

Enough clarity on FBT rules for Esops?



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Companies listed overseas could face problems

EVER since its introduction in April this year, the levy of fringe benefit tax ("FBT") on employee stock option plans (Esops) has been regarded as arbitrary, illogical, and a deterrent to employee-employer partnership spirit. It is also out of sync with the tax systems of our major trading partners, such as the US, resulting in unavailability of tax credit.

The valuation of shares for the purpose of levy of FBT has to be based on the fair market value (FMV) of the security on the date of the vesting of the stock option. In this respect the valuation rules recently announced state that, in cases where the securities of a company offering such stock options is listed on a recognised stock exchange, the fair market value of the shares or securities shall be the average of the opening price and closing price of that security as on the date of vesting of the stock option. Thus, for listed companies, the valuation rules seem to be quite simple and easy to follow. Nonetheless, this may still be problematic for foreign companies listed outside India, since the stock exchange may not be recognised in India, and hence all foreign companies granting stock options to employees in India may have to refer to the valuation rules prescribed for unlisted companies.

For unlisted companies, the government has been wise in its approach, and instead of prescribing its own arbitrary set of rules, it has instead trusted the community that knows its job best, i.e., the merchant bankers, and left the valuation technique to be determined by them.

Thus, the merchant bankers will have the flexibility and responsibility to adopt the most apt method for valuation as principles of valuation of employee stock options continue to evolve world over. In fact, in a recent development, the US Securities and Exchange Commission (SEC), instead of following traditional valuation techniques like the Black Scholes method, has issued a letter to Zions Bancorporation permitting it to use an auction process to establish the fair value of the stock options. Ultimately, while price may be a result of demand and supply, valuation can only be a matter of opinion.



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Set clear guidelines for unlisted companies

CORPORATE entities have reconciled themselves to the fact that Esops are subject to FBT levy. The fringe benefit value on which FBT is payable at the rate of 33.99% is the difference between the fair market value (FMV) of the shares on the date of vesting of the options and the price paid by the employee on exercise. If it can be any of consolation, tax laws do not prohibit employers from recovering FBT from the employees. However, the administrative costs involved and the ambiguities in the FBT provisions continue to plague the corporate sector.

Guidelines for determination of the FMV issued recently are fairly clear for Indian listed companies. If on the date of vesting, the shares are listed on a recognised stock exchange, the FMV is the average of the opening price and closing price of the share on that date on that exchange. The guidelines also factor in a lack of trading on the vesting date, in which case the FMV shall be the closing price on a date immediately preceding and closest to the option vesting date. In all other instances, the FMV has to be determined by a Category 1 merchant banker.

As the guidelines refer to recognised stock exchanges, only Indian stock exchanges fall within the definition. Thus, companies which are only listed overseas will have to engage a merchant banker for FMV determination. This would include instances where employees of Indian subsidiaries are awarded shares of the foreign parent/affiliate under global stock option plans. CBDT may consider naming select international stock exchanges as 'recognised' for the purpose of the determination of the FMV.

The onus of choosing an appropriate valuation method falls on the merchant banker as no method has been prescribed. To avoid subjectivity and tax litigation, guidelines could have been set. The Wealth Tax Act, for instance, prescribes guidelines for valuation of unlisted securities. Even listed companies will face administrative hassles, as FBT is triggered on allotment of the shares. Indian listed companies will also have to get archival price information of their listed securities as on the date of vesting, where options have vested earlier but shares were allotted after Esops came within the FBT domain.