HR Law Hotline

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LIBERALIZATION OF STOCK OPTION REGULATIONS

In another step towards liberalization, the Reserve Bank of India ("**RBI**") has issued Circular No. 90 dated May 3, 2004, ("**Circular**") permitting foreign companies to freely price their stock options ("**ESOP**") being offered to the employees / directors of their Indian office, branch or subsidiary. This relaxation coupled with the general relaxation announced by the RBI in February 2004 permitting Indian residents to purchase foreign securities under the automatic route for amounts up to USD 25,000 would make the ESOP route more attractive for structuring of employee compensation packages.

Under the Indian exchange control regulations, the grant of stock options by any foreign company to resident Indians must be in accordance with the provisions of the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2000 ("**Regulations**"). One of the conditions laid down in sub-regulation 19(2)(a) of the Regulations stipulated that the "the shares are offered at a concessional price". While 'concessional' price had not been defined, it was interpreted to mean that the exercise price should be less than the fair market price of the shares of the foreign company on the date of grant of the stock options. The Regulations were also silent on the quantum of concession and the mechanism for determining the concession and the price, especially in case of unlisted shares. This condition posed great difficulties to US parent companies desiring to grant options to their Indian employees as under the US GAAP, grant of option at a discount results in accounting charge for the discount, amortized over the vesting period. Further, options granted at a discount, would not qualify as 'Incentive Stock Options' triggering certain US tax consequences.

Post the relaxation under the Circular, foreign companies can now freely price their options thus also making them administratively more attractive in their home countries. The ESOP issued by foreign companies would continue to be in compliance with the Employees' Stock Option Plan or Scheme Guidelines issued by the Ministry of Finance in order to qualify for the single point beneficial tax treatment in the hands of the employees.

In addition to the above, the Circular also permits the Indian employees and directors to sell the shares acquired under an ESOP without obtaining the prior permission of the RBI, provided the proceeds thereof are repatriated to India.

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Sources:
- *RBI A.P. (DIR Series) Circular No. 90 dated May 3, 2004.*
- *The Economic Times, Mumbai edition, dated May 4, 2004.*

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