

# Redemption of stock appreciation rights prior to 01 April 2000 not taxable as perquisite: SC

## Summary

The Supreme Court (SC), in a recent case<sup>1</sup>, has held that the amount received on redemption of Stock Appreciation Rights (SARs) prior to 01 April 2000 cannot be treated as a 'perquisite' under the provisions<sup>2</sup> of the Income-tax Act, 1961 (Act).

## Facts of the case

- The taxpayer, an individual, was employed as the Chairman and Managing Director of P&G India Ltd, a subsidiary of P&G USA. During the period 1991 to 1996, P&G USA had issued SARs to the taxpayer without any consideration. The taxpayer had redeemed the SARs on 15 October 1997 and claimed this as an exempt income in his return of income.
- The tax officer held that the amount received on redemption is taxable as a 'perquisite' under the Act. Alternatively, it was held liable to tax as 'business income' under<sup>3</sup> the Act instead of capital gains. The First Appellate Authority upheld the tax officer's order.
- On further appeal, the Ahmedabad Bench of the Income-tax Appellate Tribunal (ITAT) opined that stock options are capital assets and gain therefrom is liable to capital gains tax and is not taxable as a perquisite.
- On appeal, the Gujarat High Court (HC) upheld the ITAT's views. However, the HC held that no capital gains arose to the taxpayer since there was no cost of acquisition involved in the transaction.
- Aggrieved by the HC order, Revenue filed an appeal before the SC.

## SC decision

- The SC placed reliance on the decision in the case of Infosys Technologies Ltd<sup>4</sup>, wherein it was held that unless a benefit is in the nature of income or specifically included by the legislature as part of income, it is not taxable. During the relevant assessment years, there was no provision in law which made SARs taxable as income.

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<sup>1</sup> Additional Commissioner of Income-tax v Bharat v Patel (Civil Appeal 4380 of 2018)

<sup>2</sup> Under Section 17(2)(iii) of the Act

<sup>3</sup> Under Section 28(iv) of the Act

<sup>4</sup> Commissioner of Income Tax v Infosys Technologies Ltd, [2008] 297 ITR 167 (SC)

- The SC noted that the amendment<sup>5</sup> vide Finance Act 1999 (effective from 01 April 2000)<sup>6</sup> brought within the definition of 'perquisite', the value of any specified security allotted or transferred by any person directly or indirectly, free of cost or at a concessional rate, to an individual who is/has been in employment of that person.
- The taxpayer's case pertains to a period prior to 01 April 2000; therefore, in the absence of an express provision of retrospective effect, the redemption of SARs cannot be covered under the amendment.
- The SC held that it is a fundamental principle of law that a receipt under the Act must be made taxable before it can be treated as income. Courts cannot construe the law in such a way that brings an individual who is otherwise not liable to pay tax, within the ambit of the Act to pay tax.
- SC disregarded Revenue's reliance on the CBDT Circular<sup>7</sup> which dealt with the taxability of shares issued at less than the market price, since the taxpayer was allotted SARs by P&G USA, which is different from the allotment of shares.
- Dismissing Revenue's appeal, the SC concluded that it is a well-established rule of interpretation that taxing provisions shall be construed strictly so that no person who is otherwise not liable to pay tax, is made liable to pay tax.
- The SC also observed that the taxpayer's case cannot be considered as income from business as the benefit did not arise from the business activities or profession.

## Our comments

SARs are rights granted to reward the employees with appreciation in the value of shares.

These are conceptually different from Employee Stock Option Plans (ESOPs) since shares are not actually allotted to the employees and, at the time of exercise, the appreciation in value of shares is generally given to employees in cash.

This ruling is a welcome relief for salaried taxpayers who have earned gains on redemption of SARs before 01 April 2000. The SC decision reinforces the principle that an amendment cannot come into force retrospectively in the absence of any express statutory provision.

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<sup>5</sup> Via clause (iiia) in Section 17(2) of the Act; later omitted by the Finance Act 2000 w.e.f. 01 April 2001

<sup>6</sup> Later omitted by the Finance Act 2000 w.e.f. 01 April 2001

<sup>7</sup> CBDT Circular No. 710 dated 24 July 1995



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