

The Changing Taxation of Buy-backs in India



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Evolution of Share Buy-backs

1. Share buy-backs, also known as share repurchases, are corporate actions in which a company reacquires its own outstanding shares from existing shareholders, reducing the number of shares available in the market. As a capital management tool, buy-backs enable companies to optimise their capital structure, enhance shareholder value, and deploy surplus cash in a tax-efficient manner.
2. Historically, dividends were the primary mechanism for distributing corporate profits, while share buy-backs were relatively uncommon and, in many jurisdictions, restricted due to concerns over potential market manipulation. A significant shift occurred in 1982 when the U.S. Securities and Exchange Commission introduced Rule 10b-18¹, providing a safe harbour for share repurchases and regulatory certainty for companies undertaking buy-backs.
3. Following this development, buy-backs emerged as a major means of returning capital to shareholders. Between 2003 and 2012, S&P 500 companies allocated approximately 54% of their net earnings to share repurchases, compared to 37% distributed as dividends². The growing acceptance of buy-backs was also reflected globally, with jurisdictions such as the United Kingdom, Japan and India introducing statutory frameworks by the late 1990s permitting share repurchases, subject to safeguards for shareholder protection and market integrity.
4. In India, buy-backs were originally prohibited under the Companies Act, 1956³ ("**CA, 1956**"). Recognising their importance as a legitimate corporate finance and capital restructuring tool, the legislature introduced enabling provisions in 1998⁴, permitting companies to repurchase their shares and empowering the Securities and Exchange Board of India ("**SEBI**") to establish a regulatory framework for such transactions. Since then, buy-backs have become a widely used mechanism for capital allocation, enabling companies to optimise capital structures, return surplus cash to shareholders, and signal confidence in their future prospects.

Corporate and Regulatory Framework Governing Share Buy-backs in India

5. Currently, share buy-backs in India are governed by the Companies Act, 2013 ("**CA, 2013**") and the Securities and Exchange Board of India (Buy-Back of Securities) Regulations, 2018 ("**Buy-back Regulations**"), which prescribe conditions for undertaking buy-backs, including limits on the quantum of repurchases, approval requirements, permissible funding sources, disclosure obligations, and post buy-back leverage thresholds. SEBI has also strengthened the regulatory framework in recent years by enhancing transparency requirements and increasing the minimum utilisation threshold for open-market buy-backs from 50% to 75%⁵.
6. Section 68 of the CA, 2013 sets key conditions for buy-back, including a 25% cap on paid-up capital and free reserves, restriction to fully paid-up securities, and a post buy-back debt-equity ratio generally not exceeding 2:1. The buy-back must be completed within one year of the approving resolution. The law also mandates the transfer of the nominal value of repurchased shares to the Capital Redemption Reserve⁶ and the extinguishment of bought-back shares, thereby balancing corporate flexibility in capital management with the protection of shareholder and creditor interests.

Taxation of Buy-backs in India

I. Pre-2013 Era- Capital Gains Tax in Shareholders' Hands

7. Historically, Section 77 of the CA, 1956, prohibited companies from purchasing their own shares to preserve capital. This position changed in 1998 with the introduction of section 77A, which permitted buy-backs. To address tax implications, section 46A was inserted⁷ in the Income-tax Act, 1961 (applicable till March 31, 2026) ("**1961 Act**").

Under this regime, buy-back proceeds were treated as capital gains in the hands of shareholders. At the same time, section 2(22)(iv) of the 1961 Act excluded such payments from the definition of “dividend.” As a result, the tax liability rested entirely with the shareholders based on their holding period and cost of acquisition.

II. Buy-back Tax (Section 115QA) Payable by Unlisted Companies (2013 amendment)

8. As companies began favouring buy-backs over dividends to avoid Dividend Distribution Tax (“DDT”), the Government intervened to address this perceived tax avoidance. Unlisted companies, in particular, were using buy-backs instead of payment of dividends in order to avoid payment of DDT, particularly where the capital gains arising to the shareholders are either not chargeable to tax or are taxable at a lower rate.
9. The Finance Act, 2013, introduced section 115QA in the 1961 Act, mandating an additional income tax of 20% (plus surcharge and cess) on the distributed income of unlisted companies on buy-back of shares. Distributed income was defined as the consideration paid by the company on buy-back, minus the amount originally received upon the issuance of shares. Once this tax was paid, the proceeds were exempt in the hands of the shareholders under section 10(34A) of the 1961 Act.

III. Extension of Buy-back Tax to Listed Companies (2019 amendment)

10. By 2019, the Government observed that listed companies were also adopting buy-back strategies to provide tax-efficient exits to shareholders. Consequently, the Finance (No. 2) Act, 2019, extended the 115QA tax regime to listed companies, creating uniform taxation for all corporate buy-backs⁸.

IV. Buy-back Proceeds as Deemed Dividends (2024 amendment)

11. The Finance (No. 2) Act, 2024, introduced a significant shift, characterising buy-back proceeds as deemed dividends⁹ taxable in the hands of shareholders at the applicable rates. It effectively discontinued the buy-back distribution tax under Section 115QA and introduced a new framework in which the consideration received by shareholders on buybacks was treated as deemed dividend income. The Memorandum to the Finance (No. 2) Bill, 2024 states that, since dividends have been taxable in shareholders’ hands following the abolition of DDT in 2020, buy-backs, being a similar mode of distributing accumulated reserves, should also be taxed in the hands of shareholders.
12. As a result, such receipts became taxable in the hands of shareholders under the head “Income from Other Sources¹⁰”. Resident shareholders were required to pay tax on this income at their applicable slab rates, while non-resident shareholders became subject to withholding tax, subject to relief under relevant tax treaties¹¹.
13. Further, to address the potential inequity of taxing the gross receipt without reducing the investment cost, the amendment also provided that the shareholder would be entitled to claim the cost of acquisition of the shares as a capital loss. This loss could then be set off against any other capital gains or carried forward in accordance with the provisions of the Income-tax law.

V. Returning to Capital Gains (2026 amendment)

14. The Finance Act, 2026 amended¹² Section 69 of the Income-tax Act, 2025 (“2025 Act”) by restoring the taxation of buy-back proceeds as capital gains instead of dividends. As a result, shareholders are taxed only on the net gain (i.e., buy-back consideration less the cost of acquisition), addressing concerns under the 2024 deemed-dividend regime where tax was imposed on the gross buy-back proceeds. Significantly, the amendment introduces a differentiated tax framework for promoters and promoter companies, under which gains arising from buy-backs are subject to an effective tax rate of 30% in the hands of promoters and 22% in the case of promoter companies.

15. The table below summarises the evolution of the taxability of share buy-backs in India:

S.No.	Time Frame	Relevant Provision	Type of Securities	Tax Treatment at Company Level	Tax Treatment for Shareholders & Applicable Rates ¹³
1.	Up to May 31, 2013	Section 46A of the 1961 Act	Listed & unlisted shares, and specified securities	No tax liability at the company level	Taxed as Capital Gains. ➤ Long-term Capital Gains (“LTCG”) ▪ Unlisted Shares taxed @20%; ▪ Listed Shares exempt under Section 10(38) (subject to Securities Transaction Tax) ➤ Short-term Capital Gains (“STCG”) ▪ Unlisted Shares taxed at slab rates; ▪ Listed Shares taxed @15% under Section 111A

2.	June 01, 2013 – July 04, 2019	Section 115QA of the 1961 Act (introduced)	Unlisted shares	Buy-back Tax (“BBT”) payable @20% (plus surcharge and cess)	Exempt under Section 10(34A) of the 1961 Act
3.	July 05, 2019 – September 30, 2024	Section 115QA (extended to listed companies)	Listed and unlisted shares	BBT payable @20% (plus surcharge and cess)	Exempt under Section 10(34A) of the 1961 Act
4.	October 01, 2024 – March 31, 2026	Section 2(22)(f) + withdrawal of Section 115QA of the 1961 Act	Listed and unlisted shares	No company-level taxation	Taxable as deemed dividend at applicable slab rates under “Income from Other Sources”
5.	April 1, 2026, onwards	Section 69 of the 2025 Act	Listed and unlisted shares	No company-level taxation	Taxable as capital gains : ➤ Non-Promoters : STCG @20% and LTCG @12.5% ➤ Promoter- Domestic Companies : 22% ➤ Promoter- Others : 30%

16. Further, shift in the domestic characterization of buy-back proceeds has implications under tax treaties, particularly in determining whether such receipts are governed by the Dividend Article or the Capital Gains Article.

An Analysis under the Tax Treaty Framework

17. The Finance Act, 2026 reshapes the treaty analysis of buy-back transactions by restoring the capital gains character of buy-back proceeds and reversing the deemed-dividend regime introduced in 2024. As a buy-back involves the extinguishment of shareholder rights and constitutes an “alienation” of property, the amendment aligns domestic law more closely with the legal and economic substance of the transaction and strengthens the application of the Capital Gains Article under tax treaties. However, the precise treaty outcome continues to depend on the wording of the relevant treaty. While the 2024 deemed-dividend regime prompted non-resident shareholders to invoke the Dividend Article to access reduced withholding tax rates, the 2026 amendment shifts the analysis back to capital gains, necessitating a treaty-specific examination of the applicable provisions:

(i) **India-UK Tax Treaty**: Previously, since domestic law treated buy-backs as dividends, they could fall under Article 11(3)¹⁴ of the India-UK tax treaty, which includes items subject to the same tax treatment as income from shares; accordingly, the tax rate applicable to Dividends under the tax treaty would apply to buy-back consideration received by a non-resident shareholder.

After the 2026 amendment, since the domestic law itself treats buy-backs as capital gains, the Capital Gains Article (Article 14¹⁵) would likely prevail, allowing India to tax these gains strictly in accordance with its domestic law.

(ii) **India-Mauritius Tax Treaty**: Even under the 2024 regime, there was a strong argument that buy-back proceeds fell outside Article 10 (Dividends) of the India-Mauritius tax treaty. Article 10(4) defines the term “dividends” to mean **income from shares or other corporate rights** which is subjected to the same taxation treatment as income from shares under the laws of the State of which the company making the distribution is a resident. Since buy-back consideration is received on the extinguishment of shareholder rights and not by virtue of any continuing corporate right, it could be argued that such proceeds are more appropriately characterised under Article 13 (Capital Gains).

Following the Finance Act, 2026, the treaty position is considerably clearer. As domestic law now treats buy-back proceeds as capital gains, they should be governed by Article 13 of the India-Mauritius tax treaty. Accordingly, while the 2024 regime gave rise to uncertainty in characterisation, the 2026 amendment reinforces the capital gains treatment of buy-back transactions.

(iii) **India-US Tax Treaty**: Even under the erstwhile regime, there was a strong argument that buy-back proceeds did not qualify as “dividends” under Article 10(3) of the India-US tax treaty, which defines **dividends as income from shares or other corporate rights subject to the same taxation treatment as income from shares**. Since buy-back consideration arises from the extinguishment of shareholder rights, it could arguably fall outside the Dividend Article. However, the applicability of Article 13 (Capital Gains) was also uncertain, as the treaty does not define the term “alienation”.

After the 2026 amendment, because domestic law itself treats buy-back proceeds as capital gains, there is a stronger basis for characterising such proceeds under Article 13 of the India-US tax treaty.

Conclusion: A Return to First Principles, But Not Yet to Certainty

18. The Finance Act, 2026 marks a welcome return to first principles in the taxation of share buy-backs. By abandoning

the deemed dividend regime introduced in 2024 and restoring capital gains treatment, the legislature has realigned tax outcomes with the legal and economic nature of a buy-back as an extinguishment of shareholder rights. The amendment permits taxation on a net basis by deducting the acquisition cost; it reduces treaty characterisation disputes, and generally restores a more coherent and internationally aligned framework.

19. However, the reform must be viewed against the backdrop of India's evolving buy-back tax regime. The shift from capital gains taxation to a company-level buy-back tax, to deemed dividend treatment, and now back to capital gains within a relatively short period reflects a degree of policy volatility undermining certainty for investors. Frequent legislative changes require repeated reassessment of distribution strategies, tax costs, and treaty positions, increasing compliance burdens and reducing predictability.
20. The impact has been particularly significant for foreign investors. While the 2026 amendment substantially mitigates treaty characterisation challenges due to the 2024 regime, some uncertainty remains because the treatment of buy-back proceeds as capital gains continues to depend largely on individual treaty interpretation, rather than on an express statutory provision. In this regard, a model solution may be found in the FPI regime, wherein section 2(14) of the Income-tax Act conclusively characterises securities held by FPIs as capital assets. A similar deeming provision for buy-back consideration could strengthen certainty and reduce litigation by avoiding treaty-specific characterisation.
21. Ultimately, the 2026 reforms represent a significant improvement in both principle and policy design. Yet, for investors, certainty is often as important as the substantive tax outcome itself. The long-term success of the regime will therefore depend not only on the restoration of capital gains treatment but also on the government's ability to provide a stable, predictable framework free from further oscillations.

¹ Rule 10B-18 is a Securities and Exchange Commission (SEC) rule that is intended to reduce liability for companies (and their affiliated purchasers) when the company repurchases shares of the company's common stock.

² How the US Taxes Stock Buy-backs and Dividends by Caroline Osborn - <https://bipartisanpolicy.org/explainer/how-the-u-s-taxes-stock-Buy-backs-and-dividends/>

³ Section 77 of the Companies Act, 1956

⁴ Share Buy-backs were first officially allowed in India when the Companies (Amendment) Act, 1999 introduced Section 77A into the old Companies Act, 1956

⁵ Chapter IV, Regulation 15(i) of the Securities and Exchange Board of India (Buy-Back of Securities) Regulation, 2018

⁶ Section 69(1) of the CA, 2013

⁷ Inserted by the Finance Act, 1999, w.e.f. April 1, 2000

⁸ Para 6.15, Budget 2019-20, Speech of Minister of Finance dated July 05, 2019

⁹ Insertion of clause (f) in Section 2(22) of the 1961 Act w.e.f. October 1, 2014

¹⁰ Section 56 of the 1961 Act

¹¹ As per Section 90 of the 1961 Act, where India has entered into a tax treaty with another country and both jurisdictions possess taxing rights over a particular income, the provisions of the Act or the treaty, whichever are more beneficial to the taxpayer, shall prevail.

¹² Clause 42 of the Finance Act, 2026

¹³ Rates are exclusive of applicable surcharge and cess

¹⁴ Article 11(3) of India-UK DTAA: The term "dividends" as used in this Article means income from shares, or other rights, not being debt-claims, participating in profits, as well as any other item which is subjected to the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

¹⁵ Article 14 of India-UK DTAA: Except as provided in Article 8 (Air Transport) and 9 (Shipping) of this Convention, each Contracting State may tax capital gains in accordance with the provisions of its domestic law.