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EQUITY INCENTIVES RECEIVED IN RESPECT OF SERVICES RENDERED IN INDIA ARE TAXABLE IN INDIA, RULES TRIBUNAL

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Recently, the Mumbai Bench of the Income Tax Appellate Tribunal (Tribunal) delivered an interesting ruling in the case of Unnikrishnan V S v ITO [ITA Nos. 1200 and 1201/Mum/2018] on taxation of perquisites arising out of equity incentives to a non-resident which were granted in India. The Tribunal held that if shares are allotted under an equity incentive scheme to a non-resident individual in connection with the services rendered by him in India, then regardless of the residential status of the individual, such perquisite will be taxable in India.

Background

Mr Unnikrishnan V S (Taxpayer) was an employee of HDFC Bank Limited, India (India Co). In June 2007, the Taxpayer was granted options under the India Co's employee stock option plan (ESOP) to subscribe to the shares of India Co (Shares) at a discounted price. The options got vested in two tranches over two financial years (FY) i.e., FY 2008-09 and FY 2009-10. In October 2007, the Taxpayer was deputed to India Co's representation office in the United Arab Emirates (UAE). In FY 2012-13, whilst being a resident of UAE, the Taxpayer exercised his options, and India Co allotted Shares thereto.

Per Section 17 of the Indian Income-tax Act, 1961 (IT Act), if any employee receives securities free of cost or at a discounted price, the value of such securities (less any price paid) is considered as perquisite and taxable under the head of 'salary'. The employer company is required to withhold appropriate taxes at the time of allotment of shares. Thus, consequent to allotment of Shares, India Co withheld taxes on the perquisite arising to the Taxpayer.

For the relevant year, the Taxpayer filed his annual tax return claiming a refund of the taxes withheld by India Co on the premise that the benefits received by him under ESOP were on account of the services rendered by him in the UAE between the FYs 2008-09 and 2009-10. As per the Taxpayer, given that he is a non-resident of India, the benefit is not taxable in India since the benefit cannot be said to have arisen or accrued in India which is a sine qua non for taxing the income of a non-resident under the IT Act. The Taxpayer further contended that even under Article 15 of the India-UAE Tax Treaty (Treaty), income of a UAE resident, in the nature of salaries and other remuneration which will include benefits akin to ESOP, will be taxable in India only if the UAE resident has rendered services in India.

The tax authorities rejected this stance and passed an order to the effect that options were granted to the Taxpayer in consideration for the services rendered in India when

he was a resident of India. This was upheld by the Commissioner of Income-tax (Appeals). Aggrieved, the Taxpayer filed an appeal before the Tribunal.

Ruling

The Tribunal observed that Section 17 of the IT Act only decides the timing of taxation of an income arising out of an equity incentive plan; it does not cancel out the fact that the benefit sought to be taxed has arisen much earlier i.e., at the point in time when options were granted.

Even the commentaries in the context of tax treaty law by the United Nations and the Organisation for Economic Cooperation and Development ("OECD") on treatment of employee stock options note that the income arising out of a stock option plan must relate back to the jurisdiction where services were rendered. If the grant of stock option is part of remuneration, the OECD rightly observes that the benefits accrue in the jurisdiction in which the qualifying services are rendered.

In the instant case, the Taxpayer was a non-resident of India at the 'time' of taxation of the benefit. However, he was a resident of India when the options under ESOP were granted to him and hence, the income arose at an earlier point in India. Hence, under the IT Act, the income of the Taxpayer relatable to exercise of options was taxable in India. Similarly, no relief is available to the Taxpayer under Article 15 of the Treaty as the benefit received by the Taxpayer relates to services rendered by him in India and not the UAE.

Accordingly, the Tribunal upheld the order of the tax authorities and ruled that the benefits under ESOP arising to the Taxpayer, a non-resident, was taxable in India.

Comments

This ruling reaffirms the principle that exercise of an option fructifies the timing of its taxation and not right of taxation of the jurisdiction. The place of accrual of a benefit relating to equity incentives is the place where 'services have been rendered' or 'employment exercised' by the employee. Interestingly, the Tribunal pivots its observation on the fact that the options have been granted to the employee by virtue of the services already rendered by him in India. If that has been the case, the Tribunal has rightly concluded. Having said that, the ruling does not shed much light on the fact that options were granted to the Taxpayer for past services.

On a careful consideration of the ruling, it appears that in determining taxation of equity incentive, it is important to factor, amongst other terms of the grant, whether the entity granting the benefit envisaged remunerating the employee for the past services or for the services being rendered by him during the vesting period.

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