Did you know?

British
High Commission
New Delhi

pwc

Ambiguity in tax deductibility of ESOPs issued by companies to its employees could discourage the use of ESOPs.

Issue 7: Taxability of ESOP expenses

ESOPs are used by various companies as a measure to retain employees. The difference of value on a reporting date and the cost to the employee is debited to the P&L account and claimed as a deduction by companies. The industry practice on the basis of valuing the ESOP and the periodicity of debiting the P&L account varies across taxpayers.

Given the nature of ESOP expenses, the tax authorities often seek to deny the expense claim in the hands of the corporate taxpayer contending the following:

- It is a short receipt of consideration for issue of shares and, therefore, capital in nature and hence not an expenditure per se.
- ESOP expenditure is a contingent expenditure until and unless the eligible employee exercises the option.

The aforesaid positions taken by the tax authorities and the absence of any statutory provision governing the taxation of ESOP expenses have led to litigation.

Impact

ESOP allows the workforce to participate in the growth of the company, thereby improving their morale and satisfaction. Difficulty in getting tax deduction for ESOP expenses may discourage companies from giving ESOPs to their employees.

Proposed solution

- There should be clarity in the taxation regime for ESOPs. Suitable amendments or clarifications should be issued to memorialise the intent of the government with regard to taxation claim of ESOP expenses.
- Courts have accepted deductibility of ESOP expenses on the basis of the Securities and Exchange Board of India (Employee Stock Options Scheme and Employee Stock Purchase Scheme) Guidelines, 1999. This may be considered as basis for allowing deduction of ESOP expenses.

PwC-India British High Commission joint tax project seeks to understand direct tax issues faced by UK-based companies in India