

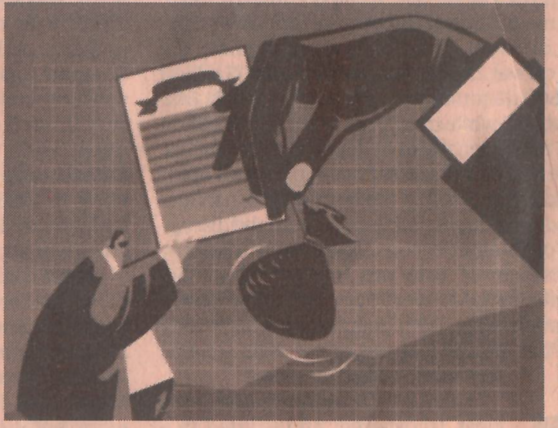
Experts suggest that the more tax-efficient option between the two depends on the perspective considered.

Currently, companies paying dividends do not face any tax outgo, as dividends are taxed based on the individual tax slabs of the recipients. In contrast, companies have to pay over 20 per cent as buyback tax.

In FY23, India Inc spent ₹21,453 crore on share repurchase programmes, according to PRIME Database, while the total dividend payout was nearly 20x higher at ₹4.4 trillion, according to Capitaline data. Between 2016-17 (FY17) and 2018-19 (FY19), the share of buybacks in the total reward pool surged due to a tax anomaly favouring buybacks during this period.

From April 1, 2016, onwards, the government imposed an additional 10 per cent tax on dividends, bringing the effective dividend distribution tax to 20.6 per cent. Meanwhile, buybacks by listed companies enjoyed tax exemptions. Consequently, buybacks' share in the total reward pool increased from 1 per cent in FY16 to an average of 25 per cent during FY17–FY19.

ILLUSTRATION: BINAY SINHA



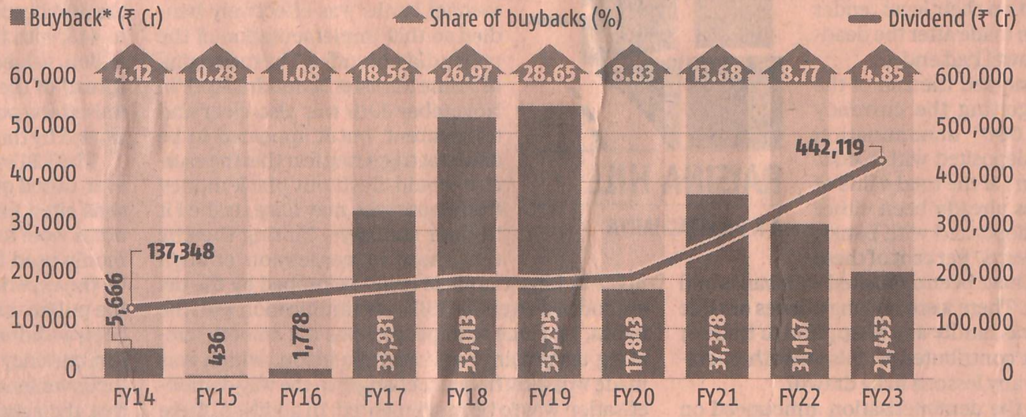
REPORT CARD

TCS's latest buyback could be India's largest ever

	End date	Size* (₹ cr)
TCS	Mar 23,'22	18,000
TCS	Sep 21,'18	16,000
TCS	Jan 1,'21	16,000
TCS	May 31,'17	16,000
Infosys	Dec 14,'17	13,000
Wipro	Jun 30,'23	12,000
Wipro	Dec 13,'17	11,000
Wipro	Aug 28,'19	10,500
L&T	Sep 25,'23	10,000

TAX TROUBLES

Share of buybacks in the reward kitty has shrunk after the introduction of buyback tax with effect from FY20



Note: *Actual amount acquired; Source: PRIME Database, Capitaline

To address this tax loophole, the government introduced a 20 per cent buyback tax on April 1, 2019, and a year later abolished the dividend distribution tax, shifting the tax burden to shareholders. There were speculations that the government might do the same for buybacks in the previous Union Budget.

Currently, from the perspective of large shareholders, buybacks could be more rewarding. Consequently, prominent promoter-backed firms such as Tata Consultancy Services (TCS) and Wipro have opted for buybacks over dividends in recent years.

TCS, a flagship firm of Tata Group, is expected to announce another buyback soon. Experts suggest that the share of buybacks could increase this year if India Inc's balance sheet position improves.

"The consideration received by the shareholder on buyback is not taxable in the hands of the shareholder. However, in the case of a dividend, the entire amount is taxable in the hands of the shareholder. The rate of tax in the case of a dividend depends on the status of the shareholder. Therefore, depending on the facts, one should decide which form is better for rewarding shareholders," said Vijay Gilda, partner, tax and regulatory services, BDO India.

"In my view, buybacks are a more efficient way to reward the shareholders, as there is no additional income tax payable on the buyback sale proceeds in the hands of the shareholders. On the other hand, a dividend also attracts tax liability at the time of filing the income-tax return. Even strategically, to show confidence, the buyback option sends a message to the outside world that the stock is undervalued by the company," said Rubal Bansal Maini, partner, Luthra and Luthra Law Offices India.

Experts point out that tax is just one of the many factors companies have to consider, including the frequency of buybacks, debt levels, and shareholding structure. Not all companies qualify for buybacks.

Ideally, buybacks are conducted by companies with high cash reserves and low debt. Additionally, a company can use only a fourth of its reserves for buybacks. Consequently, nearly two-thirds of buybacks in recent years have come from information technology companies, which are typically asset-light and cash-rich.

Market regulator Securities and Exchange Board of India is said to have urged the government to reconsider how buybacks are taxed. This is because only a small fraction of shareholders participate in buybacks, but the tax bill — in the current form — is borne by all shareholders. Gilda believes there is merit in transferring the tax liability to shareholders.

"Given the intent to bring parity with the tax on dividends and the fact that dividends are now taxable in the hands of the recipient, the government can consider moving back the tax on buybacks to the hands of the recipient," he said.