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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ ITA 564/2012

PVR LTD ..... Appellant
Through: Mr. Salil Kapoor and Mr. Sumit Lalchandani, Advocates

versus

COMMISSIONER OF INCOME TAX ..... Respondent
Through: Mr. Sanjay Kumar and Ms. Easha Kadian, Advocates

% Date of Decision: 23rd August, 2022

CORAM:
HON'BLE MR. JUSTICE MANMOHAN
HON'BLE MS. JUSTICE MANMEET PRITAM SINGH ARORA

J U D G M E N T

MANMOHAN, J (Oral):

1. Present appeal had been admitted by this Court on 30th April, 2013 on the following question of law:-

> "Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal erred in law in holding that the difference between the price at which stock options were offered to employees of the appellant company under ESOP and ESPS and the prevailing market price of the stock on the date of grant of such options was not allowable revenue expenditure under Section 37(1) of the Income Tax Act, 1961?"

2. During the pendency of the present appeal, the Karnataka High Court in ***Commissioner of Income Tax vs. Biocon Ltd. [2020] 121 taxmann.com 351 (Karnataka)*** has upheld the judgment of the Special Bench of the Tribunal deciding the aforesaid question of law in favour of the assessee. The relevant portion of the aforesaid judgment is reproduced hereinbelow:-

> *"2. The shares of the company were transferred to the trust at the face value and the employees of the assessee were allowed to exercise the option to buy the shares within the time prescribed under the scheme subject to terms and conditions mentioned therein. The assessee claimed the difference of market price and allotment price as a discount and claimed the same as an expenditure under Section 37 of the Act. The Assessing Officer rejected the claim on the ground that the assessee has not incurred any expenditure and the expenditure is contingent in nature and therefore, the assessee is not entitled to claim the difference between the market price and the allotment price as an expenditure under Section 37 of the Act. The assessee thereupon filed an appeal before the Commissioner of Income Tax (Appeals) who by an order dated 13.11.2009 dismissed the appeal preferred by the assessee.*
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> *6. We have considered the submissions made by learned counsel for the parties and have perused the record. The singular issue, which arises for consideration in this appeal is whether the tribunal is correct in holding that discount on the issue of ESOPs i.e., difference between the grant price and the market price on the shares as on the date of grant of options is allowable as a deduction under Section 37 of the Act. Before proceeding further, it is apposite to take note of Section 37(1) of the Act, which reads as under:*
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> > *Section 37(1) says that any expenditure (not being expenditure of the nature described in sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee), laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head, "Profits and Gains of Business or Profession".*

7. Thus, from perusal of Section 37 (1) of the Act, it is evident that the aforesaid provision permits deduction for the expenditure laid out or expnded and does not contain a requirement that there has to be a pay out. If an expenditure has been incurred, provision of Section 37(1) of the Act would be attracted. It is also pertinent to note that Section 37 does not envisage incurrence of expenditure in cash.

8. Section 2(15A) of the Companies Act, 1956 defines 'employees stock option' to mean option given to the whole time directors, officers or the employees of the company, which gives such directors, officers or employees, the benefit or right to purchase or subscribe at a future rate the securities offered by a company at a free determined price. In an ESOP a company undertakes to issue shares to its employees at a future date at a price lower than the current market price. The employees are given stock options at discount and the same amount of discount represents the difference between market price of shares at the time of grant of option and the offer price. In order to be eligible for acquiring shares under the scheme, the employees are under an obligation to render their services to the company during the vesting period as provided in the scheme. On completion of the vesting period in the service of the company, the option vest with the employees.

9. In the instant case, the ESOPs vest in an employee over a period of four years i.e., at the rate of 25%, which means at the end of first year, the employee has a definite right to 25% of the shares and the assessee is bound to allow the vesting of 25% of the options. It is well settled in law that if a business liability has arisen in the accounting year, the same is permissible as deduction, even though, liability may have to quantify and discharged at a future date. On exercise of option by an employee, the actual amount of benefit has to be determined is only a quantification of liability, which takes place at a future date. The tribunal has therefore, rightly placed reliance on decisions of the Supreme Court in Bharat Movers supra and Rotork Controls India P. Ltd., supra and has recorded a finding that discount on issue of ESOPs is not a contingent liability but is an ascertained liability.

10. From perusal of Section 37(1), which has been referred to supra, it is evident that an assessee is entitled to claim deduction under the aforesaid provision if the expenditure has been incurred. The expression 'expenditure' will also include a loss and therefore, issuance of shares at a discount where the assessee absorbs the difference between the price at which it is issued and the market value of the shares would also be expenditure incurred for the purposes of Section 37(1) of the Act. The primary object of the aforesaid exercise is not to waste capital but to earn profits by securing consistent services of the employees and therefore, the same cannot be construed as short receipt of capital. The tribunal therefore, in paragraph 9.2.7 and 9.2.8 has rightly held that incurring of the expenditure by the assessee entitles him for deduction under Section 37(1) of the Act subject to fulfillment of the condition."

(emphasis supplied)

3. This Court in ***Principal Commissioner of Income-tax vs. New Delhi Television Ltd., [2018] 99 taxmann.com 401 (Delhi)*** has followed the judgment passed by the Special Bench in ***CIT vs. Biocon Ltd.*** (Supra).

4. The subsequent appeals being ITA 107/2015 and ITA 214/2019 filed by the Commissioner of Income Tax on similar issues have been dismissed by this Court following the judgment of the Karnataka High Court in ***Biocon Ltd. vs. DCIT (LTU), Bangalore***.

5. Consequently, following the judgment of the Karnataka High Court in ***CIT vs. Biocon Ltd. (Supra)***, the question of law is decided in favour of the assessee and it is held that the Income Tax Appellate Tribunal erred in law in holding that the difference between the price at which stock options were offered to employees of the appellant company under ESOP and ESPS and the prevailing market price of the stock on the date of grant of such options was not allowable revenue expenditure under Section 37(1) of the Income

Tax Act, 1961. Accordingly, the impugned judgment of the Tribunal is set aside.

6. With the aforesaid directions, the present appeal is disposed of.

MANMOHAN, J

MANMEET PRITAM SINGH ARORA, J

AUGUST 23, 2022
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HIGH COURT OF DELHI
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