

ESOP exp. is an employee cost; ITAT allows deduction for difference between market price and issued price

Summary – The Bangalore ITAT in a recent case of Novo Nordisk India (P.) Ltd., (the Assessee) held that where in terms of Employees Stock Purchase Scheme (ESOP), assessee company offered shares of its parent company to employees, difference between fair market value of shares of parent company on date of issue of shares and price at which those shares were issued by assessee to its employees was to be regarded as expenditure incurred for business purpose allowable under section 37(1)

Facts

- The assessee was a wholly owned subsidiary of NNAS Denmark. It was primarily engaged in the marketing and distribution of healthcare products.
- NNAS, the parent company of the assessee had a scheme called NNAS Global Share Programme 2005 ('the Plan'). As per the plan the employees of NNAS were entitled to purchase shares of NNAS at a price less than the market price.
- The shares of NNAS were listed on the Copenhagen Stock Exchange. By a Board resolution, the board of directors of NNAS resolved that the employees of foreign affiliates of NNAS including assessee would also be entitled to opt to purchase shares of NNAS under the Plan.
- The assessee framed Employee Stock Purchase Scheme ('ESOP') whereby it offered shares of NNAS to its employees subject to certain terms and conditions set out in the scheme.
- As per the ESOP, the difference between fair market value of shares of parent company on date of issue of shares and price at which those shares were issued by assessee to its employees, was reimbursed by the assessee to its parent company. The sum so reimbursed was claimed as expenditure in the profit and loss account of the assessee as an employee cost.
- The Assessing Officer rejected the claim of the assessee for deduction of the aforesaid expenditure on ground that it resulted in capital building of the parent company and, therefore, there was no expenditure incurred by the assessee in the regular course of its business.
- The Commissioner (Appeals) confirmed the order of the Assessing Officer.
- On second appeal:

Held

- In the present case, there is no dispute that the liability has accrued to the assessee during the previous year. The only question to be decided is as to whether it is the expenditure of the assessee or that of the parent company.
- The foreign parent company has a policy of offering ESOP to its employees to attract the best talent as its work force. In pursuance of this policy, the foreign parent company allowed its subsidiaries/affiliates across the world to issue its shares to the employees.

- As far as the assessee in the present case which is an affiliate of the foreign parent company is concerned, the shares were in fact acquired by the assessee from the parent company and there was an actual outflow of cash from the assessee to the foreign parent company.
- The price at which shares were issued to the employees was paid by the employee to the assessee who in turn paid it to the parent company. The difference between the fair market value of the shares and the price at which shares were issued to the employees was met by the assessee.
- This factual position is not disputed at any stage by the revenue. In such circumstances, there is no basis on which it could be said that the expenditure in question was a capital expenditure of the foreign parent company.
- As far as the assessee is concerned, the difference between the fair market value of the shares of the parent company and the price at which those shares were issued to its employees in India was an employee cost which is a revenue expenditure incurred for the purpose of the business of the company and had to be allowed as deduction.
- There is no reason why this expenditure should not be considered as expenditure wholly and exclusively incurred for the purpose of business of the assessee.
- With regard to the observations of the Commissioner (Appeals) that the ESOP actually benefits only the parent company, it can be said that the expenditure in question is wholly and exclusively for the purpose of the business of the assessee and the fact that the parent company is also benefited by reason of a motivated work force would be no ground to deny the claim of the assessee for deduction, which otherwise satisfies all the conditions referred to in section 37(1).
- In the facts and circumstances of the present case, the expenditure in question was wholly and exclusively for the purpose of the business of the assessee and had to be allowed as deduction as a revenue expenditure.
- In the result, the appeal of the assessee is allowed.