**Representation for reducing period of holding of business undertaking from 3 years to 2 years and shares transferred via Offer for sale in IPO from 2 years to 1 year to turn long term**

* Finance (No.2) (FA) 2024 reformed the capital gains taxation regime by rationalisation of period of holding and LTCG/STCG tax rates for different types of capital assets.
* The holding period for all capital assets was rationalised to 1 year for listed securities and 2 years for other assets. However, there exists an anomaly (perhaps unintended) for period of holding for following two types of assets.
  + Business undertaking referred in s.50B for taxation of slump sale of undertaking
  + Shares sold in Offer for sale (OFS) in an IPO

**Reduction of holding period of “undertaking” from 3 years to 2 years.**

* Section 50B provides the mechanism for computation of capital gains arising on slump sale. FA 2024 reduced the holding period for all capital assets to 12 or 24 months to turn into long term. However, it appears the holding period for a business “undertaking” as specified in proviso 7 to section 50B(1) of the Act appears to be unintentionally left out to be reduced from 36 months to 24 months.
* Hence, it is recommended to reduce holding of undertaking from 3 years to 2 years.

**Reduction of holding period of shares transferred in OFS in IPO from 2 years to 1 year**

* India’s IPO market has seen a significant growth, driven by strong demand from both retail and institutional investors
* The trend is fuelled by the positive economic outlook in India, the availability of private equity and venture capital funding, and the government's initiatives to simplify the IPO process
* In FY2023-24, around 247 companies raised about INR 64,126 crores through IPOs. The capital raised in current FY 2024-25 has already crossed INR 1 lakh crores.
* Reorganization of capital structure is one of the key considerations in making the company ready for IPO
* As per SEBI (ICDR), 2018 regulations
  + minimum promoter holding shall be locked in for a period of 18 months from the date of allotment in the IPO
  + promoter’s holding in excess of the above shall be locked in for a period of 6 months from the date of allotment in IPO

Based on the above, the promoters will have to wait at least 6 months before they can sell a portion of their shares on the stock exchange, unless they sell it in OFS. Accordingly, they may be compelled to sell a portion of their shares in OFS than wait for their lock in to complete before selling it on the stock exchange.

* Also, from market perspective any sale by promoters immediately post listing may impact the market sentiment and negatively impact the price
* Further, SEBI mandates a minimum public shareholding of 25%. The company may not really need fresh infusion/capital for the business. Hence, there is a mix of both primary and OFS part in the IPO as promoters also wish to get some liquidity.
* Furthermore, agreements with private equity (PE) and venture capital (VC) investors often include clauses that require promoters to provide liquidity through an OFS during the IPO. These investors seek exits within specific timeframes, which can be facilitated more effectively through an OFS.
* Hence, the company generally structure their capital immediately pre-IPO
* As part of the capital restructuring, companies resort to methods like issuance of bonus and share splits
* This is primarily done to ensure that there is enough liquidity of shares in the market and the price per share is affordable for the retail investors
* As part of IPO, companies raise capital as well as promoters/investors get liquidity by selling some portion of their shares in the IPO (Offer for sale) (OFS)
* The taxability in the hands of Promoters/Investors depends upon the period of holding of shares
* Section 2(42A) of the Income-tax Act, 1961 (‘the Act’), a threshold of 12 months in the case of listed shares and 24 months in the case of unlisted shares has been provided for determining whether the shares qualify as a long term/ short term capital asset
* Accordingly, it is imperative to understand whether the shares sold through an OFS to be considered as listed or unlisted to determine the period of holding of such shares and classifying the gains as long term or short term
* As per section 97(13)(aa) of Securities Transaction Tax, ‘taxable securities transaction’ is defined to mean sale of unlisted equity shares by any holder of such shares under an offer for sale to the public included in an initial public offer and where such shares are subsequently listed on a recognised stock exchange
* Based on above, it is inferred that the shared transferred in OFS are treated as ‘unlisted’ and hence the period of holding should be more than 24 months for the same to qualify as long-term capital asset. However, all other tax consequences of sale of shares in OFS are same as listed shares which are as follows :-
  + LTCG rate is 12.5% u/s. 112A and STCG rate is 20% u/s. 111A
  + Such transfer is liable to STT at higher rate of @ 0.2% as compared to listed shares (@ 0.1%)
  + Such shares are also eligible for “grandfathering benefit” u/s. 55(2)(ac) of substituting FMV as on 31 Jan 2018 for cost of acquisition
* Section 111A and 112A of the Act which provides for special rates in case of short-term and long-term capital asset respectively does not provide a specific reference to the shares being listed on stock exchange. Instead, these sections apply to the shares on which Securities Transaction Tax (‘STT’) has been paid in accordance with relevant provisions.
* Consequently, based on the period of holding, gains arising on transfer of shares under an OFS is covered under the provisions of section 111A and 112A of the Act even though the shares subject to OFS are not listed on the date of transfer
* Further, any purchase or sale of any equity shares of a company entered into in a recognised stock exchange would require the payment of STT
* For the period upto 2012, there was no STT paid on unlisted securities sold to the public under an OFS included in an IPO. However, in the year 2012, the Finance Minister in his Budget speech on Finance Bill, 2012 quoted the following:

*“…..To promote further depth of the capital markets through listing of companies, I propose to extend the benefit of tax exemption on long term capital gains to the sale of unlisted securities in an initial public offer. For this purpose, I propose to provide the levy of Securities Transaction Tax (STT) at the rate of 0.2 per cent on such sale of unlisted securities….”*

* It is imperative to note that this amendment was made in the STT in order to promote listing of companies and extend the benefit of section 10(38) of the Act to unlisted securities. This shows that the intention of the legislators was to treat the securities transferred through an OFS on par with listed securities
* Moreover, a company which proposes to get listed through an IPO would have to obtain an in-principle approval from the recognised stock exchange in which the shares are proposed to get listed
* Investors are then permitted to submit orders for OFS shares on a designated platform within a recognized stock exchange. After order placement, the stock exchange is responsible for the allocation of shares to investors.
* Since the procedure for an OFS through IPO involves offering of shares to the public in designated stock exchange, it would be appropriate to treat the shares offered in OFS as listed
* Accordingly, the period of holding for same should be 12 months to classify the same as long term capital asset
* The above clarification would help in following:
  + Eliminating multiple tax rates for unlisted securities sold off market or through OFS.
  + Expedite the road map for an IPO by reducing the time by 12 months as companies may look to go public immediately after 12 months of capital restructuring
  + Possibility of advancing the tax collections by a year as overall timelines for IPO get reduced by 12 months
  + It would also ensure the overall objective and intent of the government to promote listing of Indian companies

**Recommendation**

* It is recommended to amend first proviso to s.2(42A) to include unlisted shares sold under an offer for sale to the public included in an initial public offer to reduce the holding period for such shares to turn long term from 24 months to 12 months. It is also recommended to amend first proviso to s.50B to substitute “thirty-six” months with “twenty-four” months to reduce the period of holding of business undertaking to turn long term.
* Suggested text of amendment is provided below :-

*“(42A) "short-term capital asset" means a capital asset held by an assessee for not more than twenty-four months immediately preceding the date of its transfer :*

*Provided that in the case of a security  listed in a recognized stock exchange in India or equity shares not listed in a recognised stock exchange in India sold under an offer for sale to the public included in an initial public offer or a unit of the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963) or a unit of an equity oriented fund or a zero coupon bond, the provisions of this clause shall have effect as if for the words twenty-four months", the words "twelve months" had been substituted:”*

***“50B.****(1) Any profits or gains arising from the slump sale effected in the previous year shall be chargeable to income-tax as capital gains arising from the transfer of long-term capital assets and shall be deemed to be the income of the previ­ous year in which the transfer took place :*

*Provided that any profits or gains arising from the transfer under the slump sale of any capital asset being one or more undertakings owned and held by an assessee for not more than ~~thirty-six~~ twenty-four months immediately preceding the date of its transfer shall be deemed to be the capital gains arising from the transfer of short-term capital assets.”*