

Pr. CIT v. M/s Bayer Vapi Private Limited

[2019] 106 taxmann.com 395 (Gujarat)

Legal fees incurred on buyback of shares allowable as revenue expenditure

Introduction:

Companies incur significant expenses at the time of buyback of shares. The allowability of legal and professional expenses incurred on buyback of shares is often litigation prone. Companies who have just completed their buyback transaction or are contemplating a buyback of shares stand to gain by the recent decision of the Gujarat High Court in Pr. CIT v. M/s Bayer Vapi Private Limited [2019] 106 taxmann.com 395 (Gujarat), which has ruled that legal fees incurred on buyback of shares is allowable as revenue expenditure.

The controversy about allowability of such expenses essentially arises due to the fact that the same are related to the share capital of the assessee, which is generally considered to be in capital field. Courts have consistently held that expenses incurred on issue of share capital is capital expenditure.

a. Expenses incurred on issue of share capital – capital expenditure

In the following decisions, expenses incurred in connection with issue of share capital has been held to be capital in nature:

- Punjab State Industrial Development Corpn. Ltd. v. CIT [1997] 225 ITR 792 (SC);
- Brooke Bond India Ltd. v. CIT [1997] 225 ITR 798 (SC);
- Groz-Beckert Saboo Ltd. v. CIT [1986] 160 ITR 743 (P & H).

In the case of Punjab State Industrial Development Corpn. Ltd. (supra), the Hon'ble Supreme Court held that:

“The fee paid to the Registrar for expansion of the capital base of the company was directly related to the capital expenditure incurred by the company and although incidentally that would certainly help in the business of the company and may also help in profit-making, it

still retained the character of a capital expenditure since the expenditure was directly related to the expansion of the capital base of the company. Therefore, the amount paid to the ROC, as filing fee for enhancement of capital, was not a revenue expenditure.”

Hence, the general rule laid down by these decisions was that expenses in connection with share capital would be regarded as capital expenditure, due to which, controversy exists as to whether expenses in connection with other changes in share capital, such as bonus issue, buy-back, etc. would also be regarded as capital expenditure.

b. Expenses on bonus issue of shares – revenue expenditure

In case of issue of bonus shares, Courts have held that since issue of bonus shares does not result in expansion of capital base, the expenditure incurred in respect thereof would not be considered as capital expenditure.

In CIT vs. General Insurance Corporation [2006] 286 ITR 232 (SC), the Hon’ble Supreme Court distinguished the case of Punjab State Industrial Development Corpn. Ltd. (*supra*):

“Issue of bonus shares does not result in the expansion of capital base of the company. Thus, the expenditure incurred in connection with issuance of bonus shares is a revenue expenditure.”

This decision has also been followed in the case of CIT v. Tata Chemicals Ltd. [2016] 75 taxmann.com 228 (Bombay) and the Court has taken a view that expenditure on bonus issue of shares is a revenue expenditure.

c. Expenses on buyback of shares – revenue expenditure

In Britannia Industries Limited v. Department of Income Tax [ITA No. 1789/Kol/2008], the Hon’ble ITAT has distinguished between issue of shares and buy-back of shares and held that expenses incurred on buyback is revenue expenditure. The Hon’ble ITAT held as under:

- Buyback of shares is distinct from issue of shares and hence, the decision of Punjab State Industrial Development Corpn. Ltd. (*supra*) is not applicable.

- Buyback of shares is rather akin to issue of bonus shares, i.e., many conditions for issue of bonus share are *pari materia* with provisions relating to buyback of shares. Accordingly, the decision of General Insurance Corporation (*supra*) was applicable.

The recent decision in M/s. Bayer Vapi Private Limited (*supra*) further strengthens the stand by ruling that legal fees incurred for buyback of shares is revenue in nature. In Bayer's case, the Hon'ble High Court ruled that:

- The expenditure does not include the price paid to shareholders for buying back the shares, but it only relates to expenditure incurred for carrying out buyback scheme.
- The expenditure was incurred for implementation of buyback of shares, which would not in any manner enhance the capital structure of the assessee, but instead there is an outflow of capital.
- Accordingly, such an expenditure is revenue in nature.

2. Comments:

In certain cases, like Chemosyn Ltd. v. ACIT (2012) 25 taxmann.com 325 (Mum.) which is affirmed in [2015] 371 ITR 427 (Bom) and Echjay Industries Ltd. v. DCIT [2004] 88 TTJ 1089 (Mum), the Hon'ble High Court has held that even premium paid on the buyback of shares of a warring shareholder is allowable as a revenue expenditure as it was incurred to ensure the smooth running of business.