

## **India FBT**

In 2007 the Indian Tax Authorities extended the existing FBT to include equity-based compensation. This was generally seen as a way to ensure the government received all tax monies due on equity income since it transferred liability for payment from the employee to the employer. While an individual may "hide" taxable income, a corporation is significantly less likely to do so.

### **India FBT: What & Who?**

What exactly is FBT? As mentioned above, it is the Fringe Benefits Tax, which is generally paid by employers on non-cash benefits in kind such as housing or car allowances, gym memberships, and other such perks. Many countries have such a tax. Effective April 1, 2007, the rules in India were amended to include income from all equity awards settled in shares. This includes stock options, ESPP, Restricted Stock Awards & Units (RSAs & RSUs), and Stock-settled Stock Appreciation Rights (SSARs).

Under the updated requirements, the tax is payable by the employer on the taxable event: stock option exercise, ESPP purchase, and RSA/RSU vesting, but is calculated on the spread at vest. To make matters worse, the spread is not necessarily based on the company's definition of the fair market value (FMV), but is based on a market valuation provided by a Category I registered merchant banker in India.

Valuation for options must be obtained for each vesting date. Issuers with monthly vesting schedules beware! Additionally, there was no grandfathering for existing awards: the new rules affect any award made in India for which the taxable event occurs on or after April 1, 2007.

The employer is allowed to pass through the tax to the employee, but be careful — it is not like the U.K. NIC Joint Election which transfers legal liability for the payment of employer social taxes from the employer to the employee. In the case of the Indian FBT, the employer is still legally responsible for ensuring the payment is made, so it is more of a recovery of payment than a pass-through. U.S. issuers have the additional problem of how to handle a pass-through on existing awards. Unless grant agreements already contained provisions for payment of the FBT, implementing a pass-through after the award has been made may be considered a modification to the terms of the grant.

### **Issuer Challenges and Concerns**

Interestingly, the administrative challenges of calculating the FBT do not seem to have affected granting practices in India. From a survey conducted by SOS in October 2008, of 30 firms who currently grant or have granted in India, 63% have not altered their granting practices, while only 7% have stopped granting there. 40% of respondents pass through the tax while an almost equal number (32%) do not.

What are the most challenging aspects of the India FBT? Certainly obtaining a valuation from a Category 1 merchant banker is difficult: an issuing company can try to find a merchant banker who will agree to use the company's definition of FMV as the market value, but what if that is not possible? Many equity

recordkeeping systems do not have the ability to store multiple market values so this data must be kept outside the system. Additionally, most systems do not calculate or store the spread at vest, especially when it is not based on the FMV. Stock plan managers must then track market values and perform calculations in a manual fashion. The merchant banker valuation must be communicated to employees in a timely manner as it becomes their cost basis for purposes of calculating capital gains at sale. Employees must file and pay capital gains on a quarterly basis, so it is very important to convey this data quickly.

If your company decides to pass through the FBT to employees, what is the process for doing so? It can be handled as part of the settlement process if you have a quick way to calculate the spread for each vesting tranche (a larger issue for stock option exercises than ESPP purchases or RSU vesting). Another consideration is how to handle the pass-through and tax payment when the stock price has declined. The spread at exercise may be less than the sum total of the spread at each vesting tranche, resulting in a negative benefit to employees. Understandably, employees may not be pleased with this outcome. As with China SAFE registration, if your company is starting to review these requirements, proceed carefully. Consider alternative forms of compensation such as cash-settled or phantom awards for the future, especially if you have small numbers of employees in India. Engage your vendors or other consultants, as they may have solutions or tools that can help you manage existing awards. FBT cannot be ignored: it must be included with corporate tax returns in India.

If you have questions on any portion of this article, please e-mail us at: [xtra@sos-team.com](mailto:xtra@sos-team.com).

### **About Stock & Option Solutions**

Stock & Option Solutions is a leading provider of top-tier stock plan management and consulting services for companies offering equity compensation and benefit programs to its employees. For ten years, hundreds of organizations, from private start-ups to Fortune 500 companies, have relied on Stock & Option Solutions' expertise for strategic planning, methodologies and skilled resources to build and support the most effective stock plan programs possible.

For more information about our products or services, please contact us at:

[sales@sos-team.com](mailto:sales@sos-team.com)

888 SOS-0199 (888 767-0199)