IN THE INCOME TAX APPELLATE TRIBUNAL
HYDERABAD BENCHES "A", HYDERABAD

BEFORE
SHRI RAMA KANTA PANDA, ACCOUNTANT MEMBER
&
SHRI K.NARASIMHA CHARY, JUDICIAL MEMBER

ITA No. 320/Hyd/2018
(Assessment Year: 2008-09)

Anil Bhansali, Hyderabad [PAN No. AEHPB1389J]	Vs.	Addl.Commissioner of Income Tax, Range-12, Hyderabad
Appellant		/ Respondent

Assessee by:	Shri H.Srinivasulu, AR
Revenue by:	Shri Y.V.S.T.Sai, CIT-DR

Date of hearing:	07/06/2022
Pronouncement on:	22/07/2022

ORDER

PER K. NARASIMHA CHARY, JM:

Aggrieved by the order dated 15/09/2017 passed by the learned Commissioner of Income Tax (Appeals)-1, Hyderabad ("Ld. CIT(A)"), in the case of Sh. Anil Bhansali ("the assessee") for the assessment year 2008-09, assessee preferred this appeal.

2. Brief facts of the case, necessary for the disposal of this appeal are that the assessee is an individual and employed as general manager in M/s Microsoft India (R&D) private limited. For the assessment year 2008-09 he is a resident of India. He filed the return of income for the assessment year 2008-09 on 28/02/2009 declaring a total income of Rs. 2,91,43,913/-. During the course of assessment, learned Assessing Officer noticed that the assessee had acquired 2,274 shares of M/s Microsoft Corporation in the financial year 2001-02 with a grant price of $ 5.97 and 735 shares during the financial year 2003-04 at the 0 cost under ESOP. Learned Assessing Officer further noticed that the assessee sold such shares during the financial year 2007-08, but failed to offer the capital gains in the assessment year 2008-09. Learned Assessing Officer noted the details of the shares in his order and called upon the assessee to explain why the income of Rs. 28,90,037/-shall not be added to the income of the assessee. Assessee explained that he used the fair market value (FAIR MARKET VALUE) of the shares prevailing at the time of stock option to compute the capital gains as he had paid the federal taxes in US for the same and believed that the capital gains have to be computed considering such fair market value. He further submitted that he filed the revised computation of long term capital gains wherein the grant price was considered as the cost of acquisition of such shares acquired by exercising stock options granted by Microsoft Corporation to him.

3. Learned Assessing Officer, however did not accept the contention of the assessee, and brought the amount of Rs. 28,90,037/- to tax in the hands of the assessee.

4. The assessee further claimed an amount of Rs. 30,19,013/- as the tax credit as per article 25 (2) (a) of the Double Taxation Avoidance Agreement between India and USA (DTAA) read with section 90(2) of the Income Tax Act, 1961 (for short "the Act"). Observing that the assessee has not produced the proof in respect of the same in the shape of transcripts, learned Assessing Officer disallowed the same. Learned Assessing Officer further decline to grant credit of taxes that were deducted on the shares vested under ESOP stating that no proof was submitted at that time and such a request will be considered on the production of proof.

5. Aggrieved by such an order of the learned Assessing Officer, assessee filed appeal before the Ld. CIT(A). Case of the assessee before the Ld. CIT(A) was that at the time of exercise of stock option in USA and also at the time of stock awards, the assessee paid the difference between the fair market value of the shares prevailing at the time of such exercise and paid the federal taxes thereon, and therefore, the fair market value of the shares shall be taken as the cost of acquisition. In support of this contention the assessee submitted that the OECD report on "cross-border income tax issues arising from employee stock option plans" where it was stated that the difference between the market value of shares at the time of exercising of options and the amount paid by the employee to acquire them should be considered as employment income, namely, additional salary. Inasmuch as the assessee was a non-resident at such time, as per section 5(1)(c) of the Act the assessee was not liable to be taxed in India and, therefore, the benefit arising from the exercise of stock option under ESOP/vesting of stock awards in USA being the difference between the fair market value and the grant price, was not taxable in India in the hands of

the assessee for the financial year 2001-02 and financial year 2003-04 respectively. Alternative submission made by the assessee was that if for any reason the grant price was taken as cost of acquisition of shares, the assessee requested to allow the foreign tax credit of taxes paid by him in USA at the time of exercise of stock options/vesting of stock awards, as per the provisions of section 90 (2) of the Act read with Article 25(2)(a) of the DTAA.

6. Ld. CIT(A), on a consideration of the material before him, observed that ESOP has 3 stages, namely, granting, vesting and exercise of option and the assessee could not bring out the 3 stages of ESOP before him. Further according to the Ld. CIT(A), since the assessee submitted that he has already paid the differential amount between the grant of ESOP and the FAIR MARKET VALUE, the cost of acquisition of the shares under ESOP should be nil and the sale value should be taken as capital gains. On this premise and also stating that the assessee did not produce the sufficient evidence as to the residential status or the details as to the sale of the shares, Ld. CIT(A) declined to interfere with the findings of the learned Assessing Officer and dismissed the relevant ground.

7. In respect of the long term capital loss of Rs. 7,72,984/- and the Long Term Capital Gain (LTCG)'s of Rs. 5,62,744/- arising on sale of shares transferred through stock exchange Ld. CIT(A) observed that this issue was not taken during the assessment proceedings and, therefore, directed the learned Assessing Officer to look into the issue and examine the same. Insofar as the non-grant of tax credit of Rs. 30,19,013/- as per Article 25(2)(a) of the DTAA, Ld. CIT(A) directed the learned Assessing Officer to

verify the claim of the assessee and allow the foreign tax credit if it is found.

8. In view of this impugned order, assessee preferred this appeal contending that the authorities below committed a grave error in considering the grant price as cost of acquisition vis-à-vis fair market value at the time of exercise/questing of ESOP and SA without appreciating and considering the factual and legal submissions made by the assessee. The main plank of contention raised by the Ld. AR that if the assessee happens to be a resident of India, he would have been entitled to claim the fair market value of the shares acquired by him under the ESOP and stock award plan of the Microsoft Corporation, USA in terms of section 49(2AB), 49(2AA), and 115WC(1)(ba) of the Act, but merely because he happens to be a national or citizen of USA, though he was a resident in India in the assessment year 2008-09 he is not given the benefit of such provisions and on the further ground that the tax was not paid by the employer but it was paid by the assessee himself in the financial years 2001-02 and 2003-04 in USA, and therefore, the assessee in the same circumstances like any other resident offered capital gain under section 45 in India.

9. Ld. AR further argued that the OECD stipulates that when a tax is imposed on nationals and foreigners in the same circumstances, it must be in the same form, regards both the basis of charge and the method of assessment, its rate must be the same and finally the formalities connected with the taxation, namely, returns, payment, prescribed times etc., must not be more onerous for foreigners than the nationals. Basing on this he submits that the cost of acquisition of ESOP and stock award shares at fair market value is a connected matter to the capital gain

computation. He further submitted that ESOP shares in India and USA are taxed by and large in the similar way, and therefore, the assessee is entitled to adopt fair market value of the ESOP and stock award shares on which tax was paid in USA, otherwise it would lead to double taxation and amount to more burdensome as compared to the citizens of India. For this purpose, he placed reliance on the decisions reported in Rajeev Sureshbhai Gajwani ITA No. 1807 and 1978/AHD/2006, CIT Vs. Herbal life International (P) Ltd in ITA 7 of 2007 of Hon'ble Delhi High Court, Metchem Canada Inc Vs. DCIT (2006) 100 ITD 251 (Mumbai ITAT), ITO Vs. Filco Trade Centre in ITA No. 6486/Del/2014 and Daimler Chrysler India (P) Ltd (2009) 29 SOT 202 (Pune ITAT for the principle that the fair market value has to be allowed under Article 26 of the DTAA).

10. Per contra, it is the submission of the Ld. DR that at the time of sale of shares and taxing of capital gains, the assessee is a resident of India and in terms of article 4.1 (a) of the DTAA, assessee cannot be considered as a person to be eligible to be covered by the DTAA, and for similar reasons as at the time of acquisition of shares the assessee was a resident of USA, at the time also he cannot be considered to have been covered by the provisions of DTAA. He further submitted that the taxes paid in USA in assessment year 2002-03 as withholding tax on wages for acquisition of shares or the taxes payable in India on account of capital gain on shares during the assessment year 2008-09 are not covered under any exemption/credit under the DTAA. According to him Article 13 of the Treaty clearly states that each contracting state may tax capital gains in accordance with the provisions of its domestic law. He submits that with regard to the wages income also, the same is not subject matter of DTAA

in the present case because the assessee was a non-resident of India in the assessment year 2002-03. According to the Ld. DR Article 24 to 26 of the DTAA and various decisions relied upon by the assessee have no application to the facts of the case, inasmuch as there is no discrimination and shelter under section 90 and 91 of the Act is not available to a person who is a resident simplicitor of one of the contracting States.

11. Adverting to the claim of the assessee to treat the fair market value as on the date of sale as cost of acquisition, Ld. DR submits that inasmuch as such shares were not subject matter of being a perquisite under section 17(2)(vi) of the Act or treated as fringe benefit under section 115 WC(1)(ba) of the Act, sections 49(2AA) or section 49(2AB) of the Act have no application. Insofar as the taxes paid by the assessee at the time of acquisition of the shares is concerned, argument of the Ld. DR is that such amount of tax paid is not in the nature of capital gain on sale of shares but it is only a tax on personal income which is in the nature of perquisite which are part of salary income. According to him, the capital gains on movables is not the subject matter falling under the scope of Indo-US DTAA. Inasmuch as the submission is that the tax paid in USA at the time of acquisition of shares is in the nature of personal tax/perquisite, it cannot be said to be an expenditure in the nature of perfecting the title in shares and such an expenditure is not allowable as deduction as there is no provision under section 48 of the Act to allow the same. Ld. DR placing reliance on the deletion of the Hon'ble Apex Court in the case of R.M.Arunachalam Vs. CIT (1997) 93 Taxman 423 (SC) and the decision of Hon'ble Madras High Court in the case of Smt. T.A.H. Zubaida Ummal Vs. ITO (2021) 124 taxmann.com 442 (Madras) for the principle that the

expenditure incurred must be the expenditure incurred wholly and exclusively in connection with the transfer of property, or for the purpose of making the title complete and perfect where it was not so, -and not the expenditure in the shape of taxes like estate duty etc. For all these reasons Ld. DR submitted that the taxes paid on the salary of the assessee in USA cannot be treated as any improvement to the property in shares, nor could be treated as an expenditure connected with the transfer of shares.

12. We have gone through the record in the light of the submissions made on either side. Assessee was a non-resident in the financial years 2001-02 and 2003-04 in which years, the assessee acquired certain number of shares of Microsoft Corporation under ESOP and Stock Awards Scheme. Under Stock Award Scheme, 7,000 shares were allotted, which were reduced to 3,500 in consolidation scheme at the grant price of US $ 5.97. Under Stock Award Scheme, the assessee was allotted 735 shares without any cost. According to the assessee, the difference between the fair market value of such shares and the vesting price of shares in the respective calendar years was taxed as income from salary and the assessee paid such taxes in USA. On this basis, assessee claims that the cost of acquisition of such shares has to be taken at fair market value as on the date of their acquisition and, therefore, when such shares were sold during the financial year 2007-08, the capital gains have to be reckoned on the difference between the sale price and the fair market value.

13. Learned Assessing Officer, however, did not agree with this proposition by the assessee and taking the grant price as the cost of acquisition, learned Assessing Officer calculated the capital gains in the following way:

S.No.	No. of shares	Year of acquisition	Total indexed cost of acquisition (Rs.)	Total sale consideration (Rs.)	Net capital gains (Rs.)
1	1499	2001-02	4,69,152	17,96,345	13,27,192
2	450	-do-	1,40,840	5,42,390	4,01,550
3	150	-do-	46,553	1,75,890	1,29,337
4	100	-do-	31,468	1,16,291	84,823
5	75	-do-	23,601	89,939	66,339
6	735	200-03	NIL	8,80,796	8,80,796
			7,11,614	36,01,652	28,90,037

14. Under section 48 of the Act, the income chargeable under the head "capital gains" shall be computed, by deducting from the full value of the consideration received or accruing as a result of the transfer of the capital asset, the expenditure incurred wholly and exclusively in connection with such transfer and the cost of acquisition of the asset and the cost of improvement thereto. Entire dispute in this matter revolves around the question what constitutes the cost of acquisition in this matter. As could be culled out from the arguments of the Ld. AR, as advert to the above, he is harping on the contention that the assessee paid the difference between the fair market value and the grant price of the shares in USA, and under section 49(2AB) of the Act the cost of acquisition of the sweat equity shares shall be taken to be the fair market value. He, therefore, submits that by applying Article 26 of the Indo US DTAA, the assessee shall be given benefit of the taxes paid in USA when the exercise of the option, and the fair market value of the sweat equity shares shall be taken to be the cost of acquisition.

15. Precisely on this point, it is the argument of the Ld. DR that the sweat equity shares allotted by the Microsoft to the assessee was a perquisite in view of the fact that under section 17 (2) (vi) of the Act, the word perquisite includes the value of any sweat equity shares allotted by

the employer free of cost or at concessional rate. He further submitted that when we read this with the statement of the assessee that the assessee paid taxes on the difference between the fair market value and the grant price, it is abundantly clear that whatever the taxes that the assessee paid on the difference between the fair market value and the grant price is nothing but the taxes paid on the salary, which is personal in nature and has nothing to do with the cost of acquisition of the property. He therefore, submitted that the payment of taxes on the difference between the fair market value and the grant price has nothing to do with the cost of acquisition of property.

16. An examination of section 49 of the Act amply makes it clear that there are two provisions therein which deals with the valuation of the cost of acquisition in respect of sweat equity shares. Such provisions are section 49(2AA) of the Act and section 49(2AB) of the Act. 49(2AA) of the Act, as it stood prior to 1/4/2010, reads that where the capital gain arises from the transfer of the shares, debentures or warrants, the value of which has been taken into account while computing the value of perquisite under clause (2) of section 17, the cost of acquisition of such shares, debentures or warrants shall be the value under that clause. Whereas under section 49(2AB) of the Act where the capital gain arises from the transfer of sweat equity shares, the cost of acquisition of such shares shall be the fair market value which has been taken into account while computing the value of fringe benefits under clause (ba) of sub-section 1 of section 115WC of the Act.

17. When the legislature enacted both section 49(2AA) and 49(2AB) of the Act and both the provisions are to be found on the statue book, it is

the circumstances that drive the application of either of the provisions. From a reading of these two provisions, it is clear that when the capital gains arise from the transfer of sweat equity shares which were treated as perquisite in the hands of the employee, the cost of acquisition of such shares shall be the value under that clause. However, in case of sweat equity shares which were subjected to fringe benefit tax for the purpose of computing capital gain on the transfer of such sweat equity shares in future, the cost of acquisition of sweat equity shares shall be the fair market value, which has been taken into account while computing the value of fringe benefit under section 115WC(1)(ba) of the Act.

18. In this case, according to the assessee, he paid federal taxes on the difference between the fair market value and the grant price. It is not his case that the employer paid the fringe benefit tax in tune with the provisions under section 115WA of the Act while taking into consideration the fair market value in accordance with 115WC(1)(ba) of the Act. This fact clearly establishes that it is a clear case of assessee paying tax treating the value of shares as perquisite, but not the employer paying the fringe benefit tax on the difference between the fair market value and the grant price. According to us, to this scenario, provisions under section 49(2AA) of the Act, but not section 49(2AB) of the Act are applicable. When section 49(2AB) of the Act has no application to the facts of the case, the argument of the learned AR basing on the applicability of Article 26 of the DTAA falls to ground.

19. In these circumstances, we do not find any merit in the grounds raised by the assessee nor in the arguments advanced on behalf of the assessee. Hence, grounds No. 1 to 3 are dismissed.

20. The other ground in respect of 234C of the Act also does not hold any water because charging of interest under section 234C is consequential and mandatory in nature and the Ld. CIT(A) rightly held so.

21. In the result, appeal of the assessee is dismissed.

Order pronounced in the open court on this the 22nd day of July, 2022

Sd/-	Sd/-
(RAMA KANTA PANDA)	**(K. NARASIMHA CHARY)**
ACCOUNTANT MEMBER	**JUDICIAL MEMBER**

Hyderabad,
Dated: 22/07/2022

TNMM

Copy forwarded to:

1. Anil Bhansali, A-25, Hill Ridge Villas, Hyderabad.
2. Addl.Commissioner of Income Tax, Range-12, Hyderabad.
3. The CIT(Appeals)-1, Hyderabad.
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