What is ESOP (Employee Stock Ownership Plan)?

An ESOP (Employee stock ownership plan) is an employee benefit scheme that offers employees ownership stake in the organization they work. Usually, ESOPs are issued in the form of allocation of direct stock (shares) to employees. Similarly, profit-sharing plans or bonuses also are forms of ESOP. The employer has the discretion in deciding which employee should avail ESOP.

In brief: ESOP

- Companies are using the ESOP method to keep their valuable employees in the background of cash scarcity. ESOPs are becoming more useful during the Covid times where firms lack ready cash to pay their staff.
- ESOP is the mechanism where the employer (company) gives remuneration to the employees in the form of shares in the company.
- This helps the company to avoid cash payment and helps the employee a beloved sense and willingness to work hard for the better prospects of the firm they work.
- Still tax implications are there for the employee who gets the ESOP.
- Budget 2020 has given incentives (tax) to ESOPs.

What are the benefits of ESOP?

As employees get ownership rights in the company they work, their sense of responsibility may increase. This will encourage employees to put the best effort to develop the company.

indianeconomy.net

Another advantage is that there are some tax benefits for the employer in remunerating employees with stock. This benefit depends upon the prevailing tax laws.

Another critical element is that employers can avoid cash payment remuneration while giving ESOPs.

Similarly, start-ups give ESOP to employees who are outstanding and are decisive in developing the company. Start-ups generally use ESOPs to attract and retain highly talented employees during the initial years.

For the employees also, tax concessions are there which changes from country to country and from time to time.

ESOP attraction during Covid and recession times

In this uncertainty period, companies lack cashflows to give salaries. Though non-critical employees can be sent off, the skill-oriented techies cannot be sent back. Hence, companies prefer to give remuneration to their important employees using ESOP.

Tax implication of ESOPs

ESOPs leave tax liability to employees as these are remuneration they receive instead of salaries and other perks. Hence, employees have to pay taxes when they receive ESOPs. The Income Tax Act provides for taxation of ESOPs as a prerequisite. As per the rules, the taxable value of ESOP is the fair market value (FMV) of shares on the date of allotment or transfer (reduced by the exercise price paid by the employee). There are different methods to estimate the FMV for listed companies and unlisted companies.

indianeconomy.net

FMV of listed firms: The FMV for shares of Indian listed companies is based on the ruling stock market price in India

FMV of whereas for unlisted companies (including foreign-listed companies): needs to be valued by a Category I Merchant Banker registered with the SEBI.

Usually, tax on ESOP is paid by the employee by considering it as part of his income. When such tax payment is made at the time of getting shares, actually employees are paying ready tax without selling the shares they got through ESOPs. This may create difficulty of the employee and they may decline ESOPs. Hence, to encourage the ESOP practice, the Budget 2020 has given a concession to employees for paying taxes.

ESOP tax concession under budget 2020:

As a step to boost the start-up ecosystem who are using more ESOPs, the budget eased the tax burden on the employees by deferring the ***tax payment by five years*** or till the employee leave the company or when they sell their shares, whichever is earliest.

****