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# TAX FLASH NEWS

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## Employment Stock Option Plan exercised by non-resident, if granted for employment in India, not eligible for treaty benefits

As per the Act[1], the value of any specified security or sweat equity shares transferred by an employer, directly or indirectly, free of cost or at a concessional rate would be taxable as a perquisite.

For a taxpayer qualifying to be a non-resident in India, income received, deemed to be received, accrued, deemed to be accrued, arising or deemed to be arising in India would be subject to tax in India.

In this regard, recently, Mumbai Bench of Income-tax Appellate Tribunal (the Tribunal) has held[2] that for taxpayer being a Non Resident of India, claim of benefits (as available under the relevant Treaty) for the Employment Stock Option Plan (ESOPs) exercised by him, granted for his employment in India would not be available.

### Facts of the case

A Non-resident taxpayer, being employed with HDFC Bank Limited, Mumbai was deputed to HDFC Bank representative office, Dubai on 1 October 2007. During the relevant tax year (TY), the taxpayer exercised the options granted to him by HDFC Bank Limited on 27 June 2007, which had later vested on 27 June 2008 (50 per cent) and on 27 June 2009 (50 per cent).

The difference between the grant price and the market price of the options amounting to INR 72,77,320 was considered as perquisites and accordingly taxes had been deducted at source by the employer (i.e HDFC Bank Limited) for the options granted to the taxpayer during the relevant TY.

During the relevant TY, the taxpayer had qualified to be a Resident of Dubai. While filing the return of income for the relevant TY, the taxpayer had declared a total income of INR 78,50,010 and had availed the benefits[3] under the Double-Taxation Avoidance Agreement between India and UAE (DTAA), alluding that ESOP perquisites were not taxable in India as the ESOPs were granted for the services rendered in the UAE. Accordingly, he had claimed relief of INR 20,44,855 in his return of income.

During the scrutiny assessment, the Assessing officer (AO) observed that the options were granted to the taxpayer in consideration for services rendered in India during the year 2007, when the taxpayer was a resident in India. Thus, the AO had disallowed the claim of relief amounting to INR 20,44,855 under Section 90 in his return of income.

Aggrieved by the order passed by the AO, the taxpayer had filed an appeal with the Commissioner of Income-tax (Appeals) [CIT(A)]. The CIT(A) had upheld the order of the AO.

Aggrieved by the order of the CIT(A), the taxpayer had filed an appeal with the Tribunal.

### Taxpayer's contentions

The taxpayer was of the view that ESOP perquisite is not taxable in India as he was a NR in India during the relevant TY. He further contended that though the income from ESOP perquisite was not taxable in India, the taxpayer had reported the said income in his return of income and made relevant disclosures in order to seek the refund of the tax deducted at source by the employer.

Further, the taxpayer had contended that income in the nature of ESOP benefits earned by the taxpayer does not accrue or arise in India[4] and consequently, ESOP perquisites cannot be taxed in India.

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[1] Section 17(2)(vi) of the Act
[2] Unnikrishnan V S V ITO (International Taxation 4(3)(1), Mumbai) dated 13 January 2021
[3] Article 15(1) of the DTAA
[4] Section 5(2) of the Act

Additionally, the taxpayer had made an alternate submission relying on Article 15 of DTAA on Dependent personal services which provides for taxation of salaries, wages and other similar remunerations. The taxpayer had stated that the ESOP benefits earned by him during the relevant TY shall be covered under the scope of expression "other similar remuneration" and the term "exercised" in relation to the stock option refers to the a place where the employee physically rendered its services.

The taxpayer also placed reliance on certain judicial precedents[5] wherein it was held that income cannot be taxed in India if the employment services over the period from years of grant to years of vesting/exercise are rendered outside India.

Given this, the taxpayer argued that the income from ESOP benefits shall be taxable only in UAE, as the services were rendered in UAE during the period of grant to vest and accordingly the said income cannot be taxed in India as per Article 15 of DTAA.

## Tribunal's observation and ruling

The Tribunal had placed relevance on the on SC ruling[6] and stated that accrual or arising of an income cannot be equated with receipt of an income and observed that though the ESOP benefit has arisen to the tax payer in the relevant TY, the related rights were granted to the taxpayer in 2007 for the services rendered in India.

The Tribunal placed reliance on the following principles[7] and concluded that the ESOP benefits relate back to the point of time when the benefit is granted. It cannot, therefore, be viewed as accruing or arising at the point of time when the ESOP benefits are exercised:

- ESOP should not relate to services rendered after the period of employment (for future services) though there may be conditions attached with the benefit respect to continuance of employment;
- ESOP should only be considered to relate to services rendered before the time it is granted as a reward for the services.

The Tribunal observed that the income in respect of ESOP accrued and had arisen at the time of the grant of the ESOP rights, even though the taxability of the same, on account of the specific provisions[8], has arisen in the relevant tax year.

Further, the Tribunal also explained that Article 15 envisages taxation of ESOP benefit (other similar remuneration) as well, in the jurisdiction in which the related employment is exercised. In the instant case since the employment services were rendered in India, such claim may not be available in the hands of the taxpayer.

Separately, Tribunal also observed in certain judicial precedents[9] that where a taxpayer, qualifying to be a Non-resident (NR) or Not Ordinarily Resident (NOR), has rendered services only partly in India for the whole grant period, then only such proportion of the ESOP perquisite relatable to the service rendered by the taxpayer in India would be taxable in India. The facts of the instant case are different.

Given all of the above, the Tribunal concluded that since the taxpayer was in receipt of the ESOP benefit on account of the services rendered in India at the time of grant, he would not be eligible to avail the benefit of Article 15 of the DTAA in respect of the said income at the time of exercise and had rejected the said claim.

## Our comments

This decision well covers the taxability of income based on source. Income sourced in India would be taxable in India. While determining the source, the decision also discusses the principles of availing Treaty exemption for trailing compensation benefits.

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

[6] E D Sassoon & Co Ltd Vs C.I.T. [(1954) 26 I.T.R. 27 (S.C.)]
[7] Placing reliance on United Nations Model Conventions Commentary 2017 @ 405-7
[8] Section 17(2)(vi) of the Act

[9] CIT vs Robert Arthur Keltz [ITA No. 57/2014 dated 23 July 2014][Delhi]; CIT vs Robert Arthur Keltz (2013) [59 SOT 2037 [ITAT- Delhi] ; Anil Bhansali vs ITO [53 taxmann.com 367] [ITAT- Hyderabad] dated 21 January 2015

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