

Tax Hotline

October 24, 2007

FINALLY... RULES FOR VALUATIONS OF SECURITIES AND SHARES FOR PAYMENT OF FBT ANNOUNCED

Employee stock option plans have in the past been utilized as an incentive tool to retain employees. However, in light of the recent amendment, brought about by Finance Act, 2007 employers are currently liable to pay fringe benefit tax ("FBT") for all such stock options granted by them to their employees. FBT is required to be paid at the time exercise of the stock option on the fair market value of the shares on the date of vesting of the stock option.

Finally after a patient wait by the corporate community, the Central Board of Direct Taxes ("Board") by way of circular dated October 23, 2007 threw light on the valuation norms to be applied while calculating FBT on stock options. The stock option valuation norms will come into effect from April 1, 2008 and shall be applicable to all assessments made from and after assessment year 2008-2009.

The circular states that, in cases where the securities of a company offering such stock options is listed on a recognized 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.

However, if such security is listed on more than one recognized stock exchange, the fair market value of that security shall be the average of the opening price and closing price of that security as recorded on the stock exchange in which such security records the highest volumes of trade. Further, if no trading in the security takes place on the recognized stock exchange on the date of vesting of the stock option, the fair market value shall be the closing price of the security as on the date closest to the date of vesting. If such security is listed on more than one recognized stock exchange, the closing price shall be same as above, but as on the recognized stock exchange which records the highest volumes of trade in the date closest to the vesting of the stock option.

In case of unlisted security, the fair market value of the security as on the date of vesting of the stock option shall be the value as may determined by a Securities and Exchange Board of India ("SEBI") registered Category I Merchant Banker on the specified date. "Specified date" has been defined as *"the date of vesting of the stock option" or "any date earlier than the date of the vesting of the stock option, not being a date which is more than 180 days earlier than the date of the vesting"*. This definition of the term specified date leads to a confusion as to whether companies have an option to choose any fair market value earlier than 180 days of the date of vesting of the stock option.

Further in light of the above mentioned circular, companies having monthly vesting schedules will face a herculean task of getting valuations.

The corporate community had been waiting in anticipation for these valuation rules to be announced and the delay in the release of these rules have added to their suspense. The rules however seem to be quite simple and have made India Inc. wonder why these could not have been released earlier. Having said that, there are still some unanswered questions regarding FBT on stock options, especially with respect to applicability of FBT to foreign companies, availability of tax credit, problems in estimation of FBT when stock options are exercised at the end of the financial year etc. It is hoped that the Board will come out with clarifications on some of these issues.

To know more on FBT on stock options please refer to our [Tax Hotline dated June 15, 2007](#)

- Vivek Mimani & Parul Jain

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