

Perquisite arises as on date of allotment of shares under ESOP

Background

As per provisions¹ of the Income-tax Act, 1961 (the Act), a perquisite is triggered upon allotment of shares to employees at a value less than the prescribed Fair Market Value (FMV). Further, the value of such perquisite is the difference between FMV as on date of exercise and amount paid by the employee as the exercise price.

In this context, the Hyderabad bench of the Income-tax Appellate Tribunal (the Tribunal) has recently held² that the obligation for withholding tax at source is triggered only when the shares are allotted and not on the date of exercise.

Facts of the case

- The taxpayer, a company incorporated under the Companies Act, 1956, had granted compensation in the form of Employee Stock Option (ESOP) to one of its employees (the taxpayer).
- Such taxpayer had exercised the options under ESOP on 13 October 2011. The taxpayer had allotted the shares to the taxpayer after completion of certain agreed upon conditions on 4 May 2012.
- Accordingly, the taxpayer had withheld tax at source on the underlying perquisite value of ESOP and remitted the same to the Government Treasury on 7 June 2012.
- A survey operation³ was conducted in the case of the taxpayer to verify compliance with TDS provisions and the Assessing Officer (AO) had passed an order wherein *inter-alia* interest⁴ was levied for delay in deducting/payment of taxes on perquisite of ESOP.

- The AO was of the view that taxes had to be withheld on the date of exercise of shares (13 October 2011) and not on the date of allotment of shares (4 May 2012).
- Aggrieved by the order passed by the AO, the taxpayer had filed an appeal before the Commissioner of Income-tax, Appeals [CIT(A)], wherein the CIT(A) *inter-alia* sustained the interest levied by the AO.
- Aggrieved by the order passed by the CIT(A), the taxpayer had filed an appeal with the Tribunal.

Taxpayer's contentions

- Withholding tax obligation arises⁵ when the employer makes any payment to the employee. Hence, a perquisite⁶ is accrued to an employee only on allotment of shares pursuant to his exercise of options under ESOP.
- Since shares were not allotted to the taxpayer on the date of exercise, there would be no taxable perquisite on such date of exercise.

Tribunal decision

- The Tribunal noted the following:
 - The exercise of the option is only an acceptance of a proposal which in the instant case, came with certain conditions
 - Upon exercise, the price payable for the shares are frozen

¹ Section 17(2) (vi) of the Act

² Bharat Financial Inclusion Ltd v. DCIT (ITA No. 237/Hyd/2017, dated 03 August 2018)

³ Section 133A of the Act

⁴ Section 201(1A) of Act

⁵ Section 192 of the Act

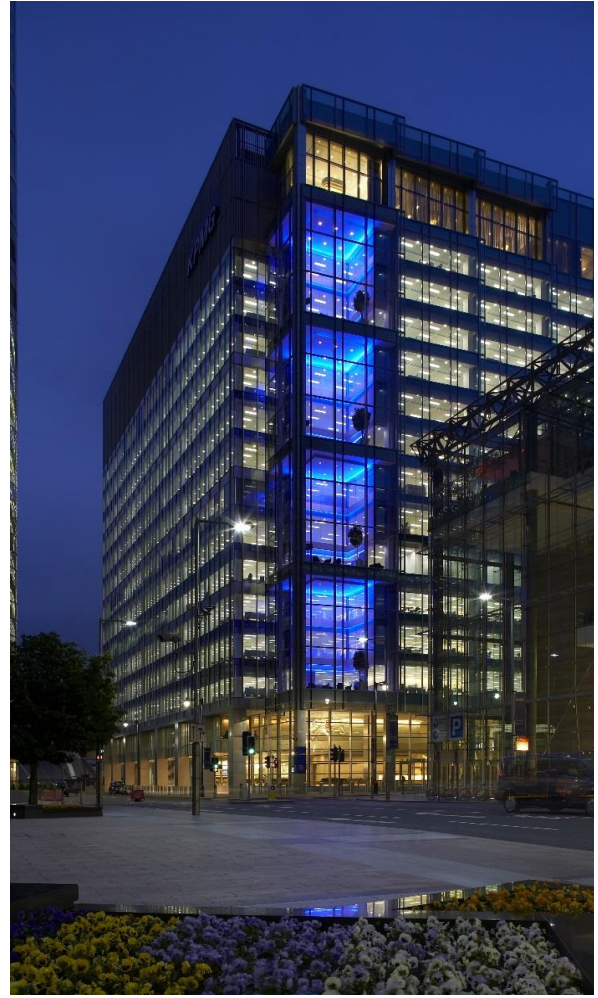
⁶ Section 17(2)(vi) of the Act

- The allotment was completed only upon completion of all conditions and after receipt of the full price of shares
 - Withholding tax obligation⁷ arises only on payment basis and not on an accrual basis
 - Hence, withholding tax obligation arises only at the time of allotment of shares.
- Given the above, the Tribunal held that withholding tax arose only when the shares were allotted after completion of commitments on the part of the taxpayer who exercised the option and deleted levy of interest.

Our comments

In this decision, the Tribunal has upheld the provision of the law that obligation to withhold tax in respect of perquisite on ESOP is triggered only when shares are actually allotted to an individual and not at the time of exercise.

Considering that this is a fact-specific case and a ruling of the Tribunal, adoption of the same in other jurisdictions/set of facts could be evaluated on a case-to-case basis.



⁷ Section 192 of the Act

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