



Share based employee benefit plans – economics, taxation, accounting & regulation-

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Types of Schemes

Employee Stock Option Plan
(ESOP)

Employee Stock Purchase Plan
(ESPS)

Stock Appreciation Scheme
(SARS)

Restricted Stock Units (RSUs)

Phantom Stocks

Key terminologies (1/2)

Employee

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graph TD; Employee[Employee] --> CompaniesAct[Companies Act, 2013]; Employee --> SEBI[SEBI (SBEB and Sweat Equity) Regulations, 2021];
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Companies Act, 2013

Rule 12 of SHA Rules

Includes

- permanent employee of the company who has been working in India or outside India
- director of the company, whether WTD or not but excluding IDs;
- an employee of a subsidiary, in India or outside India, or of a holding company of the company

Excludes*

- an employee who is a promoter or a person belonging to the promoter group; or
- director or through relative or any body corporate, directly or indirectly, holds more than 10% of the outstanding equity shares of the company.

**not applicable in case of startups up to 10 years from date of its incorporation or registration – similar exemption in case of listed entities has not been provided.*

SEBI (SBEB and Sweat Equity) Regulations, 2021

In case of SBEB - regulation 2(h)

Includes

- permanent employee as designated by of the company, who is exclusively working in India or outside India
- director of the company, whether WTD or not, including a NEDs other than promoter or member of promoter group, but excluding IDs
- employee of a group company/subsidiary/ associate company, in India or outside India, or of holding company of the company

Excludes

- an employee who is a promoter or a person belonging to the promoter group; or
- director or through relative or any body corporate, directly or indirectly, holds more than 10% of the outstanding equity shares of the company.

Key terminologies (2/2)

Grant

- Process through which company issues benefits
- Employee is offered the options/rights

Grant date

- Date on which compensation committee approves the grant

Vesting

- Process by which the employee becomes entitled
- To receive benefits of grant made to him/her under the scheme

Vesting period

- Period during which the vesting of option, SAR or a benefit granted under any of the scheme takes place

Exercise

- Application by employee for issue of share or cash
- Against option/SAR vested in employee

Exercise period

- Period after vesting period
- Within which employees can exercise the right vested upon them

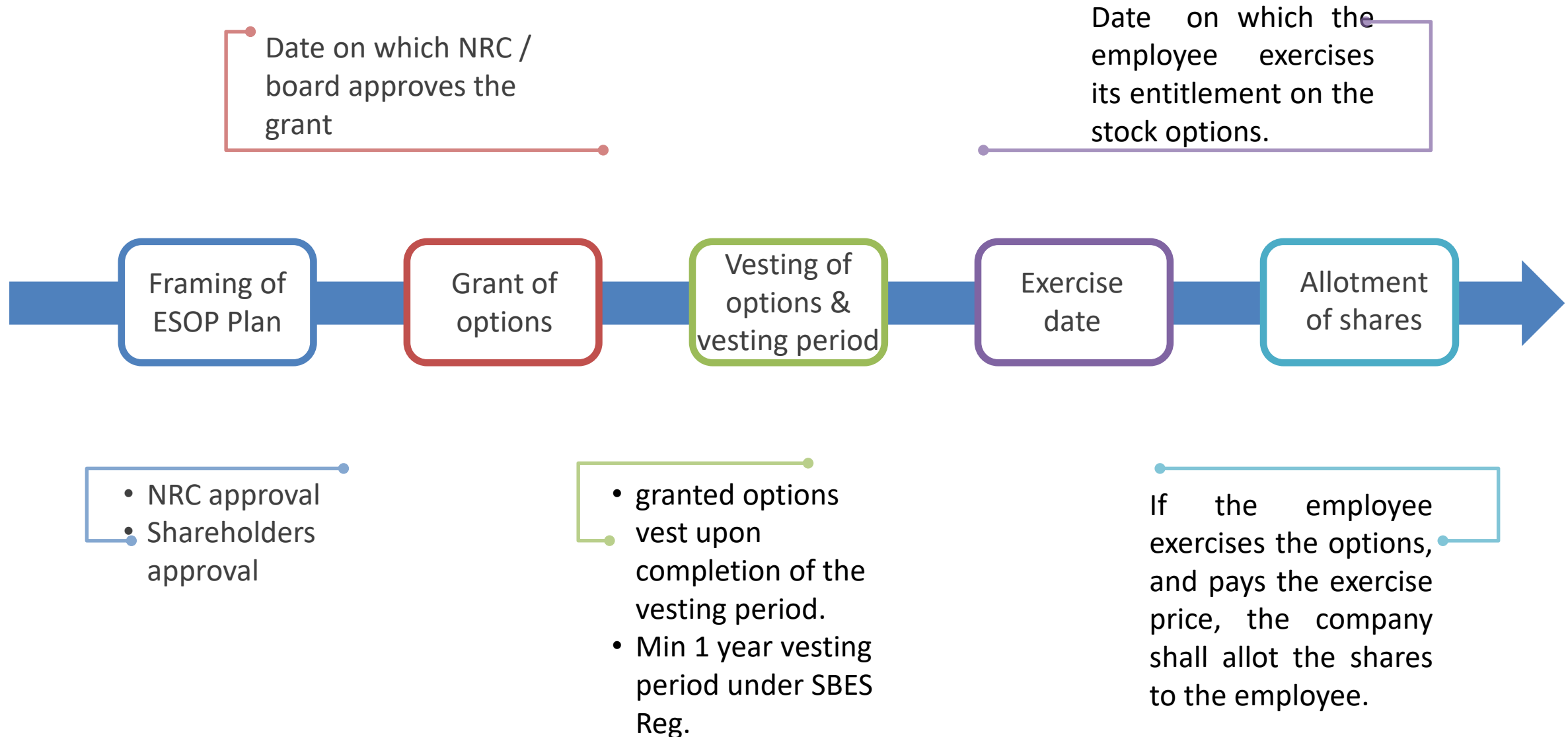
Exercise price

- Price, if any, payable by an employee
- MP 1 day prior to the NRC meeting approving grant

Lock-in

- Period, if any, during which the shares received pursuant to exercise can't be sold by the employee

Life cycle of ESOPs



ESOPs and RSUs

- ESOP refers to:
 - a right, but not an obligation,
 - granted to eligible employees
 - to purchase or subscribe to a specified number of shares of the company
 - at a fixed pre-determined price i.e. the exercise price on a future date.
 - Employee can exercise his option after the minimum vesting period
- The exercise price remains fixed even if the market price goes up in future.
- RSUs are same – except that offered to more senior level employees

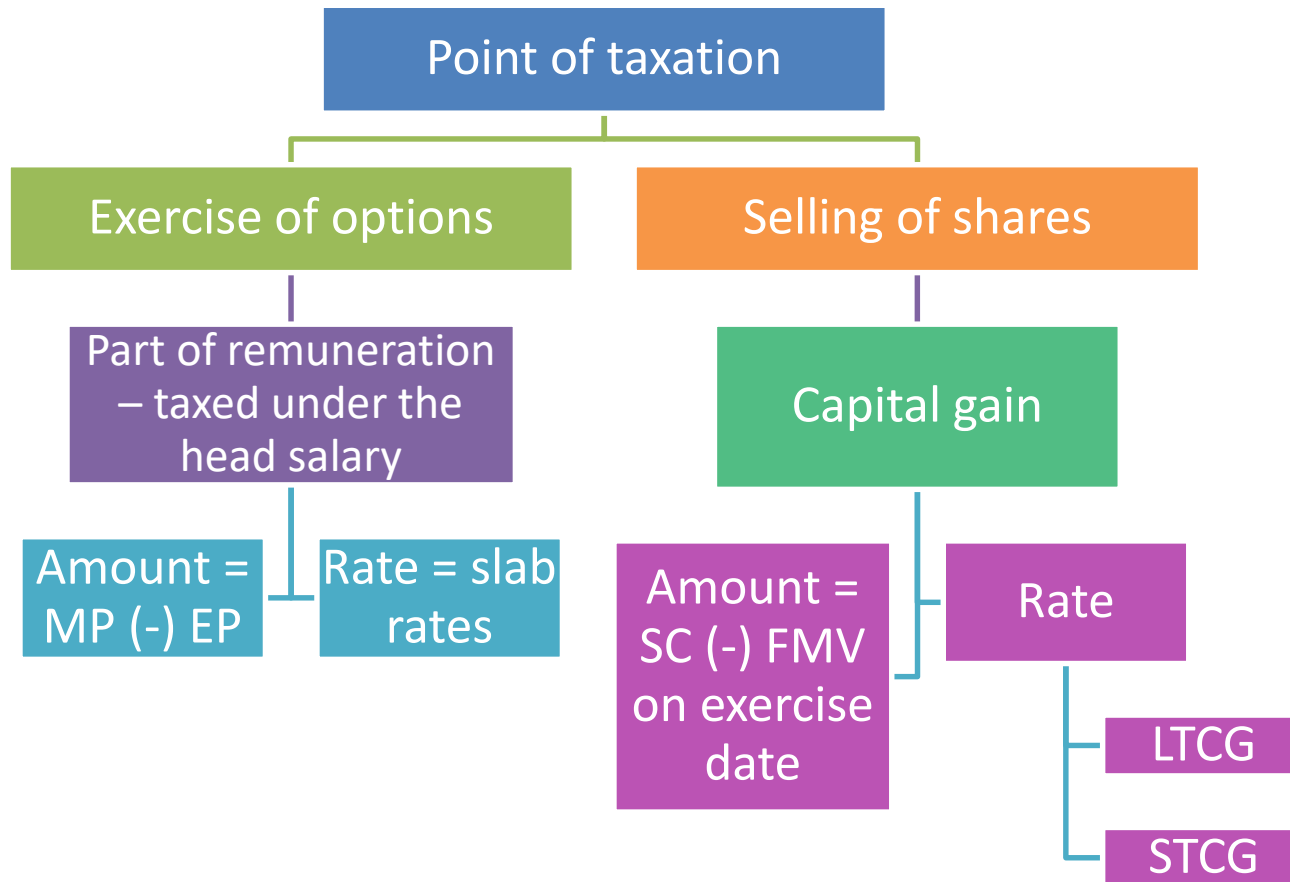
Economics for the employer

- Tax deduction available u/s 37
- No cash outflow
- Tool for deferred compensation
- Leads to dilution of share capital
- CTC

Economics for the employee

- Ownership in the company
- No mandatory post allotment lock-in
- Tax on two instances

Taxation aspects



- Eg: 200 options granted to an employee. Exercise price = Rs. 100 FMV on exercise date = Rs. 150 Sale price = Rs. 300 FMV on date of sale = Rs. 300

Perquisite = MV on date of exercise (-) Exercise Price

$$= 150 (-) 100$$

$$= \mathbf{Rs. 50}$$

CG = Sale price (-) FMV on exercise date

$$= 300 (-) 150$$

$$= \mathbf{150}$$

ESPS

- In ESPS
 - an employee has an option to purchase the shares of the company
 - at a certain discounted price on the date of scheme
 - as a part of public issue or through a trust (may undertake secondary acquisition) or otherwise
- No conditions are laid down for purchase
- However, there are restrictions on the sale of the securities

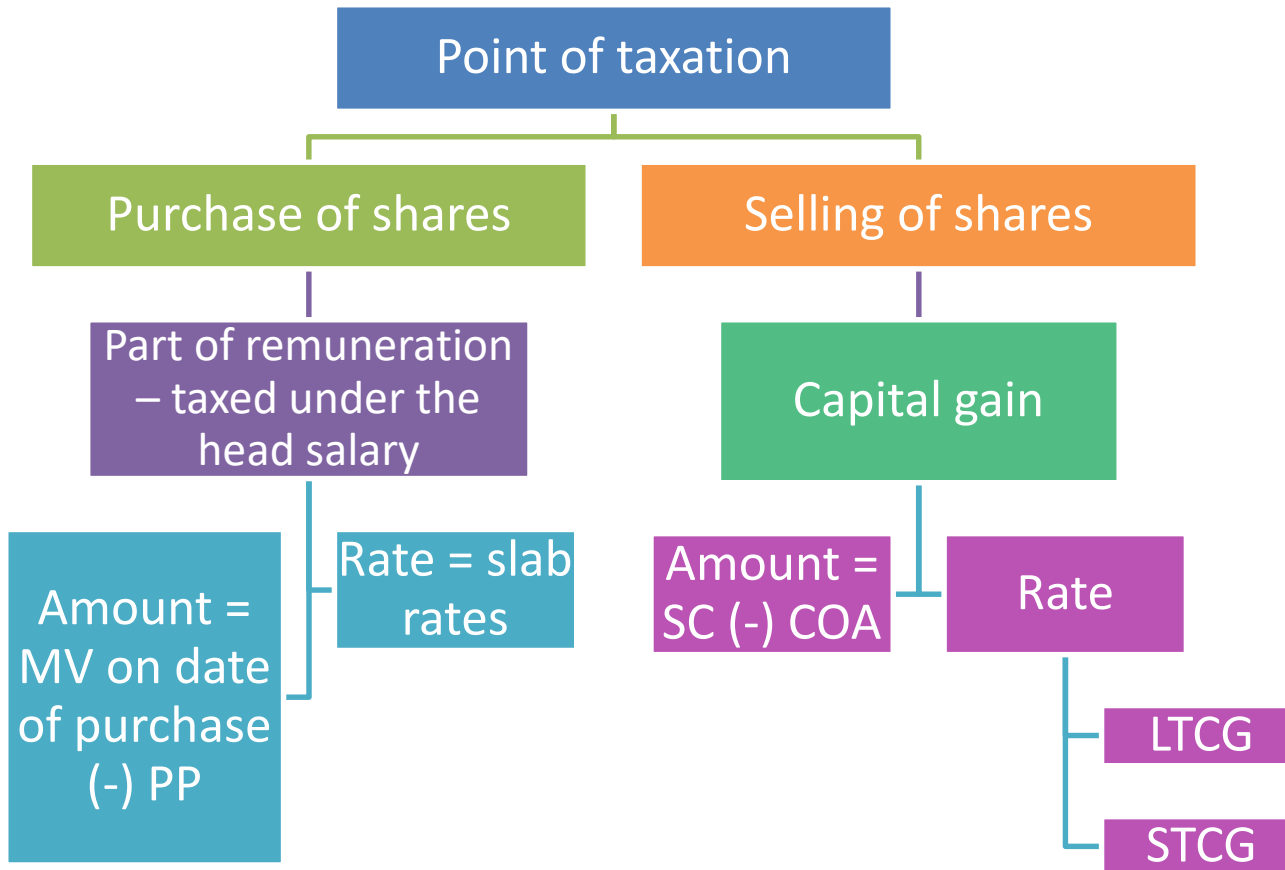
Economics for the employer

- No cash outflow
- CTC of the company
- Lower expense as compared to other schemes
- Lower retention

Economics for the employee

- Shares available at lower than market price
- No vesting period
- Lock-in period

Taxation aspects

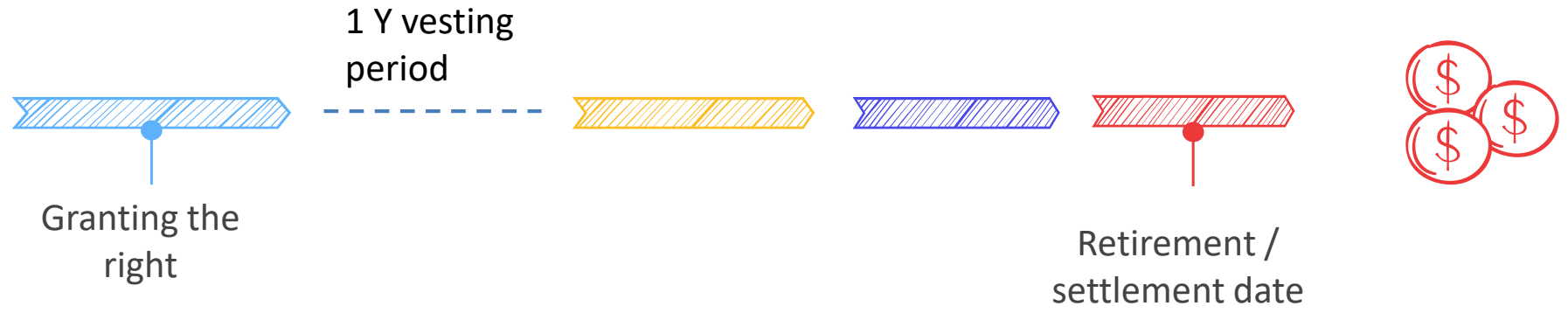
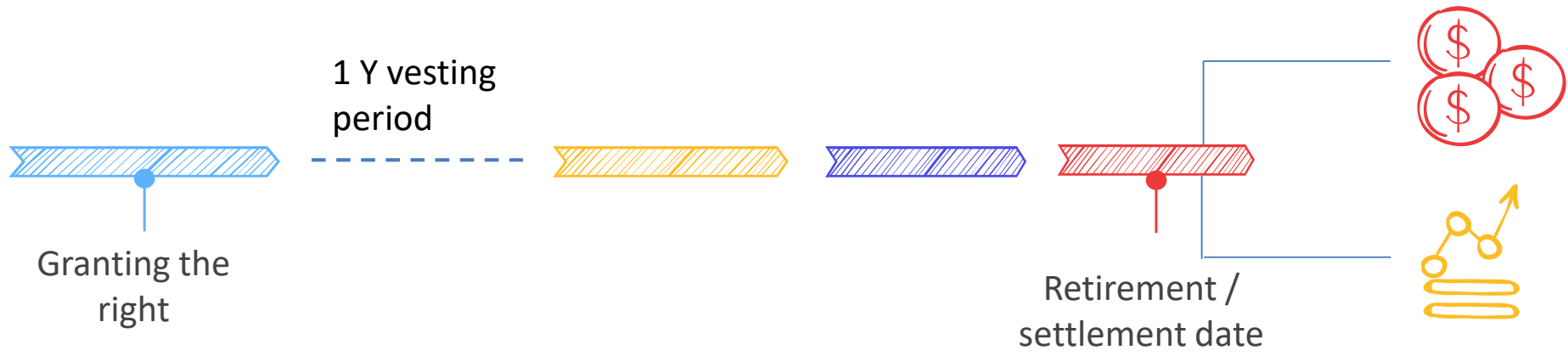


Eg: 200 shares granted to an employee.
Purchase price = Rs. 100 FMV on purchase date = Rs. 150 Sale price = Rs. 300

Perquisite = MV on date of purchase (-)
Purchase Price
= 150 (-) 100
= **Rs. 50**

CG = Sale price (-) FMV on purchase date
= 300 (-) 150
= **150**

SARs & Phantom Stocks



SARs & Phantom Stocks

- SARs refer to

Rights entitling employees to **receive cash or shares** for an amount equivalent to the appreciation in the value of shares over a specific period

- Appreciation = Difference between exercise value and base value

- Results in two forms of underlying entitlements at the time of exercise of SARs

By way of shares referred to as equity settled SARs

By way of cash referred to as cash settled SARs.

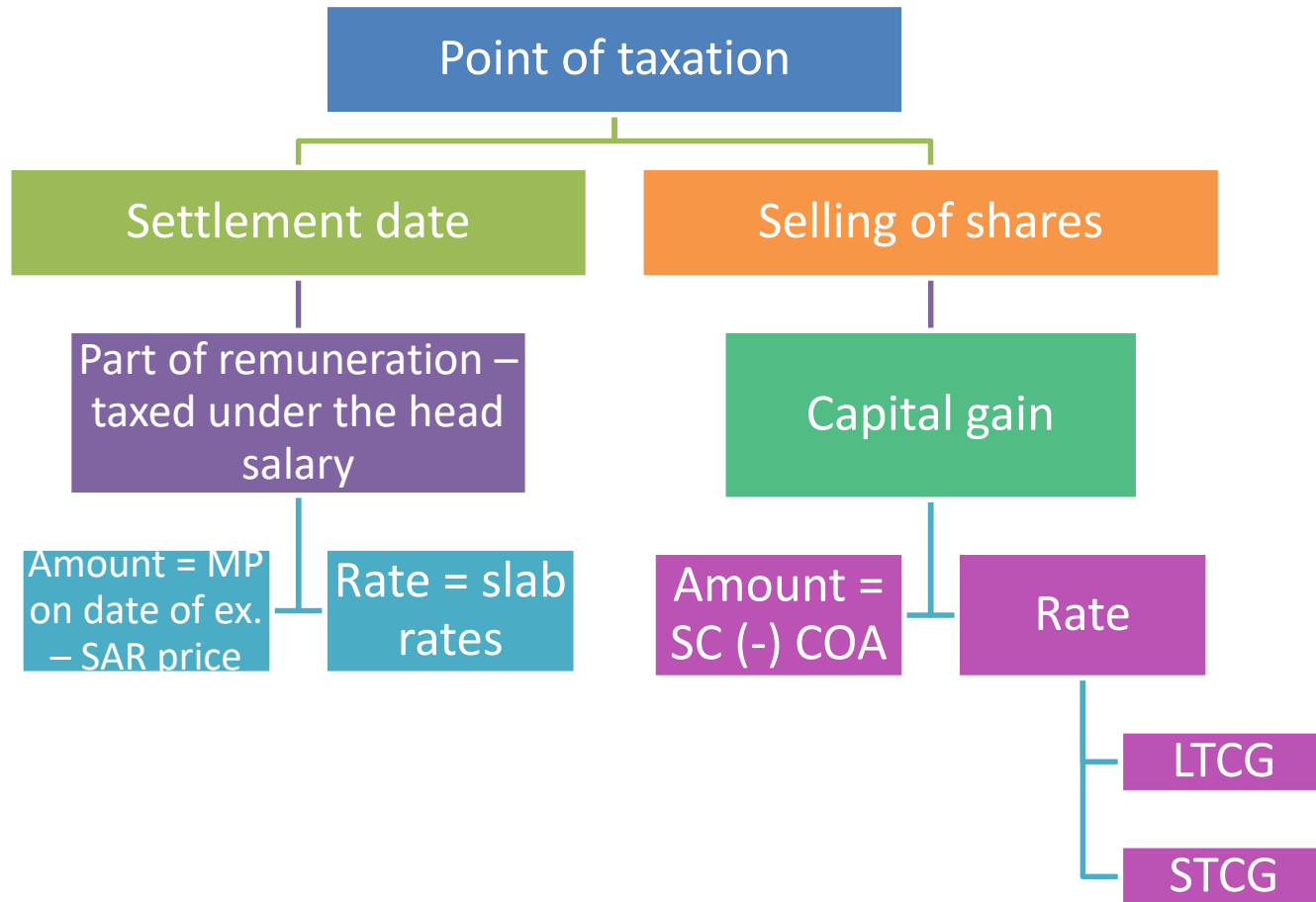
Economics for the employer

- Does not necessarily lead to dilution of share capital
- In case of cash settled SARs – cash outflow is high

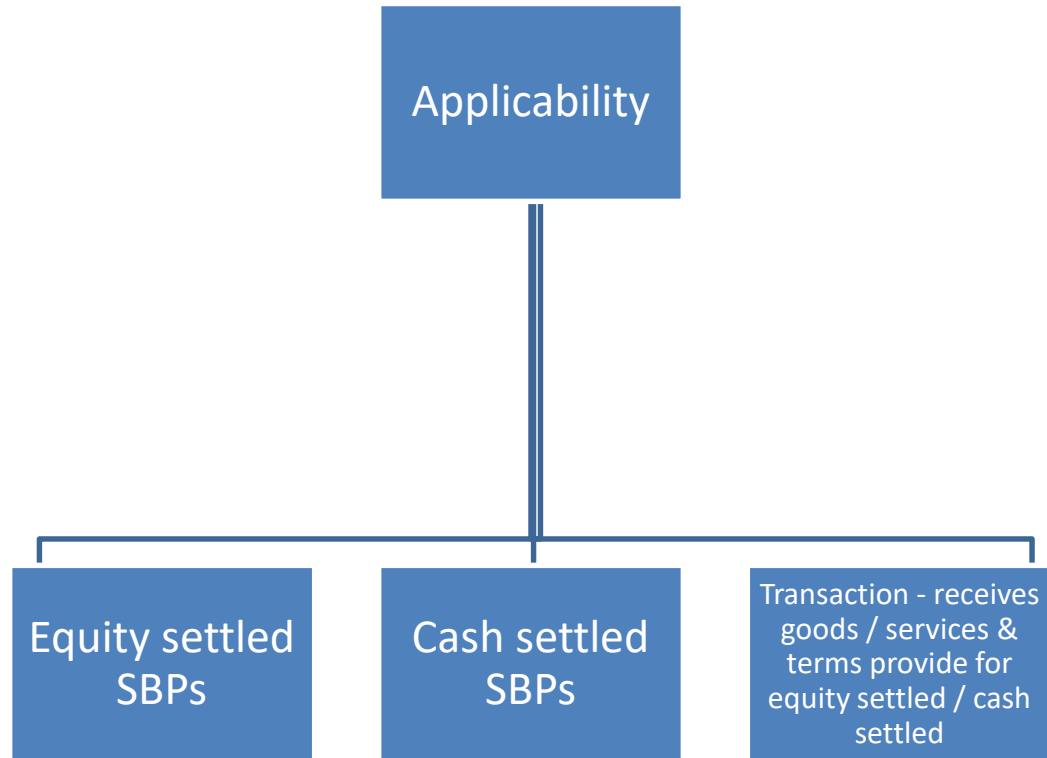
Economics for the employee

- No mandatory lock-in period
- No cash outflow
- Can be a deterrent in case an employee wants equity stake

Taxation aspects



Accounting aspects – Ind AS- 102 (1/3)



- In case of equity settled – *viz.* ESOPs, RSUs, the asset / expense is recognised over the vesting period and a corresponding increase in equity is made
- In case of cash settled *viz.* SARs, the asset / expense when received / incurred shall be recognised with a corresponding increase in liability. The liability shall be remeasured a FV at the end of each reporting period until settled.

Accounting aspects – Ind AS- 102 (2/3)

Equity settled

	Grant date	Vesting date	Exercise date
Determination of FV	-	-	-
Estimation of no. of options expected to vest	Yes	Adjustment according to actual options vested	-
Recognition of expenses over the vesting period	-	At the end of each vesting period	-
Transfer of employee stock option reserve to the equity share capital	-	-	Yes

- **At the end of each vesting period**

Employee Compensation Exp A/c ... Dr
 To O/s stock expense a/c

P/L A/c ... Dr

To Employee Compensation Exp A/c

(being compensation expense recognized in respect of the ESOP)

- **At the time of exercise**

Bank A/c ... Dr {options x exercise price}

O/s Stock Exp A/c ... Dr {carrying amount}

To Share Capital a/c {shares x FV}

To Securities Premium Reserve { }

(being shares issued to the employees against the options vested in pursuance of ESOP)

Accounting aspects – Ind AS- 102 (3/3)

- A company shall recognise goods / services received – when obtains goods / receives services
- If goods / services received in an equity settled SBP – corresponding increase in equity OR
- If goods / services received in a cash settled SBP – corresponding increase in liability
- If not possible to recognise as asset – recognise as expense
- **When will services be said to be received or when will expense be recognised?**
 - over the vesting period, if any
 - or else on grant date i.e. immediate vesting
- On what value?
 - Fair value
- No relevance of exercise period

Case A- All options have not vested as performance conditions could not be satisfied

Illustration: A company gives 100 options each to 500 employees. Vesting period = 3 years. FV = Rs. 15. Expected forfeiture = 3% per year. EP = Rs. 50. MP on the date of exercise is Rs. 100

Here, the recognition of expense will be as under:

	1 st Y end	2 nd Y end	3 rd Y end
Grant date estimation	$100 * 97 / 100 = 97$	$97 * 97 / 100 = 94.09$	$94.09 * 97 / 100 = 91.27$
Total no. of options			$91.27 * 500 * 15 = 6,84,525$
Recognition over the vesting period (684525/3)	2,28,175	2,28,175	2,28,175

Employee Compensation A/c ... Dr 2,28,175
 To outstanding stock options A/c 2,28,175

Bank A/c ... Dr { $91.27 * 500 * 50$ } 22,81,750
 Outstanding stock options A/c ... Dr 6,84,525
 To ESC { $91.27 * 500 * 10$ } 4,56,350
 To SPR 25,09,925

P/L A/c ... Dr 2,28,175
 To Employee Compensation Exp A/c 2,28,175

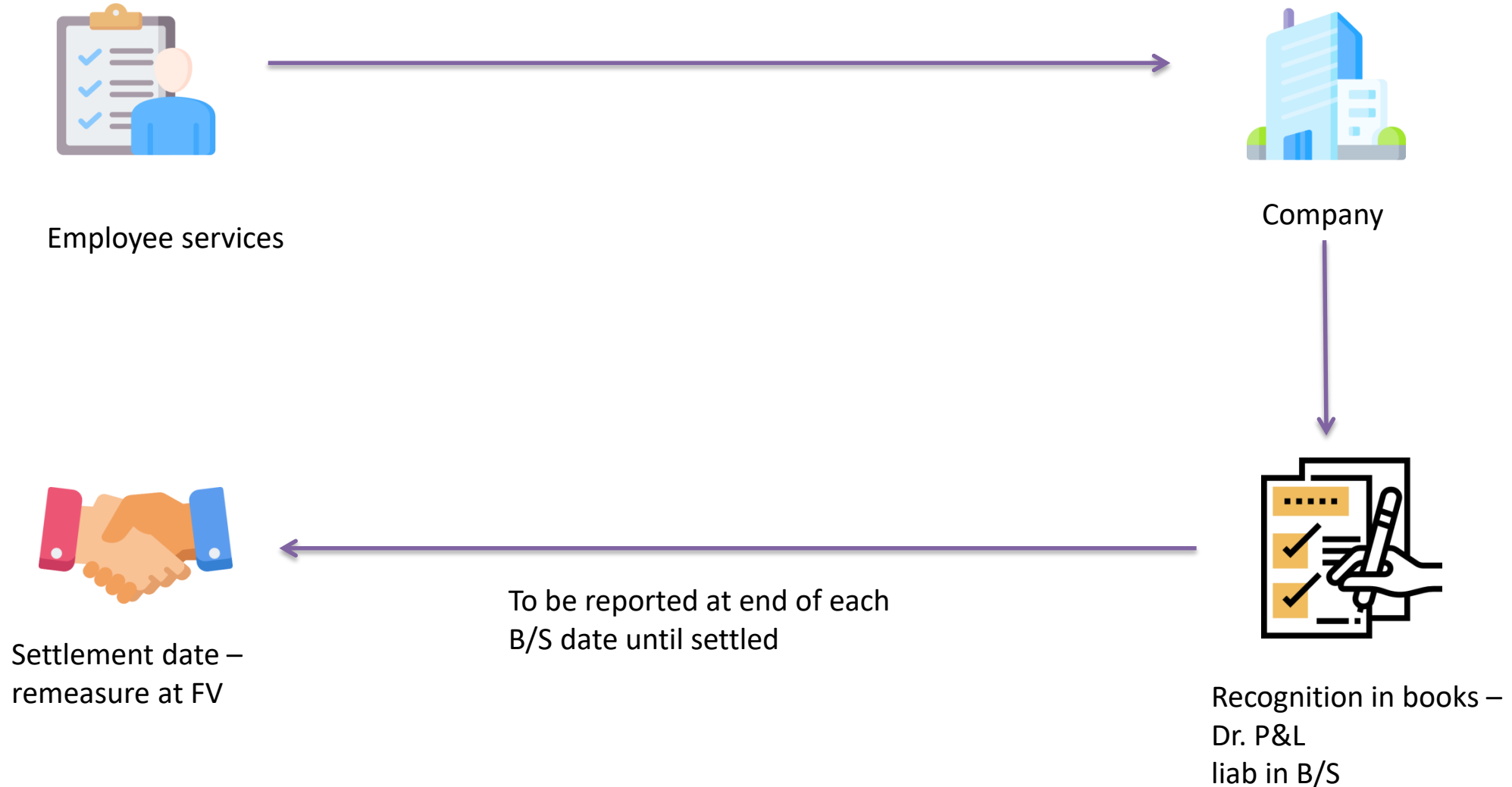
Case B- Some vested options have not been exercised and have been lapsed / forfeited

- If option has been vested but employee does not exercise / option gets forfeited
 - NO adjustment after the vesting date
 - NO reversal
 - Exception – company can recognize transfer within equity

Employee Compensation A/c ... Dr 2,28,175	Outstanding stock options A/c 2,28,175
To outstanding stock options A/c ... Dr 2,28,175	To General Reserve A/c 2,28,175

P/L A/c Dr.. 2,28,175
To Employee Compensation Expense A/c 2,28,175

Accounting aspect – Ind AS- 102 - cash settled (1/3)



Accounting aspects – Ind AS- 102 (2/3)

Cash settled

	Grant date	Vesting date	Exercise date
Determination of FV	-	-	-
Determination of FV at the end of every B/s date	-	Yes	-
Recognition of expenses over the vesting period	-	Yes	-
Transfer of employee stock option reserve cash	-	-	Yes

- **At the end of each vesting period**

Employee Compensation Exp A/c ... Dr
 To Share Based Payment Liability

P/L A/c Dr...

To Employee Compensation Exp A/c

(being liability recognized in respect of the cash settled options)

- **At the time of exercise**

Share Based Payment Liability A/c ... Dr {carrying amount}
 To Cash a/c

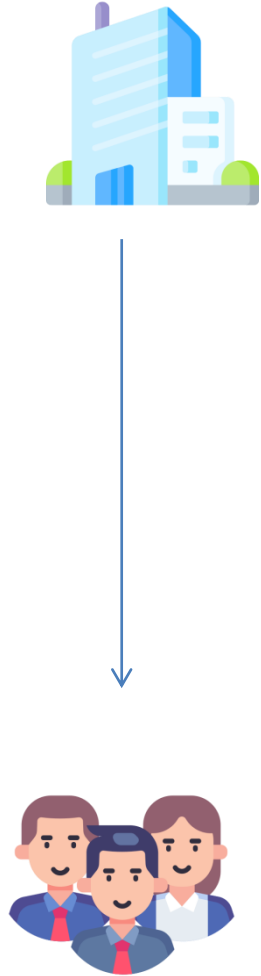
(being cash paid to the employees against the exercise of cash settled options)

Accounting aspects – Ind AS- 102 (3/3)

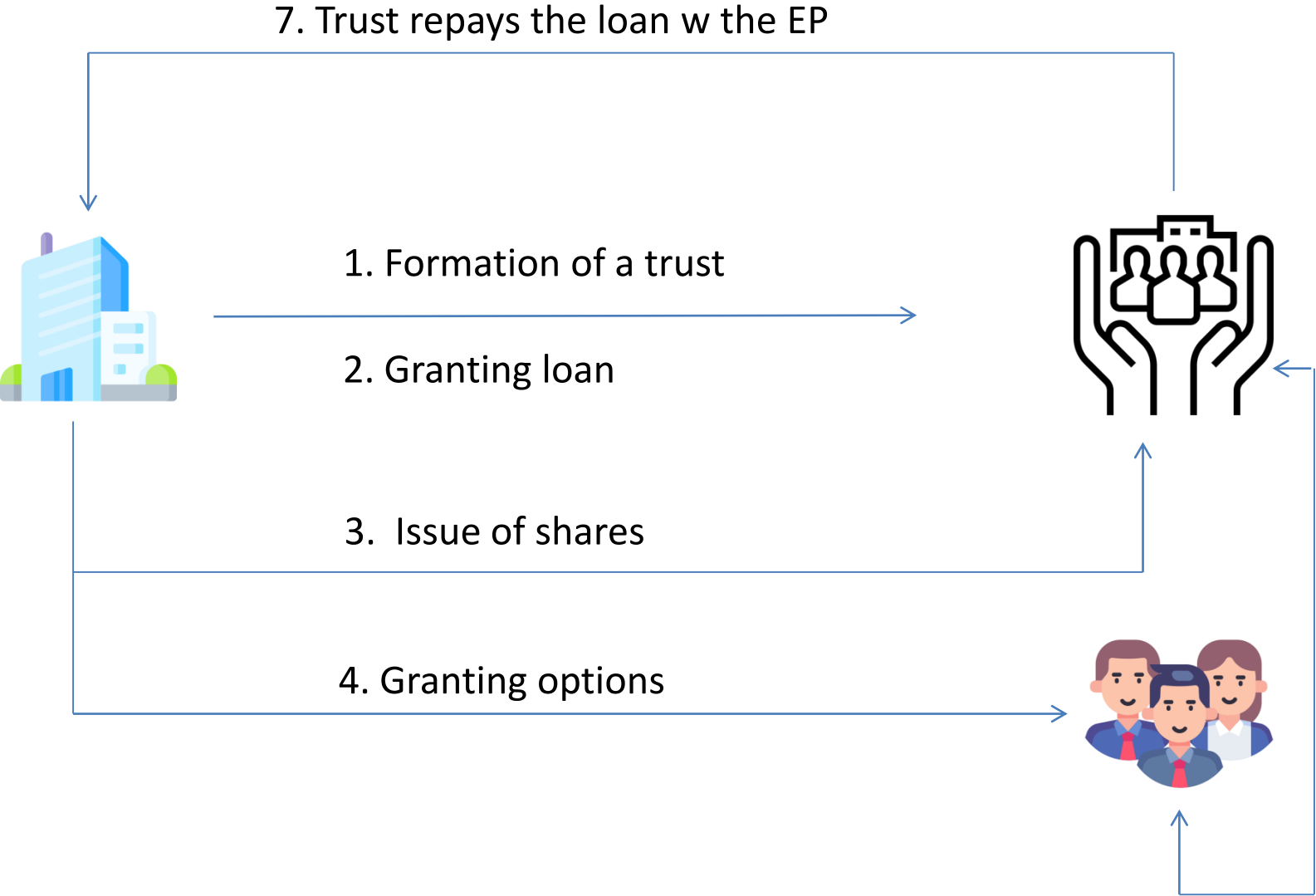
- The entity shall measure the services at the fair value
- There will be a corresponding credit in Share Based Payment Liability
- Until the liability is settled, the entity shall remeasure the fair value of the liability at the end of each B/s date and on the settlement date
- **When will services be said to be received or when will expense be recognised?**
 - over the vesting period, if any
 - or else on grant date i.e. immediate vesting
- **On what value?**
 - Fair value

Modes of issuance

Direct mode



Trust route



7. Trust repays the loan w the EP

1. Formation of a trust

2. Granting loan

3. Issue of shares

4. Granting options

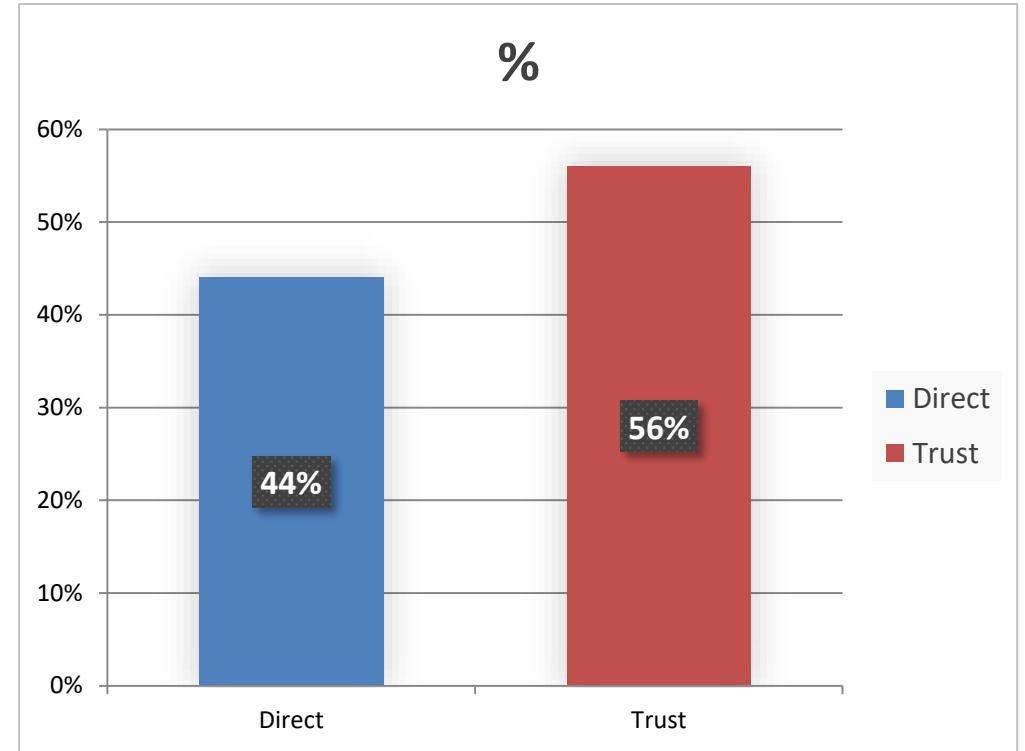
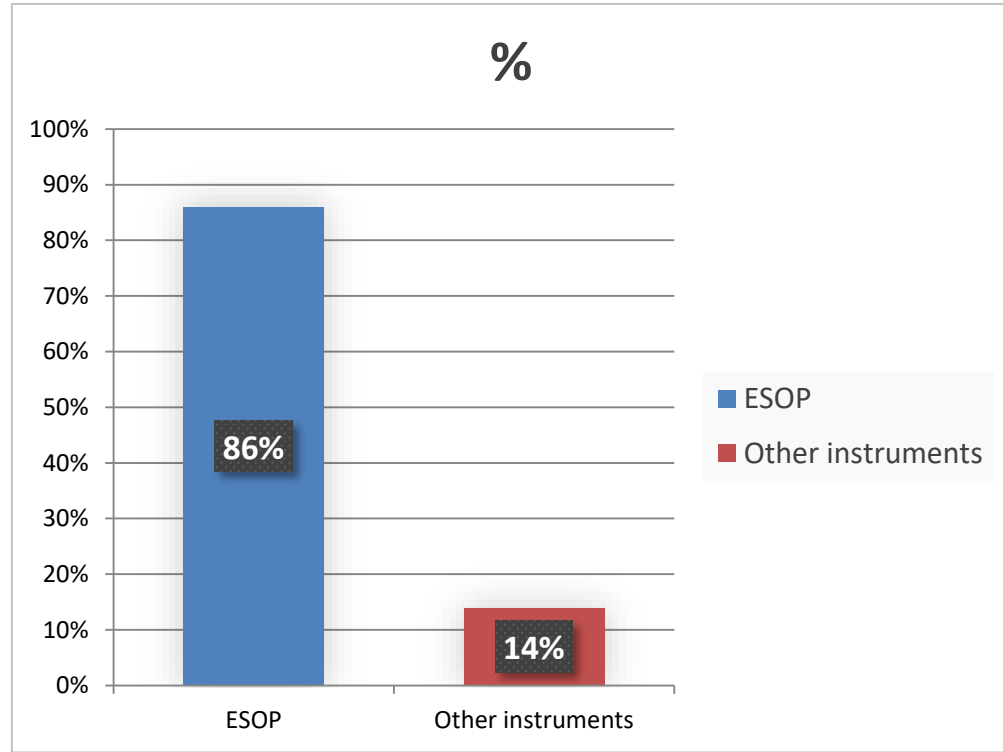
6. Trust gives shares to employees

5. Employee exercises & pays the EP

Diff b/w Direct & Trust route

BOD	Direct route	Trust route
Cost	Cost effective – preferred by startups	Funding to ESOP trust – preferred by large companies
Benefit for employee	Co. may grant loan sub to section 67. Not available to all employees	Cashless exercise of options – all employees are eligible
Acquisition mode	Only fresh issue	Fresh issue & secondary acquisition both
Administration	By the co.	Better governance by an independent entity
Restrictions on trust	N.A.	Disclosures under PIT

Market data – top 50 companies



{source: BSE top 50 companies}

Other instruments include:

- RSUs
- ESOPs
- SARs
- Phantom stocks

Comparative analysis

BOD	ESOPs	RSUs	ESPS	SARs	PSOs
Features	Options given by company to employees at a predetermined price – can be with / w/o any vesting schedule	Same as ESOPs – given to more senior level employees	Company offers employee to purchase shares at a discounted price.	Appreciation for a specified no. of shares – settled in equity / cash	Same as SARs – appreciation settled in cash only
Economics for employees (pros & cons)	<ul style="list-style-type: none"> ▪ Shares available at lower than market price ▪ No vesting period ▪ Lock-in period 		<ul style="list-style-type: none"> ▪ Shares available at lower than market price ▪ No vesting period ▪ Lock-in period 	<ul style="list-style-type: none"> ▪ No mandatory lock-in period ▪ No cash outflow ▪ Can be a deterrent in case an employee wants equity stake 	
Economics for employer (pros & cons)	<ul style="list-style-type: none"> ▪ Tax deduction available u/s 37 ▪ No cash outflow ▪ Tool for deferred compensation ▪ Leads to dilution of share capital ▪ CTC 		<ul style="list-style-type: none"> ▪ No cash outflow ▪ CTC of the company ▪ Lower expense as compared to other schemes ▪ Lower retention 	<ul style="list-style-type: none"> ▪ Does not necessarily lead to dilution of share capital ▪ In case of cash settled SARs – cash outflow is high 	

PIT aspects

- Can ESOPs be granted during trading window closure?
 - Yes, not a trading
- Will exercising of ESOPs considered as trading?
 - No, but will apply at the time of selling of options
- Can employees sell shares at any point after exercise?
 - Yes. Not a contra trade w.r.t. exercise
- Can ESOPs be exercised during T/w closure or while in possession of UPSI?
 - Yes. However, pre-clearance will have to be obtained.
- Can ESOP Trust trigger the open offer obligation under SAST?
 - No. Trustees of a trust are not entitled to vote in respect of shares held by such trust. Therefore, shares proposed to be held by the trust will not be taken into account for calculating the percentage of voting rights under SAST. IG in the case of [Capital Trust Limited](#)
- Which price is to be considered for 10 lac disclosure under PIT for the Trust?
 - Market Price
- Will cashless exercise of options by Trust be considered as contra-trade?
 - No. IG in the case of [KPIT Technologies](#)

Virtual ESOPs

Virtual ESOPs is an overseas nomenclature. There is no equity participation. A participation agreement is signed b/w the company and the employee and the employee gets equated w the real shareholders. Employees do not receive any real equity but are entitled to benefits.

Can this concept be introduced in India?

Reg. 26(6) of the LODR Regulations can prove to be a hindrance

Thank You