



IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION
INCOME TAX APPEAL NO. 135 OF 2024

Pr. Commissioner of Income Tax-3, Pune

... Appellant

Vs

Bajaj Finance Ltd.

... Respondent

Mr. Vikas T. Khanchandani for the appellant.

Ms. Vasanti Patel for the respondent.

CORAM: G. S. KULKARNI &
AARTI SATHE, JJ.

DATE: 17 APRIL 2026.

ORAL JUDGMENT: (Per G. S. Kulkarni, J.)

1. This appeal by the revenue, filed under Section 260A of the Income-tax Act, assails the order dated 9 December, 2022 passed by the Income-tax Appellate Tribunal, Pune Bench, whereby the appeal filed by the respondent-assessee against the order dated 31 January, 2018 passed by the Commissioner of Income-tax (Appeals) has been allowed, while the cross-appeal filed by the revenue has been dismissed. The Assessment Year in question is 2013-14.

2. The revenue has raised the following question of law in the present appeal:

“A) Whether on the facts and circumstances of the case and in law, the Tribunal is justified in holding that the assessee was eligible for claim of deduction in respect of Employee Stock Options (ESOP) an expenditure of Rs. 12,85,12,529/- by ignoring the fact that no such expenditure was actually incurred by the assessee?

B) Whether on facts and in the circumstances of the case and in law the Tribunal is justified in holding that facts and finding of the extant case are similar to the case of CIT LTU vs Biocon Ltd. decided by the Special Bench of the Income Tax Appellate Tribunal, Bangalore, as reported in (2020) 121 taxman.com 351 on which the Tribunal relied upon, without disputing the differentiating features as brought out by the Assessing Officer?

C) Whether on facts and in the circumstances of the case and in law the Tribunal, while allowing relief to the assessee, ignored the decision of Hon'ble Supreme Court in Padmasundara Rao (Dead) and Ors. Vs. State of Tamilnadu wherein it is clearly held that Court should not place reliance on decisions without discussing as to how the factual situation fits in with the fact situation of the decision on which reliance is placed?"

3. The question as raised was reframed as under:

"Whether the 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 was allowable as a deduction under Section 37 of the Income-tax Act?

4. We have accordingly heard learned counsel for the parties. At the outset, we may observe that, the Tribunal in passing the impugned order in allowing the assessee's appeal, reliance was placed on the decision of the Special Bench of the Income-tax Appellate Tribunal, Bangalore, in case of **Biocon Limited vs. DCIT(LTU), Bangalore**¹. The Special Bench, in the said decision, held that the discount on ESOP, being a general expense, was an allowable deduction u/s 37(l) of the I. T. Act during the years of vesting on the basis of percentage of vesting during such period, subject to upward or downward adjustment at the time of exercise of option.

5. The said decision was carried in appeal by the revenue before the Karnataka High Court in **CIT LTU vs. Biocon Ltd.**², wherein the High Court held that Section 37 (l) of the I. T. Act permits deduction for the expenditure laid out or expended and does not contain a requirement that there has to be a pay-out. It was held that if an expenditure has been incurred, provisions of Section 37(l) of

¹ (2013) 35 taxmann.com 335(Bangalore-Trib.)(SB)

² (2020) 2 taxman.com 351 (Karnataka)

the Act would be attracted. It was further held that Section 37 does not envisage incurrence of expenditure in cash. The High Court also considered the provisions of Section 2(15A) of the Companies Act, 1956, which 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 pre-determined price. It was observed that 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. It was further held that for being eligible for acquiring shares under the scheme, the employees are under an obligation to render their services to the company during the vesting period and on completion of the vesting period in the service of the company, the option vest with the employees. It was thus held that on consideration of provisions of Section 37(1), it was evident that an assessee was entitled to claim deduction under the aforesaid provision if the expenditure has been incurred. It was also held that the 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. Thus, considering the primary object that such 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. It was also held that the deduction of discount on ESOP over the vesting period is in accordance with the accounting in the books of accounts, which was prepared in accordance with Securities And Exchange Board of India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999. Thus, the High Court answered the questions of law against the revenue and in favour of the assessee.

6. We find that the decision of the Special Bench in **Biocon Limited vs. DCIT(LTU), Bangalore** (supra), as affirmed by the Karnataka High Court in **CIT LTU vs. Biocon Ltd.** (supra) was also subject matter of consideration before the Division Bench of the Delhi High Court in **PVR Ltd. vs. Commissioner of Income Tax**³. In the said proceedings, the following question of law fell for consideration before the Division Bench of the Delhi High Court:

“Whether on the facts and in the circumstances of the case, the Tribunal erred in law in holding that difference between the price at which stock options were offered to employees of the appellant-company under ESOP and ESPS and the prevailing market price of the stock on the date of grant of such options was not allowable revenue expenditure under Section 37(1) of the I. T. Act, 1961?

7. In answering the said question, the Division Bench referred to the decision of Karnataka High Court in **CIT LTU vs. Biocon Ltd.** (supra) when the following observations were made:

“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:

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.

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 date 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 paragraph 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 fulfillment of the condition.”

8. We find that the view taken by the Karnataka High Court in **CIT LTU vs. Biocon Ltd.** (supra) was also followed by the Delhi High Court in **Principal Commissioner of Income Tax vs. New Delhi Television Ltd.**⁴ as noted in paragraph 3 of the decision in **PVR Ltd. vs. Commissioner of Income Tax** (supra).

9. Learned counsel for the revenue has submitted that the decision of the Karnataka High Court in **CIT LTU vs. Biocon Ltd.** (supra) was subject matter of challenge before the Supreme Court, however, the Special Leave Petition has now been disposed of, possibly on the ground of low tax effect. He fairly submitted that the decision of the Delhi High Court in **PVR Ltd. vs. Commissioner of Income Tax** (supra) has been challenged by the revenue before the Supreme Court and the proceedings are pending, however, there is no order of stay operating against the said decision.

10. Having heard the learned counsel for the parties and having perused the said decisions, the provisions of Section 37(1) as also the findings rendered by the Tribunal in the impugned order, following the decision of the Special Bench in **Biocon Limited vs. DCIT(LTU), Bangalore** (supra), we are in complete agreement with the view taken by the Tribunal as also by the Delhi High Court (supra), which takes into consideration the effect and purport of Section 37(1) of I. T. Act in the context of ESOPs, read with the provisions of Section 2(15A) of the Companies Act, 1956 as also the provisions of Securities And Exchange Board of

⁴ (2018) 99 taxmann.com 401 (Del.)

India (Employee Stock Option Scheme and Employee Stock Purchase Scheme) Guidelines, 1999. We are, thus, not inclined to take a different view in the present proceedings.

11. For the aforesaid reasons, we are, of the opinion, that no question of law would arise for consideration in this appeal. The appeal is accordingly dismissed. No costs.

(AARTI SATHE, J.)

(G. S. KULKARNI, J.)