

Analysis of Fringe Benefits Tax and Its Collection Pattern

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A recent controversial tax policy change has been the introduction of the fringe benefits tax in 2005. The central government claims that it has been introduced to tax those kinds of fringe benefits, which are collectively enjoyed by employees in the form of facilities/amenities and are difficult to identify, segregate, and apportion among beneficiaries for taxation. Accordingly, the tax liability has been fixed on employers, not on employees. The FBT collection data for the first two years have been analysed here to gain insight for further reforming and fine-tuning the FBT regime. FBT collections from various sectors of the economy have been examined and the significant heads of FBT identified. The banking, petrochemical and infotech sectors are the largest contributors, and employee welfare, conveyance and telephone connections are the largest contributing heads of FBT.

Taxation is a certainty in today's world. It is the most important instrument available to governments for taking away resources from the private sector. Salary income, which is also known as income from employment is generally the most important component of income of individuals in many countries. In general, salary income includes wages, salaries, pensions, gratuity, leave salary, perquisites, allowances and fringe benefits. Taxation of salary income is one source where tax compliance is generally maximum as the tax is deducted at the source itself (called withholding tax) in most countries. Still, ways and means have been devised to reduce the amount of taxable salary. The payment of a part of the salary to employees in the form of non-cash facilities, allowances, fringe benefits and reimbursements is a common way of reducing tax liability.

Taxation of various kinds of employees' fringe benefits has always been a vexing issue for taxation authorities/governments. In most cases, such fringe benefits are either not taxed or are subjected to softer tax treatment. It is primarily due to the fact that such benefits are difficult to identify and still more difficult to apportion among benefited individual employees. Further, there are practical difficulties and administrative inefficiencies in bringing such benefits to tax. However, over a period of time, tax authorities in many countries have come up with different methods for identifying, valuing and taxing such fringe benefits. On the other hand, employers also have come up with novel ways of providing fringe benefits to their employees to avoid taxation. Thus, on many occasions, it has been claimed by tax authorities that the proliferation of various fringe benefits plans is slowly eroding the tax revenue of governments.

There is no universally accepted definition of "fringe benefits". It is generally accepted that fringe benefits provided by the employer to employees cover all advantages other than monetary salary and wages, in consequence to services rendered. Thus, they are a part of employees' overall remuneration packages but not in the form of cash payments. Some exceptions can also arise, for example "entertainment allowances" or other cash expense allowances granted/reimbursed to an employee, which exceeds his or her actual expenses incurred. Sometimes, an employer may also have a statutory obligation to provide a benefit (for example, employees provident fund contribution by employers in India). In some countries, including India, a distinction is made between wages/salaries in kind (often called perquisites in those countries) and other fringe benefits. Examples of the "in kind" components of salary may be rent-free accommodation or a free car provided by the employer. With the introduction

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of the fringe benefits tax (FBT), this distinction has been made more prominent in India.

The most important justification for taxation of fringe benefits is fairness and equity of a tax system. Although the concept of equity in taxation is generally accepted as a desirable objective, it often poses a difficult practical problem in implementation. The notion of “horizontal equity”, which suggests that “equals should be treated equally”, in turn implies that employees/taxpayers in receipt of an equal economic remuneration should pay an equal amount of tax irrespective of the mix (cash, kind or facilities) of the remuneration package. Due to this reason, softer/favourable taxation of fringe benefits may be unfair for those who cannot take advantage of such benefits. Similarly, “vertical equity” implies that “unequals should be treated unequally”. Clubbing this concept with the idea of progressive taxation requires that the taxpayers’ amount of tax liability and average rate of tax should increase as their income increases. It is generally accepted that highly paid executives are more likely to receive a greater share of their remuneration in the form of fringe benefits. This being the case, a soft fringe benefits tax regime also violates the principle of vertical equity and reduces the progressivity of the tax system.

Another justification for taxing fringe benefits is that of erosion of the tax base. When fringe benefits are subjected to a soft and favourable tax treatment, it erodes the tax base and tax revenues are lost. It has been apprehended that the loss in tax revenue and erosion of tax base may be significant when this process of soft tax treatment continues for a long time. The spread of fringe benefits can have some broader economic implications also. It can affect resource allocation and market structure.

Despite these economic arguments favouring taxation of fringe benefits, tax authorities the world over have faced numerous practical and administrative difficulties in their efforts to bring fringe benefits to tax. The vexing issues of its identification, definition of its base, valuation rules, record keeping requirements and administration have often thwarted numerous efforts towards an effective and efficient taxation of fringe benefits.

1 Fringe Benefits Tax in India

A brief outline of the FBT in India:

1.1 Meaning and Application

Recently, Indian income tax authorities have come up with a creative though highly controversial way of taxing fringe benefits. In the annual budget of 2005, the finance minister introduced a new tax called the “fringe benefits tax”. It is a tax that the employer (not the employees) pays on perquisites or benefits that his employees derive as a result of employment. The taxation of fringe benefits has been justified by the government both on grounds of equity and economic efficiency. However, this tax has been vehemently opposed by the corporate sector, trade associations as well as by substantial sections of academia. It is claimed that in the age of fiscal and taxation reforms, such a tax is a retrograde step.

The tax is payable by a certain class of employers on the value of fringe benefits provided or deemed to have been provided by them to their employees. The deeming provisions are a presumptive

method of valuation of fringe benefits wherein the tax is applied to certain heads/categories of expenditure as a measure/indicator of fringe benefits. The Indian Income Tax Act already contains provisions relating to the taxation of various kinds of perquisites and allowances, which employees receive in addition to their salary or wages. These perquisites are taxed as a part of salary income. Therefore, with the introduction of the FBT, the relevant provision relating to taxation of various perquisites has been amended to make them coterminous with the new provisions of the FBT.

1.2 Tax Base, Valuation and Rate

A mixed category of expenses, which are generally incurred by employers for providing benefits/facilities to employees either at the workplace or otherwise has been defined as the base for the FBT. A comprehensive and specific list of such expense categories/heads have been enumerated in the Income Tax Act. Through the deeming provisions, a particular percentage (which varies from 5 per cent to 100 per cent) of such categories of expenses has been declared as “deemed to have been incurred for providing fringe benefits to the employees” of the organisation and this becomes the value of fringe benefits. The FBT is applicable to this value at a flat rate of 30 per cent with an applicable surcharge and cess. At present, there are 20 such heads of expense. Table 1 gives a snapshot view of the base and valuation of FBT system.

Further, in the case of some sectors of the economy, the valuation base has been kept low for certain kinds of expenses, considering the special nature of the business. For example, for employers

Table 1: FBT Heads and Valuation Base Rate

Expense Heads Specified as FBT Base	Valuation Rate (as a % of Expense)
Contribution to superannuation fund (above Rs 1,00,000 per employee per annum)	100
Free or concessional ticket	100
Value of employee stock ownership plans*	100
Entertainment	20
Hospitality of any kind by an employer	20
Conference excluding fee for participation by employees in any conference	20
Sales promotion including publicity but excluding specified expenditure on advertisement	20
Employees’ welfare	20
Conveyance @	20
Use of hotel, boarding and lodging facilities	20
Repair, running (including fuel) and maintenance of motorcar and the amount of depreciation thereon	20
Repair, running (including fuel) and maintenance of aircraft and the amount of depreciation thereon	20
Use of telephone (including mobile phone)	20
Maintenance of any accommodation in the nature of guest house	20
Festival celebration	50
Use of health club and similar facilities	50
Use of any other club facilities	50
Gifts	50
Scholarships	50
Tour and travel including foreign travel @	5

*Introduced from financial year 2007-08.

@ These two heads were together in the first year with a valuation base of 20 per cent and have been separated as two distinct heads with different valuation base from the second year, i.e., 2006-07. Source: Central Board of Direct Taxes.

engaged in the computer software business, the value of fringe benefits arising from conveyance expenses has been fixed at 5 per cent of conveyance expenses, instead of 20 per cent, which is applicable to other sectors. Table 2 gives the details of economy sectors and concessional FBT valuation base for these sectors.

Table 2: Concessional Economy Sectors for FBT Valuation

Business Activity/ Economy Sector	FBT Heads Hospitality of Any Kind	Conveyance	Use of Hotel, Boarding, and Lodging	Running, Depreciation, Repair of Car
FBT Valuation Base (% of expense incurred)				
Airline and air cargo	5	—	5	—
Construction	—	5	—	—
Computer software	—	5	5	—
Hotel	5	—	—	—
Pharmaceuticals	—	5	5	—
Shipping	5	—	5	—
Transport (goods and passengers)	—	—	—	5
All others	20	20	20	20

Source: CBDT.

The FBT is administered with income tax and there is a common tax return form. Other provisions of administration, assessment and tax payment, etc, have also been made coterminous with the income tax system in India.

2 Collection Analysis

The FBT was introduced in the financial year 2005-06. Since then, three years have passed. Although there has been a strong demand from various corporate lobbies for the removal of this tax on grounds of its perceived inefficiency, weird logic and increased compliance cost for taxpayers, the government does not appear to be in any mood to accept this demand. On the contrary, “value of employee stock ownership plans (ESOP)” has been included as one of the fringe benefits in the last budget. Without delving too deeply into the argument about the desirability of the FBT and the efficiency and effectiveness of the Indian mechanism to tax fringe benefits, which is the subject matter of another article, an attempt has been made to analyse FBT collection data for first two years of its operation.

No such analysis of the FBT collection pattern has been attempted in India. There has been general discussion on the FBT in India but the researcher could not find any serious empirical study in this regard. In general, tax policy analysis and related empirical studies have largely been neglected by researchers and academicians. One of the important reasons for inadequate empirical research in this area is the lack of availability of reliable data. The data in the income tax department itself is not easily available and its access to outside researchers is even more difficult. In the light of its recent origin and controversial nature, this paper is an attempt at analysing the collection of FBT to gain insight and derive meaningful observations for further reforming, fine-tuning and modifying the FBT regime.

2.1 Research Design and Data Collection

Starting from 2006-07, paperless electronic filing (popularly called e-filing) of income tax returns (including FBT returns) has been made compulsory for corporate taxpayers. It has been extended to firms also from 2007-08. This facility has greatly

facilitated the present exercise of collection as well as analysis of data. The data for the present study has been taken from FBT returns electronically filed by corporate taxpayers for 2005-06 and 2006-07. For this purpose, special permission was granted to the researcher by the Central Board of Direct Taxes, ministry of finance, government of India to access and use the electronic data from the returns of tax of around 1,000 top FBT payers for financial years 2006-07 and 2007-08.¹ There are only two years for which FBT return data was available at the time of the study. The return for the third year, i.e., 2007-08 is due during 2008-09, the last date for filing of return being October 31, 2008.

Since the data relating to tax returns are personal and proprietary in nature with the income tax department being only a custodian, the names of individual companies/taxpayers have not been disclosed in the report. Instead, the industry segment, which a particular taxpayer represents has been taken as a basic unit of analysis.

For 2005-06, tax return data for the top 1,000 FBT payers were filtered and collected for some selected fields. For 2006-07, again, data for the same top 1,000 taxpayers were filtered and collected. Naturally, the rank did not remain the same over the years. Thus, the individual taxpayers in the top 1,000 list for both the years are not exactly same, though majority of them are same. The data so obtained was then cleaned. Finally, data with respect to 965 and 987 taxpayers remained for 2006-07 and 2005-06, respectively. As we see in the following section, data for the top 350 FBT payers have mostly been used for detailed analysis.

2.2 Overall Collection of FBT and ABC Pattern

Although the imposition of the FBT has been controversial due to various reasons, if we see its collection figures within overall direct tax collection, it is not very significant. Table 3 gives the direct tax collection figures for past three years of the operation of the FBT. FBT collection as a percentage of total direct tax collection has been around 2.8, 2.3 and 2.2 per cent in the first three years, thus showing a slow decline in its contribution to total collection. However, it has shown a growth rate of 11.5 per cent and 26.7 per cent in 2006-07 and 2007-08, respectively. The growth of 11.5 per cent in 2006-07 is significant because the provisions of the FBT were slightly relaxed in this year. Even then, in percentage terms, it does not appear to be an important contributor in total direct tax collection. However, it must be

Table 3: Collection of Direct Taxes (in Rs million)

Components of Direct Taxes	Financial Year		
	2005-06	2006-07	2007-08 (Provisional)
Corporate tax	10,12,770	14,32,600	18,82,620
Income tax	5,59,850	7,60,350	10,39,240
Fringe benefits tax	47,723	53,230	67,430
Securities transaction tax	25,590	46,480	85,770
Banking cash transaction tax	3,210	5,020	5,730
Other taxes (including wealth tax)	3,010	3,230	6,500
Total direct taxes	1,652,150	2,300,910	3,087,290

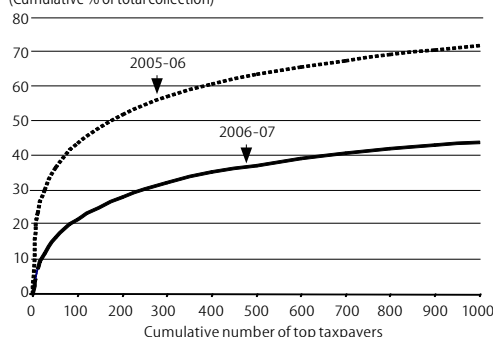
Source: CBDT.

noted that for a resource starved country, an additional Rs 60-70 billion is not a small sum.

Next, the analysis of collection figures shows that FBT collection is showing an ABC pattern. This means that out of the total

number of FBT payers, a small number of taxpayers are contributing a maximum amount of the FBT. By corollary, a large number of small FBT payers are contributing small amounts. There are more than 4,00,000 FBT payers. Out of this, the analysis of the top 1,000 FBT payers very clearly manifests the ABC pattern. Further, the ABC pattern is very prominent in the first year of operation. Figure 1 shows this finding. For 2006-07, the top 1,000 taxpayers contributed around 45 per cent of FBT, whereas it was as much as 72 per cent for the previous year. This proportion was 34 per cent and 59 per cent for the top 350 FBT payers. A look at these taxpayers has shown that they are from all the sectors of the economy and represent all types of business activities. Therefore, the top 350 taxpayers being a representative sample, data for only these FBT payers has been analysed in detail. Interestingly, it may be noted that the ABC pattern is found even in the case of corporate income tax.

Figure 1: ABC Pattern in FBT, 2006-07 and 2005-06
(Cumulative % of total collection)



Source: CBDT.

classification adopted here has been influenced heavily by the information available in the return of income tax/FBT, which itself follows a detailed classification system for economic activities. Further, it has also been influenced by the consideration of devising a classification, which may best cater to the needs of tax analysts, tax policymakers and is easy to comprehend.

Accordingly, all economic activities have been divided into 22 economic sectors. The data from FBT returns have been analysed by grouping all the individual taxpayers into these 22 categories of economic activities.

2.4 Economic Sector-wise Distribution of FBT Collection

The total collection of FBT during 2006-07 and 2005-06 was Rs 53,230 million and Rs 47,723 million, respectively. Out of this, the research sample

of the top 350 FBT payers, which has been analysed in detail, contributed around 34 per cent and 59 per cent of total FBT collection in 2006-07 and 2005-06, respectively.

2.4.1 Sector-wise Collection Pattern

Table 4 represents a 22-fold classification of economic sectors and the contribution from these sectors in total FBT collection for 2006-07 for the top 350 taxpayers in absolute amounts as well as in percentage. Banking is the largest sector contributing around 15.5 per cent of total FBT collection, followed by petrochemical, infotech-software, infotech-information technology

Table 4: Sector-wise Distribution of FBT Collection for 2006-07

Economy Sectors	Amount of Fringe Benefits		Number of FBT Payers	
	Rs Million	% of Total	Numbers	% of Total
Banking	8,343.73	15.47	38	10.86
Petrochemical	4,717.63	8.74	10	2.86
Infotech-software	4,613.60	8.55	34	9.71
Infotech-ITES	3,535.57	6.55	27	7.71
Insurance	3,299.89	6.12	12	3.43
Electrical/electronics manufacturing	2,899.26	5.37	19	5.43
Services-financial-consultancy	2,831.63	5.25	27	7.71
Telecom services	2,740.66	5.08	8	2.29
Engineering manufacturing	2,402.03	4.45	13	3.71
Pharma-drugs-biotech	2,218.16	4.11	23	6.57
Power-energy	2,107.54	3.91	14	4.00
Diversified	2,065.11	3.83	16	4.57
Automobile-ancillary	1,799.43	3.34	17	4.86
Minerals-metals	1,774.99	3.29	11	3.14
Steel	1,455.68	2.70	7	2.00
Fast moving consumer goods	1,324.15	2.45	9	2.57
Trans-hotel-commun-storage	1,255.05	2.33	10	2.86
Agro-food-beverage	1,225.27	2.27	15	4.29
Construction	1,089.46	2.02	11	3.14
Trading-retail	792.91	1.47	9	2.57
Media-entertainment	766.10	1.42	9	2.57
Chemical-fertiliser	689.82	1.28	11	3.14
Total fringe benefits	53,947.66	100.00	350	100.00
Fringe benefits tax	18,071.06			

Source: CBDT.

Table 5: Sector-wise Distribution of FBT Collection for 2005-06

Economy Sectors	Amount of Fringe Benefits		Number of FBT Payers	
	Rs Million	% of Total	Numbers	% of Total
Banking	23,890.84	28.43	41	11.70
Insurance	14,170.67	16.86	14	4.00
Petrochemical	5,342.10	6.36	10	2.90
Power-energy	4,873.80	5.80	25	7.10
Infotech-software	3,643.78	4.34	23	6.60
Automobile-ancillary	2,988.25	3.56	23	6.60
Telecom service	2,904.44	3.46	9	2.60
Electrical/electronics manufacturing	2,787.71	3.32	19	5.40
Infotech-ITES	2,615.64	3.11	22	6.30
Pharma-drugs-biotech	2,550.98	3.04	26	7.40
Diversified	2,267.26	2.70	14	4.00
Services-financial-consultancy	2,252.59	2.68	20	5.70
Trans-hotel-commun-storage	1,990.40	2.37	12	3.40
Engineering manufacturing	1,913.15	2.28	15	4.30
Fast moving consumer goods	1,823.15	2.17	12	3.40
Steel	1,735.36	2.07	6	1.70
Minerals-metals	1,719.01	2.05	11	3.10
Agro-food-beverage	1,301.68	1.55	12	3.40
Chemical-fertiliser	1,112.01	1.32	13	3.70
Construction	819.71	0.98	9	2.60
Trading-retail	732.31	0.87	8	2.30
Media-entertainment	597.18	0.71	6	1.70
Total fringe benefits	84,032.01	100.00	350	100.00
Fringe benefits tax	28,213.45			

Source: CBDT.

enabled services (ITES), insurance, electrical and electronics manufacturing, services-financial-consultancy and telecom services sectors. The same analysis has been repeated on collection data for 2005-06 and results are shown in Table 5 (p 47).

The largest contributing sector has remained the same over the two years whereas the insurance sector has fallen in ranking from second to fifth place. In the first year of FBT, collection from the banking and insurance sectors was unusually high, making up 45 per cent of total collection of the sample, which has decreased to 21 per cent in 2006-07. This was mainly due to heavy collection under the head "contribution to superannuation fund" from these sectors. The reasons for it would become clear in the next section. For the sake of clarity and analysis, the infotech sector has been divided into two sectors, infotech-software and infotech-ITES. If we add the collection from these two sectors, the infotech sector as a whole would be as large as the banking sector in 2006-07.

A sector-wise frequency distribution is also attempted to examine the number of taxpayers in the top 350 list from each sector. The results form part of Tables 4 and 5. The sector-wise frequency distribution for 2005-06 is not very different from that of 2006-07 and shows consistency.

2.4.2 What Can We Infer?

Can we infer something about the extent of fringe benefits an employee can expect on employment in a particular sector? Although it may be gross generalisation, it appears that the financial service sectors, mainly the banks and insurance sectors, are quite generous in terms of providing benefits to their employees. The petrochemical and infotech sectors can also be put in the same category. On the other hand, the sectors like media-entertainment, trading-retail, construction, chemical-fertiliser and agro-food-beverages appear to be parsimonious in terms of providing fringe benefits to their employees. These five sectors have been the bottom five sectors in both years contributing only around 9 per cent of total FBT collection. Presence of media-entertainment and trading-retail sectors, which represent the new economy sectors and are perceived to be very good paymasters at the bottom of the contributor list is surprising.

For 2006-07, it is noted that the top six sectors contribute more than 50 per cent of total collection and top 10 sectors contribute around 70 per cent of total collection. Among the top six sectors,

only two economy sectors are manufacturing while four represent service sectors. Petrochemical being the second largest contributor, is represented by only 10 taxpayers, most of which, obviously, are public sector companies. It points towards the fact that this sector is perhaps the best in terms of providing benefits to its employees. It should also be noted that the banking and insurance sectors too, with few exceptions, are dominated by public sector companies. Further, the telecom service sector, being the eighth largest contributor is represented by only eight taxpayers in the sample being analysed. It would be interesting

to know which are the important fringe benefits for different sectors of the economy. We will be looking at this later on.

Though the FBT has been in operation for only three years, a time series analysis of collection from different sectors of the economy has been attempted. The proportion of contribution made by the banking, insurance and power sectors has reduced in 2006-07. In the case of banking and insurance, it has reduced significantly as is clear from Figure 2. If we factor out the change due to banking and insurance, the overall pattern of contribution from all other sectors of the economy does, however, show a consistent pattern.

Figure 2: Comparison of Sector-wise Collection of FBT for Two Years
(% of collection)

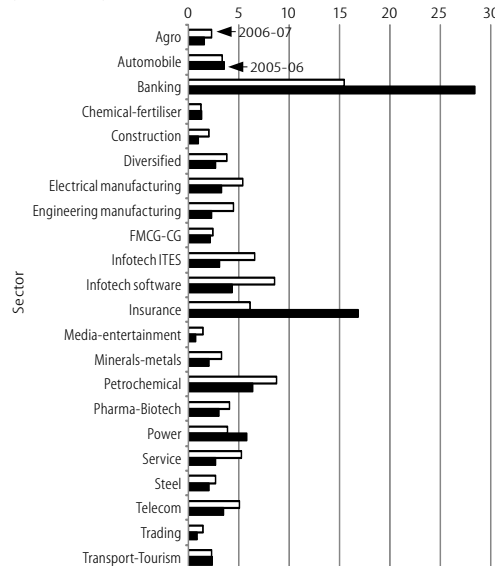
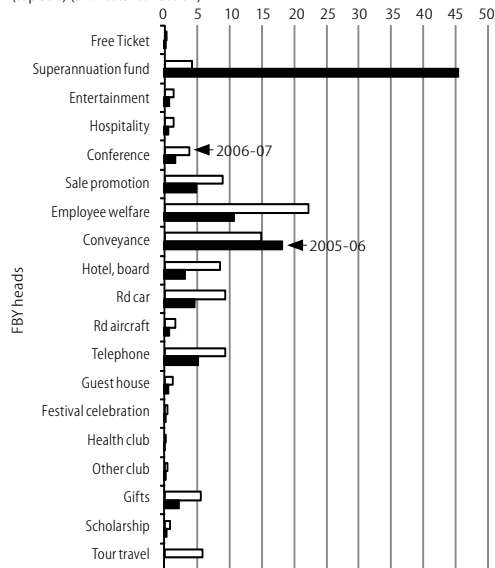


Figure 3: Comparison of Head-wise FBT Collection
(top 350) (% of total collection)



2.5 Analysis of Head-wise FBT Collection

The next stage of the analysis looks at collection from different heads of the FBT as prescribed by the law. There are 19 heads of expenses, which have been included in defining the base of the FBT. Most of these expenses are of a mixed category wherein a particular percentage of these can be and is generally incurred for providing benefits to the employees. Some of these expenses are even primarily incurred for providing benefits to the employees, like employee welfare, gifts to employees, scholarships, contribution to superannuation fund, free lunch, free tickets and other benefits.

What has been attempted by the deeming provisions of the FBT is to

include almost all possible heads of expenses under the FBT base, which are/can be used to provide benefits to the employees. This does defy the logic of identification and enumeration of the correct base. However, it was claimed to have been done to plug the loophole whereby the FBT could have been evaded/avoided by booking the expense under a non-FBT head. However, due to differential

bases for different category/heads of expenses, an opportunity to avoid the FBT still remains. Employers can book expenses under those heads where the valuation base is low (20 per cent), if that is possible.

2.5.1 Head-wise Collection Pattern

There were 18 heads of expenses, which were included in the FBT base in the first year of its operation, i.e., in 2005-06. However, the head conveyance, tour and travel of 2005-06 was

Table 6: Head-wise Distribution of FBT Collection for 2006-07

FBT Heads	Top 350 FBT Payers		Top 1,000 FBT Payers	
	Amount of Fringe Benefits (Rs Million)	% of Total	Amount of Fringe Benefits (Rs Million)	% of Total
Employee welfare	11,955.01	22.16	14,649.21	20.92
Conveyance	8,018.07	14.86	10,172.60	14.52
Telephone	5,014.91	9.30	6,938.88	9.91
Rep, runn, dep on car	5,021.94	9.31	6,921.80	9.88
Sales promotion (and publicity)	4,805.57	8.91	6,294.84	8.99
Use of hotel, boarding	4,581.93	8.49	6,228.93	8.89
Tour and travel	3,116.51	5.78	4,405.72	6.29
Gifts	2,991.81	5.55	3,716.08	5.31
Contribution to superannuation fund	2,232.53	4.14	2,721.88	3.89
Conference	2,073.67	3.84	2,643.63	3.77
Rep, runn, dep on aircraft	887.77	1.65	998.14	1.43
Entertainment	742.42	1.38	987.91	1.41
Hospitality	757.27	1.40	970.83	1.39
Maintenance of guest house	669.91	1.24	920.83	1.31
Scholarships	403.54	0.75	463.87	0.66
Festival celebration	223.97	0.42	407.33	0.58
Other club	237.13	0.44	334.30	0.48
Free/concessional ticket	138.86	0.26	180.72	0.26
Health club	74.85	0.14	110.35	0.16
Total fringe benefits	53,947.66	100.00	70,067.85	100.05
Fringe benefits tax	18,071.06		23,488.21	

Source: CBDT.

Table 7: Head-wise Distribution of FBT Collection for 2005-06

FBT Heads	Top 350 FBT Payers		Top 1,000 FBT Payers	
	Amount of Fringe Benefits (Rs Million)	% of Total	Amount of Fringe Benefits (Rs Million)	% of Total
Contribution to superannuation fund	38,200.62	45.46	40,541.91	39.60
Conveyance, tour, travel	15,267.50	18.17	21,101.40	20.61
Employee welfare	8,995.89	10.71	11,265.80	11.01
Telephone	4,358.11	5.19	6,098.13	5.96
Rep, runn, dep on car	3,968.71	4.72	5,651.07	5.52
Sales promotion (and publicity)	4,118.82	4.90	5,582.35	5.45
Use of hotel, boarding	2,648.56	3.15	3,532.06	3.45
Gifts	1,863.33	2.22	2,464.38	2.41
Conference	1,399.49	1.67	1,851.35	1.81
Entertainment	627.19	0.75	839.76	0.82
Maintenance of guest house	505.98	0.60	715.38	0.70
Hospitality	528.30	0.63	708.10	0.69
Rep, runn, dep on aircraft	609.75	0.73	710.24	0.69
Scholarships	326.74	0.39	386.84	0.38
Other club	226.58	0.27	315.45	0.31
Festival celebration	155.61	0.19	282.88	0.28
Free/concessional ticket	173.53	0.21	237.63	0.23
Health club	66.92	0.08	93.27	0.09
Total fringe benefits	84,041.62	100.01	1,02,377.99	100.01
Fringe benefits tax	28,213.45		34,370.18	

Source: CBDT.

broken up into two heads in 2006-07, namely, conveyance and tour and travel and valuation base for tour and travel was reduced to 5 per cent of total expenses, whereas it remained 20 per cent for conveyance. Therefore, total number of heads became 19 in 2006-07.

The head-wise collection for 2006-07 (top 1,000 and 350 taxpayers) has been analysed and summarised in Table 6. Employee welfare is the largest contributing head followed by conveyance, telephone, repair, running and depreciation on car, sales promotion and use of hotel, boarding and lodging facilities in that order. Similar analysis has been done with the collection figures for the year 2005-06 and is summarised in Table 7.

Contribution to superannuation fund was the largest contributor in 2005-06 with a share of around 40 per cent, followed by conveyance, tour and travel, employee welfare, telephone and sales promotion. This high collection from contribution to superannuation fund was due to the fact that the whole contribution made by employers was taken to be the base for valuation. On representation from various sectors, relevant provisions were modified and from 2006-07, only contributions above Rs 1,00,000 per employee per year are taken as the base for valuation. With this change, the per cent collection from this head has decreased drastically to around 4 per cent of total collection of FBT in 2006-07.

It is also noticed that the proportion of collection from different heads did not change much by increasing the sample size from 350 to 1,000. In 2006-07, for the top two heads, it has slightly decreased whereas for the next five heads, it has slightly increased. There is no clear pattern of increasing or decreasing trend with an increase in sample size. This is in conformity with the assumption that the data set of 350 FBT payers is a representative sample.

The two-year data on head-wise FBT collection was compared. The results are given in Figure 3 (p 48). As noted earlier, collection from contribution to superannuation fund and conveyance, tours and travel has decreased in 2006-07. The reason has already been discussed.

2.5.2 Running and Maintenance of Aircraft

In the sample data, the head "running, repair, depreciation on aircraft" is conspicuous because its contribution is nil for as many as seven sectors of the economy. These sectors are banking, electrical/electronics manufacturing, fast moving consumer goods, infotech-software, insurance, service-financial-consultancy and telecom service. However, in overall terms it ranks 11th contributing 1.65 per cent of total FBT collection. Further, in the case of five sectors of the economy, it is among the top 10 heads contributing 5-10 per cent of total FBT on an average. These sectors are automobile (5.8 per cent), construction (4.2 per cent), petrochemical (5.9 per cent), steel (10.6 per cent) and transport-hotel-tourism (8 per cent). Due to its special nature and the peculiar collection pattern, this head can be made applicable to only those five sectors of the economy where its contribution is above 5 per cent. Alternatively, it can be made applicable to an additional 10 sectors of the economy, where it is contributing something and can be

removed from the FBT base from the seven sectors where its contribution is nil.

2.6 Identifying Important and Unimportant Heads

FBT heads are the building block of FBT systems. There has been wide-ranging debate on the nature of different FBT heads and justification for including or excluding the same in the FBT base. It has been vehemently argued by the government that all heads have been included in the FBT base only after due consideration and serious thought. The debate is closely related with the issue of classification and standardisation of expenses heads and complete liberty available to business organisations for booking expenses. Against this backdrop, it is examined which heads are significant and which are not from the point of view of their contribution to the total FBT collection and their distribution in different sectors of the economy. The FBT returns data for 2006-07 only (having 19 heads of expenses) has been used in this analysis because the collection data for this year is more stable and balanced, representing the changes made in some of the provisions.

2.6.1 Top 10 and Bottom Five Heads

An analysis of largest and smallest contributing heads has given some interesting insights. However, this analysis has been done only for the collection figures of 2006-07. There are about 10 FBT heads, which are major contributors, sharing among themselves more than 90 per cent of total FBT collection. Similarly, the cumulative contribution by the bottom five heads is only around 2 per cent of total FBT collection, with the least contributing head health club contributing as less as 0.14 per cent of total FBT collection. These can be seen in Table 6.

Next, we would like to know whether such a pattern of top and bottom heads is evident even for separate sectors of the economy. For this purpose, the data was further segregated for each of the 22 economy sectors. This has given insight into what is the proportion of collection from the top 10 and bottom 5 heads in the different sectors of the economy. It is seen that for most of the economic sectors, these top 10 heads are indeed contributing more than 90 per cent of total FBT collection, except for the automobile, petrochemical, steel and transport-tourism sectors. However, in these four cases, when the top 11th FBT head (being running, repair and depreciation on aircraft) was included the total contribution became more than 90 per cent.

Thus, even on segregating data on the basis of sectors of the economy, the top 10 heads are found to be the same for all the sectors of the economy contributing almost 90 per cent of total FBT collection. However, within these top 10 heads, the proportion of contribution by different

heads has been found to differ for each economy sector. Thus, employee welfare is not always the top-most head for each sector of the economy. Similarly, it is found that the contribution of the bottom five heads did not exceed 2 per cent for most of the sectors. Further, for as many as 10 sectors of the economy, this per cent was as low as 1 per cent or less. These results are given in Table 8.

2.6.2 Removal of Unimportant Heads and Booking of Expenses

On the basis of the above analysis, it is easy to conclude that the bottom five heads of FBT, namely scholarship, other club, festival celebration, free or concessional ticket and health club, which are contributing to minuscule amounts of FBT, can be removed from the FBT base without significantly affecting its collection. However, such a conclusion would be simplistic. The issue is closely linked with the issue of classification of expenses and discretion available to business organisations to book expenses under any head.

As of now, there is no standard procedure or classification system for the booking of expenses by business organisations. It solely depends on the accounts/finance department to devise or determine a head and book an expense under it. No guidelines or accounting standard have been issued by the Institute of Chartered Accountants of India for this purpose. What is generally found in the books of account of large organisations is a broad four- or fivefold classification of all expenses into manufacturing, selling, employees, administrative and miscellaneous expense heads. These broad heads are then subdivided into various specific heads for the booking of expenses and there is no uniformity even for naming a specific head. This

gives complete discretion to an organisation for classifying and booking an expense. The classification issue is a complex one. It should also be realised that due to the complex nature of modern business enterprises and diversity in the nature and type of expenses incurred in the course of business, it is very difficult to have a practicable classification system and standardised booking of expenses.

It may be noted that out of the bottom five heads, four are those where the base/valuation rate is 50 per cent of the total expense. Further, these four heads are such that the expense made for these purposes can also be booked under other heads of expense, notably employee welfare. Employee welfare is a general type of head, which can include expenses incurred for providing scholarship, festival celebration, etc, and doing so would perfectly be within the four corners of the law. However, when done, it will have the impact of reducing the FBT liability due to differential valuation bases for these heads of expense. Prima facie, it may be the reason

Table 8: Contribution by Top 10 and Bottom Five Heads
(2006-07, as % of total)

Economy Sector	Contribution by Top 10 Heads	Contribution by Bottom 5 Heads
Agro-food-beverage	93.14	1.87
Automobile-ancillary	84.16	4.21
Banking	92.19	1.11
Chemical-fertiliser	95.48	1.37
Construction	89.99	1.34
Diversified	89.82	2.59
Electrical/electron manufacturing	93.65	0.98
Engineering manufacturing	95.31	1.06
Fast moving consumer goods	97.39	1.58
Infotech-ITES	91.64	1.15
Infotech-software	93.92	0.74
Insurance	95.89	0.50
Media-entertainment	95.50	1.40
Minerals-metals	93.14	0.83
Petrochemical	87.47	0.91
Pharma-drugs-biotech	96.27	0.96
Power-energy	94.37	0.51
Services-financial-consultancy	94.61	1.73
Steel	80.89	0.95
Telecom service	96.89	0.95
Trading-retail	94.39	1.64
Trans-hotel-tourism-storage	83.16	3.00
Total	92.33	2.01

Source: CBDT.

why the heads with 50 per cent base are the least contributing ones and also why employee welfare is the largest contributing head. However, it would be too naïve to arrive at such a conclusion on the basis of above analysis.

What is needed is further analysis of the data before making any observation regarding removing some of the least contributing heads from the FBT system. Some advanced analysis and statistical tests were conducted to further probe the issue. The details of these tests will be put together in a subsequent paper. Here, it is sufficient to mention that some initial statistical tests do indicate that there is a high level of heterogeneity in the sample data, indicating an arbitrary booking of expenses, perhaps to avoid the FBT. In such a situation, it would perhaps not be appropriate recommending the removal of the least contributing heads because that may lead to a substantial loss of revenue.

Table 9: Top Four Contributing FBT Heads for Each Sector

Economy Sectors	Top Four Contributing Heads			
	1st	2nd	3rd	4th
Banking	Conveyance	Employee welfare	Telephone	Cont to supfund
Petrochemical	Employee welfare	Conveyance	Run, dep of car	Gifts
Infotech-software	Employee welfare	Conveyance	Hotel, boarding	Telephone
Infotech-ITES	Employee welfare	Hotel, boarding	Conveyance	Tour, travel
Insurance	Cont to sup fund	Employee welfare	Gifts	Conveyance
Electrical/electronics manufacturing	Conveyance	Hotel, boarding	Sale promotion	Employee welfare
Services-financial-consultancy	Employee welfare	Hotel, boarding	Telephone	Conveyance
Telecom service	Employee welfare	Run, dep of car	Sale promotion	Conveyance
Engineering manufacturing	Employee welfare	Gifts	Conveyance	Hotel, boarding
Pharma-drugs-biotech	Sale Promotion	Conference	Gifts	Tour, travel
Power-energy	Employee welfare	Run, dep of car	Conveyance	Telephone
Diversified	Sale promotion	Conveyance	Employee welfare	Hotel, boarding
Automobile-ancillary	Sale promotion	Employee welfare	Run, dep of car	Hotel, boarding
Minerals-metals	Employee welfare	Run, dep of car	Conveyance	Gifts
Steel	Conveyance	Employee welfare	Run, dep of aircraft	Run, dep of car
Fast moving consumer goods	Sale promotion	Conference	Employee welfare	Hotel, boarding
Transport-hotel-communication-storage	Employee welfare	Run, dep of car	Conference	Conveyance
Agro-food-beverage	Sale promotion	Employee welfare	Conveyance	Run, dep of car
Construction	Run, dep of car	Sale promotion	Employee welfare	Hotel, boarding
Trading-retail	Employee welfare	Conveyance	Run, dep of car	Hotel, boarding
Media-entertainment	Sale promotion	Conveyance	Employee welfare	Telephone
Chemical-fertiliser	Sale promotion	Employee welfare	Run, dep of car	Conveyance
Overall	Employee welfare	Conveyance	Run, dep of car	Telephone

Source: CBDT.

2.7 Sector-wise Important Heads

We have earlier seen that there are only 10 heads which are major contributors to the FBT collection. It is also seen that these top heads remain the same for almost all the sectors of the economy. However, it must be noted that though the heads remain the same, their rankings do vary considerably for different sectors of the economy. Table 9 is a summarised representation of the top four heads for each sector of the economy. It is very clear that there is considerable variation among the top four heads and the same is the case for other heads also.

It is noted that generally employee welfare, conveyance and sales promotion are the top heads for most of the sectors of economy. However, running and maintenance of car is the largest contributing head for the construction sector and contribution to

superannuation fund is the largest contributing head for the insurance sector. Gifts being the eighth ranking head (overall) is among the top four heads for as many as five sectors of the economy. What else can we infer from this analysis?

3 Concluding Remarks

Only three years have passed since the introduction of the FBT in India. The analysis of the collection pattern has given some interesting and important insights. There is much variability in the collection from different sectors of the economy and from different heads of the FBT. Though only around half of the heads of expenses forming the base of the FBT are significant, contributing as much as 90 per cent of collection, it should not lead us to conclude that the least contributing heads should be removed from the FBT base. Significantly, the important FBT heads are the same for almost all the sectors of the economy. Further analysis shows that these highly contributing heads are those with lower valuation bases.

The FBT has been quite a controversial tax since its introduction. It has been criticised on many grounds – on the method of its valuation, deeming provisions – all leading to increased compliance costs for taxpayers, on its absurd logic of taxing expense, etc. On the contrary, the government has argued that there is no additional burden in terms of cost of compliance, the deeming provisions have been introduced to make it simple and for making its collection and administration efficient.

It has been suggested that this tax should be replaced by a “tax-equivalent” surcharge on corporate income tax. If done so, it would translate into a flat rate surcharge of around 4 per cent on corporate tax. However, as we have seen previously, there is wide variability in collection from different sectors of the economy as well as from different heads of expenses. In such a situation, any flat surcharge would not be able to take these intrinsic differences

into account. In any case, it should be noted that there is a huge scope for further deliberation, research and empirical analysis of FBT collection data through the involvement of all stakeholders to gain valuable insight into the issue. It would help in informed discussion, reform of the FBT regime and overall improvement of tax policy formulation and taxation structure of our economy.

NOTES

- 1 It may be noted that return of income tax or FBT is due in the next financial year. Thus, for the financial year 2005-06 (called the previous year in income tax terminology), the return of tax was due and filed in the financial year 2006-07 (called assessment year in income tax terminology).
- 2 For a detailed description of NIC classification, the web site of the Ministry of Statistics and Programme Implementation, Government of India may be referred to at www.mospi.nic.in