

आयकर अपीलिय अधिकरण, 'ए' न्यायापीठ, चेन्नई
IN THE INCOME TAX APPELLATE TRIBUNAL
'A' BENCH, CHENNAI

श्री एस एस विश्वनेत्र रवि, न्यायिक सदस्य एवं श्री एस. आर. रघुनाथ लेखक सदस्य के समक्ष
BEFORE SHRI S.S. VISWANETHRA RAVI, JUDICIAL MEMBER AND
SHRI S. R. RAGHUNATHA, ACCOUNTANT MEMBER

आयकर अपील सं./ITA No.:1339 /Chny/2025
निर्धारण वर्ष / **Assessment Year: 2017-18**

M/s. Updater Services Limited (formerly known as Updater Services Private Limited), No.2/302-A, UDS Salai, Off Old Mahabalipuram Road, Thoraipakkam, Chennai – 600 097.	vs.	DCIT, Central Circle -2(3), Chennai.
[PAN:AAACU-6845-J] (अपीलकर्ता/Appellant)		(प्रत्यर्थी/Respondent)

आयकर अपील सं./ITA No.: 1616/Chny/2025 &
C.O.No.66/Chny/2025 (in ITA No.: 1616/Chny/2025)
निर्धारण वर्ष / **Assessment Year: 2017-18**

DCIT, Central Circle -2(3), Chennai.	vs.	M/s. Updater Services Limited (formerly known as Updater Services Private Limited), No.2/302-A, UDS Salai, Off Old Mahabalipuram Road, Thoraipakkam, Chennai – 600 097.
(अपीलकर्ता/Appellant)		[PAN:AAACU-6845-J] (प्रत्यर्थी/Respondent/ Cross Objector)

Assessee by : Shri. K. Prasanna, C.A.
Department by : Ms. E. Pavuna Sundari, C.I.T.

सुनवाई की तारीख/Date of Hearing : 20.08.2025
घोषणकी तारीख/Date of Pronouncement : 14.11.2025

आदेश /ORDER

PER S. R. RAGHUNATHA, AM:

These appeals filed by the assessee and revenue and cross objections filed by the assessee are directed against the order of the learned Commissioner of Income Tax (Appeals), Chennai, (in short "Id.CIT(A)") for the assessment year (A.Y.) 2017-18, vide order dated 27.03.2025. Since, facts are

identical and issues are common, for the sake of convenience, these appeals filed by the assessee and revenue are being heard together and disposed of by this consolidated order.

2. The grounds raised by the assessee are as follows:

ITA 1339/Chny/2025:

1. General

1.1 The order passed by the learned Deputy Commissioner of Income Tax, Central Circle 2(3), Chennai (learned AD) and to the extent confirmed by the Commissioner of Income-tax (Appeals) Chennai -19 (learned CIT(A)') under Section 250 of the Income Tax Act, 1961 (the Act) to the extent prejudicial to the Appellant is erroneous, bad in law, and contrary to the facts and circumstances of the case.

2. Non-applicability of Section 115QA of the Act

2.1 The learned CIT(A) erred in interpreting that the order of the jurisdictional ITAT against the directions of the Principal Commissioner of Income Tax under Section 263 of the Act curtails the rights of the Appellant to raise grounds on applicability of Section 115QA.

2.2 The learned CIT(A) failed to appreciate the fact that the Hon'ble Chennai ITAT has addressed only the grounds raised in respect of the jurisdictional validity of the revisionary proceedings and not the merits of the case.

2.3 The learned CIT(A) erred in law and facts by arriving at a conclusion merely relying on the observations of the learned AD and the learned Principal Commissioner of Income Tax and without independent examination / application of mind on the grounds raised by the Appellant.

2.4 The learned CIT(A) erred in law in applying the provisions of Section 115QA of the Act to buy-back of shares undertaken prior to 01 June 2016 under Section 391-394 of the Companies Act, 1956.

2.5 The learned CIT(A) erred in law in holding that the provisions of Section 77A of the Companies Act, 1956 apply to the buyback of shares undertaken by the Appellant under Section 391-394 of the Companies Act, 1956 without appreciating the fact that the limits, procedure, and compliances prescribed under both the regimes are different.

2.6 The learned CIT(A) failed to appreciate that the scheme approved by the Hon'ble Madras High Court is binding on them in all aspects, and the taxability has to be evaluated in light of the scheme approved and cannot be interpreted in a different manner.

2.7 The learned CIT(A) failed to appreciate the fact that the total amount of buy-back undertaken by the Appellant is not within the threshold prescribed under Section 77A of the Companies Act, 1956 and it can only be possible under a scheme of arrangement under Section 391-394 of the Companies Act, 1956.

2.8 The learned CIT(A) failed to appreciate the fact that the Appellant has challenged the levy of tax under Section 115QA and therefore the need to challenge the quantum/computation is not warranted.

2.9 The learned CIT(A) erred in law in holding that buy-back tax under Section 115QA of the Act would apply in respect of the said buy-back transaction.

3. The Appellant craves leave to add, alter, vary, omit, amend or delete one or more of the above grounds of appeal at any time before, or at the time of, hearing of the appeal.

3. The grounds raised by the revenue are as follows:

ITA 1616/Chny/2025:

1. The order of the learned Commissioner of Income Tax (Appeals) is erroneous on facts of the case and in law.

2 The LA CIT(A) erred in deleting the addition made on account of transaction considered under section 56(2)(via) without appreciating the fact that there was a receipt of property, being shares of a company not being a company in which the public are substantially interested & the recipient was company not being a company in which the public are substantially interested & the transaction of receipt was with consideration which is inadequate consideration being the difference between the value of Rs. 607 per share and the transactional Rs.273 per share multiplied by the number of shares (20,75,000) of Rs.68,89,00,000/- ($607-275 \times 20,75,000/- = Rs.68,89,00,000/-$), as mandated by the provisions.

3. The Ld. CIT(A) erred in allowing the appeal of the assessee without appreciating that in a case of buyback of shares, shares being the property which exchanges hands from the transferor to the transferee, who had earlier issued the shares either for consideration which if found to be inadequate triggers the taxable event envisioned under Section 56(2)(via).

4. The Ld.CIT(A) erred in allowing the appeal of the assessee without appreciating the section does not foresee that the property reverend should become the property of the recipient as such a condition is neither inbuilt nor needs to be built in, when one takes into consideration the intention of the legislature for having brought in section 56(2) (via), which is an anti-abuse provision.

5. The Ld.CIT(A) erred in allowing the appeal without appreciating that that all the ingredients necessary to trigger the tax incidence are present in the transaction in question to attract the provisions of section 56(2) (via) i.e., inadequate consideration being the difference between the value of Rs.607 per share and the transaction value of Rs.275 per share multiplied by the number of shares (20,75,000), The amount worked out to R. 68,89,00,000/- ($607-275 \times 20,75,000/- = Rs.68,89,00,000/-$)

6. *The Ld. CIT(A) erred in allowing the appeal by deleting the Disallowance of proportionate interest u/s.36(1)(iii) of the IT Act on amount paid of Rs.57,06,25,000/- to the sister concern company to buy back the shares at the rate of 10% - Rs.5,70,62,500/-*

7. *The Ld.CIT(A) erred in allowing the appeal without appreciating that as per the Proviso to 36(1)(iii) of the IT Act any amount of interest paid, in respect of capital borrowed for acquisition of an asset (whether capitalized in the Books of Accounts or not) for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use shall not be allowed as deduction.*

4. The grounds raised by the assessee in **CO No.66/Chny/2025** are as follows:

1. Non-applicability of Section 56(2)(viiia) of the Act

1.1 *The Commissioner of Income Tax (Appeals) Chennai-19 ('learned CIT(A)'), after duly examining the facts of the case, rightly held that the provisions of Section 56(2)(viiia) of the Income Tax Act, 1961 (the Act') would not be applicable for buyback of own shares by a company.*

1.2 *The learned CIT(A) has rightly held that the legislative intent behind the provisions of Section 56(2)(viiia) of the Act was to prevent the transfer of unlisted shares at a value lower than the fair market value ('FMV') and the would not apply in case of buyback of own shares by a company.*

1.3 *The learned CIT(A) has in line with the observations made by coordinate benches and rightly held that buyback of own shares by a company would not be tantamount to receipt/ acquisition of any new asset/ property as envisaged under the provisions of Section 56(2)(viiia) of the Act.*

1.4 *The learned CIT(A) has rightly held that the fair market value of the shares bought back by the respondent when computed under the Net Asset value method as prescribed under Rule 11UA of the Income Tax Rules, 1962 is less than the buyback price and hence, the provisions of Section 56(2)(viiia) of the Act would not apply to the instant case.*

2. Non-applicability of Section 36(1)(iii) of the Act

2.1 *The learned CIT(A) duly examining the facts of the case rightly held that the provisions of Section 36(1)(iii) of the Act would not be applicable to the instant case.*

2.2 *The learned CIT(A) has rightly made a considered observation that buyback of own shares by a company would neither result in creation of any capital asset nor would result in any enduring benefit to the company and accordingly the application of the provisions of Section 36(1)(iii) of the Act to such cases is not warranted.*

- 2.3 *The learned CIT(A) after duly examining the facts of the case, has rightly observed that the Respondent had sufficient interest free equity funds, hence such funds were utilized for the buyback of shares and the same is in line with the principles upheld by the Hon'ble Apex Court*
3. *The Respondent craves leave to add, alter, vary, omit, amend or delete one or more of the above grounds of objections at any time before, or at the time of, hearing of the appeal.*

5. The brief facts of the case are that the assessee Updater Services Limited is engaged in the business of providing manpower and facility management services to various industries such as information technology, manufacturing, hospitality, catering services, etc. For the impugned assessment year, the assessee filed its return of income on 20.02.2018 declaring a total income of Rs. 28,44,80,180/-.

6. The return of income filed by the assessee was selected for scrutiny under Computer Assisted Scrutiny Selection ('CASS') and notice u/s.143(2) of the Act was issued by the AO on 21.08.2018. Further, survey u/s.133A of the Act was conducted at the business premises of the assessee between 12.02.2019 to 15.02.2019 and various documents, including explanation / clarification relating to buy back transaction, were sought and collated from the assessee.

7. As part of survey proceedings, a statement under oath was recorded wherein the details of buy-back undertaken by the assessee, the tax position adopted by the shareholders and valuation for the buy-back were recorded.

8. Subsequently, a notices u/s.142(1) of the Act was issued requiring the assessee to submit various information/documents as specified in the respective notices. Against the same, the assessee had submitted the details called for.

9. The AO passed the assessment order u/s.143(3) of the Act on 26.12.2019 with an addition of Rs.12,11,48,267/- u/s.36(1)(va) of the Act.

10. Against the above order of the AO, the Ld.PCIT issued a show cause notice dated 10.03.2021 u/s.263 of the Act and requested the assessee to show cause why the order u/s.143(3) of the Act cannot be treated as an order prejudicial to the interest of the revenue on account of the following observations:

- Applicability of Section 115QA of the Act to the transaction of buy-back of shares undertaken by the assessee during the assessment year under consideration.
- Applicability of Section 56(2)(via) of the Act to the transaction of buy-back of shares undertaken by the assessee during the impugned assessment year.
- Disallowance of proportionate interest relating to working capital loan, if any, utilized towards buy-back of shares during the subject, year.

11. The assessee objected to the proposal of the Ld.PCIT. However, the Ld.PCIT passed the order u/s.263 of the Act on 30.03.2022, directing the AO to redo the assessment considering the following observations: -

- The scheme of buyback approved by the Madras High Court under Section 391-394 of the Companies Act, 1956 squarely falls under Section 77A of the Companies Act, 1956 and hence the provisions of Section 11QA of the Act shall be applicable to the subject buy-back;
- Questioned the independence of the valuer by referring to subsequent valuations/transactions; and

- The assessee has not established that the factual matrix of the how the case of Vora Financial Service Private Limited (2018) (171 ITD 646) is applicable to the Respondent's facts.

12. Aggrieved with the order of the Ld.PCIT u/s.263 of the Act, the assessee filed an appeal before this Tribunal, which was dismissed by this Tribunal on 18.04.2023. Pursuant to the order of the Ld.PCIT u/s.263 of the Act, the AO passed the impugned assessment order u/s.143(3) r.w.s 263 of the Act with the following adjustments/additions:

- Levy of tax of Rs.11,06,17,190/- u/s.115QA of the Act;
- Addition of Rs.68,89,00,000/- u/s.56(2)(viiia) of the Act; and
- Disallowance of interest expenditure of Rs.5,70,62,500/- under Section 36(1)(iii) of the Act, being computed at 10% of the buyback value, i.e., Rs.57,06,25,000/-

13. Aggrieved with the above order of the AO, the assessee preferred an appeal before the Ld.CIT(A). Considering the submissions of the assessee, the Ld.CIT(A) passed an order on 27.03.2025. The outcome of the appeal / directions of the Ld.CIT(A) are as under: -

#	Grounds Raised	Result
1	Levy of tax under Section 115QA of the Act.	Dismissed (i.e., levy sustained)
2	Addition under Section 56(2)(viiia) of the Act	Allowed (i.e., addition deleted)
3	Disallowance of interest expenditure under Section 36(1)(iii) of the Act	Allowed (i.e., addition deleted)

14. Aggrieved by the above order of the Ld.CIT(A), the present cross appeals and cross objections are filed before us.

15. The Ld.AR, appearing on behalf of the assessee vehemently argued and filed the written submission as under: -

1. Background

- *Updated services Limited ('UDS' or 'the Company') is engaged in the business of providing manpower and facility management services to various industries such as information technology, manufacturing, hospitality, catering services, etc.*
- *In respect of the year under appeal, the Company's case was selected for scrutiny and notice under Section 143(2) of the Income Tax Act, 1961 ('the Act') was served on the Company on 21 August 2018.*
- *During the course of the assessment proceedings, survey under Section 133A of the Act was conducted at the business premises of the Appellant between 12 February 2019 to 15 February 2019 and various documents, including explanation / clarification relating to buy-back transaction, were sought and collated from the Appellant.*
- *Assessment order under Section 143(3) of the Act was passed on 26 December 2019 by the learned Assessing Officer ('learned AO') with an addition of INR 121,148,267 under Section 36(1)(va) of the Act.*
- *Subsequently, the learned PCIT passed a revision order under Section 263 of the Act on 30 March 2022, directing the learned AO to redo the assessment after taking note of the following observations (**refer pg no. 94 to 106 of the paperbook**):*
 - *The scheme of buyback approved by the Madras High Court under Section 391-394 of the Companies Act, 1956 squarely falls under Section 77A of the Companies Act, 1956 and hence the provisions of Section 115QA of the Act shall be applicable to such buy-back;*
 - *The Appellant has not established that the factual matrix of the how the case of Vora Financial Service Private Limited (2018) (171 ITD 646) is applicable to the appellant's facts.*
- *Giving effect to the order of the learned PCIT under Section 263 of the Act, the learned AO passed the order under Section 143(3) read with Section 263 of the Act on 30 March 2023 with the following adjustments (**refer pg no. 113 to 165 of the paperbook**)*
 - *Levy of tax of INR 11,06,17,190 under Section 115QA of the Act (being 20% of the distributed income as computed by the learned AO);*
 - *Addition of INR 68,89,00,000 under Section 56(2)(vii) of the Act; and*
 - *Disallowance of interest expenditure of INR 5,70,62,500 under Section 36(1)(iii) of the Act, being computed at 10% of the buyback value, i.e., 57,06,25,000*

- Pursuant to the appeal filed by the Company, the Hon'ble Commissioner of Income Tax (Appeals) (CIT(A)) passed an order under Section 250 of the Act dated 27 March 2025 (refer pg no. 199 to 287 of the paperbook) in the following manner:

	Grounds Raised	Result
1	Levy of tax under Section 115QA of the Act.	Upheld the Assessment Order
2	Addition under Section 56(2)(viiia) of the Act	Deleted the adjustments made by the AO
3	Disallowance of interest expenditure under Section 36(1)(iii) of the Act	

- Aggrieved by the order passed by the Hon'ble CIT(A), the Company and the Department has preferred an appeal before the Hon'ble Chennai ITAT in respect of the CIT(A) order.

2. Arguments before the Hon'ble bench

2.1. Adjustment made under Section 56(2)(viiia) of the Act (Ground No.1 of the Department Appeal)

- During the financial year (FY) relevant to the subject AY (i.e.FY 2016-17), the Company bought back 20,75,000 equity shares from one of its shareholders, Mis. Tangi Facility Solutions Private Limited through a scheme of arrangement under Section 391-394 of the Companies Act, 1956.
- The buyback was made at a price of INR 275 per share, resulting in total consideration of INR 57,06,25,000 (constituting 81.92% of the total paid up capital and free reserves) paid to the shareholders.
- In respect of the buyback undertaken by the Company, learned AO held that the fair market value of the shares bought back works out to INR 607 per share relying on a valuation carried out under "Discounted cash flow" (DCF) method.
- As the consideration paid by the Company (ie, INR 275 per share) is less than the FMV of the shares bought back determined under the DCF method, the learned AC proceeded with making an adjustment under Section 56(2)(viiia) for the differential price.

2.1.1. Buy back of its own shares do not constitute 'property u/s 56(2)(va)

- Section 56(2)(via) of the Act states that where a person receives any "property" without any consideration or for a consideration less than its fair market value (FMV) (determined in accordance with Rule 11UA of the Income Tax Rules, 1962), then the

difference between FMV of the property received and actual consideration paid shall be chargeable to tax if such difference exceeds INR 50,000.

- The term 'property' has been exhaustively defined in clause (d) of Explanation to Section 56(2)(vii). The relevant extracts of the same is produced below:
- “.....Property means the following **capital asset** of the assessee, namely:
 - (i) Immovable property being land or building or both;
 - (ii) Shares and securities
- From the above definition it is clear that for shares and securities to fall within the ambit of property as defined under Section 56(2)(vii), they must constitute a "capital asset" in the hands of the person receiving such shares.
- It is a well settled position that shares would constitute a capital asset only when they are shares of another Company (held as investment) and not own shares. Further, upon buyback of shares the capital of the Company stands reduced and the shares so bought back cannot be accounted as an investment (i.e., capital asset) in the balance sheet.
- The aforesaid position was affirmed by the **Hon'ble Mumbai Tribunal** in the case of **Vora Financial Services (P.) Ltd ([2018] 96 taxmann.com 88)** wherein the following observations were made by the tribunal (**refer para 31 & 32 of the judgment, page no. 121 of the case laws paper book**):
- Therefore, it follows the shares should become "property" of recipient company and in that case, **it should be shares of any other company and could not be its own shares. Because own shares cannot be become property of the recipient company.**
- In the instant case, the assessee herein has **purchased its own shares under buyback scheme and the same has been extinguished by reducing the capital and hence the tests of "becoming property and also "shares of any other company" fail in this case. Accordingly, we are of the view that the tax authorities are not justified in invoking the provisions of sec. 56(2)(vii) for buyback of own shares....."**
- Following the principles laid down in the ruling cited above, the **Hon'ble Chennai Tribunal** in the case of **Venture Lighting India Ltd. ([2023] 150 taxmann.com 523)** held as follows (**refer para 9 of the judgement, page no. 111 of the case laws paper book**):
- We have gone through the provisions of section 56(2)(vii) of the Act and from plain reading of section, it is clear that the same can be invoked only where the assessee receives a property for an inadequate consideration and in the present case before us, **the assessee company only brought back its own shares from its shareholder and there is reduction of share capital by such buyback and hence, this would not tantamount to purchase or acquire of any property as envisaged u/s 56(2)(vii) of the Act...."**
- Similar position has been adopted by venous tribunals in the following cases as well:

Name of judgement	Citation	Jurisdiction	Para No.	Reference case laws paperbook
Lupin Investments Pvt. Ltd. v. DCIT	ITA No. 4635/Mum/2024	Mumbai Tribunal	8 & 9	Pg. no. 126 to 129
DCIT v. Infrastructure Ltd.	ITA No. 6433/Del/2018	Delhi Tribunal	7	Pg. no. 138
VITP (P.) Ltd. v. DCIT	[2022] 143 taxmann.com 304	Hyderabad Tribunal	11 & 12	Pg. no. 144 and 145

2.1.2. Valuation undertaken by the Company is in adherence with Rule 11UA of the Income Tax Rules 1962 ('the Rules')

- To determine deemed income under Section 56(2)(viiia) of the Act, section prescribes a valuation methodology under Rule 11UA of the Rules. As per Rule 11UA(1)(c) provides that the FMV of unquoted shares for the purpose of Section 56(2)(viiia) shall be determined using the "Net Asset Value" ('NAV') method.
- However, the learned AO, to the contrary has adopted a valuation made as per DCF method and erroneously concluded that the FMV of the shares bought back for Section 56(2)(viiia) would be Rs.607 per share (**refer para 6.7 of the order passed by the learned AQ, pg no. 154 of the paperbook**).
- Therefore, the difference between INR 607 per share and the buyback price (i.e., INR 275 per share) was wrongly assessed as income under Section 56(2)(viiia) of the Act. The learned AO failed to note that the valuation of INR 607 determined under the DCF method is not in accordance with the valuation methodology prescribed under the Act.
- If one were to compute the FMV of the shares bought back under the NAV method as prescribed under Rule 11UA, it works out to INR 68.48 per share and the consideration paid by the Company is considerably higher than the same. (**refer pg. no 298 to 303 of the paperbook**)

2.1.3. Observations of the Hon the CIT(A) in this regard:

- The observations of the Hon'ble CIT(A) in the order passed has been summarized below (**refer para 6.3.11 and 6.3.12 of the CIT(A) order, pg no. 273 of the paperbook**):
 - The actual consideration paid by the Company (i.e., Rs. 275 per share) is significantly higher than the FMV of the shares determined as per Rule 11UA which works out to Rs. 68.48 per share.
 - Buyback being an internal corporate mechanism involving purchase and cancellation of its own shares by a Company, the same shall not fall within the purview of Section 56(2)(viiia).
 - Section 56(2)(viiia) being provisions enacted to regulate transfer of shares from one person to other below FMV, shall not apply to a buyback transaction (wherein a Company purchases its own shares).

- Relying on the rulings in the case of Vora Financial Services (P.) Ltd (Supra) and venture Lighting India Ltd (Supra), deleted the addition made under Section 56(2)(vii) of the Act.
- Basis the above submissions, we humbly request this Hon'ble bench to uphold the decision of the CIT(A) which is in line with the principles established by various other coordinate benches in this regard,

2.2. Disallowance under Section 36(1)(iii) of the Act (Ground no. 2 of the Department Appeal)

2.2.1. The Company was in possession of sufficient non-interest bearing equity funds

- Relying on an e-mail communication between the Company personnels and the tax consultant, the learned AO has concluded that the Company has utilized its working capital funds towards payment of the buyback consideration.
- Further, the learned AO proceeded to disallow a sum of INR 5,70,62,500 (being 10% of the total consideration paid by the Company) on an **ad-hoc** basis under Section 36(1)(iii) of the Act as interest on funds utilized for acquiring a capital asset (being own shares of the Company) and shall therefore not be allowed as deduction as per the proviso to Section 36(1)(iii) of the Act.
- From the equity position of the Company as at 31 March 2016 it can be observed that the Company had sufficient non-interest bearing equity funds which is greater than the consideration paid towards buyback. The relevant screenshot from the financial statements of the Company (**refer note no 3 & 4 of the financial statements, pg no. 17-18 of the paperbook**) is produced below:

Updater Services Private Limited			
Balance Sheet as at March 31, 2017			
<i>(All amount are in Indian Rupees unless otherwise stated)</i>			
Particulars	Notes	As at March 31, 2017	As at March 31, 2016
EQUITY AND LIABILITIES			
Shareholders' funds			
Share Capital	3	528,174,790	100,366,090
Reserves and Surplus	4	819,943,100	596,186,705
		<u>1,348,117,890</u>	<u>696,552,795</u>

- From the above, it can be observed that the Company had sufficient non-interest bearing equity funds (of INR 69,65,52,795) to meet the consideration paid for buyback of shares being INR 57,06,25,000 (1.e., the non-interest-bearing equity funds were greater than the consideration paid for buyback).
- It is a well settled principle that when the amount of equity funds is greater than the borrowed funds, there shall be an implicit presumption that funds were utilized from equity and not borrowed funds

- The aforesaid position has been upheld by the Hon'ble Supreme Court in the case of **South Indian Bank Ltd ([2021] 130 taxmann.com 178 (SC))**, wherein it was held as follows (refer para 17 of the judgement, pg no. 149 of the case laws paperback):

“...In a situation where the assessee has mixed fund (made up partly of interest free funds and partly of interest-bearing funds) and payment is made out of that mixed fund, the investment must be considered to have been made out of the interest free fund. To put it another way, at respect of payment made out of mixed fund, it is the assessee who has such right of appropriation and also the right to assert from what part of the fund a particular investment is made and it may not be permissible for the Revenue to make an estimation of a proportionate figure...”

- Similar position has been taken by the Hon'ble Supreme Court in the following cases as well:

Name of Judgment	Citation	Para No.	Reference in case laws paperback
<i>CIT v. Reliance Industries Ltd.</i>	[2019] 102 taxmann.com 52	7	Pg. no.154
<i>CIT v. UTI Bank Ltd.</i>	[2022] 142 taxmann.com 136	Para 1 to 3	Pg. no. 156 & 157

- Although the above rulings were rendered in the context of Section 14A, the principles establish shall squarely apply to the instant, case and accordingly, there shall be a presumption that the non-interest bearing equity funds were utilized for the payment of buyback consideration and hence, Section 36(1)(iii) would not be applicable. This aspect was also noted by the Ld. CIT(A) in his order.

2.2.2. Expenditure on buyback of shares is not a capital expenditure

- Buyback of its own shares by a Company **would neither result in creation of any new capital asset nor would provide enduring benefits to the Company.**
- The above position has been upheld by the Hon'ble Gujarat High Court in the case of **Bayer Vapi (P.) Ltd ([2019] 106 taxmann.com 395)** (refer para 3.3 and 4.5 of the judgement, pg no. 160-161 of the case laws paperback).
- A similar position was taken by the Courts in the following cases as well:
 - Hon'ble Delhi High Court in the case of **CIT v. Selan Exploration Technology Ltd ([2010] 188 taxman 1)** (refer para 11 of the judgement, pg no. 167 of the case laws paperback)
 - Hon'ble Bombay High Court in the case of **PCIT v. Merck Ltd ([2020] 120 taxmann.com 361)** (refer para 5(a) of the judgement, pg no. 170 of the case laws paperback)

- Accordingly, buyback of shares does not result in creation of any capital asset nor would provide any enduring benefits to the Company, no disallowance under Section 36(1)(iii) is warranted.

2.2.3. Observations of the Hon'ble CIT(A) in this regard

- The observations of the Hon'ble CIT(A) in the order passed has been summarized below (**refer para 6.4.9 to 6.4.11 of the CIT(A) order, Pg no. 285 & 286 of the paperbook**):
 - The Company had sufficient equity funds to meet the consideration paid on the buyback of shares undertaken and accordingly, the principles established by the Apex Court would apply to the instant case.
 - Further, buyback did not create any capital asset that would provide enduring benefits to the Company and accordingly, expenditure on buyback would not qualify as a capital expenditure and hence, the question of applicability of Section 36(1)(iii) shall not arise.
- Basis the above submissions, we humbly pray before this Hon'ble Bench to uphold the decision of the CIT(A) in this regard.

2.3. Levy of buyback, tax under Section 115QA of the Act (Ground no. 1 of the Company Appeal)

2.3.1. Section 391-394 vs. Section 77A of the Companies Act, 1956

- The Company filed for a scheme of arrangement before the Hon'ble Madras High Court for buyback of its own shares and the same was approved by the court on 28 April 2016 (refer pg no. 33 of the paperbook).
- Under Section 77A of the Companies Act, 1956 a buyback is subject to the following conditions:
 - The number shares bought back shall be less than or equal to 25% of the total number outstanding shares issued;
 - Amount to be utilized for buy back should be less than or equal to 25% of the paid up share capital and free reserves of the Company and
 - The debt to equity ratio of the Company post buyback shall not be more than 2:1
- However, for a buyback of shares carried out under a scheme of arrangement approved by the Court under section 391 to 394 of Companies Act, 1956, the above conditions/ restrictions would not apply. Hence, we humbly submit that the entire process/compliances etc under court approved buy back is different from those under Section 77A.
- In the instant case, the consideration paid by the Company for the buyback of shares undertaken is more than 25% of the aggregate of paid up share capital

& free reserves which was carried through a scheme approved by the Hon'ble Madras High Court. Hence, this cannot be regarded as a buyback carried out under Section 77A. A table capturing the above computation was produced as a part of the submissions made to CIT(A) (refer pg no. 177 of the paperbook).

- However, the learned AD erroneously treated the buyback undertaken by the Company through a court approved scheme under Section 391-394 as buyback under Section 77A (refer para no. 5.16 of the assessment order pg no. 140 of the paper book) and proceeded to levy tax under Section 115QA of the Act and learned CIT(A) has upheld the same.
- The erstwhile provisions of the Companies Act, 1956 did not have any mandate that buybacks carried out through a court approved scheme must be in compliance with the provisions of Section 68 [erstwhile] Section 77A of the Act. Further, it is humbly submitted that buy back under Section 77A of the Companies Act, 1956 was an alternative method provided to the Company as against Section 391-394 of the Companies Act.
- The above position has been upheld by the Hon'ble Bombay High Court in the case of **Sterlite Industries (India) Ltd. (45 SCL 475)** wherein it was held as follows (refer para 22 & 23 of the judgement):

“.....The legislative intention behind introduction of Section 77A is to provide an alternative method by which a company may buy back upto 25% of its total paid up equity capital in any financial year subject to compliance with Sub-sections (2), (c) and (4). It does not supplant or take away any part of the pre-existing jurisdictions of the Company Court to sanction a scheme for such reduction under Sections 100-104 and Section 191

- A similar position was taken by the Hon'ble Bombay High Court in the case of **Capgemini India (P.) Ltd (2016) 67 taxmann.com 1 (Bombay)** (refer para 5 of the judgement, pg no. 31 of the case laws paperbook).
- Further, It is a settled principle that once a scheme of arrangement is approved by the court to be well within the corners of law, it shall be binding on the tax authorities (refer Hon'ble Madras High Court ruling in the case of **Pentamedia Graphics Limited (236 CTR 204)**) (refer para 21 of the judgement, pg no. 24 of the case laws paperbook).
- Basis the above, it is evident that buyback of shares under Section 77A of the Companies Act, 1956 is different from buyback of shares undertaken through a court approved scheme of arrangement under Section 391-394.

2.3.2. Reliance placed by the learned AO on the Delhi NCLT ruling in the case of RS live Media (2017] 79 taxmann.com.461)

- The learned AO has failed to appreciate the fact that in the above mentioned case, the NCLT dealt with sanction of a scheme of buyback under Section 230(10) of the Companies Act, 2013.

- However, in the instant case the scheme of buyback was approved by the Hon'ble Madras High Court on 28 April 2016 (refer pg no. 33 to 48 of the paperbook) when **Section 230 of the Companies Act, 2013 was not in force.**
- Accordingly, the principles upheld in the aforesaid ruling shall not apply to instant case as the factual matrix and law in force was different from that of the Company's case.

2.3.3. Amendment to Section 1150A of the Act vide Finance Act 2016 shall not have a retrospective application

- Section 115QA of the Act as it stood before amendment vide Finance Act, 2016 was applicable for buyback of shares undertaken under Section 77A of the Companies Act, 1956. The relevant extracts from the explanation to the said Section is produced below:

“... Explanation-For the purposes of this Section

"buy-back" means purchase by a company of its own shares in accordance with the provisions of section 77A of the Companies Act, 1956 (1 of 1956);...."

- Subsequently, Section 115QA of the Act was amended vide Finance Act 2016 to include buyback undertaken by a Company "under any law for time being in force" under its ambit
- Finance Bill, 2016 and the memorandum to the Finance Bill, 2016 specifically provided that the said amendment shall take effect from **01 June 2016 (refer pg no. 34 of the case laws paperbook)**. As the Finance Billy Memorandum specifically clarifies that the amendment made shall take effect from 01 June 2016, it cannot be said to have a retrospective application.
- The Hon'ble Supreme Court in the case of **Sedco Forex International Drill Inc. (279 ITR 310)** has held that when a provision/ amendment is specifically clarified to take effect from a particular date, the same shall come into force from such date and cannot said to have a retrospective application (refer para 12, 18 and 20 of the judgement, pg no. 70 & 71 of the case laws paperbook).
- A similar position was taken in the below mentioned cases as well:

Name of Judgement	Citation	Jurisdiction	Para No.	Reference in case laws paperbook
M. M Aqua Technologies Ltd v. CIT	[2021] 129 taxmann.com 145	Supreme Court	Para 22	Pg no. 126 to 129
PCIT v. Era infrastructure (India) Ltd.	[2022] 141 taxmann.com 289	Delhi Court	Para 5,6 & 8	Pg no. 138

- *As stated earlier, the scheme of buyback in the instant case was approved by the Hon'ble Madras High Court on 28th April 2016 (refer pg no. 33 of the **paperbook**) (i.e., before the amendment came into force) under Section 391 to 394 of the Companies Act, 1956 and accordingly Section 115QA of the Act would not apply to the instant case.*
- *For the reasons cited above, it is humbly prayed before this Hon'ble Bench to delete the levy of tax under Section 115QA of the Act to the instant transaction.*

16. The Ld.DR, appearing on behalf of the Revenue, vehemently supported the findings and conclusions arrived at by the AO. The Ld.DR further contended that the Ld.CIT(A) erred in adjudicating the appeal without calling for a remand report from the AO, especially in light of various additional evidence and fresh facts which were admittedly produced by the assessee for the first time before the Ld.CIT(A). It was the submission of the Ld.DR that the failure to seek a remand report from the AO in such circumstances amounts to a procedural infirmity, as it deprived the AO of an opportunity to verify and rebut the new material brought on record by the assessee. Accordingly, it was prayed that the order of the Ld.CIT(A) be set aside and the matter be restored to his file for adjudication afresh after obtaining a proper remand report from the AO.

17. We have heard the rival contentions and perused the material on record. We note that a survey u/s.133A of the Act was conducted at the premises of the assessee on 12.02.2019. During the course of survey, it was ascertained that during AY 2017-18, the assessee company bought back 20,75,000 equity shares from M/s.Tangi Facility Solutions Private Limited @ Rs.275/- per share, amounting to Rs.57.06 Crores, under a High Court approved scheme of Arrangement and Compromise, but no tax was paid u/s.115QA of the Act.

Secondly the buy back was done at a value lower than the Fair Market Value (FMV), attracting the provisions of Section 56(2)(viiia) of the Act. Thirdly, an impounded document indicated that internal discussions took place regarding the implications of using the company's working capital to fund the buyback, which could lead to a proportionate disallowance of interest paid on the working capital loan. However, this aspect was not verified by the AO.

18. The Id.PCIT, upon reviewing the assessment records, observed that the AO did not seek clarification on these issues in notices issued u/s.142(1) of the Act on 23.08.2019 and 21.11.2019, not any additions were made in the assessment order dated 26.12.2019 in this regard. The Id.PCIT noted that, the AO failed to invoke Section 115QA, Section 56(2)(viiia) of the Act, or disallow the proportionate interest on diverted working capital. This omission was deemed erroneous and prejudicial to the Revenue's interest. Consequently, a notice u/s.263 of the Act was issued on 10.03.2021, stating that the assessment order required revision. In response, the assessee objected to the revision on various grounds, including the claim that Section 263 of the Act was not applicable, and that the buyback was executed through a scheme of arrangement rather than under Section 77 of the Companies Act, making Section 115QA inapplicable. The assessee also contested the applicability of Section 56(2)(vii)(a) of the Act and the disallowance of interest on the working capital loan used for the buyback. The objections were rejected after careful consideration by the Id.PCIT. The primary reason for invoking Section 263 was

that the assessment order lacked proper enquiries and verification, making it erroneous and prejudicial to the interest of revenue. The claim that the AO was aware of all documents were found irrelevant since the issues were never raised in the Section 142(1) notices. Furthermore, the final assessment order did not discuss the applicability of Sections 115QA, 56(2)(vii)(a), or the proportionate disallowance of interest. Therefore, it was concluded that the assessment was completed without the necessary scrutiny, warranting revision u/s.263 of the Act. The Id.PCIT passed order u/s.263 of the Act dated 30.03.2022 set aside the assessment order passed u/s.143(3) of the Act dated 26.12.2019 with the direction to the AO to redo the assessment after considering the observation made on the issues for which proceedings u/s.263 of the Act was initiated. The Id.PCIT directed the AO to call for additional details, afford reasonable opportunity to the assessee company and revise the assessment.

19. During the course of set aside assessment proceedings, the AO issued show cause notices relating to three issues viz..

- i. The assessee's liability to pay additional tax u/s.115QA on the distributed income by way of buy back of shares.
- ii. The assessee's liability to income under the head "Other Sources" by invoking the provisions of section 56(2)(vii)(a) of the Act to the extent of inadequate consideration paid at the time of buy back of shares.
- iii. Disallowance of proportionate interest as the working capital has been utilized for buy back of shares.

20. The assessee company responded to the notices of the AO and made submissions upon each of the above identified issues. The assessee company had only one class of equity shares, each with a face value of Rs.10/-, fully paid

up. During the previous year relevant to the assessment year under consideration, the assessee purchased and extinguished 20,75,000 equity shares out of its total issued capital of 1,00,36,090 shares. This buyback was executed as per the reconciliation provided in “Note 3 – Share Capital” and “Note 37” of the financial statements. The buy back was carried out under a Scheme of Compromise and Arrangement approved by the Hon’ble High Court of Madras on 28.04.2016. The assessee had initially approved a proposal to repurchase up to 21,82,000 equity shares at a price not exceeding Rs.275/- per share, with a total value not exceeding Rs.60.00 Crores. However, it ultimately bought back and extinguished 20,75,000 shares for a total consideration of Rs.57.063 Crores.

21. The shareholding pattern before and after the buy back changed significantly. The buy back was carried out entirely from Tangi Facility Solutions Private Limited which was primarily controlled by T. Raghunandana who held 99% of its equity shares. The reserves and surplus position was impacted significantly by the buy back. The Profit & Loss Account credit balance before buyback stood at Rs.45.93 Crores and was reduced to Rs.4.31 Crores. The General Reserve, which was Rs.9.48 Crores, was completely utilized. Similarly, the Securities Premium Account, which had a balance of Rs.4.19 Crores, was fully utilized. The total reserves and surplus before buyback were Rs.69.65 Crores, out of which Rs.57.16 Crores was used for the buyback, amounting to 82.07% of the total reserves. The assessee did not pay any additional tax on

the consideration paid to M/s.Tangi Facility Solutions Private Limited for the buyback. This was justified on the ground that the buyback was not conducted u/s.77A of the Companies Act, but rather through a Scheme of Arrangement u/s.301 to 304, which had received High Court sanction.

22. The AO observed that in this case, the buyback was executed as a scheme of arrangement, whereby the company repurchased a specific number of shares at a fixed price. When the scheme was implemented, the repurchased shares were extinguished and a capital redemption reserve, equal to the face value of the bought back shares, was created. The payment of buyback was met using the profit and loss account credit balance and general reserve, with the securities premium account reduced correspondingly. This process resulted in exhausting the entire general reserve of Rs.9,48,81,000/- and nearly all of the profit and loss account credit balance, which ended at Rs.45,49,94,000/- out of a balance of Rs.45,93,12,295/-. The buy back, covering 20.67% of the equity basket with a total payout of Rs.57,06,25,000/-, would have otherwise left accumulated profits available for distribution as dividends amounting to Rs.54,98,75,000/-. The assessee company explained that it restored to seeking High Court Sanction u/s.77A of the Companies Act, 1956 because the payment of consideration exceeded 25% of the paid up capital and reserves, even though the number of shares bought back was within the 25% ceiling. This extra procedure was necessary as Sections 301 to 304 do not prescribe a specific buyback procedure, thereby justifying the High Courts intervention.

23. The AO held that buyback transaction falls within the ambit of Section 115QA of the Act. The fact that the assessee company resorted to a High Court sanctioned Scheme of Arrangement to comply with the Companies Act does not excuse the breach of the 25% ceiling on paid-up capital and reserves. Despite the introduction of parallel provisions under the Companies Act, 2013 and the Companies Act, 2016, Section 230(10) prohibits any buyback beyond this 25% limit, mandating adherence to Section 68. Furthermore, the "Repeal and Savings" provisions u/s.430 of the Companies Act, 2013, which protect acts done under the erstwhile Companies Act, 1956, do not confer any vested right to the assessee u/s.391 of the old Act. These observations are supported by the order of the Principal Bench of the NCLT, New Delhi, in the case of RS Live Media Private Limited dated 28th March 2017, where a similar Scheme of Arrangement involving a buyback exceeding the prescribed ceiling was reused. Consequently, the assessee is liable for the tax incidence u/s.115QA of the Act.

24. The AO computed the distributed income u/s.115QA of the Act by observing the original shares subscribed to by the predecessor to the present transferor had paid the assessee company only for 49,783 shares and the corresponding premium being Rs.342.31 X 49,783 = 1,70,41,218.73. The paid up capital is Rs.4,97,830/-. Total amount received by the company in relation to the shares bought back is therefore Rs.1,75,39,048/-. This would be deducted from the sale consideration to arrive at the taxable distributed income. In the present case, the sale consideration is Rs.57,06,25,000/-. Less: the amount

received by the assessee company for issue of shares (Rs.1,75,39,048/-). The balance distributed income is at Rs.55,30,85,952/- and tax thereon @ 20% is Rs.11,06,17,190/-.

25. The AO vide a show cause notice dated 29.09.2022 & 19.11.2022 called for the assessee to explain as to why the sum of Rs.68,89,00,000/- (607-275 X 20,75,000) should not be added back to the income and brought to tax as income under the head "other sources" by invoking the provisions of section 56(2)(vii)(a) of the Act. In response, the assessee company vide submission dated 18.03.2021 filed Valuer's submission to justify the correctness of valuation. The AO observed in the valuation report that the valuation was finalized on 21.03.2016 for a buyback transaction with M/s.Tangi Facility Solutions Private Limited, a related party under common control with the assessee. With Mr.T.Raghunandana and Mrs.T.Shanthi holding significant stakes in both entities, the transaction needed to meet the arm's length standard regarding the consideration. The buyback was executed at a consideration of Rs.275/- per share, as per the valuation report, yet the valuer did not disclose the basis of this valuation. This omission is particularly significant given that a subsequent share issuance to an uncontrolled third party was priced at Rs.607/- per share in the first tranche, prior to bonus shares. The valuer failed to explain the revenue projections, discount factor, growth rate, and terminal value assumptions that led to a 2.2 times increase in valuation within just eight months. The AO held that the Valuer's reply lacks factual substantiation and

does not adequately rebut the allegations made in the order u/s.263 of the Act and rejected the same.

26. The AO held that all the ingredients necessary to trigger the tax incidence are present in the transaction in question to attract the provisions of section 56(2)(vii)(a) of the Act and therefore the inadequate consideration being the difference between the value of Rs.607/- per share and the transaction value of Rs.275 per share multiplies by the number of shares (20,75,000). The AO brought to tax a sum of Rs.68,89,00,000/- u/s.56(2)(vii)(a) of the Act for the A.Y.2017-18.

27. Secondly, the AO observed from the records that during the previous year relevant to A.Y.2017-18, a sum of Rs.57,06,25,000/- was paid to M/s.Tangi Facility Solutions Private Limited by the assessee company to buy back its own shares. As the working capital has been utilized for the buyback of shares, the proportionate interest needs to be disallowed. Therefore, a show cause notice was issued to the assessee company. In response to the show cause notice the assessee company responded vide submission dated 07.03.2023.

28. The assessee's response was reviewed, and their contention that the Id.PCIT did not address the disallowance of proportionate interest was rejected. This claim was not acceptable because the case was set aside with directions for a re-assessment, and the interest issue was one of the reasons for initiating proceedings u/s.263 of the Act. Furthermore, the assessee claimed that the interest expenditure incurred for the buyback of shares should be allowable as

it relates to the business and not to the acquisition of a capital asset. However, as per the provisions of Section 36(1)(iii) of the Act, interest on capital borrowed for business is allowable, the proviso disallows any interest on funds borrowed for acquiring an asset until the asset is first put to use. In the case of the assessee company, a sum of Rs.57,06,25,000/- was paid for the buyback, and it is evident from internal communications that the working capital was used for this buyback and therefore is not allowable as a deduction. Accordingly, the AO disallowed a sum of (10% of Rs.57,06,25,000/-) Rs.5,70,62,500/- being the proportionate interest attributable to the amount paid to purchase the company's share from its shareholders and added back to the total income of the assessee company for the A.Y.2017-18 and completed the set aside assessment proceedings by passing order u/s.143(3) r.w.s 263 of the Act on 30.03.2023.

29. We observed that the Ld.CIT(A) has sustained the action of the AO in levying additional tax amounting to Rs.11,06,17,190/- u/s.115QA of the Act. The Ld.CIT(A) has noted that the assessee did not contest the quantum of distributed income as determined by the AO, nor were any specific arguments advanced before him challenging the correctness or accuracy of the computation of such additional tax. On careful consideration of the rival submissions and the material available on record, we are of the considered opinion that the authorities below have not properly appreciated the following:

- detailed computations of NAV valuation under Rule 11UA;

- financial statement extracts relating to availability of non-interest-bearing funds;
- various High Court and Tribunal decisions not cited before AO;
- workings relating to Section 77A ceiling and buy-back under Companies Act;
- explanations regarding factual distinction between Court-approved scheme and Section 77A buy-back.

30. Therefore, in our considered view in the present factual matrix of the case and the contentions raised by the assessee as well as the revenue, we are inclined to set aside the order of the Id.CIT(A) and remit the matter back to the files of AO for framing the assessment denovo considering the size and complexity of the issues, particularly valuation under Rule 11UA, factual nexus between borrowed funds and buy-back payment, and nature of the scheme under Companies Act, are such that proper factual verification by the AO is indispensable.

31. Before parting, we also clarify that we have not expressed any opinion on the merits of the additions or deletions. All legal and factual grounds raised by both parties remain open. The AO shall provide adequate opportunity to the assessee, examine all materials including those filed before Id.CIT(A) and before us, consider judicial precedents cited and pass a reasoned order on all three following issues:

- (i) applicability of section 115QA,
- (ii) addition under section 56(2)(viiia), and
- (iii) disallowance under section 36(1)(iii) of the Act.

32. In the result, the grounds of appeal raised by both the assessee and the Revenue, as well as the grounds raised in the cross-objections filed by the assessee, are treated as allowed for statistical purposes.

33. In the result, the appeals of both the revenue and assessee and cross objections of the assessee are allowed for statistical purposes.

Order pronounced in the court on 14th November, 2025 at Chennai.

Sd/-
(एस एस विश्वनेत्र रवि)
(S.S. VISWANETHRA RAVI)
न्यायिक सदस्य/**Judicial Member**

Sd/-
(एस. आर. रघुनाथा)
(S.R.RAGHUNATHA)
लेखा सदस्य/**Accountant Member**

चेन्नई/Chennai,

दिनांक/Dated, the 14th November, 2025

SP

आदेश की प्रतिलिपि □ ग्रेषित/Copy to:

1. □ पीलार्थी/Appellant
2. प्रत्यर्थी/Respondent
3. आयकर आयुक्त/CIT– Chennai/Coimbatore/Madurai/Salem
4. विभागीय प्रतिनिधि/DR
5. गार्ड फाईल/GF