INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "F": NEW DELHI
BEFORE MS SUCHITRA KAMBLE, JUDICIAL MEMBER
AND
SHRI PRASHANT MAHARISHI, ACCOUNTANT MEMBER

ITA No.2283/Del/2013 (Assessment Year: 2008-09)

Religare Commodities Ltd, D3, P3B, District Centre, Saket, New Delhi PAN:AAACF8356R	Vs.	ACIT, Circle-15(1), New Delhi
(Appellant)		**(Respondent)**

ITA No.3634/Del/2014 (Assessment Year: 2009-10)

Religare Commodities Ltd, D3, P3B, District Centre, Saket, New Delhi PAN:AAACF8356R	Vs.	DCIT, Circle-15(1), New Delhi
(Appellant)		**(Respondent)**

Assessee by :	Sh. Ajay Vohra, Sr. Adv Sh. Rohit Garg, Adv Ms. Tejasvi Jain, CA
Revenue by:	Sh. FR Meena, Sr. DR
Date of Hearing	05/10/2016
Date of pronouncement	04/01/2017

<u>O R D E R</u>

<u>PER PRASHANT MAHARISHI, A. M.</u>

1. These are the two appeals filed by the assessee against the order of the ld CIT (A)-XVIII, New Delhi dated 28.02.2013 and 03.03.2014 for the Assessment Year 2008-09 and 2009-10 where in the disallowance of stock appreciation rights made by the Ld AO was confirmed and further the disallowance was enhanced for AY 2008-09 holding some expenditure as capital expenditure with respect to Stock appreciation rights. As in both the appeal the issue involved is identical, therefore, these are disposed of by this common order stating the facts for the assessment year 2008 -2009 and then decision taken for that year shall be applied for appeal of AY 2009-10.
2. The assessee has raised the following grounds of appeal for the Assessment Year 2008-09:-

"1. That the Commissioner of Income tax (Appeals) erred on facts and in law in sustaining the disallowance of Rs.11,47,623 (as against correct amount of Rs.10,89,249) made by the assessing officer on account of the difference between purchase price of Stock Appreciation Right OSAR) and the sale price of such SAR at the time of exercise by the employees, holding the same to be capital loss not allowable business deduction.

1.1 That the Commissioner of Income tax (Appeals) erred on facts and in law in not appreciating that the above differential amount actually represents the loan granted by the appellant to Religare Enterprises Ltd. Employees SAR Trust ('the Trust') for the purpose of administering Employee Stock Appreciation Right Scheme ('SAR scheme'), which was not meant to be and, in fact, not recovered from the latter in accordance with the SAR scheme.

1.2 That the Commissioner of Income tax (Appeals) erred on facts and in law in not appreciating that the above SAR scheme was implemented to motivate, reward and retain key employees whereby each SAR granted to the employees of the appellant stood equivalent to one share of Religare Enterprises Ltd. ('REL') and the aforesaid differential amount was, thus, in the nature of employee benefit allowable under section 37(1) of the Income Tax Act, 1961 ('the Act').

1.3 Without prejudice, the Commissioner of Income tax (Appeals) erred on facts and in law in not allowing deduction of the aforesaid amount of loan written off as loss incidental to business under section 28 of the Act.

2. That the Commissioner of Income tax (Appeals) erred on facts and in law in enhancing the income of the appellant by directing further disallowance of Rs.27,89,501 on account of difference between the sale price of SAR and the exercise price of SAR (prefixed at Rs. 140 per SAR) paid to the employees of the appellant, holding the same to be capital expenditure incurred in relation to issue of shares to employees.

2.1 That the Commissioner of Income tax (Appeals) erred on facts and in law in not appreciating that the above differential amount of Rs.27,89,501 was in the nature of employee compensation allowable as deduction under section 37(1) of the Act.

2.2 Without prejudice, and in the alternative, the Commissioner of Income tax (Appeals) erred on facts and in law in not allowing deduction of the above differential amount of Rs.27,89,501 under section 36(1)(ii) of the Act alleging that the same was not in accordance with the provisions of the Payment of Bonus Act, 1965."

3. The assessee has raised the following grounds of appeal for the Assessment Year 2009-10:-

"1. That the Commissioner of Income tax (Appeals) erred on facts and in law in sustaining the disallowance of Rs.15,12,621 made by the assessing officer on account of the difference between purchase price of Stock Appreciation Right ('SAR') and the sale price of such SAR at the time of exercise by the employees, holding the same to be capital loss and not allowable business deduction.

1.1 That the Commissioner of Income tax (Appeals) erred on facts and in law in not appreciating that the above differential amount actually represents the loan granted by the appellant to Religare Enterprises Ltd. Employees SAR Trust ('the Trust') for the purpose of administering Employee Stock

Appreciation Right Scheme ('SAR scheme'), which was not meant to be and, in fact, not recovered from the latter in accordance with the SAR scheme.

1.2 That the Commissioner of Income tax (Appeals) erred on facts and in law in not appreciating that the above SAR scheme was implemented to motivate, reward and retain key employees whereby each SAR granted to the employees of the appellant stood equivalent to one share of Religare Enterprises Ltd. ('REL') and the aforesaid differential amount was, thus, in the nature of employee benefit allowable under section 37(1) of the Income Tax Act, 1961 ('the Act').

1.3 Without prejudice, the Commissioner of Income tax (Appeals) erred on facts and in law in not allowing deduction of the aforesaid amount of loan written off as loss incidental to business under section 28 of the Act."

4. The assessee is a limited company engaged in the business of providing granting of loan corporate advisory services and distribution of dividends etc. For the year It filed its return of income on 27/09/2000 declaring the total income of Rs. 22807670/- subsequently the return was revised on 29/03/2010 showing total income of Rs. 22490250/-. In the return of income, the assessee has claimed an amount of Rs. 147623/- as deduction of on account of stock appreciation Right expenses and treated it as a loss incidental to business. Before the Ld. assessing officer, it explained that the Religare enterprise Ltd launched a stock appreciation Right scheme effective from 01/04/2007 for employee's retention purposes. The grant price of this stock appreciation Right was nil. However, the value of each stock appreciation Right was Rs. 140/-. The scheme was administered through a trust. The trust purchase shares of Religare from the stock exchange at an average price of Rs. 503/- per share. The funding of such purchase was by way of loan, which was initially given by Religare enterprise Ltd, but later on the respective companies paid to Religare enterprise Ltd. On exercise of the stock appreciation Right by an employee the trust sold the corresponding number of shares on the stock exchange and the amount realized was paid to the respective company in the settlement of the loan. The company paid to the employees , the amount which was the difference between the sale price of the shares and the stock appreciation Right value of Rs. 140/- multiplied by the number of stock appreciation rights exercised by the employee, after deducting tax at source. Stock appreciation rights that were granted to the employees of the company were 24220 total amount of the loan that was given by the assessee to the trust is Rs. 12182660/- being amount paid for 24220 stock appreciation rights at the rate of Rs. 503/- per right. For the purpose of exercising the right by the employee a sum of Rs. 2789501/- for 47993 units were paid to the employees as bonus and allowed by the AO as

deduction. Consequently, the amount of Rs. 1147623/- was the outstanding amount which was written off during the year under consideration and claimed as deduction under section 37 of the income tax act in the computation of the total income by the assessee. The above sum was disallowed by the Ld. assessing officer considering it as a capital loss. Consequently, the total income of the assessee was assessed at Rs. 2,36,37,870/- against the returned income of Rs. 2,24,90,250/- vide order dated 29/12/2010. Assessee challenged the above addition to the total income before the Ld. first appellate authority. The Ld. first appellate authority confirmed the action of the Ld. assessing officer and further enhanced the total income of the assessee by Rs. 27,89,501/- further as distribution of bonus incentive paid to the employees holding it to be a capital expenditure and therefore it is not allowable expenses. Therefore, against the total disallowance made by the Ld. assessing officer of Rs. 11,47,623/– he confirmed the addition of Rs. 39,37,124/- on account of the stock appreciation Right expenditure holding it to be a capital expenditures. Therefore aggrieved by the order of the Ld. first appellate authority assessee is in appeal before us.

5. The Ld. authorized representative submitted before us that that above expenditure is incurred by the assessee in accordance with Religare enterprise Ltd's employee stock appreciation Right scheme of 2007. He placed on record the scheme. He further took us to the trust deed between the appellant and this trust of the scheme to administer the above stock appreciation Right scheme. He further placed before us the audited financial statements of the trust for financial year 2007 – 08 and 2008 – 09. He submitted that those salient features of the stock appreciation rights scheme are to reward and retain the employees to attract best talent to provide motivation for best performance of the employees. According to that scheme effective from 01/04/2007 specified employees of the appellant were granted a specific number of stock appreciation Right that was at Rs. Nil. He submitted that each stock appreciation rights right was equivalent to one share of Religare commodities Ltd. He further explained the nature of the scheme which says that the base price which is the market price of the shares of the appellant was considered at Rs. 140/- per share, and if there is an increase in the value of those shares on the date of exercise of the right by the employees then the difference between the base market price and the enhanced or increased value shall be payable to the to the holder of such rights' holder employees. He further explained that the trust initially purchased 532630 shares of the appellant from the stock exchange at an average price of Rs. 50 3.79 per share, which was

financed through loans given to the trust by the respective Religare group companies employing the employees and implementing the stock option Right scheme. At the end of the year the appellant had granted 41330 stock appreciation Right to its 52 employees out of its 861 employees, out of this 52 employees 5 employees are entitled to 6860 stock appreciation Right which were transferred to Religare securities Ltd and one employee was entitled to 500 stock appreciation Right was transferred to the appellant. Therefore, only 34780 stock appreciation rights were granted to 48 employees of the appellant. With respect to the deduction available under the income tax act for the above expenses that the appellant is entitled to deduction of the total cost that it incurred in relation to the stock appreciation rights scheme of 2007 which was for awarding and retaining employees and motivating them for better performance. Therefore, the above said cost represents the real tangible outflow of money and is beyond doubt revenue expenditure in nature. With respect to the enhancement is submitted that it is also related to the same scheme and therefore it is eligible for deduction as revenue expenditure only. He submitted that the difference between the stock appreciation Right value and the sale price is also allowable to the assessee as revenue expenditure and whereas the difference between the sale price and the purchase price is also allowable to the assessee as a revenue loss and according to him, both these claim are allowable. He further submitted that above issue is now squarely covered in favour of the assessee by the decision of the Hon'ble Delhi High Court in case of CIT versus Lemon tree hotels Ltd, ITA No. 107 – 2015 date 18/08/2015. He further submitted that the about issue is also squarely covered in favour of the appellant in view of the decision of the Hon'ble Madras High Court in case of CIT versus M/s PVP ventures Ltd reported at 211 taxman 554. He further relied on the decision of the special bench of ITAT in Biocon Ltd versus deputy Commissioner of income tax reported at 155 TTJ 649 wherein it is held that discount on issue of employee stock option plans cannot be said to be a contingent liability but the real liability and same is allowable as deduction even though the liability may have to be quantified and discharged at a future date. He further submitted that the decision of the Ranbaxy laboratories relied upon by the Ld. assessing officer has been overruled by the decision of the special bench in case of Biocon Ltd. He further referred to the decision of the coordinate bench in the case of Religare enterprise Ltd employees SAR trust versus ITO in ITA No. 6595/del/2013 and 4856/del/2014 dated 28/11/2014 wherein it has been held that the assessee claims that that particular trust is a pass through entity. In view of this is submitted that issue is now squarely covered in favour of the assessee.

6. Ld. departmental representative relied upon the orders of the order of the lower authority and vehemently claimed that the expenditure incurred by the assessee in stock appreciation rights scheme is capital expenditure is in contingent in nature.

7. We have carefully considered the rival contentions and material placed before us. We have also perused the various judicial precedent placed before us. The claim of the assessee was that the assessee has introduced the writ stock option scheme to motivate reward and retained the employees including employees of its subsidiaries and it was implemented through separate employees stock option trust. The assessee was granted stock appreciation rights, which were equivalent to one share of the assessee aggregating to 532630 stock appreciation rights. To honour its commitment the trust purchased the equal number of the equity shares from the stock market at an average price of Rs. 503.79 per share. The assessee trust sold equal number of the shares of the appellant on the stock exchange with respect to the stock appreciation Right exercised by the employees every year and the money was remitted to the respective companies. The companies on their part and in accordance with the scheme retained Rs. 140/- per share and paid the balance amount to the employees SAR compensation. The loan amount given to the trust by the company was adjusted towards the acquisition of shares to the extent of sale price and the balance amount was the loss incurred by the appellant, as it was not recoverable from the trust. For the appellant 34780 stock appreciation rights for granted to 52 employees for which the appellant has given a loan of Rs. 17522013/- for 434780 shares. The cost of the SAR was of Rs. 363.79, being Rs. 503.79 per share less Rs. 140/- and that crystallized at the beginning itself on purchase of the shares by the trust. This amount was amortized on estimated basis by the management over a period of 3 years, which was the vesting period over which this stock appreciation rights would be exercised by the employees equally each year. On analyzing the scheme of these stock appreciation rights. It was held by the Ld. first appellate authority that it is akin to the employee's stock option schemes. The issue of deductibility of ESOP expenditure has been decided extensively by the special bench of ITAT in Biocon Limited V DCIT (LTU) Bangalore in 144 ITD 21 as under :-

> "**8.** We will take up these three steps one by one for consideration and decision.
> I. WHETHER ANY DEDUCTION OF SUCH DISCOUNT IS ALLOWABLE ?

9.1 The crux of the arguments put forth by the ld. AR is that discount under ESOP is nothing but employees cost incurred by the assessee for which deduction is warranted. On the other hand, the Revenue has set up a case that no deduction can be allowed as such discount is not only a short capital receipt but also a contingent liability.

A. Is discount under ESOP a short capital receipt?

9.2.1 The ld. DR stated that the question of deduction u/s 37 can arise only if the assessee incurs any expenditure, which thereafter satisfies the requisite conditions of the sub-section (1). He submitted that the word "expenditure" has been described by the Hon'ble Supreme Court in the case of Indian Molasses Co. (P.) Ltd. v. CIT [1959] 37 ITR 66 as denoting spending or paying out, i.e. something going out of the coffers of the assessee. It was put forth that by issuing shares at discounted premium, nothing is paid out by the company. Once there is no "paying out or away", the same cannot constitute an expenditure and resultantly section 37(1), which applies to only expenditure, cannot be activated. He further took pains in explaining that there is no revenue expenditure involved in the transaction of issuance of ESOP at discount. The so called 'discount' represents the difference between market price of the shares at the time of grant of options and the price at which such options are granted. Since the amount over and above the face value of the shares, being the share premium, is itself a capital receipt, any under-recovery of such share premium on account of obligation to issue shares to employees in future at a lower premium, would be a case of short capital receipt. If at all it is to be viewed in terms of expenditure, then, at best, it would be in the nature of a capital expenditure. He supported his view by relying on the order passed by the Delhi Bench of the Tribunal in Ranbaxy Laboratories Ltd. v. Addl. CIT [2010] 39 SOT 17 (URO). It was stated that the Tribunal in that case has held that since the receipt of share premium is not taxable, any short receipt of such premium on issuing options to employees will be notional loss and not actual loss for which any liability is incurred. The learned Departmental Representative contended that the Mumbai bench of the Tribunal in the case of VIP Industries v. Dy. CIT [IT Appeal No.7242 (Mum.) of 2008 has also taken similar view vide its order dated 17.09.2010.]

9.2.2 Per contra, the learned AR submitted that it is not a case of any short receipt of share premium but that of compensation given to employees. He supported the admissibility of deduction of the amount of discount on the strength of the order passed by the Chennai bench of the tribunal in the case of S.S.I. Ltd. (supra) granting deduction of such discount by treating it as an employee cost. He submitted that the above view taken by the Chennai Bench has been approved by the Hon'ble Madras High Court in CIT v. PVP Ventures Ltd. [2012] 211 Taxman 554/23 taxmann.com 286. The learned AR argued that PVP Ventures Ltd. (supra) is a solitary judgment rendered by any High Court on the issue and hence the same needs to be followed in preference to any contrary Tribunal order. It was also pointed out that the Chennai bench's view has been subsequently followed by the Chandigarh Bench of the Tribunal in Asstt. CIT v. Spray Engineering Devices Ltd. [2012] 23 taxmann.com 267/53 SOT 70 (URO).

9.2.3 Let us examine the facts of the case of Ranbaxy Laboratories Ltd. (supra), which has been strongly relied by the learned Departmental Representative. It deals with a situation in which the assessee granted stock option to its employees. The shares were to be issued at Rs. 559 per share as against the face value of Rs. 10 and the market price on the date of grant at Rs. 738.95 per share. The assessee treated the difference between Rs. 738.95 and Rs. 595 as employees compensation in the books of account and charged the same to its Profit and loss account by spreading it over the vesting period. It was one of the years of the vesting period for which the assessee claimed deduction that came up for consideration before the Tribunal. It was held by the Tribunal that the market price of Rs. 738.55 per share would have resulted in realization of higher share premium. Since the assessee did not account for the difference between Rs. 738.55 and Rs. 10 as its income during the year, there was no loss of income. It was further noticed that by issuing shares at below the market price, there was no incurring of any expenditure. Rather it resulted into short receipt of share premium which the assessee was otherwise entitled to. As the receipt of share premium is not taxable, any short receipt of such premium will only be a notional loss and not actual loss requiring any deduction. The Tribunal further noticed that incurring of such notional loss cannot be considered as expenditure within the meaning of section 37(1) as there was no "spending" or "paying out or away". The contention of the assessee that SEBI Guidelines recommend claim for deduction of discount over the vesting period, did not find favour with the Tribunal on the ground that the SEBI Guidelines were not relevant in determining the total income chargeable to tax.

9.2.4 In order to appreciate the rival submissions, it is of the utmost importance to understand the concept of ESOP. Section 2(15A) of the Indian Companies Act, 1956 defines "employee stock option" to mean 'the option given to the whole-time Directors, Officers or employees of a company, which gives such Directors, Officers or employees, the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a predetermined price". In an ESOP, the given company undertakes to issue shares to its employees at a future date at a price lower than the current market price. This is achieved by granting stock options to its employees at discount. The amount of discount represents the difference between market price of the shares at the time of the grant of option and the offer price. In order to be eligible for acquiring the shares under the ESOP, the concerned employees are obliged to render services to the company during the vesting period as given in the scheme. On the completion of the vesting period in the service of the company, such options vest with the employees. The options are then exercised by the employees by making application to the employer for the issue of shares against the options vested in them. The gap between the completion of vesting period and the time for exercising the options is usually negligible. The company, on the exercise of option by the employees, allots shares to them who can then freely sell such shares in the open market subject to the terms of the ESOP. Thus it can be seen that it is during the vesting period that the options granted to the employees vest with them. This period commences with the grant of option and terminates when the options so granted vest in the employees after serving the company for the agreed period. By granting the options, the company gets a sort of assurance from its employee for rendering uninterrupted services during the vesting period and as a quid pro quo it undertakes to compensate the employees with a certain amount given in the shape of discounted premium on the issue of shares.

9.2.5 The core of the arguments of the ld. DR in this regard is two-fold. First, that it is not an expenditure in itself and secondly, it is a short capital receipt or at the most a sort of capital expenditure. In our considered opinion both the legs of this contention are legally unsustainable.

9.2.6 There is no doubt that the amount of share premium is otherwise a capital receipt and hence not chargeable to tax in the hands of company. The Finance Act, 2012 has inserted clause (viib) of section 56(2) w.e.f. 1.4.2013 providing that: 'where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares', then such excess share premium shall be charged to tax under the head 'Income from other sources'. But for that, the amount of share premium has always been understood and accepted as a capital receipt. If a company issues shares to the public or the existing shareholders at less than the otherwise prevailing premium due to market sentiment or otherwise, such short receipt of premium would be a case of a receipt of a lower amount on capital account. It is so because the object of issuing such shares at a lower price is nowhere directly connected with the earning of income. It is in such like situation that the contention of the learned Departmental Representative would properly fit in, thereby debarring the company from claiming any deduction towards discounted premium. It is quite basic that the object of issuing shares can never be lost sight of. Having seen the rationale and modus operandi of the ESOP, it becomes out-and-out clear that when a company undertakes to issue shares to its employees at a discounted premium on a future date, the primary object of this exercise is not to raise share capital but to earn profit by securing the consistent and concentrated efforts of its dedicated employees during the vesting period. Such discount is construed, both by the employees and company, as nothing but a part of package of remuneration. In other words, such discounted premium on shares is a substitute to giving direct incentive in cash for availing the services of the employees. There is no difference in two situations viz., one, when the company issues shares to public at market price and a part of the premium is given to the employees in lieu of their services and two, when the shares are directly issued to employees at a reduced rate. In both the situations, the employees stand compensated for their effort. If under the first situation, the company, say, on receipt of premium amounting to Rs. 100 from issue of shares to public, gives Rs. 60 as incentive to its employees, such incentive of Rs. 60 would be remuneration to employees and hence deductible. In the same way, if the company, instead, issues shares to its employees at a premium of Rs. 40, the discounted premium of Rs. 60, being the difference between Rs. 100 and Rs. 40, is again nothing but a different mode of awarding remuneration to employees for their continued services. In both the cases, the object is to compensate employees to the tune of Rs. 60. It follows that the discount on premium under ESOP is simply one of the modes of compensating the employees for their services and is a part of their remuneration. Thus, the contention of the ld. DR that by issuing shares to employees at a discounted premium, the company got a lower capital receipt, is bereft of an force. The sole object of issuing shares to employees at a discounted premium is to compensate them for the continuity of their services to the company. By no stretch of imagination, we can describe such discount as either a short capital receipt or a capital expenditure. It is nothing but the employees cost incurred by the company. The substance of this transaction is disbursing compensation to the employees for their services, for which the form of issuing shares at a discounted premium is adopted.

9.2.7 Now we espouse the second part of the submission of the ld. DR in this regard. He canvassed a view that an expenditure denotes "paying out or away" and unless the money goes out from the assessee, there can be no expenditure so as to qualify for deduction u/s 37. Sub-section (1) of the section provides that any expenditure (not being expenditure in 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". To put it differently, an expenditure must be laid out or expended wholly and exclusively for the purpose of business so as to be eligible for deduction u/s 37(1). There is absolutely no doubt that section 37(1) talks of granting deduction for an 'expenditure', and the Hon'ble Supreme Court in Indian Molasses Co. (P.) Ltd. (supra) has described 'expenditure' to mean what is 'paid out or away' and is something which has gone irretrievably. However, it is pertinent to note that this section does not restrict paying out of expenditure in cash alone. Section 43 contains the definition of certain terms relevant to income from profits of business or profession covering sections 28 to 41. Section 37 obviously falls under Chapter IV-D. Sub-section (2) of section 43 defines "paid" to mean: "actually paid or incurred according to the method of accounting upon the basis of which the profits or gains are computed under the head 'profits and gains of business or profession'." When we read the definition of the word "paid" u/s 43(2) in juxtaposition to section 37(1), the position which emerges is that it is not only paying of expenditure but also incurring of the expenditure which entails deduction u/s 37(1) subject to the fulfilment of other conditions. At this juncture, it is imperative to note that the word 'expenditure' has not been defined in the Act. However, sec. 2(h) of the Expenditure Act, 1957 defines 'expenditure' as : 'Any sum of money or money's worth spent or disbursed or for the spending or disbursing of which a liability has been incurred by an assessee……'. When section 43(2) of the Act is read in conjunction with section 37(1), the meaning of the term 'expenditure' turns out to be the same as is there in the aforequoted part of the definition under section 2(h) of the Expenditure Act, 1957, viz., not only 'paying out' but also 'incurring'. Coming back to our context, it is seen that by undertaking to issue shares at discounted premium, the company does not pay anything to its employees but incurs obligation of issuing shares at a discounted price on a future date in lieu of their services, which is nothing but an expenditure u/s 37(1) of the Act.

9.2.8 Though discount on premium is nothing but an expenditure u/s 37(1), it is worth noting that the Hon'ble Supreme Court in the case of CIT v. Woodward Governor India (P.) Ltd. [2009] 312 ITR 254/179 Taxman 326 has gone to the extent of covering "loss" in certain circumstances within the purview of "expenditure" as used in section in 37(1). In that case, the assessee incurred additional liability due to exchange rate fluctuation on a revenue account. The Assessing Officer did not allow deduction u/s 37. When the matter finally reached the Hon'ble Supreme Court, their Lordships noticed that the word "expenditure" has not been defined in the Act. They held that : "the word "expenditure" is, therefore, required to be understood in the context in which it is used. Section 37 enjoins that any expenditure not being expenditure of the nature described in sections 30 to 36 laid out or expended wholly and exclusively for the purposes of the business should be allowed in computing the income chargeable under the head "profits and gains of business or profession". In sections 30 to 36 the expression "expenditure incurred", as well as allowance and depreciation, has also been used. For example depreciation and allowances are dealt with in section 32, therefore, the parliament has used expression "any expenditure" in section 37 to cover both. Therefore, the expression "expenditure" as used in section 37 made in the circumstances of a particular case, covers an amount which is really a "loss" even though the said amount has not gone out from the pocket of the assessee'. From the above enunciation of law by the Hon'ble Summit Court, there remains no doubt whatsoever that the term 'expenditure' in certain circumstances can also encompass 'loss' even though no amount is actually paid out. Ex consequenti, the alternative argument of the ld. DR that discount on shares is 'loss' and hence can't be covered u/s 37(1), also does not hold water in the light of the above judgment. In view of the above discussion, we, with utmost respect, are unable to concur with the view taken in Ranbaxy Laboratories Ltd. (supra).

B. Is discount a Contingent liability ?

9.3.1 The learned Departmental Representative supported the impugned order by contending that the entitlement to ESOP depends upon the fulfilment of several conditions laid down under the scheme. It is only when all such conditions are fulfilled and the employees render services during the vesting period that the question of any ascertained liability can arise. He submitted that during the entire vesting period, it is only a contingent liability and no deduction is admissible under the provisions of the Act for a contingent liability. The options so granted may lapse during the vesting period itself by reason of termination of employment or some of the employees may not choose to exercise the option even after rendering the services during the vesting period. It was, therefore, argued that the discount is nothing but a contingent liability during the vesting period not calling for any deduction. In the opposition, the learned AR submitted that the amount of discount claimed by the assessee as deduction is not a contingent liability but an ascertained liability. He stated that in the ESOP 2000, there is a vesting period of four years, which means that the options to the extent of 25% of the total grant would vest with the eligible employees at the end of first year after rendering unhindered service for one year and it would go on till the completion of four years.

9.3.2 It is a trite law and there can be no quarrel over the settled legal position that deduction is permissible in respect of an ascertained liability and not a contingent liability. Section 31 of the Indian Contract Act, 1872 defines "contingent contract" as "a contract to do or not do something, if some event, collateral to such contract does not happen". We need to determine as to whether the liability arising on the assessee-company for issuing shares at a discounted premium can be characterized as a contingent liability in the light of the definition of contingent contract. From the stand point of the company, the options under ESOP 2000 vest with the employees at the rate of 25% only on putting in service for one year by the employees. Unless such service is rendered, the employees do not qualify for such options. In other words, rendering of service for one year is sine qua non for becoming eligible to avail the benefit under the scheme. Once the service is rendered for one year, it becomes obligatory on the part of the company to honor its commitment of allowing the vesting of 25% of the option. It is at the end of the first year that the company incurs liability of fulfilling its promise of allowing proportionate discount, which liability would be actually discharged at the end of the fourth year when the options are exercised by the employees. Now the question arises as to whether the liability at the end of each year can be construed as a contingent one?

9.3.3 The Hon'ble Supreme Court in Bharat Earth Movers v. CIT [2000] 245 ITR 428/112 Taxman 61 dealt with the deductibility or otherwise of provision for liability towards encashment of earned leave. In that case, the company floated beneficial scheme for its employees for encashment of leave. The earned leave could be accumulated up to certain days. The assessee created provision of Rs. 62.25 lakh for encashment of accrued leave and claimed deduction for the same. The Assessing Officer held it to be a contingent liability and hence not a permissible deduction. When the matter finally came up before the Hon'ble Supreme Court, it was held that the provision for meeting the liability for encashment of earned leave by the employee was an admissible deduction. In holding so, the Hon'ble Apex Court observed that : "the law is settled : if a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. The liability is in praesenti though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain." From the above enunciation of law by the Hon'ble Supreme Court, it is manifest that a definite business liability arising in an accounting year qualifies for deduction even though the liability may have to be quantified and discharged at a future date. We consider it our earnest duty to mention that the legislature has inserted clause (f) to section 43B by providing that "any sum payable by the assessee as an employer in lieu of any leave at the credit of his employee" shall be allowed as deduction in computing the income of the previous year in which such sum is actually paid. With this legislative amendment, the application of the ratio decidendi in the case of Bharat Earth Movers (supra) to the provision for leave encashment has been nullified. However, the principle laid down in the said judgment is absolutely intact that a liability definitely incurred by an assessee is deductible notwithstanding the fact that its quantification may take place in a later year. The mere fact that the quantification is not precisely possible at the time of incurring the liability would not make an ascertained liability a contingent.

9.3.4 Almost to the similar effect, there is another judgment of the Hon'ble Supreme Court in the case of Rotork Controls India (P.) Ltd. v. CIT [2009] 314 ITR 62/180 Taxman 422. In that case, the assessee-company was engaged in selling certain products. At the time of sale, the company provided a standard warranty that in the event of certain part becoming defective within 12 months from the date of commissioning or 18 months from the date of dispatch, whichever is earlier, the company would rectify or replace the defective parts free of charge. This warranty was given under certain conditions stipulated in the warranty clause. The assessee made a provision for warranty at Rs. 5.18 lakh towards the warranty claim likely to arise on the sales effected by the assessee. The Assessing Officer disallowed the same on the ground that the liability was merely a contingent liability and hence not allowable as deduction u/s 37 of the Act. When the matter finally came up before the Hon'ble Supreme court, it entitled the assessee to deduction on the "accrual" concept by holding that a provision is recognized when : "(a) an enterprise has a present obligation as a result of a past event; (b) it is probable that an outflow of resources will be required to settle the obligation : and (c) a reliable estimate can be made of the amount of the obligation". Resultantly, the provision was held to be deductible.

9.3.5 When we consider the facts of the present case in the backdrop of the ratio laid down by the Hon'ble Supreme Court in Bharat Earth Movers (supra) and Rotork Controls India (P.) Ltd. (supra), it becomes vivid that the mandate of these cases is applicable with full force to the deductibility of the discount on incurring of liability on the rendition of service by the employees. The factum of the employees becoming entitled to exercise options at the end of the vesting period and it is only then that the actual amount of discount would be determined, is akin to the quantification of the precise liability taking place at a future date, thereby not disturbing the otherwise liability which stood incurred at the end of the each year on availing the services.

9.3.6 As regards the contention of the ld. DR about the contingent liability arising on account of the options lapsing during the vesting period or the employees not choosing to exercise the option, we find that normally it is provided in the schemes of ESOP that the vested options that lapse due to non-exercise and/or unvested options that get cancelled due to resignation of the employees or otherwise, would be available for grant at a future date or would be available for being re-granted at a future date. If we consider it at micro level qua each individual employee, it may sound contingent, but if view it at macro level qua the group of employees as a whole, it loses the tag of 'contingent' because such lapsing options are up for grabs to the other eligible employees. In any case, if some of the options remain unvested or are not exercised, the discount hitherto claimed as deduction is required to be reversed and offered for taxation in such later year. We, therefore, hold that the discount in relation to options vesting during the year cannot be held as a contingent liability.

C. Fringe benefit

9.4.1 There is another important dimension of this issue. Chapter XII-H of the Act consisting of sections 115W to 115WL with the caption : "Income-Tax on Fringe Benefits" has been inserted by the Finance Act, 2005 w.e.f. 1.4.2006. Memorandum explaining the provisions of the Finance Bill, 2005 highlights the details of the Fringe Benefits Tax. It provides that : 'Fringe benefits as outlined in section 115WB, mean any privilege, service, facility or amenity directly or indirectly provided by an employer to his employees (including former employees) by reason of their employment.' Charging section 115WA of this Chapter provides that : "In addition to the income-tax charged under this Act, there shall be charged for every assessment year………..fringe benefit tax in respect of fringe benefits provided or deemed to have been provided by an employee to his employees during the previous year…………". Section 115WB gives meaning to the expression 'Fringe Benefits'. Sub-section (1) provides that for the purposes of this Chapter, 'fringe benefits' means any consideration for employment as provided under clauses (a) to (d). Clause (d), which is relevant for our purpose, states that : 'any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer free of cost or at concessional rate to his employees (including former employee or employees)' shall be taken as fringe benefit. Explanation to this clause clarifies that for the purposes of this clause,- (i) "specified security" means the securities as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and, where employees' stock option has been granted under any plan or scheme thereof, includes the securities offered under such plan or scheme. Thus it is discernible from the above provisions of the Act that the legislature itself contemplates the discount on premium under ESOP as a benefit provided by the employer to its employees during the course of service. If the legislature considers such discounted premium to the employees as a fringe benefit or 'any consideration for employment', it is not open to argue contrary. Once it is held as a consideration for employment, the natural corollary which follows is that such discount (i) is an expenditure; (ii) such expenditure is on account of an ascertained (not contingent) liability ; and (iii) it cannot be treated as a short capital receipt. In view of the foregoing discussion, we are of the considered opinion that discount on shares under the ESOP is an allowable deduction.

II. IF YES, THEN WHEN AND HOW MUCH?

10.1 Having seen that the discount under ESOP is a deductible expenditure u/s 37(1), the next question is that 'when' and for 'how much' amount should the deduction be granted ?

10.2 The assessee is a limited company and hence it is obliged to maintain its accounts on mercantile basis. Under such system of accounting, an item of income becomes taxable when a right to receive it is finally acquired notwithstanding the fact that when such income is actually received. Even if such income is actually received in a later year, its taxability would not be evaded for the year in which right to receive was finally acquired. In the same manner, an expense becomes deductible when liability to pay arises irrespective of its actual discharge. The incurring of liability and the resultant deduction cannot be marred by mere reason of some difficulty in proper quantification of such liability at that stage. The very point of incurring the liability enables the assessee to claim deduction under mercantile system of accounting. We have noticed the mandate of the Hon'ble Supreme Court in Bharat Earth Movers (supra) that if a business liability has definitely arisen in an accounting year, then the deduction should be allowed in that year itself notwithstanding the fact that such liability is incapable of proper quantification at that stage and is dischargeable at a future date. It follows that the deduction for an expense is allowable on incurring of liability and the same cannot be disturbed simply because of some difficulty in the proper quantification. A line of distinction needs to be drawn between a situation in which a liability is not incurred and a situation in which the liability is incurred but its quantification is not possible at the material time. Whereas in the first case, there cannot be any question of allowing deduction, in the second case, deduction has to be allowed for a sum determined on some rational basis representing the amount of liability incurred.

10.3 We have earlier underlined the concepts of grant of options, vesting of options and exercise of options. The period from grant of option to the vesting of option is the 'vesting period'. It is during such period that an employee is supposed to render service to the company so as to earn an entitlement to the shares at a discounted premium. The vesting period may vary from a case to case. If the vesting period is, say, four years with equal vesting at the end of each year, then it is at the end of the vesting period or during the exercise period, which in turn immediately succeeds the vesting period, that the employee becomes entitled to exercise 100 options or qualify for receipt of 100 shares at discount. Though the shares are allotted at the end of the vesting period, but it is during such vesting period that the entitlement is earned. It means that 25 options vest with the employee at the end of each year on his rendering service for the respective year. If during the interregnum, he leaves the service, say after one year, he will still remain entitled to exercise option for 25 shares at the discounted premium at the time of exercise of option. In that case, the benefit which would have accrued to him at the end of the second, third and fourth years would stand forfeited. Thus it becomes abundantly clear that an employee becomes entitled to the shares at a discounted premium over the vesting period depending upon the length of service provided by him to the company. In all such schemes, it is at the end of the vesting period that option is exercisable albeit the proportionate right to option is acquired by rendering service at the end of each year.

10.4 Similar is the position from the stand point of the company. An obligation falls upon the company to allot shares at the time of exercise of option depending upon the length of service rendered by the employee during the vesting period. The incurring of liability towards the discounted premium, being compensation to employee, is directly linked with the span of service put in by the employee. In the above illustration, when 25 out of 100 shares vest in the employee after rendering one year's service, the company also incurs equal obligation at the end of the first year for which it becomes entitled to rightfully claim deduction u/s 37(1) of the Act. Similarly at the end of the second year of service by the employees, the company can claim deduction for discounted premium in respect of further 25 shares so on and so forth till fourth year when the last tranche of discounted premium in respect of 25 shares becomes available for deduction. It, therefore, transpires that a company under the mercantile system can lawfully claim deduction for total discounted premium representing the employees cost over the vesting period at the rate at which there is vesting of options in the employees.

10.5 From the above discussion it is lucid that at the event of granting options, the company does not incur any obligation to issue the shares at discounted premium. Mere granting of option does neither entitle the employee to exercise such option nor allow the company to claim deduction for the discounted premium. It is during the vesting period that the company incurs obligation to issue discounted shares at the time of exercise of option. Thus the event of granting options does not cast any liability on the company. On the other end is the date of exercising the options. Though the employees become entitled to exercise the option at such stage but the fact is that it is simply a result of vesting of options with them over the vesting period on the rendition of services to the company. In other words, it is a stage of realization of income earned during the vesting period. In the same manner, though the company becomes liable to issue shares at the time of the exercise of option, but it is in lieu of the employees compensation liability which it incurred over the vesting period by obtaining their services. From the above it is apparent that the company incurs liability to issue shares at the discounted premium only during the vesting period. The liability is neither incurred at the stage of the grant of options nor when such options are exercised.

10.6 Let us consider the facts of the case of S.S.I. Ltd. (supra), which has been strongly relied by the ld. AR in support of his claim for deduction of discount during the years of vesting of options. In that case the vesting period was three years and the assessment order was passed u/s 143(3), inter alia, allowing deduction of Rs. 66.82 lakh under the head "Staff welfare expenses" on account of amortization of discounted value of option over a period of three years. The CIT revised such order by directing the A.O. to disallow ESOP expenditure of Rs. 66.82 lakh. When the matter came up before the Tribunal, it was held that the expenditure in that behalf was an ascertained liability and not contingent upon happening of certain events. It was further noticed that the assessee claimed deduction of such discount on ESOP by following the SEBI

Guidelines. As the expenditure itself was an ascertained liability, the Tribunal held that the same to be deductible.

10.7 Before proceeding further it would be befitting to take stock of the nutshell of the SEBI Guidelines in this regard. These Guidelines provide for granting of deduction on account of discount on issue of options during the vesting period. It has been so explained with the help of an example in Schedule I to the Guidelines. For the sake of simplicity, we are taking an instance under which an option of share with face value of Rs. 10 is given under ESOP to employees at the option price of Rs. 10 as against the market price of such shares at Rs. 110 on that date. Further suppose that the vesting period is four years with equal vesting @ 25% at the end of each year. Total discount comes to Rs. 100 (Rs. 110 - Rs. 10). These Guidelines provide for claiming deduction in the accounts for a total discount of Rs. 100 divided over the vesting period of four years on straight line basis at the rate of Rs. 25 each. The case of S.S.I. Ltd. (supra) deals with a controversy relating to one of the vesting years. The tribunal entitled the assessee to proportionate deduction. Thus it is evident that the view taken by the tribunal in that case not only matches with the SEBI Guidelines but also the 'accrual concept' in the mercantile system of accounting, thereby allowing deduction at the stage of incurring of liability.

10.8 Reverting to the questions of 'when' and 'how much' of deduction for discount on options is to be granted, we hold that the liability to pay the discounted premium is incurred during the vesting period and the amount of such deduction is to be found out as per the terms of the ESOP scheme by considering the period and percentage of vesting during such period. We, therefore, agree with the conclusion drawn by the tribunal in S.S.I. Ltd.'s case (supra) allowing deduction of the discounted premium during the years of vesting on a straight line basis, which coincides with our above reasoning.

III. SUBSEQUENT ADJUSTMENT TO DISCOUNT

11.1.1 Having answered the first major issue in affirmative that the discount on options under ESOP is an ascertained liability and the second major issue that the discount is deductible over the vesting period on straight line basis unless the vesting is not uniform, then arises the present issue as to whether any subsequent adjustment is warranted at the time of exercise of options, to the deductions earlier allowed for the amount of discount. It is noticed that the assessment years 2003-2004 to 2007-2008 are under consideration and during these years ESOP 2000 has come to an end and the ESOP 2004 has started. Further, the extant issue is a vital part of the overall question of the deductibility or otherwise of the amount of discount under ESOP.

11.1.2 We have noticed above that the company incurs a definite liability during the vesting period, but its proper quantification is not possible at that stage as the actual amount of employees cost to the company, can be finally determined at the time of the exercise of option or when the options remain unvested or lapse at the end of the exercise period. It is at this later stage that the provisional amount of discount on ESOP, initially quantified on the basis of market price at the time of grant of options, needs to be suitably adjusted with the actual amount of discount.

11.1.3 As regards the adjustment of discount when the options remain unvested or lapse at the end of the exercise period, it is but natural that there is no employee cost to that extent and hence there can be no deduction of discount qua such part of unvested or lapsing options. But, as the amount was claimed as deduction by the company during the period starting with the date of grant till the happening of this event, such discount needs to be reversed and taken as income. It is so because logically when the options have not eventually vested in the employees, to that extent, the company has incurred no employee cost. And if there is no cost to the company, the tentative amount of deduction earlier claimed on the basis of the market price at the time of grant of option ceases to be admissible and hence needs to be reversed. The ld. AR stated that the discount in respect of the unvested/lapsing options has been reversed on the happening of such events and the overall employee cost has been correspondingly reduced. We find that the SEBI Guidelines also provide that the discount written off in respect of unvested options and the options lapsing at the end of the exercise period shall be reversed at the appropriate time. As the accounting treatment directed through the Guidelines accords with the taxation principle of not allowing deduction for the amount of discount on unvested/lapsing options and further the assessee has admitted to have offered such amount as income in the relevant years, we stop here by holding that the amount of discount claimed as deduction earlier in respect of unvested/lapsing options, has to be taxed as income on the happening of such events.

11.1.4 Now we take up the second situation in which the options are exercised by the employees after putting in service during the vesting period. In such a scenario, the actual amount of remuneration to the employees would be only the amount of actual discounted premium at the time of exercise of option. The Hon'ble Supreme Court in the case of CIT v. Infosys Technologies Ltd. [2008] 297 ITR 167/166 Taxman 204 relevant to the assessment years 1997-98 to 1999-2000 has held that the allotment of shares to employees under ESOP subject to a lock in period of five years and other conditions could not be treated as a perquisite as there was no benefit and the value of benefit, if any, was unascertainable at the time when options were exercised. The Finance Act, 1999 inserted section 17(2)(iiia) with effect from 1st April, 2000 providing that : "the value of any specified security allotted or transferred, directly or indirectly, by any person free of cost or at a concessional rate to an individual who is or has been in employment of that person" shall be treated as a perquisite. It further provides that in a case the 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. Such clause (iiia) was subsequently deleted with effect from 1st April, 2001. After certain changes to the relevant provisions in this regard, the position which now stands is that the discount on ESOP is taxable as perquisite u/s 17(2)(vi) for : 'the value of any specified security or sweat equity shares allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at concessional rate to the assessee'. Clause (c) of Explanation to section 17(2)(vi) provides that : 'the value of any specified security or sweat equity shares shall be the fair market value of the specified security or sweat equity shares, as the case may be, on the date on which the option is exercised by the assessee as reduced by the amount actually paid by, or recovered from, the assessee in respect of such security or shares'. Two things surface from the above provisions. First, that the perquisite arises on the 'allotment' of shares and second, the value of such perquisite is to be computed by considering the fair market value of the shares on 'the date on which the option is exercised' by the assessee as reduced by the amount actually paid. The position that such amount was or was not taxable during some of the years in the hands of the employees is not relevant in considering the occasion and the amount of benefit accruing to the employee under ESOP. Any exemption or the deductibility of an allowance or benefit to employee from taxation does not obliterate the benefit itself. It simply means that the benefit accrued to the assessee but the same did not attract tax. The position has now been clarified beyond doubt by the legislature that the ESOP discount, which is nothing but the reward for services, is a taxable perquisite to the employee at the time of exercise of option, and its valuation is to be done by considering the fair market value of the shares on the date on which the option is exercised.

11.1.5 The other side of the coin is the amount of remuneration to the employees in the hands of the company. We have noticed earlier that an expense becomes deductible on the incurring of liability under the mercantile system of accounting. Although the stage of taxability of perquisite in the hands of the employee may differ from the stage of the deductibility of expense in the hands of the company depending upon the method of account followed by the company, but the amount of such discount or employees remuneration can never be different. If the value of perquisite in the hands of the employee, whether or not taxable, is 'x', then its cost in the hands of the company has also to be 'x'. It can neither be 'x+1' nor 'x-1'. It is simple and plain that the amount of remuneration which percolates to the employees will always be equal to the amount flowing from the company and such remuneration to the employee in the present context is the amount which he actually becomes entitled to on the exercise of options. Thus, it is palpable that since the remuneration to the employees under the ESOP is the amount of discount w.r.t. the market price of shares at the time of exercise of option, the employees cost in the hands of the company should also be w.r.t. the same base.

11.1.6 The amount of discount at the stage of granting of options w.r.t. the market price of shares at the time of grant of options is always a tentative employees cost because of the impossibility in correctly visualizing the likely market price of shares at the time of exercise of option by the employees, which, in turn, would reflect the correct employees cost. Since the definite liability is incurred during the vesting period, it has to be quantified on some logical basis. It is this market price at the time of the grant of options which is considered for working out the amount of discount during the vesting period. But, since actual amount of employees cost can be precisely determined only at the time of the exercise of option by the employees, the provisional amount of discount availed as deduction during the vesting period needs to be adjusted in the light of the actual discount on the basis of the market price of the shares at the time of exercise of options. It can be done by making suitable northwards or southwards adjustment at the time of exercise of option. This can be explained with the following example with the assumption of vesting period of four years and the benefit vesting at 25% each at the end of 1st to 4th years:—

	At the time of granting option	At the time of exercise of option		
		Situation I	Situation II	Situation III
Market value per share	110	110	130	90
Option price	10	10	10	10
Employees compensation or Discount	100	100	120	80

11.1.7 From the above table it can be noticed that the market price of the shares at the time of grant of option was Rs. 110 against the option price of Rs. 10, which resulted in discount at Rs. 100. With the vesting period of four years with the equal vesting, the company can rightly claim deduction at the rate of Rs. 25 each at the end of first, second, third and fourth year of vesting. But this total deduction for discount of Rs. 100 over the vesting period needs to be adjusted at the time of exercise of option by the employee when the shares are issued. In Situation I, the market price of shares at the time of exercise of option is at Rs. 110, which is similar to the market price at the time of grant of option. As the total amount of discount of Rs. 100 over the vesting period is actually quantified at Rs. 100, no further adjustment to the discount is required at the time of exercise of option. In Situation II, the market price of the share at the time of exercise of option has gone up to Rs. 130. The amount of real compensation to employee is Rs. 120 as against the tentative compensation of Rs. 100 per share which was accounted for and allowed as deduction during the vesting period. As the actual quantification of the compensation has turned out to be Rs. 120, the company is entitled to a further deduction of Rs. 20 at the time of exercise of option. In Situation III, the market price of the share at the time of exercise of option has come down to Rs. 90. The amount of real compensation to employees is Rs. 80 as against the tentative compensation of Rs. 100, which was allowed as deduction during the vesting period. As the actual quantification of the compensation has turned out to be Rs. 80, the company is liable to reverse the deduction of Rs. 20 at the time of exercise of option.

Taxation vis-à-vis Accountancy principles

11.2.1 It has been noticed that broadly there are three stages having effect on the total income of the company in the life cycle of ESOP, viz., (i) during the vesting period, (ii) at the time of unvesting/lapse of options and (iii) finally at the time of exercise of options. It has been argued that the assessee company claimed deduction for the amount of discount during the vesting period on the basis of the market price of shares at the time of grant of options and also reversed the proportionate discount on unvesting/lapsing of options at the appropriate time on the basis of the SEBI Guidelines. If this contention is correct, it would mean that the first two stages have been rightly given effect to. But the appellant assessee does not appear to have made any downward adjustment to the amount of discount at the time of exercise of option by the employees with the difference in the market price of the shares at the time of grant of option and price at the time of exercise of option. The argument seems to be that the SEBI Guidelines do not provide for such downward adjustment. It has been argued by the ld. AR that where the provisions of the Act specifically provide for treatment of a particular source of income in a particular manner, then the germane provision should be followed. If, however, there is no specific provision dealing with an issue in the Act, then the accounting principles should be adhered to while determining the total income of the assessee. In this regard, he relied on the judgment in the case of Challapalli Sugars Ltd.'s (supra), wherein the Hon'ble Supreme Court has held that the interest payable on capital borrowed by the assessee for purchase of plant and machinery before the commencement of business should be capitalized on the basis of accepted accountancy rule. Similarly in the case of U.P. State Industrial Development Corpn. (supra), the Hon'ble Apex Court held in the case of an underwriter that it would be right to consider the net investment, that is the purchase price less the underwriting commission received by the underwriter as investment as against treating the gross amount by taking into consideration the principles of commercial accounting. He stated that since there is no specific provision in the Act providing for the treatment of discount on ESOP in the computation of total income, the accounting principles formulated by way of the SEBI Guidelines are required to be followed.

11.2.2 In the oppugnation, the learned Departmental Representative submitted that the SEBI Guidelines cannot mandate the deductibility or otherwise of an amount under the provisions of the Act. He relied on the judgments of the Hon'ble Supreme Court in Tuticorin Alkali Chemicals & Fertilizers Ltd. (supra) and Godhra Electricity Co. Ltd. (supra) in support of this proposition.

11.2.3 We are not persuaded by the submissions put forth by the ld. AR that, in the absence of any specific provision in the Act, the accounting principles should be followed for determining the total income of the assessee. What is true for accounting purpose need not necessarily be true for taxation. Taxation principles are enshrined in the legislature. Power to legislate lies with the Parliament. Accounting standards or Guidance Note or Guidelines etc., by whatever name called, issued by any autonomous or even statutory bodies including the Institute of Chartered Accountants of India, or for that matter, the SEBI are meant only to prescribe the way in which the transactions should be recorded in books or reflected in the annual accounts. These guidelines do not have the force of an Act of Parliament. Since the subject matter of tax on income falls in the Union List as per Part XI of the Indian Constitution, it is only the Parliament which can legislate on its scope.

11.2.4 Be that as it may, there is no weight in the contention of the ld. AR that there is no specific provision in the Act on the ESOP discount. It is axiomatic that the taxation rules are always embodied in the relevant Act, either in a specific or a general manner. These can be specific by making a clear cut provision in respect of deductibility of a particular item of expense or taxation of a particular item of income. General provisions are those which set out the overall principles to govern the deductibility or taxability of unspecified items. For example, the definition of 'income' u/s 2(24) has been given by the Act in an inclusive manner. There have been enshrined clauses (i) to (xvi) dealing with the items specifically listed. However, the provision has been couched in such a way so as to include general items of receipts having character of income, even though not specifically mentioned. Similar is the position regarding deductions. Under the head 'Profits and gains of business or profession', there are sections granting deductions in respect of specific expenses or allowances. Similarly, there is section 37(1), which grants deduction for expenses not specifically set out in other sections, if the conditions stipulated in the section, are fulfilled. All other items of expenses, which fulfil the requisite conditions, gain deductibility under section 37(1). To put it in simple words, this section is a specific provision for granting deduction in respect of the unspecified or the general categories of expenses. Discount on ESOP is a general expense and hence covered by the specific provision of section 37. The contention of the ld. AR that there is no provision in the Act dealing with the deductibility of ESOP discount, is therefore, devoid of any merit. This concludes the question of granting of deduction of discount during the vesting period.

11.2.5 The SEBI Guidelines have been taken shelter of to contend that there is no requirement for the adjustment of discount at the time of exercise of options. Primarily, we are unable to trace the proposition anywhere from the Act that the accounting principles are also determinative of the tax liability. The jurisprudence is rather the other way around. In Tuticorin Alkali Chemicals & Fertilizers Ltd. (supra), the Hon'ble Supreme Court has laid down in so many words that the taxing principles cannot walk on the footsteps of the accounting principles. At this juncture, it would be useful to have a glimpse at the following observations of the Hon'ble Supreme Court in the afore noted case: 'It is true that this court has very often referred to accounting practice for ascertainment of profit made by a company or value of the assets of a company. But when the question is whether a receipt of money is taxable or not or whether certain deductions from that receipt are permissible in law or not, the question has to be decided according to the principles of law and not in accordance with accountancy practice. Accounting practice cannot override section 56 or any other provision of the Act. As was pointed out by Lord Russell in the case of B.S. C. Footwear Ltd. v. Ridguary (Inspector of Taxes [1970] 77 ITR 857 (CA), the income-tax law does not march step by step in the footprints of the accountancy profession.'

11.2.6 The same view has been adopted by the Hon'ble Supreme Court in Godhra Electricity Co. Ltd. (supra), by holding that : 'Income-tax is a levy on income. No doubt, the Income-tax Act takes into account two points of time at which the liability to tax is attracted, viz., the accrual of the income or its receipt; but the substance of the matter is the income. If income does not result at all, there cannot be a tax, even though in book-keeping, an entry is made about a hypothetical income, which does not materialise.'

11.2.7 It follows that accounting principles have absolutely no role to play in the matter of determination of total income under the Act. If an accounting principle is referred to by the higher judiciary, then there is an underlying presumption that such accounting principle is in conformity with and not in conflict with the taxation principle. The essence of the matter is that taxation principles are to be followed. If an accounting principle is in conformity with the mandate of taxing principle and reference is made to such accounting principle while deciding the issue, it does not mean that the accounting principle has been followed. It simply means that the taxation principle has been followed and the accounting principle, which is in line with such taxation principle, has been simply taken note of. If however, an accounting principle runs counter to the taxation principle, then there is no prize for guessing that it is only the taxation principle which shall prevail.

11.2.8 The plea now raised before us by the ld. AR, relying on the case of Challapalli Sugars Ltd. (supra), was also taken up before the Hon'ble Supreme Court in the case of Tuticorin Alkalis Chemicals & Fertilizers Ltd (supra). Dealing with the same, the Hon'ble Supreme Court held that : "The question in Challapalli Sugars Ltd.'s case (supra) was about computation of depreciation and development rebate under the Indian Income-tax Act, 1922. In order to calculate depreciation and development rebate it was necessary to find out "the actual cost" of the plant and machinery purchased by the company. This court held that "cost" is a word of wider connotation than "price". There was a difference between the price of a machinery and its cost. This court thereafter pointed out that the expression "actual cost" had not been defined in the Act. It was, therefore, necessary to find out the commercial sense of the phrase. ....The judgment in Challapalli Sugar Ltd's case (supra), goes to show that the court was not in any way departing from legal principles because of any opinion expressed by the Institute of Chartered Accountants." From the above observations there is not even an iota of doubt in our minds that there can be no question of following the accounting principle or Guidance notes etc. in the matter of determination of total income.

11.2.9 The trump card of the ld. AR to bolster his submission for assigning the status of binding force to the SEBI Guidelines is the order in the case of S.S.I. Ltd. (supra) which came to be affirmed by the Hon'ble Madras High Court in PVP Ventures Ltd. (supra). We have noticed above that the said case dealt a situation falling within one of the three years of the vesting period, in which it was held that one third of the total amount of discount computed on the basis of the market price of the shares at the time of grant of option, is deductible. It is evident from the SEBI Guidelines that these deal with the deductibility of discount in the hands of company during the years of vesting period. These Guidelines are silent on the position emanating from variation in the market price of the shares at the time of exercise of option by the employees vis-à-vis the market price at the time of grant of option. In other words, the SEBI Guidelines prescribe accounting treatment only in respect of the period of vesting of the options and the situation arising out of unvested options or vested options lapsing. The very reference by the Chennai Bench of the Tribunal in SSI Limited (supra) to the SEBI Guidelines is indicative of the fact that it dealt with a year during which the options were vesting with the employees and the company claimed discount during the vesting period. The Hon'ble Madras High Court in the case of PVP Ventures Ltd. (supra) has upheld the view taken by the Chennai Bench in the case of S.S.I. Ltd. (supra). The granting of the binding force to the SEBI Guidelines by the Hon'ble Madras High Court should be viewed in the context of the issue before it, which was about the deductibility of discount during one of the vesting years. In the earlier part of this order, we have held that the deductibility of discount during the vesting period, as prescribed under the SEBI Guidelines, matches with the treatment under the mercantile system of accounting. To that extent, we also hold that the SEBI guidelines are applicable in the matter of deduction of discount. Neither there was any issue before the Hon'ble Madras High Court nor it dealt with a situation in which the market price of the shares at the time of exercise of option is more or less than the market price at the time of grant of option. It is a situation which has also not been dealt with by the Guidelines. Accordingly, the aforenoted taxation principle of granting deduction for the additional discount and reversing deduction for the short amount of discount at the time of exercise of option, needs to be scrupulously followed.

11.3 We, therefore, sum up the position that the discount under ESOP is in the nature of employees cost and is hence deductible during the vesting period w.r.t. the market price of shares at the time of grant of options to the employees. The amount of discount claimed as deduction during the vesting period is required to be reversed in relation to the unvesting/lapsing options at the appropriate time. However, an adjustment to the income is called for at the time of exercise of option by the amount of difference in the amount of discount calculated with reference the market price at the time of grant of option and the market price at the time of exercise of option. No accounting principle can be determinative in the matter of computation of total income under the Act. The question before the special bench is thus answered in affirmative by holding that discount on issue of Employee Stock Options is allowable as deduction in computing the income under the head 'Profits and gains of business or profession'."

8. Hon'ble Madras High Court has also an occasion to consider the allowability of the ESOP expenditure in 211 taxman 554 wherein Hon'ble high court has held that the claim of the ESOP is an ascertained liability for deduction on is allowable. Similarly Hon'ble Delhi High Court in case of CIT versus Lemon tree

hotels Ltd in ITA No. 107/2015 has held that the expenses debited as cost of employee stock option plan in the profit and loss account is allowable. In view of the above judicial precedents of special bench of tribunal and decision of the Hon'ble Delhi and Madras High Courts, we respectfully hold that stock Appreciation right expenses claimed by the appellant, amounting to Rs. 393714/– is not in a capital expenses, but revenue expenditure and ascertained liability therefore it is allowable expenses. In the result the disallowance made by the Ld. and assessing officer of Rs. 1147623/– and enhancement made to that taxable income of the appellant by Ld. 1st appellate authority of Rs. 2789501/– is held to be erroneous and therefore set aside. In the result the appeal of the assessee for AY 2008-09 is allowed.

9. As the appeal for AY 2009-10 is also related to the similar disallowance amounting to Rs. 15,12,621/- we for the reasons sated in our decision for AY 2008-09 also delete the above disallowance and allow the appeal of the assessee.

10. In the result appeal of the assessee for AY 2008-09 and 2009-10 are allowed.

11. Order pronounced in the open court on 04/1/2017.

-Sd/-	-Sd/-
(SUCHITRA KAMBLE)	**(PRASHANT MAHARISHI)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Dated: 04/1/2017
A K Keot

Copy forwarded to

1. Applicant
2. Respondent
3. CIT
4. CIT (A)
5. DR:ITAT

ASSISTANT REGISTRAR
ITAT, New Delhi