July 2009

Abolition of Fringe Benefit Tax

Implications and Opportunities for India Inc.

Hewitt

“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”.

- Dr. P. Chidambaram, Finance Minister of India, Budget 2005

“This tax has been perceived as imposing considerable compliance burden. Empathizing with these sentiments, I propose to abolish the Fringe Benefit Tax”.

- Pranab Mukherjee, Finance Minister of India, Budget 2009

Contents

- Background to Fringe Benefit Tax (FBT)
- Industry Reaction
- Budget 2009-10: Abolishment of Fringe Benefit Tax
- Possible actions

Background to Fringe Benefit Tax

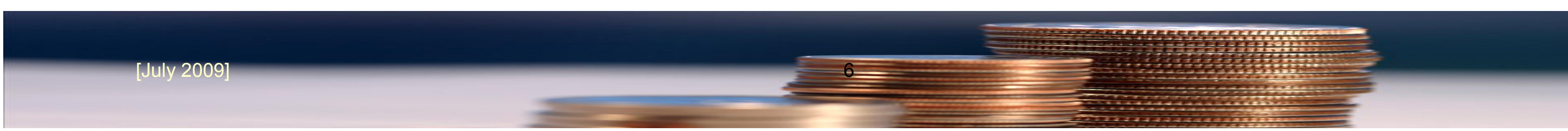
- Introduced in 2005 for all non-mandated benefits like insurance, travel, hotel, etc.
- Benefits like healthcare and term-life insurance which were provided in the absence of sustainable government-sponsored programs were deemed fringe benefits and hence taxed
- Significant administrative and financial impact to employers compelling them to rethink pay and rewards programs
- In the subsequent years minor changes were made to FBT rates; most significant change was in the case of superannuation where an exempt limit was introduced upto INR 100,000
- Administration of FBT increased the compliance burden, which in terms of cost and effort was not proportionate to the monitoring costs

Industry Reaction

- Corporate's tax liability increased owing to introduction of FBT
- This compelled employers to re think and redesign their pay and benefit programs. Some of the measures introduced were:
  - Tax impact fully or partially shared with employees: this was largely achieved by lowering the benefits to neutralize the tax impact
  - Tax completely borne by the employer
  - Withdrawal and/ or rationalization of benefit programs

Budget 2009-10: Abolishment of Fringe Benefit Tax

- Empathizing with the industry sentiments, FM proposed to remove Fringe Benefit Tax (FBT) as contained in Chapter XII H of the Income Tax Act. However, deemed value of these benefits will be taxed in the hands of the employees as "perquisites'.
- Superannuation (SA) and Employee Stock Options (ESOP) are proposed for taxation under 'perquisites'
  - SA contribution exceeding INR 100,000 will be a deemed perquisite. Hence this is a clear case of tax burden moving from employer to employee. The affected employees are with monthly salary of INR 55,600 and above (assuming the contribution rate specified in the plan is 15%)
  - Tax on ESOP in the first instance on the employee, will be for the difference between grant price and fair market value. A second incidence of tax on the employee will be 'Capital gains' tax at the time of sale of shares
- In addition to above mentioned SA and ESOP benefits, the Finance bill has not listed any additional benefits (or amenities) that will be treated as perquisites. These are expected to be inserted in the days to come. Until these are listed /inserted there is uncertainty on the impact of tax



Hewitt

Read the Fine Print

- **Perquisite**
  - Perquisites were always a part of salary income for taxation. FBT regime was built by transferring some items of benefit from perquisites and including certain new items
  - The current proposal does not clarify whether all the listed benefits from the erstwhile FBT regime will get transferred to perquisites. Instead it states that benefit list and its perceived value for taxation under perquisites will be prescribed
- **Implications**
  - Abolition of FBT is a good initiative as it frees the employer from compliance burden. It will also leave the employer with less tax outgo. However, employee may need to pay additional tax on account of perceived income and its true measure can be determined only after the 'list of benefits and its perceived value' is prescribed by the Board of Direct Taxes.

Short term: possible actions

- **Employers might utilize the FBT saving to**
  - Improve or restore certain benefit programs
  - Make cash compensation competitive: provide some relief to salary increases for 2009
  - Cross-subsidize: channel savings to increase spending on priority business areas
  - Improve bottom line: build shareholder confidence by using funds to protect bottom line

Long-term: possible actions

Employers can evolve the benefits model and offer a range of benefits based on employee choice, with a minimum core benefits set:

- **Core Benefits**
  - Bare-minimum, statutory/ non-statutory and compulsory
  - Employer can set the level and form of benefits
- **Flexible Benefits: employers perspective**
  - Controlled benefit cost; protects from year on year benefit cost inflation
  - Focus from “Total Compensation” to “Total Rewards”
- **Flexible Benefits: employees perspective**
  - Tailored to diverse and changing needs of employees
  - Makes pay delivery more tax efficient

For further information please contact the nearest Hewitt Consultant:

Mumbai:	+91 22 40345000
Bangalore:	+91 80 66938000
Gurgaon:	+91 124 4155000

Disclaimer: Hewitt Associates is a Human Resource Consulting firm and its opinions on accounting and taxation principles have to be validated with the organization's legal and financial auditors. We, as a firm, do not take any responsibility for financial, taxation and legal advice provided as a part of this exercise.

Hewitt