

Phantom Shares

The concept of Phantom Stock Options

'Phantom Stocks Options' or 'Shadow Stocks Options' ("Phantom Stock Options") is a popular nomenclature derived from usage for SARs which are settled by way of cash entitlement. A Phantom Stock Option is a performance-based incentive plan which entitles an employee the right to receive cash payments after a specific period of time or upon fulfilment of specific criteria and is directly linked to the valuation and the appreciated value of the share price of the company. Thus, the underlying entitlement for an employee at the time of exercise of Phantom Stock Options is a cash payment unlike the Stock Plans which entitles an employee to an equity stake in the company. Thus, while Phantom Stock Options may be beneficial to companies and its management (read employers), they may not be an attractive option for employees who may be seeking an equity stake in the company in the form of Stock Plans or equity settled SARs as against a cash incentive.

Tax Implications of Phantom Stocks

The income received by an employee, in the form of cash entitlement at the time of the exercise of Phantom Stock Options, is taxed under the head of salary income as perquisites in the hands of the employee. No incidence of the tax arises in hands of the company (read the employer) at the time of making payment of the cash entitlement to the employee. However, considering that the cash entitlement received by the employee upon the exercise of the Phantom Stock Options is taxed under the head of salary income, the company is required to withhold taxes (read tax deducted at source) just before making payment of the cash entitlement to the employees.

Legal Framework for Phantom Stock Options

Under the Companies Act 2013: While the Companies Act, 2013 has prescribed rules for issuance of shares to employees under Stock Plans, it is silent on the grant and exercise of SARs including issuance of equity settled SARs and Phantom Stock Options.