

INTRODUCTION TO ESOPs

Treelife Consulting





WHAT IS AN ESOP?

An Employee Stock Option Plan (ESOP) is a type of employee benefit plan which is intended to encourage employees to acquire stocks or ownership in the company.

SALIENT FEATURES

- A type of Option
- A right granted to employees
- To purchase shares of a company
- At a discounted price

UNDERSTANDING TERMS

Term	Meaning
Grant Date	Date on which agreement is entered into between the Company and Employee for grant of ESOPs by issuing the grant letter
Vesting Period	The period between the Grant Date and the date on which all the specified conditions of Employees Stock Option (ESOP) Plan should be satisfied
Vesting Date	Date on which conditions of granting ESOPs are met
Exercise	It means exercising the right to subscribe the options granted to the employee
Exercise Period	The period after vesting date given to an employee to exercise the options given under the plan
Exercise Price	Price payable by the employee for exercising the right on the options granted

PROCESS OF ESOP



FACTUAL SITUATION



RAMESH



GOOD HEALTH PVT. LTD



TOTAL NO. OF ESOPs GRANTED = 100



VESTING PERIOD = 4 years, equal vesting annually



EXERCISE PRICE = INR 10/- each share



GRANT OF ESOPs

How are ESOPs granted?



VESTING OF ESOPs

Vesting of ESOP at different intervals



TOTAL NO. OF ESOPs GRANTED = 100

25%

Year 1

25 shares

50%

Year 2

25 + 25 shares

75%

Year 3

25 + 25 + 25 shares

100%

Year 4

100 shares

EXERCISE OF ESOPs

Details of ESOPs issued by the Company



Guidelines to ESOP

Exercise Period - From the first vesting date till a Liquidation Event

Employee can exercise the options till the occurrence of a Liquidation Event

Employee need to pay exercise price of INR 10/- per share



Action Plan of ESOP

Employee will exercise the options within exercise period

Employee will pay i.e., INR 1,000 (10*100 options) to the Company

Company will allot the shares to employees

MILESTONE OF ESOPs

Grant of ESOPs

The Company will grant options to employees through issue of grant letters

Express interest

The employees will provide letter of interest as prescribed in grant letter

Exercise ESOPs

The employee will exercise the options through complying to all conditions of the ESOP

Vesting of ESOPs

The Company will provide vesting guidelines in ESOP document issued to employees

Pay Exercise Price

Employees will need to pay the exercise price to the Company

Allotment of Shares

Upon complying to conditions, the Company will allot shares to employees.

Simple way to understand ESOP milestone for the Company

ESOP TAXATION

Simple understanding of tax treatment of ESOPs in the hands of employees



On Exercise of ESOPs

Number of Shares = 100

FMV = INR 500 per share

Exercise price paid by employee = INR 10 per share

Gain to Employee = INR 490 per share

Taxable Income = INR 4,90,000 (taxable as Salary income)



On Sale of ESOPs

Number of Shares = 100

FMV = INR 600 per share

FMV on date of exercise of option = INR 500 per share

Gain to Employee = INR 100 per share

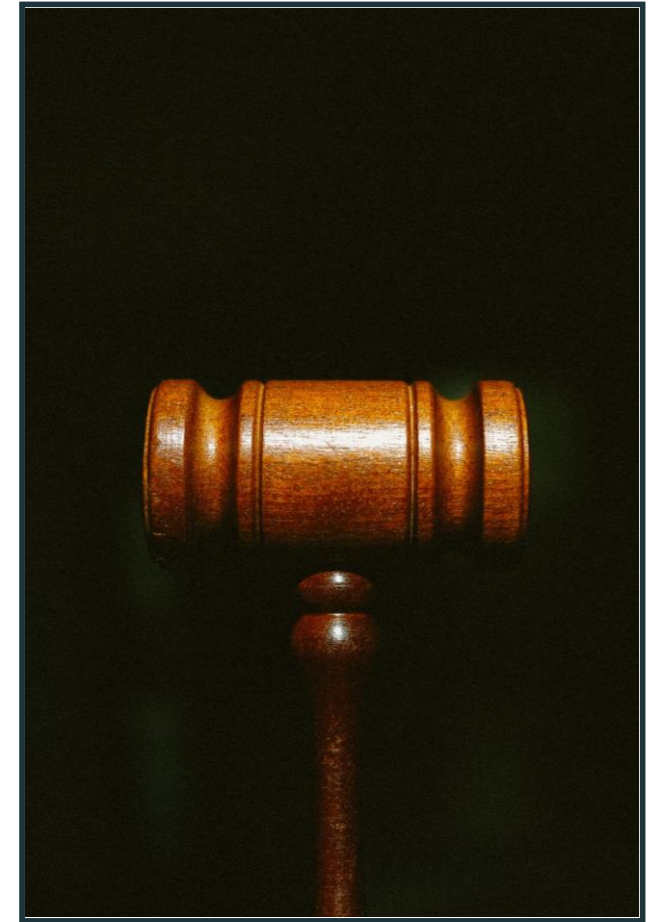
Taxable Income = INR 1,00,000 (taxable as capital gain)

ESOP TAXATION - BUDGET 2020 AMENDMENT

As per the Budget 2020 amendment, where ESOPs have been granted by an 'eligible start-up' (i.e., a start-up which has obtained Inter Ministerial Board certificate), there is no taxable event on the date on which employees exercise their options.

Instead, taxable event gets DEFERRED to when of the following events occur, whichever is earliest -

1. Expiry of 5 years from end of the year in which options were exercised
 2. When employee ceases to be in employment of the organization
 3. When employee sells the shares
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