



An Analytical study of fringe benefit Tax in India

Dr Jayaram Prasad Pal

Assistant professor

H.N.S Bhuneswar Janta College, Dhansoi, Buxar

&

Prof (Dr) Sanjay Kumar Singh

Faculty of Commerce, VKS University ARA

Abstract: Under the proposed provisions, fringe benefit tax is payable by an employer who is either an individual or a Hindu undivided family engaged in a business or profession; a company; a firm; an association of persons or a body of individuals; a local authority; a sole trader, or an artificial juridical person. The tax is payable in respect of the value of fringe benefits provided or deemed to have been provided by an employer to his employees during the previous year. The value of fringe benefits so calculated, is subject to additional income tax in respect of fringe benefits at the rate of thirty per cent, as provided in section 115WA. The fringe benefit tax is payable by the employer even where he is not liable to pay income-tax on his total income computed in accordance with the other provisions of this Act. The benefit does not have to be provided by the employer directly for him to attract fringe benefit tax. Fringe benefit tax may still be applied if the benefit is provided by a third party or an associate of the employer or by under an arrangement with the employer

Keywords: additional income tax, Fringe benefit, resource allocation

Introduction

Since 1990s, there have been major changes in tax systems of countries with a wide variety of economic systems and levels of development during the last two decades. The motivation for these reforms has varied from one country to another and the thrust of reforms has differed from time to time depending on the development strategy and philosophy of the times. In many developing countries, the immediate reason for tax reforms has been the need to enhance revenues to meet impending fiscal crises. One of the most important reasons for recent tax reforms in many developing and transitional economies has been to

evolve a tax system to meet the requirements of international competition. The transition from a predominantly centrally planned development strategy to market based resource allocation has changed the perspective of the role of the state in development. The transition from a public sector based, heavy industry dominated, import substituting industrialization strategy to one of allocating resources according to market signals has necessitated systemic changes in the tax system. In an export-led open economy, the tax system should not only raise the necessary revenues to provide the social and physical infrastructure but also minimize distortions.



What is Fringe Benefit Tax?

The taxation of perquisites or fringe benefits provided by an employer to his employees, in addition to the cash salary or wages paid, is fringe benefit tax. Any benefits or perks that employees (current or past) get as a result of their employment are to be taxed, but in this case in the hands of the employer. This includes employee compensation other than the wages, tips, health insurance, life insurance and pension plans. Fringe benefits as outlined in section 115WB of the Finance Bill, mean any privilege, service, facility or amenity directly or indirectly provided by an employer to his employees (including former employees) by reason of their employment. They also include reimbursements, made by the employer either directly or indirectly to the employees for any purpose, contributions by the employer to an approved superannuation fund as well as any free or concessional tickets provided by the employer for private journeys undertaken by the employees or their family members.

Reason for Introducing Fringe Benefit Tax:

Attribution of the personal benefit poses problems, or for some reasons, it is not feasible to tax the benefits in the hands of the employee, thereby, it was proposed to levy a separate tax known as the fringe benefit tax on the employer on the value of such benefits provided or deemed to have been provided to the employees. For this purpose, a new Chapter XII-H is proposed to be inserted in the Income-tax Act containing sections 115W to 115WL, which provides for the levy of additional income tax on fringe benefits. The chapter is divided into three parts. Part A contains the meaning of certain

expressions used, Part B enumerates the basis of charge, and Part C delineates the procedures for filing of return in respect of fringe benefits, assessment and the payment of tax thereon.

Perquisites which can be directly attributed to the employees will continue to be taxed in their hands in accordance with the existing provisions of section 17(2) of the Income-tax Act and subject to the method of valuation outlined in rule 3 of the Income-tax Rules.

FBT will be taxed on the following items

- (a) entertainment;
- (b) festival celebrations;
- (c) gifts;
- (d) use of club facilities;
- (e) provision of hospitality of every kind to any person whether by way of food and beverage or in any other manner, excluding food or beverages provided to the employees in the office or factory;
- (f) maintenance of guest house;
- (g) conference;
- (h) employee welfare;
- (i) use of health club, sports and similar facilities;
- (j) sales promotion, including publicity;
- (k) conveyance, tour and travel, including foreign travel expenses;
- (l) hotel boarding and lodging;
- (m) repair, running and maintenance of motor cars;
- (n) repair, running and maintenance of aircraft;
- (o) consumption of fuel other than industrial fuel;
- (p) use of telephone;
- (q) scholarship to the children of the employees.



In cases where the employer is engaged in the business of carriage of passengers or goods by motor car or by aircraft, a lower percentage of expenses on repair, running and maintenance of motor cars or aircrafts or fuel expenses has been specified.

Similarly, for hotels, a lower percentage of the expenses incurred on hospitality have been specified for purposes of calculating the liability under the fringe benefit tax.

An employer liable to pay fringe benefit tax is required to furnish a return of fringe benefits before the due date as given in Section 115WD. Section 115WE outlines the procedure for the assessment of the return of fringe benefits filed by the employer and the determination of tax or interest payable or refund due and in either case the issue of intimation to that effect.

Who pays Fringe Benefit Tax

Under the proposed provisions, fringe benefit tax is payable by an employer who is either an individual or a Hindu undivided family engaged in a business or profession; a company; a firm; an association of persons or a body of individuals; a local authority; a sole trader, or an artificial juridical person. The tax is payable in respect of the value of fringe benefits provided or deemed to have been provided by an employer to his employees during the previous year. The value of fringe benefits so calculated, is subject to additional income tax in respect of fringe benefits at the rate of thirty per cent, as provided in section 115WA. The fringe benefit tax is payable by the employer even where he is not liable to pay income-tax on his total income computed in accordance with the

other provisions of this Act. The benefit does not have to be provided by the employer directly for him to attract fringe benefit tax. Fringe benefit tax may still be applied if the benefit is provided by a third party or an associate of the employer or by under an arrangement with the employer.

Explanation of How FBT Will Operate

Fringe benefit tax on use of cars, etc-The tax on perquisites like maintenance of a car, club membership, free meals, credit cards and tours and travel, which were earlier taxed in the hands of the employees, has been withdrawn and the employer will now be liable to pay tax on this. Whereby, it will not give any relief to the employees.

Illustration: In the case of the perquisite value of a car, employees are taxed at a rate ranging between Rs 1,100 (for small cars) and Rs 1,700 a month (for bigger vehicles) in addition to Rs 300 or 500 for a driver provided by the company.

It will badly hit the Corporates in India-Reports suggest that the fringe benefits tax will result the Indian incorporations to an additional expenditure of about Rs 25,000 crore.

Advertising agencies will be hit by fringe benefit tax-The 30 per cent fringe benefit tax will hurt advertising agencies badly as in this sector about 10% o 12% of an employee's salary comes in the form of perks.

In the glamorous world of advertising attending conferences all over the world, wining and dining to network with clients and bag more business, etc is the one thing. Now all these expenses will come under the ambit of fringe benefit tax.



Also, advertising agencies are people-oriented one and staff welfare and salaries account for almost 50 per cent of their expenses. The fringe benefit tax will thus hurt ad agencies badly.

Reaction of the Indian Incorporations as to the enactment of FBT-India Inc is quite nervous about the proposed fringe benefit tax and feels that the gains from the reduction in corporate tax announced in the last Budget would be nullified by the cut in depreciation rates.

Reaction of Software firms[6]-Some software firms feel that a wide variety of payments would come under the ambit of fringe benefit tax. A recent survey also said that because of the impact of the fringe benefit tax, companies across sectors are likely to cut down on the increments that employees would get. The proposal has invited criticism even from the Institute of Chartered Accountants of India, which has otherwise praised the finance minister for rationalising the tax administration.

Small firms might be spared: A Business Standard report said that the finance ministry is considering threshold staff strength for levying the fringe benefit tax on employers.

Finance ministry officials indicated that organizations with very few employees could be exempted from the tax. This is based on the assumption that small employers do not spend large amounts on fringe benefits. The ministry will also examine combining the tax return for fringe benefits with the income tax return to avoid the need for filing separate forms, the report said.

How to calculate a fringe benefit rate:

A **fringe benefit rate** is a percentage that is calculated by adding together the annual cost of all benefits and payroll taxes paid, and dividing this amount by the annual wages paid.

Annual cost of all benefits and payroll taxes

Annual wages paid

For example, if the total benefits paid were \$35,000 and the wages paid were \$100,000, then the fringe benefit rate would be 35%.

Emergence of the term fringe benefits

Fringe benefits" as a term was first used in 1943 by the National War Labour Board of United States of America during World War II, in the context of wage freeze not being applicable to such benefits (EBRI, 2002). The board was unable to allow direct wage increases, so in place of them it encouraged companies to grant indirect benefits. In the face of a very tight ingenious form of benefits to lure marginal workers, the expenses incurred were passed on to the Government as part of cost plus contract. In India, Fringe Benefits paid in the early years of industrial development consisted mainly of gratuitous payment made by employers to deserving employees. Here also fringe benefits increased considerably during the 2nd World War.

According to a study made by the Indian Institute of Public Opinion, New Delhi in 1956, the percentage of Fringe Benefits to wages and salaries in 28 industries rose from 3.3 percent in 1946 to 5.4 percent in 1956. The second survey report regarding Fringe Benefits in



Indian Industry conducted by the Employers' Federation of India (1969) showed that Fringe Benefits account for as much as 27.11 percent of the combined wage bill of the plantation mining and manufacturing sectors. According to a study conducted by Mangla (1971), Fringe Benefits as percentage of total wage bill vary from 22 percent to 28.4 percent in the various steel plants in India and 5 percent to 38 percent in the various public enterprises in the year 1960-70. In another study conducted by Employers' Federation of India, 1964 on Fringe Benefits in India it was revealed that these account for approximately 27 percent of the total pay roll costs.

In a survey undertaken by the Employers' Federation of India in 1962, fringe benefits were defined as "payment made for time not worked, profit and other bonuses legally required, payments on social security schemes, workmen's compensation welfare cess and contributions made by employers under such voluntary schemes as catered for the past retirement, medical, educational, cultural and recreational needs of the workmen. The term also includes the

The following table shows that is liable for tax on fringe benefits in various countries:

COUNTRY	FBT levied on employers	FBT levied on employees
Australia	☺	
China		☺
Hong Kong		☺
Japan		☺
Malaysia		☺
New Zealand	☺	
Russia		☺
Singapore		☺
United Kingdom		☺
United States of America		☺

The British Institute of Management (1970) published the findings of a survey

monetary equivalent of free light. Fuel water etc paid to the workers and of subsidized housing and related services". These benefits are primarily aimed at supporting the employees towards the improvement of their environment facilities.

The 19th Annual Conference of the Indian Institute of Personnel Management at Bangalore (1967) defined fringe benefits as "those arising out of employment and not those which arise from a part of the remuneration". In a study entitled "International Comparisons of Real Wages" published by I.L.O (1956), fringe benefits have been defined as under, "Wages are often augmented by special cash benefits by the provision of medical or other services, or by payment in kind that forms part of the wage or expenditure as other goods and services. In addition, workers commonly receive such benefits as holidays with pay, low cost meals low rent housing etc. Such additions to the wage papers are sometimes referred to as fringe benefits".

on fringe benefits for executives and commented that "they can't take the place of good salary with the exception of



a car". But the problem of the concept is complicated by the fact that there are some benefits which are envisaged as fringe benefits in one country, while the same are a part of regular wages in another country.

Fringe benefits Tax in India

Fringe benefits are goods and services in addition to wage payments as conditions of employment, as incentives for greater work and efforts, as conveniences for the employer or as promoters of employee health goodwill and efficiency. In a very comprehensive study of fringe benefits, Moonman (1973) wrote that individual fringe benefits cost relatively little and although the thesis that they are a good investment is difficult to prove in conclusive terms, the general feeling in the light of experience is that this is so. The companies today are extending a basket full of benefits to their executives and these are increasing at a much faster pace as compared to their salaries and have assumed newer dimensions and proportions over the last few decades.

Fringe Benefit Tax is one more addition made under the Income Tax Act to the already existing burden of Income Tax, Surcharge, Cess, Interest Tax, Dividend Tax, Minimum Alternate Tax, Securities Transaction Tax and Banking Cash Transaction Tax. The Finance Minister while presenting Budget 2005 stated that this new tax is introduced to tax, in the hands of employer, the benefits collectively enjoyed by employees. However, the provisions of this new tax indicate a totally different picture. Many expenses incurred by employer, which have no direct or indirect benefit to employees, individually or collectively, are under the ambit of Fringe Benefit Tax. How could this happen? What is the solution? Is it because the

Government blindly adopted the system that existed in Australia and New Zealand, without modifying it into Indian requirements or Was the Government keen on making up the budget deficit by introducing new taxes which has ambiguity in it, thereby harassing and tax payers and raking up the revenue.

The Indian model of Fringe Benefit Tax is similar to that of Australia and New Zealand. In the Indian model of Fringe Benefit Tax, the benefits have been broadly classified into two categories, viz;

1. Fringe Benefits identifiable with employees.
2. Deemed Fringe Benefits.

Fringe Benefits identifiable with employees: This category includes- Any privilege, service, facility or amenity provided by employer to employees, including former employees, directly or indirectly by way of reimbursement or otherwise; Free or concessional tickets for private journeys of employees/their family members; and Contribution by employer to approved superannuation fund for employees.

Valuation of Fringe Benefits: These fringe benefits are valued, for the purpose of levying fringe benefit tax, on various bases. The following table summarizes the basis of valuation:



Fringe Benefit	Taxable Value of the Benefit
Free or Concessional tickets provided for private journeys	As provided by employer to general public as reduced by any amount paid or recovered
Employer's contribution to an approved superannuation fund	Actual Expenses
Other privilege, service, facility or amenity	Presumptive Basis

Most fringe benefits fall under presumptive basis category. Presumptive method is most preferable compared to discretionary method of valuing fringe benefits for the following reasons:

DISCRETIONARY METHOD	PRESUMPTIVE METHOD
High Compliance Cost	Low-compliance Cost
High Administrative Cost	Low Administrative Cost
Accommodate personal circumstances	Assumes homogeneity
Potential for disputes	Limited scope for disputes
Opportunity for corruption	No opportunity for corruption.

1. When Fringe Benefit Tax was first proposed and introduced, there existed a lot of confusions and clarifications. For clarifying all the

nuances the Central Board of Direct Taxes issued a circular on 29th of August, 2005. However, the clarifications seem to justify in a very illogical manner, a totally unjustifiable tax. The following points present a discussion on the unjust of fringe benefit tax and its non-compliance with its basic purpose and objective:

2. The taxation of perquisites or fringe benefits is justified both on the grounds of equity and economic efficiency. When fringe benefits are under-taxed, it violates both horizontal and vertical equity. A tax payer receiving his entire income in cash bears a higher tax burden in comparison to another tax payer who receives his income partly in cash and partly in kind, thereby violating horizontal equity. Further, fringe benefits are generally provided to senior executives in the organization. Therefore, under-taxation of fringe benefits also violates vertical equity. It also discriminates between companies which can provide fringe benefits and those, which cannot, thereby adversely affecting market structure. However, the taxation of fringe benefits raises some problems primarily because –

- (a) all benefits cannot be individually attributed to employees, particularly in cases where the benefit is collectively enjoyed;
- (b) of the present widespread practice of providing perquisites, wherein many perquisites are disguised as reimbursements or other miscellaneous expenses so as to enable the employees to escape / reduce their tax liability; and
- (c) of the difficulty in the valuation of the benefits.

In India, prior to assessment year 1998-99,, some perquisites/ fringe benefits were included in salary in terms of section 17 and accordingly taxed under



section 15 of the Income-tax Act in the hands of the employee and a large number of fringe benefits were taxed by the employer-based disallowance method where the quantum of the disallowance was estimated on a presumptive basis. In practice, taxation of fringe benefits by the employer-based disallowance method resulted in large-scale litigation on account of ambiguity in defining the tax base. Therefore, the taxation of fringe benefits by the employer-based disallowance method was withdrawn by the Finance Act, 1997. However, the withdrawal of the provisions relating to taxation of fringe benefits by the employer-based disallowance method resulted in significant erosion of the tax base. The Finance Act, 2005 has introduced a new levy, namely, The FBT as a surrogate tax on employer, with the objective of resolving the problems enumerated above, expanding the tax base and maintaining equity between employers.

3. A new concept is being enumerated for collection of revenue and it is the ground of equity and efficiency for which new words like vertical and horizontal equity etc. have been invented without considering the fact that still proprietorship and HUF concerns are out of the ambit of FBT and this in turn converted the whole matter into the subjective equity.

4. The Finance Minister, while presenting Budget 2005, stated that "I now propose that where the benefits are usually enjoyed collectively by the employees, they shall be taxed in the hands of the employer". But, there are many items of 'deemed fringe benefits' which gives no benefit to employees, whatsoever, like:

- (a) expenditure incurred by employer on conducting conference for agents, dealers, etc.
- (b) payment made to brand ambassador and celebrities,
- (c) free samples distributed,
- (d) expenditure on free offers such as freebies like tattoos, cricket cards or similar products, to trade or consumers (excluding employees) including expenditure incurred on the artwork or for the payment of royalty charges of such freebies,
- (e) hotel stay and air tickets of customers and clients,
- (f) salary to car drivers and flight pilots,
- (g) gifts to distributors and retailers, and
- (h) scholarships.

The levy of fringe benefit is contradicting with the basic purpose with which it was levied.

Conclusion

Such unjustified clarification without matching the intention clearly expressed at the time of presenting the original budget by the Finance Minister is an indication of the loophole existing in the administration system of the Nation. When can this be plugged? Already, Companies have shelled down huge amount as Fringe Benefit Tax and many companies have restructured their packages to employees, resulting in lesser benefits to employees. Was this the intention of introducing FBT. Therefore, from the above we can clearly understand the reason why the center(Finance Ministry) has enacted this Fringe Benefit Tax. This will surely act as a boon as this tax is nothing but an economic security measure that is enhanced by the Government in order to achieve the equality and also increase the government fund through a rightful mean. Hence, FBT is constitutionally



valid. Whereby, it's time for the Government to make clarifications as to the doubts that has raised in the application of FBT.

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