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Strategic modes for exit for shareholders

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Background – Exit Strategies

Background - Exit strategies

Driver for exit

An exit enables a promoter or investor to monetize its investment and realize the value of their stake. Such exit may be driven by commercial, strategic, regulatory, or shareholder-related considerations.

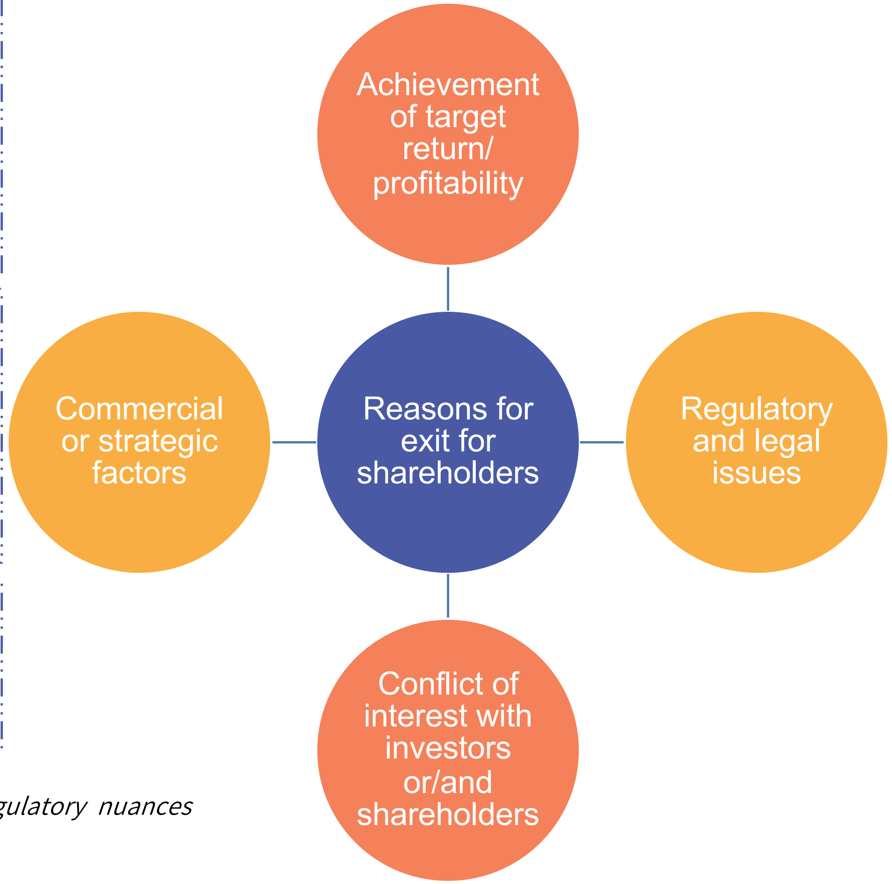
Efficient monetization and timely receipt of consideration by exiting shareholders is a key factor in determining the most suitable exit route. A promoter or investor may seek to exit its investment in a business, either wholly or partially, for a variety of reasons

Factors to Consider in Selecting the Exit strategies

- Nature of the investee entity (e.g. Company, LLP, joint venture, etc.),
- Tax, legal, regulatory, and foreign exchange considerations
- Type of instrument involved (equity shares, preference shares, debentures, etc.),
- Residential status of the investor, etc.
- Contractual rights and restrictions under transaction documents
- Timelines, valuation, and implementation feasibility

Common exit strategies

Share transfer, buyback, reduction of capital, IPO - offer for sale, demerger, and slump sale, each of which involves distinct legal, regulatory, tax, and commercial considerations.



The ensuing slides discuss commonly used shareholder exit strategies and the key legal and regulatory nuances associated with each of the mode.

Exit routes for shareholders

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Exit routes for shareholders

Cash Exits

Immediate liquidity events for shareholders without altering the company's going concern status Primarily executed via **Buyback** and secondary sales.

Structural Exits

Realigning the capital table without immediate cash outflow. Includes **Capital Reduction**, issuance of **Differential Voting Rights** and **Conversion of securities**.

Terminal Exits

The ultimate winding up of the corporate entity, All assets are distributed. Executed via **Voluntary Liquidation**

SHARE TRANSFER

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Share Transfer

Concept

- Direct transfer of ownership from the exiting shareholder to an incoming investor (strategic / financial / promoter / existing shareholder / identified buyer)
- No change in the company's capital structure – only the shareholder identity changes
- Most flexible and commercially negotiated exit route

Key Advantages

- Immediate liquidity for exiting shareholders
- Minimal company-level intervention – no NCLT process / no capital restructuring
- Flexibility in deal terms – price, earn-outs, staggered exit, reps & warranties
- Widely accepted for strategic sales, PE secondaries and promoter exits

Key Considerations

- **Pricing & Valuation** – FMV compliance (Section 79 of IT Act, 2025 / erstwhile Section 50CA; FEMA pricing guidelines)
- **Taxation**
  - Capital gains based on holding period (listed vs unlisted); TDS / withholding for non-residents
  - TDS under section 194Q - Whether shares are goods? Industry practice of deducting TDS. Exemption only for listed securities
- **Competition Law**: CCI Approval threshold
- **SEBI:** Takeover Code in case of listed company
- **FEMA :** FEMA pricing & reporting for cross-border transfers; sectoral caps; indirect transfer provisions
- **Contractual:** SHA restrictions: ROFR / ROFO, tag-along, drag-along, lock-in
- **Execution:** Buyer identification, funding certainty, escrow / earn-out structuring
- **Stamp Duty:** 0.015% of consideration on share transfer. Additional stamp duty on share purchase agreement

Preferred route where buyer interest exists, valuation is agreed and regulatory constraints are manageable.

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Share Transfer – Capital gains tax on shares

Particulars	Details
Consideration	• Should not be less than the FMV of the shares being transferred as per the Section 79 of the Act *(Section 50CA of the erstwhile Act)*
Listed shares held > 12 months	Sale by Indian residents or non-residents attracts capital gains tax of 12.5% (excluding surcharge and cess) on gains exceeding INR 1.25 lakhs.
Listed shares held ≤ 12 months	Gains attract capital gains tax of 20% (excluding surcharge and cess).
Unlisted shares held for more than 24 months	Gains on unlisted shares held for more than 24 months are taxable at 12.5% (plus surcharge and cess) without indexation. For shares acquired before 1 April 2001, FMV as on 1 April 2001 may be adopted as the cost of acquisition.
Unlisted shares held for period not exceeding 24 months	Gains on unlisted shares held for 24 months or less are taxable at the applicable normal tax rates.

Contingent consideration on exit

Concept

Contingent Consideration or an earn out is a mechanism by which, more commonly, part of the purchase price is calculated by reference to the future performance of the target company or business

This would normally be linked to the profits or sales of the target, but such a mechanism can involve any financial measure which is relevant to the target.

Earn-outs are payable only in case of satisfaction of agreed conditions such as on achieving target profit or sales etc.

The law is not clear on tax treatment when consideration for transfer of a capital asset is contingent on one or more uncertain events.

Here the key question is when will the contingent consideration accrue in such cases?

View 1: Consideration accrued only after the fulfilment of condition

Few judicial authorities[1 & 2] have held that an amount can accrue to assessee if he acquires a legally enforceable right to receive it from the debtor and in case of contingent consideration, such legally enforceable right to receive the consideration can be acquired only after fulfilment of conditions. **Hence, it will accrue on the day of fulfilment of conditions.**

[1]CIT v Hemel Raju Shete, ITA No. 2348 of 2013 (Bombay High Court)

[2]*Huntsman Investments (Netherlands) BV v. DCIT, International tax*

View 2: Consideration accrued in the year of transfer ignoring conditions

On the other hand, there are few judicial precedents[3] wherein it has been held that merely because the agreement provides for payment of the balance of consideration upon the happening of an events, **it cannot be said that the income has not accrued in the year of transfer and taxed the entire considerations in the year of transfer.**

[3]*CIT v Indira R. Shete, ITA No. 342/Mum/2010 (Mumbai ITAT)*

Case study 1 - Redemption of Preference Shares

View 1: Premium on redemption of preference shares considered as dividend	View 2: Capital gain tax on gain on redemption of preference shares
▪ Where redemption is funded out of accumulated profits, the payout entails release of company's assets to shareholders – arguably "distribution" of accumulated profits, deemed dividend u/s 2(22)(a) / 2(40)(a). ▪ Premium discharged out of free reserves / P&L (and not out of securities premium or proceeds of a fresh issue) is contended by Revenue to be distribution of accumulated profits.	▪ Redemption results in extinguishment of shareholder's rights in the shares – squarely covered as "transfer" u/s 2(47) of the erstwhile Act / corresponding provision of IT Act, 2025 ▪ The Supreme Court in the case of Anarkali Sarabhai held that redemption of preference shares is a transfer and the excess amount received by the shareholder on redemption would have to be treated as 'Capital Gain' and taxed accordingly. ▪ Payment of redemption premium out of securities premium cannot be considered as distribution out of accumulated profits since securities premium is not available for distribution of dividend and hence cannot be considered as accumulated profit ▪ Section 2(22) / 2(40) contains a specific carve-out for non-participating preference shares issued for full cash consideration.

BUYBACK – THE CASH EXIT ROUTE

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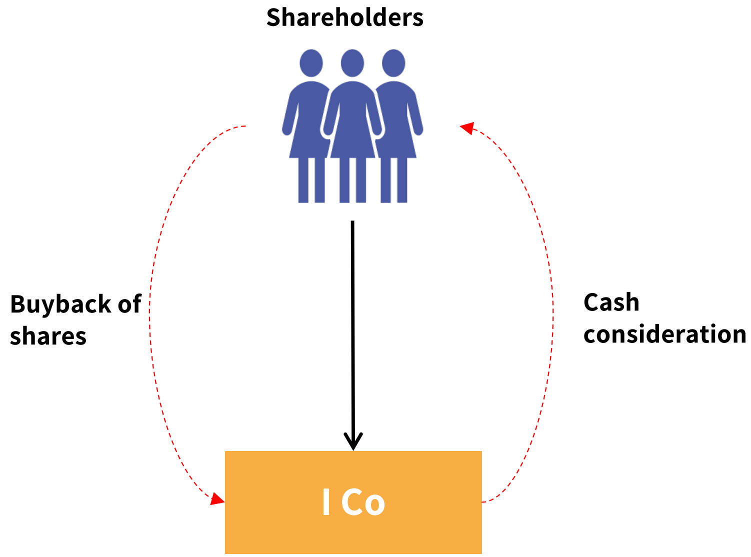
Buyback – The cash exit route

Buy-back of shares is a corporate action in which a company uses its own cash reserves to repurchase its outstanding shares from existing shareholders. This form of payout is primarily used by companies to return surplus cash to shareholders coupled with optimization of company's equity.

- ❑ Allows the company to purchase its own shares from existing shareholders
- ❑ Effective tool to repatriate the funds and provide exit from the company
- ❑ Enhance promoter's stake
- ❑ Capital restructuring
- ❑ Discover the significant benefits, including enhanced financial ratios, improved earning per share, and flexibility in capital allocation.



Buyback – Requisites and Limits under Companies Act

Requisites

Authorization Required:

- Articles of Association of the company
- **Board Resolution** – if 10% or less of equity and free reserves (including securities premium)
- **Special resolution** – if more than 10% of equity and free reserves (including securities premium)

Sources of Buyback Funds:

- Free Reserves
- Securities Premium
- Proceeds of fresh issue of shares or securities (not being same kind of shares or securities to bought back)

Restriction post buyback:

- **New issue post buyback:** No further issue of same kind of shares **within 6 months** (except through bonus issue, conversion of instruments, discharge of any pre-existing obligation etc.)
- **Debit-Equity Ratio:** Debt-equity ratio post buyback should not be more than 2:1
- **Cooling period:** One-year gap between consecutive buybacks *(Proposed by the Companies Amendment Bill, 2026 to reduce the time to six months)*
- Should be not be funded by bank debt

Limits

Maximum shares that can be bought back in one financial year – 25% of equity share capital

Maximum cash that can be utilized for the buyback – 25% of paid (paid up share capital + free reserves (including securities premium))

Historical perspective – Company Law

- Prior to 1999, the Indian Company Law largely followed the UK doctrine of ***"Capital Maintenance Rule"***
  - The landmark English case of ***Trevor v. Whitworth (1887)*** established the principle that it was *ultra vires* (beyond the legal power) for a company to buy its own shares
- UK introduce the concept of buy-back of shares in 1981
  - This was largely to fall in line with the ***European Economic Community (EEC) Second Directive***, which sought to harmonize company law across member states.

Buy-back of Shares under Indian Company Law		
Era	**Legal Status**	**Mechanism**
1913 – 1956	**Prohibited**	Only formal Reduction of Capital was allowed with High Court sanction.
1956 – 1998	**Prohibited**	Section 77 of the 1956 Act explicitly banned companies from buying their own shares.
1999 – Present	**Permitted**	Introduced via the 1998 Amendment (Sections 77A, 77AA, 77B) to provide a "fast-track" way to return capital without court intervention. Companies Act 2013 continues to permit buy-back of shares (Sections 68, 69, 70)

Historical perspective – Indian Tax Law

- The Taxation of Buy-back proceeds went through numerous amendments under the Income-tax Act, 1961:

Period	Taxation Mechanism	Key Section(s)
Pre-1st October 1998	No Concept of Buy-back. Any distributions from accumulated profits / capital reduction treated as deemed dividend	Sec 2(22)
1st October 1998 to 31st March 1999	Buy-back permitted under the Companies Act. However, the said proceeds were treated as "deemed dividend" under the Income-tax Act to the extent of accumulated profits	Sec 2(22) / 45
1st April, 1999 to 30th June 2013	Shifted to Capital Gains in the hands of the shareholder. This allowed shareholders to benefit from lower capital gains rates and indexation.	Sec 46A
1st June 2013 to 31st May 2016	Introduction of Buyback Tax (BBT) on buy-backs by unlisted companies covered u/s 77A of Companies Act. The company pays a flat tax on "distributed income," and the receipt is exempt for the shareholder under Section 10(34A).	Sec 115QA
1st June 2016 to 5th July 2019	The scope was widened to include buybacks under "any law for the time being in force", effectively closing the loophole which allowed companies to buy-back under a court-scheme.	Sec 115QA
6th July 2019 to 30th September 2024	The amendment covered listed companies under the buy-back tax. All public announcements made on or after 6th July 2019 covered	Sec 115QA
1st October 2024 to 31st March 2026	Buy-back proceeds deemed to be dividend. The original cost treated as capital loss	Sec 2(22)(f) and 46A

Taxation of share buyback

Buy-back of shares - Capital gains regime introduced (Applicable from TY 2026-27 onwards)

Following the amendment introduced by the Finance Act, 2025, the tax treatment of share buy-backs has been revised such that the consideration received on buy-back will now be taxable under the head 'Capital gains', rather than being classified as dividend income. The below table summarizes effective rate of Capital Gains in the hands of various categories of shareholders:

Sr. No.	Type of Capital Gain	Promoter is Domestic Company	Promoter is other than a Domestic Company	Non-Promoter
Buyback of Listed Equity Shares				
1.	Short-term Capital Gains	22% (20% + 2%*)	30% (20% + 10%*)	20%
2.	Long-term Capital Gains	22% (12.5% + 9.5%*)	30% (12.5% + 17.5%*)	12.5%
Buyback of Shares other than Listed Equity Shares				
1.	Short-term Capital Gains	22%	This will depend on Applicable Rates	
2.	Long-term Capital Gains	22% (12.5% + 9.5%*)	30% (12.5% + 17.5%*)	12.5%

**Additional tax (For the purpose of the above table, it is presumed that domestic company has opted for new tax regime. Further, the above rates are subject to applicable rate of surcharge and cess.) 12% surcharge on the additional tax liability for promoters only on share buyback as introduced by Finance Act 2026.*

'Promoter' shall mean:

- *For Listed Companies: As per SEBI (Buy-Back of Securities) Regulations, 2018*
- *For Unlisted Companies: As per Companies Act, 2013 or a person holding more than 10% of the shareholding*

Definition of “Promoter” in a listed company …

- **Promoter of a ‘Listed Company’**
  - Under the SEBI (Buy-Back of Securities) Regulations, 2018, a promoter is the one as defined under the SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011
  - Under SEBI Takeover Code, the term “promoter” has the same meaning as defined in the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 and includes a member of the promoter group
  - Also, under SEBI Takeover Code, the term ‘promoter group’ has the same meaning as defined in the SEBI (ICDR) Regulations 2009

Under the SEBI (ICDR) Regulations 2009, the term ”promoter” and “promoter group” defined in an inclusive and wide manner.

…Definition of "Promoter" in a listed company …

- **Definition of Promoter under SEBI (ICDR) Regulations 2009 includes:**

Category	Criteria / Description
Named Identity	Named as a promoter in the Draft Offer Document (DRHP), Offer Document, or identified in the Annual Return (Section 92 of Companies Act, 2013).
Control	Has direct or indirect control over the affairs of the issuer (whether as a shareholder, director, or otherwise).
Advice/Direction	A person in accordance with whose advice, directions, or instructions the Board of Directors is accustomed to act.
Exception	A person acting merely in a professional capacity (e.g., a lawyer or consultant) is not deemed a promoter.

The term "control" is defined in an inclusive manner. It refers to the right to appoint majority of the directors or to control the management or policy decisions exercisable *by a person or persons acting individually or in concert, directly or indirectly,* including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner

...Definition of "Promoter" in a listed company

- **Definition of Promoter Group under SEBI (ICDR) Regulations 2009 includes:**

Entity/Person	Inclusion Criteria
Promoter	The individual themselves.
Immediate Relatives	Spouse, parents, brothers, sisters, and children (including those of the spouse).
Body Corporate	Any body corporate where 20% or more of equity is held by the promoter, their immediate relatives, or a firm/HUF where they are members.
HUF / Firm	Any HUF or firm where the aggregate share of the promoter and their relatives is 20% or more.

Apparent Omission from the definition of "relatives": Daughter-in-law and Son-in-law !

...Definition of "Promoter" in an unlisted company

- **Definition of Promoter of an unlisted company under the Companies Act, 2013 (Section 2(69):**

Category	Description
1. Identification	Who has been named as such in a prospectus or is identified by the company in the annual return (under Section 92).
2. Control	Who has control over the affairs of the company, directly or indirectly, whether as a shareholder, director, or otherwise.
3. Influence	In accordance with whose advice, directions, or instructions the Board of Directors of the company is accustomed to act.

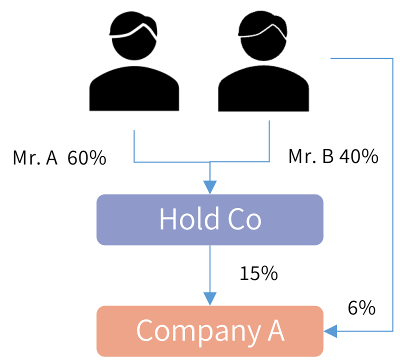
- **Under the tax law, promoter of an unlisted company also includes a shareholder who holds, directly or indirectly, more than 10% of the shareholding in the company**

The term 'control' is defined in an inclusive manner under the Companies Act 2013 and includes include the right to appoint majority of the Directors or to control the management or policy decisions exercisable by a person or persons **acting individually or in concert, directly or indirectly**, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements or in any other manner;

Buyback - Technical Issues

Few Considerations

1. Whether Section 69 regarding taxation on ‘buy-back’ includes shares of a ‘private company’?
2. No specific exclusion under definition of dividend in respect to buy back undertaken by companies ? (erstwhile IT Act, 1961 provided specific exclusion for buy back undertaken under the provisions of Companies Act) – Could absence of specific exclusion in the definition of dividend may lead to unwarranted litigation on characterization
3. Deemed characterization as capital gains under the Act – interplay with the DTAA where the DTAA typically offers a lower rate of taxation in case of dividends
4. Whether deeming fiction of section 79 of the Act *(Section 50CA of the erstwhile Act)* is applicable or not on buyback proceeds?
5. The definition of promoter includes a person holding more than 10% directly or indirectly - Computation mechanism for “indirect” holding – proportionate shareholding v. control



Whether Mr. B will be regarded as a promoter in case where Company A undertakes a buyback of his 6% shareholding ?

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Other regulatory implications

FEMA

- Buy-back transactions are considered akin to transfer of capital instruments and therefore, the regular conditions applicable to such capital account transactions under FEMA apply to such buyback transactions.
- A buyback from foreign shareholders is treated as a transfer of capital instruments from a Person Resident Outside India (PROI) to a Person Resident in India (PRII) (the company). Accordingly, applicable pricing, reporting, sectoral, and other transfer-related compliances must be met, with requirements varying based on whether the shares are held on a repatriable or non-repatriable basis.

SEBI

The pricing for buyback is dependent upon the manner of buyback.

- **Tender Offer Route:** The company determines a fixed buyback price, typically supported by a valuation report to justify the price.
- **Open Market (Book Building) Route:** No fixed buyback price is prescribed; the price is market-driven and discovered through the book-building process in accordance with Regulation 22B of the SEBI (Buy-back of Securities) Regulations.
- **Open Market (Stock Exchange) Route**: Buyback through order matching mechanism *(to be reintroduced from Aug 1, 2026 with additional operational safeguards)*
- **Price Cap:** Under the book-building route, shares are purchased at prevailing market prices, subject to the maximum buyback price approved by the company.

Stamp Duty

- Buyback of shares is akin to a share transfer; accordingly, stamp duty may be applicable. However, an alternative view is that stamp duty may not apply, as the shares bought back are extinguished upon completion of the buyback rather than being transferred to another person. Generally, in listed shares, transaction are routed through stock exchange accordingly stamp duty is levied.
- State specific stamp duty regulations to also be considered for applicability on buyback / cancellation / extinguishment of shares.

CAPITAL REDUCTION

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Capital Reduction - Overview

Capital reduction usually means reducing or cancelling a part of a company's share capital. Indian company law gives companies significant flexibility regarding the reasons for carrying out a capital reduction and the methods they can use to implement it.

It provides an exit as well as fund repatriation from the company to the shareholders.

Capital reduction is usually undertaken for the following reasons:

- Restructuring the balance sheet in case of financial stress by offsetting losses against the capital
- Return surplus capital, in excess of the wants of the company, to its shareholders

Modes of capital reduction

- Extinguish or reduce the liability on any of its shares in respect of the share capital not paid up
- Cancellation of paid-up share capital which is lost or unrepresented by available assets with or without extinguishment of shares
- Pay off the paid-up share capital, which is in excess of the needs of the company with or without extinguishment of shares

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Capital Reduction - Modes

Modes of capital reduction

Extinguish or reduce the liability on any of its shares in respect of the share capital not paid up	Cancellation of paid-up share capital which is lost or unrepresented by available assets	Pay off the paid-up share capital, which is in excess of the needs of the company
Illustration	**Illustration**	**Illustration**
Where shares of INR 120 each are partly paid, with INR 90 paid up, the company may reduce such shares to INR 90 fully paid-up shares. This would extinguish the shareholders' liability in respect of the unpaid portion of INR 30 per share.	Where shares with a face value of ₹120 each, fully paid-up, are backed by assets worth only ₹90 per share, the company may undertake a reduction of share capital. This can be done by cancelling ₹30 per share and correspondingly writing off the same amount from the asset side.	Where shares of face value of INR 120 each fully paid-up can be reduced to face value of INR 30 each by paying back INR 90 per share. Alternatively, Company can also cancel shares entirely say 10 shares at the time of paying back Rs 90 to shareholders

Capital Reduction – Implications

Corporate law

- Section 66 – Enabling provision
- Authorized by Articles of Association
- Shareholder approval through a special resolution in the general meeting is mandatory
- Three months' notice must be given to RD, RoC, SEBI and the creditors of the company to make representations to NCLT
- Effective through NCLT order

Stamp Duty

Capital reduction results in extinguishment of shares rather than transfer. Accordingly, unless there is any specific entry in the stamp duty schedule for cancellation / extinguishment of shares, arguably stamp duty may not be levied.

Income-tax

Dividend

- Under Section 2(40)(d) of the Act, Distribution to the shareholders by a company is taxable as deemed dividend to the extent of accumulated profits, whether capitalized or not
- Dividend is taxable in the hands of the shareholders at slab rates.
- If the company has accumulated losses, then the sum received by the shareholders not to be taxed as deemed dividend

Capital Gains

- Difference between the consideration received, over and above the accumulated profits, and cost of acquisition is taxable as capital gains in the hands of shareholders.

Capital Gains treatment where reduction happens with or without cancellation of shares ?

Capital Reduction – Implications

Income-tax – Non Resident shareholder

- Distribution is generally regarded as income accruing or arising in India and is bifurcated into:
  - **Deemed dividend:** to the extent of accumulated profits; and
  - **Capital gains:** in respect of the balance consideration.
- The applicability of the relevant tax treaty is crucial in determining the ultimate tax treatment of both the components.
- While the deemed dividend component is generally taxable in India (subject to applicable treaty relief, if any), the capital gains component may be taxable or exempt depending on the provisions of the tax treaty.

FEMA

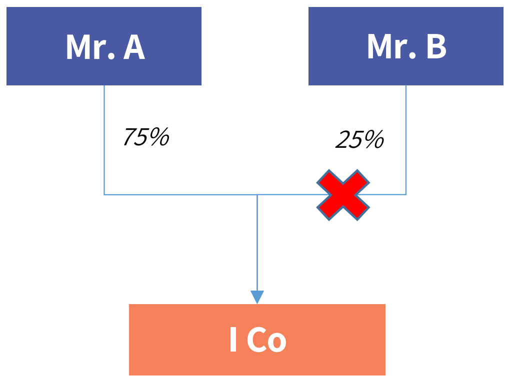
- NDI rules and OI Rules do not specifically deal with compliance requirements applicable in case of capital reduction.
- Capital reduction is akin to transfer / disinvestment, essentially it is cancellation of shares
- Transaction must align with the Foreign Exchange Management Act (FEMA) framework, including pricing guidelines prescribed under the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019.
- Payout to non-resident shareholders must be supported by fair valuation
- Appropriate reporting must be undertaken within prescribed timelines.

Case study 2 - Capital reduction without consideration

Facts

- A and B hold equity shares of I Co in ratio of 75:25
- No accumulated profits in I Co
- I Co proposes to reduce shares held by B without any consideration

Proposed Transaction



Issue

- Whether such selective capital reduction permissible?
- Tax implications under the provisions of Section 50CA of the Act *(Section 79 of the New IT Act)* in hands of Mr. B
- Whether Mr. B can claim capital loss?

Case study 2 - Capital reduction without consideration

Availability of Capital loss to Mr B. being shareholder of I Co.

View 1 - Capital loss would not be available to Mr. B

- If there is no consideration received or accruing to B as a result of the transfer, the machinery section enacted in section 72 of the Act *(Section 48 of the erstwhile Act)* would be wholly inapplicable*
- Accordingly, capital loss may not be available to B in case no consideration is received**

View 2 – Capital loss would be available to Mr. B

- Selective capital reduction amounts to relinquishment / extinguishment of right and accordingly amounts to transfer of capital asset.***
- Possible to take a view that since consideration received is ‘zero’, capital loss may be available to Mr. B

**CIT v. Mohanbhai Pamabhai [1973] 91 ITR 393 (Gujarat)*
*** Bennett Coleman & Co. Ltd. v. ACIT [2011] 14 taxmann.com 1 (Mumbai)*
****Kartikeya V. Sarabhai v. CIT [1997] 14 SCL 73 (SC)*

Applicability of Section 56(2)(x) to Capital reduction

- Section 92(2)(m) of the Act *(Section 56(2)(x) of the erstwhile Act)* is applicable in following scenario:
  - ✓ Recipient 'receives' specified 'property' from another person; and
  - ✓ the receipt should be without consideration or for a consideration which is less than the fair market value of such 'property'
- 'Property' is defined to include shares and securities also

Issue: Whether capital reduction of shares by a company without any payout to shareholders or at an amount less than fair market value of shares can attract tax under Section 92(2)(m) of the Act?

View 1:

– Since the term 'property' includes shares also, where a company undertakes capital reduction without any payout to shareholders or at an amount less than fair market value of shares, the difference can be charged to tax in the hand of the company under Section 92(2)(m) of the Act.

View 2:

– The word 'receive' presupposes the existence of property in the hands of the recipient.

– Under capital reduction, **shares are immediately cancelled** and are not received or held as capital asset by the company.

– In case of ***Vora Financial Services (P.) Ltd. v. ACIT [2018] [TS-7463-ITAT-2018(MUMBAI)-O]***, Mumbai Tribunal in context of buy back of shares has held that shares tendered under buyback cannot be said to be received by the company since a company cannot hold its own shares under Indian law. Similar view can be adopted for capital reduction also and hence, capital reduction without any payout or at an amount less than fair value of shares should not entail any tax in the hands of the company.

LIQUIDATION

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Liquidation – Implications

Corporate law

- Approval of the shareholders by special resolution, resolved that the company be wound up (in case of voluntary liquidation)
- Declaration of solvency required in case of voluntary liquidation
- Proceeds are distributed in accordance with the statutory waterfall mechanism

Stamp Duty

No stamp duty is applicable on cash distribution however, stamp duty may be applicable if the distribution is undertaken in kind (e.g., immovable property)

FEMA

Investment of the shareholders stands cancelled which would be regarded as a case of transfer/disinvestment under FEMA. Hence, the regular requirements for such transfer pertaining to pricing, reporting, sectoral compliance etc. as applicable

Income-tax

- **Dividend**
  - Under Section 2(40)(c) of the Act, Distribution to the shareholders by a company is taxable as deemed dividend to the extent of accumulated profits, whether capitalized or not
  - Dividend is taxable in the hands of the shareholders at slab rates
  - If the company has accumulated losses, then the sum received by the shareholders not to be taxed as deemed dividend
- **Capital Gains**
  - Difference between the consideration received, over and above the accumulated profits, and cost of acquisition is taxable as capital gains in the hands of shareholders.
  - **Non-resident shareholders** – Respective tax treaty to be evaluated to determine the tax treatment of both the component-

Liquidation – Tax Implications

Proceeds of liquidation to be taxed in two-parts: -

Component	Head of Income
Distribution attributable to accumulated profits of the company before liquidation (whether capitalized or not)	To be taxed as Deemed Dividend u/s 2(40)(c) - Income from Other Sources
Remaining proceeds (i.e., total FMV/money received minus the above deemed dividend)	Capital Gains

Illustration: Tax treatment in hands of Mr. B (Shareholder of A Ltd.)

Particulars	Details
Company	A Ltd.
Stake of Mr. B	5%
Cost of Acquisition of shares (COA)	INR 10,00,000
Money Received upon liquidation	INR 30,00,000
Accumulated profits of company	INR 50,00,000

Deemed Dividend (IFOS: Share of accumulated profits = INR 2,50,000 (50,00,000*5%)

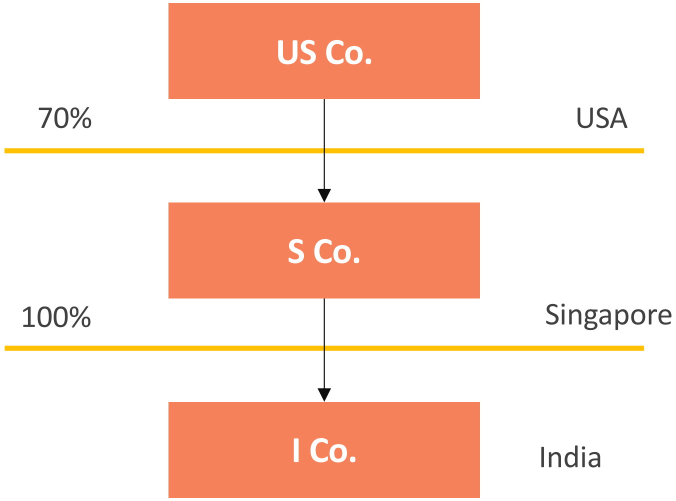
Capital Gains: INR 30,00,000 (Money received) – INR 2,50,000 (Taxed as Deemed Dividend) – INR 10,00,000 (COA) = INR 17,50,000

Case study 3 - Liquidation of foreign company having Indian assets

Case Study

- US Co. (US entity) holding 70% shares in S Co. (Singapore entity) which in turn holds 90% shares in I Co. (Indian entity).
- Upon liquidation of S Co. , US Co. being the holding company to receive the shares of I Co.

Whether the provisions of Section 9(1)(i) of the Act indirect transfer provisions in case of distribution of shares of Indian Company upon liquidation?



Case study 4 – Year of taxability

Facts

A company is under liquidation pursuant to which shareholder receives following distributions from liquidator:

Year	Amount
Year 1	500
Year 2	2500
Year 3	2000
Total	**5,000**

The liquidation of the company is completed in Year 3

Issue under consideration

When will the amounts received pursuant to liquidation be chargeable to tax under section 68 of the Act *(Section 46 of the erstwhile Act)*?

Case study 4 – Year of taxability

View 1

Capital gain arises only upon final liquidation / winding up of the company

- The overall scheme of computation of capital gains under Section 68(2) of the Act *(Section 46(2) of the erstwhile Act)* requires that there is transfer of capital asset for consideration and that capital gain is computed by reducing admissible cost.
- The scheme of capital gains does not contemplate multiple / repetitive computations in respect of only one asset.
- The expression "full value of consideration" may be interpreted to refer to the totality of consideration and each piecemeal receipt cannot be considered to be full value.

View 2

Capital gain arises in respect of each distribution in the respective year of distribution

Section 68(2) of the Act *(Section 46(2) of the erstwhile Act)* creates a charge on receipt independent of Section 67 of the Act *(Section 45 of the erstwhile Act)*.

Various High Courts* have held that receipts under Section 68(2) of the Act *(Section 46(2) of the erstwhile Act)* should be subjected to tax under the head 'Capital Gains' for the relevant assessment year based on the date of receipt and chargeability cannot be postponed to the year of total liquidation

**ITO v. Cables & Wireless Limited [1977] 107 ITR 293 (Bombay),*
**CIT v .Inland Agencies (P.) Ltd. [1983] 143 ITR 186 (Madras)*

EXIT THROUGH IPO ROUTE

– OFFER FOR SALE

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Exit through IPO – Conceptual Overview

Concept
- IPO = first-time public offering of a company's shares on a recognized stock exchange
- Serves as both a capital raising avenue and an exit route for existing shareholders
- Transitions a privately held company to a widely held listed entity

Key Benefits
- Liquidity and transparent price discovery
- Access to a wider pool of capital
- Enhanced brand visibility and credibility
- Listed shares serve as currency for future M&A
- Staggered exit flexibility post lock-in

Modes of Exit via IPO
- Fresh Issue – primary issuance; proceeds flow to the company
- Offer for Sale (OFS) – secondary sale; proceeds to selling shareholders
- Combination (Fresh Issue + OFS) – most prevalent structure
- Post-listing market sale – staggered exit, subject to lock-in

Key Considerations
- SEBI ICDR eligibility – profitability / net worth thresholds or QIB route
- Promoter lock-in – Minimum Promoter Contribution (20%)
- Pre-IPO investor lock-in
- Continuous disclosure & governance under SEBI (LODR)
- Market timing and valuation risk
- Long execution timeline – typically 9–18 months

Suitable for scalable businesses seeking liquidity, market visibility and staggered monetisation.

Case Study 5-Exit through IPO route - Offer for sale (OFS)

<u>Concept</u>

Offer for Sale (OFS) enables existing shareholders, such as promoters or early investors, to divest their stake and achieving liquidity without infusing new funds into the business. Practically, consideration is collected and the shares are credited to investor's demat account **prior to the listing date.**

<u>Date of transfer from promoter to the investor</u>

View 1:

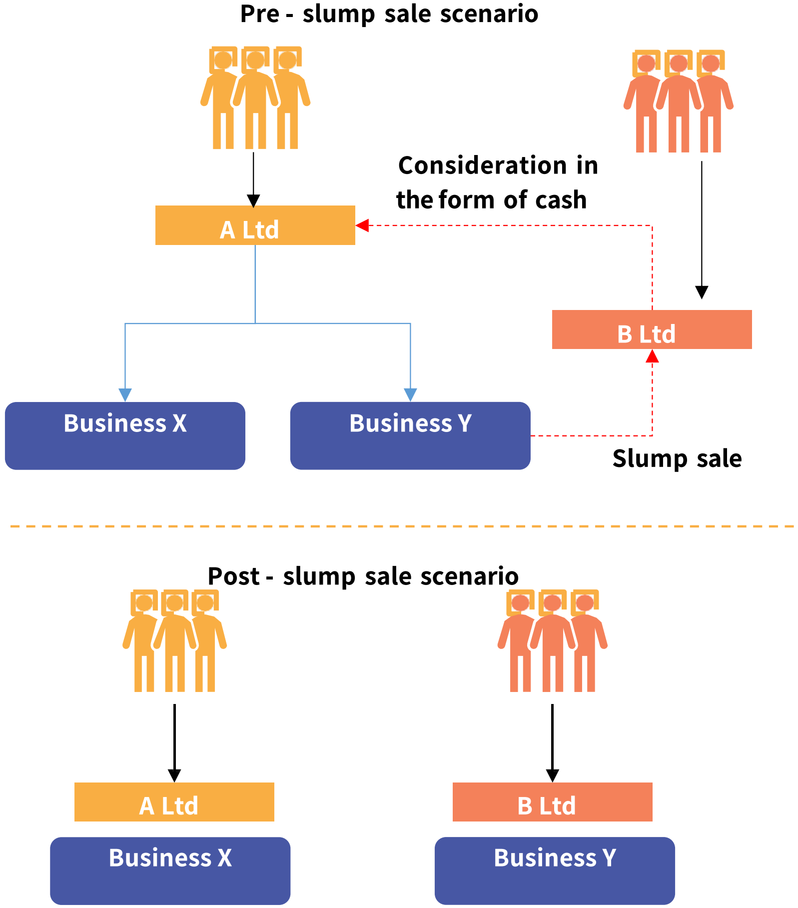
- The shares are not listed on stock exchange at the time of transfer of shares through OFS.
- It can be treated as transfer of unlisted equity shares.
- Under this view the period of holding would be 24 months for long-term capital gains and the slab rate would be applicable under short-term capital gains.

View 2:

- STT is being paid mandatory on transfer of shares during OFS, therefore fulfilling the conditions of section 196 and 198 of the Act *(Section 111A and 112A of the erstwhile Act).*
- One view is benefit of lower tax rate is available of 20% in short term capital gains because the transaction is routed through stock exchange.

MONETIZATION THROUGH SLUMP SALE

Slump Sale - Concept



Concept of slump sale

- Transfer of identified business undertaking / division through Business Transfer Agreement
- Transfer for lumpsum consideration without values being assigned to individual asset and liabilities
- Buyer to discharge consideration in the form of cash or kind

Key Drivers

- Exit from Business (Monetization and value unlocking for promoter group and other shareholders)
- Segregation of core and non-core business

Slump Sale – Implications

Corporate law

- Approval of Board of Directors
- Approval of the shareholders of the Seller Company, at least 75% of its shareholders for effecting such business transfer.
- Approval of shareholders required in case of related party transaction

SEBI Act / Exchange

- Approval from majority of minority / public shareholders shall be required as per Regulation 37A of SEBI (LODR) regulations (in case of listed entities)

Stamp Duty

- Stamp duty is applicable based on the Indian state in which the transferred assets are located and where BTA is executed.

Income-tax

- **Period of holding** for determining long term vs short term - **36 Months**
- **Capital Gains** = Sale Consideration – Cost of Acquisition of Undertaking
- **Cost of Acquisition of Undertaking** = Tax WDV of depreciable assets + Book Value of other assets – Book Value of liabilities
- Indexation benefit not available
- Accumulated tax losses of seller are not transferred to buyer
- Undertaking held for more than 36 months – 12.5% (increased by surcharge and 4% cess)
- Undertaking held for 36 months or less - charged to tax at the normal applicable rates of tax.

Slump Sale - Issues for consideration

Whether Rule 53 *(Rule 11UAE of erstwhile Rules)* may be said to be contrary to section 2(103) of the Act *(Section 2(42C) of the erstwhile Act)*

- Computation of FMV1 under Rule 53 *(Rule 11UAE of erstwhile Rules)* involving assignment of specific values to individual assets and liabilities to jeopardize the claim of transaction being in the nature of slump sale?
- Section 2(103)(b)(ii) of the Act (section 2(42C) - Explanation 2 of the erstwhile Act) provides that determination of value of asset or liability for the sole purpose of payment of stamp duty registration fees or other similar taxes not to be regarded as assignment of values to individual assets or liabilities
- Assignment of specific values under Rule 53 is for the limited purpose of determination of full value of consideration and may not lead to inference of assignment of specific values commercially

Slump Sale - Issues for consideration

Complexity in valuation of shares comprising part of undertaking

- Cross holding between companies and multiple level subsidiaries
- No provision for adjustment in valuation for differential rights as to voting, dividend etc.
- Valuation to be based on audited balance sheet as on date of slump sale

No relevance of commercial consideration even in case of genuine transactions

- Deeming fiction u/s 77 of the Act *(Section 50B of the erstwhile Act)* to apply even in case of slump sale transaction between non-related parties
- Additional consideration for hidden assets / intangibles and discount for hidden / contingent liabilities or distress situations to be ignored
- No provision for reference to valuation officer where fair market value as per Rule 53 (Rule 11UAE of erstwhile Rules) not reflective of the actual consideration for slump sale

EXIT THROUGH CORPORATE RESTRUCTURING

Exit through corporate restructuring

Concept

- Corporate restructuring enables shareholders to monetise / unlock value by reorganising the business prior to (or in lieu of) a third-party exit
- Typically used to segregate core vs. non-core, carve-out, consolidate, or convert the legal form to make the business "exit-ready"

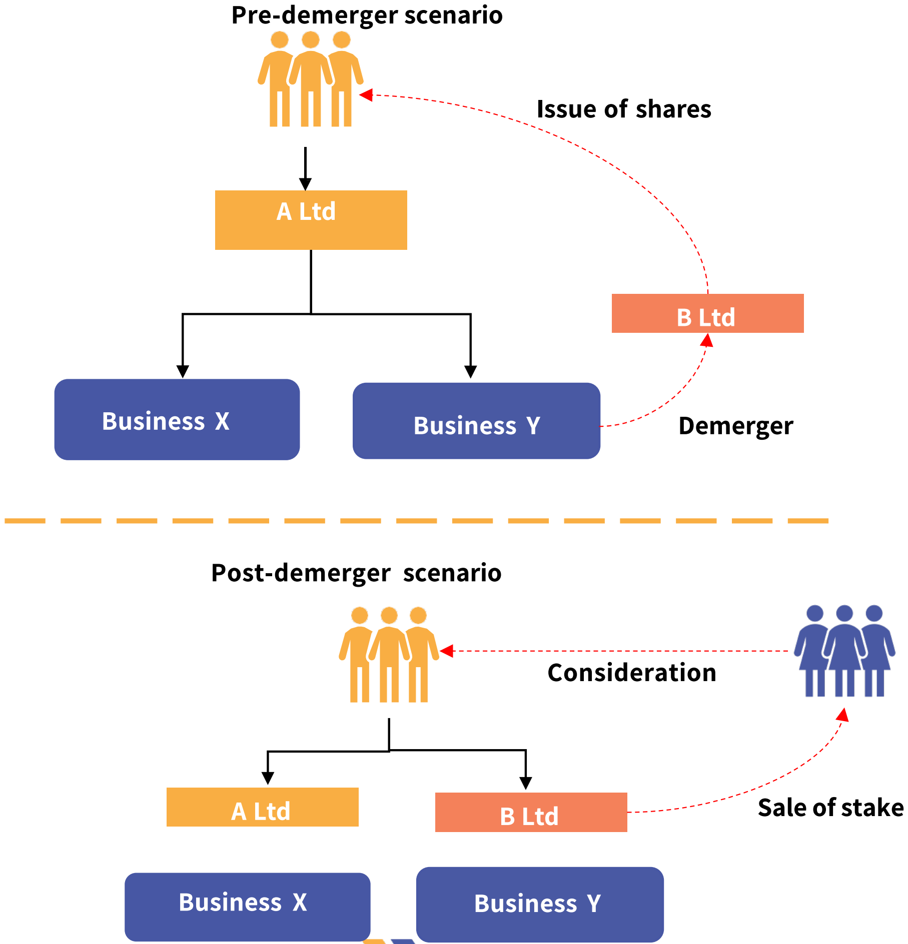
Routes for exit

- **Merger / Amalgamation** – consolidation of two or more entities; useful for promoter consolidation or strategic sale of combined business or direct merger into Buyer entity
- **Demerger** – transfer of an identified undertaking from Demerged Co. to Resulting Co.; shares of Resulting Co. issued to shareholders of Demerged Co., enabling **sale of stake post-demerger**
- **Conversion of LLP into Company** *(reverse: Company into LLP)* – to make the entity IPO-ready or PE-ready, or to step-up to a more flexible holding vehicle

Key considerations / drivers of restructuring

- Liquidity- immediate liquidity or stake in merged entity
- Restructuring cost
- Tax cost
- SEBI – Takeover code

Case Study 6- Liquidity through corporate restructuring



Concept of Demerger

- Transfer of identified business undertaking from one company (i.e., demerged company) to another company (i.e., resulting company)
- In consideration, the resulting company issues shares of the demerged company pursuant to the demerger to the shareholders of the demerged company.
- **Post demerger liquidity:** Shareholders of demerged company can sell out the shares of the resulting company to the identified buyer to create the liquidity

Key Drivers

- Monetize and value unlocking for the shareholders
- Attracting investors
- Segregation of core and non-core business

Demerger - Key considerations

Key considerations for shareholders of demerged company upon demerger

- Upon demerger, no capital gains tax for shareholders of demerged company as it is a tax-neutral transaction
- Cost of Acquisition of shares of resulting company to be calculated as under:

$$\frac{\text{Cost of acquisition shares in demerged company * Net book value of assets of demerged undertaking}}{\text{Net worth of demerged company prior to demerger}}$$

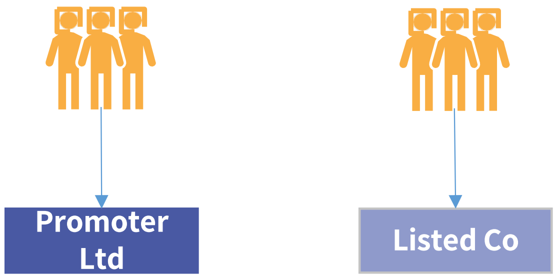
- Cost of acquisition of original shares held in demerged company = Cost of acquisition of such original shares less Cost of acquisition of shares in resulting company
- **Period of holding** of shares in the resulting company to include the period for which shares were held in the demerged company

Key considerations for shareholders on post demerger sale of shares of resulting company

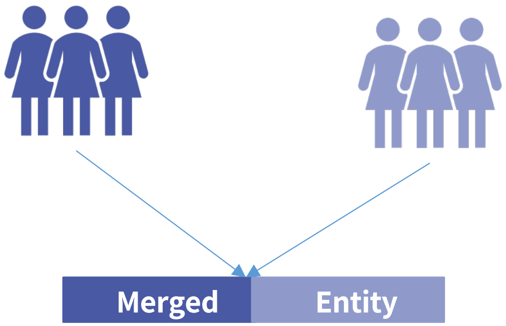
- Gains arising on subsequent sale of shares of resulting company shall be taxed under the head capital gain

Case study 7- Merger / Amalgamation

Pre-merger scenario



Post merger scenario



Concept of merger

- A merger involves the union of two or more companies into one company
- All assets, liabilities, contracts and employees of transferor company are transferred to the transferee company
- Transferee company issues shares to the shareholders of transferor company as consideration
- Transferor company would cease to exist post-merger

Key considerations

- No immediate tax outflow
- Promoters can sell shares of listed company subject to lock in if any
- Approval of SEBI, stock exchange and lenders
- Testing majority of minority rule
- Takeover code trigger- exemption under takeover code for merger related acquisition subject to conditions
- Whether grandfathering benefit of FMV as on 31.1. 2018 available where shares in transferor entity acquired prior to cut of date but merger concluded in 2026-27 ?

SUCCESSION OF FIRM BY A COMPANY FOLLOWED BY SHARE SALE

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Succession of firm by a company

Per the provisions of section 47(xiii) of the Act */ Section 70(1)(zd) of the New IT Act* any transfer of a capital asset or intangible asset by a firm to a company as a result of succession by a company in the business carried on by the firm shall be exempt subject to fulfilment of conditions mentioned below :

- all the assets and liabilities of the firm relating to the business immediately before the succession become the assets and liabilities of the company;
- all the partners of the firm immediately before the succession become the shareholders of the company in the same proportion in which their capital accounts stood in the books of the firm on the date of the succession;
- the partners of the firm do not receive any consideration or benefit, directly or indirectly, in any form or manner, other than by way of allotment of shares in the company; and
- the aggregate of the shareholding in the company of the partners of the firm is not less than fifty per cent of the total voting power in the company and their shareholding continues to be as such for a period of five years from the date of the succession.

View 1

On plain reading, it seems that benefit of exemption is only provided to the firm and is not provided to the partner receiving shares of the company in lieu of partnership interest in the firm

Section 47(xiiib) of the Act */ Section 70(1)(ze) of the New IT Act* provides exemption to LLP as well as to its partners and in absence of similar exemption under section 47(xiii) of the Act *(Section 70(1)(zd) of the New IT Act)*, partners of the firm may be chargeable to tax

View 2

Intention of the legislature is to exempt entire transaction without specifically restricting benefit to the firm and hence partners of the firm may not be chargeable to tax

Case Study 8 - Succession of firm by a company

Case study

- LLP had three partners, namely Mr. A, Mr. B and Mr. C.
- LLP got converted into a private limited company, Mr. A, Mr. B and Mr. C received the shares of the company in proportion to their respective interests in the LLP.
- Immediately upon the conversion and allotment of shares, Mr. A, Mr. B and Mr. C transferred their entire shareholding in the private limited company to an identified buyer.

Issues under considerations

- Conditions under Section 47(xiiib) of the Act */ Section 70(1)(ze)* not satisfied due to change of control
- How to compute capital gains, Period of holding of the shares of the company and Cost of acquisitions
- What if Buyer becomes a partner for a nominal stake in LLP and then conversion happens.

EXIT BY NON-RESIDENTS

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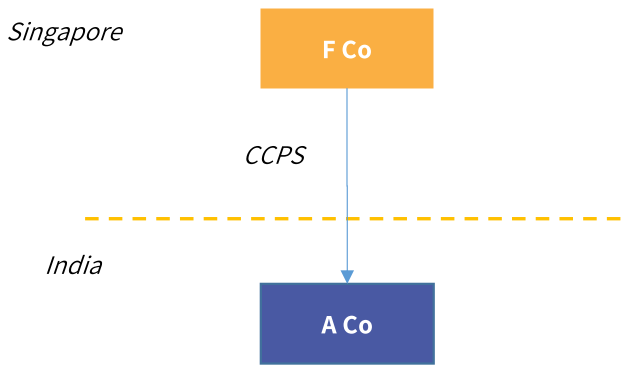
Case Study 9 – Grandfathering under DTAA

Facts of the case

- F Co is Singapore based Fund
- It acquired compulsorily convertible preference shares of Indian unlisted company A Co in FY 2015-16.
- A Co proposes to list its shares on Indian stock exchange. Accordingly, CCPS held by F Co are converted into equity shares in 2025-26
- In FY 2026-27, F Co sold equity shares of the Indian company under OFS



Whether the capital gains arising on the sale of shares of the Indian company in FY 2026-27 would be eligible for protection under the grandfathering provisions contained in the Article 13(4A) of the India–Singapore Double Taxation Avoidance Agreement (DTAA)?

INDIRECT TRANSFER

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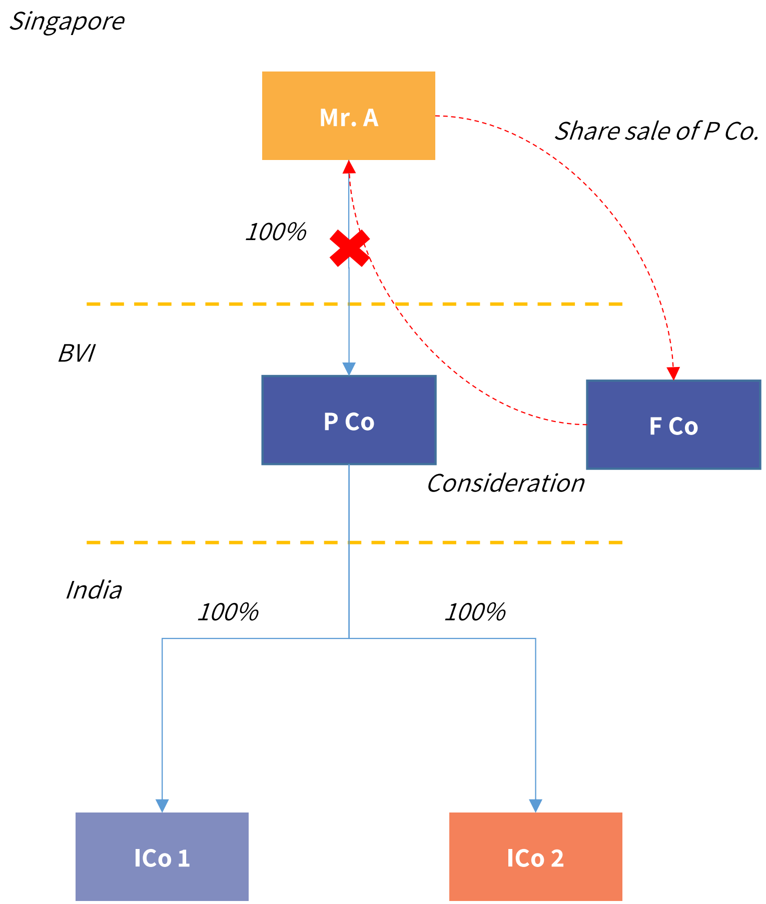
Case Study 10 – Indirect transfer



Facts

- P Co is a company incorporated under the laws of British Virgin Islands ('BVI') whose entire capital is held by Mr. A, Singapore citizen and resident.
- P Co holds 100% stake in two Indian entities viz. I Co 1 and I Co 2.
- P Co holds shares of I Co 1 and I Co 2 as a 'capital asset'.
- Mr. A is proposed to sell the shares of P Co. to F Co. incorporated under the laws of BVI

Points for consideration

Taxability of share sale of Mr. A to F Co under the provisions of the Act in the hands of following:

a) F Co (Buyer)

b) Mr. A, shareholders of P Co. (seller)

c) Whether treaty benefit available to Mr. A ***(Reference to Tiger Global Judgement)***

QnA

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