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Analysing developments impacting business

EDUCATION 'CESS' NOT A TAX?

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Recently, in the case of *Sesa Goa Limited v The Joint Commissioner of Income-Tax* (ITA No. 17/2013), the High Court of Bombay at Goa allowed a deduction in respect of cess (education cess and higher and secondary education cess) from the business income of the taxpayer.

Background

As per the Income Tax Act, 1961 (IT Act), the base tax liability of a tax payer is to be increased by a surcharge (at the rates applicable for each category of taxpayer), and the aggregate of tax and surcharge is to be further increased by a 'cess' (earlier in the form of an education and higher and secondary education cess at the rate of 3%, and now replaced with a health and education cess at the rate of 4%).

While computing the business or professional income of any taxpayer, a deduction is allowed for all expenses which are incurred in relation to such business (subject to certain exceptions). However, by way of a specific provision (Section 40(a)(ii) of the IT Act), a deduction with respect to any expenditure in the nature of a 'rate' or 'tax' has been specifically disallowed.

The question which therefore arises is whether for the purpose of this provision, a 'cess' would be considered as a 'tax' and would accordingly be disallowed as a business expenditure. This issue has been dealt with in the aforesaid decision of the High Court of Bombay, as well the earlier decision given by the High Court of Rajasthan in the case of *Chambal Fertilisers & Chemicals Ltd v Commissioner of Income-Tax, Range 2, Kota* (which has been followed by the Income Tax Appellate Tribunal in several decisions).

Decision of the Bombay High Court

The key contention of the taxpayer in this case was the term 'any rate or tax' does not include 'cess' and therefore, cess should be allowable as a deduction against its business income.

In response, the tax department contended that 'cess' is inherently included in the scope of the expression 'any rate or tax' and therefore, should not be allowed as a deduction.

The High Court examined the legislative history in relation to Section 40(a)(ii) of the IT Act and noted the following:

- The Income Tax Bill, 1961 which introduced Section 40(a)(ii) into the IT Act, contained the expression 'cess, rate or tax' and therefore specifically included 'cess' as an item separate from tax. However, a Select Committee of the Parliament omitted the term 'cess' under the final provisions; and
- This issue has also been dealt with in a circular issued by the Central Board of Direct Taxes (CBDT) dated 18 May 1967, which specifically refers to the omission of the term 'cess' made by the Select Committee of the Parliament (as discussed above), and states that the effect of the omission of the word 'cess' is that only taxes paid are to be disallowed.

The High Court therefore observed that the legislature could have easily included reference to cess in the provision, and non-inclusion of the same shows the intention to allow such cess as a deduction, and therefore decided in favour of the taxpayer.

Comments

While the impugned judgement has been rendered in the context of education cess and higher and secondary education cess, the principle would equally hold good for health and education cess as well. Based on this decision and the earlier decision of the High Court of Rajasthan, taxpayers may explore the opportunity to claim a deduction with respect to the 'cess' paid on the basic tax amount. Moreover, apart from the above CBDT circular, the taxpayer may also take guidance from other provisions under the IT Act under which tax has been defined, and a distinction has been made between tax and cess.

However, with respect to the quantum or proportion of cess which may be claimed as a deduction in each year, some aspects may need further evaluation. For example, it is unclear whether the deduction with respect to cess should be restricted only to cess paid on the business income of the taxpayer (since such deduction is allowed against the business income of a taxpayer), and whether such deduction must be allowed on an accrual basis or on a payment basis.

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