

# FRINGE BENEFITS UNDER INDIAN INCOME TAX ACT 1961

[A Case Study of Their Valuation and Audit Procedure]

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**Abstract :** Fringe Benefits is a comprehensive concept which include both monetary and non-monetary benefits derived from employment that doesn't constitute cash salary or wages and an employee get it in addition to regular salary or wages. The tax liability of salary is never been question. As long as employees are getting cash salary and allowances, it is easy to quantity taxable income. But however with corporation turning more and more towards non-cash benefits [i.e. fringe benefits] it become difficult to quantity taxable income of employees. This paper tries to explain meaning, types, valuation and audit procedure of Fringe Benefits under Indian Income Tax Act - 1961 specially after abolishing Fringe Benefit Tax (which taxable in Hand of Employer) by The Finance Act - 2009 w.e.f. Assessment Year 2010-11.

**IndexTerms - Fringe Benefit Tax (FBT), Assessment year (AY), Previous year (PY), With effect from (w.e.f.), Maximum Outstanding Balance.**

## I. INTRODUCTION

We know that salary is an important part of income of man persons working in any organisation. The Tax liability of salary is never been question. However, with the repaid industrialisation and economies becoming more and more competitive, it become necessary to give employees not only good salary but also cash and non-cash benefits. For example - Free accommodation, car facility, medical facility, entertainment facility, leave travel concession, interest free loan, credit card facility, free food, gift etc. As long as employees are getting cash salary and cash allowances it is easy to quantity taxable income. However, with corporation turning more and more towards non-cash benefits it becomes difficult to quantity taxable income of employees.

The Income Tax Act - 1961 contains provision for taxation of non-cash benefits like free accommodation, car facility, medical facility, etc. The Act provides exemption in some case. Over the year Government realised with experience that with all the efforts to bring to tax non-cash benefits a scope for tax evasion was always left-open.

The first reason responsible for tax evasion was the difficulty in getting accurate information by employer to his employees. The second reason was the difficulty regarding valuation of such non-cash benefits.

The Government took many measures to overcome these problems. It framed elaborate rules of valuation of benefit also called perquisites. It required employer to provide information of perquisites provided to their employees in the annual return of tax deducting at source. However that was not much success achieved in bringing to tax the full value of perquisites enjoyed by employees.

## Meaning of Fringe Benefits

Fringe Benefits is a comprehensive concept which include both monetary and non-monetary benefits derived from employment that does not constitute cash salary or wages and an employee get it in addition to regular salary or wages. It includes various types of payments, services, facilities and welfare plans which fulfill the salary of employee and for which nothing is to be paid by employee. These benefits may be personal or collective immediate or long-term and are financial. These types of benefits increase efficiency, life-level and moral of employee and helps to establish industrial relation in economic world.

## Objects of Fringe Benefits

Fringe Benefits are depend upon payment capacity and Labour-power. At the time of determining Fringe Benefits Programme cost, payment capacity, needs of employees, various taxes, public-relation, social responsibility and reaction of employees must be considered Fringe Benefits programe fulfill the following objects :

- (i) To provide equal benefits to the employees of own organisation as compare to other in market.
- (ii) To increase the income of employee
- (iii) To maintain adequate level of skilled and experienced man power.
- (iv) To increase moral of employees by providing necessary paid vacation on occasion of social and religious events.
- (v) To increase production and industrial peace.
- (vi) To fulfill economic, social and psychological needs of employees by organising various programes.
- (vii) To help in participate labour conferences or seminars.
- (viii) To increase income and personal and social satisfaction of employees.
- (ix) To ensure forced savings for retirement and bad time.
- (x) To giving tax consideration
- (xi) To enhance motivational level.
- (xii) To reduce the rate of absenteeism.

## Types of Fringe Benefits

In Indian, various types of benefits provided by employer to his employee which are classified into following five categories :

- A. *Payment for Time not worked*
  - Paid Vacation
  - Paid Holiday
  - Voting pay allowances
  - Shift premium
  - Grievance time
  - Bargaining time
  - Sick leave with pay
- B. Employee security
  - Retrenchment compensation
  - Lay-off compensation
  - Continuous and minimum wages
  - Job security
- C. *Safety and Healthy*
  - Safety measures
  - Workmen's compensation
  - Health benefit
  - Sickness benefit
  - Maternity benefit
  - Disablement benefit
  - Dipendent benefit
- D. *Personal Services and Family Benefit*
  - Canteen facility

- Consumer stores
- Credit societies
- Holiday Homes
- Educational facilities
- Tour and Travel
- Transportation
- Loan Program
- On site child care facility
- On site fitness and medical facility
- Stock option
- Adoption Assistance
- Elder Care facility

E. *Old Ageds and Retirement Benefits*

- Old age survivors
- Disability and Health insurance
- Provident Fund
- Pension Scheme
- Gratuity
- Old ager assistance
- Old ager counselling
- Job to son or daughter of deceased employees

## II. TAXATION OF FRINGE BENEFITS

Taxation of Fringe Benefits raises some problems primarily because :

- [A] All benefits cannot be individually attributed to employee, particularly in case where the benefits are collectively enjoyed.
- [B] Of the present widespread practices of providing perquisites where in many perquisites are disguised as reimbursements or other miscellaneous expenses so as to enable the employees to escape/reduce their tax liability.
- [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 hand of employee and a large number of fringe benefits were taxed by the employer-based disallowances method where the quantum of the disallowances was estimated on a presumptive basis.

In practice, taxation of fringe benefits by the employer-based disallowances methods resulted in large scale litigation on account of ambiguity in defining the tax base. Therefore, the taxation of fringe benefits by the employer based disallowances method was withdrawn by the Finance Act-1997. Now again, The Finance Act-2005 has imposed a new tax - Fringe Benefit Tax on the employer CDBT termed "FBT" as a "surrogate tax" on the employer. The provision relating to this new chapter XII-H (Section 115W to 115WL) of the Income Tax Act - 1961, introduced by Finance Act - 2005 with effect from Assessment year 2006-07. With introduction of FBT and the consequential amendment perquisites or fringe benefit given by employer to his employees were treated as :

- I. Fringe Benefits / perquisites are chargeable to FBT in the hand of employers and exempted for income tax in hand of employee.

II. Fringe Benefit taxable or income (salary) in the hand of employee and exempted from FBT in employers hand.

III. Fringe Benefits / perquisites exempted in the hand of both employers as their employees.

The rationale for FBT on employee that certain fringe benefits can't be attributable to individual employees as these are enjoyed by employees collectively. Therefore, these collective fringe benefits are to be taxed in the employer's hand by imposing FBT on employers. But, those benefits which are fully attributable to the employee they are taxed in the hand of employee.

The main aim of Fringe Benefits Tax is to bring some of such facilities provided by the employer to their employees on which neither employer nor employees paid any tax. Now, only employers have to pay the tax, but the aim to bring. FBT become wrong gradually, because on some of the indispensable needs employer had to pay tax. So this provided opposite to the aim of income-tax. Aim of the Income Tax is to tax on income, but FBT became one of the taxes on expenses.

Due to several reason Fringe Benefits Tax was the matter of debate, promoted the paper work, increased collecting expenses and become burden over employer. So finally it was abolished by the Finance act 2009 with effect from AY 2010-11 by a new section 115 WM.

### III. VALUATION OF PRESCRIBED FRINGE BENEFIT OR AMENITIES RULE 3(7)

With effect from Assessment year 2010-11 Fringe benefits provided by Employer to his employees are taxable in the hand of employer and become part of taxable salary. In term of Sec. 17(2) (VIII) the value of following benefits or amenities are to be included in the income of employee.

1. Interest free or concessional loan
2. Holiday Enjoyment
3. Free Food
4. Gift
5. Expenses charge to a credit card
6. Club expenses
7. Use of movable Assets.
8. Transfer of Movable Assets
9. Any other benefit or amenity

#### 1. Interest free or concessional loan 3(7) (I)

Where the employer or any other person on his behalf has made available interest-free or concessional loan to the employee or any member of his household, the value of benefits shall be determined as under :

- [A] Where the amount of loans in the aggregate during previous year doesn't exceed Rs. 20,000. The value shall be taken as NIL.
- [B] Where loans are made available medical treatment in respect of diseases specified in Rule-3A (eg. - cancer, tuberculosis, AIDS, etc.) - The value shall be taken as NIL. However, the exemption shall not apply to so much of the loan has been reimbursed to the employee under any medical insurance scheme.

For example, the employer has taken a loan from his employer Rs. 200,000 for cancer treatment. He received Rs. 80,000 under medical insurance scheme. The benefit of interest Rs. 120,000 (200,000 - 80,000) shall be tax free and on Rs. 80,000 shall be liable to tax.

- [C] Loan for any purpose discussed above [A] and [B]. The value shall be the sum equal to the interest computed at the rate charged per annum by the State Bank of India, as on the 1st day of the relevant

previous year in respect of loans for the same purpose advanced by it. The interest shall be computed on the maximum outstanding monthly balance or reduced by the interest, if any actually paid by the employee or any member of the household. Here, "maximum outstanding balance" means the aggregate outstanding balance for each loan as on the last day of each month.

Now, I try to illustrate with following example : Let Ram borrowed Rs. 100,000 on 01.05.18 from his employer to purchase a car. He started repayment of loan w.e.f. 01.06.18 @ Rs. 1000 pm. In the following circumstances determine the taxable amount of interest for A.Y. 2019-20 by assuming that the rate of interest on car loan charged by the State Bank of India is 10% P.A.

- (I) When employer doesn't charge any interest on loan;  
 (II) When employer charges interest @5% on maximum outstanding monthly balance.

Explanation : Computation of chargeable interest for the Assessment year 2019-20.

CASE-I	Date	Balance
	31-05-2018	100,000
	30-06-2018	99,000
	31-07-2018	98,000
	31-08-2018	97,000
	30-09-2018	96,000
	31-10-2018	95,000
	30-11-2018	94,000
	31-12-2018	93,000
	01-01-2019	92,000
	28-02-2019	91,000
	31-03-2019	90,000
	Total	= 10,45,000

Interest on 1045,000@10% PA for one month.

$$= 1045000 \times \frac{10}{100} \times \frac{1}{12} = 8708$$

Case-II : Interest calculated as above-I	=	8708
Less : Interest charged from Ram	=	4354
Chargeable interest as fringe benefits	=	4354

## 2. Holiday Enjoyment [Rule 3(7) (ii)]

- A. The value of travelling, touring, accommodation, any other expenses paid for or borne or reimbursed by the employer for any holiday availed by the employee or any member of his household shall be the amount of expenditure incurred by the employer in the behalf. However, this rule shall not apply to "Leave Travel Concession" under sec. 10(5) and Rule 2B.
- B. Where such facility is maintained by the employer and is not available uniformly to all employees, the value of benefit shall be taken to be the value at which such facilities are offered by other agencies to the public.

It means if such facility is maintained by the employer and it is made available to all employee uniformly, the value of the benefit shall be nil.

- C. Where employee is on official tour and the expenses are incurred in respect of any member of his household accompanying him, the amount of expenditure incurred by the employer shall be the value of amenity.
- D. Where any official tour is extended as a vacation, the value of the benefit will be valued to the expenses incurred in relation to the extended period of stay or vacation.

In all the aforesaid cases, the amount so determine shall be reduced by the amount if any paid or recovered from the employee for such benefit.

### 3. Free Food [Rule 3(7) (iii)]

The value of free food and non-alcoholic beverage provided by the employer to an employee shall be as under :

- A. Tea and snacks provided during working hour - Nil
- B. Free food and non-alcoholic beverages provided during working hours in a remote area or an off-shore installation - Nil
- C. Free food and non-alcoholic beverage provided during working hours at office or business premises or through paid vouchers which are not transferrable and usable only at eating joints, the value therefore shall be the amount of expenditure incurred by the employer as reduced by (i). The amount paid or recovered from the employees and (ii) Rs. 50 per meal.

### 4. Gift [Rule 3(7) (iv)]

The value of any gift or voucher or token in lieu of which such gift may be received by the employee or by member of his household on ceremonial occasions or otherwise, shall be the sum equal to the amount of such gift.

Where the gift are given to the employees social and religious occasions like Diwali, Christmas, New year, The anniversary of the organization etc. Such gift upto Rs. 5000 in the aggregate during previous year would be exempt, beyond which it would be taxed as perquisites.

However, gifts made in cash or convertible into cash like gift cheque etc. shall not be exempted.

### 5. Expenses charge to a credit card [Rule 3(7)(v)].

The amount of expenses including membership fees and annual fees incurred by the employee or any member of his household, which is charged to a credit card (including add-on-card) provided by the employer or otherwise paid or reimbursed by the employer shall be taken to be the value of perquisite.

However, from such amount, the amount paid or recovered from the employee for such benefit or amenity shall be reduced and the balance shall be the value of perquisite.

Where the expenses are incurred wholly and exclusively for official purposes and the prescribed details and certificates are maintained, the value of perquisite shall be taken as nil.

### 6. Club expenses [Rule 3(7) (vi)]

Where employer pays or reimburses any expenditure incurred (including the amount of annual or periodical fee of the club) in a club by the employee or by any member of this household, the value of benefit shall be the actual amount of expenditure incurred or reimbursed by the employer on that account.

From the value so determined the amount paid or recovered from employee for such benefit shall be reduced and the balance shall be the value of the benefit. Where the employer has obtained corporate membership of the club and the facility is enjoyed by the employee or any member of this household. The value of perquisite shall not include the initial fee paid to acquired such corporate membership.

Exceptions : In the following cases the value of benefit shall be taken as NIL :

- (I) Where such expenditure is incurred wholly and exclusive for business purposes.
- (II) Where the employer provides the facility of health club, sports and similar facilities uniformly to all employee.

#### 7. Use of movable Assets [Rule 3(7) (vii)]

Where the employer provides any movable assets (other than assets already specified in this rule and laptops and computers) for the use of employee or any member of his household, the value of benefits shall be :

- (I) Assets belonging to the employer - 10% of total actual cost of such assets.  
However, the value of perquisites for assets use for more than ten years would be taken as nil.
- (II) Assets taken on Rent-Rent or charges paid or payable the employer for such assets.  
However, from the value so determined the amount paid or recoverable from the employee for such use shall be reduced.

#### 8. Transfer of Movable Assets [Rule 3(7) (viii)]

Where the employer transfer any movable assets belonging to him, directly or indirectly to these employee or any member of his household, the value of benefits shall be determined as under :

	Computer and Electronic Items	Motor Car	Other movable Assets
Cost of Assets Less : Depreciation on WDV method for each completed year during which the assets is put to use of employer	✓ (@50%)	✓ (@20%)	✓ (@10%)
Less : Amount Recovered from employee	✓ (✓)	✓ (✓)	✓ (✓)
Value of benefits	***	***	***

#### 9. Any other benefit or Amenity [Rule 3(7) (ix)]

The value of any other benefit or amenity, services, right or privilege provided by the employer, shall be determined on the basis of cost to the employer under the arms Length transaction as recorded by the employee's contribution, if any.

Exception : Expenses on telephone including mobile phone actually incurred on behalf of the employee by the employer shall not be treated as taxable perquisites.

### IV. AUDIT PROCEDURE

In regards of various fringe benefits the Auditor must have be aware of the possibility that violation of tax laws and regulations may have occurred. The auditor is expected to inquire of management and other appropriate parties and obtained representations from management concerning whether the plan is in compliance with the law and regulation that effect the plan's qualified status. The auditor also is required to inspect correspondence, if any, with the IRS. In addition if specific information comes to the auditor's attention that provides evidence concerning the existence of possible violations affecting the financial statements, he or she should apply auditing procedure specifically directed to ascertaining whether a violation has occurred.

The financial statement audit for employee benefit plans typically cover employee and employees contributions, benefit payments, plan investments and investment income, participant data, participant allocation, Liability and plan obligations, Loans to participant and administrative expenses. In addition, the auditor consider other matter that may effect the financial statement as discussed below :

**(i) Contribution :** The auditor test contributions from the employees and employer to determine whether the amount received by or due to the plan are properly determined and recorded and disclosed in financial statement and whether any appropriate allowances have been made for uncollectable amounts.

**(ii) Benefits and Benefit Payments :** Benefits are tested to determine the payments are in accordance with plan provision and related documents, whether payments are made to or on behalf of the person entitled to them and only to such person, and whether transactions are properly recorded in the proper amount and period.

**(iii) Loans to participants :** Loans to participants and related interest are tested to determine whether the amount due to the plan have been properly identified, valued, recorded and disclosed in the financial statements.

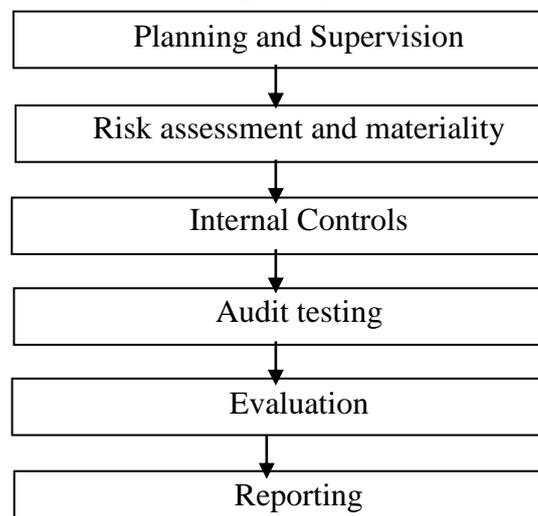
**(iv) Administrative expenses :** Expenses may be tested to determine if anyone in accordance with agreements are properly classified and are recorded in appropriate amounts in the proper period

**(v) Liabilities and plan obligations :** The auditors performs tests to determine whether all plan liabilities are reported in the financial statements. In a defined benefit plan the auditor will test him obligation to determine that they are properly estimated and reported in the financial statements. Testing plan obligations typically will include of using the work of a actuary.

**(vi) Investment and Investment Income :** The auditor applies procedure whether investment and investment income are properly recorded, owned by the plan. Properly valued as on the financial statement date properly presented in financial statement and the appropriate related disclosures are made and that investment transactions are made accordance with investment policy.

**(vii) Participant data and allocations :** The auditor applies procedure to relevant participant data, such as demographic data (eg. sex, marital status, birth date and period of service), payroll data relevant to determining contributions and benefits payments (eg. wages rate, hour worked, earning and contributions to plan) participant elections (e.g. investment elections and elected deferral rates); and benefits data (eg. benefit levels and options selected) to determine whether all covered employees have been properly included and whether accurate participant data were supplied to plan management and the plan actuary, if applicable.

The following audit process should be adopted by auditor :



## V. CONCLUSION

Fringe Benefits are ordinarily understood as side non wages benefits which an employee gets in addition to regular salary or wages. If employee receives his entire income in cash then bear a higher tax burden comparison to another employee who receives his income partly in cash and partly in kind. But, with corporation turning more and more toward fringe benefits it become difficult to quantify taxable income of employee and a real problem arise here and also a chance of tax evasion occurs.

In India prior to assessment year 1998-99 fringe benefits are taxable by the employer-based disallowances method which result large scale of Litigation on account of ambiguity in defining the tax base and it withdrawn by Finance Act-1997.

Then after, by the Finance Act 2005 introduced Fringe Benefit Tax which levied on employer for those fringe benefits which collectively enjoyed by employees and cannot attributable individually among them. Neither employer and nor employee paid any tax on such benefit, now taxable in the hand on employer. But due to several reason Fringe Benefit Tax become the matter of debate, promot paper work, increase collective expenses become burden over employee and finally by the Finance Act 2009 FBT abolished.

Now, with effect from Assessment year 2010-11 some prescribed Fringe Benefits are taxable in the hand of employee and become part of taxable salary in term of Sec. 17(2)(viii) and some are treated as Tax free.

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