IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI 'I' BENCH, MUMBAI

[Coram: Pramod Kumar (Vice President),
and Saktijit Dey (Judicial Member)]

ITA Nos. 1200 and 1201/Mum/2018
Assessment years: 2013-14 and 2014-15

Unnikrishnan V S **……..……Appellant**
C/o G P Kapadia & Co
61 A, Mittal Tower, Nariman Point
Mumbai 400 021 [PAN: AAPPU3300G]

Vs.

Income Tax Officer
International Taxation 4(3)(1), Mumbai **……Respondent**

Appearances by
Kirit Mehta *for the appellant*
S S Iyengar *for the respondent*

Date of concluding the hearing : January 12, 2021
Date of pronouncement : January 13, 2021

O R D E R

Per Pramod Kumar, VP:

1. These two appeals pertain to the same assessee, involve a common issue regarding taxation of ESOP benefit and were heard together. All the relevant material facts are admittedly the same, except for a variation in the quantum of ESOP benefits brought to tax- while the the amount of ESOP benefit in question, in dispute, for the assessment year 2013-14 is Rs 72,77,320, the quantum of ESOP benefit for the assessment year 2014-15 is Rs 83,59, 125. We will take up the appeal of the assessee for the assessment year 2013-14 first, and whatever we decide in the said appeal, as learned representatives agree, will apply *mutatis mutandis* 2014-15 as well. The said appeal calls into question the correctness of the order dated 19th January 2018, passed by the learned C.I.T. (A) in the matter of assessment under section 143(3) of the Income Tax Act, 1961 *(hereinafter referred to as 'the Act'*) for the assessment year 2013-14.

2. Grievances raised by the appellant, which, it may also be added, are common in both the years before us, are as follows:

1. On the facts and in the circumstances of the case and in law, the Commissioner of Income-tax (A) has erred in upholding the action of the learned Assessing Officer to tax Employee Stock Option as perquisite u/s 17.

2. Without prejudice to above, on the facts and in the circumstances of the case and in law, the CIT(A) has erred in concluding that the Appellant is not entitled for relief from taxability of perquisite in the form of Employee Stock Options, under the provisions of Section 90 of the Act read with Double Taxation Avoidance Agreement between India and UAE ('DTAA');

3. The assessee before us is an individual. He is an employee of HDFC Bank Limited, Mumbai, and currently on deputation to HDFC Bank Representative Office in Dubai. He is stated to be working in Dubai, U.A.E., since 1st October 2007. The status of the assessee, so far as the present assessment year is concerned, is of the non-resident. During the relevant financial period, the assessee exercised the options granted to the assessee by the HDFC Bank Limited on 27th June 2007, which vested on 27th June 2008 (50%) and on 27th June 2009 (50%). Upon exercise of these options in respect of 18,500 shares. The grant price of these options was Rs 219.74 per share, whereas the market price, as on the date on exercising the option, ranged from Rs 507.40 to Rs 659. The perquisite value of these options, being the difference in the market value of the shares vis-à-vis grant price of the shares, aggregated to Rs 72,77,320. It was in this backdrop that the HDFC Bank Limited deducted tax at source of Rs 22,48,685 on the said perquisite value in respect of exercise of options. However, while filing the return of income, disclosing total income of Rs 78,50,010 and claiming an income tax refund of Rs 21,46,410, on 28th August 2013, the assessee claimed a relief of Rs 20,44,855 under section 90. When the income tax return was picked up for scrutiny and this claim was probed further, assessee submitted that "**though the income from ESOP perquisite was not taxable in India**", on account of limitations in reporting and disclosure of said income in the return of income, "**the assessee had to report and disclose the said income in its form, as reflected in the return of income filed by the assessee, and seek refund of tax deducted at source by the employer i.e. HDFC Bank**". It was then explained by the assessee that under section 5(2) of the Act, what can be taxed in the hands of a non-resident assessee is only the income which **"accrues or arises, or is deemed to accrue or arise, in India**", and the income which "**is received or is deemed to be received in India by such year by or on behalf of such a person**". The case of the assessee was that the ESOP benefits received by the assessee did not fall in any of these categories. It was contended that "**ESOP perquisite are in the nature of salary income** *(and)* **the right to receive salary income arises only upon rendering of services**". In substances, thus, it was contended that "**the ESOP benefits are received by the assessee on account of services rendered in connection to employment with Dubai representative office of HDFC Bank in U.A.E. over the years from F.Y. 2007-08 to F.T. 2009-10. So the ESOP perquisites are received for employment services rendered in U.A.E., and, therefore, shall not accrue or arise in India** *(Extracts from letter dated 9th March 2016, relevant reproductions at page 4 of the assessment order)*". A reference was then made to the deeming fiction under section 9(1)(ii). A large number of judicial precedents were also referred to, and finally it was submitted that:-

"In the light of the above facts on record and binding judicial precedents on the subject, we humbly submit that the income in the nature of ESOP benefits earned by the assessee in captioned AY does not fall in any of the expressions which is sine qua non for taxability under section 5(2) of the Act, and consequently, ESOP provisions cannot be taxed under the provisions of the Act.

We, therefore, request yourself to kindly accept the aforesaid tax position of the assessee, as filed in the return of income w.r.t ESOP perquisite and release the refund as claimed by the assessee alongwith interest due under section 244A of the Act"

4. The assessee then made an alternative submission on treaty protection under the India U.A.E. Double Taxation Avoidance Agreement **[(1993) 205 ITR (Statutes) 49; Indo U.A.E. tax treaty**, *in short*]. This claim of the assessee, as noted in the assessment order at pages 5 and 6, was as follows:

At the outset, reliance is placed on Article 15 of DTAA between India and UAE on Dependent personal services which provides for taxation of salaries, wages and other similar remunerations. The ESOP benefits earned by the assessee during the captioned AY shall be covered under the scope of expression "other similar remuneration" which has been duly accepted by the OECD in its 2014 edition of commentary on Model Tax Convention and 2011 edition of UN Model Double Taxation Convention. India in its comments to the aforesaid commentary on the subject has not raised any reservations and/or objections to the ESOP benefits being covered under the expression 'other similar remuneration', thereby impliedly accepting the said scope of expression; (Copy of the said DTAA is attached as attachment 4)

- **The relevant extracts of Article 15 of DTAA are reproduced below for your record ready reference:**

"Article 15(1).'..... salaries, wages land other similar remuneration (ESOP benefits) derived by a resident of a Contracting State (UAE) in respect of an employment shall be taxable only in that State (UAE), unless the employment is exercised in the other-contracting State (India). If the employment is so exercised, such remuneration as is derived there from may be taxed in .that other State (India)"

- **The expression 'exercised' has been Interpreted by OECD in its 2014 edition of Commentary on Model Tax Convention and 2011 edition of UN Model Double Taxation Convention, to mean a place where the employee physically rendered its services. India in Its comments to the aforesaid commentary on the subject has not raised any reservations and/or objections, thereby impliedly accepting the said scope of expression;**

- **On perusal of the said Article and in context of facts of the assessee, yourself would appreciate and agree that assessee is resident of UAE and has exercised employment services also in UAE;**

- **Therefore, as per Article 15(1) of India-UAE DTAA, the income from ESOP benefits shall be taxable only in UAE and the said income cannot be taxed in India;**

9. Further, yourself would agree and appreciate that India is a signatory to the UN Model Double Taxation Convention and observer to the OECD Model Tax Convention. Further, India has provided its comments to both the commentaries of the respective Model Tax Conventions. The treatment of employee stock-options has been explained in Para 12.1 to Para 12.15 to the 2014 Edition of Commentary on OECD Model Tax Convention and the UN has accepted the said treatment of employee stock-options. Further, India in Its comments to the aforesaid paras in the commentary on the subject, has not raised any reservations and/or objections, thereby impliedly accepting the tax treatment of employee stock options, provided therein. As, India has accepted the said position and In light of principle of contemporaneous exposition, it is binding on the Income-tax department to accept the treatment of employment stock-options;

10. The treatment of employment stock-options as provided in the above paras are duly followed and complied in the Return of Income filed by the assessee and support the tax position of the assessee of non-taxability of ESOP benefits as per Article 15(1) India-UAE DTAA; and

11. Therefore, we humbly submit that the1 ESOP benefits earned by the assessee over the financial years by rendering employment service in UAE shall not be taxed in India as per Article 15(1) of India-UAE DTAA.

12. The aforesaid proposition have also been accepted by the following Hon'ble High Court as well as Hon,ble Tax Tribunals upholding that income cannot be taxed in India if the employment services over the period from years of grant to years of vesting/exercise are rendered outside India.

- **CIT vs Robert Arthur Keltz [ITA No. 57/2014 dated 23 July 2014] [Delhi];**
- **CIT vs Robert Arthur Keltz [59 SOT 2037 [ITAT- Delhi];**
- **Anil Bhansali vs ITO [53 taxmann.com 367] [ITAT- Hyderabad], etc**

13. In light of above facts and in law and further for want of doctrine of binding legal precedents and legal discipline applicable to yourself, the assessee humbly submits that the income of the assessee from ESOP benefits, are not taxable in India neither under the provisions of the Act nor under the beneficial provisions of India-UAE DTAA; and

> **14. Consequently, we therefore request yourself to kindly accept the aforesaid tax position of the assessee as filed in the return of income w.r.t. ESOP perquisites and release the refund as claimed by the assessee along with interest due under Section 244A of the Act.**

5. None of these submissions, however, impressed the Assessing Officer. The Assessing Officer noted that the options were granted to the assessee in consideration were services rendered in India, way back in 2007, when the assessee was a resident in India. The claim of the assessee that the income reflected by the ESOP benefit did not accrue or arise in India, was, thus, rejected. The Assessing Officer thus proceeded to bring the income to tax in India, as was indeed offered by the assessee as well, and decline the claim of relief of Rs 20,44,855 under section 90. Aggrieved, the assessee carried the matter in appeal before the C.I.T. (A) but without any success. Learned C.I.T. (A) rejected the plea of the assessee that the income was not taxable under section 5(2) as also the plea that the treaty protection to the assessee, under article 15 of the Indo U.A.E. tax treaty was available. The assessee is not satisfied and is in further appeal before us.

6. We have heard the rival contentions, perused the material on record, and duly considered the facts of the case in the light of the applicable legal position.

7. There is no, and there cannot be any, dispute with the fundamental proposition that under Section 5(2) to bring an income to tax in the hands of a non-resident assessee, either such an income must accrue or arise or is deemed to accrue or arise, in India, or such an income must be received or must be deemed to be received in India by such year by or on behalf of the non-resident assessee. It is for this reason that we have to properly appreciate the connotations of expression "income accruing or arising in India". In Hon'ble Supreme Court's oft quoted landmark judgment in the case of **E D Sassoon & Co Ltd Vs C.I.T. [(1954) 26 I.T.R. 27 (S.C.)],** Their Lordships have, *inter alia*, observed as follows:

> …….nor the words "is received", "accrues" and "arises" have been defined in the Act. ……Mukerji, J., has defined these terms **in Rogers Pyatt Shellac & Co. v. Secretary of State for India [1925] 1 I.T.C. 363**:
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> > "…… 'Accrues', 'arises' and 'is received' are three distinct terms. So far as receiving of income is concerned, there can be no difficulty; it conveys a clear and definite meaning, and I can think of no expression which makes it's meaning plainer than the word 'receiving' itself. The words 'accrue' and 'arise' also are not defined in the Act. The ordinary dictionary meanings of these words have got to be taken as the meanings attaching to them. 'Accruing' is synonymous with 'arising' in the sense of springing as a natural growth or result. The three expressions 'accrues', 'arises' and 'is received' having been used in the section, **strictly speaking, accrues' should not be taken as synonymous with 'arises' but in the distinct sense of growing up by way of addition or increase or as accession or advantage; while the word 'arises'**

> **means comes into existence or notice or presents itself, the former connotes the idea of a growth or accumulation and the latter of the growth or accumulation with a tangible shape so as to be receivable**. It is difficult to say that this distinction has been maintained throughout in the Act and perhaps the two words seem to denote the same idea or ideas very similar, and the difference only lies in this that one is more appropriate than the other when applied to particular cases. It is clear, however, as pointed out by Fry, L.J., in Colquhoun v. Brooks [1888] 21 Q.B.D. 52 at 59[this part of the decision not having been affected by the reversal of the decision by the Houses of Lords [1889] 14 App. Cas. 493] that **both the words are used in contradistinction to the word 'receive' and indicate a right to receive. They represent a state anterior to the point of time when the income becomes receivable and connote a character of the income, which is more or less inchoate.**
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> *[Emphasis, by underlining, supplied]*

8. These observations, with which we are in the most respectful agreement, very well highlight the relevant legal position in respect to accrual and arising of an income. Quite clearly, therefore, accrual or arising of an income cannot be equated with receipt of an income. The common thread in the connotations of these expressions is that both of these expressions, i.e., accrual or arising of an income, to borrow the words quoted with approval in E D Sassoon's case *(supra),* represent a state anterior to the point of time when the income becomes receivable and connote a character of income which is more or less inchoate. Coming to the facts of the present case, in this light, we find that so far as the ESOP benefit is concerned, while the income has arisen to the assessee in the current year, admittedly the related rights were granted to the assessee in 2007 and in consideration for the services which were rendered by the assessee prior to the rights being granted- which were rendered in India all along. The character of income may be inchoate at that stage but certainly what is being sought to be taxed now, on account of the specific provision under section 17(2)(vi), is a fruit of services rendered much earlier and the benefit, which has now become a taxable income, accrued to the assessee in 2007. All that section 17(2)(vi) decides is the timing of an income, but it does not dilute or negate the fact that the benefit, in which is being sought to be taxed, had arisen much earlier i.e. at the point of time when the ESOP rights were granted. On these facts, in our considered view, the income, even if it was inchoate at the point of time when the options were granted, has accrued and has arisen in India. The assessee is a non-resident in the current assessment year, but quite clearly, the benefit, in respect of which the income is bring sought to be taxed now, had arisen at an earlier point of time in India. Viewed thus, the income in respect of ESOP grant benefit accrued and had arisen at the point of time when the ESOP rights were granted, even though the taxability in respect of the same, on account of the specific legal provisions under section 17(2)(vi), has arisen in the present in this year. As we hold so, we may mention that the use of ESOP benefits as a part of a compensation package to the employees is a global practice, and multilateral bodies like the United Nations and OECD have had occasions to examine these aspects in great detail- though in the context of tax treaty law which we will deal in a short while. In the United

Nations Model Conventions Commentary 2017 @ 405-7, it is noted that **"***(t)***he first principle is that, as a general rule, an employee stock-option should not be considered to relate to any services rendered after the period of employment that is required as a condition for the employee to acquire the right to exercise that option**", that **"***(i)***t is also important to distinguish between a situation where a period of employment is required as a condition for the acquisition of the right to exercise an option, i.e. the vesting of the option, and a situation where an option that has already vested may be forfeited if it is not exercised before employment is terminated (or within a short period after). In the latter situation, the benefit of the option should not be considered to relate to services rendered after vesting since the employee has already obtained the benefit and could in fact realise it at any time**" and that **"***(t)***he second principle is that an employee stock-option should only be considered to relate to services rendered before the time when it is granted to the extent that such grant is intended to reward the provision of such services by the recipient for a specific period**". When we view the ESOP benefit in the light of this analysis also, it leads us to the same conclusion i.e., that the ESOP benefits relate back to the point of time, and even periods prior thereto, when the benefit is granted. It cannot, therefore, be viewed as accruing or arising at the point of time when the ESOP benefits are exercised. The exercise of options only determines the timing of taxability and that too on account of a legal fiction. Similarly, an OECD Centre for Tax Policy and Administration's publication by the name of "Cross Border Income Tax Issues Arising out of Employee Tssock Option Plans" suggests that the said income must relate back to the source jurisdiction, i.e, the jurisdiction in which relates services were rendered, as it observes that "**While <u>it is clear that the granting of an employee stock-option constitutes part of the remuneration of the employee</u> for purposes of Article 15, some commentators have considered that the holding and subsequent exercise of the option constitute investment decisions and that the gain represented by the difference between the value of the option at the time it is exercised and the value of the option at the time it was granted, constitutes a capital gain falling under Article 13, which does not allow source taxation of the gain, rather than under Article 15, which would** *(emphasis, by underlining, supplied)*". If grant of stock option is the part of remuneration, as observed in this OECD publication and rightly so, it accrues a benefit when these options are granted, and the said benefit accrues in the jurisdiction in which the qualifying services are rendered. In our humble understading, therefore, the action of the Assessing Officer in bringing the said income to tax in the hands of the assessee in the present assessment year, even though the status of the assessee in the present assessment year, was non-resident, cannot be faulted. Let us now move to the assessee's claim that the ESOP benefit in question were only taxable in U.A.E. as the said income is protected by Article 15 of the Indo U.A.E. tax treaty and as the assessee was a resident of the U.A.E. in the relevant assessment year. Under Article 15(1) of the Indo U.A.E. tax treaty, "Subject to the provisions of Articles 16, 17, 18, 19, 20 and 21, **<u>salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State</u>**. If the employment is so

exercised, such remuneration as is derived therefrom may be taxed in that other State." The Indo U.A.E. tax treaty provisions in this respect are almost verbatim the same as Article 14 of U.N. Model Convention, and elaborating upon the scope of the said provision, the U.N. Model Convention Commentary states, at page 403, as follows:

> **The treatment of employee stock-options**
>
> **12. The different country rules for taxing employee stock-options create particular problems which are discussed below. While many of these problems arise with respect to other forms of employee remuneration, particularly those that are based on the value of shares of the employer or a related company, they are particularly acute in the case of stock-options. This is largely due to the fact that stock-options are often taxed at a time (*e.g.* when the option is exercised or the shares sold) that is different from the time when the employment services that are remunerated through these options are rendered.**
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> **12.1 As noted in paragraph 2.2, the Article allows the State of source to tax the part of the stock-option benefit that constitutes remuneration derived from employment exercised in that State even if the tax is levied at a later time when the employee is no longer employed in that State.**
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> **12.2 ……. the Article applies to the employment benefit derived from a stock-option granted to an employee regardless of when that benefit is taxed…..**

9. It would thus seem that the scheme of Article 15 permits taxation of ESOP benefit, which is included in the scope of the expression "other similar remuneration" appearing immediately after the words "salaries and wages", in the jurisdiction in which the related employment is exercised. Thus, in case the assessee is to get ESOP benefits in respect of his service in U.A.E. and he exercises these options at a later point of time, say after returning to India and ceasing to be a non-resident, he will still have the treaty protection of that income under article 15(1). This principle, however, is not a one-way route. Conversely, when the assessee gets the ESOP benefit on account of rendering services in India, he cannot have the benefit of article 15 in respect of the said income. The reason is simple. Article 15(1) itself provides that "salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State **unless the employment is exercised in the other Contracting State"** and so far as the "other similar benefits" are concerned, which include the ESOP benefits, the employment is exercised in the other contracting State, i.e., in India. As much as the nexus is required to be between salaries and wages vis-à-vis the employment, the nexus is also required between other similar benefits vis-à-vis the employments; what hold goods for the former holds good for the latter as well. In the absence of nexus of 'other similar benefits', as wages and salaries, received by the assessee vis-à-vis his employment in the U.A.E., the treaty protection of the said income in India cannot be available to a resident of the U.A.E. As regards learned counsel's reliance on the coordinate bench decision in the case of **ACIT Vs Robert Arthur Kultz [(2013) 59 SOT**

203 (Del)], we find that this decision is in favour of the revenue inasmuch as it holds that "**In this case it is not in dispute that the assessee was in India only for a short period i.e. 1.4.2006 onwards and that prior to it, he has not done any service connected with any activity in India. Thus applying the propositions laid down in these cases, to the facts of the case on hand, as the assessee has not rendered service in India for the whole grant period, only such proportion of the ESOP perquisite as is relatable to the service rendered by the assessee in India is taxable in India**". The treaty protection was thus extended in this case even though the assessee received the ESOP benefits in India. Simialr was the position in the case of **Anil Bhansali Vs ITO [(2015) 53 taxmnann.com 367 (Hyd)],** relied upon by the learned counsel, wherein it was held, as very well summed up in the head notes, that "**Where assessee, having residential status of 'resident but not ordinarily a resident' received certain amount as Stock Option Transfer Proceeds (SOTP) from its employer company, for rendering services partly in India and partly in USA, only that portion of SOTP was taxable in India which was attributable to services rendered in India**". These judicial precedents do not support the case of the assessee at all. Learned counsel has also cited a large number of judicial precedents at the bar, but admittedly none of these decisions do not directly cover the issue in appeal before us, and, upon our careful perusal of these judicial precedents, we find them of no relevance at all. The assessee's claim for the treaty protection is thus equally devoid of legally sustainable merits, and we reject the same.

10. In view of the above discussions, as also bearing in mind entirety of the case, we approve the conclusions arrived at by the authorities below and decline to interfere in the matter.

11. In the result, both the appeals are dismissed. Pronounced in the open court today on the 13th day of January, 2021.

Sd/-
Saktijit Dey
(Judicial Member)

Sd/-
Pramod Kumar
(Vice President)

Mumbai, dated the 13th day of January, 2021

Copies to: *(1)* *The appellant* *(2)* *The respondent*
(3) *CIT* *(4)* *CIT(A)*
(5) *DR* *(6)* *Guard File*

By order etc.

Assistant Registrar
Income Tax Appellate Tribunal
Mumbai benches, Mumbai