IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCH "A", HYDERABAD

BEFORE SMT P. MADHAVI DEVI, JUDICIAL MEMBER
AND SHRI S. RIFAUR RAHMAN, ACCOUNTANT MEMBER

ITA No. 237/Hyd/2017
Assessment Year: 2012-13

Bharat Financial Inclusion Ltd. (Erstwhile known as SKS Microfinance Ltd.), Hyderabad	vs.	Dy. Commissioner of Income-tax (TDS), Circle – 2(1), Hyderabad.

PAN – AAICS 2940J

(Appellant) (Respondent)

Assessee by : Shri K.C. Devdas
Revenue by : Shri J. Siri Kumar

Date of hearing 19/07/2018
Date of pronouncement 03/08/2018

O R D E R

PER S. RIFAUR RAHMAN, A.M.:

This appeal filed by the assessee is directed against the order dated 30/11/2016 of CIT(A) – 5, Hyderabad for AY 2012-13.

2. Brief facts of the case are, the assessee, a company incorporated under the Companies Act, 1956, is registered as a Non Banking Finance Company ('NBFC') with the Reserve Bank of India. The Company is engaged in the business of granting micro loans in rural areas, across 19 states in India.

2.1 A survey operation u/s 133A of the Act was conducted in the case of assessee on 17 December 2014 to verify the compliance with TDS provisions. During the survey, it was observed by the Deputy Commissioner of Income Tax, TDS Circle - 2(1), Hyderabad that Mr. Vikram Akula (here-in-referred to as Mr. Vikram'), then employee of

the Company, has received compensation in the form of Employee Stock Options 'ESOP' in short) granted to him and a certain amount as non-compete fee vide a Separation and General Release Agreement dated 23rd November, 2011 (the separation agreement).

2.3 The AO completed the proceedings by passing an Order u/s 201(1) and 201 (1A) of the Act dated 30 June 2015 and raised the following demands:

Particulars of demand	Amount (in Rs.)	Remarks
TDS on ESOP perquisite granted to Mr. Vikram u/s 192 o the Act	4,73,37,948	Company paid on 7 June, 2012.
Interest u/s 201(1A) on above	63,90,623	
TDS on non-compete fee payable to Mr. Vikram u/s 194J of the Act	65,00,000	Company paid on 7 June 12
Interest u/s 201(1A) on above	7,80,000	
Total	6,10,08,571	

Later, the AO passed revised order u/s 154 dated 10th November, 2016 reducing the demand raised to Rs. 1,11,36,772.

2.3 The reasons for passing the order u/s 201(1) and 201(1A) by the AO are as under:

> *"1. The Assessee should have withheld taxes on communication of desire to exercise shares by Mr. Vikram on 13 October 2011 itself - being the date of receipt of communication of exercise of ESOP from Mr. Vikram and not the date of allotment of shares, based on the following contentions:*
>
> *2. Provisions of section 192 of the Act do not permit postponement of tax withholding till receipt of TDS amount from the employee.*
>
> *3. Assessee was in possession of sufficient funds that were payable to Mr. Vikram to discharge the withholding tax on ESOP and therefore, the Assessee should have adjusted the amount payable against the withholding taxes suo moto.*

4. Separation Agreement has been used by the Assessee for deferring the tax liability of Mr. Vikram. Relying on section 23 of The Indian Contract Act, 1872 and the ruling of the Mumbai Tribunal in the case of Hathway Investments (P.) Limited (104 DTR 217), the Ld. AO has held that Separation Agreement has been used to defeat the provisions of withholding tax and therefore invalid.

5. As per the Ld. AO, the Appellant should have withheld taxes on non compete fee on entering into the Separation Agreement i.e. 23 November 2011 as the non-compete fee had 'accrued' to Mr. Vikram on entering into the Separation Agreement."

3. Aggrieved by the order of AO, the assessee preferred an appeal before the CIT(A).

4. Before the CIT(A), the assessee filed written submissions, which were extracted by the CIT(A) in his order at pages 7 to 15.

5. The CIT(A) after considering the submissions of the assessee, discussed the issue elaborately and deleted the interest levied by the AO u/s 201(1A) with respect to non-compete fee and sustained the interest levied u/s 201(1A) with respect to perquisite of ESOP.

6. Aggrieved by the order of CIT(A), the assessee is in appeal before us raising the following grounds of appeal:

"Based on the facts and circumstances of the case and in law, Bharat Financial Inclusion Limited (hereinafter referred to as the 'Appellant') respectfully craves leave to prefer an appeal against the order passed by the Learned Commissioner of Income-tax (Appeals) - 5, Hyderabad ('Ld. CIT(A)') dated 30-11-2016 on the following grounds:

On the facts and in the circumstances of the case and in law, the Ld. CIT(A):

I. Erred in holding that perquisite tax on Employee Stock Option Plans ('ESOP') is to be deducted on the date of exercise of option and not on the date of allotment of shares.

2. Erred in holding the Appellant as assessee in default both in law as well as in facts for late deduction/deposit of Tax

Deducted at Source ('TDS') to government treasury and levying interest u/s 201(1A) of the Act whereas the TDS was actually deposited within the prescribed due dates.

3. Without prejudice to Ground No.2, assuming but not admitting that interest u/s 201(1A) of the Act is to be levied, the Ld. CIT(A)

a. Erred in holding that TDS deposited by the Appellant is to be re-characterized and adjusted towards interest u/s 201(1A) of the Act

b. Erred in holding the appellant as assessee in default both in law as well as in facts for non deposit of TDS to government treasury and levying interest u/s 201(1A)(ii) of the Act whereas payment has already been made by the Appellant.

The Appellant craves, to consider each of the above grounds of appeal without prejudice to each other and craves leave to add, alter, delete or modify all or any of the above grounds of appeal."

7. Before us, the assessee filed its submissions as under:

" The provisions of Section 192 reads as under:

"(1) Any person responsible for paying any income chargeable under the head "Salaries" shall, at the time of payment, deduct income-tax on the amount payable at the average rate of income-tax computed on the basis of the rates in force for the financial year in which the payment is made, on the estimated income of the assessee under this head for that financial year."

• Accordingly, as per the provision, the withholding obligation arises when the employer makes any payment to the employee, which is chargeable under the head 'salaries'.

• Section 17(2)(vi) of the Act, provides for the definition of "Perquisite", which is taxable as

Salary and sub-clause (vi) to Section 17(2) reads as under:

"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."

• Further, the explanation to Section 17(2)(vi) defines security to include shares allotted pursuant to ESOP. '

• Therefore, as per the above provisions, a perquisite is earned/accrued to the employee only on allotment of shares pursuant to ESOP plan. Accordingly, on a combined reading of section 192(1) and section 17(2)(vi) of the Act, the withholding obligation arises only on allotment of the shares.

With regard to the valuation of perquisite in form of shares allotted pursuant to ESOP plan, explanation (c) to Section 17(2)(vi) of the Act, provides as under:

"the value of any specified security or sweat equity shares shall be the fair market value of the specified security or sweat equity shares, as the case may be, on the date on which the option is exercised by the assessee as reduced by the amount actually paid by, or recovered from, the assessee in respect of such security or shares"

Therefore, for the purpose of valuing the perk, the difference between the Fair Market Value ('FMV) of shares (as on the date of which option exercised) and amount paid by the assessee is treated as value of perk in the hands of the assessee.

• Accordingly, on combined reading of above provision the following points can be noted:

- *Withholding triggers on payment of any income chargeable as Salaries.*

- *A perquisite arises in hands of employees as on the date of allotment of shares pursuant to ESOP.*

- *The value of the perk is the difference between FMV as on date of exercise and amount paid by the employee.*

• Therefore, it is evident that the withholding obligation is triggered on the date of allotment of shares to the employee. Further, only for the purpose of valuation of perquisite, the FMV of shares as on the date of exercising the option is to be considered.

• Based on the above, in the present case of the Company, the perk can be said to have accrued to the employee i.e. Mr Vikram only on the allotment of shares pursuant to ESOP, thereby triggering the withholding obligation for the Company.

• Alternatively, the Company wishes to humbly submit that in the case of Mr. Vikram not paying the withholding amount, the

shares would have never been allotted to him and there would be no taxable perquisite accruing/arising in the hands of Mr. Vikram."

8. Ld. DR, on the other hand, relied on the order of CIT(A).

9. Considered the rival submissions and perused the material on record. We notice that Mr. Vikram (Ex-employee) exercised the ESOP option on 13/10/2011. The assessee has allotted the shares on 04/05/2012 after completion of certain conditions put forth by the assessee in the separation agreement. The essential conditions are :

The non-compete fees payable upon fulfilment of commitments made by Mr. Vikram such as

i) Non-disposal agreements entered for enforcing restriction on sale of shares to be allotted under Scheme 2007

ii) On receipt withholding tax on the allotment of shares.

These are the essential conditions in order to safeguard the interest of the assessee.

9.1 In our considered view, the ex-employee has a right to exercise, once he exercises the option, the price of the shares are freezed. That means, the exercise of the option is only acceptance of the proposal as per the scheme 2007. The proposal comes with the obligation i.e. with conditions of such exercise of option. Once the option is exercised, the company which allots the shares has certain obligation on their part to safeguard their interest. The allotment cannot be completed without receiving the full price of the shares. In the given case, mere receipt of the price agreed is not enough but to receive the cost of shares exercised along with the withholding tax. These are obligations on the part of person exercising the opinion. This transaction will come to an end as and when the person exercising the option also completes his part of commitment. Therefore, mere exercise of the option is not enough, it is only initial acceptance of right or proposal, which comes with certain

commitments. As and when the commitment is complete, the proposal said to be accepted. The goal post of acceptance shifted until completion of the commitment which comes along with the scheme. As submitted by ld. AR, the provisions of section 192 is applicable only on payment basis not on accrual basis. The value of the perquisite can be determined as per section 17(2)(vi) of the Act but is taxable only when the assessee makes the payment, in this case, allotment of shares.

9.2 In case, it is accepted the contention of ld. CIT(A) that separation agreement should not be used to defer the tax liability, the company allots the shares and pays the withholding tax. Then, the company allots the shares without receiving full consideration on such shares. In case, Mr. Vikram fails to comply with the separation agreement, the company cannot cancel the allotment of shares. Therefore, the assessee has to safeguard its interest first.

9.3 Coming to other argument that withholding tax should have been paid against the non-compete fee, in our view, the non-compete fee is not accrued in this AY, it is also the findings of ld. CIT(A).

9.4 Therefore, the amended provision as per section 17(2)(vi) is only to determine the value of ESOP transaction and the obligation for withholding tax accrues only when the shares are allotted after completion of commitments on the part of the person who exercised the option. Mere exercise of acceptance is only acceptance of general proposal. Accordingly, grounds raised by the assessee on this are allowed.

10. In the result, appeal of the assessee is allowed.

Pronounced in the open Court on 3rd August, 2018.

Sd/-	**Sd/-**
(P. MADHAVI DEVI)	**(S. RIFAUR RAHMAN)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Hyderabad, Dated: 3rd August, 2018

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3) CIT(A) – 5, Hyderabad.
4) CIT(TDS), Hyd.
5) The Departmental Representative, I.T.A.T., Hyderabad.
6) Guard File