CASE NO.:
Appeal (civil) 3725 of 2007

PETITIONER:
Commissioner of Income Tax, Bangalore

RESPONDENT:
Infosys Technologies Ltd.

DATE OF JUDGMENT: 04/01/2008

BENCH:
S.H. Kapadia & B. Sudershan Reddy

JUDGMENT:
J U D G M E N T
with
Civil Appeal No. 16 of 2008 @ S.L.P.(C) No. 16926 of 2007

KAPADIA, J.

Leave granted.

2. Respondent-assessee is public limited IT company based in Bangalore. To implement Employees Stock Option Scheme (\023ESOP\024), the assessee created a Trust known as Technologies Employees Welfare Trust and allotted 7,50,000 warrants at Re. 1/- each to the said Trust. Each warrant entitled the Holder thereof to apply for and be allotted one equity share of the face value of Rs. 10/- each for total consideration of Rs. 100/-. The Trust was to hold the warrant and transfer the same to the employees of the company under the Terms and Conditions of the scheme governing ESOP. During the assessment years 1997-98, 1998-99 and 1999-2000, warrants were offered to the eligible employees at Re. 1/- each by the Trust. They were issued to employees based on their performance, security and other criteria. Under the ESOP Scheme, every warrant had to be retained for a minimum period of 1 year. At the end of that period, the employee was entitled to elect and obtain shares allotted to him on payment of the balance Rs. 99. The option could be exercised at any time after 12 months but before expiry of the period of 5 years. The allotted shares were subject to a lock in period. During the lock in period, the custody of shares remained with the Trust. The shares were non-transferable. The employee had to continue to be in service for 5 years. If he resigned or if his services be terminated for any reason, he lost his right under the scheme and the shares were to be re-transferred to the Trust for Rs. 100 per share. Intimation was also given to BSE that 734500 equity shares were non-transferable and would not constitute good delivery. Till 13.9.1999 all the shares were stamped with the remark \023non-transferable\024. Thus the said shares were incapable of being converted into money during the lock in period.

3. For the assessment year 1999-2000, the AO held that the total amount paid by the employees consequent to the exercise of option was Rs. 6.64 crores whereas the market value of those shares was Rs. 171 crores. He held that the \023perquisite value\024 was the difference between the market value and the price paid by the employees for exercise of the option. He, therefore, treated Rs. 165 crores as \023perquisite value\024 on which TDS was charged at 30%. It was held that the respondent-assessee was a defaulter for not deducting TDS under Section 192 amounting to Rs. 49.52 crores on the above perquisite value of Rs. 165 crores. Similar orders were also passed by the AO for assessment years 1997-98 and 1998-99. These orders were confirmed by CIT(A). No

www.taxcode.in

weightage was given by both the authorities to the lock in period. Both the authorities took into account the \023perquisite value\024 as on the date of exercise of option.

4. Aggrieved by the aforesaid decisions, the respondent-assessee carried the matter in appeal to the Tribunal, which took the view that the right granted to the employee for participating in the scheme was not a \023perquisite\024 under Section 17(2)(iii) of the Income Tax Act, 1961 (\0231961 Act\024). This decision of the Tribunal stood confirmed by the impugned judgment delivered by the Karnataka High Court on 15.12.2006. Hence, these civil appeals by the Department.

5. Whether tax had to be deducted under Section 192 of the 1961 Act, by the respondent-assessee, on the amount earned by its employees from exercise of stock option granted to them by the company through the Trust, is the question which arises for determination in these civil appeals.

6. In the case of Govind Saran Ganga Saran v. Commissioner of Sales Tax and Ors. [(1985) 155 ITR 144 (SC)] this Court held that there are four components of tax. The first component is the character of the imposition, the second is the person on whom the levy is imposed, the third is the rate at which tax is imposed and the fourth is the value to which the rate is applied for computing tax liability. It was further held that if there is ambiguity in any of the four concepts then levy would fail. In this case, we are concerned with the forth concept. There is one more principle which is required to be noted. A benefit/receipt under the 1961 Act must be made taxable before it can be regarded as \023income\024.

7. During the assessment years 1997-98, 1998-99 and 1999-2000 there was no provision in the said 1961 Act which made the benefit by way of ESOP taxable as income specifically. It became specifically taxable only with effect from 1.4.2000 when Section 17(2)(iiia) stood inserted.

8. At the outset, we may state that in these civil appeals we are not concerned with taxability but with the value of a perquisite.

9. The question for consideration is whether \023perquisite\024 could be said to accrue at the time when warrants were granted or at the time when the option vested in the employee or at the time when the options stood exercised or at the time when the lock-in conditions were removed or at the time when the shares were to be sold in the share market. According to the AO, the \023perquisite value\024 was the difference between the total amount paid by the employee(s) consequent to the exercise of option amounting to Rs. 6.46 crores on which date the market value of the shares was in all Rs. 171 crores. Therefore, according to the AO, the benefit arose on the date when the options stood exercised. In this case we are concerned with the period prior to 1.4.2000.

10. We quote hereinbelow Sections 17(1) and (2), which read as follows:
\023"Salary", "perquisite" and "profits in lieu of salary" defined.

17. For the purposes of sections 15 and 16 and of this section,-

(1) "salary" includes-

(i) wages;

www.taxcode.in

Case Citation: (2017) taxcode.in 323 SC

(ii) any annuity or pension;

(iii) any gratuity;

(iv) any fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages;

(v) any advance of salary;

(va) any payment received by an employee in respect of any period of leave not availed of by him;

(vi) the annual accretion to the balance at the credit of an employee participating in a recognised provident fund, to the extent to which it is chargeable to tax under Rule 6 of Part A of the Fourth Schedule; and

(vii) the aggregate of all sums that are comprised in the transferred balance as referred to in sub-rule (2) of Rule 11 of Part A of the Fourth Schedule of an employee participating in a recognised provident fund, to the extent to which it is chargeable to tax under sub-rule (4) thereof;

(2) "perquisite" includes-

(i) the value of rent-free accommodation provided to the assessee by his employer;

(ii) the value of any concession in the matter of rent respecting any accommodation provided to the assessee by his employer;

(iii) the value of any benefit or amenity granted or provided free of cost or at concessional rate in any of the following cases:-

(a) by a company to an employee who is a director thereof;

(b) by a company to an employee being a person who has a substantial interest in the company;

(c) by any employer (including a company) to an employee to whom the provisions of paragraphs (a) and (b) of this sub-clause do not apply and whose income under the head "Salaries" (whether due from, or paid or allowed by, one or more employers), exclusive of the value of all benefits or amenities not provided for by way of monetary payment, exceeds twenty-four thousand rupees;

Explanation. -For the removal of doubts, it is hereby declared that the use of any vehicle provided by a company or an employer for journey by the assessee from his residence to his office or other place of work, or from such office or place to his residence, shall not be

www.taxcode.in

regarded as a benefit or amenity granted or provided to him free of cost or at concessional rate for the purposes of this sub-clause.\024

(emphasis supplied)

11. Warrant is a right without obligation to buy. Therefore, \023perquisite\024 cannot be said to accrue at the time when warrants were granted in this case. Same would be the position when options vested in the employees after lapse of 12 months. It is important to note that in this case options were exercisable only after the cooling period of 12 months. Further, it was open to the employees not to avail of the benefit of option. It was open to the employees to resign. There was no certainty that the option would be exercised. Further, the shares were not transferable for 5 years (lock-in period). If an employee resigned during the lock-in period the shares had to be retransferred. During the lock-in period, the possession of the shares, which is an important ingredient of shares, remained with the Trust. The Stock Exchange was duly notified about non-transferability of the shares during the lock-in period. The shares were stamped with the remark \023non-transferable\024 during the lock-in period. It was not open to the employees to hypothecate or pledge the said shares during the lock-in period. During the said period, the said shares have no realisable value, hence, there was no cash in flow to the employees on account of mere exercise of options. On the date when the options were exercised, it was not possible for the employees to foresee the future market value of the shares. Therefore, in our view, the benefit, if any, which arose on the date when the option stood exercised was only a notional benefit whose value was unascertainable. Therefore, in our view, the Department had erred in treating Rs. 165 crores as perquisite value being the difference in the market value of shares on the date of exercise of option and the total amount paid by the employees consequent upon exercise of the said options.

12. We also do not find merit in the contention advanced on behalf of the Department that Section 17(2)(iiia) inserted by Finance Act, 1999 w.e.f. 1.4.2000 was clarificatory and, therefore, retrospective in nature.

13. We quote hereinbelow Section 17(2)(iiia), which reads as under:

\023(iiia) the value of any specified security allotted or transferred, directly or indirectly, by any person free of cost or at concessional rate, to an individual who is or has been in employment of that person :

Provided that in a case where allotment or transfer of specified securities is made in pursuance of an option exercised by an individual, the value of the specified securities shall be taxable in the previous year in which such option is exercised by such individual.

Explanation.-For the purposes of this clause,-

(a) cost means the amount actually paid for acquiring specified securities and where no money has been paid, the cost shall be taken as nil;

(b) specified security means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and includes employees stock option and

www.taxcode.in

sweat equity shares;

(c) 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; and

(d) value means the difference between the fair market value and the cost for acquiring specified securities;\024

(emphasis supplied)

14. As stated above, unless a benefit/receipt is made taxable, it cannot be regarded as \023income\024. This is an important principle of taxation under the 1961 Act. Applying the above principle to the insertion of clause (iiia) in Section 17(2) one finds that for the first time w.e.f. 1.4.2000 the word \023cost\024 stood explained to mean the amount actually paid for acquiring specified securities and where no money had been paid, the cost was required to be taken as nil.

15. In the case of Commissioner of Income-Tax, Bangalore v. B.C. Srinivasa Setty [(1981) 128 ITR 294 (SC)] this Court held that the charging section and computation provision under the 1961 Act constituted an integrated code. The mechanism introduced for the first time under the Finance Act, 1999 by which \023cost\024 was explained in the manner stated above was not there prior to 1.4.2000. The new mechanism stood introduced w.e.f. 1.4.2000 only. With the above definition of the word \023cost\024 introduced vide clause (iiia), the value of option became ascertainable. There is nothing in the Memorandum to the Finance Act, 1999 to say that this new mechanism would operate retrospectively. Further, a mechanism which explains \023cost\024 in the manner indicated above cannot be read retrospectively unless the Legislature expressly says so. It was not capable of being implemented retrospectively. Till 1.4.2000, in the absence of the definition of the word \023cost\024, value of the option was not ascertainable. In our view, clause (iiia) is not clarificatory. Moreover, the meaning of the words \023specified securities\024 in section (iiia) was defined or explained for the first time vide Finance Act, 1999 w.e.f. 1.4.2000. Moreover, the words allotted or transferred in clause (iiia) made things clear only after 1.4.2000. Lastly, it may be pointed out that even clause (iiia) has been subsequently deleted w.e.f. 1.4.2001. For the aforestated reasons, we are of the view the clause (iiia) cannot be read as retrospective.

16. Be that as it may, proceeding on the basis that there was \023benefit\024, the question is whether every benefit received by the person is taxable as income? In our view, it is not so. Unless the benefit is made taxable, it cannot be regarded as income. During the relevant assessment years, there was no provision in law which made such benefit taxable as income. Further, as stated, the benefit was prospective. Unless a benefit is in the nature of income or specifically included by the Legislature as part of income, the same is not taxable. In this case, the shares could not be obtained by the employees till the lock-in period was over. On facts, we hold that in the absence of legislative mandate a potential benefit could not be considered as \023income\024 of the employee(s) chargeable under the head \023salaries\024. The stock was non-transferable and the stock exchange was also accordingly

notified. This is where the weightage ought to have been given by the AO to an important factor, namely, lock in period. This has not been done. It is important to bear in mind that if the shares allotted to the employee had no realizable sale value on the day when he exercised his option then there was no cash inflow to the employee. It was not possible for the employee to know the future value of the shares allotted to him on the day he exercises his option. Even the cost of acquisition as \023nil\024 came to be introduced in the 1961 Act by the Finance Act, 1999 only with effect from 1.4.2000. In fact, the later deletion of clause (iiia) is an indicator of the Ineffective Charge.

17. For the aforestated reasons, we are of the view that the Department had erred in treating Rs. 165 crores as a perquisite value for the assessment years 1997-98, 1998-99 and 1999-2000. During those years, the fifth anniversary had not taken place and, therefore, it was not possible for the assessee company to estimate the value of the perquisite during that period. It was not open to the Department to ignore the lock in period. Therefore, the Department had erred in treating the respondent herein as an assessee in default for not deducting the TDS at 30% as stated in the order of assessment. This is not the case of tax evasion. The assessee had floated the Trust because of the buy back problems, which were genuine problems in cases where the employees stood dismissed, removed or in the case of resignation in which cases they were required to return the allotment.

18. Estimation of TDS under Section 192 in the absence of clear provisions on valuation of \023perquisite\024 in this case would not justify the Department in treating the respondent as assessee in default. Therefore, in our view, the AO and the CIT(A) had erred in treating the respondent as defaulter for not deducting TDS under Section 192. Consequently, Section 201(1) and 201(1A) were also not applicable to the facts of this case and that the Department had erred in invoking the said two sections against the assessee.

19. Before concluding, we express no opinion on the law prevailing after 1.4.2000 except to the extent indicated hereinabove.

20. Accordingly, we find no merit in these civil appeals which stand dismissed with no order as to costs.

www.taxcode.in