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**CVO Chartered  
& Cost  
Accountants'  
Association**

Established 1973

*Enhance Excel Empower*

**To,  
The Chairman,  
The Central Board of Direct Taxes,  
New Delhi**

Dt. 30<sup>th</sup> July 2016

**Respected Sir,**

***Re: Suggestion on draft rules for prescribing manner of determination of amount received by company in respect of buy back of shares taxable u/s Section 115QA of the Income Tax Act, 1961***

#### **About CVO Chartered & Cost Accountants' Association**

CVO Chartered & Cost Accountants' Association is four decade old, non-profit professional organization established in 1973. It has acclaimed a premier position in the society. It's objective is to disseminate knowledge in the field of Taxation, Accounting, Finance and allied laws. Its members are in practice, serving in industry and also entrepreneur. Members of the Association have acclaimed respectable position in the practise and industry where they serve. It also organises general public awareness program. One of the flagship programmes is on Union Budget, which organised in Gujarati language for general public. Around 500-700 people usually attend it. The Association also publishes monthly Newsletter which is called 'CVO CA News & Views'. Besides these activities Association also supports students who are pursuing CA, CS & CWA by providing them financial assistance in the form of scholarships and interest free loans.

**SUGGESTIONS**

Draft Rules for prescribing the manner of determination of amount received by the company in respect of share - section 115QA, illustrates seven circumstances for determination of the amount received by the company. We appreciate consultative approach and the effort put in to provide clarity and remove ambiguity. However, it is observed that undermentioned scenarios has not been specifically dealt in the draft rules. In case these scenarios are intended to be covered under the residuary category it may create dichotomy and uncertainty under these circumstances:

- **Shares issued in lieu of services rendered**

The share issued in consideration for the services rendered by the employees (or directors) of the company, generally known as the Employee Stock Options is not specifically dealt by the Draft Rules. Generally shares are issued in lieu of services rendered and no paid up amount is received

Further the sweat equity shares issued under Employee Stock Option Scheme (ESOP) are taxable in the hands of the employees u/s 17(2)(vi) at the fair market value. The fair market value of shares of such shares at the time of exercise of the option, may be deemed as amount received by company, irrespective of the accounting treatment. It may otherwise lead to a double taxation as FMV of such shares was already included in total income.

- **Shares issued in lieu of purchase of an asset or an undertaking**

The shares issued to discharge consideration for purchase of an asset or an undertaking is not specifically dealt by the Draft Rules.

- **Conversion of preference shares into equity shares**

The shares issued in case of conversion of preference share into equity shares or split of one share into multiple share or combination of multiple shares into one share is not specifically dealt by the Draft Rules.

You may appreciate that in case of equity shares which are issued in lieu of conversion of preference shares there is no amount received for issue of **such** shares (i.e. the equity shares). Similarly, no amount would have been received for shares which are issued in case of share split or consolidation of shares.

Considering the language of para 6, it may interpreted that, in case of conversion of preference share or other scenarios stated above, the amount received by the company on issue of equity shares may be taken as Nil. In turn taxing the entire amount distributed by the company.

- **Conversion of Loan into shares**

Issue of shares in case of conversion of loan is not specifically dealt by the Draft Rules. **Para 7** of the Draft Rules explicitly covers conversion of the debenture or bond into shares. However, loan / other payable being converted into shares is not specifically dealt by the Draft Rules.

- **Shares issued in case of conversion of sole proprietary or firm into company**

The shares issued in case of conversion of sole proprietary concern or firm into company is not specifically dealt by the Draft Rules.

- **Treatment of shares held in 'de-materialised' form**

In case of certain unlisted companies, shares could be held in a dematerialised format. In such situation, it would not be possible to identify specific shares tendered under the buy-back. Therefore, it may be clarified that 'amount received' in respect of shares held in dematerialised format should be determined on a "Fist In First Out" (FIFO) basis.

- **Bonus shares**

According to Para 6, as bonus shares being allotted without any consideration the value of bonus shares shall be deemed to be Nil.

Assuming this to be correct, consider a situation where the share has been issued by the company for Rs. 1000 (face value Rs. 100 and premium Rs. 900). If the company issues bonus share in the ratio of 1:1 and subsequently the company makes an offer to buy back shares for a consideration of Rs. 500 per share.

At first blush one may say that the company had received Rs. 1000 and paying back Rs. 1000 (Rs. 500 x 2 shares) there should be no taxation. However, consider the Draft rules, the taxation may be as under –

<b>Particular</b>	<b>Original Share</b>	<b>Bonus Share</b>	<b>Relevant Para of Draft Rules</b>
Consideration Paid	500	500	Para 1
Less: amount received	1000	0	Para 6
Distributed Income	(-) 500	500	

As can be observed from above example, para 6 of the Draft Rules may lead to taxation of the notional income. Hence para 6 need to appropriately modified to mitigate taxation of the notional income

Thanking You,

Yours Sincerely,

For CVO Chartered and Cost Accountants Association

CA Ketan N Gada  
President

CA Paras Savla  
Chairman, Publication and Representation Committee