COLLECTIVE EMPLOYEE BENEFIT TAX: IS THE LAW ADEQUATE AFTER THE ABOLITION OF THE FBT?

JAYANTH V*

INTRODUCTION

Imagine a situation where 2 classes of employees 'A' and 'B' who do the same work in the same company and therefore earn same salaries. However 'B' employees are given certain benefits apart from the salary. These benefits are not given to each individual, rather they are given to all collectively therefore making it difficult to attribute 'x' amount of benefit to each individual; for example in the table below we cannot say that every 'B' employee gets 2 pizzas each.

	Employees 'A' – 10 in number	Employees 'B'-10 in number
SALARY	Rs.100 each	Rs.100 each
BENEFITS	No benefits what so ever	• 20 pizzas are provided for lunch to all collectively • Stationery at the disposal of the employee; some of which the employees take home • Transportation facility
AFTER INCOME TAX OF 30%	Rs. 70 left in hand	Rs. 70 left in hand

'B' employees are not paying any tax on the benefits provided to them. This is because firstly the employer would say that these benefits are incurred cost for running the business and therefore is deducted from tax; and secondly because we cannot say how much benefit was attributed to each individual as these are 'collective benefits'[1]. While both 'A' and 'B' employees pay the same amount of tax the total benefits enjoyed by

*Fourth Year, B.A. LL.B.(Hons.), *National Law School of India University*, Bangalore.

[1]Collective benefits are those benefits which are provided to the employees not individually but collectively; this therefore makes it difficult for the taxing authorities to attribute the amount of benefit each person received.

them is certainly different leading to what is called violation of horizontal equality.[2]

- In order to overcome this inequality the Fringe Benefit Tax (hereinafter FBT) was introduced by way of an amendment to the Income Tax Act (hereinafter IT Act)[3] to tax benefits enjoyed collectively[4]. Under the FBT regime the collective benefits which could not be attributable to each individual were taxed in the hands of employer instead. This created a lot of problem as now the employers were taxed for benefits which were given collectively to the employees; which only served as a disincentive for the employer to provide any benefits. Due to lobbying and political pressure etc., FBT was finally scrapped in 2009 and the "fringe benefits" were sought to be taxed as perquisite in the hands of the employee.[5] While individual benefits could be taxed in the hands of the employees as perquisite the amendment was not clear on taxation of collective benefits.[6] This paper seeks to analyze the present position regarding taxing collective benefits and the problems associated with it and whether any changes could be brought about regarding the same.

1.1 PRESENT POSITION

As previously mentioned the law is not clear with regard to taxing collective benefits. The newly inserted section 17 (2) (viii) only says that the perquisites include any other fringe benefit as may be prescribed.[7] The newly inserted deals only with regard to ESOPs and superannuation fund in detail and not with regard to other collective benefits. According to the section "as may be prescribed" refers to Rule 3 of the Income Tax Rules which would be prescribed. There were reports in the newspaper quoting some governmental officials that the new perquisite rule would include a wider range

[2]See the 2005 Explanatory notes on the provisions relating to Fringe Benefit Tax, Circular No. 8/2005, Central Board of Direct Taxes, Department of Revenue, dated 29th August 2005. The notes state that when such fringe benefits are under-taxed it violates horizontal equality.

[3]See Explanatory notes 2005, *Id.*

[4]The FBT though was meant to tax those benefits which were collectively enjoyed i.e. those which cannot be attributed to individuals directly many benefits which could be attributable to individuals directly were also taxed under the FBT regime.

[5]See Circular No. 2/2010, Central Board of Direct Taxes, Department of Revenue, dated 29th January 2010.

[6]Amendments were made to section 17 (2) of the IT Act which sought to tax collective employee benefits under sub section (viii) in 2009. However the previous amendments relating to ESOPs created so much controversy that while bringing about the 2009 amendment other collective employee benefits seems to have been completely ignored.

[7]Section 17 (2) (viii) states that perquisites include "the value of any other fringe benefit or amenity as may be prescribed".

of perquisite as existed before the FBT regime.[8] However the government seems to have retained the perquisite valuation rules as it existed before the FBT regime with only minor changes in regard to use of car and food vouchers. Rule 3 of the Income Tax Rules is the same as it existed before the 2009 amendment with no new additional benefits having been included in it. The valuation of perquisites as it exists now relates to only taxing benefits which can be attributed to the employee directly. Our problem lies in the fact that there has been no clear clarification which has been made with regard to taxing collective benefits which are not individually attributable.

1.2 CONSEQUENCE OF ABOLITION OF FBT

As previously mentioned there is no clear clarification regarding taxation of collective benefits. Nor is there any report or document published by the authorities which has illustrated how the collective benefits would be taxed. In such confusion there could be two possible consequences. Firstly such benefits could easily escape taxation for the law does not clearly provide for it. The law is clear that we cannot read into the IT Act any extraneous meaning when it has not been explicitly provided for.[9] The second consequence is that the authorities might tax such benefit on notional value. Every employee may be deemed to have received a certain amount of benefit.[10] The problem in such an approach would be that an individual would not have derived a notional amount of benefit; he or she might have received either more or less or may have not received any benefit at all in which case it would not result in equity.

Given the above complexity of taxing would it not be convenient to just exempt collective benefit tax given the fact that FBT has drawn huge criticism for its accounting hassle and also the contribution of collective benefit tax seems to be minimal[11] ? The researcher would like to answer in negative. Though it might seem that the FBT contribution is

[8] "More items will now come under perquisite taxation than what was covered prior to 2005-06" as per a Senior Government Official. ET Bureau *"Employees will now have to bear the FBT burden"* THE ECONOMIC TIMES, (July 8, 2009), available at http://economictimes.indiatimes.com/Employees-will-now-have-to-bear-the-FBT-burden/articleshow/4751321.cms. (Last visited on August 29, 2009).

[9] *CIT v Ajax Products Ltd.* [1965] 55 ITR 741 (SC), where the Court upheld an earlier case which had said "In a taxing Act one has to look merely at what is clearly said. There is no room for any intendment".

[10] For example if there are 10 employees and 20 pizzas are provided on a particular day as fringe benefits then each employee would be deemed to have consumed 2 pizzas.

[11] S. Hamsini Amritha, "FBT abolition: Minimal impact", THE HINDU BUSINESS LINE, (July 7, 2009), available at http://www.blonnet.com/2009/07/07/stories/2009070751662200.htm. (Last visited on 29th August, 2010). "FBT accounts only for 0.6% of the total taxes collected. However this 0.6 per cent alone is Rs 7997 crores which is a humungous amount."

minimal, in a multi-million dollar taxing regime such minimal contributions makes a huge impact. That apart why we need to have tax on collective benefits is that if it is not taxed it has the potential to be misused which could result in huge loss of revenue to the government. If not taxed it could be used as a tool by employers to provide more of collective benefits to employees and reduce the salary thereby allowing the employees to be taxed at a lower rate as compared to another similarly placed employee thus violating horizontal equality.[12]

2.1 FAILURE OF THE FBT

The researcher therefore would like to propose a working solution to tax collective benefits in the current regime. But before going into that we need to learn lessons from the failure of the FBT; why a regime which was so promising failed to deliver.

2.2 OVERLAP OF PERQUISITES AND FRINGE BENEFITS

Fringe benefits were meant to tax only those benefits which were not capable of being attributable to an individual. However when the FBT regime was introduced many benefits which were earlier taxed in the hands of employees was made subject to the FBT. Examples of this include free meal cards, club membership maintenance of car which was earlier taxed as perquisite was now transferred to the employee.[13] The overlap results when we read sections 115WB (1), (2) and (3). Subsection (3) excludes the taxation of benefits in respect of which tax is payable or paid by the employee.[14] However subsection (3) of 115WB applies only to the fringe benefits provided in subsection (1) and not to those provided in (2) of 115WB.[15] Therefore if there is any

[12]The Chelliah Committee on Tax Reforms in the previous decade had expressed that in a regime of income taxation which is based on comprehensive income concept it becomes important to bring all the benefits under taxation if not equity suffers and there would be an impetus for wasteful use of resources. See TCA Sangeetha, "Taxation of Fringe Benefits", (2001) 170 *CTR (Articles)* 102.

[13]Compare for example Rule 3(7) of the Income Tax Rules prior to the FBT regime and during the FBT regime. Sub rules (ii) to (vi) are no longer taxed in the hands of employees. Some of them include the value of travelling which can be easily attributable to a particular individual.

[14]Section 115 WB (3) states that "For the purposes of sub-section (1), the privilege, service, facility or amenity does not include perquisites in respect of which tax is paid or payable by the employee [or any benefit or amenity in the nature of free or subsidized transport or any such allowance provided by the employer to his employees for journeys by the employees from their residence to the place of work or such place of work to the place of residence.]"

[15]The section clearly reads as *"for the purpose of subsection (1)"*.

benefit provided under 115WB (2) it not only will be taxed as fringe benefit in the hands of the employer but also as perquisites in the hands of the employee which could lead to the problem of double taxation, as it may not benefit all the employees.[16]

2.3 DEEMING PROVISION

The FBT contained a deeming provision in section 115WB (2) which basically stated that in case where the employer has incurred any expense with regard to some of the benefits provided under the said section then the law would deem that the employer has provided such benefits to the employees and therefore the employer would be subject to a flat FBT[17] i.e. the moment the employer incurs any sort of expenses on providing any benefit (even though it may be purely for conducting business in which case it can be deducted as expenses) the law would deem that benefit has been provided. This creates a legal fiction wherein the authorities need not show any link between the expense incurred by the employer and the benefit derived by the employee;[18] the test rather is to see whether any expense has been incurred or not. In countries like Australia and New Zealand which have adopted the employer based taxation method there is the absence of such a deeming provision.[19] A result of such a deeming provision would act as disincentive to the employer who seeks to provide some sort of benefit to his or her employees. For example contribution by the employer to the superannuation fund of the employees was target under the FBT regime[20]; in such cases a reasonable employer would not naturally want to make any contribution to it thereof. Such provisions are absent in the Australian Law (The Fringe Benefit Tax Assessment Act, 1976).

2.4 PRESUMPTIVE TAX

Another feature of the FBT was that it was a presumptive tax. The basis of levying a FBT on the employer is due to the fact that it becomes impossible to carve out the "personal element" when the benefit is ostensibly for the purpose of the business but also include

[16]TR Nagarajan., "Features of Fringe Benefit Tax", 148 (1) *Taxman (Articles)* 120, 2005 at page 201.

[17]Section 115 WB (2) reads as The fringe benefits shall be ***deemed*** to have been provided by the employer to his employees, if the employer has, in the course of his business or profession (including any activity whether or not such activity is carried on with the object of deriving income, profits or gains) incurred any expense on, or made any payment for, the following purposes.....[emphasis added]

[18]Rao R, "Fringe Benefit Tax in India", 149 *Taxman (Articles)* 52, at page 55.

[19]See Philip Burges, "Reforming Fringe Benefits Taxation", 10 *UNSW Law Journal* 241, 1987, which deals with the taxation of collective benefits in Australia by comparing the same with the law in New Zealand.

[20]See section 115 WB (1) (c) of the IT Act, according to which fringe benefits would include "any contribution by the employer to an approved superannuation fund to the employees".

in some measure, a benefit of a personal nature.[21] The law basically presumes that a certain percent of the benefit which is provided would always be personal benefit as the expenditures are not classified into benefits which would go to the employee and those that would not. Presumptive tax superficially seems to be good step, for it would help circumvent administration and accounting hassle. However presumptive taxation with regard to the FBT regime suffers due to its association with the deeming provision. The moment the deeming provision comes into picture the assessee is charged a presumptive tax irrespective of the fact whether the benefit has actually accrued to the employees or not. That is to say the moment any expense is incurred by the employer towards any of the purposes mentioned in section 115 WB (2), naturally the law would deem that fri ge benefits are provided and further the law would presume of the deemed fringe benefit which would be provided a particular portion/percent of it is a "personal benefit" and not something for which the employer could claim deduction. Therefore in essence there might be situations where the employer would be taxed though absolutely no benefit would have accrued to the employee. The presumptive method therefore as compared to a discretionary method does not give any opportunity to the assessee to show that no benefit was provided or intended to be provided or even indirectly resulted in any benefit to the employee.[22]

3.1 REVAMPING THE FBT

Given the above problems that were faced under the FBT regime what changes could be made to revamp the FBT so that it could be used to effectively tax collective benefits. The most important point that needs to be kept in mind here is to identify the patterns of fringe benefits and how each pattern is going to be taxed.[23]

3.2 CATEGORIES OF FRINGE BENEFITS

A. Benefits for which the employee could claim deductions as expense i.e. the employer incurs expense as a result of compensation: Under this category there should be no FBT, there should be complete exception. This is what is followed in countries

[21]Memorandum explaining the provisions of the Finance Bill, 2005, cited from Dr. Tejinder Singh, "FBT: A detailed analysis in light of the Circular No 8/2005", 148 (1) *Taxmann (Articles)* 55, 1st October 2005, at page 58.

[22]*Ibid* 18 at 54.

[23]See for example William D Popkin, "The Taxation of Employee Fringe Benefits", 22 (3) *Boston College Law Review* 439, March 1981. In this particular article the author states that the reason why it is so difficult to adopt a comprehensible and workable approach is due to the variety of fringe benefits that are available. Therefore the initial step towards managing the complexity of the problem is to identify patterns which are useful for tax policy. The author further classifies fringe benefits into three categories, however the said classification is not considered in this paper.

like US, Australia and from the reading of answer to question no. 37 of the explanatory notes to the provisions relating to the Fringe Benefit Tax it seems that the FBT regime also held the same position.

B. Benefits wherein the employee would receive complete personal benefit and that which does not fall in the above category: Under this category the received benefits may be taxed in the hands of the employer at a flat rate.[24] The employer can pass on this tax to the employee at a notional rate.[25] It is to be noted here that this category did not exist in the FBT regime. Any benefit under this category would be taxed as perquisite if it could be individually attributable or it cannot be attributable it would taxed under FBT in which case it would be under-taxed.[26]

C. Benefits which have a "personal element" in them i.e. benefits which are ostensibly intended to provide under category "A" but would include a benefit of a personal nature: This is probably the most painstaking category. If we want to come out of the FBT regime and its problems the presumptive tax needs to go and must be replaced by the discretionary method which would give the opportunity for the employer to show whether any benefit was intended or not and if it were intended then the amount of it.[27] While it is true that this creates an accounting hassle it is not suggested that discretionary method be used in all situations; it is suggested that only where discretionary method could not be made use of should presumptive method be used i.e. presumptive taxation must be made an exception and not a rule.

3.3 SCRAPPING THE DEEMING PROVISION

As previously shown, one of the main criticism against FBT was its deeming provision. It is therefore suggested that the deeming provision be scrapped and an opportunity be

[24]Here we are having a flat rate because the entire benefit is a personal benefit unlike category C wherein there is partial personal element.

[25]We are forced to use a notional rate here because otherwise it would become impossible to tax as computation is not possible.

[26]Illustration: An employer gives Rs 100 benefit to his/her employees and the full Rs 100 is personal benefit. Under the FBT regime only Rs 20 is presumed to be a personal benefit and therefore the tax is only on Rs 20. This is in spite of the fact that when it is clear that it is a personal benefit. However in case of the approach taken in this paper the entire Rs 100 would be deemed as a fringe benefit.

[27]Illustration: An employer gives Rs 100 benefit to his/her employees. Of this only Rs 10 is personal benefit. In cases of a presumptive tax, tax would be levied on Rs 20 and not Rs 10 which would result in an extra tax burden. Or for that matter if the personal benefit is Rs 30 then it would result in under-taxation.

provided to the assessee to show that there is no nexus between the expense incurred by the employer and the benefit enjoyed by the employees.

CONCLUSION

The answer to the question whether the law is adequate in taxing collective benefits has been answered in negative and the reasons for the same have been put forth. Further the researcher has proposed a model which could simplify the law relating to the same. The question is whether the proposed model would work or not, for it might give an impression that there would be too much accounting hassle. The researcher believes it would if the government would select only a particular range of benefits to be taxed as fringe benefits and let some range of it escape the tax, while limiting the value of such benefits.[28] The reason is that if FBT is used as a residuary provision to cover every type of collective benefit it would be difficult to harmoniously administer the same as there are some fringe benefits which by nature would be better if left untaxed.[29] However it must be ensured that the value of such benefits be limited.

[28]Victor Thuronyi, *Comparative Tax Law* 251, (1st Edn., Kluwer Law International: Netherlands, 2003).

[29]For example *De minimis* fringe benefits which would be cumbersome to take into account. The basis of this is that there is no point in spending so much money trying to assess the fringe benefits and tax them as the tax which may be collected in such cases may be low. *Ibid* at 252.