Charge of Fringe Benefit Tax on ESOP/ Sweat equity - Amendments, vide Finance Act, 2007

[2007] 295 ITR(Jour.) P.1(Part-2)

-S.K. Tyagi

Employees' Stock Option Plan or Scheme (ESOP or ESOS, for short), was not liable to fringe benefit tax (FBT) upto the assessment year (AY) 2007-08, relevant to the financial year (FY) 2006-07. The reason for the same is that though under the provisions of section 115WB(1)(a) of the Income-Tax Act, 1961 (the Act), ESOP could be considered as a privilege and accordingly, chargeable to FBT, yet in the absence of specific valuation provisions in this regard in section 115WC, it could not be taxed as fringe benefit. In this context, Question No.8 and Answer thereto of Circular No.8 / 2005, dated 29.8.2005, are also relevant. For the sake of ready reference, the aforesaid Question No.8 and Answer thereto, are reproduced as follows:-

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Q. No.8 Whether the value of any benefit provided by the employer to its employees by way of allotment of shares, debentures, or warrants directly or indirectly under any Employees Stock Option Plan or Scheme of the company, is liable to FBT?

Ans. The value of any benefit provided by the employer to its employees by way of allotment of shares, debentures, or warrants directly or indirectly under any Employees Stock Option Plan or Scheme of the company is a fringe benefit within the meaning of clause (a) of sub-section (1) of section 115WB. However, in the absence of a computation provision in respect of such benefits, the charging section fails. Therefore, the value of such benefits is not liable to FBT.

At the same time ESOP was not liable to tax in the hands of the employees also, in view of the **proviso** to section 17(2)(iii) of the Act. The aforesaid proviso reads as follows:-

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Provided *that nothing contained in this sub-clause shall apply to the value of any benefit provided by a company free of cost or at a concessional rate to its employees by way of allotment of shares, debentures or warrants directly or indirectly under any Employees' Stock Option Plan or Scheme of the company offered to such employees in accordance with the guidelines issued in this behalf by the Central Government*.

It may be stated here that the aforesaid proviso was inserted vide Finance Act, 2000, with effect from 1.4.2001 and it was omitted by the Finance Act, 2007, with effect from 1.4.2008.

Thus, ESOP was neither liable to tax in the hands of the employees as a perquisite, nor in the hands of the employer as a fringe benefit upto the AY 2007-08. With a view to bringing ESOP within the purview of FBT, a new clause (d) was inserted in section 115WB(1) so as to include any specified security or sweat equity shares allotted or transferred, directly or indirectly by the employer free of cost or at concessional rate to his employees (including former employee or employees), within the ambit of '*Fringe benefits*'. Further, section 115WC(1)(ba) was also inserted in the Act, in order to provide that the fair market value (FMV) of the specified security or sweat equity shares on the date on which the option vests with the employee as reduced by the amount actually paid by or recovered from the employee in respect of such security or shares, shall be the value of fringe benefits referred to in section 115WB(1)(d). Other corresponding changes were also made in the other relevant provisions of the Act by the Finance Act, 2007. In this regard, special significance is to be attached to the insertion of new section 115WKA in the Act, which relates to recovery of FBT by the employer from the employee in respect of the specified security or sweat equity shares allotted or transferred to the employee.

After the insertion of the aforesaid section 115WB(1)(d) in the Act, representations were made before the Union Finance Minister against taxing ESOPs as fringe benefit. In this context, the reply of the Finance Minister during the course of discussion on the Finance Bill, 2007, in Lok Sabha is significant. The aforesaid reply is published in the Press Release, dated 3.5.2007, as reported in *160 Taxman (St.) 127*. For our purpose para (59) of the aforesaid Press Release is relevant. The same is reproduced as follows:-

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Representations have been received against taxing ESOPs as a fringe benefit. Worldwide, ESOPs are subject to tax. What we have done is no different, except that we have levied the tax on the employer who may, by agreement with the employee or by making a provision in the Scheme, recover the tax from the employee. Hence, the tax will stay. However, I propose to give some relief. **The fair market value of the ESOP for the purpose of taxation will be reckoned on the date of vesting of the option and not the date of allotment or transfer of the shares. The liability to tax will be attracted on the date of allotment or transfer of the shares and the period of holding of the ESOP shall also be reckoned from the date of such allotment or transfer**. (Emphasis added)

From the aforesaid provisions, it is clear that the employee is not liable to FBT in respect of ESOP / Sweat equity either at the time of vesting of the option or allotment / transfer of such ESOP / Sweat equity. The only tax liability remaining fastened to such ESOP / Sweat equity is by way of capital gains tax, at the time of sale / transfer of the same by the employee. Accordingly, amendments also have been made in sections 2(42A) and 49 of the Act.

All the aforesaid amendments / changes have given rise to numerous queries from the employers as well as the employees. The important queries in this regard may be summarized as follows:-

(i) In respect of which options is FBT applicable? Is it on options granted on or after April 1, 2007 or options vested on or after April 1, 2007 or options exercised on or after April 1, 2007?

(ii) As per section 115WJ(2), FBT has to be paid based on the estimated amount of 'liability' for the year in four instalments as advance tax on the same dates as normal advance tax. In case the employer decides to recover the FBT from the employees at the time of exercise of Options,

(a) Will it be required to deposit the entire FBT collected, into the Government Treasury by the immediately falling due date for payment of advance FBT or

(b) Pay FBT as per section 115WJ(2) or

(iii) As per Explanation to Clause (ba) of section 115WC(1), 'fair market value' means the value as determined in accordance with the method as may be prescribed by the Board (CBDT). The said method has not yet been prescribed by the CBDT. As per ESOP the exercise of options is allowed throughout the year (except from April 1 of each year till the date of AGM). In view of the above, in case the employees wish to exercise the options, how to compute the amount of FBT, since the employer may like to collect the entire amount of FBT at the time of exercise of the option.

(iv) As per ESOP, options can be exercised over a specified period of years from the date of vesting. Employees have the freedom to exercise the vested options as per their convenience. In view of this reason, how to estimate the advance tax liability on account of FBT, so as to comply with the provisions of sections 115WI and 115WJ of the Income Tax Act, 1961?

(v) Pursuant to the provisions of section 115WKA, in case the employer recovers FBT on ESOP from its employees, whether the same is required to be treated as income of the employer and whether the same can be set off against the FBT paid / payable by it?

(vi) In case the employer decides to recover the FBT from its employees, how such FBT is required to be disclosed by the employer in its books of account?

(vii) Whether the FBT recovered from the employee could be added as part of cost of acquisition of the ESOP / Sweat equity, on the part of the employee?

(viii) In case of sale of shares at a price less than the fair market value, what treatment could be given to the loss suffered by the employee? Could the FBT paid by the employee be set-off against the aforesaid loss?

In order to answer the aforesaid queries, it would be necessary to examine the provisions of the Income-Tax Act, 1961 (the Act), as also the relevant amendments brought about therein, by the Finance Act, 2007.

Chapter XII-H of the Income-Tax Act, 1961 (the Act), introduced by the Finance Act, 2005, provides for the levy of fringe benefit tax (FBT) in respect of fringe benefits provided or deemed to have been provided by an employer to his employees. Section 115WB defines fringe benefits and deemed fringe benefits. The method of computation of the value of fringe benefits referred to in section 115WB has been provided in section 115WC. The Finance Act, 2007, has brought Employees' Stock Option Plan (ESOP) within the purview of FBT. Certain consequential amendments have also been made in other corresponding provisions of the Act. All the aforesaid amendments brought about by the Finance Act, 2007, and other relevant provisions are discussed as follows:-

1. Newly inserted section 115WB(1)(d) – Inclusion of specified securities or sweat equity shares within the definition of 'Fringe benefits'

For the sake of ready reference section 115WB(1)(d),is reproduced as follows:-

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115WB(1)–*For the purposes of this Chapter, "fringe benefits" means any consideration for employment provided by way of—*

*(*d*) any specified security or sweat equity shares allotted or transferred, directly or indirectly, by 7the employer free of cost or at concessional rate to his employees (including former employee or employees).*

Explanation.—For the purposes of this clause,—

*(*i*) "specified security" means the securities as defined in clause (*h*) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and includes employees' stock option;*

(ii) "sweat equity shares" means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Section 115WB(1) has been amended with effect from the assessment year 2008-09, to include any specified security or sweat equity shares **allotted or transferred**, directly or indirectly, by the employer free of cost or at concessional rate, to his employees (including former employee or employees), within the ambit of '*fringe benefits*'.

For this purpose, '*specified security*' and '*sweat equity shares*' have been defined as follows:-

(i) '*Specified security*' means securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (SCRA) and includes employees' stock option;

(ii) '*Sweat equity shares*' means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

Under SCRA, '*securities*' include-

(i) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;

(ia) derivative;

(ib)units or any other instrument issued by any collective investment scheme to the investors in such schemes;

(ic) security receipt as defined in clause (zg) of section 2 of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002;

(id) units or any other such instrument issued to the investors under any mutual fund scheme;

(ii) Government securities;

(iia) such other instruments as may be declared by the Central Government to be securities; and

(iii) rights or interest in securities.

The aforesaid amendment is effective from 1.4.2008 viz. AY 2008-09, relevant to FY 2007-08.

2. Newly inserted section 115WC(1)(ba) – Fair market value of the specified security or sweat equity shares

For the sake of ready reference section 115WC(1)(ba) is reproduced as follows:-

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115WC(1) *For the purposes of this Chapter, the value of fringe benefits shall be the aggregate of the following, namely:—*

*(ba) the fair market value of the specified security or sweat equity shares referred to in clause (*d*) of sub-section (1) of section 115WB, on the date on which the option vests with the employee as reduced by the amount actually paid by, or recovered from, the employee in respect of such security or shares.*

Explanation.—For the purposes of this clause,—

*(*i*) "fair market value" means the value determined in accordance with the method as may be prescribed by the Board;*

(ii) "option" means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price;

Section 115WC(1)(ba) has been inserted in the Act, in order to provide that the fair market value (FMV) of the specified security or sweat equity shares **on the date on which the option vests with the employee**, as reduced by the amount actually paid by, or recovered from, the employee in respect of such security or shares, shall be the value of fringe benefits referred to in section 115WB(1)(d).

For this purpose, '*Option*' means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a pre-determined price.

The aforesaid amendment is effective from 1.4.2008 viz. AY 2008-09, relevant to FY 2007-08

In this context, the expression '*Fair market value*', shall mean the value determined in accordance with the method as may be prescribed by the Board. The Board vide Notification No.S.O.1805(E), dated 23.10.2007, has added Part VII C in the Income-Tax Rules, 1962. The aforesaid Part VII C contains Rule 40C, which provides the method for '*Valuation of specified security or sweat equity share being a share in the company*'. In other words, Rule 40C of the Income-Tax Rules, 1962, provides the method for the purpose of computation of fair market value of the specified security or sweat equity shares.

The rules for the determination of the fair market value of shares listed on recognized stock exchanges in India are summarized as follows:-

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Shares listed on a recognized stock exchange in India	*Fair Market value where shares are traded on the date of vesting of the option*	*Fair Market value where shares are not traded on the date of vesting of the option*
The share is listed on a recognized stock exchange in India	*Average of the opening price and closing price of the share on that date on the said stock exchange*	*The closing price of the share on any recognized stock exchange on a date closest to the date of vesting of the option and immediately preceding such date.*
The share is listed on more than one recognized stock exchanges in India	*Average of opening price and closing price of the share on the recognized stock exchange which records the highest volume of trading in the share.*	*The closing price of the share on a recognized stock exchange, which records the highest volume of trading in such share (if the closing price, as on the date closest to the date of vesting of the option and immediately preceding such date, is recorded on more than one recognized stock exchange.*

Besides, the rules for the determination of the fair market value of shares not listed on recognized stock exchanges in India are summarized as follows:-

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Shares not listed	*Fair Market value on the date of vesting of the option*
The share in the company is not listed on a recognized stock exchange in India.	*Value of the share in the company as determined by a Category-1 merchant banker-* *(a) on the date of vesting or* *(b) any date which is not earlier than 180 days prior to the date of vesting.*

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3. Amendment of section 2(42A) – Definition of 'Short term capital asset'

As per section 2(42A), '*Short term capital asset*' means a capital asset held by an assessee for not more than thirty six months immediately preceding the date of its transfer.

As per proviso to section 2(42A), in the case of a share held in a company or any other security listed in a recognized stock exchange in India or a unit of UTI or a unit of a mutual fund or a zero coupon bond, the words '*thirty six months*', are substituted by the words '*twelve months*'. In other words, in respect of the aforesaid capital assets, they will be treated as short-term capital assets if they are held for not more than twelve months.

In this context, we may also refer to section 2(29A), which defines '*Long term capital asset*' as a capital asset which is not a short term capital asset.

In *Explanation* 1(i) to section 2 (42A), clause (hb) has been inserted by the Finance Act, 2007, with effect from 1.4.2008, viz. AY 2008-09. As per the newly inserted clause (hb) in *Explanation* 1(i) to section 2(42A), the period of holding in case of specified security or sweat equity shares, shall be reckoned from the date of **allotment or transfer** of such specified security or sweat equity shares.

4. Newly inserted section 49(2AB) – Relating to cost of acquisition as fair market value of 'specified security' or 'sweat equity shares' for the purpose of capital gains

For the sake of ready reference the newly inserted section 49 (2AB) is reproduced as follows:-

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Cost with reference to certain modes of acquisition.

49(2AB)*Where the capital gain arises from the transfer of specified security or sweat equity shares, the cost of acquisition of such security or shares shall be the fair market value which has been taken into account while computing the value of fringe benefits under clause (*ba*) of sub-section (1) of section 115WC.*

Consequent to the insertion of section 115WC(1)(ba), providing for the value of fringe benefits referred to in section 115WB(1)(d), a new section 49(2AB) has been inserted so as to provide that the cost of acquisition of '*specified security*' or '*sweat equity shares*' shall be the fair market value under section 115WC(1)(ba),if such value has been taken into account for the purposes of levy of FBT.

The aforesaid amendment is effective from 1.4.2008, viz. AY 2008-09, relevant to FY 2007-08

5. Newly inserted section 115WKA – Recovery of FBT by the employer from the employee

For the sake of ready reference, the newly inserted section 115WKA is reproduced as follows:-

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115WKA *Notwithstanding anything contained in any agreement or scheme under which any specified security or sweat equity shares referred to in clause (*d*) of sub-section (1) of section 115WB has been allotted or transferred, directly or indirectly, by the employer on or after the 1st day of April, 2007, it shall be lawful for the employer to vary the agreement or scheme under which such specified security or sweat equity shares has been allotted or transferred so as to recover from the employee the fringe benefit tax to the extent to which such employer is liable to pay the fringe benefit tax in relation to the value of fringe benefits provided to the employee and determined under clause (*ba*) of sub-section (1) of section 115WC.*

A new section 115WKA has been inserted in the Act, in order to provide that notwithstanding anything contained in any agreement or scheme under which any specified security or sweat equity shares have been **allotted or transferred**, directly or indirectly by the employer **on or after 1.4.2007**, it shall be lawful for the employer to vary such agreement or scheme, so as to recover from the employee the FBT to the extent to which such employee is liable to pay the FBT in relation to the value of fringe benefits provided to the employee.

In this context, it will be relevant to consider the impact of the recovery of FBT from the employee, on his tax liability. Apparently, there is no scope for deduction of the aforesaid FBT from the '*Income from Salaries*' in the hands of the employee. Besides, the Act is also silent on the issue whether the aforesaid FBT recovered from the employee could become a part of the cost of acquisition of the '*specified security*' or '*sweat equity shares*'. This is because section 49(2AB) merely deems the fair market value of specified security or sweat equity shares, as cost of acquisition; it does not explicitly provide that such a tax is also part of the cost.

However, on the basis of the principles of commercial accountancy, the aforesaid FBT may be treated as an additional cost of acquisition in respect of the '*specified security*' or '*sweat equity shares*'. This is because the employee has to pay the aforesaid FBT additionally, for acquiring the ESOP / Sweat equity.

In support of the aforesaid proposition, reliance may be placed on the observations of the Apex Court in the case of *Miss Dhun Dadabhoy Kapadia Vs. CIT [1967] 63 ITR 651(SC)*, which are as follows:-

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In working out capital gain or loss, the principles that have to be applied are those which are a part of the commercial practice or which an ordinary man of business will resort to when making computation for his business purposes.- (Page 655 of the Report)

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6. Implications of the omission of proviso to section 17(2)(iii)

Consequent to the insertion of section 115WB(1)(d), the proviso to section 17(2)(iii) has been omitted with effect from 1.4.2008, viz. AY 2008-09.

The aforesaid proviso provided that the value of any benefit provided by the company free of cost or at a concessional rate to its employees by way of allotment of shares, debentures or warrants directly or indirectly under any Employees' Stock Option Plan or Scheme of the company offered to such employees in accordance with the guidelines issued by the Central Government, was not a '*perquisite*' for the purposes of section 17.

The intention of the amendment of Chapter XII-H, is to levy FBT on employers in respect of ESOPs and not to regard the ESOP benefit as a perquisite chargeable to tax in the hands of the employee.

However, the manner of amendment does not clearly bring out the aforesaid intention. While the proviso to section 17(2)(iii) exempting ESOP perquisite has been deleted, the main provisions of section 17(2)(iii) regarding a benefit or amenity provided to an employee free of cost or at concessional rate, being treated as perquisite, still remains. In this regard, it cannot be denied that ESOP also is a benefit and therefore, on a literal interpretation, the value of ESOP benefit could become taxable under section 17(2)(iii).

In this connection we may, however, refer to the provisions of section 115WB(3) and section 17(2)(vi) of the Act. As per section 115WB(3), FBT shall not be payable in respect of taxable perquisite. Further, as per section 17(2)(vi),'*perquisite*' includes the value of any other fringe benefit or amenity **(excluding the fringe benefits chargeable to tax under Chapter XII-H)** as may be prescribed. From the aforesaid provisions of sections 115WB(3) and 17(2)(vi), it can be concluded that if the ESOP is taxable as a fringe benefit in the hands of the employer, then the same cannot be taxed as a perquisite in the hands of the employee.

However, the position may be different in respect of an employee whose employer is not based in India and is not liable to FBT. In such a situation, it appears that the employee may be liable to tax under section 17(2)(iii) in respect of ESOP benefit obtained by him, read with section 9(1)(ii) of the Act, which provides that salary payable for services rendered in India shall be deemed to accrue or arise in India.

7. Clarification in respect of allotment vis-à-vis vesting of ESOP / Sweat equity

Section 115WB(1)(d) is the charging section, which provides that any '*specified security*' or '*sweat equity shares*' **allotted or transferred** by the employer to an employee is fringe benefit. **Thus, levy of FBT arises on such allotment or transfer.**

In contrast, the computation of fringe benefits is governed by section 115WC(1)(ba),which provides that the value of fringe benefit shall be the fair market value of the '*specified security*' or '*sweat equity shares*' **on the date of vesting of option**.

In this context, a reference may be made to the reply of the Finance Minister to the discussion on the Finance Bill, 2007, in the Lok Sabha. (*Supra)*

It is, thus, quite evident that **charge of FBT arises at the time of allotment of shares and not the grant or exercise of option**. On the other hand, the computation of fringe benefit is to be made on the basis of fair market value of ESOP / Sweat equity, on the date of **vesting of the option**.

8. ESOP / Sweat equity acquired upto 31.3.2007

As per the newly inserted section 115WB(1)(d), any specified security or sweat equity shares **allotted or transferred** directly or indirectly by the employer free of cost or at concessional rate to his employees (including former employee or employees), will fall within the definition of '*Fringe benefits*' and will be liable to FBT, accordingly.

The aforesaid section 115WB(1)(d) has come into effect from 1.4.2008, viz. assessment year (AY) 2008-09, relevant to the financial year (FY) 2007-08. It would mean that the aforesaid section 115WB(1)(d),will apply to FY 2007-08 viz. for the period starting from 1.4.2007.

In view of the aforesaid reasons, the ESOP / Sweat equity allotted or transferred to the employee upto 31.3.2007, will not fall within the ambit of fringe benefits and accordingly, will not be liable to FBT in the hands of the employer.

At this stage, it would be relevant to examine whether ESOP / Sweat equity allotted / transferred to the employee upto 31.3.2007 would be liable to tax in his hands. In this context, we have to refer to the proviso to section 17(2) (iii) of the Act.

In view of the aforesaid proviso, the ESOP / Sweat equity allotted / transferred to the employee upto 31.3.2007, would not be liable to tax in the hands of the employee.

It may also be stated here that the aforesaid ESOP / Sweat equity will not be liable to FBT in the hands of the employer also. This is clear from Question No.8 and Answer thereto, of Circular No.8 / 2005, dated 29.8.2005, issued by the Central Board of Direct Taxes (CBDT) by way of Explanatory Notes on the provisions of fringe benefit tax brought on the statute by the Finance Act, 2005. *(Supra)*

In this connection, it would be necessary to state that when the aforesaid securities are sold / transferred by the employee, he will be subject to capital gains. For the purpose of computation of capital gains on the sale / transfer of such securities, the cost of acquisition of such securities shall be the price at which the employee had acquired the same.

9. ESOP Sweat equity acquired on or after 1.4.2007

As already pointed out, with a view to bringing ESOPs within the purview of FBT, a new section 115WB(1)(d), has been inserted by the Finance Act, 2007, so as to include any specified security or sweat equity shares **allotted or transferred**, directly or indirectly by the employer free of cost or at concessional rate to his employees (including former employee or employees), within the ambit of '*Fringe benefits*'.

The aforesaid newly inserted section 115WB(1)(d) has come into effect from 1.4.2008 viz. AY 2008-09, relevant to FY 2007-08. It would mean that the aforesaid section 115WB(1)(d) will apply to FY 2007-08, viz. for the period starting from 1.4.2007. **Therefore, ESOP / Sweat equity allotted / transferred on or after 1.4.2007, only will be liable to FBT in the hands of the employer.**

As already pointed out in the preceding paragraph (6), if the ESOP is taxable as a fringe benefit in the hands of the employer, then the same cannot be taxed as a perquisite in the hands of the employee. **Accordingly, the ESOP / Sweat equity allotted / transferred to the employee even on or even after 1.4.2007, will not be liable to tax in the hands of the employee.**

10. Provisions of section 40 relating to tax-treatment of FBT recovered from the employee and whether the same could be treated as part of income of the employer.

Question No.(v) raises an issue whether FBT recovered from the employee could be treated as income of the employer and also whether the same could be set-off against the FBT liability of the employer.

In order to answer the aforesaid query, it would be necessary to refer to the provisions of section 40. For our purpose sub-clauses (ic), (ii) and (iia) of clause (a) of section 40 of the Act, are relevant. The same are reproduced as follows:-

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Amounts not deductible

40. *Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",—*

(a) in the case of any assessee—

(ic)any sum paid on account of fringe benefit tax under Chapter XII-H;

(ii) any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains.Explanation 1.—For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of any rate or tax levied includes and shall be deemed always to have included any sum eligible for relief of tax under section 90 or, as the case may be, deduction from the Indian income-tax payable under section 91.

Explanation 2.—For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of any rate or tax levied includes any sum eligible for relief of tax under section 90A;

(iia) any sum paid on account of wealth-tax.

Explanation.—For the purposes of this sub-clause, "wealth-tax" means wealth-tax chargeable under the Wealth-tax Act, 1957 (27 of 1957), or any tax of a similar character chargeable under any law in force in any country outside India or any tax chargeable under such law with reference to the value of the assets of, or the capital employed in, a business or profession carried on by the assessee, whether or not the debts of the business or profession are allowed as a deduction in

computing the amount with reference to which such tax is charged, but does not include any tax chargeable with reference to the value of any particular asset of the business or profession;

From the aforesaid provisions of sub-clauses (ic), (ii) and (iia) of clause (a) of section 40 of the Act, it is clear that no tax including income-tax, wealth-tax and fringe benefit tax, is deductible in computing the income from business or profession.

We may apply the aforesaid provisions of the Act in respect of the recovery of FBT from the employees under the provisions of section 115WKA of the Act. Therefore, as a logical corollary, the FBT recovered from the employees cannot be treated as part of income of the employer, because if FBT is not allowed to be deducted in the computation of income, then the same cannot also be added to the income.

As regards the set-off of FBT recovered from the employees against the FBT payable by the employer, there is no provision in the Act to allow such set-off. It may be reiterated that the employer has to pay the FBT as per the relevant provisions of Chapter–XII-H of the Act, irrespective of the fact whether the employer chooses to recover FBT from the employees or not. Such recovery of FBT from the employees is an internal arrangement between the employer and the employees and the same has nothing to do with the FBT liability payable by the employer.

In this connection, it may be stated that the FBT recovered from the employees may form part of the cost of acquisition of the ESOP / Sweat equity for the purposes of computation of capital gains in the hands of the employees on the sale / transfer of the same, as discussed in the preceding para (5).

11. Conclusion

All the relevant provisions of the Act relating to the levy of FBT on ESOP / Sweat equity, including corresponding changes in the taxation of income from Salaries and Capital Gains, have been discussed in detail in the preceding paragraphs. On the basis of the aforesaid discussion, the queries are answered hereinafter, in order of sequence.

(i) Answer to Query No.(i)

In this regard, please refer to the preceding paragraphs (8) and (9).

It has been clearly established therein that the newly inserted section 115WB(1)(d) will apply to specified security or sweat equity shares **allotted / transferred to the employee on or after 1.4.2007**.

In this regard, dates of grant, vesting or exercise of option, are not relevant. What is relevant **is the date of allotment / transfer of** the ESOP / Sweat equity shares.

(ii) Answer to Query No.(ii)

In this regard, provisions of sections 115WI and 115WJ of the Act, relating to payment of FBT in advance are relevant.

As per the provisions of section 115WI, FBT shall be payable in advance during any financial year in accordance with the provisions of section 115WJ. Further, as per section 115WJ(1), every assessee liable to pay FBT in advance, shall on his own accord, pay in advance the tax on his current fringe benefits, as laid down in section 115WJ(2) of the Act. It may be seen from the provisions of section 115WJ(2) that all the instalments in respect of advance FBT are payable within the relevant financial year itself.

In this regard, the recovery of FBT from the employees is not, at all, relevant. The FBT payable by the employer, will have to be paid as per the instalments laid down under section 115WJ(2), irrespective of the fact whether the employer recovers any FBT from the employees or not.

(iii) Answer to Query No.(iii)

As already explained, according to the provisions of section 115WC(1)(ba) of the Act, the value of fringe benefits shall be the fair market value (FMV) of the specified security or sweat equity shares, **on the date on which the option vests with the employee**, as reduced by the amount actually paid by or recovered from the employee in respect of such security or shares.

As per Explanation (i) to the aforesaid section 115WC(1)(ba), '*Fair market value*' means the value determined in accordance with the method as prescribed by the Central Board of Direct Taxes (CBDT).

As regards the method to be prescribed for the determination of the aforesaid '*Fair market value*', the Board has already inserted rule 40C in the Income-Tax Rules, 1962. The provisions of the newly inserted rule 40C have already been discussed in the earlier paragraph (2).

(iv) Answer to Query No.(iv)

As already explained, as per the provisions of section 115WB(1)(d), fringe benefits means any consideration for employment provided by way of any specified security or sweat equity shares **allotted or transferred** by the employer to his employees. Thus, what is material or relevant, is the **date of allotment / transfer** of such specified security or sweat equity shares. As explained in answer to Query No.(i), the date of vesting of the option is not relevant in this regard.

It may be reiterated here that the FBT liability in respect of ESOP / Sweat equity, arises on the date of allotment of such shares, on or after 1.4.2007.

Therefore, the advance FBT is to be paid as per the provisions of sections 115WI and 115WJ of the Act, accordingly.

(v) Answer to Query No.(v)

As discussed in the preceding para (10), the FBT recovered from the employees, cannot be added as part of income of the employer.

Further, as discussed in the earlier para (10),the FBT recovered from the employees is not required to be set-off against the FBT liability of the employer.

(vi) Answer to Query No.(vi)

As already explained in answer to aforesaid Query No.(v), the FBT recovered from the employees, cannot be added as part of income of the employer. Therefore, the aforesaid amount of FBT recovered from the employees will not be required to be disclosed in the Profit & Loss Account.

On the other hand, what the employer may be required to do is to reduce the FBT liability in its Appropriation Account and Balance Sheet, to the extent to which it is recovered from the employees.

(vii) Answer to Query No.(vii)

As already explained in the preceding para.(5), the amount of FBT recovered from the employee may be treated as an additional cost of acquisition in respect of the '*Specified*

security' or '*Sweat equity shares*'. This is because the employee has to pay the aforesaid FBT additionally for acquiring the ESOP / Sweat equity.

(viii) As regards the answer to Query No.(viii), it may be clearly stated that there is no provision in the Act for the adjustment of FBT paid by the employee against the loss suffered on the sale of ESOP / Sweat equity. In this connection, the answer to the aforesaid Query No.(v) is equally applicable. In other words, any tax including income-tax, wealth-tax or fringe benefit tax, cannot be adjusted against the income / loss of the assessee.

However, as already explained in answer to Query No.(vii), the FBT recovered from the employee, may be added as part of cost of acquisition of the ESOP / Sweat equity. This will add to the capital loss suffered by the employee.

From the aforesaid Answers to the various Queries regarding the FBT liability in respect of ESOP / Sweat equity, it may be seen that all the relevant aspects in respect thereof, have been discussed therein, in detail.

All the employers may plan and pay their FBT liability on the basis of the aforesaid guidelines.

S. K. TYAGI
M.Sc., LL.B., **Advocate**
Ex-Indian Revenue Service
Income-Tax Advisor

☎ Office : (020) 2613 3012
Fax : (020) 2616 1131
Residence : (020) 4004 4332
E-mail : sktyagidt@sify.com

Flat No.2, (First Floor)
Gurudatta Avenue
Popular Heights Road
Koregaon Park
PUNE - 411 001