Guest House Expenses-outside the purview of fringe benefit tax

197 CTR (Art.)146

- By S.K. Tyagi

The Finance Act, 2005, has inserted in the Income-Tax Act, 1961 (the Act), a new Chapter XII-H. This Chapter deals with '*Fringe Benefit Tax*' (FBT) and it contains Sections 115W to 115WL. The provisions of FBT have come into effect from 1.4.2006 viz. assessment year (AY) 2006-07, relevant to financial year (FY) 2005-06.

For the purposes of Chapter XII-H, vide Section 115WB(1) of the Act, '*Fringe Benefits* (FB) means any consideration for employment provided by way of –

(a) any privilege, service, facility or amenity, directly or indirectly provided by an employer, whether by way of reimbursement or otherwise.

(b) any free or concessional ticket provided for private journeys of the employees and their family members; and

(c) employer's contribution to an approved superannuation fund.

Besides, as per Section 115WB (2) of the Act, there are a number of deemed fringe benefits (DFB). Vide Section 115WB(2), '*Fringe benefit*' shall be deemed to have been provided by the employer to his employees, if any expenditure is incurred or payment is made for specified purposes, such as entertainment, hospitality, gifts, conference, scholarships, etc. Fringe Benefits (FB) shall be deemed to have been provided, if the following conditions are satisfied.

(i) the employer has incurred any expenditure or made any payment for certain specified purposes.

(ii) such expenditure is incurred or payment is made by the employer in the course of his business or profession or any activity, whether or not such activity is carried on with the object of deriving income, profits or gains, and

(iii) such expenditure is incurred or payment is made for certain purposes specified in clauses (A) to (P) of Section115WB(2) of the Act. These clauses enumerate the nature of expenditure or payments, which are deemed to be fringe benefits.

It may, thus, be seen that there are sixteen (16) categories of DFBs, as laid down under Section 115WB(2), in clauses (A) to (P).

In this context, I am constrained to state that the provisions contained in Chapter XII-H of the Act, have not been properly drafted. These provisions suffer from a number of ambiguities and doubts, as regards their correct interpretation. Viewed in this perspective, the provisions of clause (K) of Section 115 WB (2) of the Act, are almost a nullity, as the same are totally unworkable. The provisions of the aforesaid Section 115WB(2)(K)deal with expenses on maintenance of a guest house. In this respect, the following points are very important and relevant.

(i) The very purpose of FBT is to bring within the tax-net, benefits or perquisites which are un-taxed both in the hands of the employer as well as the employee.

As a corollary, any expenditure incurred in respect of persons other than employees, namely customers or clients or other strangers, will remain outside the ambit of FBT.

(ii) Any expenditure not resulting into any benefit or gain to the employees, cannot fall within the purview of FBT.

This legal proposition, reinforces the aforesaid corollary.

(iii) Any accommodation provided for the use of employees cannot be considered as guest house.

It is in view of the aforesaid reasons, that no FBT can be levied in respect of expenses on the maintenance of a Guest House.

The reasons for the aforesaid legal proposition, are as follows-

1. **The purpose of FBT is to bring within the tax-net, perquisites or benefits which are not taxed either in the hands of the employer or the employee**

As could be seen from the various speeches of the Finance Minister and Explanatory Memorandum to the Finance Bill, 2005, FBT has been introduced in order to tax that part of expenditure incurred by the employer, which is clearly a perquisite or benefit for the employees, but which is going untaxed both in the hands of the employer and the employee.

The purpose of FBT may be gauged from the various speeches of the Finance Minister, while introducing the Finance Bill 2005 and Explanatory Memorandum to the Finance Bill, 2005, which are discussed as follows-

(i) *Relevant part of the Finance Minister's speech, while introducing Finance Bill, 2005*

The relevant part of the Finance Minister's speech, while introducing Finance Bill, 2005, as reported in 273 ITR (St.) page 56, is reproduced as follows-

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

(ii) *Relevant part of Explanatory Memorandum to the Finance Bill, 2005*

The relevant part of Explanatory Memorandum to the Finance Bill, 2005, as reported in 273 ITR (St.) page 56, is reproduced as follows-

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The taxation of perquisites or fringe benefits provided by an employer to his employees, in addition to the cash salary or wages paid, is subject to varying treatment in different countries. These benefits are either taxed in the hands of the employees themselves or the value of such benefits is subject to a 'fringe benefit tax' in the hands of the employer. The rationale for levying a fringe benefit tax on the employer lies in the inherent difficulty in isolating the 'personal element' where there is collective enjoyment of such benefits and attributing the same directly to the employee. **This is so especially where the expenditure incurred by the employer is ostensibly for purposes of the business but includes, in partial measure, a benefit of a personal nature**. *Moreover, in cases where the employer directly reimburses the employee for expenses incurred, it becomes difficult to effectively capture the true extent of the perquisite provided because of the problem of cash flow in the hands of the employer.* [Emphasis provided]

Therefore, it is proposed to adopt a two pronged approach for the taxation of fringe benefits under the Income-Tax Act. Perquisites which can be directly attributed to the employees will continue to be taxed in their hands in accordance with the existing provisions of Section 17(2) of the Income-Tax Act and subject to the method of valuation outlined in Rule 3 of the Income-Tax Rules. In cases, where attribution of the personal benefit poses problems, or for some reasons, it is not feasible to tax the benefits in the hands of the employee, it is proposed to levy a separate tax known as the fringe benefit tax on the employer on the value of such benefits provided or deemed to have been provided to the employees

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(iii) *Finance Minister's speech while introducing amendments to Finance Bill, 2005, on May 2,2005*

The relevant part of the Finance Minister's speech while introducing amendments to Finance Bill, 2005, on May 2,2005, as reported in 144 Taxman (St.) page 121, is reproduced as follows.

'*Therefore, by the presumptive tax method what we are trying to do* **is to tax that part which is clearly a perquisite, clearly a benefit but which is going untaxed both in the hands** *of the employer and the employee'* [Emphasis provided]

(iv) *Relevant part of Finance Minister's speech relating to amendments to the Finance Bill, 2005, on May 5, 2005*

The relevant part of Finance Minister's speech relating to amendments to the Finance Bill, 2005, on May 5, 2005, as reported in 145 Taxman (St.) page 30, is reproduced as follows-

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'We have excluded a number of benefits which accrue to us. For example, canteen expenditure has been excluded, transport and travelling has been excluded. Even under the fringe benefit, as amended by Lok Sabha, we have taken care to exclude what I realized would be legitimate business expenditure and perhaps not amenable to the categorization, fringe benefit. What has been included is 'fringe benefit.'

It is, thus, clear that FBT has been introduced in order to tax that part of expenditure incurred by the employer, which is clearly a perquisite or benefit for the employees, but which is going untaxed both in the hands of the employer as well as the employee. Besides, the expenditure in question is apparently incurred for the purposes of business of the employer but the same is considered to include, in partial measure, a benefit of personal nature for the employees.

It may, therefore, be concluded that only that expenditure will fall within the ambit of FBT, which results in some kind of a personal benefit or gain for the employees. All other expenses will remain outside the purview of FBT.

2. Any expenditure not resulting into any benefit or gain to the employees, cannot fall within the purview of FBT

It may be stated here that any expenditure not resulting into any benefit or gain to the employees, cannot fall within the purview of FBT.

For this purpose, we will have to look into the scope of FBT as laid down under Section 115WB of the Act.

Here, we have to consider the scope of the '*deemed fringe benefits*', as laid down under Section 115WB of the Act. For a number of reasons to be discussed hereinafter, no part of the expenditure, where from the employee does not derive any personal benefit or gain, can be treated as deemed DFB. Thus, any expenditure which is incurred by the employer, for legitimate business purposes, from which the employees do not derive any personal benefit or gain, cannot be treated as expenditure for providing FB or DFB. This conclusion is based on the following reasoning:-

(i) As per the provisions of charging S.115WA(1) of the Act, there shall be charged additional income-tax referred to as FBT in respect of the FBs provided or deemed to have been provided by an employer to his employees.

This means that any expenditure which involves no personal benefit or gain for the employees, will not fall within the mischief of Section 115WA(1) of the Act. Thus, any expenditure incurred on persons other than employees, for the legitimate business purposes, will not be covered within the purview of fringe benefits or deemed fringe benefits as laid down under Section 115WB of the Act.

(ii) As per Section 115WB(1), for the purposes of Chapter XII-H, '*fringe benefits*' means any consideration for employment, provided by way of……etc.
This provision also clearly indicates that expenditure in question must be in consideration for employment and not otherwise.

(iii) Under Section 115WB(3), the privilege, service, facility or amenity does not include perquisites in respect of which tax is paid or payable by the employee.

It means that any expenditure which is taxed or taxable in the hands of the employee by way of perquisites, will not fall within the purview of the privilege, service, etc.

(iv) In order to find the legislative intent or ascertain the purpose behind the legislation, the speech made by the Finance Minister or the Mover of the Bill, can be taken into consideration, in view of the following judgements:-

(a) *Kerala State Industrial Development Corporation Ltd. Vs. CIT [2003] 259 ITR 51 (S.C.)*
(b) *Sole Trustee Loka Shikshana Trust Vs. CIT [1975] 101 ITR 234 (S.C.)*
(c) *K.P. Verghese Vs. I.T.O. [1981] 131 ITR 597 (S.C.)*

The Finance Minister in his speech while introducing the Finance Bill, 2005, has stated-
'*In addition I now propose that where the benefits are usually enjoyed collectively by the employees and cannot be attributed to individual employees, they shall be taxed in the hands of the employer'.*

The aforesaid part of the speech of the Finance Minister clearly proves that the intent is to tax the benefits to the employees and therefore, the provision has to be interpreted to reflect the legislative intent and not to tax any expenditure on non-employees, which does not result in any personal benefit or gain to the employees.

(v) In case of doubt or difficulties, the Explanatory Memorandum to the Finance Bill, may be used to ascertain the intention of the Legislature, as laid down in *M. Rangaswamy Vs. CWT [1996] 221 ITR 39 (Mad.)*

In the Explanatory Memorandum to the Finance Bill, 2005, it is stated-

(a) 'This is so specially where the expenditure incurred by the employer is ostensibly for purposes of the business, but includes, in partial measure*, a benefit of a personal nature'.*
[Emphasis added]

(b)'In cases where the attribution of personal benefit poses problems, or for some reasons, it is not feasible to tax the benefits in the hands of the employees, it is proposed to levy a separate tax known as the fringe benefit tax on the employer on the value of such benefits provided or deemed to have been provided to the employees'.
-[273 ITR (St.)pp.196, 197]

Thus, the FBT is proposed to be levied on the benefits to the employees and therefore, the DFBs cannot include expenditure on non-employees, which does not result in any benefit or gain to the employees.

(vi) The Finance Minister in his speech in the Parliament on 2.5.2005, has stated:
'FBT is a presumptive tax. As I said in my Budget speech, there are a large number of allowances, perquisites which are given, which go untaxed.....Therefore, by the presumptive tax method what we are trying to do is to tax that part which is clearly a perquisite, clearly a benefit but which is going untaxed both in the hands of the employer and employee'. [144 Taxman (St.)p. 121]

(vii) As is already clear, the very purpose of the provisions of Chapter XII-H, is to tax the untaxed FBs to the employees. To adopt a contrary view may result in a very heavy and unjust levy on the employer. It may result in the taxation of disproportionately high expenditure on non-employees, which does not involve any benefit or gain to the employees.

For example, if expenditure on use of hotel, boarding and lodging facilities is incurred only on customers and not on any of the employees, at all, then treatment of such an expenditure as a DFB will be totally unjust and absurd, because no benefit therefrom accrues to the employees. There may be a case of a person who has no employees at all. For example, a partnership firm may be run by the partners themselves without the aid of any employee. It would, therefore, be totally unjust and absurd to levy any FBT on the so called DFBs, which do not involve any benefit or gain for the employees of the firm.

(viii) Besides, deeming provisions are required to be construed strictly as laid down in *CIT Vs. Khimji Nershi [1992] 194 ITR 192 (Bom.).* Therefore, the provisions relating to DFBs must be strictly construed to cover only those expenses, which involve any benefit or gain for the employees.

(ix) In addition, along with the introduction of FBT provisions-

(a) Section 17(2)(vi) has been amended with effect from AY2006-07, so as to provide that FBs chargeable to FBT under Chapter XII-H, will not be included as the income of employees by way of perquisite,

(b) Rule 3 of the Income-Tax Rules, 1962, has been amended in order to exempt certain perquisites from taxation.

(x) In this context, the answer to a question by the Finance Minister in an interview to 'Economic Times on 2.3.2005, is quite relevant. The relevant part of the interview is as follows:-

Q. The industry is looking for an assurance from you that no legitimate business expenses are taxed.

A. That I have made clear. My speech said only perquisites which are disguised as fringe benefits will be taxed. No legitimate business expenditure will be taxed.

Therefore, no part of the expenditure, wherefrom the employee does not derive any personal benefit or gain, can be subjected to FBT. Thus, any expenditure, which is incurred by the employer for legitimate business purposes, from which the employees do not derive any personal benefit or gain, cannot be treated as an expenditure incurred for providing FBs or DFBs.

From the aforesaid discussion, it is again quite clear that any expenditure incurred in respect of persons other than the employees will remain outside the purview of FBT.

3. Any accommodation provided for the use of the employees cannot be considered as a guest house

An accommodation specifically provided for the use of employees of an organisation cannot be considered as '*guest house*' and therefore, the expenses incurred on its maintenance cannot be deemed to be a fringe benefit for the levy of FBT.

In support of this proposition, the meaning of the term '*guest house'* may be relied upon, as explained in the following judgements and dictionary:-

(i) *CIT Vs. Parshva Properties Ltd. [1987] 164 ITR 673 (Cal.)*

In this case, the Tribunal found that the bungalow was situated in a place which was in a remote corner of a district in Bihar and that the employees of the company, auditors, mining engineers and other Government officials went there on duty and stayed there temporarily for doing their work. The Tribunal held that it could not envisage a situation where the guests of the assessee could be normally taken to that place and be entertained, and, therefore, the bungalow could not be treated as a '*guest house'* under Section 37(4) of the Income-Tax Act, 1961.

On a reference, it was held that the bungalow in question could not be treated as a '*guest house'* and hence the expenses could not be disallowed.

(ii) *CIT Vs. Aruna Sugars Ltd. [1980] 123 ITR 619 (Mad.)*

It was observed by their Lordships, on page 623 of the Report, "*We have, therefore, to examine as to what a guest house is. The term has not been defined in the Act. The dictionary meaning of 'guest house' is 'an inn, a house separate from a main dwelling for the use of guest'. In Shorter Oxford Dictionary, 3rd Edition, the meaning of 'guest house' is given as "an inn, house or apartment for the reception of strangers or guests".*

It was further held, in a case where the assessee maintains a guest house exclusively for the directors and other employees, through whom alone it can carry on business, it cannot be stated that these personnel can be taken to be outsiders so as to be called guests. Thus, in our opinion, where the guest house is maintained, either in the principal place of business or in a place where the factory is located, for the directors and other employees of the company who have to visit it for the purpose of the company's business, then any expenditure incurred for the maintenance of such accommodation cannot be brought within the scope of section 37(3). Further, in such a case, an occasional stay by a person who visits the factory for the purpose of its business cannot also be called a guest. Any official visiting the factory for the purpose of enforcing the laws applicable to the factory, cannot also be described as an outsider so that any accommodation used by him in connection with the company's work, can be treated as accommodation in the nature of a guest house. It is only with reference to the other categories like strangers, that the accommodation which is maintained can be correctly called a guest house. Thus, employees are not strangers so as to be guests. The result is that unless the guest house is intended for use by a complete stranger, it cannot be called a guest house which falls within the scope of section 37(3).

(iii) The meaning of guest house as per Oxford English Dictionary

The meaning of the expression '*guest house'* given in the Oxford English Dictionary, which is relevant for our purpose, is '*a house or apartment for the reception or entertainment of strangers or guests'*. It would, therefore, appear that a house or apartment in which a stranger or guest is received or entertained is a guest house.

Thus, it is clear that an accommodation specifically provided for the use of the employees of an organisation cannot be considered as '*guest house*'.

To counteract the aforesaid legal interpretation, sub-section (5) was incorporated in section 37 to define '*guest house*', which reads as under:

"(5) For the removal of doubts, it is hereby declared that any accommodation, by whatever name called, maintained, hired, reserved or otherwise arranged by the assessee for the purpose of providing lodging or boarding and lodging to any person (including any employee or where the assessee is a company, also any director of, or the holder of any other office in the company) on tour or visit to the place at which such accommodation is situated, is accommodation in the nature of a guest house within the meaning of sub-section (4)".

Since no definition of guest house has been incorporated under the new provisions of FBT, the aforesaid interpretation will be applicable.

In view of the aforesaid reasons, an accommodation specifically provided for the the use of the employees of an organization, cannot be considered as '*guest house'* and therefore, the expenses incurred on its maintenance, cannot be deemed to be fringe benefit for the levy of FBT.

4. Conclusion

From the aforesaid discussion, it is quite evident that-

(i) any expenditure incurred in respect of persons other than the employees, namely customers or clients or other strangers, can never fall within the ambit of FBT.

(ii) an accommodation provided for the use of the employees of an organization, cannot be considered as '*guest house'* and therefore, the expenses incurred on its maintenance, cannot be deemed to be FB for the levy of FBT.

It is, thus, clear that any expenditure incurred on the maintenance of a '*guest house*' will not be covered under the provisions of FBT, irrespective of the fact whether-

(a) the guest house is used by the employees of the organisation or

(b) the guest house is used by persons other than the employees such as customers or clients or other strangers

In the light of the aforesaid reasons, clause (K) of sub-section (2) of Section 115WB of the Income-Tax Act, 1961, is a nullity, as the provisions of the same are not workable, at all.

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