

# Understanding Phantom Stock Options in India: Types, Benefits, and Tax Implications

written by King Stubb & Kasiva | February 27, 2023



Employee equity incentive plans have gained immense popularity in recent times, owing to the many benefits they offer to both employees and employers. These plans are an effective way of retaining and motivating employees and aligning their interests with those of the company. One such equity incentive plan that has gained significant traction in India is the Phantom Stock Option. In this article, we will delve deeper into what Phantom Stock Options are and the benefits they offer to employees and employers in India.

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**What are Phantom Stocks in India?**

Phantom Stocks are a type of equity incentive plan that provides employees with a cash payment equal to the appreciation in the company's stock price over a specific period, without actually owning any shares in the company. In other words, they are cash-settled equity awards that mirror the value of the company's actual shares. The Phantom Stock Plan is a non-cash bonus plan that is designed to reward employees for their contributions to the company's

growth.

### Common Types of Phantom Stocks in India

There are two primary types of Phantom Stock Options that are used in India: Appreciation Only Phantom Stock and Full-Value Phantom Stock. The Appreciation Only Phantom Stock Option provides employees with a cash payment equal to the appreciation in the company's stock price over a specific period, while the Full-Value Phantom Stock Option provides employees with a cash payment equal to the value of the company's stock price over a specific period.

### Benefits of using Phantom Stock as an Employee Equity Incentive

**Retaining and Motivating Employees:** Phantom Stock Options are an excellent way of retaining and motivating employees. When employees are offered a stake in the company's growth, they are more likely to stay with the company for a more extended period and contribute to its growth.

1. **Aligning Employee Interests with Company Goals:** When employees are provided with Phantom Stock Options, their interests are aligned with those of the company. They are motivated to work harder and contribute to the company's growth, knowing that their efforts will be rewarded.
2. **Tax Benefits:** Phantom Stock Options are taxed as perquisites and are not considered taxable income. This means that the tax liability of employees is reduced, and they get to keep a more significant portion of the cash payment they receive.
3. **Cost-Effective:** Unlike stock options, Phantom Stock Options do not require any capital investment on the part of employees. This makes them a more cost-effective way of providing equity incentives to employees.
4. **Flexible:** Phantom Stock Options are more flexible than traditional stock options. They can be customized to meet the specific needs of the company and can be structured to vest over a more extended period or to vest based on certain performance metrics.

### How Phantom Stock Works in India

Phantom Stock Options work in the following way in India:

The company grants Phantom Stock Options to its employees, indicating the number of units that the employee will receive. The Phantom Stock Units are linked to the company's stock price and are paid out in cash when the units vest. When the Phantom Stock Units vest, the employee is paid out the cash value of the units. The cash value is equal to the appreciation in the company's stock price over the vesting period. The employee is taxed on the cash payment received, and the company can claim a tax deduction for the cash payment made.

### Legal Framework

The legal framework for Phantom Stock Options in India is still evolving. The Securities and Exchange Board of India (SEBI) has issued guidelines for employee stock option plans (ESOPs) for listed companies, but these guidelines do not specifically cover Phantom Stock Options. However, some companies have started using Phantom Stock Options as an equity incentive, and the legal framework for such plans is expected to evolve over time.

### Conclusion

Phantom Stock Options are an excellent way of providing equity incentives to employees without actually diluting the company's equity. They are a cost-effective, flexible, and tax-efficient way of retaining and motivating employees while aligning their interests with those of the company. Although

the legal framework for Phantom Stock Options in India is still evolving, they have gained significant traction and are likely to become a popular equity incentive plan in the coming years.

Overall, Phantom Stock Options are an innovative way of providing equity incentives to employees without diluting the company's equity or requiring a capital investment from employees. They offer numerous benefits, including employee retention, motivation, tax efficiency, cost-effectiveness, and flexibility. As the legal framework for such plans evolves in India, we can expect more companies to adopt Phantom Stock Options as a part of their employee equity incentive plans.

#### FAQs

What are Phantom Stock Options in India?

Phantom Stock Options are a type of equity incentive plan that provides employees with a cash payment equal to the appreciation in the company's stock price over a specific period without actually owning any shares in the company.

What are the different types of Phantom Stock Options used in India?

The two primary types of Phantom Stock Options used in India are Appreciation Only Phantom Stock and Full-Value Phantom Stock.

Appreciation Only Phantom Stock: grants employees the right to receive a cash payment equal to the appreciation in the company's stock price over a specific period. Under this plan, the employee does not receive any dividends or other shareholder rights.

Full-Value Phantom Stock: grants employees the right to receive a cash payment equal to the value of the company's stock at the time of vesting. Under this plan, the employee may receive dividends and other shareholder rights, similar to owning actual shares in the company.

What are the key differences between Appreciation Only Phantom Stock and Full-Value Phantom Stock?

The primary difference between Appreciation Only Phantom Stock and Full-Value Phantom Stock is in the type of pay-out the employee receives. Under Appreciation Only Phantom Stock, the employee receives a cash payment equal to the appreciation in the company's stock price over a specific period, while under Full-Value Phantom Stock, the employee receives a cash payment equal to the value of the company's stock at the time of vesting.

Additionally, Full-Value Phantom Stock may provide employees with dividend payments and other shareholder rights, while Appreciation Only Phantom Stock does not.

King Stubb & Kasiva,

Advocates & Attorneys

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Tel: [+91 11 41032969](tel:+911141032969) | Email: [info@ksandk.com](mailto:info@ksandk.com)