



Final Notification on exclusions under the amended section 10(38) released

Background:

Section 10(38) of the Income-tax Act, 1961 ('the Act') was amended by the Finance Act, 2017 to limit the scope of the exemption for long term capital gains from the sale of listed equity shares. Under the amended provisions, the exemption is not available if the shares are acquired on or after 1 October 2004 and such acquisition is not chargeable to Securities Transaction Tax ('STT'). However, it was provided that this limitation would not apply to acquisitions notified by the Central Government in this regard.

The Central Board of Direct Taxes ('CBDT') released a draft notification on 3 April 2017 and invited comments and suggestions from stakeholders. The final notification after considering these comments was released today.

Final Notification:

All transactions of acquisition of equity shares entered into on or after 1 October 2004 which are not chargeable to STT are notified for the purposes of the exemption granted under section 10(38), other than the following:

- (a) *Acquisition of existing listed equity shares in a company, whose equity shares are not frequently traded in a recognised stock exchange of India, which are made through a preferential issue.*

However, the following acquisition of listed equity shares (even if made through a preferential issue) are protected and continue to be covered by section 10(38) exemption:



- Acquisition of shares which has been approved by the Supreme Court, High Court, National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf¹;
- Acquisition of shares by any non-resident in accordance with the Foreign Direct Investment (FDI) guidelines¹;
- Acquisition of shares by an Investment fund or a Venture Capital Fund or a Qualified Institutional Buyer¹;
- Acquisition of shares through a preferential issue to which the provisions of Chapter VII of the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2009 do not apply.

'Frequently traded shares' are defined to mean shares of a company, in which the traded turnover on a recognised stock exchange during the twelve calendar months preceding the calendar month in which the acquisition and transfer is made, is at least ten per cent of the total number of shares of such class of the company. It is also provided that where the share capital of a particular class of shares of the company is not identical throughout such period, the weighted average number of total shares of such class of the company shall represent the total number of shares.

(b) *Transactions for acquisition of existing listed equity shares in a company which are not entered through a recognised stock exchange.*

However, the following acquisitions¹ of listed equity shares are protected (even if not made through a recognised stock exchange) and continue to be covered by section 10(38) exemption. This is subject to the condition that these acquisitions are made in accordance with the provisions of Securities Contracts (Regulation) Act, 1956 (if applicable):

- Acquisition through an issue of share by a company other than preferential issue referred in (a) above²;
- Acquisition by scheduled banks, reconstruction or securitisation companies or public financial institutions during their ordinary course of business;
- Acquisition which has been approved by the Supreme Court, High Courts, National Company Law Tribunal, Securities and Exchange Board of India or Reserve Bank of India in this behalf;
- Acquisition under employee stock option scheme or employee stock purchase scheme framed under the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999;

¹ These exclusions did not find place in the draft notification

² This appears to cover instances of bonus shares or rights issue by companies whose shares are frequently traded, etc. where STT would not have been paid by the acquirer.



- Acquisition of shares by any non-resident in accordance with the FDI guidelines;
 - Acquisition of shares under SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011;
 - Acquisition from the Government;
 - Acquisition of shares by an Investment fund or a Venture Capital Fund or a Qualified Institutional Buyer;
 - Acquisition by mode of transfer referred to in sections 47³ or 50B⁴ of the Act if the previous owner of such shares has not acquired them by any mode which is not eligible for exemption as per this notification.
- (c) Acquisition of equity shares of a company during the period between when a company is delisted from a recognized stock exchange and when it is again listed on a recognized stock exchange.

Comments:

The amendment to section 10(38) was perceived as being excessively wide in its scope. To a large extent, this concern has been addressed, as the withdrawal of the exemption post the final notification will be limited only to a handful of situations. Specifically, the availability of the exemption in respect of shares acquired under ESOPs or pursuant to merger/demerger schemes was an important area of concern arising from the draft notification. This has been suitably addressed.

³ This would include cases of gifts, shares issued upon amalgamation or demerger, transfer of shares between holding and subsidiary companies, etc.

⁴ This would include acquisition of shares as part of a slump sale/business purchase agreement.



ADDRESS

Mumbai

1101, One IndiaBulls Centre,
11th Floor, Tower 2B,
841, Senapati Bapat Marg,
Elphinstone Road (West),
Mumbai 400 013
Tel:+91 22 6108 1000 / 1900

Ahmedabad

B3, 3rd Floor, Safal Profitaire,
Near Auda Garden,
Prahladnagar, Corporate Road,
Ahmedabad - 380 015
Tel: +91-79-6134 3434

Bengaluru

Prestige Terraces, 2nd Floor
Union Street, Infantry Road,
Bengaluru 560 001
Tel: +91-80-4660 2500

Delhi / NCR

101 & 102, 1st Floor, Tower 4B
DLF Corporate Park
M G Road, Gurgaon
Haryana - 122 002
Tel: +91-124-668 7000

Singapore

Dhruva Advisors (Singapore) Pte. Ltd.
20 Collyer Quay, #23 01
Singapore 049319
Tel: +65 9105 3645

Dubai

U-Bora Tower 2,
11th Floor, Office 1101
Business Bay P.O. Box 127165
Dubai, UAE
Tel:+ 971 56 900 5849

KEY CONTACTS

Dinesh Kanabar (Mumbai)

Chief Executive Officer
dinesh.kanabar@dhruvaadvisors.com

Vishal Gada (Ahmedabad)

Partner
vishal.gada@dhruvaadvisors.com

Ajay Rotti (Bengaluru)

Partner
ajay.rotti@dhruvaadvisors.com

Krishan Malhotra (Delhi / NCR)

Partner
krishan.malhotra@dhruvaadvisors.com

Mahip Gupta (Singapore)

Partner
mahip.gupta@dhruvaadvisors.com

Pratik Shah (Dubai)

Partner
pratik.shah@dhruvaadvisors.com

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