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Taxation of ESOPs

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1. Background:

Human Resources or Human Capital is well recognized as a key resource enabling a business to create value. Incentivizing such Human Resources through employee ownership plans has become very popular over the last few decades. Such plans are considered vital in enabling a business to attract, retain, motivate and reward human resources. Incentives through ownership plans create linkages with the overall performance of the business thereby aligning the interests of the employees with the shareholders thereby creating a win-win situation.

Before dealing with the taxation of employee stock ownership plans (ESOPs), it might not be out of place to have a very brief overview of a few important ESOPs.

1. **Employee Stock Option Scheme (ESOS)**:
   Under an ESOS, a company grants options (right without any obligation) to acquire a certain number of shares in the company or its holding / subsidiary company generally at a pre-determined price (exercise price) within a pre-determined period (exercise period) to its employees. The option to acquire shares can be exercised once the conditions are fulfilled, referred to as 'vesting conditions'. Such vesting conditions may be continued employment for a defined time or performance based or both. Upon vesting, the employee gets an unfettered right to 'exercise' the vested options by payment of the exercise price. On exercise, the shares are allotted / transferred to the employees who may sell them subject to lock-in period, if any, specified under the scheme.

2. **Employee Share Purchase Scheme (ESPS):**
   In an ESPS, employees are granted right to acquire shares at a price lower than the prevailing market price. The shares issued under an ESPS are subject to lock-in restrictions during which the employees are required to hold onto the shares and / or continue employment with the Company.

3. **Phantom Equity Plan (PEP) or Stock Appreciation Right Scheme (SAR)**
   PEP or SAR provide employees with ghost / simulated ownership. In a PEP / SAR, an employee is given notional units / shares at a benchmark price with a right to exit at a future formula based price of the phantom unit or market price / formula-based price of the SAR. On

exercise, PEP / SAR can be settled either by payment of cash (cash settled PEP / SAR) or issue of shares also (equity settled PEP/SAR).

4. **Restricted Stock Units (RSUs)**

   RSUs involve grant of shares (usually without any exercise price) to the employees upon completion of vesting conditions.

In practice there can be multiple variants of the above ESOPs with complex features / conditions attached. In many cases these ESOPs are rolled out through employee ownership trusts settled exclusively for the benefit of employees.

The Companies Act, 2013 read with Rule 12 of Companies (Share Capital and Debentures) Rules, 2014 provides the regulatory framework for granting stock options to employees etc. Listed companies are further governed by the Securities and Exchange Board of India (Share Based Employee Benefits) Regulations, 2014 (SEBI SBEB Regulations) which has superseded the SEBI (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999 (SEBI ESOP Guidelines). The SEBI SBEB Regulations are much broader in nature and cover many variants of ESOPs. The SEBI SBEB Regulations are to be read along with SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009.

Taxation of ESOPs has evolved over the last 2 decades. The phases cover uncodified tax provisions where such benefits were taxable on first principles, gradually moving to a period during which ESOPs were incentivized (subject to conditions) and taxed only at the time of final exit / sale, then to an intermediate stage when ESOPs were subject to levy of fringe benefit tax and finally to the present provisions (from 1.4.2010).

Taxation of ESOPs will vary depending on the type of ESOPs. Plans that result in allotment or transfer of shares to the employees are taxed differently than those that result in payment of cash pursuant to PEP / SAR. The analysis of the taxation provisions of ESOPs under the Income-tax Act, 1961 (the Act) are presented in a question answer format to make them more reader friendly. A few contentious issues are discussed at the end. In this article references to sections unless otherwise stated are sections of the Act.

2 Basic framework for taxation of ESOPs:

Q1 Whether benefit under an ESOP is taxable as income?

A1 Income in money's worth or equivalent of cash is also income. However, a contingent gain cannot be taxed as income. A right to receive shares of a company at a price lower than its market price

could at most be regarded as a benefit / perquisite or a concession not in the nature of income as commonly understood. This is more so when such right is not immediately exercisable as it may be subject to fulfilment of certain vesting conditions. Under the Act, income is defined u/s 2(24) to include a benefit or perquisite or concession in certain situations. Accordingly, a benefit / perquisite arising in the course of employment is taxable under the head 'Salaries' while the same arising from the exercise of a business or profession is taxable as business income. As per section 2(24)(iv), a benefit or perquisite obtained from a company by a director or relative of director is also included as income.

Q2 How is the benefit obtained under ESOS taxable in the hands of an employee?

A2 Benefit received under an ESOS is taxed as a perquisite according to the provisions of section 17(2)(vi) of the Act.

Section 17(2)(vi) provides that 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 shall be treated as perquisite.

Thus, taxation arises at the time when the specified security is allotted or transferred to the employee.

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The important aspects of section 17(2)(vi) are briefly analyzed as under:

- ***Value*** means the fair market value (FMV) of specified securities on the exercise date less any amount actually paid or recovered from the employee for such specified securities. The mechanism for determining FMV has been prescribed under Rule 3(8) & 3(9) of the Income-tax Rules, 1962 (the Rules) (discussed in Q4 below).

- ***Specified security*** means securities as defined in section 2(h) of the Securities Contracts (Regulation) Act, 1956 (SCRA). Where stock options are granted under any plan or scheme, then the securities offered under such plan or scheme i.e. the resultant securities arising on exercise of such options is included therein. The resultant securities could be shares, debentures or any other securities.

- ***Allotted or transferred*** – specified security must be allotted or transferred. Allotment signifies primary issue by the Company while transfer would include secondary transaction by way of purchase from the Trust / other entity.

- ***Directly or indirectly*** – wide enough to cover options granted through a trust especially when the trust is settled or controlled by the Company.

- ***By the employer or former employer*** – For ESOPs to be taxed, the grant / benefit should flow from the employer or former employer. Interesting issue arises where the ESOPs are granted by the holding company or by a promoter. This is discussed in Q 11.

Q3 How does the taxation of ESPS take place?

A3 In case of an ESPS, once the employee exercises the rights granted thereunder, the shares are allotted or transferred to him. Unlike ESOS where the options are exercised at a future date usually beyond one year from the date of grant, the allotment or transfer of shares in case of ESPS takes place immediately. Hence, the underlying perquisite becomes taxable immediately upon such exercise u/s 17(2)(vi). The perquisite will be the difference between the FMV on the exercise date as determined under Rule 3(8) and the price paid for such shares. It may be mentioned that in terms of section 17(2)(vi), the FMV to be considered is as on the date on which **the 'option' is exercised**. In case of ESPS no option is granted but nevertheless the employee gets a right to purchase the shares. This right will be considered as an 'option' for the above purpose.

In case of ESPS, the shares allotted are subject to lock-in period (minimum 1 year prescribed under SEBI SBEB Regulations). Few issues about taxability of ESPS which are subject to lock-in restrictions are discussed at greater length in while discussing a few issues in I1.

Q4 What is the valuation mechanism to determine the FMV as per the Rules?

A4 **Rule 3(8) & 3(9) – Determination of FMV**

In case of equity shares-

- If it is listed on any recognized stock exchange on the date of exercise, the FMV shall be average of the opening and the closing price.
- If it is listed on more than one stock exchange on the date of exercise, the FMV shall be the average of the opening and the closing price on the recognised stock exchange with the highest trading volume.
- In considering both the opening or the closing price, the first settlement or the last settlement respectively on such exchange shall be considered. Where both 'buy' and 'sell' quotes are available, the sell quotes shall be considered.
- Where there is no trading recorded on a particular day, the FMV shall be closing price on the recognised stock exchange or recognised stock exchange with highest trading volume on the closest date immediately preceding the date of exercise. It may be noted that here only the

closing price is to be considered as opposed to average of opening and closing price for considered for regularly traded shares.

- Recognised stock exchange shall have the meaning as per section 2(f) of the SCRA which refers to the stock exchange as recognised by the Central Government under section 4 of the SCRA. Thus, if equity shares are listed on a stock exchange outside India then such equity shares shall not be considered as listed on a recognised stock exchange. Accordingly, such equity shares are considered as unlisted shares for the purpose of this Rule.

In case of unlisted equity shares or securities other than equity shares

The FMV shall be the value as determined by Category 1 Merchant Banker (registered with SEBI). The FMV shall be determined either on the exercise date or any earlier date not more than 180 days prior to the exercise date. The date of report of the merchant banker is not relevant but what is relevant is the valuation date **as of which** the merchant banker determines the underlying valuation of the share. Thus, a valuation report once obtained will be valid for 180 days.

Q5 How does the taxation take place in case of PEP or SAR?

A5 Cash settled PEP / SARs

On exercise of the PEP / SAR, the Company will be obligated to pay cash based on the valuation formula specified for the PEP/ SAR. Since this is paid in cash, it is taxable as normal salary. The Tribunal (Special Bench)[1] has held that the benefit on account of SAR shall be assessable as salary in the year of redemption.

Equity settled PEP / SAR

Where shares are allotted to settle the difference payable to an employee under SARs or PEPs, the perquisite on allotment or transfer of such shares will taxable in accordance with section 17(2)(vi) based on the FMV of the shares determined as per Rule 3(8).

Q6 How are gains arising on subsequent sale of shares taxed?

A6 Gains arising on subsequent sale of shares shall be taxable as ‘capital gains’ - long term or short-term, depending upon the period of holding of such shares. The period of holding shall be computed from the date of allotment of such shares as per *section 2(42A)*. As per section 49(2AA), the FMV as per Rule 3(8) considered for determining the perquisite value u/s 17(2)(vi) shall be taken as cost of acquisition. This ensures that the employee does not suffer double taxation on the perquisite value already taxed as salaries.

[1] Sumit Bhattacharya v. ACIT [2008] 112 ITD 1 (Mum)(SB)

Q7 Whether benefit of grandfathering of cost will be available for shares of a listed company acquired on exercise of ESOPs?

A7 Where the exercise of ESOPs and allotment of the shares is done prior to 31.1.2018 and the Company was listed as on 31.1.2018, the benefit of grandfathering of cost on the basis of FMV as on 31.3.2018 in accordance with the provisions of section 55(2)(ac) r.w.s. 112A will be available. It may be mentioned that section 112A provides that long term capital gains resulting from sale of equity shares which are subjected to securities transaction tax ('STT') both at the time of acquisition as well as transfer shall be subjected to tax @ 10% without availing the benefit of indexation. The Central Government has issued *a* Notification[2] which *inter alia* specifies that shares acquired pursuant to ESOS or ESPS framed under the SEBI ESOP Guidelines shall be covered by section 112A even though no STT is paid on them at the time of acquisition. This is a beneficial notification. However, the notification gives reference to the SEBI ESOP Guidelines despite the same being already superseded by SEBI SBEB Regulations even prior to the issue of the aforesaid notification. This seems a unintended lapse. Hence, despite the anomaly, shares acquired under ESOPs framed both under SEBI ESOP Guidelines and SEBI SBEB Regulations are eligible for the benefit under the said notification.

Q8 **How are sweat equity shares to be taxed?**

A8 Sweat equity shares are defined to mean equity shares issued by a company to employees or directors at a discount or for non-cash consideration for know-how / IP / value addition provided by such employees / directors. The issue of such sweat equity shares will have to comply with the provisions of the Companies Act, 2013 for the unlisted companies or the SEBI (Issue of Sweat Equity) Regulations, 2002 for the listed companies. Section 17(2)(vi) also covers issue of sweat equity shares within its fold and hence, the value of perquisite shall be determined with reference to as FMV as per Rule 3(8) & 3(9) less the price paid for such shares, if any.

Q9 How are ESOPs offered to consultants or advisors to be taxed?

A9 The Indian regulations viz. the Companies Act, 2013 and the SEBI SBEB Regulations do not permit ESOPs to be offered to non-employees. However, in case equity shares are allotted or transferred to consultants or advisors who are engaged in business or profession, then the perquisite element, if any, will be taxed in accordance with section 28(iv) as profits and gains of business or profession.

Q10 What is the taxation of ESOPs given to directors who are not employees?

A10 The Companies Act, 2013 and the SEBI SBEB Regulations do not permit issue of ESOPs to independent directors. However, non – independent directors who are not in an executive capacity may also be given ESOPs. If these directors receive such ESOPs as part of their business or

[2] Notification No. 60/2018/F. No. 370142/9/2017-TPL dated 1.~~ October ~~10.2018

profession, then they will be taxed u/s 28(iv). In other cases, the value of benefit or perquisite obtained by a director from a company is deemed as income u/s 2(24)(iv) and taxed as 'income from other sources'. However, no valuation guidelines are prescribed under the Act or the Rules for such cases. Whether the perquisite is to be valued in accordance with Rule 3(8) or Rule 11UA read with section 50CA or Section 56(2)(x) seems an open question. Under Rule 3(8), the valuation of the underlying unlisted share would be the FMV determined by a merchant banker whereas under Rule 11UA, the FMV will be the book value of the share as adjusted for certain assets as prescribed therein.

If the perquisite element is taxed, a collateral issue will be whether at the time of sale of the shares, the FMV so considered for taxing the perquisite element will be available as cost. Section 49(2AA) provides adjustment for cost of acquisition only where the perquisite is taxed u/s 17(2)(vi). It might be a good case to argue that the FMV considered for perquisite taxation ought to be available as cost basis existing jurisprudence as otherwise it will result in double taxation.

Q11 Are ESOPs offered by Holding Co. to the employees of Subsidiary Co. taxable as salary?

A11 In the case of Microsoft Corporation USA[3], the Authority for Advance Rulings ('AAR') held that the benefit arising to the employee of Indian subsidiary from stock option granted by its US parent company was taxable in the hands of Indian employee as 'salary'. The AAR, by lifting the corporate veil, held that *'the parent company has made such offer to the employees of the subsidiary company only because it regards its subsidiary and itself as the same concern'.* In another decision, the Tribunal (Special Bench – Mumbai)[4] relying on the decision of the Supreme Court[5] held that employer-employee relationship is not necessary for an income to be taxed under the head 'Salaries'. It is enough if the sum earned is a reward for services rendered by the employee. Similar view has also been taken in other cases[6]. In most such cases, the parent company may be recovering the benefit so provided by way of cross charge from the subsidiary. Further the obligation to deduct rightful taxes on the salaries paid to employees will be on the employer company. Keeping all these aspects in mind, in most cases, the benefit received is accordingly treated as taxable under the head 'salaries' and appropriate TDS is being done. Even if the same is not taxable under the head 'salaries', it may be taxable under 'income from other sources'.

Q12 What will be the tax treatment in case shares allotted under ESOPs are bought back by the Company?

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[3] (P. No. 15 of 1998) [1999] 235 ITR 565 (AAR)
[4] Sumit Bhattacharya v. ACIT [2008] 112 ITD 1 (Mum)(SB)
[5] Justice Deoki Nandan Agarwal v. Union of India [1997] 237 ITR 872 (SC)
[6] ACIT v. Chittaranjan A. Dasannacharya [2014] 64 SOT 226 (Bangalore - Trib.)

A12 Section 46A specifically deals with the tax implications in case of buyback by a company of its own shares or specified securities. Hence, in case where shares are listed, buy back of shares allotted under ESOPs would be subject to provisions of section 46A and taxed accordingly. In doing so, the cost will be determined in accordance with section 49(2AA).

However, in case of buyback of shares of an unlisted company, section 115QA applies. As per section 115QA, the 'distributed income' paid to the shareholder is charged to tax @ 20% plus applicable surcharge and cess. 'Distributed income' has been defined as buyback price minus the 'amount received by the company' for issue of shares. As per rule 40BB of the Rules, the 'amount received by the company' in case of shares issued under stock option plan shall be the FMV determined by the merchant banker for taxation of perquisite under Rule 3(8) **to the extent credited to the share capital and share premium account.**

Let us consider an example, shares of face value of Rs. 10 having FMV on date of grant of Rs. 100 are granted at Rs. 80. The Company can account for Rs. 20 as discount to be amortized over the vesting period. Assume the FMV at the time of exercise for determining the perquisite is Rs. 400. As per the generally accepted accounting practice, the amount received at the time of exercise (Rs. 80) plus the discount of Rs. 20 will be credited to the share capital and share premium account in aggregate. The difference of Rs. 300 out of Rs. 320 on which the employee has paid the perquisite tax will again suffer buy back tax u/s 115QA since the entire value on which perquisite tax is paid is not credited to the share capital or share premium account. Once the employee has been taxed on the perquisite based on the FMV, the further requirement of the same being credited to share capital or share premium seems out of place and inequitable.

Q13 It is quite common for companies to set up a Trust exclusively for implementing ESOPs? What are the tax implications in such cases?

A13 Generally, in an ESOP Trust, the beneficiaries are identified by a class and their individual interest would be indeterminate. Such ESOP Trusts set up by the Company will be governed by proviso (iv) to section 164 and accordingly, they will not be taxed at maximum marginal rate but as per the rates applicable to an AOP i.e. as individuals.

Q14 Is the Employer Company required to withhold any taxes on account of perquisite element under an ESOP?

A14 The employer shall be liable to deduct taxes at source on the perquisite under an ESOP. The perquisite u/s 17(2)(vi) is taxable at the time when the shares are allotted or transferred. Under Rule 3(8), the underlying FMV of the shares is to be determined as on the date of exercise. Nevertheless, the perquisite arises only at the time of allotment or transfer of shares and hence,

the TDS obligation will also arise at the time of such allotment or transfer and not on the date of exercise[7].

Q15 How are ESOPs taxed in case of a cross border situations?

A15 In the present era, employees are mobile and are internationally engaged. Further, the life cycle of an ESOP from grant – vesting - exercise - sale is spread over many years. It may be possible that employees would have moved to many countries during this period. Taxation of the employees in such cases can be complicated as each of the countries in which the employee may have worked during the entire life cycle of an ESOP may tax ESOPs in differing manner. There can be situations of either double taxation or double non taxation. Credit for taxes withheld can also pose some challenges. The topic is worthy of a separate article and is therefore, not addressed here.

3 <u>Issues:</u>

Some of the key issues in ESOP taxation are briefly discussed here.

I 1 In case of ESPS the shares allotted or transferred are subject to lock-in. How is the FMV determined under 3(8) to be adjusted for such lock-in conditions.

A1 In case of ESPS, the lock-in conditions can be of 2 types - a) where the employee is precluded from selling the shares during the lock-in period or b) where the employee is compelled to retransfer the shares if conditions like continued employment are not fulfilled during the lock-in period.

If there is merely a restriction on sale during the lock-in period, the benefit will nevertheless be taxable by virtue of section 17(2)(vi). However, such lock-in restrictions ought to be suitably factored while determining the taxable value. For listed shares, unfortunately, the FMV is the quoted price and hence, the lock-in restriction cannot be factored in the valuation. However, in case of unlisted shares, the merchant banker may suitably factor in the lock-in restrictions while valuing the shares considering the duration of the lock-in period.

In some cases of lock-in resrictions, the shares received under an ESPS are to be compulsorily re-transferred, at the issue price, in case of failure to comply with the conditions of continued employment or other conditions during the lock-in period. Thus, unless the conditions are fully complied with, there is no benefit arising to the employee. The Supreme Court in case of Infosys Technologies Ltd[8] had ruled that where shares are re-transferrable on account of resignation etc. during the lock-in period, the shares have no realizable value and hence, there is no perquisite in

[7] Bharat Financial Inclusion Ltd. v. DCIT (TDS) [2018] 172 ITD 198 (Hyderabad-Trib.)
[8] [2008] 297 ITR 167 (SC)

the hands of the employee. However, this decision was rendered before the provisions of section 17(2)(vi) were brought on the statute. One may also want to press the real income theory and other case laws which have upheld such a position. However, due to express provisions of section 17(2)(vi) read with Rule 3(8), this may be subject to litigation.

I 2 What is the taxability of stock options exercised by the legal heirs in case of death of the employee?

A2 As per the Companies Act, 2013 as well as the SEBI SBEB Regulations, 2014, upon the death of an employee, all options granted, shall vest and such vested options, may be exercised by the legal heirs or nominees, as the case may be. In the context of gratuity payment, the CBDT[9] has clarified that lumpsum gratuity paid to legal heirs of deceased employees is not taxable. Similarly, exemption is available in case of leave encashment paid to legal heirs of deceased employees[10]. It may also be pointed out that there are several judicial precedents which have held that amount received by legal heirs of deceased person amounts to a capital receipt not chargeable to tax. It can also be contended that in absence of any employer-employee relationship, the same should not be taxable as perquisite u/s 17(2)(vi). Hence it seems to be a very good case to argue that no amount will be taxable in the hands of the legal heirs on exercise of the vested options.

However, where such shares are allotted or transferred at a price which is lower than the FMV under Rule 11UA, whether the difference can be brought to tax u/s 56(2)(x) is a matter of debate. Exceptions to applicability of section 56(2)(x) do not provide for any carve out in respect of any property received on exercise of options by legal heirs. The carve out for property received under inheritance or will may not apply in this case as the shares will be received from the Company and not from the deceased employee. It may be argued that the right to exercise the vested options devolves upon the legal heirs pursuant to the contract of the Company with the deceased employee and hence, the benefit is flowing on account of inheritance or will and should be covered by the carve out u/s 56(2)(x).

I 3 What is the taxability in cases where the individual promoter of a company makes a grant to employees of the company of which he is a promoter. Such grants may be either directly or through an employee welfare trust set up for benefit of the employees?

A3 Where the grant of shares is made directly to the employees as a gratuitous act for years of association with the company in which the promoter is interested and it is one-time in nature, then one may argue that it is a capital receipt. In such cases, the application u/s 56(2)(x) may pose a challenge. However, where the grant to the employees is linked to continued employment or other

[9] *Vide* Circular No. 573 dated 21.8.1990
[10] Vide Circular No. 309 dated 3.7.1981

performance linked conditions or where the grants are recurring in nature, then they may partake the character of 'Salaries'.

Where such shares are granted through the employee welfare trusts, it may still be a capital receipt. Such distribution is made to the employees as beneficiaries of the employee welfare trust. Hence, it may be argued that the distribution is in the capacity as a beneficiary and therefore, there is adequate consideration for the same so as not to be taxable u/s 56(2)(x). The issue is debatable and not free from litigation.

I 4 In case of an amalgamation or demerger, if the ESOPs of the amalgamating company or demerged company are substituted with similar ESOPs of the amalgamated company or the resulting company, would any taxability arise in the hands of the employees?

A4 It is common that vested or unvested ESOPs of an amalgamating company or demerged company are substituted for similar ESOPs from the amalgamated company or the resulting company on an equitable basis. Section 47(vii) and section 47(vid) provide exemption only to shareholders of the amalgamating company or demerged company. There is no specific exemption for ESOP holders. Since capital gains arise only upon transfer of a capital asset, it is necessary to examine whether ESOPs are a capital asset. Further, ESOPs by their very nature are non-transferable and hence, their realizable value is Nil. It will be a good case to argue that receipt of ESOPs from the amalgamated company or the resulting company cannot be taxed as capital gains as ESOPs are only notional in nature and benefit, if any, crystallizes only upon exercise. In any case, on exercise, the perquisite element will be taxed in the hands of the employees as per section 17(2)(vi) read with Rule 3(8). Hence, the taxability of capital gains ought not to take place.

I 5 In case an employee surrenders his right under the ESOP and receives a cash payout, whether the same will be taxed as salary or capital gains?

A5 In case of corporate actions, it is quite common that the acquirer may insist that all outstanding ESOPs be settled before the acquisition is completed. In such cases, the compensation committee administering the ESOP may decide to pay in cash the fair value of the shares less exercise price to the employees for the vested / unvested options. Taxability u/s 17(2)(vi) arises only when the shares are allotted or transferred upon exercise of ESOPs. Hence, if the ESOPs are surrendered, the same will not come within the purview of section 17(2)(vi) of the Act.

As per section 2(14) of the Act, a capital asset is defined to include "property, of any kind, whether or not connected with his business or profession'. The judicial authorities[11] have held that the

[11] Hari Brothers (P.) Ltd. v. ITO [1964] 52 ITR 399 (Punjab & Haryana); Kamlesh Bahedia v. ACIT [2014] 151 ITD 495 (Delhi - Trib.); Giridhar Krishna M. v. ACIT [2008] 117 TTJ 965 (Bang.)

definition of property is wide enough to cover even rights to subscribe to the shares of the company. Accordingly, rights granted under ESOPs should also be treated as capital assets. Where such rights are surrendered to the Company / third party, the income arising therefrom may be taxed under the head 'capital gains' and not as 'income from salary'[12] and the period of holding shall be reckoned from the date of grant of the option.

4 Conclusion:

The taxation provisions relating to ESOPs have evolved over the years. ESOPs are given by both listed and unlisted companies including start-ups. At a practical level, the biggest constraint faced by employees, especially in case of unlisted companies, is that the perquisite is taxed at the time of exercise. There may be no exit or liquidity available at the time of such exercise and hence, tax on such perquisite in most cases will have to borne by the employees out-of-their pocket. This makes ESOPs a bit unattractive and in many cases, employees are unable to exercise their vested options. The uncertainty surrounding timing of eventual exit and valuation issues further aggravate the problem. At a time when the government is keen to promote start-ups, there is strong merit to postpone the taxability of ESOPs till it is either freely encashable or upon its ultimate realization.

[12] N. R. Ravikrishnan v. ACIT [2019] 175 ITD 355 (Bangalore - Trib.)