20% tax on buyback has companies with high promoter stake in a fix

Firms will pay higher tax, but buybacks will be more tax-friendly over dividends for large shareholders

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The 20 per cent tax on share buyback introduced in the Union Budget 2019-2020 is likely to put companies with a high promoter shareholding in a dilemma.

While the move will add to the tax burden for companies, buybacks will still be more tax-friendly compared to dividends for shareholders, particularly promoters.

According to tax experts, the capital gains made by shareholders on tendering their shares in buybacks are not to be taxed. However, the total dividend income in excess of ₹10 lakh in a financial year attracts 10 per cent tax at the hands of shareholders. Promoters and other large shareholders with high dividend income will have to pay the additional tax.

"After the buyback-related tax is paid by the company, the amount received by the shareholder is free from any further incidence of taxation," said S R Patnaik, partner & head (taxation), Cyril Amarchand Mangaldas.

"For promoters with cash-flow problems, they may still look at buyback as a more viable option," he added.

Bhavin Shah, partner and leader (financial service tax), PwC India, also pointed out the tax benefit a shareholder has in the case of a buyback. "Even after the applicability of buyback distribution tax to listed companies, buyback may still be tax efficient for promoters as there is no additional tax liability on the distributed income in the hands of shareholder, unlike in case of dividend," he said.

Under the current framework, the dividend distribution tax (DDT) borne by the company is effectively taxed at the rate of 20.56 per cent. Experts say that after adding for surcharge and other levies, buyback tax will be effectively charged at 22-23 per cent, marginally higher than DDT.

Buybacks have become popular since 2016-17, following imposition of DDT of 10 per cent, which was in addition to the DDT borne by the company that offered the dividend.

Between the financial years 2017 and 2019, companies acquired ₹1.3 trillion worth of shares through the buybacks, which became a preferred route for cash-rich companies to return capital to their shareholders.

At a tax rate of 20 per cent, these buybacks would have attracted a tax liability of ₹26,789 crore.

Information technology (IT) companies in particular have been extensively using buybacks in the past few years. Analysts say IT firms with high promoter holding might continue with their buyback programmes.

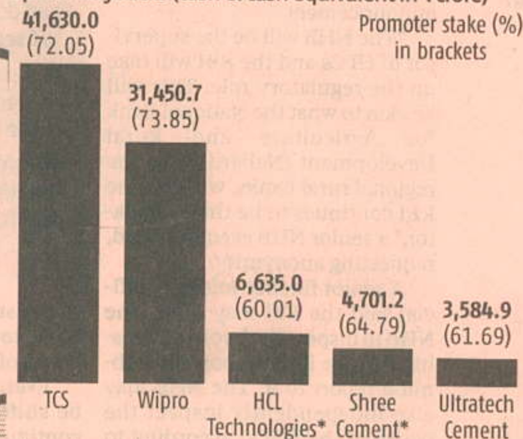
"While this (buyback tax) will increase the cash outflow for IT services companies that have been announcing buybacks, we understand that this may still be preferred over dividends (at least for companies where the promoter stake is high)," said Morgan Stanley in a note.

Some of the major IT firms where promoter stake is high include Tata Consultancy Services (72 per cent promoter stake), Wipro (73 per cent) and HCL Technologies (60 per cent).

In the past two years, TCS has returned 60 per cent of cash to shareholders through buyback, while 40 per cent has been paid through dividends. In the case of Wipro, the proportion of buyback in the same period is much higher at 90 per cent, a report by Kotak Institutional Equities stated.

TCS launched a large buyback programme of ₹16,000 crore in 2018-2019. If the buyback tax was applied back then, the tax expenses for TCS for the year would have been over ₹3,000 crore. In 2018-19, companies acquired shares worth ₹47,000 crore through the buyback route, showed data from Prime Database.

BALANCING ACT



*Companies yet to disclose FY19 financials, data available for FY18
Source: Capitaline