Stock Option Plans:

- Rahul Cherian and Lubna Kably

- Rahul Cherian is with the Technology Law Division of the international law firm of Nishith Desai Associates. Having received his B.A.L.L.B. (Hons.) from the National Law School of India University, Bangalore, in 1998, he practices in the areas of high-technology law, intellectual property law and employee stock options with the firm.
- Lubna Kably is an Assistant Editor with The Economic Times. She was admitted as an associate member of The Institute of Chartered Accountants of India in 1993. During her tenure with Nishith Desai Associates, she participated actively in the JR Varma Committee.

Nishith Desai Associates, focuses on advanced legal practice, especially in the areas of international finance and tax, technology law, international corporate and securities law and infrastructure laws. The firm advises many international companies engaged in software, media and entertainment on their strategy and operations. Members of the firm have specialized in the strategic, legal and tax aspects of space communications, Internet, telecommunication and intellectual property rights. The client base of the firm predominantly evolved in the U.S. and has now spread across the globe. The firm is currently active on the listing of companies and funds on the U.S. stock exchanges. Nishith M. Desai, the founder of the firm, was a member of a committee set up by The Securities Exchange Board of India to formulate guidelines pertaining to stock options.

The Economic Times, is among the world's three largest financial newspapers in English along with The Wall Street Journal and Financial Times. The last six-month average of daily circulation (July to December 1998) as certified by the Audit Bureau of Circulation was 3.42 lakh. According to the Decision Makers' Survey published by ORG-MARG, India's largest market research agency, The Economic Times is the corporate decision maker's paper in every respect. On an average 87 per cent of all senior executives in India read The Economic Times. Senior executives, include chairmen, CEO's, managing directors, presidents, directors, vice-presidents and general managers. Except for The Times of India, with a readership of 72 per cent, no other paper crosses the 41 per cent mark.

Stock Option Plans

- Rahul Cherian and Lubna Kably

Synopsis:

A. Introduction:

Employee Stock Option Schemes **("ESOSs")** once unheard of in India are gaining popularity by leaps and bounds, especially during the past few years. Faced with the problem of poaching and brain drain, the software industry especially has realized the importance of employee stock options to recruit and retain the best talents. In fact, new vistas in this arena have opened up, parent companies especially those based in the United States have found employee stock options a useful human resource development tool. Cross border stock option plans, whereby Indian resident employees, participate in global stock option plans of their parent company (or any foreign company of the same group) are now in vogue.

The software industry was the first to jump onto the bandwagon, but now, other sectors including the core sectors such as steel have realized the potential that ESOSs hold. Plain vanilla stock options seem to be the most popular, but cases of share purchase plans and stock appreciation rights, especially in cross border options schemes are not an uncommon phenomena. In response to the growing need of using ESOSs as a tool of recruiting and retaining the best talent, The Securities and Exchange Board of India **("the SEBI")** constituted a committee **("the Committee")** in November 1997, chaired by Prof. J.R. Varma to review the existing regulations relating to ESOSs and give its recommendations. Pursuant to the Committee's report, SEBI has formulated the Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines **("the Guidelines").** These have come into force with effect from June 19, 1999.

B. The domestic scene (SEBI's Guidelines):

Guiding principles on ESOSs:

The Committee took the view that rather than impose numerous restrictions on the issue of employee stock options to check possible abuses, the issuance should rely on the twin principles of <u>*complete disclosure and shareholder approval*</u>. These principles have to be kept in mind while granting employee stock options. In the course of its meetings, the Committee opined that India's competitive strength is derived from the skills and talent of its people and it felt that employee stock options are critical to the success of Indian companies in the global marketplace. It also noted that the typical employee in India is not a hard-nosed investor and significant concessions would have to be granted to him if he were to participate in an ESOS. Hence the Committee came to the conclusion that for present, options could be granted with an exercise price substantially lower than market price of the shares as long as certain conditions are fulfilled.

Mechanism of stock options

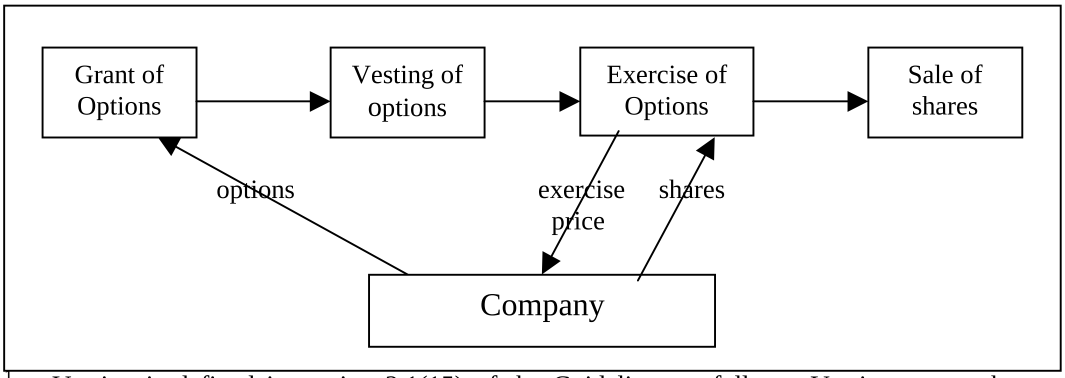
A stock option is defined under the Guidelines as "a right but not an obligation granted to an employee in pursuance of the employee stock option scheme to apply for shares of the company at a pre-determined price".

In simple terms the consequence of the above definition is that an option can be converted to shares if the holder of the option fulfills certain conditions. These conditions are the "vesting criteria" and can be either number of years of continued service after receiving the option, satisfaction of some performance goals by the option holder, or both. After the vesting criteria are satisfied the options are said to be "vested[1]".

A vested option gives the option holder an unfettered right to "exercise[2]" the option and be allotted shares of the company. But if the employee is terminated for misconduct, then even his vested options may lapse[3]. Exercise of an option is the process by which a vested option is converted into shares by payment of the exercise price. The exercise price is normally determined at the time the option is granted to the employee.

The shares received on exercise of the option will rank *pari passu* with the other shares in the same class. The option holder is not entitled to either dividend or voting rights until he exercises his option and is allotted shares. If the company so wishes, it can impose a lock-in on the shares issued pursuant to the exercise of the options.

How a stock option works:



[1] Vesting is defined in section 2.1(15) of the Guidelines as follows: Vesting means the process by which the employee is given the right to apply for shares of the company against the options granted to him in pursuance of the employee stock option scheme.

[2] Exercise is defined in section 2.1(5) as follows: exercise means making of an application by the employee to the company for issue of shares against option vested in him in pursuance of the employee stock option scheme.

[3] Subject to the Compensation Committee of the Board of Directors putting in place policies for such lapse.

The following example will illustrate how an employee may benefit from being granted stock options. On January 1, 1999, an employee is granted one (1) option with an exercise price of Rs 10 per option. On January 1, 1999, the shares of the company are trading at Rs 10. The vesting criteria of the option would be, say, two (2) years of continuous employment from the date of grant of option, which is January 1, 1999. Therefore on January 1, 2001, the options will vest. At any point after that time, he can pay Rs 10 and exercise his option thereby getting one share of the company. Assume that on January 1, 2001, the shares of the company are trading in the market at Rs 50. If the employee were to purchase one share of the company from the market, he would have to pay Rs 50, but if he exercises his option granted pursuant to the ESOS, he will get the share at Rs 10. When he sells the share he will make a profit of whatever amount is the difference between the sale price of the shares and his purchase price, which in this case is Rs 10. At the same time, if on January 1, 2001, the shares are trading at RS 8 then he need not exercise his option, waiting till the shares are trading at a higher price.

Applicability of Guidelines

The Guidelines would have effect from June 19, 1999 and would apply only to companies whose shares are listed on any stock exchange in India. Therefore, private companies would not be covered by the Guidelines. Unless the shares issued pursuant to exercise of options are in accordance with the Guidelines, such shares will not be listed on any stock exchange. Private companies who give shares pursuant to stock options will be able to get such shares listed even if they do not satisfy conditions prescribed under the Guidelines.

Who can be granted options

- Under the Guidelines it is possible for a company to grant options to the employees of its holding company ("**HoldCo**") and its subsidiary companies ("**SubCo**"). The SubCo can be either a domestic company or a foreign company, but the HoldCo has to be an Indian company.
- Permanent employees working in India or abroad and directors whether whole-time or not are covered by the definition of employee[4] under the Guidelines, and therefore can be granted stock options pursuant to an ESOS. It is to be noted that permanent employees are not defined under the Guidelines. Part-time employees can be granted stock options if they are permanent employees.

---

[4] Section 2.1(1) of the Guidelines. This includes part time employees.

- The Guidelines do not include a provision under which non-employee service providers of the company, such as advisors or lawyers, may be granted options. This is in clear diversion to the law in the United States, where non-employees who add value to the company are often granted stock options.
- An employee who is a promoter[5] or belongs to the promoter group[6] would not be eligible to receive options pursuant to an ESOS[7].
- The Guidelines also state that any director who either by himself or through his family or through any investment company, directly or indirectly holds more than 10 per cent of the outstanding equity shares of the company will not be eligible to participate in the ESOS[8].
- Although the Guidelines are silent on this issue, an employee who is neither a promoter nor a director, but who holds more than 10 per cent of the outstanding equity shares of a company may be eligible to participate in an ESOS.

Vesting and exercise criteria

As mentioned earlier, vesting criteria could be either time-based, performance-based, or both. The Guidelines mandate that there should be a gap of at least one year between the grant of the options and their vesting. Therefore, any time-based or performance-based criteria that the company may place for the vesting of options should take into account the above.

Vesting can occur in one stroke or in several staggered strokes. For example, if five hundred options (500) are granted, they can all vest together at a particular time or in several stages, say, one hundred (100) options for every one year of employment. In the second case all the options will therefore vest at the end of five (5) years of employment.

As vesting gives the employee an unfettered right to exercise his options to receive shares, even if the holder of a vested option ceases to be an employee, he can still exercise his vested options. All his unvested options will lapse and the options will not vest, and consequently, he cannot exercise them. In the event

5 Section 2.1(11) of the Guidelines defines Promoter to be a) the person or persons who are in over-all control of the company; b) the person or persons who are instrumental in the formation of the company or program pursuant to which shares were offered to the public; c) the person or persons named in the offer document as promoter(s). The explanation to this section states that where a promoter of a company is a body corporate, the promoter of that body corporate shall also be deemed to be promoters of the company.

6 Section 2.1(13) of the Guidelines states that promoter group means a) an immediate relative of the promoter; b) persons whose shareholding is aggregated for the purpose of disclosing in the offer document "shareholding of the promoter group".

7 Section 4.2 of the Guidelines.

8 Section 4.3 of the Guidelines.

that the option holder ceases to be an employee due to misconduct, then his vested options will also lapse[9].

	one year minimum		no minimum limit		no minimum limit	
Grant	→	Vest	→	Exercise	→	Sale of shares
	no maximum limit		no maximum limit		no maximum limit	

Non-transferability of options

By definition, employee stock options are not transferable and only the employee shall be entitled to exercise the options. The options cannot be pledged, hypothecated, mortgaged or otherwise alienated in any respect. An exception to this general rule is provided in the Guidelines, where, in the case of death of the option holder while he was an employee, all options granted to him including all unvested options will vest in his legal heirs on the date of his death and they shall be able to exercise the options. If he was not an employee at the time of his death, then all the options that had vested will transfer to his legal heirs and they may exercise the vested options.

Buy-back dilemma

Buy-back of shares including options is permitted by a recent amendment to the Companies Act, 1956. However SEBI regulations for buy-back are not explicit about the permissibility of buy-back of stock options held by employees. The Guidelines also prohibit transfer of stock options (except in certain circumstances, explained subsequently). Furthermore, buy-back through negotiated deals or private arrangements is specifically prohibited, this also puts a question mark on the issue of buy-back of shares issued pursuant to the exercise. Thus lack of buy-back of the options by the company and perhaps also the said shares may continue to be a drawback. However, it is up to the Compensation Committee to decide whether or not there should be a lock in after issue of shares. Thus the concerned employee will be able to encash his shares in the capital markets, either immediately or after the lock in period (if

[9] Supra note 1.

any).

Administration of the ESOS

The Guidelines prescribe that every ESOS is to be administered under the superintendence and direction of a Compensation Committee of the Board of Directors **(``the Compensation Committee").** This Compensation Committee is to consist of a majority of independent directors[10].

Powers and duties of the Compensation Committee

The powers and duties of the Compensation Committee are prescribed by the Guidelines. They are as follows:

- The Compensation Committee shall determine the quantum of options to be granted under any ESOS, both in aggregate and to any specific employee.

- The Compensation Committee shall put in place systems and policies to guard against violations of the Securities and Exchange Board of India (Insider Trading) Regulations, 1992 and the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 1995, by employees in the course of exercise of stock options.

- The Compensation Committee shall formulate the detailed terms and conditions of the ESOS, including but not limited to:

  a) the conditions for lapse of vested options in the event that the employee is terminated for misconduct;
  b) the procedure for making a fair and reasonable adjustment to the number of options and to the exercise price in case or rights issues, bonus issues and other corporate actions;
  c) regulations for the grant, vesting and exercise of options in the event of the employee going on long leave;
  d) the exercise period within which the employee should exercise the options and that option would lapse on failure to exercise the option within the exercise period;
  e) the right of an employee to exercise all options vested in him at one time or at various points of time within the exercise period; and
  f) the procedure for cashless exercise of options.

The Compensation Committee may also provide that in the event that an

[10] Section 2.1.9 defines independent director to be a director of the company, not being a whole time director and who is neither a promoter nor belongs to the promoter group.

employee resigns from the services of the company, or his employment is terminated, the employee's vested options shall be exercised within a specified period of time.

Pricing of options

An employee can exercise his vested option and receive shares of the company on payment of the exercise price[11]. At the time of seeking the approval of the shareholders, the exercise price or the pricing formula has to be disclosed or determined.

The Guidelines state that companies will be free to fix the exercise price at any level provided they conform to accounting principles specified in the Guidelines[12]. There is therefore no restriction on pricing of options if conditions as prescribed in the Guidelines are satisfied.

Prior to the coming into effect of the Guidelines, pricing of issue of stock options was governed by SEBI's Guidelines for Disclosure and Investor Protection, which came into effect from August 4, 1994. As per Clause 4 of this the issue of shares on a preferential basis could be made at a price not less than the higher of the following:

(a) The average of the weekly high and low of the closing prices of the related shares quoted on the stock exchange during the six months preceding the relevant date; or
(b) The average of the weekly high and low of the closing prices of the related shares quoted on a stock exchange during the two weeks preceding the relevant date.

Explanation:

(a) "relevant date" for this purpose meant the date thirty days prior to the date on which the meeting of the General Body of shareholders is convened, in terms of section 81(1A) of the Companies Act, 1956 to consider the proposed issued.
(b) "stock exchange" meant any of the stock exchanges in which the shares are listed and in which the highest trading volume in respect of the shares of the company had been recorded during the preceding six months prior to the relevant date.

---

11 Exercise price is defined in Section 2.1.7 of the Guidelines as follows: Exercise price shall mean the price payable by the employee for exercising the option granted to him in pursuance of the employee stock option scheme.

12 Section 8 of the Guidelines.

The J.R. Verma Committee felt that if the employees were to benefit under the stock option mechanism, it would be preferable that the price at which the option is granted/exercised be discounted to the prevailing market prices or the average market prices. This has led to SEBI permitting free pricing.

Approvals and disclosures required

- **Special Resolutions**

  Before an ESOS becomes effective, the Guidelines prescribe that the ESOS has to be approved by a special resolution[13] of the shareholders of the company. The special resolution shall contain all relevant details of the ESOS, including identification of classes of employees entitled to participate in the ESOS, conditions relating to vesting and exercise of the options, including the pricing formula or the exercise price, the appraisal process for determining the eligibility of employees to participate in the ESOS and the upper limit on the quantum of stock options to be issued per employee and in the aggregate. This special resolution shall also state that the company shall conform to the accounting policies as mentioned in the ESOS.

  If employees of the subsidiary or holding company of the company are to be granted options, then a specific shareholder approval is required. If any specific employee, during any one year, is to be granted options equal to 1 per cent or more of the issued capital of the company at the time of grant, then such grant shall be subject to individual voting by the shareholders. If the terms of the unexercised options have to be varied in a manner not prejudicial to the interests of the option holders, then also a special resolution is required.

- **Director's Report**

  The Guidelines list out disclosures required in the Directors' Report or in the annexure to the Directors' Report the following details of the ESOS:

  a) options granted;
  b) the pricing formula;
  c) options vested;
  d) options exercised;
  e) the total number of shares arising as a result of exercise of option;
  f) options lapsed;

---

[13] Under Section 81(1A) of the Companies Act, 1956.

g) variation of terms of options;
h) money realized by exercise of options;
i) total number of options in force;
j) employee wise details of options granted to;-
- senior managerial personnel;
- any other employee who receives a grant in any one year of option amounting to 5 per cent or more of option granted during that year;
- identified employees who were granted option, during any one year, equal to or exceeding 1 per cent of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;

k) diluted Earnings Per Share (EPS) pursuant to issue of shares on exercise of option calculated in accordance with International Accounting Standard (IAS) 33.

These details will be communicated to the shareholders during the annual general meeting, via the Director's Report so that the shareholders are kept abreast of the position with respect to the ESOS.

- **Certificate from auditors**

The Guidelines prescribe that where a special resolution is passed, adopting an ESOS, the Board of Directors shall place at each annual general meeting a report of the auditors of the company that the ESOS has been implemented in accordance with the Guidelines and in accordance with the special resolution adopting the ESOS[14].

- **Options outstanding at Public Issue**

If any option is outstanding at the time of public issue, the Guidelines deem that the offer document shall disclose all the information that the director's report has to include.

If any option is outstanding at the time of initial public issue, the promoter's contribution shall be calculated with reference to the enlarged capital as if all vested options are exercised[15]. It is silent on the options granted but not vested.

Cashless exercise

---

14 Section 14 of the Guidelines.
15 Section 15.2of the Guidelines.

Cashless exercise of options is allowed under the Guidelines. The company may itself fund this cashless exercise or permit the empanelled stock brokers to fund the payment of exercise price which shall be adjusted against the sale proceed of some or all the shares, subject to provisions of the Companies Act, 1957.

If the Company funds the exercise price, then Section 77 of the Companies Act, 1957, which deals with companies granting loans to purchase its own shares would come into play. Under the provisions of section 77(2) no public company and no private company which is a subsidiary of a public company can whether directly or indirectly fund the purchase of its own shares or shares of its holding company. However a proviso to this section provides for certain exceptions. Under clause (c) the company can give loans to bonafide employees (other than directors, managing agents, secretaries, treasurers or managers) for this purpose. Section 77(3) puts a cap on the amount of such loan and restricts it to not more than six months salary.

These provisions have to be kept in mind when the company decides to allow cashless exercise of options. Cashless exercise of options would be where the employees, at the time of exercising the options, engage the services of a broker or any third party, to sell an appropriate number of shares. The sale proceeds from these shares should be adequate to cover the amount that the employee has to pay the company for exercising all the shares. The broker or the third party would make the payment (in respect of the shares sold by the employees) to the company on behalf of the employees. In such circumstances, no cash is to be paid by the employees. The employees would therefore get the balance shares, or the amount for the sale, if all the shares were sold. A suitable example would illustrate this.

Number of shares subject to options	100
Exercise price	Rs. 100
Total exercise price to be paid to the company for all the shares.	Rs. 10,000
Market value on date of exercise	Rs. 200
Number of shares sold via cashless exercise	50
Amount received for such sale and paid by broker to company[16]	200* 50 = Rs. 10,000
Number of shares left for the employee[17]	50

Tax issues:

[16] This amount does not include broker's charges.
[17] These shares can be held or sold as the employee so wishes

- **For the employee**

Prior to the Finance Act, 1999

The Finance Act, 1999 has made certain amendments in the Income Tax Act, 1999 and mitigated some of the lacunae which existed earlier in the realm of ESOSs. Prior to such amendments, the circular issued by the Central Board of Direct Taxes **("CBDT")** governed the tax implications in the hands of an employee who had been issued shares at less than the market price[18]. This circular covered the tax consequences, which arose, when the employer issued shares to the employees at a price less than the market price of the shares. This difference, according to the circular was to be treated as a perquisite and is to be taxed accordingly. It specified that:

> "(i) Where the shares held by the government have been transferred to the employee, there will be no perquisite because the employer-employee relationship does not exist between the government and the employee (transferor and the transferee);
>
> (ii) Where the company offers shares to the employees at the same price as have been offered to other shareholders or the general public there will be no perquisite;
>
> (iii) Where the employer has offered the shares to its employees at a price lower than the one at which the shares have been offered to other shareholders/public, the difference between the two prices will be taxed as a perquisite;
>
> (iv) Where the shares have been offered only to the employees, the value of the perquisite will be the difference between the market price of the shares on the date of acceptance of the offer by the employee and the price at which the shares have been offered."

The CBDT circular concentrated on issue of shares rather than issue of options. This gives rise to a few ambiguities, especially when attempts were made to stretch it to fit into stock option plans.

It did not take into account the pertinent stages in an ESOS such as grant, vesting, and exercise. It was not clear when the tax should be imposed on the 'perquisite value'. Should it be the year in which the options are granted or the year of exercise of such options or still further should it be in the year of sale of

[18] Circular number 710 dated July 24, 1995

the shares?

Furthermore, Clause (iv) of the above circular mentioned that where the shares have been offered only to the employees, the value of the perquisite would be the difference between the market price of the shares on the date of acceptance of the offer by the employee and the price at which the shares have been offered. When is the offer accepted, is it when the options have been granted? Or when the options have been exercised? To some extent these questions have been answered.

Secondly, under the provisions of this circular, there was a double incidence of tax. First, the employee was taxed on the perquisite value. When the shares (acquired on exercise of the option) were sold, the cost of acquisition was not enhanced by the perquisite value, leading to a higher incidence of capital gains. The Finance Act, 1999 has rectified this problem.

J.R. Varma Committee recommendations

The J.R. Varma Committee recognized that the issue of taxation of stock options does not come within the ambit of the Securities and Exchange Board of India (SEBI). However, since it realized that some elements of the current taxation laws could become major impediments to the success of ESOSs, it made its recommendations and suggested that SEBI take up these issues with the appropriate authorities.

It recommended that there should be no tax incidence at the time of grant of options since at this time the options have not vested and the benefit to the employee is a mere contingency. The committee added that taxation at the point of exercise of options also has its share of problems. In order to avoid double taxation of the same amount both as a perquisite and then as a capital gain, when the shares are sold, it recommended that the amount on which the perquisite is paid be adjusted and then capital gains be levied. To some extent the Finance Act, 1999 has taken this into cognizance.

The Committee recommended that in terms of timing, the tax liability should be at the time of sale, however it suggested that the taxable income at this point of time could be partly in the form of a perquisite value (charged at normal tax rates) and partly in the form of capital gains (with attendant concessional treatment).

This can be explained with the help of an example:

Exercise price (EP) of option	Rs. 100

Market value on date of grant (MVG)	Rs. 150
Perquisite calculated on difference between MVG and EP	Rs. 50
Sale price (SP)of share	Rs. 200
Capital gains calculated on difference between SP and MVG	Rs. 50

It is noticed that the Guidelines make an adjustment for the amount on which perquisite is levied.

The total tax incidence under the Guidelines would be 30[19]per cent of Rs. 50 (perquisite) + 10[20]per cent of Rs. 50 (capital gain) = Rs. 16.5 + 5.5 = Rs. 22.

Concurring with the report of the National Task Force on Information Technology and Software Development, the J.R. Varma Committee agreed that tax should be levied only when shares arising out of the exercise are sold.

Provisions prescribed by the Finance Act, 1999

The Finance Act, 1999 has made an attempt to deal with several anomalies prevailing earlier in CBDT's circular. To impart legislative finality to the taxation of ESOSs, two sections have been inserted in the Income Tax Act, 1961. These are section 17(2)(iiia) relating to perquisite and section 49(2B) which determines the cost of acquisition for computing capital gains. These new sections come into effect from April 1, 2000 (assessment year 2000-2001).

Section 17(2)(iii): Perquisite now includes, 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 the 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 purpose 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

[19] Ibid n. 39.
[20] Ibid n. 39.

of the Securities Contracts (Regulation) Act, 1956 (42 of 1956) and includes employees' stock option and 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 **(“FMV”)** and the cost for acquiring specified securities.

The value of the specified securities shall be taxable in the previous year in which such option is exercised by such individual.

It can be observed that now there is no confusion about the year in which the options will be taxable, the aforementioned section clearly provides that the value of the specified securities shall be taxable in the previous year in which such option is exercised by such individual. In other words the tax incidence arises in the year of exercise and not of grant.

However, the term ‘value' is defined to mean the difference between the fair market value and the cost for acquiring specified securities. It does not state when the value is to be determined. The FMV could be the value prevailing as on the date of exercise of the option or date of allotment of the shares, consequent to the exercise. However, section 49(2B) tends to throw some light on this issue.

Section 49(2B): Where the capital gain arises from the transfer of the specified security referred to in sub-clause (iiia) of clause (2) of section 17, the cost of acquisition of such specified security shall be the FMV as on the date of exercise of the option.

The new provisions of the Income Tax Act, 1961 have mitigated to a great extent the double taxation on the same income, by providing that the cost of acquisition at the time of sale, for computing capital gains shall be the FMV as on the date of exercise of the option. Prior to this amendment the cost continued to the discount price or the exercise price that led to a higher incidence of capital gains.

This can be explained with the following example:

Exercise price (EP) of option	Rs. 100
Fair Market value on date of grant (MVG)	Rs. 150
Fair Market value on date of exercise (MVE)	Rs. 180
Perquisite calculated on difference between MVE and EP	Rs. 80
Sale price (SP)of share	Rs. 200
Capital gains calculated on difference between SP and MVE	Rs. 20

The total incidence of tax under the Finance Act, 1999, will be:

30per cent[21] of Rs. 80 (perquisite) + 10per cent[22](new rate for long term capital gain) of Rs. 20 (capital gain) = Rs. 26.4 + 2.2 = Rs. 28.6.

However, had the suggestions of the J.R. Varma Committee been accepted the overall incidence of tax would have been lower. This is because, this committee recommended that the perquisite value be the difference between the FMV as on the date of grant and the exercise price, resulting in a lower perquisite value (on which the tax rate is comparatively higher) and a higher capital gains tax incidence (which is subject to a lower tax rate).

- **For the employer**

While the Income Tax Act, 1961 has clarified the tax treatment for the employees, the Act is not explicit as regards the tax treatment in the hands of the employer. The guidelines relating to accounting entries, in simple terms prescribe for amortization of the accounting value (explained subsequently) over the period of vesting.

The issue is whether such debits to the profit and loss account will be allowed as a bonafide business deduction in the hands of the company.

Under the provisions of section 37(1) of the Income Tax Act, 1961:

“Any expenditure (not being expenditure of 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 the profession shall be allowed in computing the income chargeable under the head Profits and gains of business or profession”.

Courts have on several occasions held that expenditure incurred towards the welfare of the employees is a bona fide business deduction. The basic objective of issuing stock options goes beyond employee welfare. Its objective is to attract and retain the best talent. Human resources are one of the most important assets of the company. The discount, which is debited in the profit and loss account of the company, is thus expenditure incurred wholly and exclusively for the purpose of the business. Hence it should be allowed under the provisions of section 37(1) of the Income Tax Act, 1961.

However, it is likely that the bonafides of each case may be examined by the assessing officer. If the discount is found to be excessive having regard to

[21] Subject to a surcharge of 10per cent.
[22] Subject to a surcharge of 10per cent.

commercial consideration, it may happen that a certain portion may be disallowed.

There are several analogous cases to support the view that such expenditure should be allowed as deductible business expenditure. A summary of one such case law is enumerated hereinbelow.

- (1963) 49 ITR 708, Lonappan (C.D.) v/s CIT; (Ker)
  SECTIONS: 10(02)(x), Indian Income Tax Act '22

Headnote:

Where the profits of the assessee during the relevant accounting year are substantial, but the average salary of the employee is quite meager and there is no evidence regarding the other conditions of service or the existence of other amenities and facilities and it is impossible to say that the bonus paid by the assessee to his employees is not reasonable, the Appellate Tribunal is not justified in disallowing a part of the bonus paid to the employees. Held: The Appellate Tribunal cannot disallow the bonus or any part thereof as a bonafide business expenditure.

But, at the same time there are other decisions including one by the House of Lords that do not support this contention.

- (1980) 123 ITR 29B, Vishwanath Seth v/s CIT; (All)

Headnote:

The amount of remuneration or salary paid to an employee has to be adjudged from the standpoint of business needs. Inflated and excessive amounts of remuneration, which are not commensurate with the business needs of an assessee, cannot be claimed as business expenditure. If the Income-tax Officer is satisfied that the remuneration or the salary paid is excessive and not commensurate with the genuine business needs he has jurisdiction to disallow such claims. Where the assessee had enhanced the salaries of three employees during the relevant previous year by 200 per cent. and the Tribunal held that, keeping in view the business requirements of the assessee, it was not reasonable on the part of the assessee to have granted further remuneration by way of giving a percentage of the profits earned. Held: that the Tribunal was right in disallowing the expenditure.

- (1940) 8 ITR (E.C.) 88, Lowry v/s Consolidated African Selection Trust Ltd.; (HL)

Headnote:

A Company issued to its employees shares at par, when their market value was at a premium. It was claimed that, that was done to further the interests of the company's trade and to secure a benefit to the company, and that the sum representing the difference in price was therefore a sum expended for the purposes of their trade, and was consequently deductible before arriving at the amount of the company's profits.

Held: (Lord Wright and Lord Romer dissenting), that it had not been established by the respondents that any sum had thus been expended or laid out for the purposes of the trade of the company.

Lord Wright and Lord Romer were of opinion that Usher's Wiltshire Brewery v. Bruce [1914] 84 L.J.K.B. 417, precisely covered this case, and that under it the difference between the price at which the company could have issued the shares and the par value at which they in fact issued them was a sum laid out for the purposes of the company's trade and was deductible by them in fixing what their profits were. Decision of the Court of Appeal in Consolidated African Selection Trust v. IRC 108 L.J.K.B. 374; [1939] 7 ITR 442 reversed.

In the United States, a deduction is generally available to the employer in case of Non-Qualified Stock options. In such stock option plans the optionee has to pay regular taxes (income tax) on the difference between the exercise/option price and the FMV as on the date of exercise. Thus, the tax incidence falls in the year of exercise of the NQSO. For example, if the FMV as on the date of exercise is Rs 200 and the exercise/grant/option price is Rs 100, then the difference of Rs 100 is taxed at the normal rates in the year of exercise of the option. The employer gets a corresponding deduction of Rs 100.

Such benefits are not available to the employer in case of Incentive stock options, where certain tax concessions are granted to the employer. In case of ISO's provided certain conditions are met, the optionee/employee is taxed only on the long term capital gains which is the difference between the sale consideration and the exercise price.

Employers obligation to withhold tax at source

The perquisite value will be added to the salary income of the respective employees. This imposes the obligation on the employer to withhold tax at source under the provisions of section 192 of the Income Tax Act, 1961

Accounting Policies:

When granting options at a discount is essential that accounting policies as laid down in the Guidelines are followed. If an option that is granted has an exercise price, which is at a discount to the market price on date of grant of options, then it would be treated as another form of employee compensation in the financial statements of the company. In other words, companies issuing options at a discount would take a direct earnings hit in their reported earnings.

Section 13.1 and Schedule I of the Guidelines elaborate the accounting policies to be followed in the case of an ESOS. The aggregate over all options granted during any accounting period of the excess of the fair value[23] of the option, on the date of grant of option will be treated as another form of employee compensation in the financial statements of the company.

Where any amount is accounted for as employee compensation in accordance with the Guidelines, the amount shall be amortized on a straight-line basis over the vesting period[24]. When unvested option lapses after employee compensation for the option has been accounted for, this accounting treatment shall be reversed by a credit to employee compensation expense equal to the amortized portion relating to the lapsed options, and a credit to deferred employee compensation expense equal to the amortized portion[25].

When a vested option lapses on expiry of the exercise period, after the fair value of the option has already been accounted for as employee compensation, this accounting treatment shall be reversed by a credit to the employee compensation expense[26].

C. Labour issues:

In India, labor legislation is essentially welfare legislation, meant to protect those sections of society that are at weaker bargaining positions than their employers are. As a consequence, most of these enactments do not afford rights to those who are economically well placed.

A number of labor law provisions need to be kept in mind to ensure that ESOSs do not violate Indian labor laws.

---

[23] Fair value means the option discount, or, if the company so chooses, the value of the option using the Black Scholes formula or other similar valuation method. Option discount is defined as the excess of the market price of the share at the date of grant of the option under the ESOS over the exercise of the option.

[24] Schedule 1 (c) of the Guidelines.

[25] Schedule 1 (d) of the Guidelines.

[26] Schedule 1 (e) of the Guidelines.

Permissibility of excluding employees and restricting eligibility

The Industrial Disputes Act, 1947, applies only to “workman”. A "workman" is defined as a person employed to do any manual, skilled, technical, operational, clerical or supervisory work. However, persons employed in a supervisory capacity and whose wages exceed Rs. 1,600 per month, or perform managerial functions are expressly excluded from the definition of workmen. Therefor, collective bargaining and similar concepts are relevant only to “workmen”. Individual contract of employment governs the employee- employer relationship, where the employee is not covered by the Industrial Disputes Act, 1947.

Clause 9, Schedule V of the Industrial Disputes Act, 1947 relating to unfair labor practices, may come into the picture, if the Compensation Committee, which is vested with the powers to grant options, had wide discretionary powers. These powers may be challenged by either the trade union or by any of the aggrieved employees on the grounds of victimization or partiality between similarly situated employees.

Thus ideally, the extent of discretion vested in the Compensation Committee should be limited by guidelines specified in the ESOS (for eligibility of classes of employees, evaluation of performance, selection of employees for grant and the factors that will be considered in the grant of options like the performance of the employee, the performance of the company issuing the options and the global performance of a group as a whole). It is necessary to lay down the objective criteria under which an eligible employee is entitled to benefits of the ESOS. This will enable the company to issue options on a discretionary basis based upon qualitative and quantitative factors.

Acquired rights

The employees who are granted benefits under any ESOS cannot claim guaranteed rights to continue receiving benefits after the ESOS has ceased, where this is laid out in the ESOS itself. The ESOS itself should state that no employee shall be guaranteed any benefits under the ESOS after the prescribed period during which the ESOS subsists is completed.

Negotiation with union, or works council, or personnel representatives

Labor laws in India, do not dictate that the ESOSs should be negotiated with the trade unions. Whether or not to undertake discussions and negotiations with trade unions is a strategic decision to be taken by the concerned company.

However, the terms and conditions of the ESOS should always be made clear to all employees coming within the purview of the ESOS and their written consent should be obtained. The local employer plays a very important role in this regard.

D. Cross border option plans

Issues involved

Cross border stock option plans enable employees of Indian companies to participate in the global stock option plans of their parent company or any other foreign company in the same group. The employees resident in India have to adhere in certain spheres to the laws laid down in the jurisdiction of the parent (group) company that has issued the options, such as rules pertaining to Insider trading. However, local (Indian) laws pertaining to exchange control and taxation continue to embrace the Indian resident employees.

The most important issues revolve around exchange controls, labor laws, certain ancillary issues and taxation. Those relating to exchange controls and tax issues are elucidated hereinbelow, followed by an explanation on the cash mechanism and cash-less mechanism via which cross border option plans can be structured.

Exchange controls:

It is not legal for residents to hold common stock of foreign companies without first obtaining an approval and a holding license from the Reserve Bank of India **("RBI").**[27]

Permission from the RBI is required to implement the stock option plan in India. Approval is generally available but is subject to several conditions.

For example –

- Dividends have to be repatriated into India within a "reasonable time"
- The capital gains once they arise have to be repatriated into India within a "reasonable time"
- The ex-employees or beneficiaries of the deceased employees may continue to hold the option certificates for further exercise or share certificates for future sale. However as stated before, once the shares are sold, the gains must be repatriated into India within a "reasonable time."
- If the stock option plan envisages a cash-less mechanism, the RBI generally, also takes an undertaking from the Indian resident employees that in the

[27] Section 19 of the Foreign Exchange Regulation Act, 1973 places this restriction. Without permission of the RBI a Indian resident employee cannot acquire, hold or dispose off any foreign security

event loss is incurred in the exercise of options (that is when the options are not in the money) there will be no outward remittance. This condition is imposed by RBI, because RBI has perhaps envisage~~s~~ a situation where an employee in India, erroneously exercises the option at a price higher than the prevailing market price (i.e.: when the option is not in the money).

- In case of dividends or capital gains received pursuant to the stock option plan, no written guidelines have been framed by the RBI. In the case of direct investment by Indian parties abroad (such as in joint ventures or wholly owned subsidiaries), Paragraph 11.2 of the Exchange Control Manual specifies that: "The Indian party shall remit to India in free foreign exchange dividends and profits after tax due to it from a foreign concern within a period of 60 days from the date on which they are declared or approved by the Directors or shareholders of the foreign concern. The remittances mentioned above shall be subject to the time taken for clearance of the remittance by the Central Bank of the host country." The same rules are followed in practice in case of dividends or capital gains received pursuant to stock option plans by Indian resident employees. RBI officials expect dividends or capital gains to be repatriated within 60 days, though some delay owing to genuine reasons is condoned. The repatriation has to be through the normal banking channels.
- Permission has to be sought by the employees who wish to hold on to the shares after exercise of the options. Alternatively this can be sought collectively by the Indian company.

The RBI's permission for implementing the stock option plan in India is sought in the form of a letter accompanied by the following details/documents:

- A copy of the stock option scheme. If the scheme envisages a cash-less mechanism this should be clearly stated. In addition the role of the broker under the cash-less mechanism has to be brought out. RBI has to be informed that the broker may be holding the balance shares in the "employee brokerage account" until the employee requests sale of shares
- Details of foreign currency equity shares
- A copy of the offer letter or resolution of the Board of Directors of the parent company, supporting the offer of shares to the employees at concessional rates
- A list of the names of employees who will be eligible to receive options granted under the plan

The RBI has in place a compliance system. The Indian company (whose employees are participating in the global stock option plan) has to periodically file a statement with the RBI giving particulars of the stock option scheme of the foreign company. The particulars which have to be submitted include employee-wise details such as the names of the employees, the date of the offer, the validity of the offer, offer price, number of options offered, number of options exercised, number of options outstanding, sale price, particulars of brokers note, net amount repatriated (if any), name of the authorized dealer through whom the inward remittance has been received. These particulars have to be furnished in the format prescribed by the RBI, immediately after the receipt of the offer letters from the overseas company and thereafter on a half yearly basis.

At times, options are granted on a discretionary basis. At the time of making the application to the RBI for approval of the stock option plan, it is impossible to decipher who the participating employees are. In such cases, it is mandatory for the Indian company to furnish the particulars immediately after the receipt of offer letters from the overseas company and thereafter on a half yearly basis.

In addition the company in India, has to keep on record the following employee-wise stock option documents:

- Copies of the letters of offer in support of options received from the overseas parent company
- Broker’s contract note in support of simultaneous purchase/sale of foreign currency options as and when an employee exercises his/her options
- Certificate of foreign inward remittance in support of the repatriation into India of the difference between the sale and purchase of options (in other words the capital gains).

Cash mechanism:

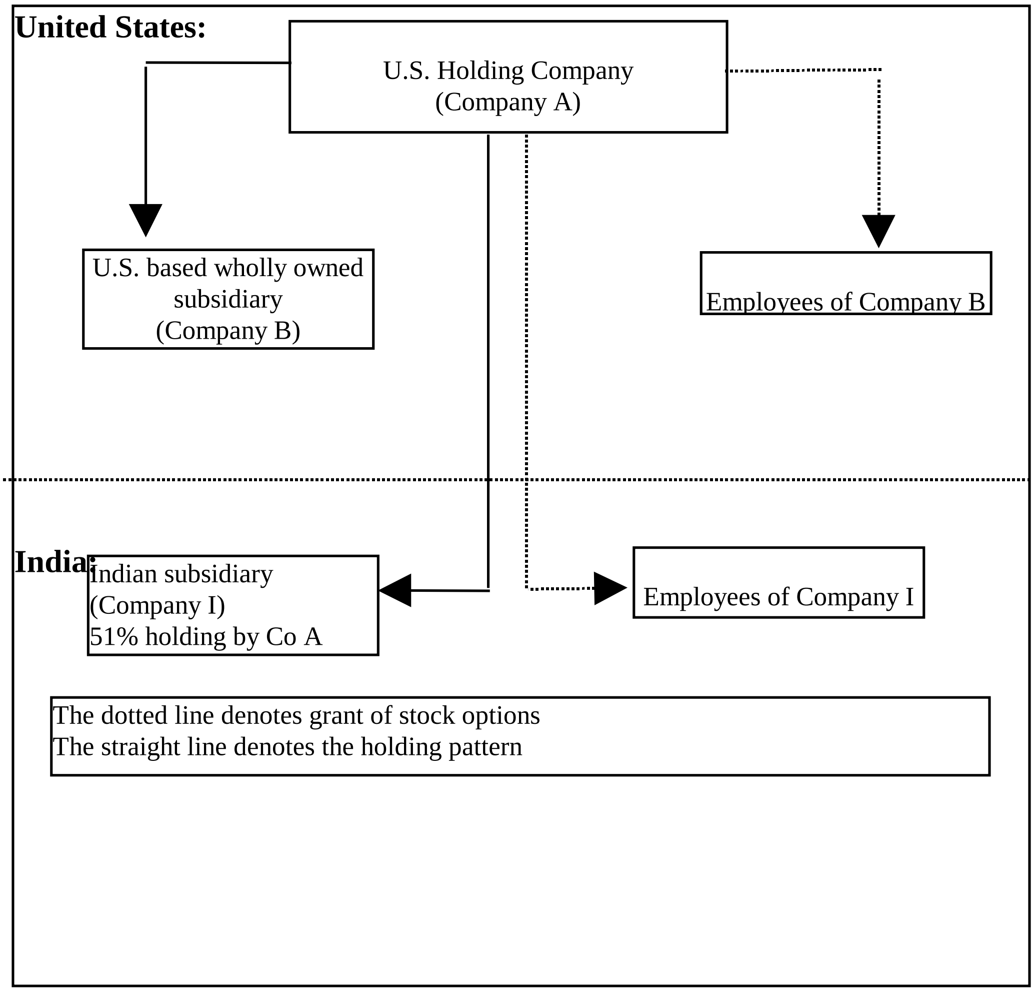
Vide paragraph 12.7 of Chapter 12 “Bank Accounts and Other Assets Overseas of Residents" of the Exchange Control Manual issued by the RBI, applications from the employees of Indian offices/branches of foreign companies as also joint ventures/subsidiaries in India in which the foreign equity holding is 51 per cent and above, for the acquisition of foreign currency equity shares of foreign companies are considered by the regional offices of the RBI.

Under the Foreign Exchange Regulations, there are limits on the amounts that an employee can remit outside India to purchase equity interest in a foreign parent company. The RBI has relaxed this limit[28]. After December 4, 1997 employees of Indian offices/branches of foreign companies and employees of

[28] A.D.(M.A. Series) Circular No 49, dated December 4, 1997. This circular states: Attention of the authorized dealers is invited to the instructions contained in paragraph 12.7 of the Exchange Control Manual in terms of which applications from the employees of Indian offices/branches of foreign companies for remittance towards acquisition of foreign currency equity shares of foreign companies, offered at concessive rates below the market price are considered by the RBI provided the amount does not exceed U.S. $ 750 or its equivalent per employee once in a period of five years. It has now been decided to extent this facility also to the employees of Indian companies with majority shareholding by foreign companies (51 per cent and above) and to enhance the ceiling amount to U.S. $ 10,000 in a block of five years

Indian companies (where the majority shareholding of such foreign company is 51per cent or more) can remit up to U.S.$ 10,000 (or its equivalent) once in a continuous period of five years for acquiring shares offered under the plan.

This payment may be made in installment but the gross total remittance within this period under the stock option plan cannot exceed the aforesaid limit. This period of five years begins on the date on which the options were granted to the employees. Thus, for example, if Mr. A, an Indian resident employee of the subsidiary company in India, was granted options on January 29, 1998 he can remit within the five-year period commencing January 29, 1998 up to U.S. $ 10,000 for the exercise of the options. The diagram below clearly explains the modalities of a cash mechanism.



As can be seen from the above diagram, Company A which is issuing the stock options under the global stock option scheme is directly holding 51 per cent in the Indian subsidiary company (Company I).

The cash mechanism suffers from two drawbacks. Based on the RBI circular (mentioned above) it can be interpreted that Indian resident employees can participate in global stock option plans and remit money abroad for the purpose only if the foreign company (issuing the options/shares) holds at least 51 per cent in the Indian subsidiary company. In the absence of a direct holding by the company issuing the stock option plan, it may be difficult for the Indian employees to remit any funds abroad for the purpose of the exercise of the options. RBI can however, be approached for seeking a special permission for repatriation by the Indian resident employees (within the limits laid down), even in the absence of a direct holding by foreign company issuing the options/shares.

Second, the maximum amount which can be remitted abroad is restricted to a sum of U.S. $ 10,000 once in a block of five years. The cash-less mechanism helps overcome both the above drawbacks.

Cash-less mechanism:

Generally when this mechanism is adopted, the foreign company that is issuing the options, designates a few brokers who sell the shares issued under the stock option plan -- the payment of the exercise price is made out of the sale proceeds of the shares. This enables the Indian resident employees to enjoy the benefits of the global stock option plan without the need for a cash payment. This mechanism absolves the need for repatriation of funds out of India for exercising the options.

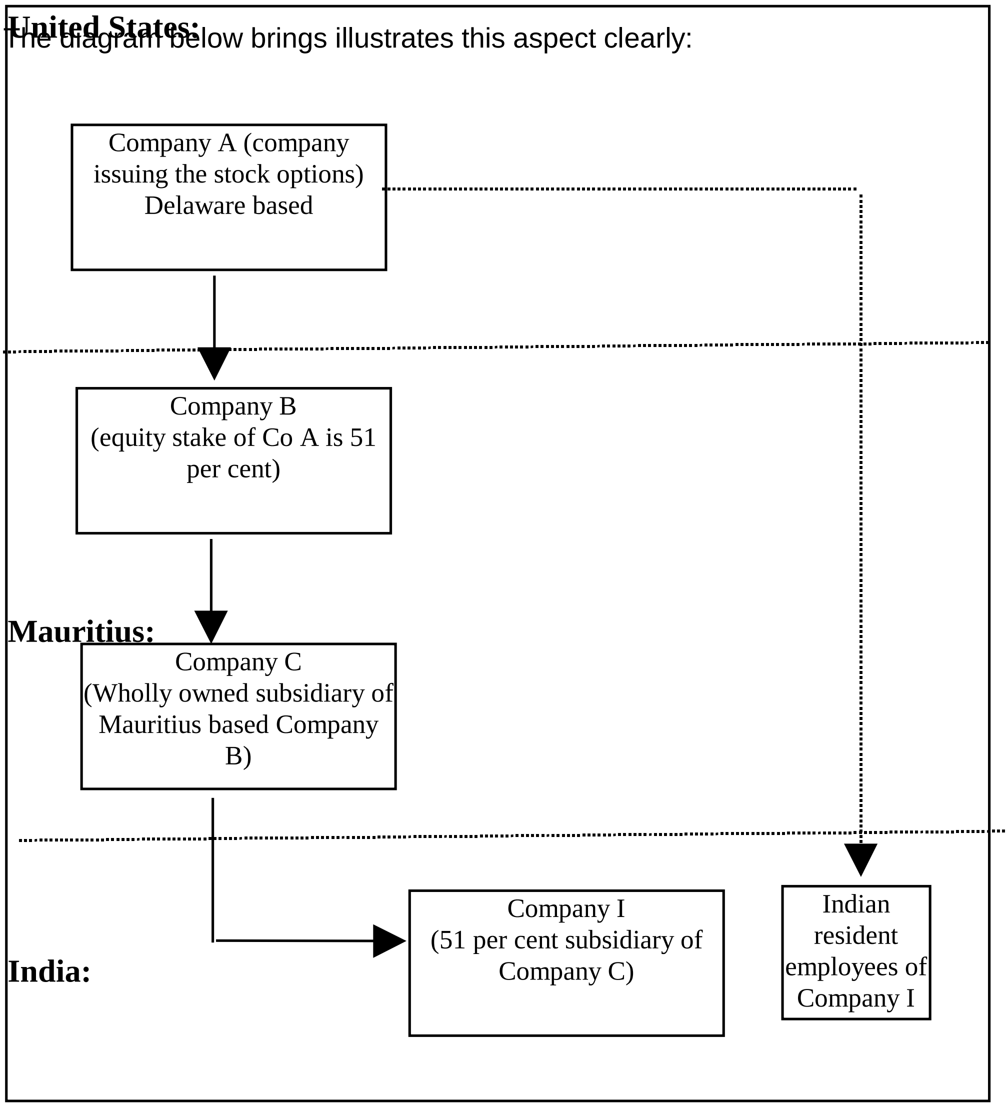
Here, the employee has to intimate to the stock option administrator (Compensation Committee) his intention to exercise the options. Simultaneously he has to initiate the sale of shares through the broker. The Administrator/Committee finalizes the exercise and holds the share certificates issued on conversion of the options. The Administrator/Committee then requests the broker for the payment of dues and sends the certificates to the broker for payment. The broker in turn remits the net amount (after having deducted his fees) to the Indian resident employee.

This can be explained with the help of an illustration:

Company A based in Delaware issues an option to its employees worldwide to purchase 100 shares for U.S. $ 0.5 per share. Later when the fair market value is U.S. $ 1, the Indian resident employee intimates the Administrator of the intention to exercises the option. He also takes steps to initiate the sale of shares through the designated broker. The broker will sell 50 shares in the open market and remit the proceeds to Company A to pay for the exercise price. For the sake of simplicity in this illustration, the broker's charges have not been adjusted. Else the broker will adjust his charges against the sale proceeds. A proportionate amount is sold by the broker to cover not only the exercise price but also his won charges. The balance shares are held by Company A or in the employees brokerage account and sold only on the explicit instructions of the Indian resident employee which may or may not be simultaneous. The Indian resident employees can after obtaining RBI's permission also hold the shares on their own account.

A cash-less mechanism can be adopted effectively, even if Company A does not directly hold at least a 51 per cent share in the Indian Company.

The diagram below brings illustrates this aspect clearly:



In India several joint ventures have been structured through tax favorable jurisdictions such as Mauritius. As can be seen, Company A does not directly hold a 51 per cent stake in Company I. It is the Mauritius based Company C which holds a direct 51 per cent stake in the Indian Company. Still owing to the adoption of a cashless mechanism, Indian resident employees of Company I are able to participate in the global stock option plan of Company A. However, such stock option plans are subject to the rules prevailing in the host country, which may or may not permit employees of group companies to participate in the plan.

If a cash-less mechanism is wished to be adopted, the stock option plan should clearly specify that one of the modes of exercise will be: By delivery of a written exercise notice, including irrevocable instructions to the Company to deliver the stock certificates issuable upon exercise of the option directly to a broker named in the notice, who has agreed to participate in a cash-less exercise on behalf of the optionee. The Guidelines have also permitted the cash-less mechanism for domestic issues of stock options.

Tax issues

As per the Income Tax Act, 1961 the difference between the FMV as on the date of exercise and the exercise price is treated as a perquisite -- income arising out of the employer-employee relationship, it is included in the salary income of the employee and is taxed as ordinary income. Only income tax is payable and the employer is required to withhold the income tax.

However, in the case of the global ESOSs, it can be contended that the employer-employee relationship does not exist between the parent (group) company issuing the options and the Indian resident employees of the Indian company. Such a relationship exists between the Indian company and its employees, the parent company merely has a stake in the Indian company and is not the employer of the Indian resident employees.

To give rise to "perquisite" an employer-employee relationship is necessary between the company issuing the options and the options. In cross border stock option plans, as the Indian company does not issue options, no "perquisite" can be said to arise.

However, recently in the case of Microsoft Corp. US[29], the Authority for Advance Rulings ('**AAR**') in India, by lifting the corporate veil has held that the foreign holding company and the Indian subsidiary should be treated as the same entities and the stock options granted by a foreign company to the employees of

[29] [1999] 102 Taxman 74 (AAR).

its wholly owned Indian subsidiary would be taxable in India. The AAR has held that when the employees exercise the option, the difference between the exercise price and the market price would be taxable as salary in the hands of employees. According to the AAR, the profits gained by the employees on exercising the option would be considered as additional remuneration received on behalf of the employer and hence subject to taxation as salary income.

In the case of the advance ruling cited above, the AAR held that the foreign parent would have the responsibility to withhold tax at source in respect of the perquisite value taxable in the hands of the Indian employees.

Although advance rulings are private and binding only in respect of the applicant and the tax authorities, the ruling could have some persuasive value. Therefore, if taxes are not withheld on the perquisites, it could lead to litigation.

It is unclear at this time whether when an Indian company gives options to the employees of its parent company the ruling in Microsoft is of significance or not. This is because it is unclear whether there is an employer-employee relationship in this case.

After exercise of the options, instead of an immediate sale, the Indian resident employee may continue to hold the shares after procuring RBI's permission. In such cases, dividends repatriated into India are subject to tax as ordinary income. They are not added to the salary of the employee and the local employer is not required to withhold taxes. If under the laws of the country (where the company issuing the options is a resident) taxes have been withheld at source, then depending upon the relevant treaty provisions the Indian resident employee may be able to obtain tax credits.

E. ADR/GDR linked option plans

The Finance Minister, Mr. Yashwant Sinha had announced in the Union budget[30] for 1998-99, that software companies would be allowed to issue employee stock options linked to American Depository Receipts **("ADRs")** / Global Depository Receipts **("GDRs").** Further to that announcement on June 23, 1998 the government notified guidelines for issue of software stock options linked to international equity offerings by software companies[31].

The salient features of these guidelines are as follows:

- A software company has been defined as a company that has at least 80 per cent of its turnover accruing from software activities. This would have to be certified by a chartered accountant

[30] The budget speech was delivered on June 1, 1998

[31] Source: Business Standard and The Economic Times, June 24, 1998

- ADR/GDR linked employee stock options would have to be included as a part of the ADR/GDR application to the Ministry of Finance
- Software companies can offer their employees stock options at a maximum discount of 10 per cent to the prevailing market price (as on the date of offer)
- Promoters and their relatives have been barred from receiving stock options
- The issue of stock options is limited to 10 per cent of the paid-up capital of the Company
- The issue of stock options will require a special resolution (under the Companies Act, 1956) as applicable to preferential allotment of shares
- The allotment of stock options shall be done by a committee of the board of directors of the Company and shall include a minimum of two non-executive members of the board as its members
- While the stock options will not be transferable the ADRs/GDRs acquired by exercising the options may be freely transferable
- The RBI on August 7, 1998 allowed the remittance of money abroad by employees of Indian software companies for procuring ADR/GDR linked stock options. Such options can be offered to non-resident/resident permanent employees (including Indian and overseas working directors). Accordingly an employee of an Indian software company is entitled to remit funds up to a maximum of U.S. $ 50,000 once in a block of five years, for acquisition of ADRs/GDRs.
- The RBI's permission will be required to retain or continue holding the ADRs/GDRs acquired pursuant to the stock option scheme
- Upon liquidation of the ADRs/GDRs the Indian resident employee will need to repatriate the proceeds to India, unless permission of the RBI has been obtained for the retention or use of the funds abroad
- The ADRs/GDRs acquired on exercise of the stock options will be eligible for concessional tax treatment under section 115ACA of the Income Tax Act, 1961. Accordingly, income by way of long term capital gains (gains earned on the holding of the shares for a period of more than 12 months) would be taxed at a concessional rate of 10 per cent. Dividends declared by Indian companies are anyway exempt under the provisions of section 10(33) read together with section 115-O of the I-T Act

The RBI instructions, which curtail free pricing, and quantum of issue seem to directly contravene the provisions of The Guidelines. The RBI may have to come out with clarifications that are in conformity with the Guidelines.

F. Conclusion:

All the regulatory authorities including SEBI, the RBI and the Ministry of Finance have recognized the potential of ESOS and certain steps in the right direction have been taken. Some clarifications are needed, which can be worked out in the course of time. On the whole, with ESOSs India can move on and provide the level of employee participation and commitment as is required to propel the Indian economy to the next millennium.

The contents of this paper should not be construed as legal opinion or professional advice.