



SAUMITRA BHADURI

While share buybacks are a routine corporate finance decision in the developed world, in India, they have been repeatedly shaped by evolving tax policies, often yielding unintended consequences. The recent Union Budget's decision to revisit buyback taxation is therefore not merely a technical correction, but a window into how India views corporate payouts, investor behaviour, and market discipline.

At a basic level, a share buyback is simply a company returning excess capital to its shareholders by purchasing its own shares. The economic logic is straightforward. When firms generate cash beyond their investment needs, buybacks allow capital to be returned efficiently without locking shareholders into recurring obligations, as dividends do. The buybacks also play a role in improving capital efficiency and signalling management confidence.

International data underscores how buybacks have become the norm. The global listed companies spent over \$1.6 trillion on buybacks in 2022, the highest on record, up 22 per cent from 2021 and nearly tripling since 2012. S&P 500 companies alone repurchased \$925 billion in 2024 and projected \$1.075 trillion in 2025. In 2022, the global share of buybacks accounted for 94 per cent of the total dividends paid out by major companies worldwide, meaning buybacks were almost as large as dividends combined. This surge was primarily driven by North American firms, which bought back shares equivalent to 158 per cent of their dividends, along with strong contributions from oil & gas and technology sectors. In stark contrast, emerging markets, including India, lagged far behind, with buybacks representing only 18 per cent of dividends.

India's journey has been markedly different and volatile. Until 2013, dividends in India were taxed at the company level through the Dividend Distribution Tax (DDT), while share buybacks were taxed as capital gains in shareholders' hands, often at lower effective rates, incentivising buybacks. To limit this arbitrage, the Finance Act, 2013 introduced a company-level tax on buybacks while exempting shareholders. This parity was undone in 2020, when DDT was abolished, and dividends became taxable at slab rates in shareholders' hands, while the company-level buyback tax remained,



Buybacks not a problem — it is policy volatility

COURSE CORRECTION. Tax policy swings fundamentally altered the economics of buybacks. Thankfully, Budget 2026 amendments will support revival of this credible payout instrument

GETTY IMAGES

sharply increasing the relative appeal of buybacks. As buybacks increasingly substituted dividends and allowed promoters to extract large payouts at low effective tax rates, concerns over revenue leakage and inequity re-emerged. These culminated in the Finance Act, 2024, which, from October 1, 2024, taxed buyback proceeds as deemed dividends in shareholders' hands. This change fundamentally altered the economics of buybacks. For high-income investors, the effective tax rate crossed 35 per cent, significantly higher than under the earlier regime.

India's buyback trends from FY20-25 corroborate this sharp volatility tied to tax policy swings. Buybacks peaked at ₹67,687 crore in FY19 amid favourable company-level taxation but fluctuated post-2020 DDT abolition — surging to ₹49,533 crore in FY21, then dipping amid regulatory curbs, before a FY24 revival at ₹49,314 crore. The October 2024 shift to shareholder slab-rate taxation triggered a historic plunge to ₹8,147 crore in FY25 (ratio to dividends at 1.4 per cent), reflecting promoter apathy.

While both dividends and share buybacks return surplus cash to shareholders, they differ fundamentally in how they signal firm quality, shape capital structure, and manage flexibility. Dividend payouts are a commitment device. Initiating or increasing dividends signals management's confidence in stable, recurring cash flows. Because dividend cuts are heavily

penalised by markets, firms use dividends to convey long-term earnings sustainability and financial discipline. Dividends also cater to income-seeking investors — pension funds, insurance companies, and households — which helps anchor a stable shareholder base.

SIGNALLING INSTRUMENT

Buybacks, by contrast, are a flexible signalling instrument. They signal that management views the firm's shares as undervalued or that excess capital cannot be deployed profitably in new investments. Buybacks allow firms to return cash without committing to recurring payouts, making them attractive when cash flows are episodic or uncertainty is high. They also improve per-share metrics such as earnings per share and return on equity, and provide a mechanism to optimise capital structure by reducing excess equity.

The appropriate choice between dividend payouts and buybacks, therefore, depends on a firm's cash-flow stability, growth opportunities, ownership structure and investor clientele, as well as prevailing market conditions. Having credible access to

The way forward lies in a stable, predictable framework that treats dividends, buybacks, and capital gains consistently

both instruments is unambiguously welfare-enhancing, as it allows firms to tailor payouts efficiently while improving capital allocation and market signalling. Impeding this choice often leads to distortion, hoarding cash, or pursuing marginal investments, none of which necessarily improve economic efficiency or tax outcomes.

In that light, the 2026 Budget marks a clear course correction by undoing the taxation of buybacks as shareholder-level dividends and taxing them as capital gains. To curb arbitrage, promoters face additional levies ensuring minimum effective rates of 22 per cent for companies and 30 per cent for others. Together, these changes restore two credible payout instruments, enabling firms to choose optimally and supporting a revival of buyback activity after the post-October 2024 slowdown.

India's repeated recalibration of buyback rules reflects its lack of confidence in markets to self-adjust and address every perceived arbitrage through tax intervention, often creating large distortions. The way forward lies in a stable, predictable framework that treats dividends, buybacks, and capital gains consistently, backed by strong disclosure and anti-abuse safeguards from the regulator. The correction in the Budget of 2026 should thus be seen less as a fix and more as an opportunity to commit to durable policy clarity.

The writer is Professor, Madras School of Economics

