

**IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH: BANGALORE**

**BEFORE SHRI B. R. BASKARAN, ACCOUNTANT MEMBER
AND
SMT. BEENA PILLAI, JUDICIAL MEMBER**

IT(TP)A No.759/Bang/2017
Assessment Year: 2012-13

M/s. Northern Operating Services Pvt. Ltd. 2 nd Floor, RMZ Ecospace, Campus 1C, Sarjapur Outer Ring Road Bellandur Village, Varthur Hobli Bengaluru 560 103. PAN NO : AACCN1652J	Vs.	JCIT Special Range-5 Bengaluru
APPELLANT		RESPONDENT

Appellant by	:	Shri K.R. Vasudevan, A.R.
Respondent by	:	Shri Muzaffar Hussain, D.R.

Date of Hearing	:	30.08.2021
Date of Pronouncement	:	01.09.2021

O R D E R

PER B.R. BASKARAN, ACCOUNTANT MEMBER:

The assessee has filed this appeal challenging the assessment order dated 31.1.2017 passed by the A.O. u/s 143(3) r.w.s. 144C(13) of the Income-tax Act,1961 ['the Act' for short] for assessment year 2012-13.

2. The assessee has filed revised grounds of appeal as per which, only issue urged by the assessee relates to disallowance of “ESOP expenses” claimed by the assessee.

3. The assessee is engaged in the business of providing transaction-based business process outsourcing services to the Group companies.

4. The facts relating to the above said issue are stated in brief. The assessee has floated "Employees Stock Option Scheme" (ESOP). During the year under consideration, the assessee has vested ESOP rights to certain employees. Normally, the shares are issued under ESOP scheme at price below the market price. Accordingly, the assessee claimed a sum of Rs.1,36,10,974/-, being the difference between the market price of shares and the issue price as ESOP expenses u/s 37(1) of the Act. The assessee placed its reliance on the decision rendered by the Special bench, Bengaluru in the case of Biocon Ltd. Vs. DCIT (2013) 35 Taxmann.com 335 in support of its claim. In the above said case, the special bench has held that the difference between the market price of shares at the time of grant of ESOP options to the employees and the price at which shares are offered to the employees is allowable as deduction u/s 37(1) of the Act. The A.O. observed that the revenue has not accepted the decision rendered by Tribunal in the case of Biocon Ltd (supra) and has filed further appeal before Hon'ble Karnataka High Court. The A.O. further observed that the loss claimed by the assessee should be real as in the case of income, which should be real in order to get it taxed. Accordingly, he held that the loss claimed by the assessee i.e. the difference between market value of shares at the time of grant of options to the employees (Vesting period) and the actual price at which shares are offered is a notional loss and cannot be allowed as deduction u/s 37 of the Act. Accordingly, he disallowed the claim.

5. The Ld. DRP took the view that if the assessee had treated the discount amount as perquisite in the hands of the employees and accordingly deducted TDS therefrom, then the corresponding

discount is allowable as deduction. Otherwise, the same requires to be disallowed u/s 40(a)(ia) of the Act. The relevant discussions made by the DRP are extracted below:

“76. *The Panel has examined the submissions of the assessee. There are four stages in the grant of the ESOP.*

- *Granting of option*
- *Vesting of option*
- *Exercise of option*
- *Selling of shares*

Normally, the ESOP is designed in such a way that there is a gap of one or more years between each of the first three stages.

77. *The Biocon decision also holds that the expenditure is allowable at the time of vesting. Since this is position as per the Biocon decision, then the same becomes taxable in the hands of the employee. What has not been brought before and therefore not considered by the Hon. Special Bench in Biocon is that when the same amount becomes taxable in the hands of the employee. Therefore, the Panel has examined the issue.*

78 *The assessee is claiming that the provisions for ESOP expenses are ascertained liability. However, it is contended that the taxability arises in the hands of the employee on the date of Exercise. The TDS on perquisite amount arising out of the vesting transaction must have been deducted by the assessee. However, from the records it is not clear when the TDS is made.*

79. *Thus, the gap between the date of Vesting and the date of Exercise is the period for which there is a tax loss to the revenue. Each transaction has two sides. One is 'Expenditure side' and the other is 'Income side'. In the hands of the company it is an expense and in the hands of the employee it is income. The second question arises is whether the income is taxable.*

80. *In the hands of the employee the taxability cannot be seen on a different basis. Thus, the same transaction becomes allowable expenditure in the hands of the assessee but does not become income in the hands of the employee. This situation is not permissible as per the law. If the liability in the hands of the assessee is ascertained then the perquisite/salary in the hands of the employee also becomes ascertained because it is the same transaction which is triggering both, and the salary/ perquisite is taxable on the 'due basis' as per the section 15 of the IT Act*

81. Section 15 in The Income- Tax Act, 1995 is extracted hereunder:

"15. Salaries

The following income shall be chargeable to income- tax under the head "Salaries"

(a) any salary due from an employer or a former employer to an assessee in the previous year, whether paid or not;

(b) any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it became due to him;

*(c) any arrears of salary paid or allowed to **him** in the previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.*

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Further, u/s 17 of the Act the salary and perquisites are inclusive definitions and ESOP is covered within these provisions.

82. To summarize, the.13locon decision holds that the expenditure is allowable at the time of vesting. Therefore, by corollary the, income becomes taxable at the time of vesting itself. Therefore, two situations arise.

a. First, the assessee. has not considered the 'perquisite amount at the time of vesting' as salary income of the employee and has not deducted tax on the same. In such a situation the expenditure is to be disallowed by the AO u/s 40(a)(ia).

b. Second, the assessee has considered 'perquisite amount at the time of vesting' as salary income of the employee and has deducted tax on the same. In such a situation, the expenditure is to be allowed by the AO.

83. Accordingly, the objection is decided as above."

6. Accordingly, while passing final assessment order, the A.O. called for the details of ESOP given to the employees. From the details furnished, the A.O. noticed that the assessee has not deducted tax at source when the ESOP was vested with the employees. Accordingly, he disallowed the claim.

7. The Ld. A.R. placed his reliance on the decision rendered by the special bench in the case of Biocon Ltd. (supra) and submitted that the ESOP expenditure is allowable as deduction when the option of ESOP was granted to the assessee i.e. when the right is vested with the employees. He submitted that the assessee would be deducting

TDS when the options are actually exercised by the employees. He invited our attention to paragraph 11.1.5 of the order passed by the special bench and submitted that the special bench has visualized the situation that the stage of taxability of perquisite in the hands of the employee may differ from the stage of the deductibility of expense in the hands of the company, depending upon the method of accounting followed by the company. Only condition mentioned by the special bench is that the amount of such discount or the perquisite amount taxed in the hands of employees cannot be different. Accordingly, the Ld. A.R. submitted that it is not correct to say that the ESOP discount claimed by the assessee should be assessed as perquisite in the current year itself. He further submitted that the decision rendered by special bench in the case of Biocon Ltd. (supra) has since been upheld by Hon'ble Karnataka High Court, vide its order dated 11.11.2020 passed in ITA No.653 of 2013.

8. The Ld. D.R., on the contrary, relied upon the order passed by Ld. DRP and A.O.

9. We heard the rival contentions and perused the record. We notice that the A.O. has made the impugned disallowance of Rs.136,10,974/-, only for the reason that the assessee has not deducted tax at source from the above said amount in the current year itself, i.e. it is the case of the A.O that the ESOP discount amount should have been assessed as perquisite in the hands of the concerned employees in the current year itself and TDS should have been deducted there from. Thus, there is no dispute now that the ESOP expenses claim is allowable u/s 37 of the Act. The dispute is whether the TDS is to be deducted during the current year itself or not.

10. We have noticed that the Tribunal has made a specific mention about the taxability of the discount amount as perquisite in the hands of the employees in paragraph 11.11.5 of its order. The special bench has observed that the stage of taxability of perquisite in the hands of the employee may differ from the stage of deductibility of expenditure. The assessee would be liable to deduct tax when the discount amount becomes perquisite in the hands of the concerned employee. It is the submission of the Ld. A.R. that the same will be considered as perquisite in the year in which the option is exercised by the concerned employee and TDS would be deducted therefrom at that point of time.

11. We have noticed that the Ld. DRP has understood that there are 4 stages in grant of ESOP i.e. granting of option, vesting of option, exercise of option and selling of shares. Hence there will be time different between “vesting of option” and “exercise of option” and accordingly the period of taxability of ESOP benefits as perquisite may also differ. Hence, we are of the view that the tax authorities are not justified in holding that the assessee should have deducted tax at source from the discount amount by assessing the same as perquisite in the hands of the assessee in the year in which ESOP was vested in them.

12. Accordingly, we hold that the assessee is entitled for deduction of ESOP expenses when the rights are vested in the hands of the assessee as held by Hon'ble Karnataka High Court in the case of Biocon Ltd (supra). Accordingly, we direct the AO to allow the claim. However, the AO is entitled to satisfy himself that the assessee has either deducted tax at source when the option is exercised by the employee or has reversed the expenditure when the concerned employee did not exercise the option, if it is considered necessary by the AO.

13. In the result, the appeal filed by the assessee is treated as allowed.

Order pronounced in the open court on 1st Sept, 2021

Sd/-
(Beena Pillai)
Judicial Member

Sd/-
(B.R. Baskaran)
Accountant Member

Bangalore,
Dated 1st Sept, 2021.
VG/SPS

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

Asst. Registrar,
ITAT, Bangalore.