# Tax Flash News

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# FMV on exercise date allowed as cost of acquisition of shares even if perquisite was not taxed in India

## Executive summary

In the case of *Rajesh R. Hemrajani*,[1] the Mumbai Bench of the Income-tax Appellate Tribunal ('the Tribunal') held that the Fair Market Value ('FMV') as on the exercise date under the Employee Stock Option Plan ('ESOP') constituted the cost of acquisition for computing capital gains on subsequent sale of shares, notwithstanding that the ESOP perquisite was not taxable in India due to the employee's non-resident status.

The Tribunal rejected the Revenue's position to take actual exercise price as cost of acquisition of the shares.

The Tribunal distinguished the decision of the Hyderabad Bench of the Tribunal[2] holding that the said decision was on peculiar facts of that case and cannot be read as laying down an absolute proposition that the benefit of section 49(2AA) of the Income-tax Act, 1961 ('the 1961 Act') is available only where the perquisite has suffered tax in India.

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[1] *Rajesh R Hemrajani v. ITO (ITA No. 1284/Mum/2025)*

[2] *Ramamurthy Sridharan* v. *ACIT (ITA No.1238/Hyd/2008)*

## Facts of the case

The taxpayer was a non-resident individual as per the provisions of the 1961 Act[3] and a tax resident of the United Kingdom. He was employed with the UK branch of an Indian company ('ICo').

Under a stock option scheme of ICo, the taxpayer was granted stock options in ICo, at an exercise price of INR1 per share. During Financial Year ('FY') 2018-19, the taxpayer exercised 1,540 vested options and received corresponding shares.

The Fair Market Value ('FMV') of the shares on the exercise date was approximately INR 1,754 per share. The taxpayer subsequently sold the shares and computed a short-term capital loss by adopting the FMV on the exercise date as the cost of acquisition.

The Revenue contended that since the stock perquisite was not taxable in India owing to his non-resident status, the taxpayer was not entitled to adopt FMV as the cost of acquisition and that only the actual exercise price should be considered as cost. Accordingly, the Revenue assessed short-term capital gains.

[3] Section 6

## Relevant provisions

Section 17(2)(vi) of the 1961 Act defines "perquisite" to include the value of any specified security or sweat equity shares allotted or transferred by the employer (or former employer) to the employee, either free of cost or at a concessional rate.

Explanation (c) to section 17(2)(vi) provides that the perquisite value is the FMV of the security/ share on the date of exercise as reduced by the amount actually paid by, or recovered from, the employee.

Section 49(2AA) provides that where capital gain arises from the transfer of shares received under a stock option scheme, the cost of acquisition of such shares will be the FMV which has been *taken into account* for the purposes of perquisite valuation.

## Revenue's contentions

The taxpayer could not rely on provisions of section 49(2AA) to determine the cost, as the stock perquisite related to services rendered outside India and was not taxable in India.

The cost of acquisition should be restricted to the actual amount paid by the taxpayer, i.e., the exercise price of INR1 per share.

Capital gains arising from sale of shares of an Indian company were taxable in India and should be computed using such exercise price as cost.

## Tribunal's decision

The Tribunal ruled in favour of the taxpayer and directed the Revenue to recompute the capital gains by adopting FMV on the exercise date as the cost of acquisition. Key observations of the Tribunal included:

### Section 49(2AA) does not require actual taxation of perquisite in India

The relevant provision refers to FMV that has been "taken into account" for determining the value of the stock benefit. It does not require that such perquisite must actually be taxed in India.

### The expression "taken into account" has wider import

The expression refers to FMV determined in accordance with the prescribed valuation mechanism and is independent of whether the resulting perquisite ultimately forms part of taxable income in India.

### No additional condition can be read into the statute

Section 49(2AA) does not require the ESOP perquisite to have been taxed in India and reading such a condition into the provision would amount to adding words not contemplated by the Parliament.

Additionally, it rejected the distinction drawn by the Dispute Resolution Panel between perquisites taxed in India and those taxed overseas, observing that the statute makes no such distinction.

### Computation of perquisite and its chargeability to tax operate independently

The computation of perquisite and its chargeability to tax operate in different fields. Therefore, the availability of FMV as cost is not dependent on whether the perquisite was taxable in India.

### Judicial precedents distinguished

The Tribunal distinguished the decision of the Hyderabad Bench of the Tribunal[4] holding that the said decision was on peculiar facts of that case and cannot be read as laying down an absolute proposition that the benefits of section 49(2AA) of the 1961 Act is available only where the perquisite has actually suffered tax in India.

The judicial precedents[5] relied upon by the Revenue mainly dealt with the residential status and taxability of salary/ perquisites and did not specifically examine the scope and interpretation of section 49(2AA) while determining the cost of acquisition of shares acquired under the ESOP Scheme for the purposes of computing capital gains.

## Our comments

The ruling is particularly relevant for employees who acquired shares under an ESOP while being non-resident in India and where subsequent sale of such shares is liable to tax in India. It supports the application of the FMV as cost basis even where the related perquisite has not been taxed in India. However, considering the divergent judicial views, it remains to be seen how higher forums will reconcile the differing judicial views.

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[4] *Ramamurthy Sridharan* v. *ACIT (ITA No.1238/Hyd/2008)*

[5] *CIT* v. *Avatar Singh Wadhwan* [2011] 115 Taxman 536 (Bombay); *Smt. Sumana Bandyopadhyay* v. *DCIT* [2017] 88 taxmann.com 847 (Calcutta); *DIT* v. *Prahlad Vijendra Rao* [2011] 198 Taxman 551 (Karnataka); *Devi Dayal* v. *DCIT/ACIT* [2024] 158 taxmann.com 572 (Delhi Tribunal); *Avdesh Kumar* v. *DCIT* [2018] 96 taxmann.com 340 (Delhi Tribunal)

# KPMG in India addresses:


**Ahmedabad**
Commerce House V, 9th Floor, 902, Near Vodafone House, Corporate Road, Prahlad Nagar, Ahmedabad – 380 051.
Tel: +91 79 4040 2200

**Bengaluru**
Embassy Golf Links Business Park, Pebble Beach, 13/02, 'B' Block, 1st & 2nd Floor, Off Intermediate Ring Road, Bengaluru – 560 071
Tel: +91 80 6833 5000

**Chandigarh**
Elante Offices, Unit No. A505, 5th Floor, Plot No.178-178A, Industrial Area Phase-1, Chandigarh – 160 002.
Tel: +91 172 664 4000

**Chennai**
KRM Towers, Ground, 1st, 2nd, & 3rd Floor, No. 1, Harrington Road, Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

**Gurugram**
Building No.10, 8th Floor, DLF Cyber City, Phase II, Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

**Hyderabad**
Salarpuria Knowledge City, Orwell 6th Floor, Unit-3, Survey No 83/1, Plot No 2, Raidurg, Hyderabad – 500 081.Tel: +91 40 6111 6000

**Jaipur**
Signature Towers, Office No. 402, Fourth Floor, S Plot No. DC-II, Lal Kothi District Shopping Center, Tonk Road, Jaipur – 302 001
Tel: +91 141 – 672 1000

**Kochi**
Syama Business Centre, 49/179, 3rd Floor, NH 47, Bypass Road, Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

**Kolkata**
Unit No. 604, 6th Floor, Tower – 1, Godrej Waterside, Sector – V, Salt Lake, Kolkata – 700 091.
Tel: +91 33 4403 4000

**Mumbai**
Lodha Excelus, Apollo Mills Compound, 2nd Floor, N M Joshi Marg, Lower Parel, Mumbai- 400 011.
Tel: +91 22 3989 6000

**Noida**
Unit No. 501, 5th Floor, Advant Navis Business Park, Tower-A, Plot# 7, Sector 142, Expressway Noida, Gautam Budh Nagar, Noida – 201 305.
Tel: +91 0120 386 8000

**Pune**
9th floor, Business Plaza, Westin Hotel Campus, 36/3-B, Koregaon Park Annex, Mundhwa Road, Ghorpadi, Pune – 411 001.
Tel: +91 20 6747 7000

**Vadodara**
Ocean Building, 303, 3rd Floor, Beside Center Square Mall, Opp. Vadodara Central Mall, Dr. Vikram Sarabhai Marg, Vadodara – 390 023.
Tel: +91 265 619 4200

**Vijayawada**
PR heights, 4th Floor, NH 16 Service Rd, opp. Manipal Hospital Road, Tadepalle, Andhra Pradesh – 522 501.
Tel: +91 0864 536 2000


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