

TDS AND TAX PAYMENT ON ESOPs GIVEN BY START- UPS

As per Section 17(2)(vi), perquisite includes the value of ESOPs allotted or transferred by an employer to the employee. Accordingly, the value of such perquisite is taxable in the year when such ESOPs are allotted/transferred to the assessee employee. **This leads to cash-flow problems for the employee who does not sell the shares immediately and continues to hold the same for long-term.** Further, Start-ups generally use ESOPs to attract and retain highly talented employees as the start-up has liquidity crunch in the beginning. To incentivize the Start-up ecosystem, **Finance Act, 2020 has deferred the TDS liability of the start-up employer [Section 192(1C)] and also the tax liability of the employee [Section 140A] to within 14 days from "Specified Date".**

"SPECIFIED DATE" MEANS:

- **The date of expiry of 48 months/4 years from the end of the relevant assessment year i.e., the year in which the ESOPs are allotted or transferred.**
- **The date of sale of such ESOPs by the assessee**
- **The date of assessee ceasing to be the employee of the start-up employer.**

whichever is the earliest.

Now, it is important to note, that there is no change in valuation of perquisite or its year of chargeability. The **perquisite continues to be chargeable to tax in the year of accrual (allotment or transfer of ESOPs).** Only payment of tax or deduction of tax thereon is deferred.

The effect of amendments by Finance Act, 2020 is as under:

1. **The value of perquisite on ESOPs shall be included in the income of the employee in the previous year in which ESOP is allotted. Let us say ESOP is allotted on 30.1.2023, therefore, the perquisite on ESOP shall be included in the income of the employee in Previous Year 31.3.2023 i.e., A.Y. 2023-24.**
2. **However, as per amendment in section 140A by Finance Act, 2020, the self-assessment tax for Previous Year 30.3.2023 shall be reduced by the tax on perquisites on ESOPs beside other reductions as per Section 140A. Therefore, employee is not required to pay tax on perquisite on ESOP alongwith return of income of Previous Year 31.3.2023 and he shall not be treated as assessee in default.**

3. The employer shall deduct TDS on ESOPs within 14 days from the "Specified Date" as per newly inserted section 192(1C) by Finance Act, 2020.
4. As per section 191(2) inserted by Finance Act, 2020, if employer is not able to deduct TDS on ESOPs within 14 days from "Specified Date", then employee shall pay tax on his own within 14 days from "Specified Date".
5. As per Section 156(1), the Assessing Officer shall issue a notice of demand to the assessee specifying the sum payable on such value of perquisite as disclosed in the return of income for the year in which ESOPs were allotted or transferred i.e., Previous Year 31.3.2023. Such sum would have been payable within 30 days of receipt of such notice failing which, the assessee would have been treated as assessee-in-default under section 220(4). **However, Section 156(2) inserted by Finance Act, 2020 provides a protection to the assessee from such deeming provision of being assessee-in-default.**

The employee shall not be deemed as assessee in default on receipt of notice of demand. However, the provisions of deeming the employee as assessee-in-default shall become applicable if the payment is not made within 14 days from "Specified Date".

Illustration:

Mr. X, an employee of A Ltd. (an eligible start-up) provides the following details in respect of his income for the P.Y. 2022-23.

Gross Salary ₹ 26,50,000

In December 2021, A Ltd. granted options to Mr. X to apply for 20,000 shares @ ₹ 20 each. All the options were exercised by Mr. X on March 1, 2022 when the fair market value of the shares was ₹ 200 each. However, the shares were allotted to Mr. X on July 20, 2022 when FMV of shares is ₹ 230 per share. Now, out of such 20,000 shares, Mr. X transfers:

- 10,000 shares on August 5, 2025 through recognised stock exchange at the rate of ₹ 500 each.
- 10,000 shares on May 15, 2029 through recognised stock exchange at the rate of ₹ 700 each.

Mr. X resigns from A Ltd. on March 31, 2030. Mr. X and A Ltd. want to know the tax consequences in their respective hands as per the above information.

Answer:

(I) Assessment Year 2023-24 Computation of tax liability of Mr. X

Particulars	Amount (in ₹)
Income under the head "Salaries"	
Gross salary	26,50,000
Add: Value of Perquisite [20,000 shares × (₹ 200 – ₹ 20)]	36,00,000
Less: Standard deduction	50,000
Total Income	62,00,000
Tax on total income	19,13,340

TDS liability of A Ltd.

Tax on Total Income	19,13,340
Average rate of tax $\left(\frac{19,13,340}{62,00,000} \times 100 \right)$	30.86%
Tax to be deferred as per section 192(1C) (30.86% of 36,00,000)	11,10,960
Tax to be deducted under section 192 by A Ltd. during F.Y. 2022-23.	8,02,380

Assuming A Ltd. deducts the above tax appropriately, Mr. X's advance tax liability or self-assessment tax liability shall be NIL.

(II) LIABILITY ON SALE OF 10,000 shares on August 5, 2025

As per Section 192(1C) the TDS liability of A Ltd. shall be deferred to **the earliest of:**

- April 14, 2028 (31st March, 2024 + 48 months + 14 days)
- August 19, 2025 (5th August, 2025 + 14 days)
- April 14, 2030 (31st March, 2030 + 14 days)

i.e., August 19, 2025.

Accordingly, A Ltd. shall be required to deduct TDS under section 192(1C) on or before August 19, 2025 as follows:

$$₹ 11,10,960 \times \frac{10,000}{20,000} \text{ shares} = ₹ 5,55,480$$

The liability of A Ltd. and Mr. X shall be as under:

- (i) X Ltd. is required to deduct TDS of ₹ 5,55,480 by 19th August, 2025.
- (ii) If X Ltd. does not deduct TDS by 19th August, 2025, then Mr. A is required to pay tax of ₹ 5,55,480 by 19th August, 2025 failing which he shall be deemed to be an assessee in default under section 156.

Computation of Capital Gains in hands of Mr. X in A.Y. 2026-27

Gross sale proceeds	₹ 50,00,000
Less: Cost of Acquisition [Section 49(2AA)] (10,000 shares × ₹ 200)	₹ 20,00,000
Long term capital gain under section 112A	₹ 30,00,000
Tax on capital gain	₹ 2,90,000

(III) LIABILITY ON APRIL 14, 2028

As discussed above, TDS liability shall be attracted in the hands of A Ltd. on the value of perquisite pertaining to 10,000 shares which Mr. X holds as on date.

Accordingly, the balance of deferred TDS of ₹ 5,55,480 shall be deductible on or before 14th April, 2028. If A Ltd. does not deduct TDS of ₹ 5,55,480 on or before 14th April, 2028, then Mr. X shall have to pay this tax on or before 14th April, 2028, failing which he shall be deemed to be an assessee in default.

(IV) CAPITAL GAIN ON SALE OF 10,000 shares ON MAY 15, 2029.

Long-term capital gain under section 112A shall be ₹ 30,00,000 and tax on same shall be ₹ 2,90,000.