Karnataka High Court

The Commissioner Of Income - Tax vs M/S Biocon Ltd., on 11 November, 2020

Author: Alok Aradhe Prasad

IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 11TH DAY OF NOVEMBER 2020

PRESENT

THE HON'BLE MR. JUSTICE ALOK ARADHE

AND

THE HON'BLE MR. JUSTICE H.T.NARENDRA PRASAD

I.T.A. NO.653 OF 2013

BETWEEN:

1. THE COMMISSIONER OF INCOME-TAX
LTU
JSS TOWERS
BSK III STAGE
BANGALORE.

2. THE DY. COMMISSIONER OF INCOME-TAX
LTU
JSS TOWERS
BSK III STAGE
BANGALORE

... APPELLANTS

(BY SRI.K.V.ARAVIND, ADV.,)

AND:

M/S BIOCON LTD.
20TH KM, HOSUR ROAD
ELECTRONIC CITY
HEBBAGODI
BANGALORE - 560 100.

... RESPONDENT

(BY SRI.T.SURYANARAYANA, ADV.)

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THIS ITA IS FILED UNDER SECTION 260-A OF I.T. ACT, 1961 ARISING OUT OF ORDER DATED 16.07.2013 PASSED IN ITA NO.248/BANG/2010 FOR THE ASSESSMENT YEAR 2004-05, PRAYING TO:

(I) FORMULATE THE SUBSTANTIAL QUESTIONS OF LAW STATED ABOVE.

(II) ALLOW THE APPEAL AND SET ASIDE THE ORDERS PASSED BY THE ITAT, BANGALORE IN ITA NO.248/BANG/2010 DATED 16.07.2013 CONFIRMING THE ORDER OF THE APPELLATE COMMISSIONER AND CONFIRM THE ORDER PASSED BY THE DEPUTY COMMISSIONER OF INCOME TAX, LTU, BANGALORE.

THIS ITA COMING ON FOR FINAL HEARING, THIS DAY, ALOK ARADHE J., DELIVERED THE FOLLOWING:

JUDGMENT

This appeal under Section 260A of the Income Tax Act, 1961 (hereinafter referred to as the Act for short) has been preferred by the revenue. The subject matter of the appeal pertains to the Assessment year 2004-05. The appeal was admitted by a bench of this Court vide order dated 07.03.2014 on the following substantial questions of law:

> (i) Whether on the facts and in the circumstances of the case and in law the tribunal was right in holding that the discount on issue of ESOP is allowable deduction in computing the income under the head profits and gains of the business?
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> (ii) Whether on the facts and in the circumstances of the case and in law the tribunal was right in holding that difference between market price of the shares at the time of grant of option and offer price amounts to discount and the same has to be treated as remuneration to the employees for their continuity of service?
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> (iii) Whether on the facts and in the circumstance of the case and in law the tribunal committed an error in not in not examining the scheme of ESOP from which it is clear that the employees will not get any right in the shares till completion of the period prescribed and the expenditure claimed is contingent and recorded perverse finding?

2. Facts leading to filing of this appeal briefly stated are that the assessee is a company engaged in the business of manufacture of Enzymes and Pharmaceuticals Ingredients. The assessee filed its return of income for the Assessment Year 2004-05 on 31.10.2004 declaring total income of Rs.50,65,18,080/-. The case was selected for scrutiny by the Assessing Officer. The Assessing Officer by an order dated 29.12.2006 inter alia held that assessee has floated a scheme viz., Employees Stock Option Plans (ESOP) and under the scheme had constituted the Trust. The shares of the company were transferred to the trust at the face value and the employees of the assessee were allowed to exercise the option to buy the shares within the time prescribed under the scheme subject to terms and conditions mentioned therein. The assessee claimed the difference of market price and allotment price as a discount and claimed the same as an expenditure under Section 37 of the Act. The Assessing Officer rejected the

claim on the ground that the assessee has not incurred any expenditure and the expenditure is contingent in nature and therefore, the assessee is not entitled to claim the difference between the market price and the allotment price as an expenditure under Section 37 of the Act. The assessee thereupon filed an appeal before the Commissioner of Income Tax (Appeals) who by an order dated 13.11.2009 dismissed the appeal preferred by the assessee.

3. The assessee thereupon filed an appeal before the Income Tax Appellate Tribunal (hereinafter referred to as 'the tribunal' for short). The division bench of the tribunal made a reference to the special bench. The special bench referred the question 'whether discount on the issue of employees for options is allowable as deduction in comnputing the income under the head 'profits and gains' of business'?. The Special bench of the tribunal by an order dated 16.07.2013 while answering the reference inter alia held different amount of between the market value and the face value at which shares are allotted are part of remuneration, which are paid to the employees in order to compensate them for the continuity of their services to the company and therefore, the same is allowable as an expenditure under Section 37 of the Act. It was further held that the expenditure is not contingent in nature. The appeal preferred by the assessee was directed to be placed before the division bench for decision in the light of findings recorded by the special bench. In the aforesaid factual background, the revenue has filed this appeal. Learned counsel for the revenue submitted that the expenses claimed by the assessee towards ESOP was neither incurred nor accrued during Assessment Year 2004-05 and therefore, the same could not be claimed as deduction under Section 37 of the Act. It is further submitted that expenses towards ESOP is contingent and not crystallized liability which was enforceable during Assessment Year 2004-05 and since, the assessee is following mercantile system of accounting, the expenditure is not allowable during the year. It was also submitted that expenditure claimed by the assessee is not real and same is hypothetical, notional and imaginary. It is also urged that the shares are not handed over to the employees and the aforesaid exercise is liable for termination in any situation either at the instance of the employer or the employee. It is also urged that in a case where mercantile system of accounting is followed unless a legal liability is incurred, the expenditure is not allowable as accrued. It is also contended that in the instant case, as the control of shares remains with the assessee for the period of scheme, the assessee has neither assumed any liability nor has incurred the same. It is also argued that the tribunal has failed to appreciate that no amount was paid to claim the same as expenditure under Section 37(1) of the Act. It is also urged that the tribunal has failed to appreciate mercantile system of accounting. In support of aforesaid submissions, reliance has been placed on decisions of Supreme Court in 'COMMISSIONER OF INCOME-TAX, BANGALORE VS. INFOSYS TECHNOLOGIES LTD.', (2008) 166 TAXMAN 204 (SC), 'MORVI INDUSTRIES LTD VS. COMMISSIONER OF INCOME-TAX', (1971) 82 ITR 835 (SC), 'KESHAV MILLS LTD. VS.

COMMISSIONER OF INCOME-TAX', (153) 23 ITR 230 (SC), 'COMMISSIONER OF INCOME-TAX VS. A. GAJAPATHY NAIDU', (1964) 53 ITR 114 (SC).

4. On the other hand, learned counsel for the assessee submitted that discount on the issue of ESOPs is not a contingent liability but is an ascertained one. It is further submitted that ESOPs vest over a period of 4 years at the rate of 24%, which means that at the end of first year the employee has a definite right of 25% of the shares and the assessee is bound to allow the vesting of 25% of the options. In this connection, our attention has been invited to paragraphs 9.3.1 to 9.3.6 of the order passed by the tribunal and reliance has been placed on decision of the Supreme Court in 'BHARAT EARTH MOVERS VS. CIT', (2000) 112 TAXMAN 61 (SC), 'ROTORK CONTROLS INDIA PVT. LTD VS. CIT', (2009) 180 TAXMAN 422 (SC). It is also argued that for the purposes of Section 37(1) of the Act, it is sufficient if the expenditure has been incurred and therefore, issuance of shares at a discount were the assessee absorbs the difference between price at which it is issued and the market value of the shares would also be an expenditure incurred for the purpose of Section 37 of the Act. Our attention has been invited to the findings recorded by the tribunal in paragraphs 9.2.7 to 9.2.8 of the tribunal and reliance has been placed on decisions in 'MADRAS INDUSTRIAL INVESTMENT CORPN. LTD. VS. CIT', (1997) 225 ITR 802 (SC), 'CIT VS. WOODWARD GOVERNOR (INDIA) PVT. LTD.', (2009) 179 TAXMAN 326 (SC). It is also urged that discount on issue of ESOPs is only a form of compensation paid to the employee and if not a short capital receipt. It is also urged that deduction of discount on ESOP over the vesting period is in accordance with the accounting in the books of

accounts, which were prepared in Securities And Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999. In support of aforesaid submission reliance has been placed on decision in 'CIT VS. UP STATE INDUSTRIAL DEVELOPMENT CORPORATION', (1997) 92 TAXMAN 45 (SC), 'CHALLAPALLI SUGARS LTD. VS. CIT', (1975) 88 ITR 167 (SC). It is also urged that the decision relied on by the revenue does not support its case and the issue with regard to deduction of ESOP has been decided by different High Courts. In this connection, reference has been made to 'CIT VS. PVP VENTURES LTD.', (2012) 23 TAXMANN.COM 286 (MAD), 'CIT VS. LEMON TREE HOTELS LIMITED', ITA NO.107/2015 DECIDED ON 18.08.2015,'CIT VS. LEMON TREE HOTELS LIMITED', (2019) 104 TAXMANN.COM 26 (DEL). It is also pointed out that from the Assessment Year 2009-10, the Assessing Officer has accepted the claim of the assessee and has permitted ESOP expenses as deduction. Therefore, the revenue cannot be now permitted to alter its stand.

5. By way of rejoinder reply, learned counsel for the revenue submitted that judgment of the Supreme Court in Bharat Earth Movers is no applicable to the fact situation of the case as in the aforesaid decision the Supreme Court was dealing with statutory liability pending fixation of liability, whereas, in the instant case, the assessee has a liability, therefore, the aforesaid decision of the Supreme Court does not apply. It is also pointed out that in Rotork Controls India, the Supreme Court was dealing with allowability of provision as deduction and it has been held that subject to compliance of certain conditions on matching principle, the deduction is permissible. It has further been held in the aforesaid decision that income from sale of goods is subjected to tax, therefore, the corresponding expenditure is to be allowed in the same year. The aforesaid decision is also of no assistance to the assessee as the assessee has not incurred any expenditure.

6. We have considered the submissions made by learned counsel for the parties and have perused the record. The singular issue, which arises for consideration in this appeal is whether the tribunal is correct in holding that discount on the issue of ESOPs i.e., difference between the grant price and the market price on the shares as on the date of grant of options is allowable as a deduction under Section 37 of the Act. Before proceeding further, it is apposite to take note of Section 37(1) of the Act, which reads as under:

> Section 37(1) says that 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 profession shall be allowed in computing the income chargeable under the head, "Profits and Gains of Business or Profession".

7. Thus, from perusal of Section 37 (1) of the Act, it is evident that the aforesaid provision permits deduction for the expenditure laid out or expnded and does not contain a requirement that there has to be a pay out. If an expenditure has been incurred, provision of Section 37(1) of the Act would be attracted. It is also pertinent to note that Section 37 does not envisage incurrence of expenditure in cash.

8. Section 2(15A) of the Companies Act, 1956 defines 'employees stock option' to mean option given to the whole time directors, officers or the employees of the company, which gives such directors, officers or employees, the benefit or right to purchase or subscribe at a future rate the securities offered by a company at a free determined price. In an ESOP a company undertakes to issue shares to its employees at a future date at a price lower than the current market price. The employees are given stock options at discount and the same amount of discount represents the difference between market price of shares at the time of grant of option and the offer price. In order to be eligible for acquiring shares under the scheme, the employees are under an obligation to render their services to the company during the vesting period as provided in the scheme. On completion of the vesting period in the service of the company, the option vest with the employees.

9. In the instant case, the ESOPs vest in an employee over a period of four years i.e., at the rate of 25%, which means at the end of first year, the employee has a definite right to 25% of the shares and the assessee is bound to allow the vesting of 25% of the options. It is well settled in law that if a

business liability has arisen in the accounting year, the same is permissible as deduction, even though, liability may have to quantify and discharged at a future date. On exercise of option by an employee, the actual amount of benefit has to be determined is only a quantification of liability, which takes place at a future date. The tribunal has therefore, rightly placed reliance on decisions of the Supreme Court in Bharat Movers supra and Rotork Controls India P. Ltd., supra and has recorded a finding that discount on issue of ESOPs is not a contingent liability but is an ascertained liability.

10. From perusal of Section 37(1), which has been referred to supra, it is evident that an assessee is entitled to claim deduction under the aforesaid provision if the expenditure has been incurred. The expression 'expenditure' will also include a loss and therefore, issuance of shares at a discount where the assessee absorbs the difference between the price at which it is issued and the market value of the shares would also be expenditure incurred for the purposes of Section 37(1) of the Act. The primary object of the aforesaid exercise is not to waste capital but to earn profits by securing consistent services of the employees and therefore, the same cannot be construed as short receipt of capital. The tribunal therefore, in paragraph 9.2.7 and 9.2.8 has rightly held that incurring of the expenditure by the assessee entitles him for deduction under Section 37(1) of the Act subject to fulfillment of the condition.

11. The deduction of discount on ESOP over the vesting period is in accordance with the accounting in the books of accounts, which has been prepared in accordance with Securities And Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.

12. So far as reliance place by the revenue in the case of CIT VS. INFOSYS TECHNOLOGIES LTD. is concerned, it is noteworthy that in the aforesaid decision, the Supreme Court was dealing with a proceeding under Section 201 of the Act for non deduction of tax at source and it was held that there was no cash inflow to the employees. The aforesaid decision is of no assistance to decide the issue of allowability of expenses in the hands of the employer. It is also pertinent to mention here that in the decision rendered by the Supreme Court in the aforesaid case, the Assessment Year in question was 1997-98 to 1999- 2000 and at that time, the Act did not contain any specific provisions to tax the benefits on ESOPs. Section 17(2)(iiia) was inserted by Finance Act, 1999 with effect from 01.04.2000. Therefore, it is evident that law recognizes a real benefit in the hands of the employees. For the aforementioned reasons, the decision rendered in the case of Infosys Technologies is of no assistance to the revenue. The decisions relied upon by the revenue in Gajapathy Naidu, Morvi Industries and Keshav Mills Ltd. supra support the case of assessee as the assessee has incurred a definite legal liability and on following the mercantile system of accounting, the discount on ESOPs has rightly been debited as expenditure in the books of accounts. We are in respectful agreement with the view taken in PVP Ventures Ltd. And Lemon Tree Hotels Ltd. Supra.

13. It is also pertinent to mention here that for Assessment Year 2009-10 onwards the Assessing Officer has permitted the deduction of ESOP expenses and in view of law laid down by Supreme Court in Radhasoami Satsang vs. CIT, (1992) 193 ITR 321 (SC), the revenue cannot be permitted to take a different stand with regard to the Assessment Year in question.

In view of preceding analysis, the substantial questions of law framed by a bench of this court are answered against the revenue and in favour of the assessee. In the result, we do not find any merit in this appeal, the same fails and is hereby dismissed.

Sd/-

JUDGE Sd/-

JUDGE ss