Cost of ESOP Deductable or Not Under Income Tax Act, 1961 ?

Cost of granting stock options to employees is not deductible expenditure in the hands of employer

Case: *Ranbaxy Laboratories Ltd vs. DCIT ITA No. 1666/Del/2006*

- AY 2001-02
- Face value Rs.10
- Exercise price Rs.595
- Market value on the grant date Rs.738
- cost of esop per share Rs.143
- Decision : Appeal dismissed

Facts:

- The assessee has claimed the difference between the market price and the issue price to its employees as employee compensation in its books of accounts over vesting (5yrs) period as deferred revenue expenditure.
- Disallowed by the assessing officer (AO) on the basis that no liability had arisen or been paid by the assessee during the year.

Decision of Appeal:

The Commissioner of Income–tax (Appeals) (CIT(A)) held that the deduction is allowable in the **year in which the option is exercised** by the employees i.e. when the liability became **certain** and not proportionately over the vesting period as claimed by the assessee.
The assessee and the revenue, both filed an appeal before the Income Tax Appellate Tribunal (ITAT).

Contentions of the Revenue

- The assessee had neither **incurred** any expenditure nor had any liability to pay.
- To the extent of receipt of a lower amount towards share **premium,** the loss could be said to be **a notional loss**.
- The share premium received by the assessee was not its **income** and hence if the assessee received a lower amount by way of share premium, the assessee does not incur any expenditure so as to claim the same as allowable.
- The SEBI guidelines are **not conclusive to determine the allowability** of expenses for income-tax purposes.

Hence, the assessee is not entitled to claim a deduction for such expenses.

Contentions of the Assessee

•ESOP Scheme **framed as per the SEBI guidelines**, and the charge to the financial statements over the period of vesting is in keeping with the guidelines.

• The grant of shares during the year is a **benefit provided to the employees** and hence is an allowable deduction for income-tax purposes.

• Once grants are issued by the assessee to its employees under the ESOP, the **liability crystallizes** in the hands of the assessee.

Ruling of the ITAT

- Issuing shares at below market price does not result in incurring any expenditure; rather it amounts to **short receipt of share premium.**
- The requirement by SEBI Guidelines to recognise a cost does not **automatically lead to a deduction** for the income-tax purposes.
- Difference between market price and grant price is only a notional expenditure

Conclusion :- The ITAT dismissed the appeal of the Revenue and the assessee.

Difference Between Market & Offer Price is Deductible Expenditure

IN THE HIGH COURT OF JUDICATURE AT MADRAS Dated : 19.06.2012
Commissioner of Income Tax
-vs-
M/s. PVP Ventures Limited

- AY 2001-02
- Appeal against ITAT Madras 'B' bench by CIT
- Decision: In favour of Assessee

Facts:

❖ The issue expenses Rs. 66.82 lakh

❖ CIT disallowed the the expenses on the basis of Notionality of expeses.

❖ ITAT allowed the expense on the grounds that the expense is in the interest of business and as per SEBI guidelines.

Since there is contradictorily judgment the assess can take a call to claim expense under the Income Tax Act,1961 as allowable expense.

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