

ESOP Taxation in India: Perquisite on Exercise and Capital Gains on Sale (2026-27)

Description

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Quick summary

- An employee stock option (ESOP) is a right, not an obligation, to buy shares at a fixed price. Granting and vesting are not taxed; if you never exercise, there is no tax.
- On exercise, the fair market value (FMV) of the share on that date less the price you paid is a perquisite taxed as salary (section 17(1)(d)), and TDS applies.
- FMV is set by Rule 15(6): the average of the opening and closing price for a listed share, and a merchant banker's value for an unlisted one.
- On sale, capital gains are worked out with that FMV as your cost, and the holding period runs from the date of allotment.
- Employees of an eligible start-up pay the perquisite tax later: within 14 days of the earliest of 60 months from the end of the tax year, sale of the shares, or leaving the job.

An employee stock option plan (ESOP) lets an employee buy the employer's shares at a fixed price in the future. The Companies Act, 2013 calls it an employee stock option: a right, but not an obligation. ESOPs are taxed twice, at two different points, under two different heads. This post follows the Income-tax Act, 2025 and the Income-tax Rules, 2026, which apply from 01/04/2026.

The key dates

Term	Meaning
Grant date	The employer offers you the option
Vesting period	The time, or the milestones, before you may exercise
Vesting date	The date the option becomes exercisable

Term	Meaning
Exercise date	The date you tell the employer you will buy the shares
Exercise price	The price you pay per share, usually below the market price
Allotment	The shares are issued or transferred to you

Nothing is taxed on grant or vesting. If the option lapses unexercised, there is no tax either.

Stage 1: tax on exercise (salary)

Under section 17(1)(d), the value of any specified security or sweat equity share allotted or transferred by your current or former employer, free of cost or at a concessional rate, is a perquisite. The value is the **fair market value on the date the option is exercised, less the amount you actually paid or that was recovered from you** (section 17(4)(h)).

It is added to your salary and taxed at your slab rate. The employer deducts TDS on it under section 392 and shows it in your TDS certificate (Form 130).

How fair market value is fixed (Rule 15(6) and (7))

Situation on the exercise date	FMV
Share listed on one recognised stock exchange	Average of the opening and closing price on that exchange
Listed on more than one exchange	The same average, on the exchange with the highest trading volume
Listed but no trading that day	Closing price on the nearest earlier date (on the exchange with the highest volume if more than one)
Not listed	Value fixed by a Category I merchant banker registered with SEBI, as on the “specified date”
Specified security that is not an equity share	Merchant banker’s value on the specified date

The “specified date” is the exercise date or any earlier date not more than **180 days** before it. “Opening” and “closing” price mean the price of the first and the last settlement on the day, and where the exchange quotes buy and sell prices, the sell price.

Employees of an eligible start-up

If the employer is an **eligible start-up under section 140** (the section that replaced section 80-IAC), the tax on this perquisite is **not payable at exercise**. The notice of demand makes it payable within **14 days** of the

earliest of:

- the end of **60 months** from the end of the tax year in which the shares were allotted;
- the date you **sell** the shares; or
- the date you **cease to be an employee** of that employer (section 289(3)).

The tax is worked out at the rates in force for the tax year of allotment, and the employer deducts or pays it within the same time (section 392(3)). The older rule used 48 months; the 2025 Act says 60.

Stage 2: tax on sale (capital gains)

When you later sell the shares, the gain after exercise is a capital gain.

- **Cost of acquisition:** the FMV that was taken as the perquisite (section 73, Table serial 4). Your own exercise price does not matter again, because the perquisite already taxed the difference.
- **Holding period:** counted from the **date of allotment** (section 2(101)(c)).

Shares	Short-term if held for	Short-term gain taxed at	Long-term gain taxed at
Listed in India, sale on a stock exchange with STT paid	12 months or less	20% (section 196)	12.5% on the gain above ?1,25,000 a year (section 198)
Listed in India, no STT paid	12 months or less	Slab rates	12.5% without indexation (section 197)
Unlisted Indian company	24 months or less	Slab rates	12.5% without indexation (section 197)
Foreign company’s shares	24 months or less	Slab rates	12.5% without indexation (section 197)

Shares of a foreign company are not “listed on a recognised stock exchange in India”, so the 24 month period applies even if they are listed abroad.

Worked example (listed company)

You hold 2,000 options at an exercise price of ?80. On the exercise date, 10/06/2026, the FMV is ?150.

- **Perquisite:** (150 - 80) × 2,000 = **?1,40,000**, added to salary. At a 30% slab that is ?42,000 of tax before cess, mostly collected as TDS.
- **Sale within 12 months,** on 15/12/2026 at ?175: gain = (175 - 150) × 2,000 = **?50,000**, short-term, taxed at 20% = **?10,000** plus cess.
- **Sale after 12 months,** on 20/07/2027 at ?190: gain = (190 - 150) × 2,000 = **?80,000**, long-term. It is below ?1,25,000, so **no tax** on it, provided your other long-term gains from listed equity in that year do not use up the limit.

Other situations

Sell to cover

When shares are allotted, the employer must deduct TDS on a perquisite that you did not receive in cash. Many employers therefore sell part of the allotted shares on your behalf to pay the tax. That sale is itself a transfer, so it can give a small capital gain or loss (usually nil, because the price is close to the FMV used) that belongs in your return.

Buyback of options

An employer, often an unlisted company, may buy back vested options before they are exercised so that employees get cash. Employers generally treat the payment as salary and deduct TDS. We could not find a specific provision for this in the Act, so treat the position as one to confirm for a large amount.

Residence and foreign employers

A resident is taxed in India on income from anywhere in the world. A non-resident is taxed only on income that is received in India or accrues or arises here, and salary for services rendered in India accrues in India. Stock options of a foreign parent can therefore be taxed in India even if the shares are bought and sold abroad. Foreign shares also have to be reported in the foreign assets schedule of the income-tax return.

Advance tax

Gains on sale are income of the year, so include them in your advance tax instalments once the sale has happened. Delay can attract interest, so pay the tax on a sale as soon as you know the gain.

What to check before you exercise

1. Ask your employer for the **FMV method** and the FMV it will use on the exercise date.
2. Check whether the company is a **recognised eligible start-up under section 140**. If not, you owe tax at exercise even if the shares cannot yet be sold.
3. Keep the **allotment letter** and the **FMV working**. They are your cost of acquisition and holding period when you sell.
4. Keep cash aside for the tax on the perquisite, because it arises before you receive any money.

Frequently asked questions

Is tax payable when ESOPs are granted or vest?

No. The tax arises when the option is exercised and shares are allotted. If you let the options lapse without exercising them, there is no tax.

How is the ESOP perquisite worked out?

Fair market value of the share on the date you exercise the option, less the amount you paid or that was recovered from you (section 17(4)(h)). It is added to your salary and taxed at your slab rate, and the employer deducts TDS under section 392.

How is FMV decided?

For a listed share, the average of the opening and closing price on the stock exchange on the exercise date (the exchange with the highest trading volume if listed on more than one). If there was no trade that day, the closing price on the nearest earlier day. For an unlisted share, the value fixed by a Category I merchant banker as on the exercise date or any date up to 180 days before it.

What is my cost when I sell the shares?

The FMV that was taken as the perquisite (section 73, Table serial 4). The holding period starts on the date of allotment.

What happens to tax on ESOPs of a start-up?

If your employer is an eligible start-up under section 140, the tax on the perquisite becomes payable within 14 days of the earliest of three events: 60 months from the end of the tax year of allotment, sale of the shares, or your ceasing to be an employee.

Is the sale of shares taxed twice?

No. The perquisite taxes the gain up to the exercise date, and the FMV on that date becomes your cost, so only the increase in value after exercise is taxed as a capital gain.

Official sources

- Income Tax Department: Income-tax Act, 2025 (sections 17, 73, 140, 196 to 198, 289, 392)
- Income Tax Department: Income-tax Rules, 2026 (Rule 15(6) to (8))

Related reading

- Perquisites in Income Tax: Types, Valuation and Taxability for Tax Year 2026-27

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