

# TERM OF THE DAY

## ESOP



### INTRODUCTION

Employee Stock Ownership Plan (ESOP) is basically an Employee Benefit Plan that gives ownership interest at a defined price in the company as an additional benefit to the employees. These stocks remain in ESOP Trust until the option vests and employee exercises them.

**VESTING PERIOD:** Time period an employee must work before acquiring the entitlement

**STRIKE PRICE:** Amount that employee pays to convert the option to a share

### PURPOSE

- To ensure long term commitment of the employee towards the organization.
- To motivate employees to contribute to the growth and profitability of the company.
- This scheme is more prevalent in the Startup companies because ESOPs can be issued as part of remuneration to keep the valuable Employees.

### INCOME TAX PROVISIONS - EMPLOYEE

- While exercising the right (Income from Salary):
  - **Upon allotment of shares**, the employee shall be taxed u/s 17(2)(vi) of The Income Tax Act, 1961.
  - Taxable Perquisites - **FMV of shares on date of exercise (-) Exercise Price of shares at the time of grant**
  - The employer is required to deduct tax u/s 192 in the year in which shares are allotted.
  - A relief has been given to the start-ups as defined under section-80IAC, since their shares are generally unlisted and there is no available market to sell them and generate cash. This creates a cash flow challenge for employees as they receive a benefit in kind but need to pay tax from their pocket. As a relief, tax shall be deducted u/s 192 within 14 days of earlier of the following :
    - After the expiry of 48 months from the end of assessment year in which shares are allotted;
    - From the date of which the Assessee ceases to be the employee of the organization; or
    - From the date of sale of shares allotted under ESOP by the Assessee
- On sale of shares (Income from Capital gains):
  - **LISTED COMPANIES :**
    - Shares held for > 12 months, taxable as LTCG u/s 112A at 10% if such capital gain exceeds Rs 1 lakh.
    - Shares held for <= 12 months, taxable as STCG u/s 111A at 15%
  - **OTHER COMPANIES :**
    - Shares held for > 24 months, taxable as LTCG at 20% after indexation of cost
    - Shares held for <= 24 months, taxable as STCG according to respective tax slab.

CAPITAL GAIN = Sales Consideration (-) FMV of ESOPs on date of allotment

- Company can claim ESOP as deduction
- When Employee sells share to third party, there shall be no tax implication in the hands of the Company.
- However, if the shares are bought back, then tax shall be imposed at the time of buy back u/s 115QA at 20% in the hands of the company whether listed or unlisted.

## THE COMPANIES ACT PROVISIONS

- Employees to whom ESOPs can be issued:
  - Permanent employee working whether in India or outside India;
  - Director including Whole Time Director but cannot be issued to Independent Director.
  - Permanent Employee/Director (excluding Independent Director) of the holding or subsidiary company excluding
    - Employee who is also promoter of the company
    - Director who directly or indirectly is holding >10% shares of the company.
- Procedure for issuance of ESOP under The Companies Act 2013:
  - Prepare an ESOP Scheme
  - Approval of the Scheme by Nomination and Remuneration Committee (where a company has one)
  - Convene a board meeting to approve the scheme
  - Convene the shareholders meeting for approving the scheme. The notice to the shareholder meeting shall give out all details with regard to the scheme.
  - A separate shareholders resolution is required where:
    - Grant of option to employees of subsidiary or holding company
    - Grant of option to identified employees, during any one year, equal to or exceeding one percent of the issued capital of the company at the time of grant of option
  - Grant letter of option to eligible employees
  - Once the option is accepted by the eligible employees, execute the ESOP agreement with each eligible employee.
  - On expiry of vesting period, where an employee has exercised the option to acquire shares, allot shares.
- Minimum Vesting Period shall be one year from the date of grant of option till the date of vesting.
- The options are non-transferable. Further, they can't be pledged, hypothecated, mortgaged or otherwise

## EXAMPLE FROM REAL WORLD

OYO Hotels & Homes has decided to make every employee a co-owner and shareholder of the company by granting them deeply discounted ESOPs. The strike price is Rs 10 per option. As part of the commitment, vesting would continue even if they leave employment with Oyo.