IN THE INCOME TAX APPELLATE TRIBUNAL

"D" BENCH, MUMBAI

BEFORE SHRI B.R. BASKARAN, ACCOUNTANT MEMBER AND

SHRI SANDEEP SINGH KARHAIL, JUDICIAL MEMBER

ITA no.1795/Mum./2023 (Assessment Year : 2017–18)	**ITA no.1796/Mum./2023** (Assessment Year : 2018–19)

Dy. Commissioner of Income Tax
Circle–7(1)(1), Mumbai ..... Appellant

v/s

M/s. Motilal Oswal Securities Ltd.
(Now merged with Motilal Oswal Financial Services Limited), Motilal Oswal Tower
Rahimtllah Sayani Road
Opp. Parel S.T. Depot, Prabhadevi
Mumbai 400 0064 PAN – AAECM2876P ..... Respondent

Assessee by : Shri Vijay Mehta
Revenue by : Smt. Mahita Nair

Date of Hearing – 10/08/2023	Date of Order – 18/08/2023

O R D E R

PER SANDEEP SINGH KARHAIL, J.M.

The present appeals have been filed by the Revenue challenging the separate impugned orders of even date 20/03/2023, passed under section 250 of the Income Tax Act, 1961 (*"the Act"*) by the learned Commissioner of Income Tax (Appeals), National Faceless Appeal Centre, Delhi, [*"learned CIT(A)"*], for the assessment years 2017–18 and 2018-19.

2. Since the present appeals pertain to the same assessee involving similar issues, therefore, as a matter of convenience, these appeals were heard together and are being disposed off by way of this consolidated order. With the

consent of the parties, the appeal for the assessment year 2017−18 is taken up as a lead case and the decision rendered therein shall apply *mutatis mutandis* to other appeals.

ITA No. 1795/Mum./2023
Revenue's Appeal – A.Y. 2017−18

3. In this appeal, the Revenue has raised the following grounds:−

"i) Whether on facts and circumstance and in law CIT(A) was justified in deleting the disallowance made by the AO on ESOP expenses without appreciating the fact that Apex Court in its decision in the case of Punjab State Industrial Development Corp. Ltd. (1997) 225 ITR 792 (SC) and Brooke Bond India Ltd. (1997) 225 ITR 798 (SC) have held that expenditure resulting in increase in capital" is not allowable deduction even if such expenditure may incidentally help in business of the company.

ii) Whether on facts and circumstance and in law CIT(A) was justified in deleting the disallowance made by the AO on ESOP expenses without appreciating the fact that the jurisdictional ITAT in the case of VIP Industries Ltd in ITA No.7242/Mum/2008 for the AY 2005-06 has squarely applied the decision rendered by ITAT Delhi in the case of Ranbaxy Laboratories Ltd and thereby confirmed the disallowance made by the AO on account of ESOP expenses claimed by the assessee.

iii) Whether on facts and circumstance and in law CIT(A) was justified in deleting the disallowance made by the AO on ESOP expenses without appreciating the fact that ESOP expenses are not actual loss for which no liability is incurred and such notional losses are not allowable under the provisions of the Income Tax Act, 1961.

iv) On the facts and in the circumstances of the case and in law, the CIT(A) has erred to delete the amount of Rs.1,10,70,947/- made on account of disallowance of deduction claimed u/s 80G of the Act without appreciating the fact that the said amount is not a voluntary donation but a mandatory requirement as per section 135 of the Companies Act 2013 thereby defeating the very intent of inserting CSR provisions in the Companies Act, 2013.

v) The appellant craves leave to amend or alter any ground or add a new ground that may be necessary at the time of hearing."

4. The issue arising in grounds no. (i) to (iii), raised in Revenue's appeal, is pertaining to the deletion of disallowance made on account of Employee Stock Option Plan ("*ESOP*") expenses.

5. The brief facts of the case pertaining to this, as emanating from the record, are: The assessee is a non-banking financial company registered with the RBI under section 45-IA of the RBI Act, 1934 and is primarily engaged in the lending money and related activities. During the year under consideration, the assessee filed its return of income on 06/11/2017, declaring a loss of Rs. 66,56,04,139. The assessee filed a revised return of income on 31/03/2019 returning the loss of Rs. 65,28,41,392. During the assessment proceedings, it was observed that the assessee has claimed, inter-alia, the ESOP expenses amounting to Rs. 65,81,90,485. Accordingly, the assessee was asked to show cause as to why the said expenses are allowable under section 37(1) of the Act. In response thereto, the assessee submitted that the ESOP expenses are employee compensation costs. The Assessing Officer ("*AO*") vide order dated 28/12/2019, passed under section 143(3) of the Act did not agree with the submissions of the assessee and held that the lost due to ESOP is a notional loss to the extent of receipt of lesser amount towards share premium and the share premium is received by the assessee is a capital receipt and not its income. The AO further held that the assessee nowhere has incurred any expenditure so as to claim the same is allowable under section 37(1) of the Act. The AO further held that the assessee has issued shares to the employees at a concessional rate which has increased the capital base of the company and therefore, such expenditure is to be considered as capital expenditure. It was also held that the assessee has claimed expenditure, which has not been crystalised in terms of quantum and therefore can be treated as contingent liability. Accordingly, the AO disallowed the ESOP expenditure of Rs. 65,81,90,485, under section 37(1) of the Act.

6. The learned CIT(A), vide impugned order, allowed the grounds raised by the assessee on this issue by following the decision of the Hon'ble Karnataka High Court in CIT v/s Biocon Ltd [2020] 121 taxmann.com 351 (Karn.). Being aggrieved, the Revenue is in appeal before us.

7. We have considered the submissions of both sides and perused the material available on record. As per the assessee, the ESOP is provided to the employees with the right to purchase a certain number of equity shares in the company at a predetermined price after a predetermined period. The stock options are granted for the purpose of motivating, retaining, and incentivising the employees. The stock options are granted to the employees at the market price prevailing on the date of the grant of the option. The stock options vest gradually over the vesting period, as per the terms of the ESOP. On completion of the vesting period, which is ordinarily 3-5 years, the stock options can then be exercised by the employees at their discretion for the issue of shares against the options vested in them. During the year under consideration, the assessee followed the intrinsic value method to value stock options for accounting purposes. Under the intrinsic value method, the market price of the equity shares as on the date of the grant of options is reduced by the exercise price of options and since the exercise price of stock options is equal to the market price of equity shares of the assessee on the date of grant of the stock options, the assessee has not recorded any employee's compensation expenses pertaining to ESOP in its books of accounts over the grant/vesting period. The assessee claimed the deduction in respect of the aggregate amount of excess of the fair market value of equity shares over the

exercise price amounting to Rs. 28,65,26,826, under section 37(1) of the Act. As evident from the record, the AO disallowed the deduction primarily on the basis that no expenditure has been incurred by the assessee so as to claim deduction under section 37(1) of the Act and the expenditure if any is in the nature of capital expenditure and the liability is a contingent liability. We find that similar contentions of the Revenue were rejected by the Hon'ble Karnataka High Court in Biocon Ltd (supra), wherein the Hon'ble High Court dismissed the appeal filed by the Revenue and upheld the decision of the Special Bench of the Tribunal in Biocon Ltd v/s DCIT, [2013] 144 ITD 21 (Bangalore-Trib.) (SB). The relevant findings of the Hon'ble High Court, in the aforesaid decision, are reproduced as under:-

> *"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 expended 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.*
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> *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 paragraphs 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 fulfilment of the condition.

11. The deduction of discount on ESOP over the vesting period is in accordance with the accounting in the books of account, which has been prepared in accordance with Securities and Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999.

12. So far as reliance place by the revenue in the case of Infosys Technologies Ltd.(supra) is concerned, it is noteworthy that in the aforesaid decision, the Supreme Court was dealing with a proceeding under section 201 of the Act for non-deduction of tax at source and it was held that there was no cash inflow to the employees. The aforesaid decision is of no assistance to decide the issue of allowability of expenses in the hands of the employer. It is also pertinent to mention here that in the decision rendered by the Supreme Court in the aforesaid case, the Assessment Years in question was 1997-98 to 1999-2000 and at that time, the Act did not contain any specific provisions to tax the benefits on ESOPs. Section 17(2)(iiia) was inserted by Finance Act, 1999 with effect from 1-4-2000. Therefore, it is evident that law recognizes a real benefit in the hands of the employees. For the aforementioned reasons, the decision rendered in the case of Infosys Technologies is of no assistance to the revenue. The decisions relied upon by the revenue in A. Gajapathy Naidu,Morvi Industries Ltd. and Keshav Mills Ltd.(supra) support the case of assessee as the assessee has incurred a definite legal liability and on following the mercantile

system of accounting, the discount on ESOPs has rightly been debited as expenditure in the books of account. We are in respectful agreement with the view taken in PVP Ventures Ltd. And Lemon Tree Hotels Ltd.'case (supra).

13. It is also pertinent to mention here that for Assessment Year 2009-10 onwards the Assessing Officer has permitted the deduction of ESOP expenses and in view of law laid down by Supreme Court in Radhasoami Satsang v. CIT, [1992] 60 Taxman 248/193 ITR 321, the revenue cannot be permitted to take a different stand with regard to the Assessment Year in question.

In view of preceding analysis, the substantial questions of law framed by a bench of this court are answered against the revenue and in favour of the assessee. In the result, we do not find any merit in this appeal, the same fails and is hereby dismissed."

8. Therefore, in view of the aforesaid findings of the Hon'ble Karnataka High Court, we find no infirmity in the impugned order passed by the learned CIT(A) in allowing the claim of deduction of ESOP expenses under section 37(1) of the Act. Accordingly, grounds no. (i) to (iii) raised in Revenue's appeal are dismissed.

9. The issue arising in ground no. (iv), raised in Revenue's appeal, is pertaining to the deletion of disallowance of deduction claimed under section 80G of the Act on Corporate Social Responsibility ("*CSR*") expenses.

10. The brief facts of the case pertaining to this issue, as emanating from the record, are: During the year under consideration, the assessee incurred CSR expenses of Rs. 2,25,71,775, and claimed donation under section 80G of the Act amounting to Rs. 2,21,41,893. The assessee was asked to show cause as to why the claim of deduction under section 80G of the Act of Rs. 1,10,70,947, against the CSR expenses should not be disallowed. The AO vide order passed under section 143(3) of the Act did not agree with the submissions of the assessee and held that the expenditure incurred by the

assessee under the provisions of the Companies Act, 2013, cannot be claimed as a donation under section 80G of the Act. The AO further held that the expenditure under the aforesaid provisions of the Companies Act, 2013 is a mandatory contribution and not a voluntary contribution and this expenditure has categorically been disallowed under section 37 of the Act. The AO further held that if the tax deduction is allowed on CSR expenses then this would result in subsidising the expenses by one-third amount. Accordingly, the AO disallowed the deduction of Rs. 1,10,70,947, claim under section 80G of the Act and added the same to the total income of the assessee.

11. The learned CIT(A), vide impugned order, allowed the ground raised by the assessee on this issue following the judicial precedents rendered by the coordinate benches of the Tribunal. Being aggrieved, the Revenue is in appeal before us.

12. We have considered the submissions of both sides and perused the material available on record. We find that the coordinate benches of the Tribunal have consistently taken the view in favour of the assessee and held that the CSR expenses even though not allowed under section 37 of the Act pursuant to insertion of Explanation-2 to section 37 vide Finance Act, 2014 with effect from 01/04/2015. However, the said expenditure is allowable under section 80G of the Act. We find that the learned CIT(A) has also followed these judicial precedents and decided the issue in favour of the assessee, by observing as under:-

> *"11.2 The appellant's submission on the issue of 80G has been considered. I find that the expenditure incurred towards eligible Corporate Social Responsibility (CSR) activities which also fall within expenditure/contributions*

specified in section 80G (other than Swacch Bharat Kosh or Clean Ganga Fund) are allowable as deduction u/s 80G. These findings is conclusion is supported by various judgements as under-

i. In the case of Marsh Mclennan Global Services India Private Limited Vs AU, ITD, NFAC [ITA No. 2452/MUM/2022] [A.Y. 2018-19] [Date of order 27.12.2022], Hon'ble ITAT, Mumabi has held that even though deduction for CSR Expenses was not allowable under Section 37 of the Act (in view of the Explanation 2 to Section 37 of the Act inserted by the Finance Act, 2014, with effect from 01.04.2015), there was no bar for allowance of the same under Section 80G of the Act (except for the donations made to the Swach Bharat Kosh and the Clean Ganga Fund), provided all the other conditions of Sec. 80G are fulfilled. Relevant para of the order is extracted below-

9. On perusal of above, it is clear that after considering the position taken by the Assessing Officer and the objections raised by the Appellant, the DRP concluded that even though deduction for CSR Expenses was not allowable under Section 37 of the Act (in view of the Explanation 2 to Section 37 of the Act inserted by the Finance Act, 2014, with effect from 01.04.2015), there was no bar for allowance of the same under Section 80G of the Act (except for the donations made to the Swach Bharat Kosh and the Clean Ganga Fund), provided all the other conditions of Sec. 80G are fulfilled. Therefore, the DRP issued specific direction to allow deduction for INR 28,72,578/- under Section 80G of the Act after verifying whether the other conditions specified under Section 80G were fulfilled. As per mandate of Section 144C(13) of the Act, upon receipt of directions issued by DRP the Assessing Officer was required to complete the assessment in conformity with the directions issued by the DRP. We hold that the Final Assessment Order, dated 27.07.2022 passed by the Assessing Officer was not in conformity with the directions issued by the DRP and is therefore, set aside, being contrary provisions of Section 144C(13) of the Act. The issue is remanded back to the file of Assessing Officer with the directions to pass the Final Assessment Order in conformity with the directions issued by the DRP. Accordingly, Ground No. 2 raised by the Appellant is allowed while all other grounds raised by the Appellant are disposed off as being infructuous.

ii. In the case of FNF India (P.) Ltd. Vs. ACIT [2021] 133 taxmann.com 251 (Bangalore - Trib.). Hon'ble ITAT, Bangalore has held that Payment towards donation made by assessee-company on account of its corporate social responsibility to charitable institutions which was already disallowed under section 37(1) and added to total taxable income of assessee was to be allowed as deduction under section 80G

iii. In the case of DCIT Vs. Peerless General Finance & Investment & Co. Ltd. [2019] 112 taxmann.com 410 (Kolkata - Trib.). Hon'ble ITAT, Kolkata has held that any expenditure incurred towards eligible CSR activities which also fall within expenditure/contributions specified in section 80G (other than Swacch Bharat Kosh or Clean Ganga Fund) are allowable as deduction under section 80G.

11.3 In view of the above discussion, ground no. 9 is allowed."

13. Therefore, in view of the above, we find no infirmity in the impugned order passed by the learned CIT(A) in allowing the claim of deduction under

section 80G of the Act on CSR expenses incurred by the assessee. Accordingly, ground no.(iv) raised in Revenue's appeal is dismissed.

14. In the result, the appeal by the Revenue is dismissed.

ITA No. 1796/Mum./2023
Revenue's Appeal – A.Y. 2018–19

15. In this appeal, the Revenue has raised the following grounds:–

"i) Whether on facts and circumstance and in law CIT(A) was justified in deleting the disallowance made by the AO on ESOP expenses without appreciating the fact that Apex Court in its decision in the case of Punjab State Industrial Development Corp. Ltd. (1997) 225 ITR 792 (SC) and Brooke Bond India Ltd. (1997) 225 ITR 798 (SC) have held that expenditure resulting in 'increase in capital' is not allowable deduction even if such expenditure may incidentally help in business of the company.

ii) Whether on facts and circumstance and in law CIT(A) was justified in deleting the disallowance made by the AO on ESOP expenses without appreciating the fact that the jurisdictional ITAT in the case of VIP Industries Ltd in ITA No.7242/Mum/2008 for the AY 2005-06 has squarely applied the decision rendered by ITAT Delhi in the case of Ranbaxy Laboratories Ltd and thereby confirmed the disallowance made by the AO on account of ESOP expenses claimed by the assessee.

iii) Whether on facts and circumstance and in law CIT(A) was justified in deleting the disallowance made by the AO on ESOP expenses without appreciating the fact that ESOP expenses are not actual loss for which no liability is incurred and such notional losses are not allowable under the provisions of the Income Tax Act, 1961.

v) The appellant craves leave to amend or alter any ground or add a new ground that may be necessary at the time of hearing."

16. The only grievance raised by the Revenue, in the present appeal, is pertaining to the deletion of disallowance made on account of ESOP expenses. Since a similar issue has already been decided in Revenue's appeal for the assessment year 2017-18, therefore the findings/conclusions rendered therein shall apply *mutatis mutandis*. Accordingly, the impugned order passed by the

learned CIT(A) on this issue is upheld and the grounds raised by the Revenue, in the present appeal, are dismissed.

17. In the result, the appeal by the Revenue is dismissed.

18. To sum up, both the appeals by the Revenue are dismissed.

Order pronounced in the open Court on 18/08/2023

Sd/-	**Sd/-**
B.R. BASKARAN	**SANDEEP SINGH KARHAIL**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

MUMBAI, DATED: 18/08/2023

Copy of the order forwarded to:

(1) The Assessee;
(2) The Revenue;
(3) The PCIT / CIT (Judicial);
(4) The DR, ITAT, Mumbai; and
(5) Guard file.

True Copy
By Order

Pradeep J. Chowdhury
Sr. Private Secretary

Assistant Registrar
ITAT, Mumbai