What is ESOP’s/ESOS’s?

Employee Stock Option Plan or Employee Stock Option Scheme is an employee benefit plan that gives ownership interest to employees in the company and motivates them, helps in retaining the workforce, and provides tax breaks. Under ESOP, an entity grants an option to its 'eligible employees' to acquire its shares at a future date but at a predetermined price, which is not mandatory to accept or exercise the given option.

There are certain variances of ESOPs, to name, Employee Stock Option Plan (ESOP), Employee Share Purchase Plan (ESPP) and Stock Appreciation Rights Plan (SAR), Sweat equity, Compensation Plans, Incentive Plans, Phantom ESOPs, etc.

Grant Date: It is the date of the agreement between the employer and employee to give an option to own shares (at a later date).

Vesting Date: It is the date the employee is entitled to buy shares, after conditions agreed upon earlier are fulfilled. This date is also the agreed-on grant date.

Exercise Date: It is the date on which the employee exercises the option.

Vesting Period: The time between the grant date and vesting date.

Exercise Period: Once stocks have ‘vested’, the employee now has a right to buy (but not an obligation) the shares for a period. This period is called the exercise period.

Exercise Price: The price at which an employee exercises the option. This price is usually lower than the prevailing FMV (fair market value) of the stock.

Tax Calculations:

The ESOPs will be taxed at two stages. First when an employee exercises his rights i.e., difference between exercise price and prevailing market price (Income under the head salary). Secondly, at the time of selling them, the profit will be considered as either LTCG or STCG and taxed accordingly (Income under the head capital gains).

Let us explain the above with a simple example:

Mr. Narayan is a private employee, age of 38years. He has been working with this organization for the last 10years. On 1st April 2019 his employer grants 100 shares with exercise price of Rs.1000 per share, which is lower than the FMV of Rs.1200 per share and vested same on 20th April 2019. Mr.Narayan has exercised 100 shares on 1st July 2019.

FMV as of 1st July 2019 is Rs.1,600. In this case, the applicable tax on exercising ESOP is as per individual income tax slab rates. Mr. Narayan is covered under 30% slab rates. Therefore, the tax to be paid is Rs.18,000 [(30% * (1,600-1,000)*100 shares).

On Sale of Shares (Listed):

If Mr. Narayan sells his 50 shares on 2nd Dec 2019 where the FMV of the share is Rs.2,000, he needs to pay short-term capital gains tax at 15% on Rs.20,000 [15% * (2,000-1,600)*50shares] i.e., Rs.3,000.

If Mr. Narayan sells his balance shares on 2nd Nov 2020 where the FMV of the share is Rs.2,500, he needs to pay long-term capital gains tax at 10% if gains are more than Rs.1 Lakh. Here the long-term capital gain is Rs. 45,000 [(2,500-1,600)*50shares] therefore the long-term capital gains tax is Rs.0.

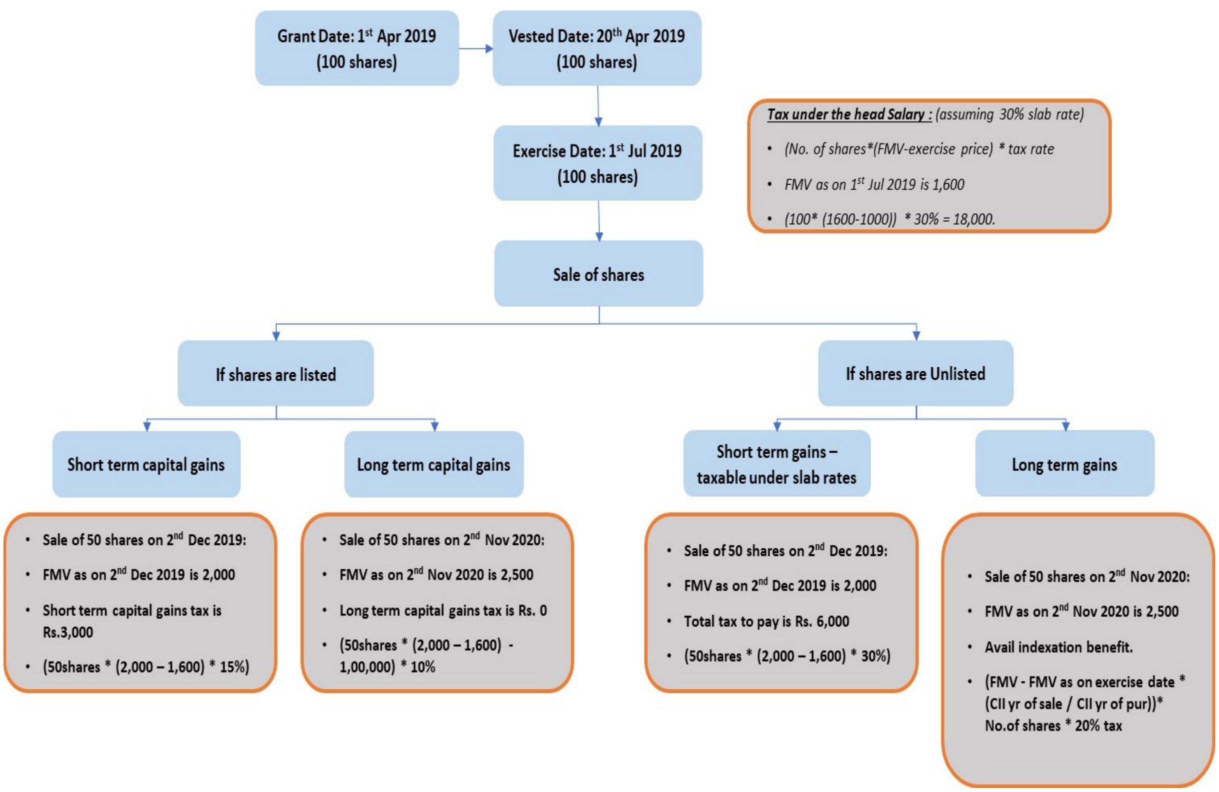
On Sale of Shares (Unlisted):

If Mr. Narayan sells his 50 shares on 2nd Dec 2019 where the FMV of the share is Rs.2,000, the gains will be taxed at as per individual income tax slab rates i.e., Rs.6,000 [30% * (2,000-1,600)*50shares].

If Mr. Narayan sells his balance shares on 2nd Nov 2020 where the FMV of the share is Rs.2,500, the gains will be taxed at 20% after indexation of cost.

20%***[**(2,500-1,600*(CII yr of sale/CII yr of purchase) *50shares**]**.

Below is the summary of above example:



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