

Fringe Benefit Tax

The Finance Bill, 2005 has introduced Chapter XII-H providing for the levy of Income-tax on fringe benefits. This chapter levies an additional income-tax on the cost of fringe benefits offered by employers to their employees. Conceptually it may be viewed that the fringe benefit tax is a tax on expenditure incurred by employers on their employees and thus strictly speaking does not constitute a tax on income. It is for consideration whether the cost of the fringe benefits which constitutes the tax base should be deemed to be income under the Income-tax Act. A similar provision is contained in section 115JB. There are many grey areas in these new provisions. This article deals with this new tax.

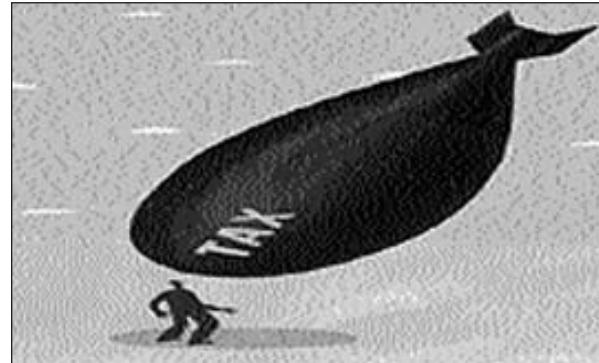
—H.N. Motiwala

The Finance Minister P. Chidambaram in his Budget speech at para 160 of the Budget 2005-06 has observed as under:

"I have looked into the present system of taxing perquisites and I have found that many perquisites are disguised as fringe benefits, and escape tax. Neither the employer nor the employee pays any tax on these benefits, which are certainly of considerable material value. At present, where the benefits are fully attributable to the employee they are taxed in the hands of the employee; that position will continue. In addition, I now propose that where the benefits are usually enjoyed collectively by the employees and cannot be attributed to individual employees, they shall be taxed in the hands of the employer. However, transport services for workers and staff and canteen services in an office or factory will be outside the tax net. The tax is not a new tax, although I am obliged to call it by a new name, namely, Fringe Benefits Tax. The rate will be 30 per cent on an appropriately defined base."

Backdrop

The taxation of perquisites or fringe benefits provided by an employer to his employees, in addition to the cash salary or wages paid is subject to varying treatment in different countries. These benefits are either taxed at the hands of the employees themselves or the value of such benefits is subject to a 'fringe benefit tax' at the hands of the employer. The rationale for levying a fringe benefits tax on the employer lies in the inherent difficulty in isolating the 'personal element' where there is collective enjoyment of such benefits and attributing the same directly to the employee. So, this is especially where the expenditure incurred by the employer is ostensibly for purposes of the business but includes, in partial measure, a benefit of a personal nature. Moreover, in cases where the employer directly reimburses the employee for expenses



incurred, it becomes difficult to effectively capture the true extent of the perquisite provided because of the problem of cash flow in the hands of the employer.

Therefore, it is proposed to adopt a two-pronged approach for the taxation of fringe benefits under the Income-tax Act. Perquisites, which can be directly attributed to the employees, will continue to be taxed at 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. In cases, where 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, it is proposed to levy a separate tax known as the **fringe**

The author is a Central Council Member of the Institute. He can be reached at hnmco@vsnl.net

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.

Charge of fringe benefit tax

Under the proposed provisions, fringe benefit tax is a 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; 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

provisions of this Act.

What are fringe benefits

Fringe benefits as outlined in section 115WB means 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.

Further, as per the provisions of the proposed section, the fringe benefits shall be deemed to have been provided if the employer has incurred any expense or made any payment for the purposes of (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 aircrafts; (o) consumption of fuel other than industrial fuel; (p) use of telephone; and (q) scholarship to the children of the employees.

How to value fringe benefits

The method of computation of the value of fringe benefits for purposes of levy of the fringe benefit tax is provided in section 115WC as the aggregate of:-

- (a) Cost of free or concessional tickets for private journeys of the employees or their family members as provided by the employer to the general public as reduced by any amount paid or recovered from the employee;
- (b) The actual amount of contribution made by the employer to the approved superannuation fund;
- (c) fifty per cent of each of the expenses enumerated as items (a) to (j) in the earlier paragraph;
- (d) 20 per cent of each of the expenses enumerated as items (k) to (o) mentioned in above paragraph;
- (e) 10 per cent of use of telephone mentioned in as item (p) in aforesaid para; and
- (f) Actual amount incurred in providing scholarship referred to as item (q) of the above-referred para.

However, in cases, where the employer is engaged in the business of carriage of passengers or goods by motorcar or by aircraft, a five percent of expenses on

repair, running and maintenance of motorcars or aircrafts or fuel expenses has been specified instead of fifty per cent. Similarly, for hotels, a five per cent, instead of fifty per cent, of the expenses incurred on hospitality has been specified for purposes of calculating the liability under the fringe benefit tax.

Return of fringe benefits

The proposed new section 115WD relates to return of fringe benefits. It, *inter alia*, provides that every person being an employer, who has paid or made provision for payment of fringe benefits to his employees during the previous year, is required to furnish on or before the due date a return of fringe benefits to the Assessing Officer. The provisions contained in the said new section 115WD relating to return of fringe benefits are broadly on the lines of section 139 of the Income-tax Act.

Assessment

The proposed new section 115WE relates to assessment. It, *inter alia*, provides that if any tax or interest is found due on the basis of the return of fringe benefits made under section 115WD, after adjustment of any advance tax paid and any amount paid otherwise by way of tax or interest, an intimation shall be sent to the assessee specifying the sum so payable which shall be deemed to be a notice of demand issued under section 156. The provisions contained in the said new section 115WE relating to assessment of fringe benefits are broadly on the lines of section 143 of the Income-tax Act.

Best judgment assessment

The proposed new section 115WF

relates to best judgment assessment. It, *inter alia*, provides that if an employer fails to furnish a return of fringe benefits under section 115WD or having made a return, fails to comply with all the terms of a notice issued under sub-section (2) of section 115WE, the Assessing Officer shall, after taking into account all relevant material and after giving the assessee an opportunity of being heard, make the assessment of the fringe benefits to the best of his judgment and determine the sum payable by the assessee or refundable to the assessee on the basis of such assessment. The provisions contained in the said new section 115WF relating to best judgment assessment of fringe benefits are broadly on the lines of section 144 of the Income-tax Act.

Escaping the assessment

The proposed new section 115WG relates to fringe benefits escaping assessment. It, *inter alia*, provides that where the Assessing Officer has reason to believe that any fringe benefits chargeable to tax has escaped assessment for any assessment year, he may assess or reassess such fringe benefits and also any other fringe benefits chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section. The provisions contained in the said new section 115WG relating to fringe benefits escaping assessment are broadly on the lines of section 147 of the Income-tax Act.

Issue of notice for escaped assessment

The proposed new section 115WH relates to the issue of notice where fringe benefits have escaped assessment. It, *inter alia*, provides that where fringe benefits have escaped assessment, before making

the assessment or reassessment under section 115WG, the Assessing Officer shall serve a notice on the assessee requiring him to furnish a return of fringe benefits within the prescribed period and in the prescribed form and manner, setting forth such particulars as may be prescribed. However, no such notice shall be issued for the relevant assessment year after the expiry of six years from the end of the relevant assessment year. It has also been provided that where an assessment under sub-section (3) of section 115WE or section 115WG has been made for the relevant assessment year, no notice shall be issued under this section, after the expiry of four years from the end of the relevant assessment year, unless the Chief Commissioner or Commissioner is satisfied, on the reasons recorded by the Assessing Officer, that it is a fit case for the issue of such notice.

Payment of fringe benefit tax

The proposed new section 115WI relates to payment of fringe benefits tax. It, *inter alia*, provides that irrespective of the fact that the regular assessment in respect of fringe benefits is to be made in a later assessment year, the tax on such fringe benefits shall be payable in advance during any financial year, in accordance with the provisions of section 115WJ.

Advance Tax

The proposed new section 115WJ relates to advance tax in respect of fringe benefits. It, *inter alia*, provides that every employer shall pay advance tax on his current fringe benefits. The amount of advance tax payable in the financial year shall be thirty per cent of the value of the fringe benefits paid or payable in each quarter. The advance tax shall be

UNION BUDGET 2005-06

payable on or before 15th day of the month following such quarter. It has also been provided that the advance tax payable in relation to the quarter ending on 31st March of the financial year shall be paid by the assessee on or before 15th March of the said financial year. It has also been provided that where an assessee, fails to pay the advance tax for any quarter or where the advance tax paid by him is less than thirty per cent of the value of fringe benefits paid or payable in that quarter, he shall be liable to pay simple interest at the rate of one per cent on the short fall, for every month or part of a month for which the shortfall continues.

Consequence of non-furnishing or delayed furnishing of return

The proposed new section 115WK relates to interest for default in fur-

nishing return of income. It, *inter alia*, provides that where the return of fringe benefits for any assessment year under section 115WD is furnished after the due date, or is not furnished, the employer shall be liable to pay simple interest at the rate of one per cent for every month or part of a month comprised in the period commencing on the date immediately following the due date and ending on the date of furnishing of the return or where no return is furnished ending on the date of completion of the assessment under section 115WF. The interest shall be charged on the amount of fringe benefit tax determined under sub-section (1) of section 115WE or on regular assessment as reduced by the advance tax paid under section 115WJ. The provisions contained in the said new section 115WK relating to interest for default in furnishing

return of fringe benefits are broadly on the lines of section 234A of the Income-tax Act. The fringe benefit tax shall not be allowed as deduction.

Application of other provisions of I-T Act

The proposed new section 115WL relates to application of other provisions of the Income-tax Act. It, *inter alia*, provides that save as otherwise provided in Chapter XII-H, all other provisions of the Income-Tax Act shall apply in relation to fringe benefits also.

Effective date of applicability

This amendment will take effect from 1st April 2006 and will, accordingly, apply in relation to the assessment year 2006-2007 and subsequent years. ■

AD