



Education Cess - Tax Implications

EDUCATION CESS – TAXATION ASPECT AS PER THE INCOME TAX ACT, 1961

Background & Meaning

- **What is a Cess?**

Cess is a form of tax and an additional levy by the Central Government to raise funds for specific purpose. Cess is resorted to only when there is a need to meet specific expenditure for the Public welfare and to be discontinued once the objective is met.

- **Cess in India**

The Government introduced levy of “cess” on tax-payers from time to time. The Education cess was introduced to meet its commitment to provide and finance universalized quality basic education needs of poor people in India as an additional levy on basic tax liability.

At present, the government charges a 4% health and education cess on the direct income tax liability of assesseees.

Analysis of Section 40(a)(ii)

Section 40(a)(ii) of the Act *inter-alia* provides as follows –

“Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head “Profits and gains of business or profession”,—

(a) in the case of any assessee—

(ii) any sum paid on account of any 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.

Explanation 1—For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of any rate or

tax levied includes and shall be deemed always to have included any sum eligible for relief of tax under section 90 or, as the case may be, deduction from the Indian income-tax payable under section 91.

Explanation 2—For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of any rate or tax levied includes any sum eligible for relief of tax under section 90A ”

On a plain reading of the above provision of section 40(a) (ii), it is evident that a sum paid of any rate or tax is expressly disallowed by this sub-clause in two cases :

- (i) where the rate is levied on the profit or gains of any business or profession, and
- (ii) where the rate or tax is assessed at a proportion of or otherwise on the basis of any such profits or gains.

Therefore a question arises as to whether such cess levied on tax-payers falls under categories (i) or (ii) above to attract disallowance.

Education cess is neither levied on the profits or gains of any business or profession nor assessed at a proportion of, or otherwise on the basis of, any such profits or gains.

History of insertion of Section 40(a)(ii)

Clause 40(a)(ii) of the IT Bill, 1961 which was originally introduced in the Parliament read 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 went up before the Select Committee, it was decided to omit the word ‘cess’ from the clause.

Issuance of a clarification - CBDT Circular

In view of the above, the CBDT in order to avoid any further litigation on the account brought the same to notice vide issue of Circular F. NO. 91/58/66-ITJ(19) dated 18.05.1967 which clarified that the education cess paid by the assessee is allowed under the Act. The effect of the omission of the word 'cess' as recommended by the Select Committee would mean that only taxes paid were to be disallowed in the assessments for the year 1962-63 and onwards, not cess.

Judgments of Courts/Tribunals

Various judicial pronouncements also support the contention that cess is an allowable expense under section 37(1) of the Act. Some noteworthy cases have been mentioned herein.

The High Court while deciding on the matter in the case of **Chambal Fertilisers and Chemicals Limited v. JCIT (D.B. ITA No. 52/2018)** held that in view of the circular of CBDT where word "Cess" is deleted, the tribunal had committed an error and thus education cess, not being a tax cannot be disallowed under section 40(a)(ii) of the Act.

The Calcutta Tribunal in the case of **The Peerless General Finance & Investment Co. Ltd. -vs. - DCIT (ITA No. 937/Kol/2018)** while relying on the judgment of the Coordinate Bench of ITAT, Kolkata in the case of ITC Limited, ITA No.685/Kol/2014 (order dated 27.11.2018) held that the issue of allowance or disallowance of education cess under the Act was no longer *res integra*, and the same not being 'income tax' was allowable as deduction under section 37 (1) of the Act.

The Calcutta Tribunal in the case of **M/s ITC Infotech India Ltd. v. ACIT, Circle-2(1), Kolkata (ITA No.552/Kol/2019)** dismissed the appeal of the Revenue and accepted the submissions of the assessee concurring with the decisions of Rajasthan High Court and binding favourable decisions of Jurisdictional Tribunal and thus allowed the claim of the education cess.

The Calcutta Tribunal in the case of **M/s ITC Limited -vs.-ACIT (ITA No. 685/Kol/2014)** considered the said issue and rejected the disallowance made by the Revenue while relying on the Hon'ble Rajasthan high court's decision in DB Income Tax Appeal No. 52/Kol/2018 M/s Chambal Fertilizers

Ltd. vs. DCIT decided on 31.07.2018 which took into account the CBDT circular dated 18.05.1967 for holding such cess(es) to be allowable as deduction. It held that section 40a(ii) applied only on taxes such than earn cess(es), and hence should be allowed under the Act.

The Calcutta Tribunal in the case of **M/s Paharpur Cooling Towers Ltd v. DCIT, Central Circle- 2(1) (ITA No.217 to 219/Kol/2018)** while taking into note the Ld Co-ordinate bench's decision in ITC Ltd. (ITA No.685/Kol/2014) dated 27.11.2018 which also decided the very issue in the assessee's favour held that the relevant statutory provision to this effect as well as the CBDT's circular issued way back on 18.05.1967 did not include "Cess", and was hence allowable.

The Calcutta Tribunal in the case of **Russell Credit Ltd DCIT, Cricle-8/Addl.CIT Range-8 (ITA No.33/Kol/2018)** also declined the arguments of the Revenue and decided the issue in favour of the assessee by allowing such cess.

Conclusion

Therefore going by the rationale of the above judicial pronouncements and the CBDT Circular being binding on the taxation authorities, a view can be taken that education cess should be allowed as deduction under section 37(1) of the Act.