



Employee Stock Option Plans (ESOPs) are a powerful wealth-creation tool for employees of Startup Companies. However, taxation at the time of exercising options has historically created a major cash-flow burden before any liquidity is available.

To address this issue, the Government of India introduced a tax deferral benefit for employees of eligible DPIIT-recognized startups that are certified by the Inter-Ministerial Board (IMB) under Section 80-IAC, allowing them to defer tax on Employee Stock Options (ESOPs) for their employees.

How ESOP taxation works for employees of Startup Companies and Companies other than Startup:

When Employees receives ESOPs, taxation is not applied at that Stage. It is applied typically at two different stages:

Stage 1: Grant of ESOPs → No Tax for both Startup Companies and Companies other than Startup

When your company grants ESOPs:

- You only receive the right to buy shares in the future.
- No shares are issued yet.
- No tax liability arises at grant.

Stage 2: Vesting of ESOPs → No Tax for both Startup Companies and Companies other than Startup

When options vest (after completing required service period):

- You earn the right to exercise them.
- Still, you haven't purchased shares yet.
- No tax is triggered at vesting.

Stage 3: Exercise of ESOPs → Major Change (Tax Deferral)

In Eligible Startups Companies:

Tax on perquisite is not payable immediately. Instead, it becomes payable at the earliest of:

1. 5 years from the year of exercise, or
2. Date of sale of shares, or
3. Date you leave the company

This significantly reduces liquidity pressure on employees of early-stage startups.

In Normal Companies:

- Perquisite value (FMV – Exercise Price) is taxed immediately.
- Employer deducts TDS in that financial year.



How It Is Calculated:

Perquisite Value = Fair Market Value (FMV) on exercise date – Exercise Price

This difference is treated as:

- Perquisite income under “Salary”
- Taxed at your normal income tax slab rate
- Employer deducts TDS

Example:

- Exercise Price = ₹100
- FMV on Exercise Date = ₹500
- Shares Exercised = 1,000

Perquisite Value = $(500 - 100) \times 1,000 = ₹4,00,000$

If you're in 30% tax bracket → Tax ≈ ₹1,20,000 (+ cess)

Ineligible Startup Companies → Pay immediately

Eligible Startups Companies → Pay only on sale / exit / after 5 years.

Stage 4: Sale of Shares → Capital Gains Tax

When you later sell the shares, Capital Gain tax arises again based on your period of holding.

Capital Gain Calculation:

Capital Gain = Sale Price – FMV on Exercise Date

(The FMV used earlier becomes your cost of acquisition.)

There is no special capital gains relief for Registered Startup Companies.

What Does *Not* Change?

- Taxability of ESOPs still happens in two stages.
- Capital gains rules remain identical.
- Tax amount calculation remains the same.
- Only the timing of payment changes.

Why This Matters?

In unlisted startups:

- There may be no immediate liquidity.
- Shares cannot always be sold easily.
- Employees could face large tax outflow without liquidity or cash in hand.

Tax deferral aligns payment closer to liquidity events (exit, buyback, IPO, or job change).

Quick Comparison Table



Affluence Advisory Pvt. Ltd. ESOP Tax Relief for Employees of Startup Registered Companies

Stage	Normal Company	DPIIT-Eligible Startup
Grant	No tax	No tax
Vesting	No tax	No tax
Exercise	Immediate perquisite tax	Perquisite Tax is deferred but not exempted
Sale	Capital gains tax	Capital gains tax

Important Points to Remember

- The benefit applies only if the company is DPIIT-recognized.
- Startup must be eligible under Section 80-IAC.
- The tax deferral is not permanent, only postponed for specified period.
- Capital gains tax will still apply at the time of sale.
- Proper documentation and compliance are critical.

Final Takeaway

ESOPs are one of the most important wealth-building tools in India's startup ecosystem. While taxation can be complex, the ESOP tax deferral benefit provides meaningful relief for employees of eligible startups.

Understanding how and when tax is triggered allows employees to make informed financial decisions and maximise the long-term value of their equity.

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