

ITAT: Allows purchase price of shares under Group ESOP Plan as revenue expenditure to Morgan Stanley

Jun 30, 2022

Morgan Stanley Advantage Services Pvt. Ltd [TS-511-ITAT-2022(Mum)]

Conclusion

Mumbai ITAT allows Assessee's appeal and holds that the expenditure on account of purchase of shares issued as ESOP is revenue in nature, thus, allowable under Section 37(1); Assessee-Company i.e., Morgan Stanley Advantage Services Pvt. Ltd. engaged in the business of rendering front and back office support to the Morgan Stanley group of companies globally, was disallowed the claim towards ESOP cost as a revenue expenditure under Section 37(1) under AY 2016-17; Revenue held that the cost incurred on account of ESOP is capital in nature as the expenditure is incurred as regards to issue of shares; CIT(A) dismissed Assessee's appeal treating the same as infructuous; ITAT notes that Morgan Stanley group has implemented an Equity Incentive Compensation Plan (EICP) to attract, retain and motivate employees of the Assessee and to compensate them for their contribution to the growth of the company; Further notes that Assessee entered into an agreement with MSDW International Employee Services LLC (MSDW), an associated enterprise, which makes awards, stock option to selected employees of the Assessee which are convertible into shares of M/s Morgan Stanley in accordance with the EICP; Observes that amount incurred by MSDW towards stock option cost is rechargeable to the Assessee by way of debit note; Notes that the Assessee makes payment to MSDW on the basis of the market price of the shares as on the date of allotment of shares to the employees, for which a deduction is claimed in the year of payment; Observes that the stock option cost payable to MSDW for the stock units are accrued over the life of the stock units i.e. between grant and conversion based on the market price of the underlying shares on the date of grant of the stock units and thus, holds that there is no question of prior period expenses being claimed; Relies on CBDT circular No. 9 of 2007, on fringe benefit tax arising on allotment or transfer of specified securities or sweat equity shares, where for Question No. 16, it is mentioned that when the employer purchases the shares and then subsequently transfers such shares to its employees, the expenditure so incurred is allowable as deduction in computing the taxable income of the employer company, however, if the shares are allotted to the employees from the share capital of the company, no deduction is allowable; Remarks that Revenue misplaced the CBDT circular; Further relies on co-ordinate bench ruling in *Goldman Sachs* and Special Bench ruling in [Biocon](#), wherein it was held that discount on issue of ESOP is allowable as deduction under the head "Profits & Gains of Business or Profession" and holds that the expenditure claimed by the assessee on account of ESOP is allowable as business expenditure under section 37(1):ITAT Mum

Decision Summary

The ruling was delivered by the Division Bench of Mumbai ITAT comprising Shri Kuldip Singh, Judicial Member and Shri Gagan Goyal, Accountant Member.

Advocate Dr. Sunil M. Lala appeared for the Assessee while the Revenue was represented by Mr. Amol B. Kirtane.

IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH "E", MUMBAI
BEFORE SHRI KULDIP SINGH, JUDICIAL MEMBER AND
SHRI GAGAN GOYAL, ACCOUNTANT MEMBER

ITA No. 1083/Mum/2021 (A.Y. 2016-17)

Morgan Stanley Advantage Services Pvt. Ltd.
Athena Building No.5, Sector-30,
Mindspace, Goregaon (West),
Mumbai-400090

PAN: AAECA3400B

..... Appellant

Vs.

Commissioner of Income Tax (Appeals),
National Faceless Appeals Centre,
Delhi.

..... Respondent

Appellant by	:	Sh. Sunil M. Lala
Respondent by	:	Sh. Amol B. Kirtane
Date of hearing	:	20/06/2022
Date of pronouncement	:	27/06/2022

ORDER

PER GAGAN GOYAL, A.M:

This appeal by the assessee is directed against the order of Commissioner of Income Tax (Appeals), National Faceless Appeals Centre (NFAC), Delhi. [hereinafter referred to as 'the CIT(A)'] vide order dated 11.12.2018 for the Assessment Year (AY) 2016-17. The assessee has raised the following grounds of appeal:

"Ground 1: Disallowance of expenditure claimed towards Employee Stock Option Scheme (ESOP) under section 37(1) of the Income-tax Act, 1961 (Act) amounting to Rs 1,84,75,816.

In this regard, the learned CIT(A)/ learned Assessing Officer has, on the facts and circumstances of the case and in law, erred on the following grounds:

(i) In not appreciating that the ESOP cost is incurred wholly and exclusively for the purpose of business and is in the nature of revenue expenditure and thereby, deductible under section 37(1) of the Act.

(ii) In erroneously concluding that the Appellant has not incurred any expenditure but has forgone the benefit or income by receiving lesser amount of premium without appreciating the fact that the amount paid by the Appellant is merely towards the recharge of stock option units granted to its employees by group entity and no shares are issued by the Appellant.

Ground 2: In Initiating penalty under section 271(1Xc) of the Act for disallowance made in respect of expenditure claimed towards ESOP cost.

On the facts and circumstances of the case, the learned Assessing Officer erred in initiating penalty proceedings under section 271(1)(c) of the Act for the disallowance made in respect of expenditure claimed towards ESOP cost in the Final Assessment Order.

Ground 3: Erroneously dismissing the appeal filed by the Appellant with the Commissioner of Income Tax (Appeals)-20 [now migrated to the Commissioner of Income Tax (Appeals), National Faceless Appeal Centre] on the ground that the appeal is infructuous since the Appellant has opted for the Vivad Se Vishwas Scheme (VSV),

In this regard, the learned CIT(A) has, on the facts and circumstances of the case and in law, erred on the following ground:

(i) *In erroneously concluding that the appeal by the Appellant filed against the CIT(A) Order is settled under the Direct tax Vivad se Vishwas Act 2020, and consequentially, erroneously dismissing the appeal by treating it as infructuous.*

Each of the grounds of appeal referred above is separate and may kindly be considered independent of each other.

The Appellant craves leave to add to, alter, amend or withdraw all or any of the Grounds of appeal herein above and to submit such statements, documents and papers as may be considered necessary either at or before the hearing of this appeal as per law."

2. Brief facts of the case are that the assessee is company filed its return of income on 17.11.2016 for AY 2016-17 declaring total income of Rs. 2,38,13,60,120/-.The case was selected for scrutiny and notices were issued under section 143(2) of the Income Tax Act, 1961 (for short 'the Act'). In response

to the aforesaid notices, Authorized Representative (AR) of the assessee furnished the details as called for.

3. The assessee-company is engaged in the business of rendering front office and back office support to the Morgan Stanley group of companies globally. The assessee-company has shown income under the heads "Business & Profession", "Capital Gains" and "Income from Other Sources".

4. During the course of assessment proceedings, the assessee was given a show-cause notice regarding allowability of claim towards the cost of Employees/Options Plans (ESOP) **pertaining to the prior period.**

5. During the course of assessment proceedings, the assessee was again given a show-cause notice regarding dis-allowability of claim towards the cost of Employees/Options Plans (ESOP) treating the same as being capital in nature.

6. The view of the AO on the matter of allowability of ESOP are reproduced as under:

"ESOP is nothing more than a expenditure related to issue of shares (capital in nature). As per provisions of section 37(1) of the Act it is amply clear that any expenses which is capital in nature is not allowable as expenditure for the purpose of computing "Income from Business"

Sec 37(1) of the Act reads as under

37(1) Any expenditure (not being expenditure of the nature described in section 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purchases of the business or profession shall be allowed in computing the income chargeable under the head "Profits and gain of business or profession."

Reliance is also placed on Explanatory circular on Fringe Benefit Tax arising on allotment or transfer of specified securities or sweat equity shares (Circular No. 9/2007 F.No. 142/25/2007 TPL)

Vide Question no. 16 CBDT has mentioned as under:

Q-16 Whether the fringe benefit arising on account of shares allotted or transferred under an ESOP is allowed as deduction in calculating the taxable income of the employer company?

Ans: In case whether the employer purchases the shares and then subsequently transfers such shares to its employees, the expenditure so incurred is allowable as deduction in computing the taxable income of the employer company. However, if the shares are allotted to the employees from the share capital of the company, no deduction is allowable in computing the taxable income of the company since no expenditure has been incurred by it.

At the outset, we wish to state that there is no specific provision under the A the deductibility of stock based incentive cost recharged/allocated to the local entity the present case) on account of shares allotted by foreign entity (in the instant case MSDW to the employees of MSAS) under a global incentive plan.

We wish to invite your attention to the provisions of section 37(1) of the Act which grants deduction for expenses not specifically set out in other sections, stated below:

“Any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the Assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head “Profits and gains of business or profession.

Thus, as per the provisions of sections of section 37(1) of the Act, a general deduction is allowed for an expense which is not covered under specific provisions, if the following conditions are satisfied:

- The expense is not of a capital nature;*
- The expense is not a personal expenditure;”*

7. For sake of clarity and to understand the issue meaning and understanding of the term ESOP is as under:

“Employee Stock options plans (ESOPS) give employees the right to purchase a certain number of shares in the company at a fixed price for a given period. The purchase price, also known as the strike price, is usually the market value of the stock on the date that the options are granted, in most cases, employees must

wait until the options are vested (usually four years (before exercising their right to buy shares at the strike price. Ideally, the market value of the stock will have increased during the vesting period, so that employees are able to purchase shares at a significant discount. The difference between the strike price and the market price at the time the options are exercised is the employees' gain. Once employees own stocks rather than options to buy stocks, they can either hold the shares or sell them on the open market. Further, various terminologies used at the time of issue of ESOP are as under

- a. Vesting means the process by which the employee gets the right to apply for and be issued shares of the company under the options granted to him.
- b. Vesting period means the period over which the vesting of the options of the employee takes place.
- c. Exercise period means the time period after vesting within which the employee should Exercise his right to buy the shares by payment of the option price on the options vested in him. If the exercise period lapses the vested option lapses and no right shall accrue to thereafter.
- d. Strike Price is usually the market value of the stock on the date that the options are granted.
- e. The act of exercise implies an application being made by the employee to the company to have the options vested in him issued as shares upon payment of the option price.

f. *Exercise can take place as specified after vesting.*

From the above what can be perused as is ESOP is nothing more than a expenditure related to issue of shares (capital in nature). As per provisions of section 37(1) of the Act it is amply clear that any expenses which is capital in nature is not allowable as expenditure for the purpose of computing "Income from Business"

8. We have perused the order passed by Id. CIT(A) who has gone beyond the facts raised in the appeal by the assessee and returned finding against the facts on record, which are as under:

"The appeal was instituted on 08/01/2019 against the order dated 11/12/2018 passed u/s 143(3) of the Income-tax Act, 1961 by the ACIT, Circle 12(3)(2), Mumbai, for the A.Y. 2016-17. Subsequently, the appeal was migrated to the National Faceless Appeal Centre in terms of Notification No. 76 of 2020 dt. 25.09.2020 in S.O. 3296(E) issued from the CBDT (A&J Division).

2. *It is noted that the appellant has opted for the Vivad Se Vishwas Scheme vide application dated 07/12/2020. Pursuant thereto, the PCIT, Mumbai-4 has certified the payment of Rs. 258673/- as taxes in terms of Form No.5 dated 25/02/2021, which has been paid by the appellant. In view of this, the appeal is treated as infructuous as per the provisions of the Direct Tax Vivad Se Vishwas Act, 2020.*

3. *Accordingly, the appeal is treated as dismissed for statistical purposes."*

9. Appellant has entered into an agreement with MSDW International Employee Services LLC, an associated enterprise towards granting stock option to its employees. MSDW makes awards, stock option to selected employee of appellant which are convertible into shares of M/s Morgan Stanley in accordance with the MS EICP. The amount incurred by MSDW towards stock option cost is rechargeable to the appellant by way of debit note.

10. MS Group has implemented and Equity Incentive Compensation Plan (EICP) to attract, retain and motivate employees of appellant and to compensate them for their contribution to the growth of appellant. The shares of MS are listed on New York Stock Exchange and are tradable in open market.

11. MSDW makes a settlement with appellant in consideration of the stock units and subsequently charge the cost incurred by on a cost basis to appellant. Appellant makes payment to MSDW on the basis of the market price of the shares as on the date of allotment of shares to the employees of appellant, a deduction for the same is claimed in the year of payment. **Hence, there is no question of prior period expenses claimed.**

12. The expenses payable (stock option cost) to MSDW for the stock units are accrued MSAS over the life of the stock units (i.e. between grant and conversion) based on the market pr of the underlying shares on the date of grant of the stock

units. The provision debited to the pr and loss account over the life of the stock units (including foreign exchange fluctuation loss, disallowed while computing the total income for MSAS (kindly refer to Annexure F of tax audit report furnished as Annexure 4 of our submission dated 15 May 2018). MSAS makes payment to MSDW on the basis of the market price of the shares as on date of allotment of shares to the employees of MSAS. A deduction for the same is claimed in year of payment (kindly refer to Annexure E of tax audit report furnished as Annexure 4 of submission dated 15 May 2018). These shares allotted to employees are taxable as perquisite in the hands of employees and taxes are withheld on the same by MSAS and deposited into the Indian Government Treasury (the same is also submitted in our submission dated 12 November 2018).

13. We have considered and put reliance on explanatory circular on fringe benefit tax arising on allotment or transfer of specified securities or sweat equity shares (Circular No.9/2007, F. No. 142/Purchase/2007-TPL).

14. Vide Question no. 16 CBDT has mentioned as under:

"Q-16 Whether the fringe benefit arising on account of shares allotted or transferred under an ESOP is allowed as deduction in calculating the taxable income of the employer company?"

Ans: In case whether the employer purchases the shares and then subsequently transfers such shares to its employees, the expenditure so incurred is allowable as deduction in computing the taxable income of the employer company. However, if the shares are allotted to the employees from the share capital of the company, no deduction is allowable in computing the taxable income of the company since no expenditure has been incurred by it."

15. CBDT Circular mentioned (supra) is misplaced by the AO, whereas it clearly deals with the issue under consideration and segregate the situation in two parts

i.e. allowable and disallowable. Facts of the assessee fall in the category of allowable one and this Circular is binding in nature over the Income Tax Authorities.

16. In addition to above and without being prejudice, we have gone through and relied upon following judicial precedents as under:

1. DCIT v. Accenture Services (P) Ltd. (2010) IT. Appeal No. 4540 (Mum-Trib.);
2. Novo Nordisk India (P) Ltd. V DCIT ((2014) 42 taxmann.com 168 (Bang-Trib.))
3. Biocon Limited v. CIT [(2013) 35 taxmann.com 335 (Special Bench Bang-Trib.);
4. M/s Goldman Sachs (India) Securities Pvt. Ltd. v. DCIT (ITA No. 6912/ Mum/2012, 222/Mum/ 2014, 902/Mum/2016); and
5. S.S.I Limited V DCIT (2004) 85 TTJ 1049]
6. CIT v. PVP Ventures Ltd. 1 (2012) taxmann.com 386 (Madras)
7. CIT v. Lemon Tree Hotels Ltd. (ITA 107/2015)
8. PCIT v. NDTV (ITA 107/2017)
9. Kotak Mahindra Bank Ltd. (ITA No. 698/Mum/2016).

17. In the case of Goldman Sachs (I) Securities Pvt. Ltd. v. DCIT (ITA No. 6912/ Mum/2012, 222/Mum/ 2014, 902/Mum/2016), the jurisdictional bench of Tribunal held as under:

“70. Brief facts are, in the course of assessment proceedings, the Assessing Officer noticing that the assessee has claimed deduction of Rs. 20,31,56,936, on account of ESOP cost called upon the assessee to justify the claim. In response, it was submitted by the assessee that it grants Restricted Stock Units (RSU), to its employees that derive their value from the shares of Goldman Sachs Group Inc. as per policy of global stock award plan. The sum payable by the assessee to Goldman Sachs Group Inc. In respect of RSUs is determined with reference to the value of the shares of GST on the date of vesting of RSU. The value of RSU is amortized over three years and assessee marks to market the value of such RSU over a three year period in its books of account. The Assessing Officer, however, did not accept the contention of the assessee. Relying upon the decision of the Tribunal, Delhi Bench in Ranbaxy Laboratories Ltd., he disallowed assessee's claim of deduction. Though, assessee challenged the disallowance before the DRP, the Panel also sustained the disallowance agreeing with

the Assessing Officer that it is a contingent liability till such time assessee actually pays it.

71. We have considered the submissions of the parties and perused the material available on record. We have noted that identical issue of deduction claimed on account of ESOP arose for consideration in assessee's own case for assessment year 2009-10 before the Tribunal in ITA no.222/Mum./2014. The Tribunal vide order dated 30th November 2015, held as under:-

"12.3. Before us, the Ld. Senior Counsel drew our attention to the decision of the Special Bench of the Bangalore Tribunal in the case of Biocon Ltd 144 ITD 21 (Bang) wherein on similar facts the discount on issue of ESOP was allowed as deduction.

12.4. The Ld. DR could not bring any distinguishing decision in favour of the Revenue. Respectfully following the decision of the Special Bench (supra), we hold that discount on issue of employees stock options is allowable as deduction in computing the income under the head profits and gains of business of profession. Ground No. 5 & 6 are accordingly allowed."

72. No material difference in facts having been brought to our notice by the learned Departmental Representative, respectfully following the decision of the co-ordinate bench as referred to above, we allow assessee's claim of deduction and delete the addition made by the Assessing Officer.

18. As discussed in the preceding paragraph, issue raised in this case by the assessee as to allowability of ESOP cost being in the nature of Revenue expenditure has already been decided by the Special Bench of Tribunal in case of Biocon Ltd. 144 ITD 21 (Bangalore). The Co-ordinate Bench of Tribunal also in case of Goldman Sachs (I) Securities Pvt. Ltd. (supra), decided the issue in favour of the assessee by holding that discount on issue of ESOP is allowable as deduction under the head "Profits & Gains of Business or Profession". So the expenditure claimed by the assessee on account of ESOP under section 37(1) of the Act is allowable. So, the impugned order passed by Id. CIT(A) directing the AO to delete the disallowance.

19. Ground No.2 is consequential in nature and based on the findings given against ground no.1, hence, no separate adjudication is required.

20. Ground No.3 is also allowed treating order of Id. CIT(A) as absurd and passed without considering the facts and law applicable.

21. In the result, appeal of the assessee is allowed.

Order pronounced in the open court on 27th day of June, 2022.

Sd/-
(KULDIP SINGH)
JUDICIAL MEMBER
Mumbai, दिनांक /Dated: 27/06/2022
SK, Sr.PS

Sd/-
(GAGAN GOYAL)
ACCOUNTANT MEMBER

Copy of the Order forwarded to :

1. अपीलार्थी/The Appellant ,
2. प्रतिवादी/ The Respondent.
3. आयकर आयुक्त (अ) / The CIT(A)-
4. आयकर आयुक्त CIT
5. विभागीय प्रतिनिधि, आय. अपी. अधि., मुंबई/DR, ITAT, Mumbai
6. गार्ड फाइल/Guard file.

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BY ORDER,

(Dy./Asstt. Registrar)
ITAT, Mumbai