Buybacks make a comeback

India Inc shifts towards repurchase programmes in FY21 after change in tax structure

SAMIE MODAK
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ILLUSTRATION: BINAY SINHA

Share buybacks made a strong comeback in financial year 2020-21 (FY21) as tax considerations have once made India Inc favour this route for rewarding shareholders.

In FY21, India Inc offered to buy back shares worth ₹39,295 crore (actual amount acquired stood at ₹34,624 crore), a whopping 97 per cent rise more than the ₹19,972 crore (actual amount acquired was ₹17,843 crore) proposed in the previous year.

Furthermore, the share of buybacks in the total shareholder reward kitty (dividend plus buyback) rose to 21 per cent in FY21 from 8.3 per cent the previous year, an analysis of data provided by Prime Database shows.

"Buybacks have emerged as a popular option for companies that have excess cash sitting on their balance sheets to reward shareholders who may be looking for an exit while at the same time allowing the company to recapitalise and improve the relative returns for existing shareholders," said Karan Marwah, partner and head — capital markets advisory of KPMG in India.

To be sure, dividend numbers might have been slightly depressed in FY21 as some companies, banks in particular, refrained from paying dividends in the wake of the Covid-19 pandemic. As a result, the total dividend kitty shrank by over 30 per cent.

The ₹9,200-crore buyback announced by tech major Infosys, however, shows that India Inc could continue to make use of this route in the current financial year.

"From April 1, 2020, dividends are taxed in the hands of shareholders. Previously, dividends received by shareholders were made tax-free in their hands, as the company was subject to dividend distribution tax (DDT). On the other hand, capital gain on the buyback on or after July 5, 2020, is exempt in the hands of shareholders. Therefore, buyback is a much better way to reward investors," said Vineet Nagla, partner, White & Brief Advocates.

Between FY17 and FY19, buybacks had gained currency as corporates looked to explore tax arbitrage between buybacks and dividends. To plug the loophole, the Centre introduced a 20 per cent buyback tax in FY20. This led to a 68 per cent slump in buybacks that year.

Though the 20 per cent buyback tax remains, the net tax paid by shareholders on dividends received has shot up as it is now taxed according to individual tax slabs, which in some cases can be in excess of 40 per cent. This tilted the scale somewhat in favour of share repurchase programmes during the just-concluded financial year.

"Dividends impact promoters and significant shareholders with an additional tax burden of 20-30 per cent over a buyback. No reason why shareholders would want to bear that burden, especially companies with large promoter or investor shareholding," said Praveen Raju, partner, Spice Route Legal.

While buybacks may make more sense from a taxation point of view, they can be difficult to execute from a regulatory standpoint.

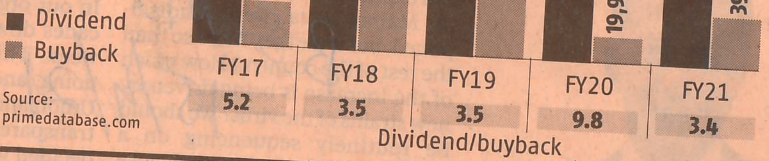
"The decision for a company to either declare a dividend or go for a buyback is a function of multiple factors such as current stock price, market capitalisation, existing debt structure, and legal restrictions," said Prashaant Rajput, also a partner at White & Brief Advocates. "Companies in sectors such as technology, which have a low debt-to-equity ratio, high net cash levels, and high payout ratios, are more inclined towards share buybacks."

According to Sebi's rules, companies with high debt-to-equity ratios cannot opt for share buybacks. Also, the buyback amount cannot exceed a fourth of paid-up capital and free reserves.

REWARD SHARE

Buybacks are gaining prominence

(in ₹ cr)



Source: primedatabase.com

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