

## Liquidation of shares allotted under ESOP to be taxed as capital gains and not as a perquisite

### Background

As per the provisions<sup>1</sup> of the Income-tax Act, 1961 (the Act), a perquisite is triggered upon allotment of shares by the employer to employees. Any subsequent gains arising out of the sale of such shares has to be treated as capital gains.

In this context, the Chennai Bench of the Income-tax Appellate Tribunal (the Tribunal) has recently held<sup>2</sup> that gains arising on sale of shares sold by parent company on behalf of the taxpayer should be treated as capital gains considering the value of shares at allotment as a cost of acquisition. Further, where such shares were allotted to the taxpayer during the years when he was a non-resident in India, perquisite taxation did not arise.

### Facts of the case

- The taxpayer, a non-resident individual, working in the USA, had exercised certain stock options issued by his employer, prior to Financial Year (FY) 2010-11.
- Subsequently, the taxpayer took up employment in the subsidiary company in India and qualified as a resident but not ordinary resident during the FY 2010-11.
- During the FY 2010-11, the parent company had sold the shares on behalf of the taxpayer and remitted the sale proceeds to the taxpayer through its Indian subsidiary.

- The Indian subsidiary had issued Form 16 including the sale proceeds as a perquisite. However, the taxpayer filed a return of income (ITR) for the FY 2010-11 by excluding the perquisite value as mentioned in his Form 16 and disclosing short-term capital gains on the sale of shares during the relevant FY
- The assessment was reopened<sup>3</sup> and an order was passed wherein the assessing officer (AO) disregarded capital gains and considered the perquisite value, as the AO was of the view that shares transferred to the taxpayer indirectly by the employer would constitute a perquisite and not capital gains.
- 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) had upheld the order passed by AO.

### Tribunal's decision

- For a taxpayer qualifying to be a non-resident in India, income accrued/deemed to be accrued, in India would be subject to tax in India. Accordingly, in relation to salary income, the income earned for services rendered outside India would not be taxable in India.
- Given this, the Tribunal observed that the value of stock options exercised by the taxpayer when he was a non-resident during the earlier FYs could not be treated as a perquisite in the hands of the taxpayer during FY 2010-11.

<sup>1</sup> Section 17(2)(vi) of the Act

<sup>2</sup> Dr. Muthian Sivathanu v. ACIT (ITA no 553/ Chny/2018, dated 24 October 2018)

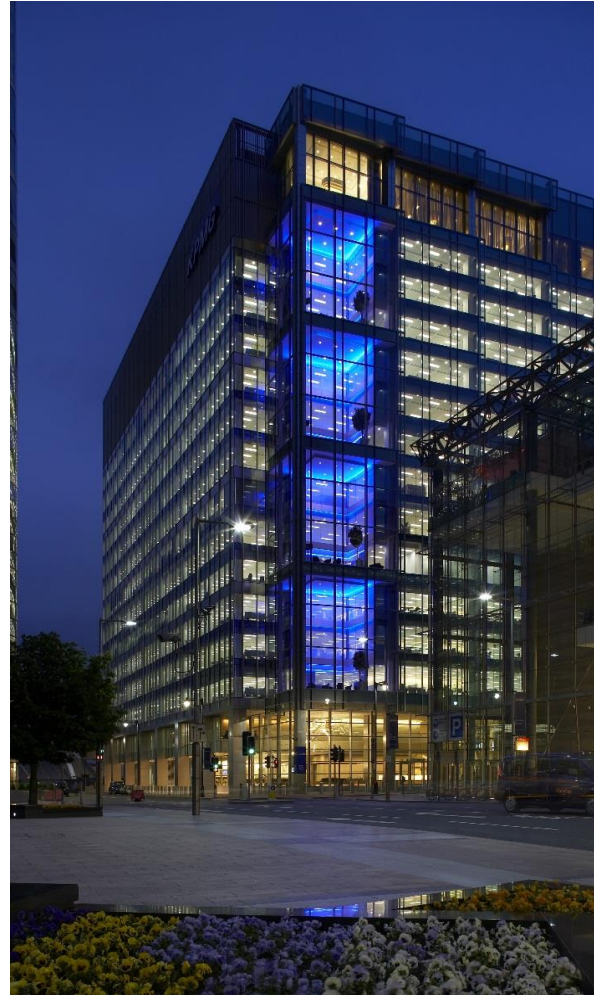
<sup>3</sup> Under Section 147 of the Act

- Further, the Tribunal noted that the shares were already allotted to the taxpayer prior to FY 2010-11 and the gain on sale of such shares arising to the taxpayer has to be treated as capital gains; such gains would be the difference between sale proceeds and the cost of acquisition wherein the cost of acquisition is the value of shares allotted to the taxpayer.
- The Tribunal also mentioned that income should be assessed in the hands of a taxpayer based on facts and as per provisions of the Act and not based on Form 16 alone.
- Given the above, the Tribunal held that treatment of taxing the entire sale proceeds as perquisites is erroneous and remanded the case back to AO to verify the accuracy of amounts disclosed as capital gains and salary income.

### Our comments

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

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.



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