

ESOP Design + Tax Checklist

From plan design to exit: company law, tax and FEMA, in the order you will meet them

You want to give your early team a real stake in what they are building. An ESOP does that, but only if the plan is set up the way Indian company law, tax law and FEMA expect. A plan that skips a step usually surfaces at the worst time: in an investor's diligence, when an employee exercises and gets an unexpected tax bill, or when a team member abroad asks how their options are reported. This checklist walks you through the plan from design to exit, in the order you will meet each step.

Part 1: Quick self-check. Does your ESOP have a gap?

Tick every statement that is true of your company today.

- ☐ Options have been promised in offer letters or emails, but no plan has been approved by shareholders.
- ☐ A co-founder or a promoter holds options.
- ☐ Some options were granted less than a year ago and are already shown as vested.
- ☐ Nobody maintains a register of options granted.
- ☐ Employees have exercised, but no return of allotment was filed.
- ☐ Your team does not know that tax is triggered when they exercise, not when they sell.
- ☐ Someone on the team works from outside India, or your India team holds options in your foreign parent, and nobody has looked at the FEMA reporting.

Ticked any of these? Each one is a gap that an investor's diligence will find. Work through Parts 2 to 6 and fix them before your next round.

Part 2: Design the plan (before a single option is granted)

- ☐ **Decide who is eligible.** Under the company-law rules, options can go to permanent employees (working in India or abroad), directors other than independent directors, and employees of your holding or subsidiary company. They cannot go to a promoter, to anyone in the promoter group, or to a director who (directly or through relatives or a company) holds more than ten per cent of the equity. **One important relief:** a startup recognised by DPIIT can grant options to promoters and to such directors for up to ten years from incorporation.
- ☐ **Fix the size of the pool and the per-person maximum.** The shareholders' notice must state the total number of options, the classes of employees who can participate, how eligibility is appraised, and the maximum options per employee and in aggregate. Size the pool to your hiring plan, not to a number someone else used.

- ☐ **Set the vesting schedule.** The law requires at least **one year between grant and vesting**. Beyond that minimum, the vesting period, the maximum vesting period and any performance conditions are yours to design, and all of them must be written into the plan.
- ☐ **Set the exercise price (or a formula for it).** An unlisted company is free to decide the exercise price, consistent with its accounting policies. Record how you arrived at it.
- ☐ **Set the exercise window and the leaver rules.** Spell out how long an employee has to exercise vested options, including after resignation or termination. The law fixes three outcomes you must build in: on resignation or termination, **unvested options lapse**; on death in service, **all options vest in the legal heirs or nominees**; on permanent incapacity in service, **all options vest immediately**.
- ☐ **Decide any lock-in** on the shares issued on exercise, and the conditions on which vested options lapse (for example, termination for misconduct).
- ☐ **State how you will value the options** and that the company will follow the applicable accounting standards. Both are required disclosures in the shareholders' notice.

Part 3: Approve the plan and grant the options properly

- ☐ **Board approval**, followed by **shareholder approval** of the plan. For a private company, the Companies Act allows the plan to be approved by an **ordinary resolution**, but the ESOP rules still refer to a **special resolution**. The safe course is to pass a special resolution, so the point never comes up in diligence. If you do, file **Form MGT-14** with the Registrar within 30 days.
- ☐ **Separate shareholder approval** is needed for two kinds of grants: options to employees of a holding or subsidiary company, and any grant to one identified employee in a year equal to or above one per cent of the issued capital.
- ☐ **Issue a grant letter to each employee** matching the approved plan: number of options, exercise price, vesting schedule, exercise window and leaver terms.
- ☐ **Enter every grant in the Register of Employee Stock Options (Form SH-6)** as soon as it is made. The register sits at the registered office (or where the board decides) and is authenticated by the company secretary or an authorised person.
- ☐ **Remember what an option is not:** options cannot be transferred, pledged or encumbered, and they carry no dividend or voting rights until shares are actually issued on exercise.
- ☐ **Changing the plan later** needs a special resolution, and only if the change does not hurt existing option holders. The notice must explain the change, the reason and who benefits.

Part 4: Every year, and at each exercise

- ☐ **Directors' Report disclosures every year:** options granted, vested, exercised and lapsed; shares issued on exercise; exercise price; any variation of terms; money received on exercise; options in force; and employee-wise details for key managerial personnel and any large grants.

- ☐ **On exercise, allot the shares by board resolution** and file the **return of allotment (Form PAS-3)** within **30 days** of allotment.
- ☐ **Update the cap table and the SH-6 register** on the day of allotment, so what you show an investor matches what the Registrar sees.

Part 5: Tax. Know when the bill arrives and how much it is

- ☐ **Tax is triggered on exercise, not on sale.** The value taxed as salary is the **fair market value of the share on the exercise date, minus the price the employee pays**. Your company withholds tax on it through payroll like any other salary.
- ☐ **For an unlisted company, the fair market value comes from a SEBI-registered Category I merchant banker's valuation**, dated on the exercise date or on any date up to **180 days before** it. Plan valuations around your exercise windows so each exercise is covered.
- ☐ **Startups can defer the employee's tax.** If your company is an eligible startup holding the Inter-Ministerial Board certificate (the same certificate that unlocks the startup profit deduction), the employee's tax on the exercise benefit is paid within 14 days of the **earliest** of: five years from the end of the tax year of exercise, the sale of the shares, or leaving the company. Tell your team this at grant; it changes how they think about exercising.
- ☐ **On sale, the employee pays capital gains tax only on the gain above the value already taxed at exercise.** The fair market value taxed at exercise becomes the cost of the shares.
- ☐ **One rule set across the new law.** The Income-tax Act 2025, in force from 1 April 2026, carries these same exercise, valuation, deferral and cost rules forward. For exercises up to 31 March 2026 the earlier Act applies; the outcomes are the same.

Part 6: FEMA. When your ESOP crosses a border

A. Your Indian company grants options to people outside India

- ☐ **Allowed**, to employees or directors of your company, or of your holding company, joint venture or wholly owned subsidiary abroad, who are resident outside India, provided the plan follows the company-law ESOP rules and stays within your sector's foreign-investment cap.
- ☐ **Government approval first** if your sector is on the approval route, or if the grantee is a citizen of Bangladesh or Pakistan.
- ☐ **Report in Form ESOP within 30 days of issuing the options.** Diarise it on the grant date; a late form attracts a late-submission fee.
- ☐ **A team member who received options while living in India and exercises after moving abroad** holds those shares on a non-repatriation basis. Tell them before they move.

B. Your India team holds options in your foreign parent

- ☐ **Allowed for resident employees and directors.** Shares taken under the parent's ESOP count as a portfolio investment when they are **up to 10% of the parent's capital and carry no control**.
- ☐ **The remittance to exercise has no amount limit**, but it is counted towards the employee's annual Liberalised Remittance Scheme limit.
- ☐ **Your Indian company (or the Indian office or branch) reports it, not the employee:** file **Form OPI** within 60 days of the end of each half-year (September and March). If an employee's holding crosses 10% or gives control, it becomes an overseas direct investment and the employee reports it in **Form FC**.
- ☐ **Buy-backs by the parent are allowed** if the shares were issued under FEMA, the buy-back follows the original offer document, and the bank reports it.
- ☐ **Tax at home still applies.** The exercise benefit from a parent's plan is taxed in India as salary on the same exercise-date basis. A resident employee (other than not ordinarily resident) who holds shares abroad must also file an Indian income-tax return every year, even if their income is below the taxable limit, and disclose the foreign shares in it.

Your ESOP is only as strong as its paperwork

Investors look at your ESOP plan, the resolutions, the SH-6 register, the grant letters and the filings together. A gap in any one of them becomes a condition in the term sheet. It is far cheaper to fix now than during a round.

A S Banka Advisors Private Limited designs ESOP plans for Indian startups and cross-border groups end to end: the plan document, the resolutions and grant letters, the tax position for your team, and the FEMA reporting when your ESOP crosses a border. Every plan is **reviewed by our experts**.

Want to pressure-test your ESOP before your next round?

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This checklist is general guidance, not advice for any specific company, and reflects the law as in force in September 2026. How these rules apply to your plan depends on your company's facts, and we confirm the current position for your specific plan as part of the engagement.