



## Residential status is relevant while exercising the option and not during the vesting period for taxability of Stock Appreciation Rights

### Background

Recently, the Chennai Bench of the Income-tax Appellate Tribunal (the Tribunal), in the case of Shri Soundarrajan Parthasarathy and Shri Kummathi Rameswar Reddy<sup>1</sup> (the taxpayers), has ruled that the value of Stock Appreciation Rights (SARs) received by the taxpayer (employees of an Indian company having a U.S. parent) is taxable either as a benefit in lieu of salary or as a perquisite under Section 17 of the Income-tax Act 1961 (the Act).

The Tribunal also rejected the taxpayers' claim that SARs was a capital asset and cannot be treated as income.

The Tribunal also held that since the taxpayers were residents in India at the time of exercise of SARs, they are liable to tax on the same irrespective of the fact that they were non-residents during the vesting period.

### Facts of the case

- Both the taxpayers were employees of Cognizant Technologies India Pvt. Ltd. (Cognizant India), which is a subsidiary company of Cognizant Technology Solutions Corporation, a Delaware Corporation, USA (parent company or Cognizant USA).
- The Cognizant USA promoted an incentive plan for the employees of Cognizant India known as '1999 Incentive Compensation Plan.' As per this plan, an option was given to the employees of Cognizant India for providing SARs.
- The eligibility for participation for the SARs was that the recipients should be employees of the company or non-employee directors and independent contractors. The taxpayers were given a right for appreciating the value of certain specified number of securities and were not offered any security or sweat equity shares.
- Cognizant India deducted tax at source by treating the SARs as a perquisite in the hands of taxpayers.
- SARs were also subjected to tax in USA since Cognizant USA also deducted tax on the same.
- Suffering double taxation both in India and the USA and also aggrieved by the decision of Assessing Officer (AO) of taxing the SARs in India which was upheld by the Commissioner of Income-tax (Appeals) [CIT(A)], the taxpayers filed appeals before the Tribunal.

<sup>1</sup> Shri Soundarrajan Parthasarathy and Shri Kummathi Rameswar Reddy v. DCIT (ITA No.390/Mds/2016) – Taxsutra.com

## Taxpayers' contentions

- The taxpayers submitted that SARs offered to them was a capital asset, therefore, the realisation of the value of the SARs is nothing but capital gain. They further contended that since no security was offered or allotted to them, the SARs cannot be construed as a perquisite.
- Since taxpayers were not the employees of the USA parent company who had given the SARs, it cannot be construed as perquisite in their hands.
- They submitted that during the vesting period, taxpayers were non-residents and as services were rendered outside India, the same was not taxable in India. Further, the amount realised on SARs was subjected to tax in the USA, therefore, taxing the same amount in India would amount to double taxation.

## Tribunal's ruling

- The Tribunal held that the incentive was given to the taxpayers as compensation for the services rendered to Cognizant India. It was not given for the transfer of capital asset or termination of any source of income. Therefore, the right conferred on the taxpayer under the scheme cannot be construed as a capital asset. The Tribunal noted that if the taxpayers were not employees of the Cognizant India, the subsidiary company of Cognizant USA, they would not have been given the option of availing SARs under the scheme. Therefore, Cognizant India would be directly benefited, and Cognizant USA is indirectly benefited. Further, this payment is in addition to salary for the service rendered to Cognizant India. Therefore, the Tribunal held that the SARs benefit received by the taxpayers was a perquisite in the hands of the taxpayers or benefit in lieu of salary for the services rendered.
- The Tribunal held that merely because the taxpayers were non-residents and rendered service outside India during the vesting period that cannot be a reason for claiming

that the same was not taxable in India. When the taxpayers exercised the option for SARs, they were residents in India. Therefore, when the SARs was vested irrespective of the residency, the same is liable to taxation in India.

- In relation to the double taxation of SAR benefit in India and the USA, the Tribunal remarked that there was no material evidence to support the claim that the value of SARs suffered tax in the USA. However, taking note of taxpayers' submission that the value of SARs was subjected to taxation in the USA, the Tribunal held that the same needed to be examined in the light of India-USA tax treaty. The Tribunal thus, remitted back the matter to the file of AO for the limited purpose of examining whether taxpayers have paid tax in the USA on the same SAR benefit in the light of India-USA tax treaty.

## Our comments

The Tribunal failed to investigate whether the SAR benefit received pertains to the services entirely rendered in India or not. In other words, the Tribunal has not realised that the stock income pertains to services rendered during the period in which the employee has worked outside India. It is relevant to mention that the Tribunal, in the case of Makarand Gadre<sup>2</sup>, also held that in case the stock options are exercised in India, the income is accrued in India. However, there are judicial precedents<sup>3</sup> which is in contrast with the present case wherein it was held that only the proportionate benefit as is relatable to the services rendered by the taxpayer in India is taxable and not the entire benefit.

It may be noted that the Chennai Tribunal has remitted back the case to the AO for analysing the provision of India-USA tax treaty for mitigating the double taxation implication on taxation of SARs.

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<sup>2</sup> Makrand Gadre v. ACIT [ITA Nos. 1278 (Hyd) of 2003 and 940 (Hyd) of 2005]

<sup>3</sup> ACIT v. Robert Arthur Keltz [2013] 35 Taxmann.com 424 (Del) Mr. Anil Bhansali v. ITO Tribunal (ITA No.220/Hyd/2014)

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