IN THE INCOME TAX APPELLATE TRIBUNAL
"C" BENCH, AHMEDABAD

BEFORE SMT. ANNAPURNA GUPTA, ACCOUNTANT MEMBER &
SHRI SIDDHARTHA NAUTIYAL, JUDICIAL MEMBER

I.T.A. No.108/Ahd/2022
(Assessment Year: 2017-18)

Infibeam Avenues Ltd. (Formerly known as Infibeam Incorporation Ltd.), 9th Floor, "A" Wing, Gopal Palace, Opp. Ocean Park, Nehrunagar, Satellite Road, Ahmedabad-380015	Vs.	Principal Commissioner of Income Tax, Ahmedabad-1
[PAN No.AACCI3501P]		
(Appellant)	..	**(Respondent)**

Appellant by :	Shri Aseem L. Thakkar, A.R.
Respondent by:	Shri A.P. Singh, CIT DR

Date of Hearing	01.10.2024
Date of Pronouncement	14.10.2024

O R D E R

PER SIDDHARTHA NAUTIYAL - JUDICIAL MEMBER:

This appeal has been filed by the Assessee against the order passed by the Ld. Principal Commissioner of Income Tax-1, (in short "Ld. PCIT"), Ahmedabad, vide order dated 11.03.2022 passed for A.Y. 2017-18.

2. The Assessee has taken the following grounds of appeal:-

"1. The Learned Pr. Commissioner of Income - Tax, Ahmedabad-1 has erred in passing an order u/s.263 of the T.T. Act,1961 setting aside the assessment order dtd. 31/10/2019 passed u/s. 143(3) of the Act which is neither erroneous nor prejudicial to the interest of revenue.

2. The Learned Pr. Commissioner of Income - Tax, Ahmedabad-1 has erred in passing an order u/s.263 of the I.T. Act,1961 setting aside the Assessment Order passed u/s. 143(3) of the I.T. Act, 1961 dtd.31. 10.2019 and directing the Assessing officer to make fresh assessment after considering in depth investigation in respect of issue of ESOP expenditure as to whether said expenses arc revenue expenditure or capita] expenditure and decide the allowability of expenditure u/s. 37 of the Act on the basis of final outcome of Supreme Court in the case of M/s. Lemon Tree Hotels

3. The Learned Pr. Commissioner of Income - Tax, Ahmcdabad-1 has erred in passing an order u/s.263 of the I.T. Act, 1961 which is barred by limitation since the issues sought to be revised have been examined in the assessment proceedings hence the same being illegal and bad in law requires to be quashed.

4. The Learned Pr. Comm. of Income Tax, Ahmedabad-1, has erred in erred in passing revision order u/s.263 of the Act prematurely holding that ESOP expenditure is capital expenditure and not allowable u/s.37 of the Act as clarity for allowability of the same is not available in the Act and SLP of the Revenue is pending with the Supreme Court in the case of M/s. Lemon Tree Hotels Pvt.

5. The Learned Pr. Comm. of Income Tax, Ahmedabad-1, has erred in holding that the Assessing Officer has not appreciated the facts of the case in proper perspective and legality involved and the order passed by him is silent for allowability of ESOP expenses debited to Profit and Loss A/c and which have been allowed as business expenses without any inquiry, examination and independent verification and to that extent the order passed by him is erroneous and prejudicial to the interest of the revenue.

6. The appellant craves leave to add. alter, amend or modify any of the grounds of appeal on or before the date of hearing of appeal."

3. The brief facts of the case are that upon reviewing the case records, PCIT observed that the Assessee Company has recorded an expense of Rs. 9.55 crore under 'Employee Benefit Expenses' in its Profit and Loss Account, of which Rs. 3.67 crore pertains specifically to Employee Stock Option Plan (ESOP) expenses claimed for the financial year in question. PCIT observed that a perusal of Note 28 of the Financial Statements reveals that the company issued shares to its employees under the ESOP at a significantly subsidized rate of Rs. 10 per share, despite the fair market values being Rs. 990 and Rs. 425. This results in a premium forgone ranging from 97.65% to 100%, with the difference in value recognized by the company as an expense in its financial records. PCIT observed that there is no explicit provision in the Income Tax Act that allows for the deduction of ESOP expenses. The only relevant section for such claims is Section 37, which lays out specific conditions that must be satisfied for an expenditure to qualify as deductible. These conditions state that the expenditure must be

genuine, it should not be covered under Sections 30 to 36, it must not constitute capital or personal expenses, and it must be incurred wholly and exclusively for business purposes. In light of these criteria, PCIT was of the view that it is evident that the expenses claimed by the Assessee Company do not meet the necessary conditions outlined in Section 37. Additionally, PCIT was of the view that there are compelling reasons to hold that the ESOP expenses cannot be classified as deductible revenue expenses. Firstly, the company appears to be opting to receive a lower or no securities premium when issuing shares to employees compared to the premiums applied to shares issued to others. This indicates that the company is not incurring any actual expenditure. Secondly, even if one were to consider the ESOP expense as a legitimate expenditure, it should be classified as a capital expenditure since the securities premium is treated as a capital item in the relevant financial year. Furthermore, the issuance of shares under the ESOP does not crystallize until the employee exercises their option. As a result, any expense recorded during the vesting period is inherently contingent. Additionally, the ESOP expense reflected in the Profit and Loss Account is largely notional, given that the company has not actually laid out any cash or resources by choosing to receive lower or no securities premium. Since the receipt of securities premium is regarded as a capital receipt and therefore not subject to taxation, any shortfall in the securities premium should likewise be classified as capital outlay, which disqualifies it from being treated as an allowable expense. In view of these considerations, PCIT issued a show cause notice to the Assessee Company on February 9, 2022, under Section 263 of the Act, requesting the company

to provide explanations and details as to why the claimed ESOP expenditure of Rs. 3.67 crore should not be reclassified as capital expenditure, disallowed, and subsequently added back to the total income.

4. In response to the show-cause notice dated February 9, 2022, the assessee company submitted its reply on February 26, 2022. In this reply, the company addressed several key conditions outlined in the notice. Firstly, regarding the interpretation of 'expenditure' under section 37(1) of the Act, the company submitted that the term encompasses losses, thereby arguing that the issuance of shares at a discount—where the company absorbs the price difference between the issue price and market value—qualifies as expenditure. The company submitted that the primary aim of granting Employee Stock Option Plans (ESOPs) is to ensure the consistent service of employees, which ultimately contributes to profitability, thus justifying the expense. Concerning the second condition mentioned, the company clarified that the expenditures incurred through ESOPs do not fall under sections 30 to 36 of the Act, and therefore should not be restricted by those provisions. Addressing the third condition, the company described the discount provided on ESOPs as a form of compensation aimed at retaining employees, categorizing it as a revenue expense rather than capital or personal expenditure. The company reiterated that the expenditures meet all necessary criteria for deduction under section 37 of the Act. With respect to the fourth condition, the company stressed that issuing shares at a discount directly serves the business objective of enhancing profitability by retaining employees. The company referred to judicial precedents, notably the decisions from the Hon'ble High Court of Karnataka in the case of Biocon

Ltd. and from the Hon'ble Madras High Court in PVP Ventures Ltd., to support its claim that all stipulated conditions of section 37 were met, warranting the allowance of ESOP expenses as a deduction for the fiscal year in question. The assessee company submitted its strategic choice to issue shares at face value without any security premium and submitted that this decision aimed to foster employee loyalty in a competitive market. The company reiterated that the costs incurred were for the purpose of compensating continuous employee service, thus qualifying as an allowable deduction. The assessee company further submitted that the motivation behind offering shares at a discount is profit maximization through employee retention, and clarified that this approach should not be misconstrued as a loss of security premium. The explanation extended to the structure of the ESOP itself, wherein the company commits to providing shares at a future date at a discounted rate, thereby linking the benefit to employee service obligations. The assessee company explained that the discount on ESOPs constitutes an ascertained liability, not a contingent one, since it arises during the accounting year. This liability becomes quantifiable upon the exercise of options by employees. Moreover, the company differentiated between a shortfall in security premium and the discount given on ESOPs, framing the latter as a revenue expenditure incurred to secure employee contributions. The assessee company contended that an erroneous order should not automatically trigger revision under section 263 of the Act unless it adversely impacts revenue interests, and submitted that no prima facie evidence existed to suggest that proper taxes were not assessed. The assessee also submitted detailed

documentation of its ESOP expenses amounting to Rs. 3.67 crore, including a list of employees and shares issued. The assessee provided evidence of TDS deducted from employees as required under section 192 of the Act, along with necessary compliance documentation. Furthermore, the company articulated its accounting treatment for ESOPs, adhering to guidelines issued by the ICAI, which stipulate recognizing expenses related to equity-settled share-based payment plans upon service receipt, with appropriate credit to equity accounts. The assessee company underlined its systematic approach to accounting for services rendered during the vesting period, ensuring adherence to prescribed time-proportion recognition and emphasizing the transitional nature of related equity accounts.

5. However, Ld. CIT(Appeals) did not agree with the contentions of the assessee. On reviewing the balance sheet of the assessee company for the year, it was noted that the opening balance of the Employee Stock Option (ESOP) outstanding account was recorded at Rs. 30,05,00,000/- under the 'other equity' section. During the year, this balance was affected by an ESOP expense of Rs. 15,23,50,000/-, a transfer to security premium upon the exercise of options amounting to Rs. 15,19,90,000/-, and a reduction due to stock option lapses totaling Rs. 6,80,000/-. Consequently, the closing balance in the ESOP account was reported as Rs. 30,01,80,000/-, and the security premium was increased by the same amount. It was concluded by Principal CIT that the ESOP expense recorded **is a provision in the profit and loss account, representing a contingent liability that only becomes an actual liability when employees exercise their options.** The company also increased its intangible assets under development by Rs.13,69,90,000/-,

which included portions attributed to salary and ESOP expenses. The relevant increase in the computer software assets account was Rs. 11,70,20,000/-. Here again, according to Principal CIT, the ESOP expense was held to be a contingent liability as opposed to a confirmed liability as on the balance sheet date. The Ld. PCIT held that the ESOP expenses were accounted for based on the vesting period rather than the exercise date of the options, indicating that the employee's option to purchase shares does not constitute an immediate financial obligation for the company. On further analysis, PCIT was of the view that under section 17(2)(vi) of the Act, the difference between the market value of shares at the time of exercise and the amount paid by employees is considered a perquisite and thus taxable as salary. If the share price decreases between vesting and exercise, the employee does not incur a tax liability on the differential price, despite the company recognizing notional ESOP expenses based on vesting schedules. **Hence, these provisions do not meet the definition of an ascertained liability under salary expenditure.** The assessee company submitted that the issuance of shares at a discount functions as a form of employee compensation to encourage continued service during the vesting period. **However, since no cash payment has been made to employees, the ESOP expenses recorded were regarded as notional**. According to section 37(1) of the Act, to qualify as deductible expenses, they must not be capital in nature and should be incurred exclusively for business purposes. The notional ESOP expenses, which arise from the difference between the share value at vesting and the amount received, do not fulfill these criteria. The PCIT observed that the assessee company cited various legal

precedents to support its claim of ESOP expenses being allowable, especially in view of judgments of the Karnataka and Madras High Courts, among others. However, PCIT observed that similar matters are pending with the Supreme Court, leaving the existing rulings as being not definitive. In view of the above facts, PCIT held that the order by the AO was held to be erroneous and prejudicial to the interests of Revenue, due to insufficient inquiry into the ESOP expenses claimed by the assessee.

6. The assessee is in appeal before us against the order passed by Ld. PCIT holding the assessment order to be erroneous and prejudicial to the interest of the Revenue.

7. Before us, the Counsel for the assessee submitted that the only reason why the assessment order was held to be erroneous was regarding the allowability of claim of ESOP expenses by the assessee. The Counsel for the assessee submitted that the issue has now been settled by various Courts in favour of assessee, which have held that ESOP expenses are not a contingent liability and are a deductible expenses in the hands of the assessee. It was submitted that the assessee had cited these decisions before the PCIT, however, the only reason why the contentions of the assessee were dismissed / discarded were on the ground that SLP of the Revenue is pending in the Supreme Court in the case of M/s. Lemon Tree Hotels Pvt. Ltd. (Para 4.12 of the order of PCIT). Therefore, the contention of the Counsel for the assessee were two fold: firstly the claim of the assessee had been duly examined by the Assessing Officer during the course of assessment proceedings and secondly, various judicial precedents including

the recent ITAT, Ahmedabad decision in the case of AXIS Bank Ltd. 166 taxmann.com 348 (Ahmedabad – Tribunal) has decided this issue in favour of the assessee and therefore, since the Assessing Officer had taken a legally plausible view, based on various decision rendered by various High Courts, the assessment order could not be set-aside as being erroneous and prejudicial to the interest of the Revenue.

8. In response, the Ld. D.R. placed reliance on the observation of the PCIT in the 263 order.

9. We have heard the rival contentions and perused the material on record.

10. On going through the facts of the assessee's case, it is observed that it has not been disputed by the PCIT that the issue had been analysed by the Assessing Officer during the course of assessment proceedings. The only reasons why the assessment order was held to be erroneous and prejudicial to the interest of the Revenue was that since the issue of allowability of ESOP expenses is pending before Supreme Court for adjudication, the matter has not attained finality and therefore, such claim of ESOP expenses should not have been allowed in the hands of the assessee. It would be useful to reproduce the relevant extract of the order passed by PCIT for ready reference:

> *"4.12 The assessee company has relied upon the following judgments in respect of its claims:*
>
> - *Hon'ble Karnataka High Court in case of M/s. Biocon Ltd. Vs. The Commissioner of Income Tax in ITA no. 653 of 2013*

- *Hon'ble Madras High Court in case of M/s PVP Ventures Ltd Vs Commissioner of Income Tax in ITA no. 1023 of 2005*
- *Hon'ble Delhi ITAT in the ccase of Lemon Tree Hotels Vs. Addl.CIT ITA NO.4588/Del/2013 dated 23.06.2014*
- *Hon'ble Delhi ITAT in the case of Oxigen Services (I) Pvt. Ltd. Vs. ACIT in ITA NO.3318 to 3320/Del/2016 for AY 2008-09 to 2010-11*

The above decisions are in the favour of the assessee company. However, similar matter is pending with Hon'ble Supreme Court in the case of PCIT Vs. M/s. Lemon Tree Hotels Pvt. Ltd. Vide Leave Petition (Civil) Diary No.(s) 1580/2019 and reported in 104 Taxmann.com 27(SC). Therefore, the above decisions are not law of land as on date."

11. On going through the order passed by PCIT, we are of the considered view that the issue regarding claim of ESOP expenses has admittedly being allowed by various High Courts in favour of the assessee. Further, even recently the Ahmedabad Tribunal in the case of Axis Bank Ltd. Vs. ACIT 166 taxmann.com 348 (Ahmedabad – Tribunal) has held that discount on issue of ESOPs i.e., difference between market price of shares at time of grant of option to employees and market price of such shares as on date of exercise by employees of assessee company, would be an allowable deduction under section 37(1) of the Act. The Ahmedabad Tribunal has made the following observations while passing the order:

"On going to the facts of the instant case, it is observed that the law that stand as on date on the allowability of ESOP expenses has been decided in favour of the assessee by the Tribunal Special Bench in the case of Biocon Ltd. v. Deputy Commissioner of Income-tax (LTU), Bangalore [2013] 35 taxmann.com 335 f Bangalore Trib.) (SB) and this decision was later confirmed by the Karnataka High Court in the case of CIT v. Biocon Ltd. [2020] L21 taxmann.com 351 (Karnataka) wherein the High Court held that on exercise of option by an employee, actual amount of benefit that had to be determined was only a quantification of liability, which would take place at a future date and hence discount on issue of ESOPs was not a contingent liability but was an ascertained liability. Further, the High Court held that issuance of shares at a discount would be an expenditure incurred for purposes of section 37(1) as primary object of aforesaid exercise was not-to waste capital but to earn profits by securing consistent services of employees and therefore, same could not be construed as short receipt of capital and thus, discount on issue of ESOP was allowable deduction under section 37(1). [Para 21]

The law on the subject, therefore, is unanimous as various Tribunals by following the decision of Biocon Ltd., Karnataka High Court have decided the issue in favour of the assessee. Secondly, it is observed (hat the ESOP scheme under consideration was part of the Annual Report of the assessee and further the specific details of ESOP benefit granted to its employees had been duly disclosed to the Assessing Officer during the course of assessment proceedings, being the difference between the market price of shares at the time of grant of option to these employees and the market price of such shares as on the date of exercise by employees of the assessee company. Therefore, even from this perspective, the expenses so claim were not contingent in nature, since the assessee had claimed the ESOP expenses at the time of actual exercise of option by its employees, during the year under consideration. It is also noteworthy that the assessee had reflected such ESOP expenses as "perquisites" in the hands of its employees and TDS at appropriate rate had also been deducted by the assessee company at the time of grant of ESOP benefits to its employees. Accordingly, in view of the judicial precedents on the subject as on date, which have consistently taken the view that ESOP expenses are allowable in the hands of assessees under section 37 and looking into the facts of the assessee's case, as highlighted above, it is viewed that the Commissioner (Appeals) has not erred in facts and in law in deciding this issue in favour of the assessee. [Para 21]"

12. The Hon'ble Apex Court in the case of **Malabar Industrial Co. Ltd. v. CIT (2000) 243 ITR 83 (SC)**, has held as under:

> *"When an **Income Tax Officer adopted one of the courses permissible in law and it has resulted in loss of revenue or where two views are possible and the Income Tax Officer has taken one view with which the Commissioner does not agree, it cannot be treated as an erroneous order prejudicial to the interest of the Revenue unless the view taken by the Income Tax Officer is unsustainable in law**."*

13. The said view has also been held in a judgment of the Hon'ble Punjab & Haryana High Court in the case of **CIT v. Indo German Fabs IT Appeal No. 248 of 2012, dated 24- 12-2014**, in the following words:

> *"Section 263 of the Act confers power to examine an assessment order so as to ascertain whether it is erroneous and prejudicial to the interest of the revenue **but does not confer jurisdiction upon the CIT to substitute his opinion for the opinion of the Assessing Officer. The words prejudicial and erroneous have to be read in conjunction and therefore, it is not each and every error in an assessment that invites exercise of powers under Section 263 of the Act**, but only orders that are erroneous and prejudicial to the interest of the revenue."*

14. In a decision rendered by Delhi High Court in the case of **CIT Vs. Sunbeam Auto 332 ITR 167 (Del.)**, wherein, while considering the distinction between lack of inquiry and inadequate inquiry, the Hon'ble court held that where the AO has made inquiry prior to the completion of assessment, the same cannot be set aside u/s 263 on the ground of inadequate inquiry:

> *"12. We have considered the rival submissions of the counsel on the other side and have gone through the records. The first issue that arises for our consideration is about the exercise of power by the Commissioner of Incometax under section 263 of the Income-tax Act. As noted above, the submission of learned counsel for the revenue was that while passing the assessment order, the Assessing Officer did not consider this aspect specifically whether the expenditure in question was revenue or capital expenditure. This argument predicates on the assessment order which apparently does not give any reasons while allowing the entire expenditure as revenue expenditure. However, that by itself would not be indicative of the fact that the Assessing Officer had not applied his mind on the issue. There are judgments galore laying down the principle that the Assessing Officer in the assessment order is not required to give detailed reason in respect of each and every item of deduction, etc. Therefore, one has to see from the record as to whether there was application of mind before allowing the expenditure in question as revenue expenditure. Learned counsel for the assessee is right in his submission that one has to keep in mind the distinction between "lack of inquiry" and "inadequate inquiry". If there was any inquiry, even inadequate, that would not by itself, give occasion to the Commissioner to pass orders under section 263 of the Act, merely because he has different opinion in the matter. It is only in cases of "lack of inquiry", that such a course of action would be open. --------- From the aforesaid definitions it is clear that an order cannot be termed as erroneous unless it is not in accordance with law. If an Income-tax Officer acting in accordance with law makes a certain assessment, the same cannot be branded as erroneous by the Commissioner simply because, according to him, the order should have been written more elaborately.* ***This section does not visualise a case of substitution of the judgment of the Commissioner for that of the Income-tax Officer, who passed the order unless the decision is held to be erroneous.*** *Cases may be visualised where the Income-tax Officer while making an assessment examines the accounts, makes enquiries, applies his mind to the facts and circumstances of the case and determines the income either by accepting the accounts or by making some estimate himself. The Commissioner, on perusal of the records, may be of the opinion that the estimate made by the officer concerned was on the lower side and left to the Commissioner he would have estimated the income at a figure higher than the one determined by the Income-tax Officer. That would not*

vest the Commissioner with power to re-examine the accounts and determine the income himself at a higher figure. It is because the Income-tax Officer has exercised the quasi-judicial power vested in him in accordance with law and arrived at conclusion and such a conclusion cannot be termed to be erroneous simply because the Commissioner does not feel satisfied with the conclusion. There must be some prima facie material on record to show that tax which was lawfully exigible has not been imposed or that by the application of the relevant statute on an incorrect or incomplete interpretation a lesser tax than what was just has been imposed. 15. Thus, even the Commissioner conceded the position that the Assessing Officer made the inquiries, elicited replies and thereafter passed the assessment order. The grievance of the Commissioner was that the Assessing Officer should have made further inquires rather than accepting the explanation. Therefore, it cannot be said that it is a case of 'lack of inquiry'."

15. Accordingly, in light of the above discussion we are of the considered view that the assessment order cannot be held to be erroneous and prejudicial to the interest of the Revenue. The Ld. AO had examined the issue during the course of assessment proceedings. The issue also finds support from various judicial precedents, including the Ahmedabad Tribunal which have held that ESOP expenses are not a contingent expense and allowable under section 37 of the Act. Therefore, in light of the above facts and the discussion in the preceding paragraphs, we are of the considered view that the assessment order is not erroneous in so far as prejudicial to the interests of the Revenue.

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

This Order pronounced in Open Court on	**14/10/2024**

Sd/-	**Sd/-**
(ANNAPURNA GUPTA)	**(SIDDHARTHA NAUTIYAL)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Ahmedabad; Dated 14/10/2024
TANMAY, Sr. PS ***TRUE COPY***

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. संबंधित आयकर आयुक्त / Concerned CIT
4. आयकर आयुक्त (अपील) / The CIT(A)-
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, अहमदाबाद / DR, ITAT, Ahmedabad
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt.Registrar)
आयकर अपीलीय अधिकरण, अहमदाबाद/ ITAT, Ahmedabad