



QAPITA



Charge of GST on account of ESOPs issued by Foreign Holding Companies to Employees of their Subsidiaries in India

1. Background

- 1.1 Employee Stock Options (“ESOPs”/ “Options”) have been used by listed and unlisted companies in India, with a view to attract, retain, motivate, and reward the employees whether working in or outside India on the rolls of the implementing company or on the rolls of its subsidiary or holding company, for over many decades. ESOPs are considered a strong tool for employee retention and motivation for seeking corporate growth. As such, foreign companies also intend to grant ESOPs under their ESOP scheme to the employees of their subsidiaries or holding company in India.
- 1.2 The taxability of ESOPs on the Indian employees or on the Indian company is governed under the provisions of the Income Tax Act, 1961. The taxability of ESOPs on employees works in 2 stages, first is when employee exercises the ESOPs and converts them to shares, income tax is payable at individual slab rate and is treated as perquisite income. Thereafter, when the shares are sold, long-term or short-term capital gain tax is applicable based upon period of holding. The taxation treatment generally remains as discussed above irrespective of whether the ESOPs are issued by Indian company or a foreign company to Indian employees.
- 1.3 The Indian Accounting Standard (“Ind-AS”) 102 as applies to an Indian company or International Financial Reporting Standards (“IFRS”) as applies to a foreign company require that a company issuing ESOPs to recognize and amortize the cost in its books and also to cross charge the cost in case of grant of ESOPs to employees of its subsidiaries or holding company. Thus, it is an accounting requirement that any foreign ESOP implementing company upon grant of ESOPs to the employees of its subsidiary in India, cross charges the relevant cost.
- 1.4 Recently, in a leading news-paper article it was reported that few Indian companies, largely in technology sector, were receiving enquiries from Goods and Services Tax (“GST”) Authorities of India, where their foreign holding companies have granted ESOPs or issued shares under their ESOP schemes to the employees of such Indian subsidiaries and have cross charged the relevant ESOP cost. As reported, the GST Authorities are considering the cost cross charged to the Indian subsidiaries as value of import of services contending for levy of 18% GST on the value of such imports in the hands of the Indian companies.
- 1.5 With this background, we have analyzed the relevant provisions of accounting requirements, taxation, and other statutes on ESOPs, to share our views on the matter.

2. Our analysis and views

- 2.1 According to GST regulations, 'import of service' refers to the supply of service by a foreign entity to an Indian recipient and is chargeable if following conditions are met:
- a) There must be a supplier of the services, located outside India;
 - b) There must be a recipient of the service located in India;
 - c) The place of supply of the service must be in India; and
 - d) The recipient of the service must be liable to pay the tax on the supply under reverse charge.
- 2.2 The argument of the GST Authorities is that the overseas company whose shares are allotted is not considered an employer, and thus, the obligation of allotting shares or providing of equivalent benefit rested on its Indian subsidiary being an employer on whose rolls the employees provide their services. Consequently, the ESOP cost or value of benefit being reimbursed by the Indian subsidiary as per accounting norms has been treated as value of service being imported, attracting an 18% GST liability.
- 2.3 Here, there is no service (except employment that is rendered and consumed in India, as narrated below) and thus, no supplier of service and recipient of service. This raises a question on the very chargeability of GST in the cases under reference.
- 2.4 Further, when ESOPs are granted to the employees, the income/ gain that arises on exercise of ESOPs (i.e. receipt of shares) is taxed as perquisite as per prevailing Income tax provisions and the Indian employer companies are also required to administer Tax Deduction at Source ("TDS") thereon. Here, indisputably, the gain arises out of "employment" and not due to rendition of any other "service". The Statutes on direct and indirect taxes are clear on "employment" vis-à-vis any other "service" and have mutually exclusive provisions to deal with these two situations.
- 2.5 Furthermore, the cost recharged to the Indian subsidiaries is the "employee cost" recognized as value of contribution of employees. As the employees do not render any other services other than that which is required under the normal course of employment, they are not required to obtain GST registration. In other words, discharge of normal employment related functions does not come under the ambit of GST.
- 2.6 Furthermore, the cross charge of cost from holding to subsidiary company and subsequent recovery by holding company is merely accounting treatment as provided under the Ind-AS and cannot be termed as supply.

- 2.7 Furthermore, ESOPs are “Securities” as per the Securities Contracts (Regulation) Act, 1956 and such Securities are neither Goods nor Services as per the Central GST Act 2017. Thus, a transaction in ESOPs may not be classified as supply of Goods nor Services; which again raises a question on the chargeability of GST.
- 2.8 Given the absence of basic requirements for charge of GST and more importantly the very chargeability, it appears that levy of GST on Indian subsidiaries of foreign ESOP implementing company is not sustainable.

As the matter remains under review, we encourage businesses to stay informed about the latest developments and prepare for potential changes in the tax landscape. In this regard, the decision made during the GST Council meeting could be of significance. While we will closely monitor the situation and keep you updated on any changes, please feel free to contact us if you have any questions or thoughts on this matter.

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About Qapita

Qapita is a leading provider of Equity Compensation solutions for startups, unlisted and publicly listed companies. Our service offerings cover the entire life cycle of ESOPs including Plan conceptualization, Design, Documentation, Plan management, Compliance and Reporting. We have serviced over 1800+ clients across all industries, domestic and international, listed and unlisted. Our team consists of experienced professionals specialising in conducting preliminary analysis, planning, designing, and implementing ESOPs. Each of our consulting team members is a qualified Chartered Accountant/ Company Secretary, a market leader in Equity Management and Marketplace solutions for unlisted and listed companies in India and South East Asia.

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