



Understanding ESOPs – A Quick Overview

This presentation will cover what ESOPs are, key terms, why companies offer them, how they work, legal aspects, valuation, taxation, exit scenarios, implementation routes, and a summary with cautions.





What is an ESOP?

An Employee Stock Option Plan (ESOP) is an incentive giving eligible employees the right to purchase company shares at a predetermined price after a vesting period. As per Section 2(37) of the Companies Act, 2013, it's an option for directors, officers, or employees to subscribe to shares at a future date. ESOPs attract, retain, and reward talent by aligning employee interests with company growth.

Basic ESOP Jargons Simplified

1

Grant

Company promises shares to the employee.

2

Vesting

Waiting period before shares can be exercised (minimum 1 year).

3

Exercise

Employee chooses to buy shares at the set price.

4

Exercise Price

Pre-decided price for buying shares.

5

Lock-in Period

Additional period before employee can sell shares.

6

Perquisite

Taxable benefit from buying shares at a lower price.



Why Companies Use ESOPs & How They Work

Companies use ESOPs to **attract and retain talent**, *foster ownership*, and **align employee interests** with long-term goals. Especially in *pre-IPO or growth-stage companies*, ESOPs help *reduce immediate cash outflows* while **building team motivation**.

Eligible employees are **granted the option to purchase shares at a predetermined price**, exercisable after a *vesting period* (typically 1-5 years). Once exercised and paid for, **shares are allotted**, and the employee may *hold or sell them* as per the scheme.

Legal Framework & Approvals

1 Governing Laws

ESOPs in India are governed by the **Companies Act, 2013**, **SEBI (SBEB & SE) Regulations, 2021**, and the **Income Tax Act, 1961**.

2 Shareholder Approval

A **special resolution** by shareholders is required to issue ESOPs, along with **filing MGT-14** and disclosures in the **Director's Report**.

3 Record Keeping

Companies must maintain a **Register of ESOPs in Form SH-6** to track grants, exercises, and allotments.

These approvals ensure transparency and statutory compliance before implementation.

Who is Eligible for ESOPs?



Permanent Employees

Eligible whether in India or abroad.



Directors

Whole-time or non-independent directors are eligible.



Holding/Subsidiary Staff

Employees of holding or subsidiary companies are also eligible.



Ineligible

Promoters, promoter group members, and directors holding >10% equity (unless exempted for DPIIT-recognised startups) are not eligible.



Pricing, Valuation & Vesting

1

Pricing

Company sets the exercise price (can be discounted or FMV).

2

Valuation at 2 Stages

- **At grant:** For accounting compensation.
- **At exercise:** For taxation (perquisite value = FMV - exercise price).

3

Vesting

- Minimum 1-year gap between grant and vesting.
- Vesting linked to tenure or performance based metrics.

ESOP EXIT

Transferability & Exit Scenarios

Transfer Rules

- Options cannot be sold, hypothecated, alienated, pledged, or transferred.
- Only the employee can exercise options.

Exit Situations

- **Death:** Options vest in legal heirs.
- **Disability:** All granted options vest immediately.
- **Resignation/Termination:** Unvested options lapse; vested ones can be exercised within timeline.



ESOP Implementation & Tax Implications

Implementation Routes

- **Direct Route:** Company directly manages grant, vesting, and allotment.
- **Trust Route:** A dedicated trust holds and distributes shares.

Tax Implications for Employees

- **At Exercise:** Difference between FMV and exercise price is a **taxable perquisite** (under salary); **TDS applies**.
- **On Sale of Shares:** Gains taxed as **capital gains**.

Summary & Caution

Powerful Tool

ESOPs are powerful for startups and growing companies.

Compliance Needed

Require compliance with legal, tax, and accounting norms.

Custom Schemes

Custom schemes can be designed with professional help.

Consult Advisors

Regulations change; always consult legal/tax advisors.

Not a Shareholder

Not a shareholder until shares are exercised.

Avoid Misuse

Misuse or misunderstanding can create tax or legal issues.

How Hedge-Square can Help

- *Structuring ESOPs That Build Trust.*

We help companies turn ESOPs into a meaningful part of their growth story — not just a compliance checklist.

Our role goes beyond paperwork: we design ESOP frameworks that are legally sound, tax-efficient, and easy to understand — for both founders and employees. From policy drafting and regulatory filings to valuation support and board approvals, we ensure every step is aligned with your vision and compliant with the law.

Because when ESOPs are structured right, they do more than reward — they retain, empower, and build lasting trust.

Disclaimer:

The above presentation is solely based on the laws/ regulations in force at the time. This is as per our understanding and interpretation of the laws/ regulations; however an alternate view may be taken by the authorities. Further, this is for the understanding of basic laws/ regulations and not for the purpose of submission with any third-party or authorities (whether local or foreign). Any action taken by reader or any other person based on our this shall be at responsibility of such person and we shall not be held liable for the same in any manner.

Contact us:

Email : contact@hedge-square.in

contact : [+91 8692 0516 11](tel:+918692051611)

Website : <https://hedge-square.com>