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Startups Clueless as Taxmen Stay Mum on Esops

Mugdha Variyar

Bengaluru:

Startups using Esops to hire talent in a fix after CBDT proposal

A section of the startup community is seeking clarity on taxation of employee stock option plans (Esops), after a recent Central Board of Direct Taxes (CBDT) proposal on exempting genuine equity investments from long-term capital gains tax didn't mention Esops.

The issue is particularly important for startups as they offer generous Esops to entice talent, especially in the early stages when they may not have the financial resources to splurge on employees.

The employees holding such stocks often sell those during initial public offerings by the company or buyouts, at times making a windfall. Payment process firm PayU India's acquisition of rival Citrus Pay last year turned 15 employees crorepatis, while an office boy took home ` . 50 lakh.

However, startup founders and investors said long-term capital gains tax could make stock options less appealing, even as tax and industry experts interpreted this week's CBDT draft notification differently for its implication on Esops. The ambiguity, they fear, could deter staff from taking Esops and make it difficult for them to hire right talent.

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They want Esops to be exempted from the purview of long-term capital gains tax.

"Employees may think twice while opting for Esops scheme" due to the lack of clarity, said Maneesh Goel, chief financial officer at PayU. "Esops per se should still be considered as a good method of compensating deserving employees and CBDT should endeavour to bring more clarity on this matter as the employees across industries are impacted," he added.

Genuine equity investments through IPOs as well as other public share sale and bonus and rights issues by listed companies won't face long-term capital gains tax even if no securities transaction tax was paid on their transfers, the CBDT draft notification said. But it didn't clearly

address concerns related to off-market transactions.

"From this notification, it could be construed that if at the time of allocation of Esops the equity is unlisted, but at the time of sale by the employee it is listed, there could be long-term capital gains tax implication," said Archit Gupta, CEO of tax-filing platform ClearTax. "More clarity is required on this."

Sanjay Khan Nagra, fellow at software products think-tank iSPIRT and a senior associate at Khaitan & Co, also said there was ambiguity on the issue of Esops.

"Practically, there will not be much impact for early-stage tech companies since not many of them are expected to list in India. But if they do list, there is no clarity on whether the sale of Esops will be exempted from long-term tax gains," Nagra said.

Some experts, however, said there would be no real impact on unlisted shares at startups.

"Since one of the conditions mentioned in the circular for not getting a capital gains tax exemption entails that purchase of listed equity shares is done outside of a recognised stock exchange, the sale of Esops during an IPO on an exchange would continue to get the exemption," said Mansi Seth, a tax expert from Nishith Desai Associates.

Citing a senior CBDT official, ET reported this week that genuine transactions "like Esops" would "not be touched".

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