

JANUARY 16, 2008
2008-012

**INDIA TAX AUTHORITY ISSUES
CIRCULAR CLARIFYING FBT ON
ALLOTMENT/TRANSFER OF
CERTAIN SHARES**

by KPMG, India (a KPMG
International member firm)

India's Central Board of Direct Taxes (CBDT) recently issued Circular No 9/2007, which provides some clarifications in respect of Fringe Benefit Tax (FBT) on Employee Stock Options (ESOPs).

India's Finance Act, 2007 brought ESOPs¹ granted to employees under the FBT provisions. (For prior coverage see the following issues of *Flash International Executive Alert*: [2007-107](#) (23 May 2007) and [2007-070](#) (22 March 2007).) The value of ESOPs for the purpose of levying FBT is determined as the fair market value (FMV) on the date on which the "option" vests with the employee as reduced by the amount actually paid by or recovered from the employee in respect of such ESOPs. "FMV" means the value determined in accordance with the method prescribed by the CBDT.

Please note, the CBDT vide notification dated 23 October 2007, prescribed the valuation rules² to determine the FMV for levy of FBT on the ESOPs granted to employees. These valuation rules are applicable for Assessment year 2008-2009. Accordingly, ESOP's, where the shares / securities are allotted or transferred on or after 1 April 2007, are to be valued as per these rules.

Below we highlight some of the clarifications made by the Circular No 9/2007.

Shares allotted or transferred by a foreign holding company to employees of an Indian subsidiary company – The Indian subsidiary company is to pay FBT as the shares are allotted to employees by virtue of their employment with the Indian company. This is irrespective of the charge-back of costs by the foreign company to its Indian subsidiary company.

Shares allotted or transferred by a foreign holding company to employees of an Indian subsidiary company while outside India – The Indian subsidiary is to pay FBT, if the employees are based in India anytime during the grant period.³ FBT will be a proportionate amount in respect of the period of stay⁴ of the employee in India during the grant period.

Shares allotted or transferred by a foreign company to its employees who are deputed to work in India – The foreign company is to pay FBT if the employee is based in India during the grant period. FBT will be a proportionate amount in respect of the period of stay⁵ of the employee in India during the grant period.

Tax paid by employees on ESOPs in other countries – No credit to the employer against its FBT liability for taxes paid by employees in other countries.

FBT paid by the employer and subsequently recovered from the employees – The employee can claim a credit in a foreign country for the FBT paid by the employer. As per the Act⁶, FBT is levied on the employer although an option has been given to the employer to recover the FBT from the employee. The employer and the employee are treated as separate taxpayers both in India and overseas. Therefore, it may be difficult for the employee to satisfy the overseas tax authorities to claim credit based on this circular.

KPMG Note – It is important to note that the Circular has clarified that FBT will be payable only on the proportionate amount in respect of the period of stay of the employee in India during the grant period. This is a welcome step as it would provide relief to employers having globally mobile employees.

In spite of the Circular, and in many cases because of it, there are still many issues that require further consideration and addressing by the tax authorities, as well as by employers.

Footnotes:

1 With effect from 1 April 2007, any allotment or transfer of any specified security or sweat equity shares by the employer free of cost or at concessional rates to its employees (including former employee or employees) would attract fringe benefit tax. "Specified security" and "sweat equity shares" have also been defined to mean as follows:

(i) "Specified security" means the securities as defined in section 2 (h) of the Securities Contracts (Regulation) Act, 1956, i.e., shares, debentures, stocks, derivatives etc. and includes employees' stock options.

(ii) "Sweat equity shares" means equity shares issued by a company to its employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever name called.

In this newsletter, the above have been collectively referred to as ESOPs.

2 Rule 40C of the Income-tax Rules, 1962.

3 Grant period: period beginning with the grant of the option and ending with the date of vesting of such option.

4 For example: Grant date : 1 April 2004

Vesting date : 31 March 2007

Exercise and allotment date : 30 June 2007

Employee based in India : 1 April 2004 to 31 March 2005, i.e., 1 year

Employee based outside India : 01 April 2005 to 31 March 2007, i.e., 2 years

FBT payable = Total FBT x 1 year / 3 years.

5 Ibid.

6 Income-tax Act, 1961.

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