

Regulation on FBT on ESOPs

The Finance Act as passed by the Parliament confirmed the Fringe Benefit Tax liability on ESOPs; however the method of determination of fair market value was unclear.

Rule 40C has now been introduced by the Central Board of Direct Taxes to determine the Fair Market Value

Rule 40 C - Calculation of Fair Market Value

Entities listed on a recognized Stock Exchange in India:

Valuation:

FBT for listed companies would be levied on the difference between the fair market value (FMV) of the any specified security on the date of vesting and the amount actually paid, or recovered from, the employee.

- The FMV will be the average of the opening and closing (sell) prices on the stock exchange which shows highest volume of trading on the date of vesting.
- In case there is no trading on date of vesting, FMV will be the closing price on the date closest to and immediately preceding the date of vesting, on the stock exchange which shows highest volume of trading.

Definition:

“Recognised Stock exchange” as defined in the Securities Contracts (Regulation) Act, 1956 is the one that is a part of the list provided in Section 4 of the Act. All the exchanges listed are Indian stock exchanges

Exclusions:

A company (Indian or Foreign) listed on an Overseas Stock Exchange will not be categorized as listed for these Rules. They will have to follow the norms given for unlisted entities

Entities not listed on a recognized Stock Exchange in India:

Valuation:

For unlisted companies, the FBT would be levied on the difference between the FMV and the amount actually paid, or recovered from, the employee; the FMV to be as determined by a Category I Merchant Banker, on the “specified date”.

Definition:

“Specified date” means either the date of vesting or any other day decided by the Category I Merchant Banker, not being more than 180 days earlier from date of vesting.

Example: If an unlisted entity approaches a Category I Merchant Banker gets the valuation as on 31st March 2007 done, all the vests happening between 31st March and 30th September 2007 can use this as FMV. The Company will have to get another valuation done on 30th September 2007 which would be valid for all the vests happening between 30th September 2007 and 31st March 2008. Thus, entities having grants vesting at various dates throughout the year will have to get the valuation done twice a year.

Application for Parent company options:

In case of employees of subsidiary company who have been granted parent company options and the shares of the Parent company are not listed on an Indian recognized stock exchange, Merchant Banker will have to value shares of parent company.

Issues in Implementing the Notification

1. Treatment of Companies listed overseas as “Unlisted Companies”
 - a. Indian Companies like SIFY, Rediff, listed only on overseas exchanges, will be treated as “unlisted companies” for the purpose of determination of FMV
 - b. Indian subsidiaries of Foreign companies listed overseas will now be treated as “unlisted” and will have to seek Merchant Banker’s valuation for listed shares of the foreign parent
 - c. Indian subsidiaries of foreign unlisted companies will have to seek Merchant Banker’s valuation for foreign unlisted parent. Willingness of the parent company to share information for valuation is an unknown.
2. Frequency of valuation
 - a. The companies with various grant dates throughout the year will have to seek the Merchant Banker’s valuation at least twice a year. This would involve high cost and will be a burden on the Company. Extending the validity of the valuation to the entire year would ease the burden on such companies.

Issues not yet clear

There are a few critical issues which still remain unanswered.

1. Whether the FBT amount will be considered as “cost of acquisition” in the hands of the employee while calculating the Capital Gains tax liability?
2. Whether the FBT recovered from the employees will be squared off against the FBT paid by the employer or treated as Income?
3. Any variation made in the scheme terms to recover tax from the employees could be construed as detrimental to the interest of the option grantees, which is specifically not permissible as per the Security Exchange Board of India (Employee Stock Option Schemes & Employee Stock Purchase Schemes) guidelines, 1999. It needs to be seen whether the Tax guidance will prevail over the SEBI guidelines. Clarification from SEBI on this front is needed to make the issue clear.

