Taxability of ESOP in hands of employee's arises on date of allotment & not on date of exercise of option

Summary – The Hyderabad ITAT in a recent case of Bharat Financial Inclusion Ltd., (the Assessee) held that Perquisite tax on 'Employee Stock Option Plans' arises in hands of employees, on date of allotment of shares and not on date of exercise of option

Facts

- The assessee-company was engaged in the business of granting micro loans in rural areas. During the survey, it was observed that employee of the assessee-company, had received compensation in the form of Employee Stock Options 'ESOP' granted to him by assessee.
- The Assessing Officer was of a view that perquisite tax on Employee Stock Option Plans ('ESOP') should have been deducted on the date of exercise of option and not on the date of allotment of shares. The Assessing Officer held assessee as assessee-in-default for late deduction/deposit of Tax Deducted at Source ('TDS') to Government treasury and levied interest under section 201(1A).
- On appeal, the Commissioner (Appeals) upheld the order of the Assessing Officer.
- On appeal to Tribunal:

Held

- It is to be noted that the ex-employee has a right to exercise, once he exercises the option, the price of the shares are freezed. That means, the exercise of the option is only acceptance of the proposal as per the scheme 2007. The proposal comes with the obligation *i.e.* with conditions of such exercise of option. Once the option is exercised, the company which allots the shares has certain obligation on their part to safeguard their interest. The allotment cannot be completed without receiving the full price of the shares. In the given case, mere receipt of the price agreed is not enough but to receive the cost of shares exercised along with the withholding tax. These are obligations on the part of person exercising the opinion. This transaction will come to an end as and when the person exercising the option also completes his part of commitment. Therefore, mere exercise of the option is not enough, it is only initial acceptance of right or proposal, which comes with certain commitments. As and when the commitment is complete, the proposal said to be accepted. The goal post of acceptance shifted until completion of the commitment which comes along with the scheme. As submitted by assessee the provisions of section 192 is applicable only on payment basis not on accrual basis. The value of the perquisite can be determined as per section 17(2)(*vi*) but is taxable only when the assessee makes the payment, in this case, allotment of shares.
- In case, it is accepted the contention of Commissioner (Appeals) that separation agreement should not be used to defer the tax liability, the company allots the shares and pays the withholding tax. Then, the company allots the shares without receiving full consideration on such shares. In case,

employee fails to comply with the separation agreement, the company cannot cancel the allotment of shares. Therefore, the assessee has to safeguard its interest first.

- Therefore, the amended provision as per section 17(2)(*vi*) is only to determine the value of ESOP transaction and the obligation for withholding tax accrues only when the shares are allotted after completion of commitments on the part of the person who exercised the option. Mere exercise of acceptance is only acceptance of general proposal. Accordingly, grounds raised by the assessee on this are allowed.