IN THE HIGH COURT OF JUDICATURE AT MADRAS

Order reserved on	27.03.2024
Order pronounced on	31.07.2024

CORAM

THE HONOURABLE MR.JUSTICE SENTHILKUMAR RAMAMOORTHY

W.P.No.26506 of 2023
&
WMP Nos.25911 & 25912 of 2023

Nishithkumar Mukeshkumar Mehta,
Resident of Flat No.403, A Block,
Kalpa Vrikesh, 35 53 Krishna Doss Main,
Perambur, Chennai,
Tamil Nadu-600 012. ... Petitioner

-vs-

1.Deputy Commissioner of Income Tax,
TDS Circle 2(1),
BSNL Building No.120,
Greams Road, Chennai,
Tamil Nadu – 600 006.

2.The Commissioner of Income Tax, TDS,
BSNL Building No.120,
Greams Road, Chennai,
Tamil Nadu-600 006. ... Respondents

PRAYER: Writ Petition filed under Article 226 of the Constitution of India, to issue a writ of Certiorarified Mandamus to call for the records relating to the Impugned Order bearing DIN No.SO/20052023/472193 received on

12.07.2023 passed by the Respondent No.1 rejecting the Petitioner's request for grant of certificate of 'NIL' deduction of tax at source and quash the same as being in irregular exercise of jurisdiction conferred under Section 197 of the Act, and to consequentially direct the Respondent No.1 to issue to the Petitioner certificate of 'NIL' deduction of tax at source under Section 197 of the Income Tax Act, 1961.

For Petitioner : Mr.Tarun Gulati, Senior Advocate
Mr.Kishore Kunal
Ms.Ankita Prakesh
for M/s. Karthik Sundaram

For Respondents : Dr.B.Ramaswamy
Senior Standing Counsel

O R D E R

Background

By this writ petition, an order dated 12.07.2023 rejecting the petitioner's request for the grant of a certificate of 'nil' deduction of tax at source is challenged and the petitioner seeks a consequential direction to the first respondent to issue a certificate of 'nil' deduction of tax at source under Section 197 of the Income-tax Act, 1961 (the I-T Act).

2. The petitioner is an employee of Flipkart Internet Private Limited

(FIPL), which is a company incorporated in India and a wholly owned subsidiary of Flipkart Marketplace Private Limited (FMPL). FMPL is a company incorporated under the laws of Singapore and is a wholly owned subsidiary of Flipkart Private Limited Singapore (FPS).

3. FPS implemented the Flipkart Stock Option Scheme, 2012 (the FSOP 2012). Under the FSOP 2012, employees' stock options (ESOPs) were granted to option grantees, who are either employees or any other persons approved by the Board and to whom stock options were granted. The expression 'employee' was defined in the FSOP 2012 as meaning a permanent employee of a Group Company working in Singapore or outside Singapore; or a director or officer of the Group Company, whether a full time director or officer or not. The expression 'subsidiaries' was also defined in FSOP 2012 as meaning all companies owned and controlled by FPS, including the four entities expressly enumerated in the definition.

4. On 21.04.2023, FPS announced compensation of US Dollar (USD)43.67 per ESOP in view of the divestment of its stake in the PhonePe business, and described such payment as being made although there is no legal or contractual right thereto under the FSOP 2012. Such compensation

was payable to all option grantees as on 23.12.2022 (the record date), whether current or former stakeholders, in respect of vested options, whereas in respect of options that had not vested, compensation was payable only to current stakeholders. As on 23.12.2022, out of the above mentioned ESOPs, 2137 had vested in the petitioner as per the terms of the FSOP 2012 and 3787 had not vested, thereby aggregating to 5924 ESOPs of FPS under the FSOP 2012. The petitioner had not exercised the option in respect of the vested ESOPs.

5. FPS determined the compensation by valuing each option at about USD 189.10 prior to the divestment and at about USD 165.83 upon divestment. As the grantee in respect of 5924 ESOPs, the petitioner received USD 258,701.08 which is equivalent to INR 2,09,54,787.48/-. Such compensation was paid to the petitioner by deducting tax at source under Section 192 of the I-T Act by treating it as falling under the head "salary". On the basis that the amount received as compensation was a capital receipt, which is not liable to income-tax, the petitioner applied for a 'nil' tax deduction certificate under Section 197 of the I-T Act for financial year 2023-24 on 09.05.2023. Such application was rejected by impugned order dated 12.07.2023. The present writ petition was filed in the said facts and

circumstances.

Counsel and their contentions:

6. Oral arguments were advanced on behalf of the petitioner by Mr.Tarun Gulati, learned senior advocate, assisted by Mr. Kishore Kunal, Ms.Ankita Prakash and Mr.Karthik Sundaram. The respondents were represented by Dr.B.Ramaswamy, learned senior standing counsel. Both parties submitted written submissions. After orders were reserved, learned counsel for the petitioner placed on record the judgment of the Division Bench of the Delhi High Court in *Sanjay Baweja v. Deputy Commissioner of Income Tax TDS Circle, 77(1), Delhi and another ('Sanjay Baweja'), [2024] 163 taxmann.com 116 (Delhi).*

7. Mr.Tarun Gulati commenced his submissions by providing an overview of the facts. He pointed out that the petitioner was an employee of FIPL when the compensation was paid and that the said entity is a step down subsidiary of FPS. He next submitted that ESOPs are rights in relation to the shares of the entity - in this case, FPS - issuing such options. As a result, he contended that ESOPs should be treated as capital assets. By pointing out that the petitioner was granted 5924 ESOPs and continues to hold the same number of ESOPs today, he contended that there was no transfer of capital

assets. In the absence of transfer of capital assets, he further contended that capital gains tax cannot be levied. Put differently, his contention was that the compensation paid to the petitioner was a capital receipt and that capital receipts are taxable as capital gains provided such gains accrued from the transfer of capital assets. Since capital assets were not transferred by the petitioner, he reiterated that capital gains tax cannot be imposed.

8. By adverting to the impugned order, learned senior counsel submitted that it was erroneously held therein that the asset transferred by the petitioner was the relinquishment of the right to sue or litigate. As an ESOP holder, learned senior counsel contended that the petitioner had no right to receive compensation for the divestment of the PhonePe business by FPS. In the absence of a right to receive compensation, he further contended that the payment was a discretionary one time payment by FPS. Even if such compensation had not been paid, he contended that the terms of the FSOP 2012 did not confer any rights on the petitioner, including the right to sue. In this connection, he further contended that a mere right to sue is not transferable as per Section 7 of the Transfer of Property Act, 1882. Consequently, he contended that the conclusion in the impugned order that the transaction falls within the scope of Section 45 of the I-T Act is untenable.

9. Since the receipt by the petitioner was a capital receipt, learned senior counsel also submitted that the I-T Act does not provide for tax deduction at source. In the context of capital gains, he submitted that the taxable event is the difference between the acquisition price and re-sale price. Whenever such capital gains are liable to be taxed, he submitted that the I-T Act provides for a machinery for the computation thereof; whereas, he pointed out that there is no machinery with regard to the taxation of receipts, such as the compensation in relation to ESOPs. He next submitted that the impugned order calls for interference not only because the conclusion that there was a relinquishment of the right to sue is erroneous, but also because such order does not identify the provision of the I-T Act under which the petitioner is liable to pay tax or under which tax is liable to be deducted at source.

10. Learned senior counsel relied upon several judgments in support of the propositions advanced by him. In order to substantiate the proposition that the compensation received by the petitioner is in the nature of a capital receipt, he relied on the following judgments:

(i) Kettlewell Bullen & Co. Ltd. v. CIT('Kettlewell Bullen'), [1964]

53 ITR 261 (SC) ;

(ii) Karan Chand Thapar & Bros. Pvt. Ltd. v. CIT('Karan Chand Thapar'), (1972) 4 SCC 124 ;

(iii) Oberoi Hotel (P) Ltd. v. CIT('Oberoi Hotel'),(1999) 103 Taxman 236 (SC) .

(iv) Godrej & Co., Bombay v. CIT ('Godrej & Co.,') (1970) 1 SCR 527

(v) Senairam Doongarmall v. CIT ('Senairam Doongarmall), [1961] 42 ITR 392 (SC).

(vi) Commissioner of Income-tax, Gujarat v. Saurashtra Cement Ltd. ('Saurashtra Cement'), [2010] 325 ITR 422 (SC)

(vii) CIT, Bombay City v. Bombay Burmah Trading Corp., Bombay, (1986) 3 SCC 709

(viii) PCIT-7 v. Pawa Infrastructure (P) Ltd. (2023) 457 ITR 392 (Delhi)

(ix) Khanna & Annadhanam v. CIT, (2013) 351 ITR 110 (Delhi)

(x) CIT v. BK Roy, (2001) 248 ITR 245 (Calcutta)

(xi) CIT v. M Ramalakshmi Reddy, (1981) 131 ITR 415 (Mad.)

(xii) CIT v. David Lopes Menezes, (2011) 336 ITR 337

(xiii) Siemens Public Communication Network (P.) Ltd. v. CIT,

Bangalore (2017) 390 ITR 1 (SC)

(xiv) Vodafone India Services (P.) Ltd. v. UOI('Vodafone'), (2014) 368 ITR 1(Bombay)

(xv) CIT v. Deutsche Post Bank Home Finance Ltd., (2014) 265 CTR 525 (Delhi)

(xvi) CIT v. Handicrafts and Handlooms Export Corporation of India Ltd.

11. In support of the proposition that capital receipts, which are not chargeable under Section 45 of the I-T Act, cannot be taxed under any other heads, he relied upon the following judgments:

(i) CIT v. D.P.Sandhu Brothers Chembur (P) Ltd., [2005] 142 Taxmann 713 (SC) ;

(ii) Cadell Weaving Mill Co. (P) Ltd. v. CIT, [2001] 116 Taxman 77 (Bombay) .

(iii) CIT v. Vazir Sultan & Sons, (1959) 36 ITR 175

(iv) United Commercial Bank Ltd v. CIT, AIR 1957 SC 918

12. He placed reliance on *CIT v. B.C.Srinivas Setty, 128 ITR 294 (SC)* , for the proposition that capital gains tax cannot be imposed in the absence of a

computation mechanism. *Baroda Cement & Chemicals Ltd. v. CIT, [1986] 25 Taxman 324 (Gujarat)*, was relied on by him to contend that a mere right to sue cannot be transferred. For the proposition that tax cannot be deducted at source if the payment does not constitute income, he relied on the following judgments:

(i) Padmaraje R.Kadambande v. CIT [1992] 195 ITR 877 (SC)

(ii) CIT v. Shaw Wallace & Co., 6 ITC 178 (PC)

(iii) Vijay Ship Breaking Corporation v. CIT (2009) 314 ITR 309 (SC).

(iv) CIT v. Canara Bank, (2016) 386 ITE 229, P&H

13. In response to these contentions, Dr. Ramaswamy made submissions on behalf of the respondents. His first submission was that ESOPs are capital assets and that such ESOPs had a higher value while FPS held an interest in PhonePe. Upon divestment of the PhonePe business by FPS, he submitted that the value of ESOPs, including those held by the petitioner, declined. As a consequence, he contended that the petitioner had the right to sue for diminution of value. Since the compensation was paid as consideration for relinquishment of the right to sue, he contended that such relinquishment qualifies as the transfer of a capital asset.

14. By relying on the judgment of this Court in *K.R.Srinath v. Assistant Commissioner of Income-Tax, judgment dated 20.04.2004 in T.C.A.No.59 of 2002 ('KR Srinath'),* he contended that the Division Bench of this Court concluded that the relinquishment of a right to sue for specific performance of a contract relating to the purchase of immovable property on receipt of compensation is a capital receipt, which is liable to capital gains tax. Therefore, learned senior standing counsel contended that the impugned order contains no infirmity and that such order was fully in consonance with the judgment of the Division Bench of this Court in *K.R.Srinath*. According to learned senior standing counsel, the amount of compensation received by the petitioner is the capital gain and that such capital gain is taxable because it accrued from the transfer/relinquishment of the right to sue for compensation for diminution in the value of the ESOPs.

15. Learned senior counsel for the petitioner summarized his submissions as follows by way of rejoinder:

i) since the ESOPs held by the petitioner were not transferred, there was no transfer of capital assets.

ii) The I-T Act does not prescribe a computational mechanism for calculating capital gains tax in respect of the one-time discretionary compensation received by the petitioner.

iii) In the absence of a specific tax rate, capital gains tax cannot be imposed on the transaction.

iv) In contrast to the judgment in *K.R.Srinath*, the FSOP 2012 does not confer a contractual right on the petitioner to sue for specific performance. The judgment of the Hon'ble Supreme Court in *Ahmed G H Ariff and others v. Commissioner of Wealth Tax, AIR 1971 SC 1691*, is a wealth tax judgment and, therefore, inapplicable.

(v) Since the compensation received by the petitioner was a capital receipt, which was not from the transfer of a capital asset, it cannot be treated as income under any provision of the I-T Act.

Discussion, analysis and conclusions:

The FSOP 2012 and the petitioner's ESOPs

16. Upon taking stock of the rival contentions, the first aspect that warrants consideration is the FSOP 2012, particularly the relevant clauses thereof. Clause 1.2 specifies that the objective of the FSOP 2012 is to advance the interest of the stakeholders of the Group. “Group” is defined in clause

2.1.22 as meaning "the Company and its Subsidiaries". "Company" is defined as Flipkart Private Limited, i.e. FPS. The expression "Subsidiaries" is defined in clause 2.1.34 as under:

> *2.1.34 "Subsidiaries" means all companies owned and controlled by the Company including (a) Flipkart India Private Limited, a private limited company incorporated under the laws of India; (b) Digitail Management Services Private Limited, a private limited company incorporated under the laws of India; (c) Mallers Inc., a company incorporated under the laws of the State of Delaware, United States of America; and (d) Myntra Designs."*

The expression "Employee" is defined in clause 2.1.14 as under:

> *"2.1.14 "Employee" means (i) a permanent employee of a Group Company working in Singapore or outside Singapore; or (ii) a director or officer of a Group Company, whether a full time director or officer or not."*

"Group Company" is defined in clause 2.1.22 as "any member of the Group". "Option Grantee" is defined in clause 2.1.28 as "an Employee or any other person approved by the Board who has been granted Stock Options in pursuance of the FSOP 2012". "Vesting" is defined in clause 2.1.35 as "subject to the FSOP 2012, the entitlement of the Option Grantee to Exercise the Stock

Options". "Exercise" is defined in clause 2.1.15 as "the exercise of the right under the Stock Option by an Option Grantee to purchase the Shares underlying the Options vested in such Employee, in pursuance of the FSOP 2012, in accordance with the procedure laid down under the FSOP 2012". In the remainder of this judgment, all defined terms from the FSOP 2012 are capitalized to indicate that they carry the meaning ascribed thereto in the FSOP 2012.

17. In the affidavit in support of the writ petition, the petitioner states that he is a salaried employee of FIPL, which is a wholly owned subsidiary of FMPL. He further states that FMPL is a wholly owned subsidiary of FPS. In effect, the petitioner is an employee of a step down subsidiary of FPS. Because "Employee" is defined in clause 2.1.14 as *inter alia* meaning a permanent employee of a Group Company and Group is defined in clause 2.1.22 as meaning "the Company and its Subsidiaries" and "Subsidiaries" is defined in clause 2.1.34 as "all companies owned or controlled by the Company", as a permanent employee of a step-down subsidiary of FPS, the petitioner falls within the definition of Employee under the FSOP 2012. As on the record date (23.12.2022), he states that he held 2137 Vested Stock Options and 3787 Unvested Stock Options, thereby aggregating to 5924 Stock

Options. With reference to the Vested Stock Options, he also states that he has not exercised the Option. The FSOP 2012 also provides that all the Group employees are eligible for being considered for the grant of Stock Options. On examining the FSOP 2012 in light of the affidavit, without doubt, the petitioner was granted Stock Options as an Employee.

PhonePe divestment and compensation

18. As stated earlier, by communication dated 21.04.2023, FPS informed all stakeholders under the FSOP 2012 that it was paying compensation for the divestment of the PhonePe business to all the Option Grantees. For such purpose, it was stated that such compensation was determined by valuing each option at about USD 189.10 prior to the divestment and at about USD 165.83 upon divestment. The said communication, in relevant part, is as under:

> *"As you are aware, the Board of Directors (BoD) of Flipkart Private Limited, publicly announced the complete separation of PhonePe business, by selling off its entire shareholding, in Dec 2022.* ***With this announcement, the value of ESOPs granted to all stakeholders (including present and former employees in our subsidiaries in India, Israel, US, Singapore, Saudi***

Arabia, Egypt, UAE, China, etc.) will drop, along with loss of opportunity to share in future accretion in the value of PhonePe shares. While there is no legal or contractual right under FSOP 2012, to provide compensation for loss in current value or any potential losses on account of future accretion to our ESOP holders, the BoD on its own discretion, has decided to pay US $43.67 as compensation for each ESOP subject to applicable withholding taxes and other tax rules in respective countries of various ESOP holders.(emphasis added)

1. The record date for individual entitlement is December 23, 2022 therefore, the number of ESOPs held on that date is the basis for quantification of this compensation. The number of ESOPs held by you before and after pay-out would remain the same. Please also note that none of your ESOP holdings will be canceled or forfeited or deemed to be repurchased as part of this pay-out.

2. This compensation will be payable on all vested options (for current and former stakeholders) and unvested options (only for current stakeholders having an ongoing business or employment relationship) with any of our business entities in different countries."

As a current stakeholder (i.e. current employee), the petitioner received USD 43.67 each in respect of all 5924 ESOPs (2137 Vested Stock Options and 3787

Unvested Stock Options), which aggregates to USD 258,701.08 or INR 2,09,54,787.48/-. The record discloses that tax was deducted at source under Section 192 of the I-T Act while paying the compensation by classifying it as "salary". In respect of such receipt, the petitioner requested for a 'nil' certificate of tax deduction at source by filing an application under Section 197 of the I-T Act. Since the order of rejection is impugned herein, I discuss the impugned order next.

19. In the impugned order, in relevant part, the following conclusions were recorded:

> *"3. While it is agreeable that the compensation to be received is not chargeable under the head 'Salaries', the contention that the same is not taxable as Capital Gains is found to be an illogical contention....*
>
> *5. Therefore, the value of compensation to be received represents the surrender value of PhonePe holding, held by applicant while holding the Flipkart Options. Therefore, the claim that no asset was transferred is found to lack credence.*
>
> *6.....This surrender or relinquishment of right to litigate is the asset transferred so as to earn this compensation and therefore the transaction squarely falls under the provisions of S.45"*

As is evident from the above extracts, the first respondent concluded that there was a capital gain arising out of transfer of a capital asset and that this is taxable under Section 45 of the I-T Act.

20. The above conclusions were assailed on the ground that there was no transfer of a capital asset. Specifically, it was contended that the petitioner held 5924 ESOPs before the compensation was paid and continued to hold the same number of ESOPs thereafter. It was also contended that the FSOP 2012 did not confer a right to compensation on the petitioner in case of divestment and, therefore, it cannot be said that there was a relinquishment of a right to sue. Before turning to the tenability of the conclusions in the impugned order, a brief discussion on the nature of ESOPs, including those under the FSOP 2012, is necessary.

Nature of ESOPs under the I-T Act

21. The FSOP 2012, as is typical of stock option schemes, provides for the grant of Stock Options and confers on an Option Grantee the right (but not the obligation) to exercise the Option upon the Vesting thereof, and thereby receive shares of the issuing company, FPS, at a pre-determined

price. In effect, the FSOP 2012 confers rights in relation to shares, albeit exercisable subject to the terms and conditions specified therein. Being rights by way of options, the Option Grantee could choose not to exercise the Option upon the Vesting thereof. The FSOP 2012 also provides for cancellation of both Vested and Unvested Options on the occurrence of specified events. Bearing in mind these characteristics, it is useful to examine whether these rights qualify as capital assets under the I-T Act for purposes of determining the nature of the compensation received by the petitioner. The I-T Act defines capital asset in sub-section (14) of Section 2. Sub-section (14), in relevant part, is as under:

> *"(14)"capital asset" means –*
> *(a) property of any kind held by an assessee, whether or not connected with his business or profession;"*

Several exclusions from the scope of capital assets are specified thereafter. These exclusions cover any stock in trade; personal effects, i.e., movable property held for personal use, such as jewellery or paintings; agricultural land in India; gold bonds; special bearer bonds and gold deposit assets. After providing the above carve-out, Explanation 1 to sub-section (14) is as under:

> *"Explanation 1 – For the removal of doubts, it is hereby*

clarified that "property" includes and shall be deemed to have always included any rights in or in relation to an Indian company, including rights of management or control or any other rights whatsoever;"

22. Thus, in order to qualify as a capital asset as per the I-T Act, it should be property of any kind held by an assessee, including, as per the legal fiction in Explanation 1, rights in or in relation to an Indian company, such as rights of management or control. Shares are indisputably capital assets because they qualify as movable goods under the Sale of Goods Act, 1930 and the Companies Act, 2013 (CA 2013) and, consequently, fall within the scope of the expression "any property" in Section 2(14) of the I-T Act. ESOPs, by contrast, are rights in relation to capital assets, i.e. rights to receive capital assets (shares) subject to the terms and conditions of the ESOP scheme. Since the petitioner has no rights in the Indian company of which he is an employee (other than as an employee), Explanation 1 is also not attracted. It is instructive to survey precedents cited by the petitioner and the respondents before drawing conclusions on whether ESOPs are capital assets and, more importantly, on the nature of receipts in relation thereto.

23. Several judgments were relied upon by the petitioner to

substantiate the contention that the compensation received by him is a capital receipt that cannot be taxed because it did not accrue from the transfer of a capital asset, and some of the said judgments are discussed below.

24. In *Kettlewell Bullen*, the appellant therein was earlier appointed as the managing agent of Fort William Jute Company Limited. As per the contract, in the event of termination, the managing agent was to receive reasonable compensation for deprivation of office. In that context, the appellant therein relinquished the managing agency subject to receipt of compensation. While holding that the compensation received by the appellant therein was a capital receipt and not a revenue receipt, the Supreme Court observed as follows and differentiated a capital receipt from a revenue receipt:

> *"Where on a consideration of the circumstances, payment is made to compensate a person for cancellation of a contract which does not affect the trading structure of his business, nor deprive him of what in substance is his source of income, termination of the contract being a normal incident of the business, and such cancellation leaves him free to carry on his trade (freed from the contract terminated), the receipt is revenue: Where by the cancellation of an agency the trading structure of the*

assessee is impaired or such cancellation results in loss of what may be regarded as the source of the assessee's income, the payment made to compensate for cancellation of the agency agreement is normally a capital receipt"

25. Hence, in *Kettlewell Bullen,* in the factual context of the relevant contract providing for compensation for termination, the compensation received for relinquishment of the managing agency was construed as a capital receipt because it was intended to compensate for the impairment of the source of revenue or profit-making apparatus. The fact situation in *Karam Chand Thapar* was substantially similar inasmuch as monetary compensation was paid to the assessee therein for termination of a managing agency contract. The Supreme Court relied on *Kettlewell Bullen* and concluded that it is a capital receipt. In *Vodafone,* the Bombay High Court held that receipts arising out of a capital account transaction cannot be taxed as income in the absence of express legislative mandate. In *Oberoi Hotels*, the assessee was managing a hotel for a management fee, which was calculated on the gross operating profits. The contract also conferred a right of first offer if the hotel were to be transferred or leased. The assessee received compensation for relinquishing its rights. In that factual context, the Supreme Court observed that the compensation was paid for the injury inflicted on the capital asset of

the assessee. Since this resulted in the loss of the source of the assessee's income, it was construed as a capital receipt.

26. In a similar vein, the Supreme Court concluded in *Godrej & Co.* that compensation for the variation of the terms of a managing agency was a capital receipt. In *Senairam Doongarmall,* the compensation received for requisitioning the factory buildings adjoining a tea garden and for the consequential cessation of tea production was held to be a capital receipt and, in *Saurashtra Cement,* the liquidated damages received for failure to supply an additional cement plant was construed as a capital receipt. The common thread running through all these cases was that compensation was paid either for the loss of the profit-making apparatus or, at a minimum, for the sterilization thereof. Consequently, such compensation was held to be a capital receipt.

27. At first blush, the ratio of the above cases seems to apply to the case at hand because compensation was paid for the diminution in value of ESOPs and potential losses on account of future accretion to ESOP holders due to the divestment of the PhonePe business. On closer examination, however, the following significant differences are noticeable. As stated

earlier, ESOPs - and, in particular, the Stock Options in this case - are contractual rights to receive shares subject to the exercise of the option in terms of the applicable scheme. The terms of the FSOP 2012 include conditions regarding Vesting, cancellation and transfer. Consequently, only in case of breach of the obligation by the issuer to allot shares upon exercise of the Option in terms of the FSOP 2012, the petitioner would have the right to claim compensation or, arguably, to sue for specific performance. ESOPs are, therefore, contractual rights that may qualify as actionable claims (albeit not as defined in the Transfer of Property Act, 1882) or *choses in action* in certain circumstances. Unlike in the case of the managing agency or tea factory in the cases discussed in the previous paragraph, ESOPs are not a source of revenue or profit-making apparatus for the holder because these actionable claims are, intrinsically, not capable of generating revenue (notional or actual) and cannot be monetised, whether by transfer or otherwise, until shares are allotted. Even at the time of allotment, there is notional but not actual benefit. Actual benefit accrues only upon transfer provided there is a capital gain.

28. Besides, in all the cited cases, the compensation was received in relation to relinquishment of rights in revenue generating and subsisting

capital assets, such as a managing agency or tea production factory. By contrast, in the case of ESOPs, the capital assets come into existence only upon allotment of shares and revenue generation from the capital asset is possible only thereafter. In sum, in this case, the compensation was not towards the loss of or even sterilization of a profit-making apparatus but by way of a discretionary payment towards - potential, as regards Unvested Options, or actual, as regards Vested Options - diminution in value of contractual rights. This conclusion is reinforced by the communication dated 21.04.2023 that expressly refers to the compensation as being paid, without legal or contractual obligation, towards loss in value of ESOPs (and not shares) on account of divestment of the PhonePe business.

29. In addition, the FSOP 2012 does not contain any representation or warranty to ESOP holders that no action would be taken that could impair the value of the ESOPs. Put differently, there is no contractual right to compensation. In the absence of a contractual right to compensation for diminution in value, it cannot be said that a non-existent right was relinquished. As discussed earlier, the ESOP holder has the right to receive shares upon exercise of the Option in terms of the FSOP 2012 and the right to claim compensation if such right were to be breached. But, here, the

compensation was not paid for relinquishment of ESOPs or of the right to receive shares as per the FSOP 2012. In fact, the admitted position is that the petitioner retains all the ESOPs and the right to receive the same number of shares of FPS subject to Vesting and Exercise. Upon considering all the above aspects holistically, I conclude that ESOPs do not fall within the ambit of the expression "property of any kind held by an assessee" in Section 2(14) and are, consequently, not capital assets. As a corollary, the receipt was not a capital receipt. Since it was concluded in the impugned order that a capital asset was transferred, notwithstanding the above conclusion, I briefly discuss the tenability of said conclusion next.

30. In this case, it is common ground that the petitioner did not exercise the Option in respect of any Vested ESOP and, consequently, shares of FPS were not issued or allotted to the petitioner. As a corollary, the petitioner neither received nor transferred a capital asset. Since the FSOP 2012 does not confer a right to receive compensation for the impairment in the value of ESOPs, both the conclusion in the impugned order and learned senior standing counsel's contention that compensation was paid towards relinquishment of the right to sue by relying on *K.R.Srinath* is untenable. Given this conclusion, the matter could have been remanded. On

instructions, however, learned senior counsel for the petitioner confirmed that the relief claimed extends to a direction for issuance of a 'nil' certificate and that, therefore, it is not sufficient to remand the matter for reconsideration. This leads to the question as to whether and, if so, in what manner the I-T Act deals with receipts in relation to the holding of ESOPs and I turn to this issue next.

31. The I-T Act defines 'income' in sub-section (24) of Section 2. In broad terms, sub-section (24) expressly covers profits and gains; dividends; the value of any perquisite or profit in lieu of salary taxable under clauses (2) and (3) of section 17; sums chargeable to income-tax under specific clauses of Section 28; any capital gains chargeable under Section 45; and sums referred to in specific clauses of sub-section 2 of Section 56. It is significant to notice that the definition is inclusive and not exhaustive. The next aspect to be examined is the specific heads of income enumerated in the I-T Act.

32. Section 14 of the I-T Act specifies the heads of income. The heads specified therein are salaries; income from house property; profits and gains of business or profession; capital gains; and income from other sources. Salaries are dealt with in Section 15 and deal with payments due or paid by

an employer or former employer to an employee or former employee. Salary and perquisite are defined in Section 17, in relevant part, as under:

> ***"17. "Salary", "perquisite" and "profits in lieu of salary" defined.***
>
> *- For the purposes of sections 15 and 16 and of this section,-*
> *(1) "salary" includes-*
> *(iv)any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages*
> *(2) "perquisite" includes-*
> *(vi)* ***the value of any specified security*** *or sweat equity shares* ***allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee****.[Substituted by Act 33 of 2009, Section 9, for Clause (vi) (w.e.f. 1.4.2010).]*
> *Explanation. - For the purposes of this sub-clause,-*
> *(a) "specified security" means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (47/ of 1956) and,* ***where employees' stock option has been granted under any plan or scheme therefor, includes the securities offered under such plan or scheme****;*
> *(b)"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;

*(c)**the value of any specified security or sweat equity shares shall be the fair market value of the specified security** or sweat equity shares, as the case may be, **on the date on which the option is exercised by the assessee as reduced by the amount actually paid by, or recovered from, the assessee in respect of such security** or shares;"(emphasis added)*

33. It is pertinent to notice that "salary" is defined inclusively to include "perquisites" and "perquisite" is also defined inclusively as covering the value of a specified security. The expression "specified security" is defined exhaustively as securities as defined in Section 2 (h) of the Securities Contracts (Regulation) Act, 1956 and, in the context of ESOPs, as including securities offered under such plan or scheme. The expression "employees stock option" is defined in Section 2(37) of the CA 2013, as "...the option given to the directors, officers or employees of a company or of its holding company or subsidiary company or companies, if any, which gives such directors, officers or employees, the benefit or right to purchase, or to subscribe for, the shares of the company at a future date at a pre-determined

price". Thus, the ESOPs granted to the petitioner as an employee of a step-down subsidiary qualify as ESOPs under the CA 2013 and, consequently, fall within the scope of Explanation (a) to clause (vi) of Section 17(2). Against this backdrop, the specific issue of whether the compensation paid to the petitioner qualifies as a perquisite under the I-T Act falls for consideration. Before doing so, it is profitable to consider the judgment of the Delhi High Court in *Sanjay Baweja* because the above issue was considered therein in the factual context of ESOPs issued to an ex-employee of FIPL under the FSOP 2012.

34. The application of an ex-employee of FIPL under Section 197 of the I-T Act for a 'nil' certificate of tax deduction at source was rejected by the Income Tax Department in *Sanjay Baweja.* Such rejection was by treating it as a perquisite. After noticing that the value of ESOPs result in a taxable perquisite upon exercise of the option, it was held in the order of rejection that compensation paid for the diminution in fair value of underlying shares would also be taxable as a perquisite. When such rejection was challenged in a writ petition, the Delhi High Court concluded that the one-time voluntary payment was a capital receipt, which was not liable to tax as a perquisite.

35. Clause (vi) prescribes that "the value of any specified security" would qualify as and be taxable as a perquisite, if allotted or transferred, whether directly or indirectly, free of cost or at a concessional rate. Since clause (vi) is illustrative of perquisite, it is not intended to tax the capital gains that may accrue if such specified security were to be sold by the allottee after capital appreciation. Instead, as the plain language indicates, clause (vi) takes within its fold and treats as a perquisite the benefit extended to the employee or any other person from and out of the grant of specified securities at concessional rates or free of cost. Additionally, in the specific context of ESOPs, Explanation (a) to sub-section (vi) explains the scope of "specified security" by using the expression "includes the securities offered under such plan or scheme". Interestingly, the phrase 'includes the securities allotted under such plan or scheme' is not used. The FSOP 2012 is admittedly a stock option plan or scheme within the meaning of Explanation (a) to clause (vi) of sub-section (2) of Section 17. Given that the petitioner has not exercised the Option in respect of any of the 5924 ESOPs held by him, shares of FPS were not issued or allotted to him. The inference that follows is that "specified security", in the context of ESOPs, is not confined to allotted shares, but includes securities offered to the holder of ESOPs. The use of

"includes" instead of 'means' also indicates that the phrase "securities offered under such plan or scheme" is not intended to be exhaustive.

36. Clause (vi) clearly refers to the value of the "specified security" (in this case, value of the ESOP). Pursuant to communication dated 21.04.2023, discretionary compensation was paid to restore *status quo ante* as regards the value of the ESOP. In my view, the expression "value of any specified security... transferred directly or indirectly by the employer ... free of cost or at concessional rate to the assessee" in clause (vi) is wide enough to encompass the discretionary compensation paid to ESOP holders to compensate for the potential or actual diminution in value thereof. Consequently, especially in view of the inclusive definition of perquisite, merely because the method of valuing the perquisite does not fit neatly into Explanation (c) to clause (vi) of sub-section (2) of Section 17, does not mean it cannot be taxed under the sub-head perquisites of the head "salaries" provided the value of the perquisite can be determined as per clause (vi). In order to determine the value of the perquisite as per clause (vi), one should be in a position to ascertain the benefit that the employee or other person received from the specified security, albeit not by way of capital gains. Whether the compensation received by the petitioner can be valued and taxed as a "perquisite" is addressed next.

37. In order to tax an ESOP as a perquisite, the benefit flowing to the employee from the ESOP should be ascertained. Because shares are offered to employees and other stakeholders under stock option schemes either free of cost or at a concessional rate, the benefit would ordinarily be the difference between the fair market price of the share and the price at which such share is offered to the ESOP holder. Since such monetary benefit would typically be realized, albeit notionally, only at the time of exercise of the option and remains a non-monetizable contractual right until then, the fair market price of the shares as on the date of exercise of option is reckoned and the price paid by the option holder is deducted therefrom to determine the value of the perquisite in the form of ESOP. Explanation (c) to clause (vi), therefore, prescribes that the value of the specified security is the difference between the fair market value of the shares on the date of exercise of the option and the price paid by the option holder. Unusually, in the current case, the assessee received a substantial monetary benefit at the pre-exercise stage by way of discretionary compensation for diminution in value of the Stock Options. I move next to the facts so as to examine whether the value of the perquisite can be determined in these circumstances.

38. From the material on record, it is not possible to discern the exercise price under the FSOP 2012. In any event, this is not material because the petitioner has not exercised the Option in respect of any of the 2137 Vested ESOPs. Effectively, no payments were made by the petitioner under the FSOP 2012 as on the record date. Nonetheless, by qualifying as an Employee under the FSOP 2012, the petitioner received compensation at the rate of USD 43.67 per ESOP on all 5924 ESOPs (both Vested and Unvested) held by him as on the record date.

39. In *Commissioner of Income Tax, Bangalore v. Infosys Technologies Ltd. [(2008) 297 ITR 167 (SC)],* the Supreme Court considered the question whether the issuer company was liable to deduct tax under Section 192 of the I-T Act in respect of shares allotted under an ESOP scheme and subject to a lock-in for five years. The relevant assessment year was 1999-2000 when clause (iii) of sub-section (2) of Section 17 defined "perquisite" as including *inter alia* the value of any benefit provided free of cost or at a concessional rate. After noticing that the amendment made to the above provision by the Finance Act, 1999, with effect from 01.04.2000, did not apply retrospectively, it was held that the notional benefit that accrued from shares that were subject to a lock-in cannot be treated as a 'perquisite' because there was no

cash inflow to the employees till the end of the lock-in period. While the principle that a notional benefit cannot be taxed as a perquisite was formulated in a specific statutory context which no longer exists, the broader principle laid down therein to the effect that the benefit from the ESOP is to be determined for purposes of, and as a prerequisite for, taxation as a perquisite continues to apply.

40. It bears repetition that atypically, in the case at hand, actual monetary benefit was received at the pre-exercise stage by the petitioner and other stakeholders. Such monetary benefit was undoubtedly paid to the petitioner on account of being an ESOP holder at the rate of USD 43.67 per ESOP on all 5924 ESOPs held by him. For reasons discussed earlier, these ESOPs were clearly granted to the petitioner as an Employee under the FSOP 2012. If payments had been made by the petitioner in relation to the ESOPs, it would have been necessary to deduct the value thereof to arrive at the value of the perquisite. Since the petitioner did not make any payment towards the ESOPs and continues to retain all the ESOPs even after the receipt of compensation, the entire receipt qualifies as the perquisite and becomes liable to be taxed under the head "salaries". In view of the above conclusion, it is unnecessary to consider whether it falls within any other head of income.

As a consequence of the conclusion that the compensation qualifies as a perquisite and not a capital receipt, the judgments cited in respect of capital gains, including those relating to the absence of a rate or computation mechanism or provision for tax deduction at source lose relevance. For various reasons set out in this order, I am also unable to endorse the opinion of the Delhi High Court in *Sanjay Baweja.*

41. As a corollary to the above conclusions, the petitioner is not entitled to a 'nil' certificate of deduction. In effect, although the basis for the conclusion in the impugned order is flawed, the rejection of the request for a 'nil' certificate of deduction is affirmed.

42. W.P.No.26506 of 2023 is, therefore, disposed of on the above terms. No costs. Consequently, WMP Nos.25911 & 25912 of 2023 are closed.

31.07.2024

Index : Yes/No
Internet : Yes/No
Neutral Citation : Yes/No
kal

To

1.Deputy Commissioner of Income Tax,
TDS Circle 2(1),
BSNL Building No.120,
Greams Road, Chennai,
Tamil Nadu – 600 006.

2.The Commissioner of Income Tax, TDS,
BSNL Building No.120,
Greams Road, Chennai,
Tamil Nadu-600 006.

SENTHILKUMAR RAMAMOORTHY J.

kal

Pre-delivery order made in
W.P.No.26506 of 2023 &
WMP Nos.25911 & 25912 of 2023

31.07.2024