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Place of services rendered and residential status during vesting period not relevant for determining taxability of Stock Appreciation Rights (SAR's) says Chennai Tribunal

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Facts

- Shri Soundarrajan Parthasarathy and Shri Kummathi Rameswar Reddy (taxpayers) were employees of Cognizant Technologies India Pvt. Ltd. (Cognizant India).
- Cognizant India is a subsidiary of Cognizant Technologies Solutions Corporation, USA (Cognizant USA).
- Cognizant USA promoted an Incentive Compensation Plan whereby an option was given to the employees of Cognizant India which gave them the right to exercise the SARs¹
- Cognizant India treated SARs as a perquisite in the hands of the taxpayers and deducted tax at source. SARs were also treated as taxable in USA and Cognizant USA deducted tax on the same. Accordingly, the taxpayers paid tax in both the countries (ie India and USA).
- Taxpayers claimed that SARs were not taxable in India as salary income since:
 - SAR is a capital asset and the realization of value of the SARs is nothing but capital gains;
 - As no security was offered or allotted to the taxpayers, SARs cannot be construed as a perquisite;
 - The taxpayers were non- resident of India, rendering services outside India when the right to exercise SARs was vested in the taxpayers. Therefore, SARs were not taxable even though the taxpayers were resident of India when the right was actually exercised;
 - SARs were given by Cognizant USA and as there was no employer-employee relationship between taxpayers and Cognizant USA, the same cannot be treated as a taxable perquisite; and
 - The amount realized on SARs was subject to tax in USA and taxing the same in India would lead to double taxation.
- The Assessing (AO) rejected the taxpayers' contentions and the Commissioner (Appeals) also confirmed the order of AO.
- Aggrieved by this ruling, the taxpayers approached the Chennai Tribunal².

¹ Stock Appreciation Right is a right to receive cash payment for appreciation in value of specified number of underlining common stock. The taxpayers were not offered any security or sweat equity shares.

² Sri Soundarrajan Parthasarathy and Shri Kummathi Rameswar Reddy v. DCIT - TS-252-ITAT-2016(CHNY)

Issue before the Tribunal

Based on the facts of the case, whether SARs are taxable in India in the hands of the taxpayers.

Rulings of the Tribunal

The Tribunal held that the SARs received by the taxpayers is a perquisite or benefit in lieu of salary taxable in India on account of the following:

- To be eligible to participate in the incentive scheme floated by Cognizant USA, the recipients should be employees of Cognizant India or non-employee directors and independent contractors. If the taxpayers were not employees of Cognizant India, SARs would not have been given to them. The SARs were given to the employees, to motivate them to perform well as they were directly or indirectly connected with Cognizant USA. Thus, Cognizant India will be directly benefited and Cognizant USA will be indirectly benefited.
- The incentive was given to the taxpayers as compensation for the services rendered to Cognizant India and not for transfer of a capital asset or termination of any source of income. Therefore, the right given to the taxpayers cannot be treated as a capital asset.
- SARs were given to the taxpayers for the service rendered to Cognizant India. Merely because the taxpayers were non-residents and rendered services outside India during the vesting period, the same cannot be treated as non-taxable. The taxpayers were residents in India at the time when they exercised the option. The residential status of the taxpayers at the time of vesting of the SARs is not relevant and the same would be liable to tax in India.

In relation to double taxation of SARs benefit in India and USA, the taxpayers had not submitted any certificate before the tax authorities evidencing payment of tax in the USA. Therefore, the Tribunal has remitted the matter back to the AO for the limited purpose of examining whether the taxpayers have paid tax in USA on the SARs as per the India- USA Double Taxation Avoidance Agreement.

Comments

The ruling of the Tribunal rejecting taxpayers' contentions that SARs were not taxable as salary income as there was no employer-employee relationship with the US entity and the right given to them in the form of SARs was a capital asset resulting in capital gain, is in line with the previous ruling³ on this issue.

However, the Tribunal has determined the taxability of the SARs based on the residential status of the employees at the time of exercise notwithstanding the fact that the services were rendered outside India during the vesting period.

While the place where services are rendered during the vesting period as well as the residential status of the employee at the stage of taxation are key factors, it is important to review the key features of each scheme / plan before concluding on taxability of stock incentives under that scheme/ plan.

Based on previous rulings⁴, the entire stock benefit was held to be taxable in India in case of Resident and Ordinarily Resident (ROR) taxpayers in the year of exercise. However, other rulings⁵ have upheld proportionate taxation for Resident but not Ordinarily Resident (RBNOR) taxpayers in the year of exercise based on the period of services rendered in India. The proportionate basis for taxation of equity / stock-based instruments in case of globally mobile employees is also laid down in the OECD Model commentary. In the instant case, the facts are unclear as to whether the taxpayers were ROR or RBNOR at the time of exercise of the SARs. This may have had a critical bearing on the decision.

³ Sumit Bhattacharya v. ACIT - [2008] 112 ITD 1 (MUM.)

⁴ Smita Anand - TS-94-AAR-2014 and ACIT v. Chittaranjan A. Dasannacharya - TS-560-ITAT-2013(Bang).

⁵ ACIT v. Robert Arthur Keltz - TS-354-ITAT-2013(DEL) and Anil Bhansali v. ITO Tribunal - TS-15-ITAT-2015(HYD)

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