

Taxation of ESOPs
Finance Bill 2009 (As on 6th July, 2009)

FBT on ESOPs has been abolished.

ESOPs have been included in the purview of Perquisites under Section 17 (2). The value of the ESOPs determined on the date of exercise, as the difference between the fair market value of the shares as on the date of exercise and the exercise price, would be taxable as a perquisite in the hands of the employees.

RELEVANT EXTRACTS

Charging Section & Quantification of tax

In section 17 (2) of Income-tax Act, the following sub-clauses are being substituted for clause (vi) with effect from the 1st day of April, 2010 -

‘(vi) the value of any specified security or sweat equity shares allotted or transferred directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee.

Explanation - For the purpose of this clause, -

- a) “specified security” means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 and where employees’ stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme;
- b) “sweat equity shares” means equity shares issued by a company to its employees or its directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.
- c) the value of any specified security or sweat equity shares shall be the fair market value of the specified security or sweat equity shares, as the case maybe, on the date on which the option is exercised by the assessee as reduced by the amount actually paid by, or recovered from the assessee in respect of such security or shares;
- d) “fair market value” means the value determined in accordance with the method as may be prescribed;
- e) “option” means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price.

Capital Gains

In section 49 of the Income-tax, for sub-section (2AA), the following sub-section shall be inserted with effect from the 1st day of April, 2010, namely:-

“(2AA) Where the capital gain arises from the transfer of specified security or sweat equity shares referred to in sub-clause (vi) of clause (2) of section 17, the cost of acquisition of such security or shares shall be the fair market value which has been taken into account for the purposes of the said sub-clause.”

WHAT DOES THIS MEAN?

Effective Date

These provisions apply to all options exercised on or after 1st April 2009.

Quantification of tax

The tax liability will now be determined on the exercise date. Tax would be levied on the difference between the fair market value (FMV) of the shares on the date of exercise and the exercise price. The tax would be levied on this value at the rate of 30% (plus cess).

Incidence of tax

Tax is payable at the time of allotment or transfer of shares, directly or indirectly (through an ESOP trust). All options exercised after 1st April, 2009 are liable to TDS, in which case options vested before 1st April, 2009 but not exercised would also be liable to tax.

Trust Route

Shares allotted or transferred directly or indirectly are covered. The shares transferred through the Trust route would also be included in the tax bracket.

A Comparison

Details	Now	Earlier
	TDS on Perquisite	FBT
Taxable Value	Difference between Fair market value on date of exercise and exercise price	Difference between Fair market value on date of vest and exercise price
Liability of payment	Taxable in the hands of the employees	Taxable in the hands of the Company, recoverable from the employees
Payable when	At the time of allotment or transfer	At the time of allotment or transfer
Tax rate	30.9%	33.99%
Example TDS / FBT Grant - Ex Price = Rs.50 Market price on Vest Date = Rs.200 Exercise Date = Rs.240	Taxable Value = 240 - 50 = 190 Tax = 190 x 30.9% = 58.71	Taxable Value = 200 - 50 = 150 FBT = 150 x 33.99% = 50.99
Capital Gains Sale Price = Rs.300	Taxable Value = 300 - 240 = 60	Taxable Value = 300 - 200 = 100
Short Term Capital Gains Listed Companies Unlisted Companies	STCG = 60 x 15% = 9 STCG = 60 x 30.9% = 18.54	STCG = 100 x 15% = 15 STCG = 100 x 30.9% = 30.9
Long Term Capital Gains Listed Companies Unlisted Companies	No tax LTCG = 60 x 10% = 6	No tax LTCG = 100 x 10% = 10

UNCLEAR ISSUES

There are certain issues which still need clarity. These would be addressed in the rules that would be published.

1. Whether the 'date of exercise' is the date of exercise by the employee or the date on which allotment of shares is done?
2. 'Fair Market Value' for listed and unlisted companies need to be defined. Whether Rule 40C for determination of fair market value is to be used? 