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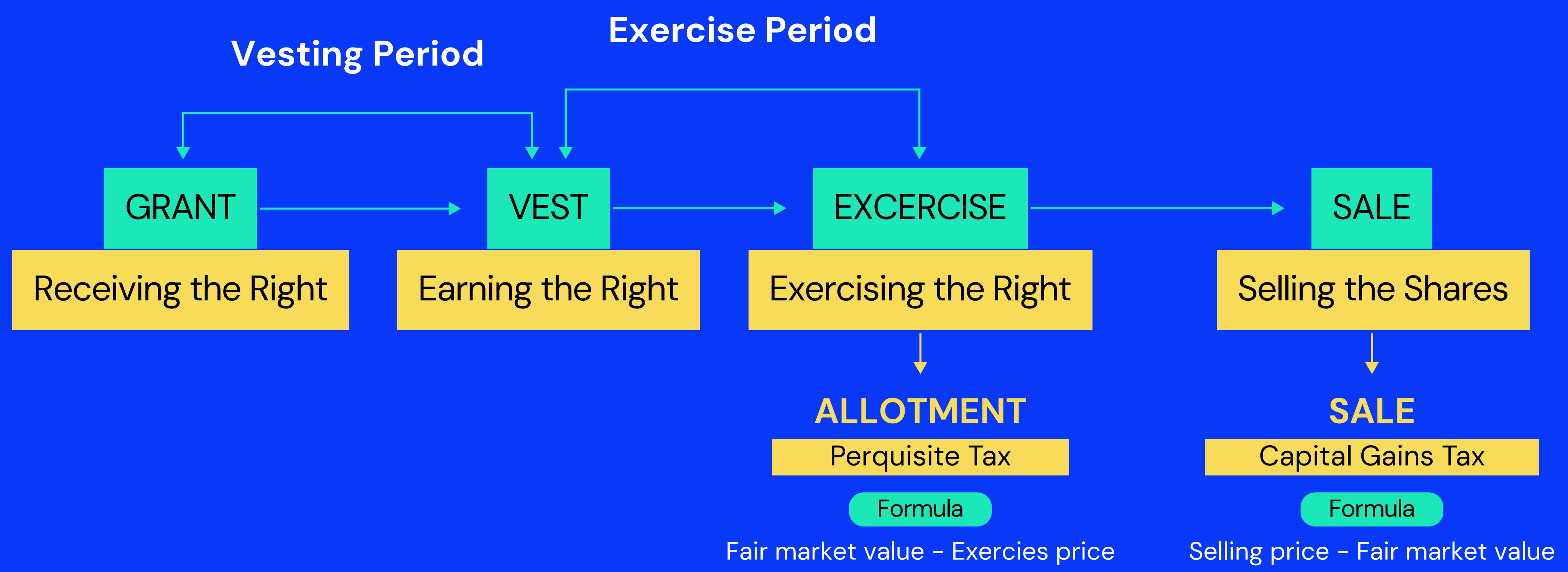
Tax Implications of ESOP Liquidity



Taxation of Employee Stock Option Plans (ESOPs) involves **dual assessment.** It is first treated as part of the **salary income** and then as a **capital gain.** This twofold taxation occurs when the individual:

1. **Initially chooses to exercise the options after vesting**
2. **Then opts to sell the exercised shares.**

Perquisite Tax @ Exercise

The value derived from exercising ESOPs upon vesting is termed the Perquisite value. In this context, the taxation on ESOPs is applied as a tax on income, specifically through Tax Deducted at Source (TDS). Simply put, the Perquisite income is calculated by determining the difference between the Fair Market Value (FMV) as of the exercise date and the Exercise Price.

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Capital Gain Tax @ sale of stocks

This scenario occurs when the individual decides to sell the company shares, triggering capital gains tax. The capital gain is evaluated as the share sales price minus the FMV of shares when exercising. Also, the capital gains tax will vary depending on the duration for which the ESOP shares were held. It will be different for short and long-term gains.

How is the FMV evaluated?

For unlisted companies, the valuation is fixed by the merchant banker. For publicly traded companies/listed companies, the market value is calculated by considering the opening and closing values on the recognized stock exchange.

Seek professional advice on Employee Stock Ownership Plans for tailored guidance. Financial advisors evaluate risk tolerance, devise tax-efficient exercise plans, and assist in developing a comprehensive financial strategy.

The Tax Rate Differs for Listed & Unlisted Shares. Take a Look.

Type of Share	Period of Holding	Capital Gain	Tax Rate*
Listed Shares	Holding Period < 12 months	STCG u/s 111A	20%
	Holding Period > 12 months	LTCG u/s 112A	12.5% in excess of INR 1.25 lac (without any indexation benefit)
Unlisted Shares	Holding Period < 24 months	STCG	Taxed at aplicable slab rates
	Holding Period > 24 months	LTCG u/s 112	12.5% without Indexation

*(plus applicable surcharge and cess)

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A Practical Scenario of ESOP Taxation

Scenario:

Rahul is an employee of XYZ Ltd., a company based in India. As part of his compensation package, Rahul has been granted ESOPs.

Details:

Let's assume that Rahul is granted 1,000 stock options at an exercise price of Rs. 100 per share.
The current market price of the company's stock at the time of exercise is Rs. 150 per share.
Rahul decides to exercise his options after the vesting period.

Tax Implications:

Tax at the time of Exercise:

The difference between the market price at the time of exercise and the exercise price is considered as a perquisite.
In this case: Rs. 150 (market price) - Rs. 100 (exercise price) = Rs. 50 per share.
Perquisite value for 1,000 shares = Rs. 50 * 1,000 = Rs. 50,000.
Here, Rahul must pay tax on this perquisite value as per his income tax slab. This amount will be added to his salary income for the financial year.

Tax at the time of Sale:

When Rahul sells the shares, he will incur capital gains tax.
The capital gain is calculated as the selling price minus the market price at the time of exercise.
Rahul sells the shares at Rs. 200 per share.
Capital gain per share = Rs. 200 (selling price) - Rs. 150 (market price at exercise) = Rs. 50 per tax implication for the employee share.
Capital gain for 1,000 shares = Rs. 50 * 1,000 = Rs. 50,000.
Here, Rahul needs to pay tax on this capital gain.