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# SKEPTIC NATURE OF EDUCATION CESS – AN ALLOWABLE EXPENDITURE OR NOT?

*By Esakki Ammal K*
*Ph.D. Research scholar, The Tamilnadu Dr.Ambedkar Law University, Chennai.*

## ABSTRACT

The question of whether or not the 'Education Cess' is deductible under the Income-tax Act of 1961 ('the Act') has been debated for some time. Various Tribunals and High Courts have recently ruled in favour of taxpayers on this subject. Based on the examination of the Income Tax Act's relevant provisions, it seems that "Education Cess" is a deductible cost under section 37(1) of the Act and is not disallowable under section 40(a)(ii) of the Act but some contents that surtax is of the same character as that of income tax and, therefore, it cannot be held that it is incurred wholly and exclusively for the purpose of business to claim as deduction and henceforth payment of surtax (we here refer to cess) would not even be eligible for deduction under section 37 of the Act. The provisions of the Act and court rulings are briefly discussed in this article in the backdrop of the confusion that arises over the nature of cess and the researches attempts to draw the probable solution that would perhaps delineate the boundary of the word cess which will confine its true meaning and taxability.

***Keywords:*** *Cess- Income tax act- Allowable Expenditure- Disallowable expenses- Surtax.*

## INTRODUCTION

Cess is a term originated from Irish farmers; as those who have the most successful yield, pay the most tax on their crop to the Government. In India it is a tax on tax, levied by the government for a specific purpose. Cess is a form of tax charged/levied over and above the base tax liability of a taxpayer. A cess is usually imposed additionally when the state or the central government looks to raise funds for specific purposes. For example, the government levies an education cess to generate additional revenue for funding primary, secondary, and higher education. Cess is not a permanent source of revenue for the government, and it is discontinued when the purpose of levying it is fulfilled. It can be levied on both indirect and direct taxes.

The government can impose cess for purposes such as disaster relief, generating funds for cleaning rivers, etc. For example, after Kerala floods in the year 2018, the state government imposed a 1% calamity cess on GST and became the first state to do it. In other instances, the central government may levy an education cess, or a health cess, or a sanitation cess. All these levies are usually imposed as a percentage of the taxpayer's basic tax liability. Under the GST (Goods and Services Tax) regime, certain sin goods and luxury items also attract a cess. The word 'cess' formed part of disallowable expenses u/s 40(*a*)(*ii*) in the Income-tax Bill, 1961 as introduced in the Parliament. It was later when the matter came up before the Select Committee, it was decided to omit the word 'cess' from the clause.

In the Income-tax Act, 1922, section 10(4) had banned allowance of any sum paid on account of 'any cess, rate or tax levied on the profits or gains of any business or profession'.

In the corresponding section 40(*a*)(*ii*) of the IT Act, 1961 the nature of the word "cess" is quite conspicuous by its absence[1].

The subject of education cess tax deductibility has sparked a lot of debate and discussion within the fraternity, and there have been rulings on both sides of the issue. This article surrounds on the issue whether educational cess can be allowed as deductible expense or not, with the help of various judicial decisions.

## DISTINCTION BETWEEN CESS, SURCHARGE AND TAX

The terms 'tax', 'cess' and 'surcharge' have been separately used in the Constitution of India, drawing different connotations for these terms. A brief of the same is provided as below:

Tax - Article 270 of the Constitution of India gives provision for the taxes levied and distributed between the Union and the States. Article 270(1) identifies the taxes that form a part of the divisible pool, meaning the taxes, proceeds of which are to be distributed between the Union and the State Governments.

Surcharge - In accordance with Article 271, these have been frequently levied usually as an additional tax on taxpayers that are included in the highest income tax rate slabs. Surcharge is stated to be "an increase" in any of the duties and taxes referred to in Articles 269 and 270. Thus, the same forms part of divisible pool which are to be distributed between the Union and the State Governments.

Cess - Article 270 states that any cess levied for 'specific purposes' under any law passed by the Parliament do not form part of the divisible pool of between Union and States. 'Specific purposes' have been recognized as a core aspect of any cess.

All proceeds from tax, cess or surcharge are credited to the Consolidated Fund of India. The funds from cess are to be earmarked within the fund and the government utilises it for the specified purpose. Unlike a cess, in the case of a surcharge, there is no need to stipulate the purpose at the time of levy and it is the discretion of the Union to utilize the proceeds of the surcharges for whichever purpose it seems fit. If the term tax/surcharge and cess were to be used interchangeably, then there would arise no need to earmark the proceeds from cess for specified purpose and the same would also form part of the divisible pool of monies to be shared with the states, which presently is not the case.

## EDUCATION CESS - BACKGROUND

Education cess was introduced for the first time by the Finance Bill 2004. The specific objective of introduction of such cess was to finance the Government's commitment to universalize quality basic education. The Finance Bill 2004 further stipulated that the Central Government may, after due appropriation made by the Parliament, utilize the money of education cess only for the aforesaid stated objective. The Government vide Finance Act 2007 introduced an additional 'secondary and higher secondary education cess'. This was in addition to the education cess introduced earlier.

[1] Bombay HC in case of Sesa Goa Ltd.

In the Finance Act 2018, the Government discontinued 'education cess' and 'secondary and higher education cess' and introduced a new cess, by the name of 'Health and education cess'. The term 'education cess' is used to include 'secondary and higher secondary education cess'.

## CONTROVERSY AROUND THE TERM "CESS" FOR THE PURPOSE OF TAX TREATMENT

The issue of tax deductibility of education cess has been a matter of much debate and discussion amongst the fraternity, there have been judgements available on both sides of the spectrum. Some of them are highlighted as under:

"Education Cess" is a deductible cost under section 37(1) of the Act :

i. Bombay High Court in the case of *Sesa Goa Ltd. v. Jt. CIT*[2]

ii. Rajasthan High Court in case of *Chambal Fertilizers & Chemicals Ltd. v. CIT*[3]

iii. Kolkata Income-tax Appellate Tribunal in case of *Gloster Ltd. v. Asstt. CIT*[4]

"Education Cess" is disallowable under section 40(a)(ii) of the Act:

i. Kolkata Income-tax Appellate Tribunal in case of *Kanoria Chemicals and Industries Ltd. v. ACIT*[5]

The issue has recently been revived by the ruling of the Income-tax Appellate Tribunal's Kolkata bench in the aforementioned case of Kanoria Chemicals and Industries Ltd. (above). The ruling is in direct conflict with past ITAT decisions as well as the Bombay HC and Rajasthan HC decisions stated above. The contradictory judgements were referred to and appropriately dismissed by the Kolkata ITAT while pronouncing the ruling in favour of revenue. The ITAT disallowed the education cess expenditure based on the Hon'ble Supreme Court's ('SC') decision in the matter of CIT v. K Srinivasan[1]. The following are the main points of the aforementioned Kolkata ITAT decision:

A review of the clauses of the Finance Acts of 2004 and 2011 reveals that the 'education cess' is a separate surcharge paid on the income tax. In the cases of "Sesa Goa Ltd" and "Chambal Fertilisers," the same has not been brought to the attention of the Hon'ble High Courts. In the case of K. Srinivasan, the Hon'ble Supreme Court ruled that surcharge and additional surcharge constitute part of the income tax. In the below analysis, we have elucidated both the views while primarily focusing on how despite the adverse judgement passed by the ITAT, the claim of deduction of education cess is still debatable.

## "EDUCATION CESS" IS A DEDUCTIBLE COST UNDER SECTION 37(1) OF THE ACT

Any terms and expressions used in the section 2(14) and the First Schedule of the Finance Act but not defined in this section and defined in the Income-tax Act shall have the meanings ascribed to them in that Act,

[2] (2020)423 ITR 426
[3] [2019] 107 taxmann.com 484
[4] [2021] 187 ITD 626
[5] IT Appeal No. 2184 (Kol.) of 2018

according to sub-section (14) of section 2 of Finance Act 2018. As previously stated, neither the Finance Acts nor the Income-tax Act of 1961 define the term "cess." However, a reference has been made in Finance Act as under:

> *"(11) The amount of income-tax as specified in sub-sections (1) to (3) and as increased by the applicable surcharge, for the purposes of the Union, calculated in the manner provided therein, shall be further increased by* ***an additional surcharge, for the purposes of the Union, to be called the "Education Cess on income-tax"****, calculated at the rate of two per cent of such income-tax and surcharge* ***so as to fulfil the commitment of the Government to provide and finance universalised quality basic education****……."*

From the foregoing, it can be seen that the government has merely referred to the education cess as an additional surcharge, but it retains its character as a cess in substance, as evidenced by the phrase "so as to fulfil the Government's commitment to provide and finance universalised quality basic education." This clearly suggests that the education cess is fundamentally distinct from the surcharge; otherwise, there would be no need to specify a goal for the use of such money. A interpretation provided in contravention of the Indian Constitution cannot be considered genuine. As a result, without clearly identifying and referring to education cess as an extra surcharge under the Finance Act, it must be disregarded in contrast to its true character and structure.

Furthermore, in *State of Bombay v. Automobile and Agricultural Industries Corporation*[6], the Hon'ble Apex Court held that the courts will not be justified in adding terms to a taxation act in order to make out some inferred legislative purpose. If the Legislature fails to use suitable wording to clear its intent, the benefit must be passed on to the taxpayer. It is well established that in the event of a dispute, the taxpayer-friendly interpretation of a taxation provision must be used."

Furthermore, perhaps in the backdrop of other Acts, the Supreme Court of India declared in *Unicorn Industries v. Union of India*[7] that education cess cannot be considered a "duty of excise," thereby separating it from taxes. The government should not, in theory, use two separate principles: one for collecting money and another for dealing with it. If a levy in the form of a cess is fundamentally distinct from a tax or surcharge with a specific purpose, the government must not mix it in with taxes and surcharges in the hands of taxpayers.

Honourable Supreme Court's decision in the matter of *K Srinivasan* is about surcharges, not cess. The above-mentioned apex court decision concerns the legality of surcharges and extra surcharges. The word 'cess' does not appear in the ruling. In the matter of *Kanoria Chemicals and Industries Ltd.*, the Kolkata ITAT relied on the aforementioned Supreme Court's decision and treated the word "education cess" as an additional surcharge, disallowing it as a deductible cost.

In the case of *Goodyear India Ltd. v State of Haryana*[8], the Supreme Court said that a

[6] [1961] 12 STC 122
[7] [2019] 112 taxmann.com 127
[8] 1989 taxmann.com 660

precedent is only authoritative for what it actually determines, not for what may distantly or even logically follow from it, and that a judgement on unargued matters cannot be considered a precedent.

The argument involved surcharge, and so, based on the Supreme Court's precedent, the decision in K Srinivasan cannot be directly applied to situations involving the deduction of education cess.Section 10(4) of the Income-tax Act of 1922 prohibited the deduction of any money paid as a result of "any cess, rate, or tax levied on the earnings or gains of any company or profession." The phrase "cess" is conspicuously absent from the analogous section 40(a)(ii) of the IT Act, 1961[9].

The above suggests that the legislature, in its spirit and in truth, opted to remove the term cess from the scope of disallowance under section 40(a) (ii). The same is backed by the CBDT's Circular No. F. No. 91/58/66-ITJ(19), dated May 18, 1967, which stated:

> *""Recently a case has come to the notice of the Board where the Income-tax Officer has disallowed the **'cess'** paid by the assessee…*
>
> *The view of the Income-tax Officer is not correct. Clause 40(a)(ii) of the Income-tax Bill, 1961 as introduced in the Parliament stood as under:-*
>
> *"(ii) any sum paid on account of any cess, rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains".*
>
> *When the matter came up before the Select Committee, it was decided to omit the word 'cess' from the clause. The effect of the omission of the word 'cess' is that only taxes paid are to be disallowed in the assessments for the years 1962-63 and onwards"*

Based on the foregoing, in the absence of the term "cess," it is a well-established concept, as stated by the Supreme Court in *Nasiruddin v. Sita Ram Agarwal*[10], that the Court cannot expand the scope of law or purpose when the wording of the provision is clear and unambiguous. It can't add or remove words from a statute, or read anything into it that doesn't exist. It will not be able to rewrite or recast legislation[11].

Some instances where distinction is made between cess, surcharge, tax etc. in the Act

Section 138 of the Act - in sub-clause (i) of clause (a) of sub-section (1), a clear distinction between the terms tax, duty or cess is made.

Explanation 2 to section 115JB (2) states that the amount of income-tax shall include:

*"...(iii) surcharge, if any, as levied by the Central Acts from time to time;*

*(iv) Education Cess on income-tax, if any, as levied by the Central Acts from time to time; and*

[9] Bombay HC in case of Sesa Goa Ltd.

[10] [2003] 2 SCC 577

[11] Kinjesh thakkar , Saurav Gada, Allowability of Education cess–Puzzle for judiciary, dilemma for taxpayers, 133 taxmann.com 227 [2021]

*(v) Secondary and Higher Education Cess on income-tax, if any, as levied by the Central Acts from time to time...."*

Clause (a) of section 43B states the below:

*"any sum payable by the assessee by way of tax, duty, cess or fee, by whatever name called, under any law for the time being in force, or"*

From the above, one may observe that wherever the legislature intended to include the term 'cess' specifically in the statue it has done so. The term 'tax' has been defined in section 2(43) of the Act to include only Income-tax, Super Tax and Fringe Benefit Tax (FBT), hence excluding the term 'cess' from the meaning of the term 'tax'.Thus, from above it can be concluded that "Cess" is not equivalent to tax but a separate levy[12].

Statutory levies can be considered to be incurred for the purpose of business

The Hon'ble SC in case of *CIT* v. *Malayalam Plantation Ltd*.[13] observed the following:

> *"The expression used in section 37 is 'for the purpose of business'. This expression is wider in scope than the expression 'for the purpose of earning profits'. It may take in not only the day-to-day running of a business but also the rationalization of its administration and modernization of its machinery, it can include measures for the preservation of the business and for the protection of its assets and property from expropriation, it may also comprehend payment of statutory dues and taxes imposed as a precondition to commence or for carrying on of a business; it may comprehend many other acts incidental to the carrying on of a business"*

*"Carrying on Business"* if simply put means doing any activity with an intent of earning income/profits from the activity. Payment of cess is a statutory due on account of earning income which arises on account of carrying of business. Thus, based on the above case law, a view can be taken that education cess is an allowable expenditure to carry on business[14].

In the Memorandum to Finance Bill 2018, there is no mention of a surcharge for health and education.

Firstly, without clear legislative insertion in the Act, a simple mention in a Budget Speech or memorandum cannot establish a different categorization than what any term truly is. Even if we accept the categorization offered in the Finance Bill 2004 when establishing the education cess, which referred to it as a "extra surcharge," the Memorandum to Finance Bill 2018 when introducing the "health and education cess" instead refers to it as a "New cess." The following is an excerpt from the Memorandum to Finance Bill 2018 that is relevant:

> *"Education Cess on income-tax" and "Secondary and Higher Education Cess on income-tax" shall be discontinued. However, a new cess, by the name of "Health and Education Cess" shall be levied at the rate of four per cent. of income tax including surcharge wherever applicable, in the cases of*

[12] Allowability educational cess paid on income tax as expenses, (8) TMI 370 (2019)

[13] [1964] 53 ITR 140

[14] Kinjesh thakkar , Saurav Gada, Allowability of Education cess–Puzzle for judiciary, dilemma for taxpayers, 133 taxmann.com 227 [2021]

*persons not resident in India including company other than a domestic company."*

Thus, based on a literal meaning, both the former 'education cess' and the current 'health and education cess' cannot be regarded equally. As a result, the adverse decisions in the instance of the education cess cannot be directly applied to the deductibility of the 'health and education cess.'

## "EDUCATION CESS" IS DISALLOWABLE UNDER SECTION 40(A)(II) OF THE ACT

Based on the verdict of the Kolkata ITAT in the matter of *Kanoria Chemicals and Industries Ltd.,* one may conclude that 'education cess' is an extra surcharge charged on income tax under the terms of the Finance Act 2004. As per the Apex Court's decision in the matter of K. Srinivasan, such additional surcharges that are a part of 'income-tax' should be banned under section 40(a) (ii).

## CONCLUSION

On this subject, there are a variety of opinions accessible. Obviously, there isn't a conclusive answer to the dispute. Though ‘"education cess" is disallowable under section 40(a)(ii) of the act’ contains some valid points, ‘"education cess" is a deductible cost under section 37(1) of the act’ cannot be dismissed because none of the above arguments has been thoroughly examined. Furthermore, depending on the hierarchy of litigation in India, the weight of court precedents to date may tip the scales in favour of ‘"education cess" is a deductible cost under section 37(1) of the act’ which is supported by two High Courts. As a result, the taxpayer can still claim the education cess as a deductible item on his or her tax return. There is a chance that the claim will be litigated.

However, as a practical matter, a taxpayer can file an income tax return without claiming the education cess deduction and then send a letter to the tax authorities indicating that the amount is to be paid under protest. This claim can be filed throughout the assessment or appeals process. The potential of not opening the scrutiny assessment might be a deterrent because this strategy isn't foolproof, but it does spare taxpayers from penalties owing to the litigious character of this issue.

To sum up, this case exemplifies how intricate our tax system is, with a sharp divide of opinion among taxpayers, specialists, revenue officials, and the judiciary. While one can wait for the Honorable Supreme Court to rule on this, there is a chance that the government would intervene through a legal amendment to the Act, as we have seen in the past with other difficult matters. The moment is ripe for taxpayers to file additional claims on this basis before the tax authorities until such a determination is reached.

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