




## **Newsflash – Reporting Requirements in respect of Equity based compensation schemes offered by Foreign Companies to the Indian Employees**

## Newsflash

# Reporting Requirements in respect of Equity based compensation schemes offered by Foreign Companies to the Indian Employees

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### 1.0 Background:

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- 1.1** In an increasingly competitive talent landscape, equity-based compensation tools such as Employee Stock Option Plans, Restricted Stock Units, Stock Appreciation Rights, and Employee Stock Purchase Plans have become more popular among the multinational corporations (MNCs) and start-ups and being used as a key talent retention strategy.
- 1.2** With the emergence of cross-border employment and globalization, these stock-based compensation strategies by multinational corporations across the globe serve as powerful tools for talent retention, motivation, and alignment of employee interests with corporate objectives. However, such compensation mechanisms come with multifaceted implications as they are governed by the Indian tax laws, foreign exchange regulations, and corporate governance frameworks.
- 1.3** With startups and multinational corporations offering generous equity packages, it is crucial for both employers and employees to understand the tax and regulatory implications of these instruments under Indian law. This Newsflash explores the various stock compensation options offered by foreign entities to Indian employees, and the corresponding reporting requirements under Indian laws.
- 1.4 Various types of equity compensation instruments that are being offered to the employees by the Companies across the globe are as under:**
- **Employee Stock Option Plans (ESOPs)** - ESOPs are the most widely used instrument. They provide employees with the option to purchase company shares at a predetermined price (exercise price) after a specified period (vesting period).
  - **Employee Stock Purchase Plans (ESPPs)** - ESPPs allow employees to purchase shares of the company, often at a discount, through payroll deductions over an offering period.
  - **Restricted Stock Units (RSUs)** - RSUs represent a promise to issue company shares in the future, subject to vesting. No payment is required by the employee. They are taxable upon vesting.
  - **Stock Appreciation Rights (SARs)** - SARs give employees the right to receive the appreciation in value of a certain number of shares over a period, usually paid in cash or equity. No actual shares are bought or sold unless exercised.

## 2.0 Implications under Income-Tax Act, 1961 ('The Act')

2.1 In accordance with the provisions of Section 15 of the Act, the following income shall be chargeable to income tax under the head "Salaries":

- a) any salary due from an employer or a former employer to an assessee in the financial year, whether paid or not;
- b) any salary paid or allowed to him in the financial year by or on behalf of an employer or a former employer though not due or before it became due to him;
- c) any arrears of salary paid or allowed to him in the financial year by or on behalf of an employer or a former employer, if not charged to income tax for any earlier financial year.



2.2 As per section 17(iv) of the Act, the term "Salary" includes Perquisite, and the term "perquisite" is defined to include—

Section 17(2) : "perquisite" includes —

- "(i).....
- (ii)....
- (iii)....
- (iv)....
- (v)....
- (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.**

Explanation. — For the purposes of this sub-clause (vi),—

- a) **"Specified security" means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and, where employees' stock option has been granted under any plan or scheme therefore, 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 employee as reduced by the amount actually paid by, or recovered from, the employee in respect of such security or shares;**

d) "fair market value" ('FMV') means the value determined in accordance with the method as may be prescribed;

e) "option" means a right but not an obligation granted to an employee to apply for the specified security or sweat equity shares at a predetermined price;

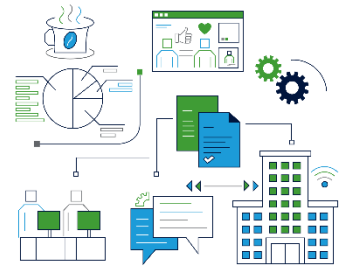
(vii)....

(viii)...."

**2.3** As per section 15(b) of the Act, any salary paid or allowed to employee in the financial year by or on behalf of an employer shall be chargeable to Income-tax under the head 'Salaries'.

## **2.4 Obligation to deduct withholding tax under section 192 of the IT Act**

- As per section 192(1) of the Act, every person who is responsible for paying any income chargeable under the head "Salaries" shall at the time of payment deduct income tax on the amount payable at the average rate of income-tax computed on the basis of the rates in force for the financial year in which the payment is made on the estimated income of the assessee under the head "Salaries" for the financial year.
- As per section 192(3) of the IT Act, the person responsible for making the payment may, at the time of making any deduction, increase or reduce the amount to be deducted under this section for the purpose of adjusting any excess or deficiency arising out of any previous deduction or failure to deduct during the financial year.
- Further, as per section 204 of the Act, for the purpose of TDS compliances a "person responsible for paying" in the case of payments of income chargeable under the head "salaries" has been defined as the employer himself or if the employer is a company, the company itself, including the principal officer thereof.
- In view of above, the perquisite value will be added to the salary income of the employees and imposes an obligation on the company to comply with the withholding tax provisions under section 192 of the IT Act in respect of taxability of perquisite discussed hereinabove.
- Since the taxability of perquisite arises in the year in which the option was exercised, failure to comply with any of the withholding tax provisions may create exposure to company such as interest, late filing fees, penalty etc. at such rates prevailing in the relevant financial year.



**2.5** In case of delayed payment of withholding tax, interest is payable at simple rate of 1.5% per month (month of *deduction* till the month of payment).

## **2.6 Tax Implications on subsequent transfer of shares**

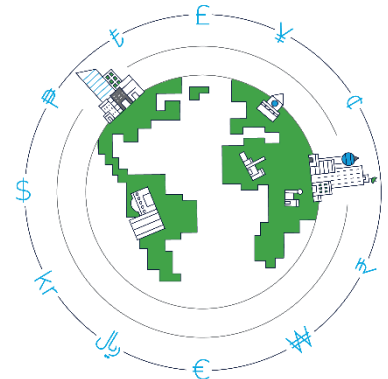
- In the event of grant of stock options in the form of shares and subsequently any income arising out of sale or transfer or any other mode of disposition of such shares shall be regarded as Capital Gain which is chargeable under Section 45 of the IT Act. Capital Gain is computed by reducing the cost of shares from the sale consideration.

- For the purpose of computation of capital gains, the fair market value of the security considered for the purpose of determination of the perquisite would be treated as cost of acquisition. Thus, the capital gain shall be the difference between the sale proceeds on transfer of shares and the FMV considered for the purpose of perquisite. Further, an employee can claim deduction of any expenditure that he may incur wholly in connection with such sale of shares.
- The capital gain is further categorized either as short-term capital gains or long-term capital gains depending on the holding period. In case the holding period of shares exceeds 24 (12 months in case of shares listed on Indian recognised stock exchange) months, it shall be considered as long-term capital gain whereas if the shares are sold within period of 24 months (12 months in case of shares listed on Indian recognised stock exchange), it would be regarded short term capital gain.
- The capital gains tax is considered as personal tax liability of employee and there is no obligation on the company in this regard from WHT perspective in case of grant in the form of shares. Hence, the employee should ensure to discharge personal tax liability within the prescribed time limit.

### 3.0 Implications under Foreign Exchange Management Act, 1999 (“FEMA”):

**3.1** Issuance of ESOPs or any other securities by a foreign company to India resident employees would tantamount to the issuance of foreign securities and therefore be treated as a capital account transaction. Accordingly, issuance of ESOPs by the foreign companies is subject to FEMA and Reserve Bank of India (“RBI”) regulations.

**3.2** The key regulatory framework governing overseas investments (including issuance of ESOPs by a foreign company) to a person resident in India is contained in Foreign Exchange Management (Overseas Investment Rules), 2022 which are to be read in conjunction with Foreign Exchange Management (Overseas Investment) Regulations, 2022 and the Foreign Exchange Management (Overseas Investment) Directions, 2022 issued by the RBI (together hereinafter referred as “Overseas investment regulations”), as amended from time to time.



**3.3** As per the overseas investment rules, the terms ODI and OPI are defined as under:

- **Overseas Direct Investment (ODI):** Investment by way of acquisition of unlisted equity capital of a foreign entity, or subscription as a part of the memorandum of association of a foreign entity, or investment in 10 percent, or more of the paid-up equity capital of a listed foreign entity or investment with control where investment is less than 10 percent. of the paid-up equity capital of a listed foreign entity
- **Overseas Portfolio Investment (OPI):** Investment, other than ODI, in foreign securities, but not in any unlisted debt instruments or any security issued by a person resident in India who is not in an IFSC

**3.4** The regulations also permit a resident individual to acquire, without limit, shares or interest under ESOP or Employee Benefit Scheme (EBS) or sweat equity shares as offered by the overseas entity subject to –

- a) resident individual being an employee or a director of
  - an office in India or a branch of an overseas entity or
  - a subsidiary in India of an overseas entity or
  - an Indian entity in which the overseas entity has direct or indirect equity holding; and
- b) issue of ESOP or EBS by the issuing overseas entity is done globally on a uniform basis.

The expression '*indirect equity holding*' has been defined to mean indirect foreign equity holding through a special purpose vehicle or step-down subsidiary.

**3.5** Further, the Foreign Exchange Management (Overseas Investment) Directions, 2022 provides that the Resident individuals are permitted to acquire foreign securities or interest without any limit. However, the value of such securities or interest to be remitted to the foreign entity would be deemed as remittance under Liberalised Remittance Scheme (LRS).

In other words, if an individual intends to USD 400,000 on exercise of the ESOPs in a financial year, he / she is permitted to remit the same. However, the individual's LRS limit of USD 250,000 would stand fully utilized towards this and no further remittance under LRS would be allowed during the relevant financial year. RBI approval must be obtained to remit the amount in excess of the amount as permitted under LRS scheme.

## 4.0 Reporting requirements:

### 4.1 From employer perspective

#### 4.1.1 Reporting requirements under Income-tax Laws:

- ✓ The employer is under an obligation to withhold tax on perquisite under the head 'Salaries' and deposit the same with the Central Government within the prescribed timeline. i.e., 7<sup>th</sup> of the succeeding month in which perquisite is determined and paid to the employee.



- ✓ The Employer must also furnish quarterly withholding tax return to report the perquisite value in the hands of the employees and corresponding taxes withheld by the employer.

#### 4.1.2 Reporting requirements under FEMA

- ✓ In case the investment by the resident individual in a foreign entity including acquisition of shares through ESOP or EBS or any other scheme qualifies as OPI i.e., less than 10% of

equity or control in the entity, the employer must report the details of such investment in Form OPI in accordance with regulation 10(3) of OI Regulations. Form OPI is a semi-annual reporting which needs to be reported within 60 days from the end of half-year periods ending March 31st and September 30th and therefore, to be filed by May-end and by November-end of every year, respectively.

## 4.2 From Employee Perspective

### 4.2.1 Reporting requirements under Income-tax Laws:

- The employee being Indian tax resident is required to report foreign assets held by him / her and details of foreign income earned during the year in their personal Income Tax Return. This mandates Indian employees to report the ESOPs, securities, interest held in the foreign entities in the annual tax return in which such rights are exercised.
- For instance, the shares allotted by foreign company to a resident employee qualify as foreign assets and the details are required to be disclosed in Schedule FA of the income-tax return form. Schedule FA of the Income Tax Return (ITR) mandates disclosure of foreign assets held by the taxpayer as on the last day of the relevant calendar year, i.e., 31st December.
- **Timing of reporting in Schedule FA:** - In case the employee is a Resident and ordinarily resident (ROR) in India, the details of all foreign assets or accounts in respect of which they are a beneficial owner, a beneficiary or the legal owner, is required to be mandatorily disclosed in the Schedule FA.

**Beneficial owner** in respect of an asset means an individual who has provided, directly or indirectly, consideration for the asset and where such asset is held for the immediate or future benefit, direct or indirect, of the individual providing the consideration or any other person.

**Beneficiary** in respect of an asset means an individual who derives an immediate or future benefit, directly or indirectly, in respect of the asset and where the consideration for such asset has been provided by any person other than such beneficiary.

- In the context of ESOPs or RSUs granted by foreign companies, reporting obligations arise based on the stage of entitlement - grant, vesting, or exercise.
  - I. **At the time of Granting:** From a legal and conceptual perspective, the mere grant of ESOPs or RSUs does not constitute ownership of a foreign asset or a legally enforceable right or ownership. These are merely contractual rights that may or may not crystallize in the future, subject to fulfilment of service or performance conditions. As such, they may not qualify as assets or financial interests as per the reporting tables in Schedule FA. Consequently, no reporting may be required at the grant stage.
  - II. **When the options are Vested:** Once the options vest, it may be stated that they have an economic right; however, until exercise is completed, no shares are allotted, and no equity or capital asset is created in the hands of the employee. Moreover, vested but unexercised ESOPs are often non-transferable, and may be forfeited upon

termination of the employment, which further supports the position that they do not constitute a capital asset or a financial interest.

Even after vesting, if the employee has not yet exercised the option or received the shares, no reporting in Schedule FA is legally required, since vested but unexercised ESOPs are typically non-transferable, non-marketable, and lack enforceable ownership rights. Hence, at the vesting stage, these are still not considered reportable assets. However, once shares are allotted upon exercise of ESOPs or vesting of RSUs, the employee acquires legal and beneficial ownership of the shares, and such shares become reportable in Schedule FA. The appropriate reporting table in Schedule FA must be selected based on the nature of the holding, direct equity or other capital asset.

However, given these broad definitions of “beneficial owner” and “beneficiary” under the ITR rules, the revenue may argue that a resident employee may be regarded as a beneficial owner of vested ESOPs, especially if they have fulfilled service conditions. Accordingly, a conservative approach would be to disclose vested ESOPs/RSUs, even if unexercised, as a financial interest or under Other Capital Assets.

III. **Upon Exercise of options:** Once the options are exercised and shares / securities being allotted to the employee, he must report the same under Schedule FA of the ITR.

- Such Indian employees receiving ESOPs/RSUs from a foreign company are required to disclose the details of the foreign demat under the relevant section of **Schedule FA** (i.e., **“Foreign Custodial Account held (including any beneficial interest)”** of the Income-tax Return). Additionally, the employee must also report the details of the foreign company in which such shares are held under the **“Financial Equity and Debt interest held (including any beneficial interest) in any entity”** section of Schedule FA.
- In conclusion, while the technical position may support disclosure only post-exercise, the risk-sensitive and conservative practice especially for senior executives or those with substantial foreign holdings would be to voluntarily disclose vested ESOPs in Schedule FA to ensure transparency and avoid litigation.
- Further, where the employee’s total income exceeds Rs. 1 crore during the concerned financial year, they will be required to report details of cost of acquisition of such shares outside India in Schedule AL as well.
- **Remittance under LRS:** As clearly stated above, the exchange control regulations allow remittance towards the ESOPs issued by the foreign entity under LRS scheme wherein the amount up to USD 250,000 can be remitted by the Indian employee to acquire ESOPs subject to the prescribed annual LRS threshold. However, the employee must obtain prior approval to remit any amount in excess of the annual LRS threshold.

#### 4.2.2 Reporting requirements under FEMA

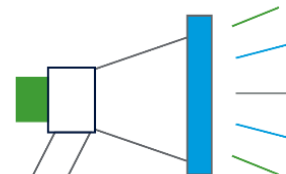
- In case the investment i.e., the securities allotted to the employee qualifies as ODI, the resident individual must report the transaction in Form FC.

#### 4.3 Reporting requirements are summarised as under:

Particulars	OPI	ODI
<b>Applicable Form</b>	Form OPI	Form FC
<b>Reporting requirement</b>	Half yearly	Yearly
<b>Timeline</b>	Within 60 days from the end of half year (Financial Year)	At the time of making outward remittance
<b>Late Submission Fee i.e., delay in reporting</b>	INR 7500	INR 7500 plus 0.025% (Amount involved * No. of years)
<b>LRS threshold</b>	Applicable	Applicable
<b>Annual Performance Report</b>	Not required	Required
<b>Income-tax</b>	<ul style="list-style-type: none"> <li>The employer must take care of withholding tax obligations and relevant filing requirements.</li> <li>The employee must report details of foreign assets including shares acquired through ESOP / EBS / any other scheme in annual tax return.</li> </ul>	

#### 5.0 Our Comments:

- 5.1** From a compliance perspective, we must determine whether the transaction would qualify as an ODI or OPI. If it qualifies as OPI, the employer concerned is liable to report the transaction whereas in the case of ODI, the employee is liable to report in the prescribed form.
- 5.2** Under erstwhile regime, the Indian entities were required to file a simple and prescribed statement of shares allotted or repurchased by the issuing foreign entity under ESOP at the end of each financial year. However, the acquisition of shares through ESOPs/EBS has been now shifted from the previous annual reporting in Form ESOP to the current half-yearly reporting in Form OPI.
- 5.3** Also, it is pertinent to note that the cashless ESOPs which were not required to report in Form ESOP would now may require to be reported in Form OPI as there is no differentiation between cashless and cash-based ESOPs under new regulatory framework.
- 5.4** It is pertinent to note that under new reporting framework, the reporting obligations are not just limited to the company but also on the Indian resident employees. However, from a practical standpoint, the companies that offer share-based compensation schemes or benefits to their Indian resident employees would also need to employ proper systems, practices and processes to assist the latter with their compliance obligations under applicable exchange laws.



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