**IN THE INCOME TAX APPELLATE TRIBUNAL**
**MUMBAI BENCHES "A", MUMBAI**

**BEFORE SHRI AMIT SHUKLA (JUDICIAL MEMBER)**
AND
**SHRI ASHWANI TANEJA (ACOUNTANT MEMBER)**

I.T.A. No. 7367/Mum/2014
(Assessment Year: 2011-12)

| | | |
|---|---|---|
| Korn Ferry International Pvt Ltd<br>Piramal Tower, Peninsula Corporate Park, Lower Parel, Mumbi-13 | vs | ACIT (OSD)<br>Mumbai |
| PAN : AAACW0557B | | |
| (Appellant) | | (Respondent) |

I.T.A. No. 7139/Mum/2014
(Assessment Year: 2011-12)

| | | |
|---|---|---|
| Dy.CIT 3 (2)(2)<br>Mumbai | vs | Korn Ferry International Pvt Ltd<br>Piramal Tower, Peninsula Corporate Park, Lower Parel, Mumbi-13 |
| (Appellant) | | (Respondent) |

| | |
|---|---|
| Appellant by | Shri Milind Thakore |
| Respondent by | Shri Ganesh Bare |

Date of hearing : 12-07-2016
Date of pronouncement : 27 -07-2016

**O R D E R**

**Per ASHWANI TANEJA, AM**

These cross appeals have been filed against the order of Commissioner of Income-tax (Appeals) [hereinafter called CIT(A)]

dt 18-09-2014 passed against the assessment order dt 27-02-2014 u/s 143(3) for A.Y. 2011-12.

**2. We shall first take up the appeal filed by the assessee in ITA No.7367/Mum/2014 which is on the following grounds:**

*1. The Hon. Commissioner of Income Tax Appeals) - 4, grossly erred in confirming the disallowance made U/s. 14A of the Income-tax Act, 1961, amounting t& Rs 64,315/-.*

*11 The Hon Commissioner of Income-tax(Appeals) erred in ignoring the fact that disallowance U/s 14A can be made only if there is actual nexus been tax free income and expenditure and no such nexus has been established in the in the appellants case*

*1.2The Hon. Commissioner of Income Tax (Appeals) grossly erred in ignoring the fact that the Appellant incurred INR 50,000 in earning the exempt income and the Appellants have suo-moto made a disallowance of Rws.50,000/- in the computation of income submitted while filing their Return of Income.*

*1.3 The Hon. Commissioner of Income Tax (Appeals) grossly erred in ignoring the fact, without rendering any opinion on the correctness of Appellant's claim of not spending any amount for earning exempt income the learned Assessing Officer could not have made a disallowance by applying the provisions of section 14A r.w.r. 8D.*

*1.4 Hon. Commissioner of Income-tax (Appeals) grossly erred in overlooking the fact that the principle of apportionment embedded in section 14A had no application where no direct expenditure was incurred to earn exempt income and entire expenditure was incurred for business purposes only.*

*2 The Hon Commissioner of Income Tax (Appeals), grossly erred in confirming the disallowance of ESOP*

*expenses, amounting to Rs 36,74,845/-, being the difference between the market price and allotment price of ESOP's granted by the Appellants Holding Company to the employees of the Appellant.*

*2.1 The Hon. Commissioner of Income Tax (Appeals) grossly erred in Ignoring the fact that the amount of Rs 36,74,845/-, is not in the nature of capital expenditure."*

**3. Ground 1:** This ground is with regard to disallowance u/s 14A. The brief facts are that during the course of assessment proceedings it was noted by the AO that total disallowance u/s 14A should be made for an amount aggregating to Rs.1,14,315 comprising of a sum of Rs.16,458 on account of indirect expenses, whereas the assessee had made suo moto disallowance of Rs.50,000 in the computation sheet filed along with the return of income. Thus, the balance disallowance of Rs.64,315 (Rs.114,315 – 50,000) was made u/s 14A. In the appeal before Ld. CIT(A), the disallowance was confirmed relying upon the orders of assessment year 2010-11.

**4.** During the course of hearing before us, it has been brought to our notice that own funds are in excess of investments in tax free securities. It is further brought to our notice that this issue is covered with the order of the Tribunal for A.Ys. 2009-10 and 2010-11.

**5.** Per contra, the ld. DR relied upon the orders of the lower authorities. With the assistance of the parties, it is noticed by us that own funds in this year are to the tune of Rs.38.26 crores as against aggregate investment of Rs.16.45 crores. Further, there are investments in growth funds from where no dividend income is received. Further, the secured loans are amounting to

Rs.12.88 lakhs, which have been utilised only for the purpose of purchase of vehicles as these where vehicle loans only. Thus, in our view, prima facie no disallowance u/s 14A is called for. It is further noted that in A.Y. 2009-10, the Tribunal deleted the disallowance vide its order dt 13-3-2016. Further in A.Y. 2010-11 also the disallowance made u/s 14A has been deleted. Under these circumstances, we find that only suo moto disallowance of Rs.50,000 should be sustained and balance disallowance of Rs.64,325 should be deleted.

**6. Grounds 2 & 2.1** deal with the grievance of the assessee against the action of lower authorities in making disallowance of ESOP expenses, amounting to Rs.36,24,845 being the difference between the market price and allotment price of ESOPs granted by the assessee company's holding company to the employees of the assessee company.

**7.** The brief facts in this regard are that during the year, the Assessee Company reimbursed Rs36,74,845/- to its ultimate holding company Korn Ferry International Inc ('KFII'), USA. Such reimbursement was made on account of the cost of restricted stock units (stocks) which have been allotted by KFII to the employees of the assessee on behalf of the Assessee Company under the Employees Stock Option Plan ('ESOP). The difference in the market price and the allotment price (i.e. Rs, 3,674,845) was reimbursed by the assessee to its ultimate holding company and same was charged to the P&L account and was claimed as a deduction in its tax return. The above payment is in the nature of compensation to the employees and the same was taxed in the hands of the employees as

perquisite under relevant provisions of the Act and appropriate tax was deducted at the time of vesting of these stocks. During the course of assessment proceedings the AO followed his order of A.Y. 2010-11 and held that such expenditure was not allowable under the law on the following grounds:

a. The shares were the capital of the Assessee Company and any loss to the capital can be considered as capital loss and not the revenue expenditure. By allotting the shares the Assessee Company has reduced the tax liability by an amount of Rs.3,6 74,845.

b. The loss suffered by the Assessee Company as a result of allotment of shares to its employees under ESOP below the market price was on capital account and the same is not allowable as deduction.

c. There is no provision under the Act to allow distribution of capital by way of shares or difference in market price of the shares as allowable expenditure under section 37 of the Act. When company receives any premium on allotment of shares over and above the issued price the same is credited to the premium reserve account and it never offered as taxable income or revenue receipt. In the same logic, any capital distribution over and above on account of difference of the cost of shares and its market price of the shares under ESOP scheme is going to reduce the reserve and not allowable as business expenditure under section 37(1) of the Act.

d. The AO relied on the decision of the Delhi Bench of ITAT in the case of Ranbaxy Laboratories Ltd. vs. Addl. CIT (124 TTJ 771). He observed that decision of Delhi Bench of ITAT in the case of Ranbaxy is directly applicable in the Assessee Company's case and the same squarely covers the issue under consideration against the Assessee Company and in favour of the Revenue.

e. 'Expenditure' is what is 'paid out' and is something which has gone irretrievably. A benefit or income foregone cannot be considered as expenditure. Since the Assessee Company had not incurred any expenditure but has merely received lesser amount of share premium, the same does not amount to expenditure within the meaning of section 37(1) of the Act. It was also observed by him that entry or absence thereof in books of account is not conclusive either for treating the amount as income or allowability or otherwise of the expenditure. Thus, only on the basis of entry in the books of account the claim of expenditure is not allowable. The entry is made on the basis of recommendation of SEBI which is said to be mandatory for a listed company. The same may be relevant for the purpose of accounting but for allowability of expenditure under the Act the direction of SEBI does not determine the allowability of the expenditure. For the purpose of allowability of expenditure under the Act the same has to be in consonance with the scheme of the Act. In the Assessee Company's case the entry made in the books of accounts as per direction of SEBI cannot be held to be conclusive for

the purpose of allowing expenditure under section 37 of the Act.

f. The has relied on the decision in the case of New India Industries Ltd. vs ACIT 112 TTJ (Del) (SB) 917 and TVS Finance & Services Ltd. Vs. Joint CIT [23 DTR (Mad) 33] wherein it has been held that unless the provisions of section 37 of the Act are complied with, the deduction is not permissible.

**8.** Being aggrieved, assessee filed appeal before Ld. CIT(A) and made detailed submissions. Relevant part of the submissions made before Ld.CIT(A) are as follows:

> *5.4.1 At the outset, it is submitted that the understanding of the Ld. AO on this issue is completely erroneous. The Appellant has never issued any share to its employees under ESOP. This can be verified from the Schedule I to the audited financials which demonstrate the movement in the share capital of the Appellant. It is KFII (listed ultimate holding company) which has issued stocks to the employees of the Appellant at a price less than the market price. The differential between market price and vesting price has been recovered by KFII from the Appellant. Therefore, it is not the case where own shares are issued at the price less than the market price and the loss on issue of shares has been booked as the expenses. In the instant case, such payment represents an incentive given to the employees for the loyalty and performance towards the*

*company. This enables the Appellant to attract and retain the employees and is as good as cash bonus paid to such employees. Accordingly, the company has treated the payment as compensation to the employees and taxed the same in the hands of the employees as perquisites under section 17(2) of the Act. Also, appropriate tax was deducted at the time of vesting of these stocks.*

*However, Ld. A.O. has proceeded on the assumption that the Appellant has issued its own shares at the price less than market price and has booked the loss as expenses. As a logical corollary, he concluded that it is a capital loss accrued on the issue of shares and is not a deductible loss. Therefore, once facts relating to the issue are understood in the right perspective, the deductibility would not be challenged.*

*It is submitted that allowability of the ESOP expenses (as any other compensation related expenses) is governed by the provisions of section 37(l) of the Act, wherein, deduction is allowed in respect of any revenue expenditure, which is laid out or expended wholly and exclusively for the purpose of business."*

Thereafter, the assessee also made exhaustive submissions before Ld. CIT(A) relying upon many judgments in favour of the assessee and also distinguished the judgments relied upon by the Assessing Officer. But the Ld. CIT(A) was not satisfied with the submissions of the assessee and relying upon his own order for A.Y. 2010-11, he decided this issue against the assessee by

making following observations:

*5.4.1 Having carefully and dispassionately considered the rival submissions, it is noted that this issue has been decided by me while deciding the appeal of the appellant for A.Y.2010-11 vide paragraph No.6.1 to 6.6 of Order bearing No. CIT(A)-4/IT-68/DCIT.3(2)/2012-13 dated 06.08.2013. The relevant paragraphs may be extracted as under:-*

*"**6.1.** I have carefully and dispassionately considered the facts and circumstances of the case. Undisputed facts are that the appellant company allotted "restricted stock units" (stocks) to its employees under the Employee Stock Option Plan (ESOP). Such shares were not allotted as per market price. The difference in the market price and allotment price i.e. Rs.52,08,592/- was debited by the assessee in its Profit & Loss Account.*

*6.2. Before me, the LAR vehemently argued that the previously mentioned difference of Rs.52,08,5921- in the market price and allotment price was in the nature of compensation to the employees and was taxed in the hands of the employees and that ESOP expenses have been claimed on the basis of SEBI guidelines. He also contended that SEBI Rules being statutory rules and since there was no specific provisions in the Act dealing with this issue, hence SEBI Rules should be applied and deduction in the difference in the market price and the allotment price should be allowed. He*

*strongly contended that the said difference in the market price and the allotment price is deductible u/s 37(1) of the Act. He has relied on the following decision in support of the proposition that the difference in market price and the cost price of shares allotted to the employees of the assessee company under ESOP scheme is allowed deduction u/s.37(1) of the Act"*

***(i)*** *S. S. I. Limited Vs. DCIT 85 TTJ 1049)(Chennai)*

***(ii)*** *ACIT Vs. Spray Engineering Devices Ltd. ITA No. 701/Chd.1 2009(CHD)*

***(iii)*** *DCIT Vs. Accenture Services Pvt. Ltd. ITA No.4540/M108 (MUM)*

*6.3. On the other hand, the LAO has held that the shares were the capital of the appellant company and any loss on account of capital should be considered as capital loss and not the revenue expenditure. Therefore, the loss suffered by the appellant as a result of allotment of shares to its employees under ESOP scheme below the market price was on capital account and not deductible as revenue expenses. When the appellant company receives any premium on allotment of shares over and above the issue price, such premium is credited to the premium reserved account and it is never offered as taxable income or revenue receipt. By the same logic, any capital distribution over and above on account of the difference of the market price and cost price of shares under ESOP scheme will reduce the corresponding reserve account and not allowable*

*u/s.37(1) of the Act. The appellant has not incurred any revenue loss by allotting shares to its employees because the issue of shares under ESOP scheme at below market price results in short receipt of share premium. Secondly,' the ESOP scheme is contingent upon the employees opting for the stocks in all the prescribed number of years. What is allowable u1s.37 of the Act, is any actual expenditure not being expenditure of the nature described u1s.30 to u1s.36 which are not in the nature of capital expenditure nor in the nature of personal expenditure and such expenditure should be wholly and exclusively incurred for the assessee's business. In the present case, the assessee has not incurred any actual expenditure, it merely received lesser amount of share premium from its employees on account of the ESOP scheme.*

*6.4. The LAR's argument that the ESOP expenses were claimed on the basis of the SEBI guidelines is also not fully acceptable and allowable. Firstly, because the SEBI guidelines are applicable only to public companies listed on the stock exchange. The present appellant is a private limited company and the appellant is not listed on any stock exchange. Therefore SEBI guidelines are not applicable in the case of the present private exchange. Secondly, SEBI norms or for that matter the RBI norms cannot override the provisions of I.T. Act in the matter of allowing of expenditure under the provisions of I.T. Act. Strong reliance is placed on the*

*following decisions:*

***(i)*** *New India Industries Ltd. Vs ACIT18 SOT 51 (SB) Delhi.*

***(ii)*** *TVS Finance and Services Ltd. Vs JCIT (2009) 23 CTR (MAD) 33.*

*6.5. Thirdly, it is well stated that the way in which entries are made by the appellant in its books of accounts is not determinative of the question that the appellant has earned any profit or suffered any loss. Therefore, it is necessary to consider the true nature of the transaction and whether it has actually resulted in profit or loss to the assessee. The reliance is placed on the following decisions:*

***(i)*** *Kedarnath Jute Mfg. Co. Ltd. Vs CIT (1971) 82 ITR 363 (SC)*

***(ii)*** *Chowringhee Sales Bureau Pvt. Ltd. Vs CIT (1973) 87 ITR 542 (SC)*

***(iii)*** *Satluj Cotton Mills vs CIT (1979) 116 ITR 01 (SC)*

*In the present case, the appellant has not incurred any actual expenditure which accrued to it during F.Y.2009-10 relevant to A.Y.2010-11. The expenditure will be ascertained at the end of the expiry of ESOP scheme time period if the then surviving employees may actually exercise the right of buying the employees stock option. Therefore, such contingent expenditure is not allowable u/s 37(1) of the Act in the light of the following decision:*

***(i)*** *Eimco KCP Ltd. Vs CIT (2000) 242 ITR 659 (SC)*

***(ii)*** *CIT Vs Reinz Taibros (P) Ltd. (2001) 252 ITR 637 (DEL)*

***(iii)*** *Ranbaxy Laboratories Ltd. Vs Addl. CIT 124 TTJ (Del)*

*771.*

*6.6. Having regard to the facts and circumstances of the case and in the light of the aforesaid decisions, the disallowance of Rs.52,08,592/- made by the L40 is confirmed. Ground ofAppealNo.3 is not allowed."*

*5.4.2 The Ld. AR has made a categorical statement that the facts and circumstances of A.Y. 2010-11 and 2011-12 are identical, therefore, Ground of Appeal No.3 has been stated to be a covered matter. Having regard to the facts and circumstances of the case and in law, I am of the considered opinion that the disallowance of Rs.36,74,845/- in respect of ESOP loss is confirmed. Duly following my decision for A.Y.2010-11 and view of judicial consistency, Ground of Appeal No.3 is not allowed."*

***9.*** Thus, from the above discussion it is seen that Ld. CIT(A) has held that the Assessee Company has not incurred any actual expenditure which accrued to it in the year under consideration and that the expenditure will be ascertained at the end of the expiry of ESOP scheme time period if the then surviving employees would actually exercise the right of buying the employees stock option. Thus, the Ld. CIT(A) held that these expenses were contingent and, therefore, not allowable u/s 37(1) of the Act. It is brought to our notice that decision of the Ld. CIT(A) for A.Y. 2010-11 reached before the Tribunal. The Tribunal decided this issue in favour of the assessee vide its order dt 31-3-2016 by relying upon another order of the Tribunal in assessee's own case by observing as under:-

*"**3.**Next ground of appeal deals with confirming the disallowance of ESOP expenses, amounting to Rs 52,08,592/-.During the course of hearing before us, the representatives of both the sides agreed that the issue stands covered by the order of the Tribunal for the earlier year (ITA/5152/Mum/2012,dtd.31.03.2016).We find that the Tribunal has deliberated upon the issue and has decided it as under:*

***"6.**Next Ground of appeal is about addition of Rs.56.40 lakhs out of the expenditure incurred under ESOP(Employee Stock Option Scheme). During the assessment proceedings, the AO found that the assessee had debited an amount of Rs.1.07 crores under the head cost of stock awarded to KF India Employees. Before the AO, the assessee stated that the expenditure was on account of ESOP. On perusal of the tax audit report, the AO found that the assessee had paid Fringe Benefit Tax(FBT)only on amount of Rs.50.65 lakhs. The AO directed the assessee to explain as to why FBT had not been paid to whole amount. The assessee vide its letter,dt.29.12.12,stated that the value of FBT taken for ESOP(Rs.50.65lakhs) as against cost of stock awarded to KF Employees(Rs.1.07crores),that the amount of Rs.50.65 represented the value of ESOP, that had been vested with the employees during FY 2007-08 and consequently considered for FBT, that the amount of Rs.1.07crores represented the amount charged by Korn Ferry International USA to Korn Ferry International Pvt. Ltd. India, towards stock awarded to the employees of the assessee .*

*After considering the same the AO held that during the year under consideration only a part (Rs. 50. 65 lakhs)out of the total amount*

*(Rs.1.07crores) was debited to P&L A/c. was vested in employees, that the balance amount would be vested in employees over a period of time, that the assessee had not paid FBT on Rs.56.40 lakhs, that liability could eventually increase or decrease in future, that it had not produced any evidence as to the fact that amount in question was actually paid. Finally, the AO made an addition of Rs.56,40,195/- to the total income of the assessee.*

***7.*** *Aggrieved by the order of the AO, the assessee preferred an appeal before the FAA. Before him, it was argued that allowability of ESOP expenses and payment of FBT for ESOP were two different concepts, that the FBT would become payable upon vesting of the ESOP in the hands of the employees accordingly the assessee had paid FBT during the year, that assessee had made full payment of Rs.1.07 crores to its parent company ,that it had claimed the cost of stock awarded to its employees entirely based on ESOP Scheme governed by the SEBI Guidelines, that the ESOP expenditure was a measure in the nature of compensation cost and was fully deductible in computing the taxable income. The FAA, in his order, held that the assessee itself had not treated the entire amount as liability, that ESOP would be effective only on the discretion of the employees to opt for stocks, that payment for shares was either a provision or an investment, that no liability in that regard had crystallised.*

***8.*** *Before us, the AR reiterated the arguments that were advanced before the FAA. He relied upon the case of Biocon*

*Ltd.(144ITD21)(SB)(Bang.); Novo Nordisk India Pvt. Ltd.(42 taxmann.com168).DR supported the order of the FAA.*

***9.*** *We have heard the rival submissions and perused the material before us. We find that stock options of the parent company were offered to the employees of the assessee company, that the assessee had made payment of Rs.1.07 crores to the parent company, that during the year FBT was paid for sum of Rs.50.65 lakhs. In our opinion, once a stock option is granted to and exercised by the employee of an assessee the liability in that behalf is ascertained and cost is allowable in the year in which stock options are granted. We find that in the case of Novo Nordisk India Pvt. Ltd.(supra),it has been held that in terms of ESOP if an assessee offers shares of its parent company to its employees, the difference between the FMV of the shares of the parent company on date of issue of shares and the price at which those shares were issued by the assessee to its employees had to be regarded as expenditure incurred for business purposes allowable u/s. 37(1) of the Act. Respectfully following the above decision, we decide Ground No.2 in favour of the assessee .”*

*Respectfully following the above order, we allow the appeal of the assessee with regard to second ground.”*

**10.** It may be thus noted from the above that once a stock option is granted to and exercised by the employee of the assessee, then liability in that option was ascertained and the cost is allowable in the year in which stock options were granted.

It is further noted that all the contentions raised by the AO in the assessment order have duly considered by the Tribunal while deciding this issue. It is further noted that no distinction has been brought before us by Ld DR on facts or law. Thus, respectfully following the order of the Tribunal, we decide this issue in favour of the assessee and allow ESOP expenses amounting to Rs.36,74,845. This ground may be treated as allowed.

**11. Now, we shall take up the revenue's appeal in ITA No.7139/Mum/2014.**

**12.** The solitary issue raised by the revenue in its appeal is with regard to action of the Ld. CIT(A) in allowing the appeal of the assessee by holding that scheme of buy back of shares was treated as dividend without appreciating the fact that despite buy back of shares the status of the company did not change. It has been further alleged in the ground that the assessee had indulged in the activity of buy back of shares is a colourable device only for the purpose of avoiding dividend distribution tax.

**13.** The brief background of this issue is that during the year under consideration, the assessee was a wholly owned subsidiary of Korn Ferry Investment India Limited, Mauritius ('Korn Ferry Mauritius'). During the year under consideration, the Assessee Company bought back 117,900 shares from Korn Ferry Mauritius at the rate of Rs.780/- per share in accordance with the share buyback scheme offer dated February 4, 2011. This resulted into capital gains of Rs.770/- per share in the hands of Korn Ferry Mauritius

after reducing the cost of acquisition of Rs.10/- per share. The total amount paid by the Assessee Company to Korn Ferry Mauritius was Rs.91,962,000/-. The AO asked the Assessee Company to submit explanation on buyback of shares as per A.Y.2010-11. The assessee submitted before the *A.O.* that buyback was a legally recognized transaction and it was undertaken in accordance with the provisions of the Companies Act, 1956. The Board of Directors of the company decided about this decision and all relevant documents were filed with the RBI. The Assessee Company placed reliance on the case of Armstrong World Industries Ltd. (Appeal No.1044 of 2011). However, the AO completely disregarded the submissions made by the Assessee Company and observed that if the company would have declared dividend (instead of buying back its shares), it would have paid Dividend Distribution Tax ('DDT') u/s 115-O of the Act. Since there is no tax liability arising due to buyback of shares, the A.O. reached to a conclusion that such buyback is a colourable device to avoid tax, and thus he brought to tax impugned transaction.

**14.** Being aggrieved, assessee filed appeal before Ld. CIT(A) and submitted that buyback is a legitimate transaction and was undertaken by the assessee company in accordance with the provisions of the Companies Act, 1956. The assessee made exhaustive submissions before the Ld. CIT(A) and explained that the said transaction was a legitimate transaction within the four corners of law. The relevant portion of the submissions made by the assessee before Ld. CIT(A) are reproduced hereunder:

*"Buyback is a legitimate transaction and has been undertaken by the Appellant in accordance with the provisions of Companies Act, 1956 ('Companies Act') is submitted that*

*buyback is a legally recognized transaction and that it was Undertaken in accordance with the provisions of the Companies Act. Section 77A of the Companies Act is the specific section which contains the basic framework for companies to buy back its own securities (provisions of section 77A of the Act are enclosed as 'Annexure 7'). Section 77A provides various guidelines which the company needs to fulfil for doing a buyback of shares. In the instant case, the Board of Directors of the company took such decision and complied with all such conditions for affecting the buy back. It is submitted that decision of buy back is the prerogative of the company and the tax authorities cannot challenge such decision. The Appellant has filed various documents with the ROC as required by the provisions of the Companies Act. Copy of such documents was duly filed with the Ld. AO to justify the genuineness of transaction.*

***Buy back transaction is not colourable device for avoiding dividend tax under section 115-O of** the Act*

*It is submitted that buyback is not a colourable device to avoid DDT implications. Further, it is submitted that in terms of clause (iv) to Section 2(22) of the Act, buyback which is effected as per Section 77A of the Companies Act is excluded from the scope of definition of "dividend". Therefore, provisions of Act itself provide that buyback transactions are not subject to dividend implications.*

*It is also submitted that as per the prevailing law (i.e. as applicable for the subject AY) income on buy back of shares is faxed in the hands of shareholder as capital gains under*

*Section 46A of the Act. Section 46A of Act was introduced by Finance Act 1999. In the course of debate, the Finance Minister made following assurance to the House:*

*Extracts from Budget Speech in 1999*

*"Very recently, the Companies Act, 1956 has been amended to permit transactions relating to buy- back of shares. There is some ambiguity in the interpretation of the law as to whether such transactions would be treated as subject to dividend tax in addition to capital gains tax. In view of this, / propose to amend the law to put it beyond doubt that on buyback of shares, the shareholders will not be subject to dividend tax, and would only be liable to capital gains tax."*

***Extracts from Explanatory Memorandum, 1999***

*"The above newly introduced provisions of buy-back of shares threw up certain issues in relation to the existing provisions of the Income-tax Act. The two principal issues are whether it would give rise to deemed dividend under section 2(22) of the Income-tax Act and whether any capital gains would arise in the hands of the shareholder. The legal position on both the issues was far from clear and settled and there was apprehension that there will be unnecessary litigation unless the issues are clarified with finality.*

*The Act therefore, has amended clause (22) of section 2 of the Income-tax Act by inserting a new clause to provide that*

*dividend does not include any payment made by a company on purchase of its own shares in accordance with the provisions contained in section 77A of the Companies Act 1956. It has also inserted a new section, namely, section 46A in the Income-tax Act, to provide that any consideration received by a shareholder or a holder of other specified securities from any company on purchase of its own shares or other specified securities shall be, subject to provisions contained in section 48, deemed to be the capital gains."*

*In view of above, it can be concluded that the current law does not deem (or empower the assessing officer to deem) the buyback of shares as declaration of dividend by the company purchasing its own shares. The express provision of the Act (i.e. section 2(22)(e) read with section 46A of the Act) leaves no discretion to the assessing officer to choose between the taxability as capital gain or treating it as dividend.*

*It is well settled that tax implications of a valid transaction need to be determined as per provisions applicable to the transaction and that the taxpayer is entitled to plan his affairs in a manner which mitigates or controls his tax liability. If buy back is effected in terms of provisions of the Companies Act, the specific tax provisions as contained in Section 46A read with Section 2(22) of the Act are clearly attracted and the same cannot be treated as a deemed dividend.*

*The transaction of buyback is subjected to levy of capital gains tax in terms of Section 46A of the Act. In the instant case, such capital gain liability does not arise due to the provisions of India Mauritius DTAA read with the provision of the Act. As a result, the company effecting buyback is not required to pay Dividend Distribution Tax while the taxpayer from treaty favourable jurisdiction is entitled to claim tax exemption in respect of capital gains income.*

*In view of above, it is submitted that buyback transaction undertaken by the Appellant is not a colourable device to avoid Indian tax and is in reality a legitimate transaction Further, it is submitted that the Appellant has actually distributed profits as dividend in subsequent year and paid DDT on same which is clearly evident from the audited financials such year (copy enclosed as 'Annexure 8'). Decision whether dividends are distributed or are to be accumulated is a commercial decision which is taken by board of directors keeping in mind companies' goals and objective to expand in future. Decision on payments of dividend or its accumulation is not a mandatory requirement in any section under company Act or the Income tax Act.*

*There are various judicial precedents wherein it has been held that any transaction within the four corners of law cannot be labeled as tax avoidance scheme, It has been held that under fiscal laws, tax planning within the*

*framework of the law to save taxes is allowed. The right to conduct the affairs of a business falls within the prerogative of the taxpayer. The taxman/tax authorities can only intervene in cases where there has been a deliberate attempt by the taxpayer to illegally evade taxes through use of dubious methods or colourable device".*

**15.** Further, the assessee supported its submissions with the help of various judgements to bring home the point that buyback done by the assessee cannot be branded as a colourable device to avoid Dividend Distribution Tax. Ld.CIT(A) considered the submissions of the assessee in detail and found that this issue was already decided in favour of the assessee by Ld.CIT|(A) in earlier assessment year i.e. A.Y. 2010-11. The relevant part of order of Ld. CIT(A) Is reproduced below:

"5.5.1 Having carefully and dispassionately considered the rival submissions, it is noted that this issue has been decided by me while deciding the appeal of the appellant for A.Y.2010-11 vide paragraph No.7.1 to 7.18 of Order bearing No. CIT(A)-4/IT-68/DCIT.3(2)/2012-13 dated 06.08.2013. The relevant paragraphs may be extracted as under:-

77.1. *I have carefully and dispassionately considered the facts and circumstances of the case. The LAO has charged dividend tax @ 15% and corollary surcharge on the buyback of shares as deemed dividend. However, he has not made any addition, whatsoever, in the computation of total income on this account. There is no separate addition on account of treatment of buyback of shares and*

*appellant's profit/income has not been increased by any amount, whatsoever, on account of buyback of the shares of the appellant company. The briefly stated facts are that the appellant is a wholly owned subsidiary of Korn/Ferry Investment India Limited, Mauritius ("Korn Ferry Mauritius"). During the year under consideration, the Appellant bought back 155,000 shares from Korn Ferry Mauritius at the rate of Rs.627/- per share in accordance with the share buyback scheme offer dated March 2, 2010. This resulted in capital gains of Rs.617 per share in the hands of Korn Ferry Mauritius after reducing the cost of acquisition of Rs.10/- per share. The total amount paid by the Appellant to Korn Ferry Mauritius was Rs.97,185,000/-. The Appellant duly filed the copy of Accountant Certificate in Form 15C with tax authorities and copy of Form 23, Form 62, Form 4A in relation to buyback with Registrar of Companies ("ROC")*

*The Appellant did not withhold tax on the remittance of Rs.97,185,000 since it is not chargeable to tax in India in terms of Article 13(4) of the Double Taxation Avoidance Agreement ("DTAA") between India and Mauritius read with provisions of section 90(2) of the Act.*

*7.2. The Appellant vide its submission dated January 14, 2013 submitted that buyback was a legally recognized transaction and that it was undertaken in accordance with the provisions of the Companies Act, 1956 ('Companies Act'). The Board of Directors of the company decides about such decisions and all relevant documents were filed with the*

*RBI. The Appellant placed reliance on the case of Armstrong World Industries vs. Director of Income-tax (A.A.R No. 1044 of 2011).*

*7.3 It was argued that buyback is a legally recognized transaction and that it was undertaken in accordance with the provisions of the Companies Act. Section 77A of the Companies Act is the specific section which contains the basic framework for companies to buyback its own securities (provisions of section 77A of the Act are enclosed as 'Annexure 6'. Section 77A provides various guidelines which the company needs to fulfil for doing a buyback of shares. In the instant case, the Board of Directors of the company took such decision and complied with all such conditions for affecting the buy back. It is submitted that decision of buyback is the prerogative of the company and the tax authorities cannot challenge such decision. The Appellant has filed various documents with ROC as required by the provisions of the Companies Act. Copy of such documents was filed with the Ld. A.O. and facts of the case were discussed in detail in the Appellant's submissions.*

*7.4 It was contended that buyback is not a colorable device to avoid DDT implications. Further, it was submitted that in terms of clause (iv) to Section 2(22) of the Act, buyback which is effected as per Section 77A of the Companies Act is excluded from the scope of definition of "dividend". The provisions of Act itself provide that buyback transactions are subject to dividend implications.*

*It was also submitted that as per the prevailing law (i.e. as applicable for AY) income on buyback of shares is taxed in the hands of as capital gains under Section 46A of the Act. Section 46A was introduced by Finance Act, 1999. In the course of debate, the Finance Minister made the following assurance to the House:*

*"Very recently, the Companies Act, 1956 has been amended to permit transactions relating to buyback of shares. There is some ambiguity in the interpretation of the law as to whether such transactions would be treated as subject to dividend tax in addition to capital gains tax. In view of this, I propose to amend the law to put it beyond doubt that on buyback of shares, the shareholders will not be subject to dividend tax, and would only be liable to capital gains tax."*

***7.5.*** *The relevant extracts from the Explanatory notes are as under:*

*'The Act, therefore, has amended clause (22) of section 2 of the income- tax Act by inserting a new clause to provide that dividend does not include any payment made by a company on purchase of its own shares in accordance with the provisions contained in section 77A of the Companies Act, 1956. It has also inserted a new section, namely, section 46A in the Income-tax Act, to provide that any consideration received by a shareholder or a holder of other specified securities from any company on purchase of its own shares or other*

*specified securities shall be subject to provisions contained in section 48, deemed to be the capital gains."*

*7.6. In view of above, the LAR strongly contended that it can be concluded that the current law does not deem (or empower the assessing officer to deem) the buyback of shares as declaration by the company purchasing its own shares. The express provision of the Act (i.e. section 2(22)(e) read with section 46A of the Act) leaves no discretion to the assessing officer to choose between the taxability as capital gain or treating it as dividend.*

*7.7. It is well settled that tax implications of a valid transaction need to be determined as per provisions applicable to the transaction and that the taxpayer is entitled to plan his affairs in a manner which mitigates or controls his tax liability. If buyback is effected in terms of provisions of the Companies Act, the specific tax provisions as contained in Section 46A read with Section 2(22) of the Act are clearly attracted and the same cannot be treated as a deemed dividend. The transaction of buyback is subjected to levy of capital gains tax in terms of Section 46A of the Act. In the instant case, such capital gain liability does not arise due to the provisions of India-Mauritius DTAA read with the provision of the Act.*

*As a result, the company effecting buyback is not required to pay Dividend Distribution Tax while the taxpayer from treaty favourable jurisdiction is entitled to*

*claim tax exemption in respect of capital gains income.*

*7.8. There are various judicial precedents wherein it has been held that transaction within the four corners of law cannot be labeled as tax avoidance scheme. It has been held that under fiscal laws, tax planning within the framework of the law to save taxes is allowed. The right to conduct the affairs of a business falls within the prerogative of the taxpayer. The taxman/tax authorities can only intervene in cases where there has been a deliberate attempt by the taxpayer to illegally evade taxes through use of dubious methods or colorable device. In this regard, reliance was placed on following judgments:*

*i. Azadi Bachao Ando tan v UOI (263 ITR 706)*

*ii. Banyan and Berry vs. Commissioner of Income-tax*

*iii. Vodafone International vs. UOI (341 ITR 1)*

*iv. Walfort Share & Stock Brokers Pvt. Ltd. (Supra)*

*7.9. The LAR vociferously contended that the consideration paid by the Appellant towards buyback of shares cannot be terms as dividend and accordingly cannot be taxed under section 115-O of the Act.*

*7.10. In this connection, it may be noted that the Finance Act 2013 has introduced Section 115AQA of the Act whereby tax of 20% is proposed to be levied on distributed income on buyback of shares by an unlisted domestic company. Consequently, such income shall be exempt in the hands of the shareholder by virtue of newly inserted Section 10(34) of the Act.*

*7.11. These provisions are applicable with effect from June*

*1, 2013. As a result, buyback which is completed prior to June 1, 2013 would be regulated by previous law and legal position. Therefore, it was strongly contended that the remittance of buyback should not be subjected to DDT in absence of express provisions for the same.*

*7.12. The LAR added that recently introduced GAAR provisions are proposed to be implemented from April, 2016. In absence of such provisions, LAO does not have any powers to re-characterize or look through the transactions. This proposition has been upheld by various courts in the decision mentioned above.*

*7.13. The LAR also distinguished the ruling of AAR in case of A Limited (supra). It was submitted that such reliance is grossly misplaced as the facts in the case of A Limited are completely different from the facts of the Appellant's case. The LAO has himself admitted that the facts are not exactly same but there are similarities, but in reality the facts are totally different.*

*7.14 In the case of 'A Limited', it was a public limited company incorporated in India and the shareholders of the A Limited were three foreign companies incorporated in US (US Co.), Mauritius (Mau Co.), and in Singapore(Sing Co.). 'A Limited' had not declared or paid any dividend to its shareholders after introduction of DDT in the Act in 2003. Instead of distributing the divided on the basis of profits that accrued, it allowed the reserves to accumulate. It offered buyback of shares to Mau Co. and it was noted that US Co. did not accept the buyback as it would have been*

*taxable in India as capital gain under the India-US DTAA and Sing Co also did not accept the buyback as its taxability would depend on certain conditions being fulfilled under India-Singapore DTAA and therefore, the scheme of buy-back was treated as colorable device to avoid tax on distributed profits.*

*7.15. In the Appellant's case, there is only one shareholder Korn Ferry Mauritius and there is no other shareholder who would not accept the buyback. Therefore, it cannot be said that it is only for availing the benefits of the India-Mauritius DTAA. Further, it is submitted that the Appellant has paid dividend and DDT in later financial years. Thus, it is evident that the facts of the case are completely different from the facts of 'A Limited' and the buyback transaction in the Appellant's case is not a colorable device to avoid tax and is a genuine transaction.*

*7.16. It was reiterated that in the case of Vodafone International Holding B.V [341 ITR 1(SC) and Azadi Bachao Andolan [263 ITR 706 (SC), it has been held that not all tax planning is illegal/ illegitimate/ impermissible and the instant case at best be classified as tax planning measure and not tax avoidance measure.*

*7.17. In the instant case, since the meaning of "any other transaction" is not very clear (and inclusion of all possible transactions does not correspond to the basic intent behind introduction of TP regulations), the phrase "any other transaction" should take colour from the preceding clauses viz, purchase, sale or lease tangible or intangible*

*property, or provision of services, or lending or borrowing money. Therefore, 'any other transaction' must be a transaction in the nature of transfer of goods or provision of services or in nature of lending or borrowing, which would impact the reportable profits/income of the taxpayer. In view of the above discussion, it is humbly submitted that the transaction of buyback of shares by the Appellant cannot be covered under the residual clause.*

*Thus, the transactions which are otherwise not taxable as income and which have no bearing on the income or loss of the Appellant were never meant to be covered within the purview of the TP provisions as indicated by the express provisions of section 92(1) of the Act.*

*7.18. Having carefully and dispassionately considered the facts and circumstances of the case and in view of the aforesaid discussion, it is held that the remittance made by the appellant to the Mauritius resident, M/s Korn Ferry Investment Ltd., Mauritius, in accordance with the buyback scheme offer dated 02.03.2010 was not liable as dividend and further not liable to Dividend Distribution Tax u/s 115-O of the Act. This is also in accordance with Indo-Mauritius Tax Avoidance Treaty. Ground of Appeal No.4 is allowed."*

5.5.2 The Ld. AO has made a categorical statement that the facts and circumstances of assessment years 2010-11 and 2011-12 are identical, and therefore, Ground of Appeal No.4 has been stated to

be a covered matter. Duly following my decision for AY 2010-11 and in view of judicial consistency, Grounds of Appeal No.4 is treated as allowed**. "**

**15.** Thus, from the above, it is seen that Ld. CIT(A) held that the remittance made by the assessee to the Mauritius resident, i.e. M/s Korn Ferry Investment Ltd, Mauritius was in accordance with buyback scheme offer dt 2-3-2010 and the same was not liable to be taxed as dividend and further not liable to be taxed u/s 115-O of the Act as Dividend Distribution Tax. Ld. CIT(A) took into consideration, the benefit provided under India-Mauritius DTAA.

**16.** Being aggrieved, revenue filed appeal before the Tribunal. During the course of hearing it was brought to our notice that the Tribunal has already decided this issue in favour of the assessee. Both the parties agreed that the issue was covered with the order of the Tribunal for A.Y. 2010-11. It is noted by us that in A.Y. 2010-11, the Tribunal has decided this issue in favour of the assessee by relying upon another decision of the Tribunal in the case of Goldman Sachs (India) Securities Pvt Ltd. The relevant part of the order of the Tribunal is reproduced hereunder:

***4.*** *The effective Ground of appeal filed by the AO is about buyback of shares. During the assessment proceedings the AO had held that assessee had indulged in activity of buy*

*back of shares, that the same was a colourable device for the purpose of avoiding dividend distribution tax, that the assessee had not declared dividend inspite of making regular profit. In the appellate proceedings, the FAA had upheld the disallowance of Rs.52.08 lakhs. But he did not agree with the AO that buyback of shares was an instrument to avoid dividend distribution tax.*

***5.*** *During the course of hearing before us, the DR and the AR stated that identical issue had arisen in the matter of Goldman Sachs (India) Securities Pvt. Ltd (ITA/3726/Mum/2015, AY 2011- 12, dtd.12. 02. 2016), that the Tribunal had decided the issue in favour of the assessee. We find that the Tribunal had deliberated upon the issue and had decided as under:*

*"The assessee is a wholly owned subsidiary of Goldman Sachs (Mauritius) LLC(GS-M). It was set up to undertake merchant banking and security business in India. Registered under the STPI scheme, it had set up a 100% export oriented unit in Bangalore to serve as a global support centre for the Goldman Sachs Group entities. On 24.11.2010, the assessee had remitted an amount Rs.1,88,99,97,781/- to GS-M under a buyback of shares scheme, whereby 4,03,93,199/- equity shares having face value of Rs.10 each were bought back from GS-M by the assessee @Rs.46.79/-per share. Taking into account the face value of Rs.10 per share, the AO in his order, passed u/s.201(1) and 201(1A) r.w.s. 195 of the Act, on 27.01.2014 held that the excess payment of Rs.36.79/-per*

*equity share for 4,03,93,199 shares bought back amounting to Rs.1,48,60, 65,791/-was nothing but its distribution of its accumulated profits to its ultimate beneficiary and the only shareholder i.e.GS-M, that the buyback of equity shares by the assessee from its holding company was a colourable transaction to avoid the payment of dividend distribution tax (DDT). The excess payment of Rs.1,48,60,65,791/-was held by the AO to be in the nature of dividend as per provisions of section 2(22)(d) of the Act. As the assessee had not deducted any DDT u/s.115 of the Act, such dividend income was found by the AO not to qualify for exemption u/s 10(34) of the Act and therefore, was taxable in the hands of the recipient namely GS-M. He further held that on remittance of such amount to a non-resident representing its income by way of dividend, tax deduction was required to be made u/s.195 of the Act. As the assessee company had not deducted any tax while making such remittance, it was held to be an 'assessee in default' in terms of the provisions of section 201 of the Act. Further, the assessee was also found to be liable to pay simple interest u/s 201(1A) of the Act. Tax at the rate of 5% of the gross amount of such dividend was determined by the AO as payable by the assessee in terms of para 2(a) of Article 10 of the India Mauritius Tax-Treaty.*

***3.*** *Aggrieved by the order of the AO, the assessee preferred an appeal before the First Appellate Authority (FAA). Before him ,it was argued that a transaction of buy back of shares referred to section2(22) (iv) of the Act was different from a transaction of capital reduction dealt by section 2(22)(d) of the Act, that*

*the transaction in question was one of buy back of shares and not a case of capital reduction. After considering the submissions of the assessee and the order of the AO, the FAA held the AO had obtained the annual report of the assessee company for the five preceding years and from such annual reports he noticed that it had been earning profits after tax for each of those years, that the reserves and surplus increased from Rs.81,01,34,000/-for the year ending 31.03.2008 to Rs.3,46,03,20,000/-for the year ending 31.03.2010,that inspite of regular profits being earned by it Directors of the assessee-company did not recommend any dividend payment on its equity shares, that money had a time value and postponement of grant of a share in the profits to a shareholder would be for purposes of re-investment in the business for the purposes of enhancing future profits, that the assessee had not shown any such requirement or compulsion as a justification for the non-grant of dividend in the regular course, inspite of the continuous accumulation of profits in its books, that the AO had specifically required the assessee to explain the commercial reason, if any, for the non issue of dividend although the profits were being accumulated year after year, that it chose to remain silent on this show cause notice issued by the AO, that by permitting the profits to accumulate in its books it had avoided the payment of DDT that would have been payable if such accumulated profits had been distributed to its share-holders, that a portion of such accumulated profit was finally passed on to the sole shareholder on 24.11.2010 by way of payment on account of*

*buy back of shares, that it had claimed the exemption available u/s.2(22)(iv) of the Act that excluded any payment made by a company on the purchase of its own shares from a shareholder in accordance with the provisions of section 77-A of the Companies Act,1956.The FAA further observed that the definition of dividend given in section 10(22) of the Act was an inclusive definition that sought to extend the scope of amounts chargeable to tax as deemed dividend but payments in the nature of dividend would always be coming within the ambit of the term dividend, that the commercial significance of a transaction of a buyback of equity shares was normally for the purposes of consolidating the share-holding of the remaining share holders and to enhance the value of the shares remaining in the hands of the continuing share holders, that GS-M was the sole equity share holder of the assessee-company both prior to and after the buyback of shares by the it, that the arrangement of buy-back of shares would not lead to any consolidation or a change in the value of its holdings in the assessee-company, that there was no commercial purpose was served through the buyback arrangement, that the assessee was a wholly owned subsidiary of GS-M, that the latter was in a position to ensure that the returns out of the profits of the assessee-company would be given to it not through dividend, that payment of dividend would have been liable to DDT, that the transaction of the receipt of its share of profits in the assessee company was given an artificial colour of capital gains, that capital gain on such transaction was exempt from tax in the hands of the recipient, that the non-*

*distribution by way of dividend of the accumulated profits, the transaction of buy back of shares offered by it and the exercise of such option by its sole share-holder was carried out not for any commercial reasons, that whole transaction was arranged for the purposes of enabling an evasion of taxes due on such distribution of Profits, that the receipt by GS-M would come within the ambit of income from a share-holding or a participation in the profits of a subsidiary, that the assessee through the recourse to the arrangement of the buyback of shares sought to give the colour to this transaction as not being in the nature of a receipt of dividend but a capital gain of the concerned share holder, that the arrangement was made to use of the provisions of section 46A of the Act and to claim exemption from tax in India on the basis of Article 13(4) of the India Mauritius Tax Treaty. The FAA referred to the case of a Indian Company that was decided by the AAR in Case No. P of 2010 vide its order dated 22.03.2012 and held that it had persuasive value. He further held that section 100 to 105 of the Companies Act dealt with reduction of capital, that the annual accounts of the assessee showed that its share-capital actually got reduced and was so reflected in the books after the buy-back of the shares, that buy-back of shares was one of the ways of capital reduction, that reliance by the AO on the provisions of section 2(22)(d) of the Act dealing with capital reduction, as including a transaction of buy-back of shares was justified, that the provisions of section 10(34) would apply only if DDT had been paid u/s.115-0 of the Act, that no DDT was paid by the assessee, that the recipient would not be*

*entitled to any exemption u/s. 10(34) of the Act, that the receipt in its hands would be chargeable to income tax, that the treatment by the AO of the assessee as an A-I-D and the raising of demand u/s.201(1) and 201(1A) r.w.s. 195 of the Act was justified. Finally, he decided the issue against the assessee.*

***4.****Before us, the Authorised Representative(AR)argued that the assessee had bought back the shares as per the resolution passed in the general meeting in the Board of Directors on 4.11.2010 (Pg 14 of PB), that the offer for buy back opened on 5.11.2010 and closed on 20.11.2010, that the shareholder tendered the shares on 23/.11.2010, that after the amendment to section 77A of the Company's Act there was no need to approach the courts to buy back the shares if the percentage of buy bought shares were less that a certain limit, that correspondingly provisions of sec.2(22)(d) of the Act were amended w.e.f 1.6.2001, that sub clause of (iv) of Section 2(22)(d) of the Act dealt with the dividends, that the amount in question was to be assessed under the head capital gains, that even after amendment to section 115QA of the Act burden of payment of tax has not been shifted to shareholders , that the AAR had not considered the provisions of sub clause (iv) of section 2(22) of the Act while deciding the application filed before it, that the payment made by the assessee was for the purchase of shares, that there was no reduction in capital. The Departmental Representative (DR) contended that the facts of the case decided by the AAR were applicable to the case under appeal, that the buy-back was not genuine, that it was a case*

*of colourable device, that the scheme had resulted in reduction in capital, that the FAA had rightly held that provisions of section 2(22)(d) of the Act were applicable.*

***5.*** *We have heard the rival submissions and perused the material before us. We are of the opinion that for deciding the issue before us, it would be useful to consider the provisions of section 77A and100-105 of the Companies Act(CA) and section 2(22) and 46A of the Act. Section 77A of the CA deals with buying back of shares in following manner:*

> *(1) Notwithstanding anything contained in this Act, but subject to the provisions of sub-section (2) of this section and section 77B, a company may purchase its own shares or other specified securities (hereinafter referred to as "buy-back") out of-*
>
> *(i) its free reserves ; or*
>
> *(ii) the securities premium account ; or*
>
> *(iii) the proceeds of any shares or other specified securities :*
>
> *Provided that no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.*
>
> *(2) No company shall purchase its own shares or other specified securities under sub-section (1) unless-*
>
> *(a) the buy-back is authorised by its articles ;*

*(b) a special resolution has been passed in general meeting of the company authorising the buy-back*

*Provided that nothing contained in this clause shall apply in any case where-(A) the buy-back is or less than ten per cent of the total paid-up equity capital and free reserves of the company; and (B) such buy-back has been authorised by the board by means of a resolution passed at its meeting:*

*Provided further that no offer of buy-back shall be made within a period of three hundred and sixty-five days reckoned from the date of the preceding offer of buy-back, if any.*

*Explanation — For the purposes of this clause, the expression "offer of buy-back" means the offer of such buy-back made in pursuance of the resolution of the board referred to in the first proviso ;*

*(c) the buy-back is of less than twenty-five per cent of the total paid-up capital and free reserves of the company :*

*Provided that the buy-back of equity shares in any financial year shall not exceed twenty-five per cent of its total paid-up equity capital in that financial year ;*

*(d) the ratio of the debt owed by the company is not more than twice the capital and its free reserves after such buy-back :*

*Provided that the Central Government may prescribe a higher ratio of the debt than that specified under this clause for a class or classes of companies.*

*XXXXXXX*

*(5) The buy-back under sub-section (1) may be-*

*(a) from the existing security holders on a proportionate basis ; or*

*(b) from the open market ; or*

*(c) from odd lots, that is to say, where the lot of securities of a pub-lic company whose shares are listed on a recognised stock exchange, is smaller than such marketable lot, as may be specified by the stock exchange ; or*

*(d) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity."*

*Section 100-105 r.w.s.391of the CA deal with reduction of capital and obtaining permission of the Court. Clearly, both deal with different situations. The Hon'ble Jurisdictional High Court has dealt with the schemes of buyback of shares and reduction of capital in the case of Capgemini India Private Limited (Company Scheme Petition No.434 of 2014 dated 28.04.2015) as under:*

*4. The entire case of the Regional Director revolves around his contention that the buyback of shares must be effected only under Section 77 A of the Companies Act,*

*1956/Section 68 of the Companies Act, 2013. According to the Regional Director if a buyback of shares is effected under Section 77A/Section 68, then the distributed income of the company as defined in Section 115QA of the Income Tax Act, would be charged to tax and it is for this reason that the company is not following the procedure prescribed under Section 77A/Section 68 and has opted for the procedure under Section 391 which would not attract such a tax under Section 115QA of the Income tax Act. According to the Regional Director by this colourable device the company is evading its liability to pay tax.*

*5. One of the contentions raised by the petitioner is that a view of the Circular dated 15th January 2014, the Regional Director has no locus in respect of tax matters, particularly when the Income tax Authorities have not raised any objection. This aspect has been considered in detail by this Court in the case of Casby CFS Pvt. Ltd. and it has-been held that the Regional Director has the requisite locus standi to raise all objections in respect of a scheme including objections pertaining to taxation laws. He can do so even if the Income Tax Authorities do not raise any objection. It has been held that this is the duty and obligation of the Regional Director. In view of the aforesaid decision of this Court the objection of the Petitioner with regard to the locus of the Regional Director is untenable and deserves to be rejected.*

*6. The Petitioner has submitted that it is open to the Petitioner to follow either the procedure under section 77A/section 68 or the procedure under section 391 read with Sections 100 to 104 to effectuate the buyback of shares and there is no compulsion for the Petitioner to follow only the procedure prescribed by Section 77 A/Section 68. In any event, under Section 77 /Section 68 a company can buyback only 25% of the total paid up capital and free reserves of the company whereas under the Scheme the company proposes buyback of 30% of its paid up capital and free reserves, which is not possible under Section 77 /Section 68. Consequently the only manner in which the company can buy back the said shares is by following the procedure under Section 391 read with Sections 100 - 104 of the 1956 Act. In support of its contentions the Petitioner has relied upon the decision of the Division Bench of this Court in the case of SEBI V/s. Sterilite Industries (India) Limited.*

*7. The Division Bench of this Court in the case of Sterilite Industries (supra) has held that a Company may either follow the procedure under Section 391 read with Sections 100 to 104 of the 1956 Act or the procedure under Section 77A (now Section 68). It is not mandatory for a company to buy back its shares only by following the procedure prescribed by Section 77 A. In this regard paragraphs 22 and 23 of the Sterilite decision are relevant and the same are reproduced below for convenience:*

*"22. The opening words of Section 77A, viz. "notwithstanding anything contained in this Act,but subject to the provisions of sub-section(2) of this section and section 77B, a company may purchase its own shares or other specified securities..." shows that section 77A is a facilitating provision which enables companies to buy-back their shares without having to approach the court under section 391 and section 100 to 104 subject to compliance with the provisions of sub-sections (2), (3) and (4). Prior to the introduction of section 77 A, the only manner in which a company could buy-back its shares was by following the procedure set out under sections 100 to 104 and section 391 which required the calling of separate meetings of each class of shareholders and creditors as well as (if required by the court) the drawing up of a list of creditors of the company and obtaining of their consent to the scheme for reduction. The legislative intention behind the introduction of section 77 A is to provide an alternative method by which a company may buy-back upto 25 per cent of its total paid- up equity capital in any financial year subject to compliance with sub-sections (2), (3) and (4). It does not supplant or take away any part of the pre-existing jurisdiction of the company court to sanction a scheme for such reduction under sections 100 to 104 and section 391.*

*23. The submission of the appellants that the non obstante clause in section 77A gives precedence to that section over provisions of sections 100 to 104, section 391 is misconceived. The non obstante clause in section 77 A*

*namely "notwithstanding anything contained in this Act .... " Only means that notwithstanding the provisions of section 77 and sections with the conditions mentioned in that section without approaching the court under sections 100 to 104 or section 77A to indicate that the jurisdiction of the court under section 391 or 394 has taken away or substituted. It is well settled that the exclusion of the jurisdiction of the court should not readily be inferred, such exclusion should be explicitly or clearly implied. There is nothing in the language of section 77 that gives rise to such an inference. We are, therefore, inclined to hold that section 77 A is merely an enabling provision and the courts powers under sections 100 to 104 and section 391 are not in any way affected. The conditions provided in section 77A are applicable only to buy-back of shares under section 77A. The conditions applicable to sections 100 to 104 and section 391 cannot be imported into or made applicable to a buy-back under section 77A. Similarly the conditions for a buy-back under section 77A cannot be applied to a scheme under sections 100 to 104 and section 391. The two operate in independent fields".*

*4.However,it is necessary to note that the above was the position in law under the1956 Act in view of the language of the provisions of Section 391 and Section 77 A of that Act. In the 2013 Act Sub-section 10 of Section 230 provides as follows:-*

*"10. No compromise or arrangement in respect of any buy-back of securities under this section shall be sanctioned by the Tribunal unless such buy-back is in accordance with the provisions of section 68."*

*This provision may have an impact on the law as laid down by this Court in the Sterilite case. However, at present Section 230 has not come into force and hence this question does not arise for consideration in this question does not arise for consideration in this case and hence the same need not to be considered. At present the law as laid down in Sterilite Industries prevails and will be applicable to the present case.*

*5. In the circumstances it is open to a company to buy back its own shares by following the procedure prescribed under section 77A/Section 68 or by following the procedure prescribed under section 391 read with Sections 100 to 104 of the 1956 Act. The contentions of the Regional Director are therefore clearly contrary to the prevailing legal position."*

*The above observations of the Hon'ble Court does not leave any doubt that buyback of shares cannot be equated with reduction of capital.*

***5.1.****We find that while amending the CA, by introduction of section 77A of the Act, Legislature had made amendments to the Income tax Act too. We would like to reproduce Section 2(22)(d) and section 46A of the Act and same read as under:*

*(22) "dividend" includes-*

*(a) …….*

*(b) …….*

*(c) ……..*

*(d) any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits which arose after the end of the previous year ending next before the 1st day of April, 1933, whether such accumulated profits have been capitalised or not ;"*

***"46A.** Where a shareholder or a holder of other specified securities receives any consideration from any company for purchase of its own shares or other specified securities held by such shareholder or holder of other specified securities, then, subject to the provisions of section 48, the difference between the cost of acquisition and the value of consideration received by the shareholder or the holder of other specified securities, as the case may be, shall be deemed to be the capital gains arising to such shareholder or the holder of other specified securities, as the case may be, in the year in which such shares or other specified securities were purchased by the company.*

*Explanation.—For the purposes of this section, "specified securities" shall have the meaning assigned to it in Explanation to section 77A of the Companies Act, 1956 (1 of 1956)."*

*The reasonable conclusions that can be drawn from the scrutiny of the above sections are that buy back of shares and reduction of share-capital are different concepts, that buyback of shares of a corporate entity cannot to be characterised as deemed dividend, that profit arising out of the buyback schemes had to taxed under the head capital gains.*

*Here, it would be useful to take notice of the Speech of the Finance Minister while introducing the amendment to the Act with regard to the buyback of shares. Relevant part of the speech of the FM reads as follow:*

*"95.Very recently, the Companies Act, 1956 has been amended to permit transactions relating to buy-back of shares. There is some ambiguity in the interpretation of the law as to whether such transactions would be treated as subject to dividend tax in addition to capital gains. In view of this, I propose to amend the law to put it beyond doubt that on buy-back of shares, the shareholders will not be subject to dividend tax, and would only be liable to capital gains tax."*

*Central Board of Direct Taxes had issued a circular (Circular no.779,dated 14.09.2099) with regard to taxability arising out of the buyback of shares and circular reads as under:*

*"28 Clarification of tax issues arising out of the provision to allow buy-back of shares by the companies*

*28.1 The Companies (Amendment) Ordinance, 1998 [subsequently enacted as the Companies (Amendment) Act, 1999] inserted section 77A in the Companies Act, 1956 which allows a company to purchase its own shares subject to certain conditions. The shares bought back have to be extinguished and physically destroyed and the company is precluded from making any further issue of securities within a period of 24 months from such buy-back.*

*28.2 The above newly introduced provisions of buy-back of shares threw up certain issues in relation to the existing provisions of the Income-tax Act. The two principal issues are whether it would give rise to deemed dividend under section 2(22) of the Income-tax Act and whether any capital gains would arise in the hands of the shareholder. The legal position on both the issues was far from clear and settled and there was apprehension that there will be unnecessary litigation unless the issues are clarified with finality.*

*28.3 The Act, therefore, has amended clause (22) of section 2 of the Income-tax Act by inserting a new clause to provide that dividend does not include any payment made by a company on purchase of its own shares in accordance with the provisions contained in section 77A of the Companies Act, 1956. It has also inserted a new section, namely, section 46A in the Income-tax Act, to provide that any consideration received by a shareholder or a holder of other specified securities from any company on purchase of its own shares or other specified securities shall be, subject to*

*provisions contained in section 48, deemed to be the capital gains.*

*28.4 This amendment will take effect from 1st day of April, 2000 and will, accordingly apply in relation to the assessment year 2000-2001 and subsequent years."*

*It is worth mentioning that provisions of section 115Q have been amended w.e.f. 01.04.2013 and profit arising out of buyback of shares is to be taxed at a particular tax rate. But, the AY before us, is prior to the April1, 2013.Therefore, we have to decide the issue as per the prevailing law applicable on the date of the transaction in question. There is no ambiguity about the provisions that would govern the buyback of shares. Section 2(22)(d)(iv) r.w.s.46A of the Act would be applicable to the buyback scheme. Accordingly, the transaction cannot be treated as deemed dividend.*

***5.2.*** *Now, we would deal with the issue of treating the assessee as A-I-D for not deducting tax at source. Once it has been decided that the profit arising out of buyback would be taxed as capital gains the next step is to determine as to whether the capital gains are taxable in the hands of parent company of the assessee in light the Indo-Mauritius Tax Treaty. Article 13 of the said DTAA provides that capital gains would not be taxable in the hands of GS-M. If the assessee was not liable to deduct taxes as per the provisions of section 195 of the Act, it cannot be held A-I-D. For invoking the provisions of section 201 of the Act, non deduction of taxes at source is a pre-condition. We also find force in the alternate*

*argument raised by the assessee. Even if the payment to GSM is considered as dividend u/s 2(22)(d) of the Act, then the taxes on the same have to be charged by way of DDT as per section 115-O of the Act. As per section 10(34) of the Act, any income by way of dividend referred to in section 115-O of the Act does not form part of total income in the hands of the recipient and company declaring dividend will be in default as per section 115Q. So, the provisions of TDS would not be applicable for dividend covered under section 2(22)(d) of the Act.*

***5.3.*** *We would also like to discuss the issue of the alleged colourability of the transaction. We find that in the matter of Capgemini India Private Limited (supra), the Hon'ble Bombay High Court has deliberated upon the almost identical facts and circumstances and has held as under:*

> *6. According to the Regional Director if the Scheme is sanctioned it will amount to evasion of income tax and outflow of foreign exchange to the tune of Rs. 248 crores and therefore on this ground the Scheme should be rejected. The Regional Director has not furnished any particulars in support of the aforesaid contention. Be that as it may, if the law permits a company to buy back its shares in more than one way; the company cannot be compelled to follow only the method that results in payment of income tax. It is well settled that an assessee can always manage his affairs in a manner so as to avoid payment of tax. In the present case since it is legally permissible for the company*

*to buy back its shares by following the procedure under Section 391 read with Sections 100 to 104 of the 1956 Act, the fact that the same may not attract income tax will not amount to it being a device to evade tax.*

*7. Even the argument of the Regional Director that foreign exchange amounting to Rs.248 crores will be drained away if the Scheme is sanctioned, is of no avail once it is held that the procedure adopted by the company is permissible in law. Moreover, the Regional Director has not shown that the law prohibits the transfer of shares by a non-resident to resident. In fact, he does not dispute that the same is permissible. The Petitioner has placed on record RBI's Circular No.49 dated 4th May 2010 which provides that shares of an unlisted Indian company can be transferred by a non-resident to a resident under the general permission of the RBI if the transfer price does not exceed the fair market value as determined by a Chartered Accountant or a SEBl registered Merchant Banker as per the DCF method. In the present case the transfer price has been arrived at in accordance with the aforesaid circular of the RBI. The Regional Director has not disputed the fair market value of the shares so determined. In these circumstances it is clear that the buyback of shares under the Scheme is in accordance with the RBI Guidelines and that being so, there is no question of there being any draining away of foreign exchange.*

*8. In view of the above and particularly the fact that in law, the Petitioner is entitled to buy back its own shares by means of a scheme under Section 391 read with sections 100-104 of the 1956 Act, the scheme cannot be said to be a colorable device to evade income tax. It is a legally permissible procedure which the Petitioner is entitled to follow to buy back its shares."*

*Following the above order, we hold that transaction in question would not fall under the category of colourable device. If an assessee enters into a deal which does not violate any provision of the Act of applicable to a particular AY, the deal cannot be termed a colourable device, if it result in non-payment or lesser payment of taxes in that year. The whole exercise should not lead to tax evasion. Non-payment of taxes by an assessee in given circumstances could be a moral or ethical issue. But, for that the assessee cannot be penalised. In light of the above discussion, we are reversing the decision of the FAA and deciding the effective ground of appeal in favour of the assessee."*

Following the above order effective ground of appeal is decided against the AO."

**17.** It is noted by us that no distinction has been brought on facts or in the legal position by the Ld. DR. It is further brought to our notice that in this year also shares were bought back from same shareholder and all the facts and circumstances and the legal position also remain the same. Thus,

respectfully following the order of Tribunal for earlier years, we find that the Ld. CIT(A) has rightly decided this issue in favour of the assessee by holding that the impugned payment made during the year before us did not amount to deemed dividend and therefore, the same was not liable to tax under any provisions including provisions for Dividend Distribution Tax u/s 115 O of the Act, in view of Indo-Mauritius DTAA. Under these circumstances, respectfully following the order of the Tribunal for earlier years, we dismiss the appeal filed by the revenue.

**18.** As a result appeal of the assessee is allowed and appeal of the revenue is dismissed.

*Order pronounced in the court on this __27th _____ day of July, 2016.*

| Sd/- | Sd/- |
|---|---|
| (AMIT SHUKLA) | (ASHWANI TANEJA) |
| JUDICIAL MEMBER | ACCOUNTANT MEMBER |

Mumbai, Dt: 27th July, 2016

Pk/-

Copy to:

1. The appellant
2. The respondent
3. The CIT(A)
4. The CIT
5. The Ld. Departmental Representative for the Revenue, A-Bench

(True copy) By order

ASSTT.REGISTRAR, ITAT, MUMBAI BENCHES