CVO Chartered & Cost Accountants' Association

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Date 11.04.2017

To,
The Director of Income-tax
TPL-2, Ministry of Finance,
New Delhi.

Dear Sir,

Re: Representation on draft of Notification to be issued under third proviso to the clause (38) of section 10 of the Income-tax Act, 1961

Dear Sir,

With respect to the draft notification issued under third proviso to section 10(38) is, in principle, a step in the right direction to curb abuse of tax provisions. We would like to suggest a few changes to the same in order to bring greater clarity and prevent unnecessary and unintended harassment to genuine investors as under:

1. Issue–

Under clause (b), the intention of the Legislation seems to capture purchase of existing shares of listed securities done off-market and not issue of new shares by a SEBI recognized mechanism (IPOs, FPOs, bonus issue, conversion, ESOPs etc.). The language of clause (b) needs to be suitably amended to reflect this intention and meaning of the term "purchase" needs to be clarified.

Justification

a. ESOPs

An employee can receive employee stock option compensation in any of the following manners:

i) Difference between the prevailing market price of the share and the agreed price is paid in case to the employee;
ii) New shares are issued by the company to the employees based on an agreed price that is generally at a discount as compared to the prevailing market price of the shares; and
iii) The employee purchases the shares from a trust formed by the company at a discounted price as compared to the prevailing market price of the shares.

Mostly, the employees in scenario i) and ii) may not face any trouble. However, the employees in scenario iii) would have purchased shares from the trust at a discounted price and as the transaction would be at a discounted price the transaction would not be through the stock exchange.

b. Others

When shares are issued as per the approval / guidelines of competent authority i.e. SEBI applicability of these provisions to such issues would lead to unintended consequences

2. Issue-

While press release does mention inter alia "acquisition by non-resident in accordance with FDI policy of the Government" to be one of the genuine cases which needs to be protected, clause (b) of the draft notification seems to indicates acquisition by non-resident which will not be entitled to 10(38) exemption.

Justification

Accordingly, it needs to be clarified that condition of applicability of STT shall not be applicable to such genuine transaction of foreign investment through a recognized approved regulatory mechanism (viz. FDI by non-resident investors, by SEBI registered Foreign Venture Capital Investor, Alternative Investment Fund, Venture Capital Fund, Qualified Institutional Placement etc).

Hence any issue which is subject to regulatory approval should be out of the ambit of these provisions

3. Issue-

In case of various genueine enumerated transactions no STT is otherwise payable.

a. Employee offer for sale;
b. Third party off market acquisition of shares of Listed Company by strategic investors, by way of purchase, exchange, say against business transfer, group restructuring;
c. Equity shares acquired pursuant to group restructuring scheme;
d. Settlement of dues under debt restructuring; and
e. Inter-se transfer of equity shares between promoters
f. Equity shares acquired in company which was not listed on the date of its acquisition
g. Equity shares acquired through any of the transactions which are exempt under section 47 of Income Tax Act.
h. Equity shares of a listed company issued pursuant to sale of business to such listed company.
i. Equity shares issued pursuant to rights issue.

Justification

These genuine transactions need to be exempted from the condition of applicability of STT on purchase/ acquisition. Tax payer would be subject to tax on sell of securities even if these transaction are genuine.To avoid such ambiguity, it is recommended to expressly clarify the intention of the legislature which is even brought out in paragraph 2 of the press release dated April 3, 2017, calling for the suggestion on for the Notification ought to be issued u/s 10(38).

4. Issue–

Through a specific explanation, it should be clarified that – "Purchase would not include the issue of equity shares by the Company."

Justification

When shares are subscribed, say in an FPO, monetary consideration is paid for the subscription. Hence, two views would be possible –

i) For a transaction to be classified as purchase there has to be a seller and in case of FPO the company is issuing shares and there is no seller; alternatively

ii) One may argue that the treatment in the hands of the company is not relevant[1], the buyer has paid a monetary consideration and got the shares against such payment therefore, the transaction ought to be classified as a purchase by the buyer.

To avoid such ambiguity, it is recommended to expressly clarify the position.

We look forward for your consideration of the same.

Thanking You,

Yours Sincerely,

For CVO Chartered and Cost Accountants Association

CA Ketan N Gada	CA Paras Savla
President	Chairman, Publication and Representation Committee

[1]Supreme Court in the case of CIT v. Kamal BehariLalSingha[1971] 82 ITR 460 (SC) has held that – In order to find out whether a receipt is a capital or revenue receipt, one has to see what it is in the hands of the receiver and not its nature in the hands of the payer. In other words, the nature of receipt is determined entirely by its character in the hands of the receiver and the source from which the payment is made has no bearing on the question.