



## Tax alert: Guidance on Regulatory reporting with respect to Employee Stock Options Scheme

29 October 2024

The Reserve Bank of India (RBI) issued revised operational guidelines for reporting of issue / transfer of shares under an Employee Stock Options Plan (ESOP) of an Indian company to employees resident outside India. The guidelines standardize the reporting under different ESOP mechanisms to ensure accurate reporting by Indian companies under the Foreign Exchange Management Act, 1999 ('FEMA').

### In a nutshell



#### Background

The issuance of shares under an ESOP to employees resident outside India qualifies as FDI, which necessitates reporting to the RBI via an Authorized Dealer bank. This ensures that the foreign investment is tracked and complies with the regulatory framework. Additionally, any transactions involving sale of shares between non-resident employees and residents also require reporting. This comprehensive reporting mechanism helps maintain transparency and supports the regulatory oversight of foreign investments in Indian companies.



#### Relevant Provisions

RBI had issued Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 dated 17 October 2019. The said regulations prescribe filing of Form ESOP and Form FC-GPR ('Foreign Currency-Gross Provisional Return') for grant of Options to Non-residents and Exercise of Options i.e., allotment of shares to Non-residents by an Indian Company respectively.

RBI had issued circular no. 16, dated 04 October 2004 prescribing Form FC-TRS ('Foreign Currency Transfer of Shares').



#### Revamping in Reporting

The RBI recognized the need for clarity regarding the reporting of shares issued under ESOPs, especially in cases of cashless exercises and shares issued through an ESOP trust. The RBI observed lapses in reporting in these transactions and felt the need to issue revised reporting guidelines to standardize the process across different methods of implementing ESOP schemes. This will not only enhance compliance but also ensure that all relevant transactions are reported accurately, thereby improving overall regulatory oversight.



#### Conclusion

The revised reporting guidelines clarifies the reporting requirements across different ESOP mechanisms, thereby improving transparency and ensuring compliance of reporting under FEMA.



Scroll down to read the detailed alert.

## Background:

- The investment in shares of Indian companies by employees resident outside India is treated as Foreign Direct Investment (FDI). Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 dated 17 October 2019 prescribes filing of Form ESOP and Form FC-GPR ('Foreign Currency-Gross Provisional Return') for grant of Options to Non-residents and Exercise of Options i.e., allotment of shares to Non-residents by an Indian Company, respectively under Employee Stock Option Scheme (ESOP).
- The aforesaid reporting is required to be done on Foreign Investment Reporting and Management System (FIRMs) portal of RBI. While the RBI has issued user manual on FIRMs portal for the guidance on the filings of Form ESOP and Form FC-GPR, RBI observed lapses in reporting, particularly in case of cashless exercises and shares issued via trust route under the ESOP by the Indian Companies. Accordingly, on 21 September 2024, RBI has revised the User Manual *inter alia* to provide clarity on reporting under ESOPs.
- This alert summarizes RBI's clarification on the revised User Manual on FIRMs portal for the guidance on the filings of Form ESOP and Form FC-GPR with respect to grant of Options and allotment of shares under ESOP through trust route.

## Overview of the revised User Manual for reporting of ESOPs:

- **Reporting requirements for ESOPs granted under direct route:**
  - In case of cash-based exercise, where the exercise price is paid by the non-resident employee on exercise of Options under ESOP, the same shall be reported in Form FC-GPR by the Company on the FIRMs portal.
  - In case of cashless exercise, where a portion of shares are sold to cover the exercise price, the net shares issued to employee shall be reportable in Form FC-GPR.
  - In case of cashless exercise where instead of issue of shares the Company sells all the shares and make net payment after deducting the exercise price, the same shall be reported in form FC-TRS by the Company for sale of shares on behalf of the non-resident employee.
- **Reporting requirements for ESOPs granted under Trust route:**
  - Where the non-resident employees pay exercise price to Trust for transfer of shares, the transfer of shares from trust to non-resident employees is considered to be in the nature of transfer from resident to non-resident and triggers reporting in Form FC-TRS. Trustees are liable to comply with the same.
  - Where upon exercise by non-resident employees, shares are held by the Trust on behalf of non-resident employees who is beneficial owner and allotment of shares to employees happens only on satisfaction of certain conditions, the guidelines equate the event of earmarking with transfer of shares to employees and this trigger reporting in Form FC-TRS on the event of earmarking.
- In case of unlisted companies, the valuation of shares obtained by a company is valid for 90 days from the date of valuation i.e., the date as on which the valuation is arrived rather than date of issuance of the valuation report.

## Comments:

- The RBI aims to maintain a comprehensive overview of Foreign Direct Investment (FDI) in Indian companies. This is crucial given the sector specific FDI limits in place. These guidelines not only streamline the compliance process but also reinforce the regulatory framework, ensuring that all transactions related to ESOPs are appropriately reported.
- There are specified guidelines and timelines to file Form FC-GPR and Form FC-TRS. Non adhering to those attract penalties to the company / trustees. Hence, compliance with revamped guidelines is essential.

- Companies will need to examine the reporting of shares sold to cover the exercise price. Whether the same is to be reported in Form FC-TRS **OR** Form FC-GPR **OR** in both forms need to be analyzed.
- Companies while extending stock options to overseas employees, need to take cognizance of the reporting requirement, the timing of reporting and the form to be used for reporting based on the mechanics of the ESOP plan.



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