Are loss-making companies liable for FBT – a fresh view!

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THE applicability of fringe benefit tax on loss-making companies, has always been a controversial issue, ever since FBT came into the statute book. One nearly unanimous view that has been that even loss-making companies are liable to FBT, because of the clear wording used in the charging Sections. A fresh look is needed into this aspect, in the light of a judicial pronouncement which has come from the Supreme Court in the Virtual Soft Systems Ltd case. Let's bear in mind that FBT is an 'additional income tax', as is clearly laid down in Sub- Section (1) of Section 115WA. A plain reading of the Sub-Section (1) makes it amply clear that the additional income tax otherwise called fringe benefit tax can be levied only if there is an income tax liability on the assessee. The Supreme Court, in the case of CIT, Bombay City v. Elphinstone Spinning & Weaving Mills Co. Ltd (2002-TIOL-211-SC-IT), had clearly held that the word "additional" in the expression 'additional income tax' must refer to a state of affairs in which there has been a tax before. Hence, for assessees who have incurred losses, there being no income tax chargeable, there can be no consequent additional income tax in the nature of fringe benefit tax. It is very interesting to note that this concept has been reiterated in a recent case of M/s Virtual Soft Systems Ltd v. Commissioner of Income tax, Delhi-I, 2007-TIOL-18-SC-IT, wherein the Apex Court had held that the words "in addition to any tax payable" can only be understood as the words "additional income-tax" and that these words pre-suppose that tax was otherwise payable". Despite the clear wording of the Sub-Section (1), which confirms that fringe benefit tax is payable only if income tax is payable, what has perhaps been dominating the minds of the tax payer, has been the wording used in Sub-Section (2), which reads as under : "Notwithstanding that no income-tax is payable by an employer on his total income computed in accordance with the provisions of this Act, the tax on fringe benefits shall be payable by such employer". This Sub-Section (2) has been widely interpreted to mean that, even loss making companies who do not pay income tax are still liable to fringe benefit tax. The critical words used in this Sub-Section are "total income". A clear understanding of the words "total income" would perhaps unravel the mystery. "Total Income" is defined under Section 2(45) to mean "the total amount of income referred to in Section 5, computed in the manner laid down in this Act". The said Section 5 of the Act gives an elaborate description of the items of income that constitute "total income". While it is not relevant to us as to what income items would get included under "total income", it would be very interesting to know if "total income" could mea a loss or a negative figure. The decision of the Supreme Court in M/s Virtual Soft Systems Ltd v. Commissioner of Income tax, Delhi-I ,

2007-TIOL-18-SC-IT, as stated earlier, comes to our immediate rescue, in an immense way. In this case, the assessee had filed a return showing a loss. The assessment order while reducing the quantum of the losses claimed went on to impose a penalty on the assessee under Section 271(1)(c) of the Act, in respect of the losses overstated. While the Tribunal deleted the imposition of the penalty, the High Court upheld the penalty attributing to the change in the legal position vide insertion of the Explanation 4 to Section 271(1)(c) brought about by the Finance Act, 1996. While delivering its judgement, the Supreme Court held that penalty can be imposed only in cases of positive income, notwithstanding the insertion of the above referred Explanation 4(a). Applying the principle laid down in Commissioner of Income Tax, Bombay City v. Elphinstone Spinning and Weaving Mills Co. Ltd, reported in (2002-TIOL-211-SC-IT), the Supreme Court reiterated in the Virtual Soft Systems Ltd case that "total income" can only denote a positive figure. Though delivered in the context of Section 271 (1)(c), the benefit of this decision, in terms of the understanding of the words "total income" is nevertheless available to assessees in the context of fringe benefit tax, as well. If "total income" cannot include a loss or a minus figure, what happens to the Sub-Section

(2), which, as stated above, has been interpreted to mean that lossmaking assessees who don't pay income tax are also liable for fringe benefit tax? This leads to the interesting discussion on a charge and its computation. In several cases, the Courts have held that a charge and its method of computation have to be read together and that, if the computation fails, so does the charge. In CIT v. B.C. Srinivasa Setty, [1981] 128 ITR 294, the Supreme Court had reiterated the principle that the charge and its computation were two parts of an integral whole and concluded therefore, that if the computation could not be done, the charge was not intended to apply. This principle would squarely be applicable to the charge meant to be covered by Sub-Section (2), in the context of computation of tax liability for an assessee with a loss, as there would no "total income" within the meaning of the Sub- Section (2). Since the computation fails, the tax also fails.

The intention of the Legislature seems to be that assessees who have availed of exemptions and deductions available under the Income tax Act (eg. under Sections 10A, 10B, 80-IAB, 80-IB, etc.) and who consequently don't pay income tax should be made to pay fringe benefit tax. Without getting into the merits of this view, to extend this logic to state that even loss-making companies (who have, in effect, a negative or minus total income) are liable to pay fringe benefit tax, would go against the law that is applicable in the aftermathof the Supreme Court's judgement in the Virtual Soft case.

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