
BUY-BACKS TAX REFORM 2026: RE-CHARACTERISING SHARE BUY-BACKS AS CAPITAL GAINS

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There has been a significant shift in the taxation framework applicable to share buybacks in India with the introduction of Union Budget 2026, where the income received by shareholders on share buybacks has been treated as income from capital gains. This marks a significant shift from the previous tax treatment where income from share buybacks was dividend income and was taxed accordingly. This shift may be beneficial to taxpayers but provides an opportunity to examine some larger issues relating to tax neutrality and India's tax treatment of corporate payouts. In addition to its immediate effects, which may be thought to be beneficial to taxpayers, there are some larger issues which need to be discussed.

Keywords: Buyback Tax Reform 2026, Share Buybacks, Recharacterization, Promoter Surcharge.

Shares Buy backs and their tax treatment prior to Budget 2026–

Share buybacks mean repurchase of the company's own shares by a company from its existing shareholders. This has been specifically recognized by the Companies Act, 2013, under Section 68(1). From a corporate law point of view, buybacks have various aims. Fundamentally, however, buybacks are not about distributing income but are akin to capital transactions.

The taxation rules regarding buybacks in India have been dynamic. Earlier, buybacks earned a capital gain tax, and shareholders were taxed only on net profits earned during buybacks. The rules regarding buybacks were framed to avoid the imposition of Dividend Distribution Tax (DDT) by businesses. Hence, a new Section 115QA was formulated, levying a 23.296% income tax at the company level, thereby making buyback income completely tax-free for shareholders. Later, between October 2024 and March 2026, buyback income was subject to a deemed dividend income, taxing the entire amount at slab rates (42.74%) when the cost of acquisition could only be claimed as a capital loss.

Irregularities under the Dividend based Buy back regime-

The dividend-based system of buyback offered many anomalies due to a failure to make a proper differentiation between capital and revenue. "Taxing the entire consideration and not just the profit resulted in investors being taxed on their own capital. For example, an investor who sold shares for ₹10 lakhs on a buyback that had an original purchase price of ₹9 lakhs was taxed on the full sale even though the profit was only ₹1 lakh."

This creates economic double taxation because repurchases are assumed to be financed out of a company's post-tax profits. Also, together with various shareholder slab rates, the resulting effective tax rate was over 50%. The absence of tax neutrality led to a phenomenon called "regulatory arbitrage," where the decisions to repurchase a company were driven not by economics, but by tax avoidance.

This creates economic double taxation since it is assumed to be financed by means of its after-tax profits. Moreover, the effective rate, which was the sum of this rate and all the slab rates prevailing among its shareholders, was above 50%. The absence of tax neutrality generated what was referred to as "regulatory arbitrage," and what drove the decision to repurchase this company was not economics at all, but rather tax avoidance reasons.

The Budget 2026 Shift: Buybacks as Capital Gains

The government, in a bid to recognize the complexity and hardship associated with the dividend style, rationalized the system from April 1, 2026. As it is today, the long and arduous journey that was imposed on investors under buyback taxation is once again shifted to a Capital Gains format, which is far more equitable for most investors.

The proposed changes by the 2026 bill are the deletion of Section 2(40)(f), regarding deemed dividend, and changes to be made to Section 69, specifically dealing with tax on buybacks. The end result is: "Buy back consideration not to be treated as deemed dividend; Shareholder to pay tax on difference between buy back consideration received and cost of acquisition taxable as capital gains – depending on whether it is short term (20%) and long term (12.5%) In the case of promoter shareholders, an additional tax such that the tax rate works out to be 22% in case the shareholder is a corporate and 30% if the shareholder is a non-corporate. No distinction between short term and long term."

All investors, Indian or foreign, are taxed at a rate of 12.5 percent on Long-Term Capital Gains (LTCG) and 20 percent on Short-Term Capital Gains (STCG), strictly on profit earned (i.e., buyback price minus cost of acquisition). This ensures that an investor gets a fair shot when selling his or her shares back to the company, as well as to any other willing buyer, bringing much-needed fairness to Indian capital markets.

This is following a definite policy consideration of not letting the promoters exploit the buyback option as a less-taxed vehicle for wealth extraction by shareholders. Conceptually, such a re-characterisation signals a return to substance over form. Consequently, the law is recognising the true nature of buybacks by treating them as capital transactions instead of artificially characterising them from the point of view of income.

The impact of the New Buyback Rules and why they are a Win for Retail Investors and Market Integrity.

The advent of a capital gains tax system in 2026 is a major milestone in enhancing minority shareholder protection. The imposition of a tax only on actual profits earned, as opposed to total proceeds, ensures that a retail investor is not differentially taxed whether they sell their stock in the market or receive a buyback. The move to a lower, more consistent rate—12.5% for LTCG—directly increases returns on investment for small investors, as opposed to a slab rate system that destroyed their capital.

Further, this system also incorporates an important "promoter surcharge" which targets controlling shareholders who intend to use buybacks as an alternative to tax planning through dividends. The government, therefore, successfully aligned incentives with effective tax planning as opposed to tax avoidance. Boards, therefore, have become more transparent and strategic; in addition, we may witness increased pressures which will be required to be justified about buybacks, especially in sectors such as IT and Pharma, which are currently "cash rich" and have the potential to move from dividends to buybacks.

Lastly, this tax evolution will function in harmony with regulations enforced by SEBI to promote market efficiency. Accordingly, as more attention shifts to buybacks, there will be greater emphasis on these buybacks acting as "market signals" to assert undervaluation. In due turn, this increases the need to be more compliant with regulations. Thus, it can be concluded that not only does this tax system promote a change in tax payment methodology, but it also

modifies corporate governance by aligning it with financial logic and fair treatment to all stakeholders.

Navigating Unresolved issues in the New Regime

Even as the 2026 system clearly settles the conceptual argument over income vs. capital, it also appears to create new administrative and interpretational complexities. An important area of uncertainty surrounds the handling of capital losses. If the buyback is below the cost of acquisition for the investor—an increasingly plausible prospect with the current market volatility—the ability of the taxpayer to apply for capital losses on other gains is still uncertain. Without clear guidelines, the taxpayer may run the risk of facing procedural difficulties in the claim for genuine economic loss, replaying the concerns of the old dividend system.

Further, there is a high valuation and reporting complexity associated with a capital gains approach. The determination of cost of acquisition, as well as fair market values, is a contentious issue, especially for unlisted companies or complex groups involving shareholding history. A lack of safe harbour rules or documentation guidelines could significantly increase evidentiary requirements.

Finally, the interaction between the promoter surcharge measure and existing capital gains exemptions, including threshold relief and roll-over provisions, is unclear. Once again, clarification from the revenue authority will be vital to ensuring that interpretative issues do not lie at the heart of any breaches of the new system.

Conclusion

The reshaping of buyback taxation under the Union Budget 2026 is way more than a mechanical adjustment; it reflects a conscious legislative effort to restore coherence to the relative taxation of corporate distributions in India. By re-characterising buybacks within the capital gains framework, the legislature seeks to correct the long-standing conceptual distortion that blurred the line between income and capital, while also addressing inequities faced by minority shareholders through calibrated treatment of promoters.

Yet, as with any structural reform, the true test lies in implementation. Clarifications regarding loss set-off, availability of exemptions, valuation standards, and the scope of the promoter surcharge will determine whether the regime achieves genuine neutrality or gives rise to fresh

interpretational uncertainty. Budget 2026 thus marks a significant and principled shift in corporate tax policy, but its enduring success will ultimately depend on regulatory precision and consistent administrative practice.