

## Bombay High Court<sup>1</sup> allows deduction of 'Education Cess' under section 40(a)(ii)

There is an ongoing legal controversy whether 'education cess and secondary and higher education cess' ('education cess') are allowable as deduction while computing business income of an assessee.

The issue arises basis the import and interpretation of **section 40(a)(ii) of the Income Tax Act, 1961** ('the Act'), which provides that notwithstanding anything to the contrary in sections 30 to 38, "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" is not allowable as deduction.

In this background, the recent ruling of the Bombay High Court<sup>1</sup> in the case of **Sesa Goa** assumes significance since it held education cess to be allowable as deduction. The High Court, while allowing the claim, reasoned as under:

- Firstly, taxing statutes ought to be interpreted strictly, and since 'cess' does not find mention in the bar imposed under section 40(a)(ii), the same deserves to be allowed;
- Secondly, unlike section 10(4) of the Indian Income Tax Act, 1922 ('the 1922 Act'), which disallowed payment of 'any cess, rate of tax'; section 40(a)(ii) expressly omitted the word 'cess';
- Thirdly, the allowability of 'cess' under section 40(a)(ii) was expressly clarified by the Circular<sup>2</sup> issued by the Central Board of Direct Taxes ('CBDT');
- Fourthly, similar claim was upheld by the Rajasthan High Court (Jaipur Bench) in the case of *Chambal Fertilisers*<sup>3</sup>;
- Lastly, the Apex Court in the case of *Jaipuria Samla Amalgamated Collieries*<sup>4</sup> held that profits or gains of any business or profession has reference only to profits and gains as determined in accordance with section 29 and that any rate or tax levied upon profits calculated in a manner other than that provided by that section could not be disallowed under section 40(a)(ii) of the Act.

### **ANALYSIS OF THE CONTROVERSY**

On the issue of *allowability of education cess*, one of the first rulings by a High Court was the judgment of the Rajasthan High Court in the case of *Chambal Fertilizers (supra)* wherein, following the *CBDT Circular dated 18.05.1967 (supra)*, the High Court allowed the deduction claimed on account of education cess paid during the year.

However, prior to the ruling in the case of *Chambal Fertilizers (supra)*, all rulings on the issue, by the various benches of the Income Tax Appellate Tribunal ('Tribunal') held against<sup>5</sup> the assessee – the ruling in *Chambal Fertilizers (supra)* thus, marked the watershed insofar as the issue of allowability of deduction on education cess is concerned. The subsequent decisions of the Tribunal however, relying on the aforesaid ruling of the Rajasthan High Court have been in favour<sup>6</sup> of the assessee.

<sup>1</sup>Sesa Goa Ltd. vs. JCIT [TA No.17/2013; decided on 28.02.2020] (Bom-Goa)

<sup>2</sup> Circular No. F. No.91/58/66-ITJ(19) dated 18.05.1967

<sup>3</sup> Chambal Fertilisers and Chemicals Ltd. vs. CIT [ITA No.52/2018; decided on 31.07.2018] (Raj-Jaipur)

<sup>4</sup>Jaipuria Samla Amalgamated Collieries Ltd Vs CIT [1971] 82 ITR 580 (SC)

<sup>5</sup>Kalimati Investments Co. Ltd. vs. ITO [I.T.A. No.4508/Mum/2010; decided on 09.05.2012]; Everest Industries Ltd. vs. JCIT [2018] 192 TTJ 904 (Mumbai - Trib.)

<sup>6</sup>ITC Ltd. vs. ACIT [I.T.A. No.685/Kol/2014; decided on 27.11.2018]; DCIT vs. Bajaj Allianz General Insurance Company Ltd. [I.T.A. Nos.1111 & 1112/Pun/2017; decided on 25.07.2019]; Atlas Copco (India) Limited vs. ACIT [I.T.A. No.736/Pun/2011; decided on 05.08.2019]; Tega Industries Ltd. vs. ACIT [I.T.A. Nos.404 & 2527/Kol/2017; decided on 23.08.2019]; Tata AutoComp Hendrickson Suspensions Private Limited vs. DCIT [I.T.A. Nos.2486 to 2488/Pun/2017; decided on 18.09.2019]; DCIT vs. ITC Infotech India Ltd. [I.T.A. Nos.67/Kol/2015 & 485/Kol/2019; decided on 23.10.2019]; Tata Steel Ltd. vs. ACIT [I.T.A. Nos.4043 &

Upon a deeper analysis of the statutory scheme coupled with the contextual understanding of the legislative history as well as application of settled ruled of statutory construction, it would follow that there exist arguments both in favour and against the allowability of such deduction, which may be outlined as under:

### ***Arguments in favour of the Assessee***

- (i) Education cess is distinct and separate from tax, and being levied for a specific purpose, and not for general purpose of Government expenditure, does not partake the character of income tax to be covered within the embargo under section 40(a)(ii);
- (ii) The *CBDT Circular dated 18.05.1967 (supra)* clarified that payment of “cess” is not covered under section 40(a)(ii);
- (iii) Section 40(a)(ii) applies to tax which is a charge on the ‘profits and gains of business’ while education cess is a charge on tax, including other incomes as well;
- (iv) The term ‘cess’ was specifically excluded from the final phraseology of section 40(a)(ii), at the time of its enactment;
- (v) Similar interpretation leading to exclusion of ‘cess’ from the meaning of tax has been accorded to section 43B(a) which also forms part of Chapter IV-D of the Act;
- (vi) ‘Cess’ has specifically been included within the meaning of tax under section 115JB [as per Explanation 2], but no such explanation finds mention under section 40(a)(ii);
- (vii) Machinery of levy and collection does not accord education cess the same character as income tax.

### ***Arguments against the Assessee***

- (i) Education cess, being an additional surcharge on income tax partakes the same character;
- (ii) The legislative history of section 40(a)(ii) is not determinative since the same pre-dates the introduction of the levy of education cess; further, the *CBDT Circular dated 18.05.1967 (supra)* envisaged cesses levied under other laws;
- (iii) The phrase ‘any rate or tax’ under section 40(a)(ii) has to be construed having regard to its ordinary acceptable meaning, which includes education cess;
- (iv) Apart from the aforesaid, education cess cannot be termed as being paid “wholly and exclusively for the purpose of assessee’s business” warranting allowance under section 37(1) of the Act.

### ***CONCLUDING REMARKS***

In view of the foregoing, the issue regarding allowability of deduction of education cess is one of such litigative instances under the Income Tax law that provides for no definitive answer. Although the bulk of the rulings are in favour of the assessee, the majority, if not all, of those trace their reasoning and basis back to the Rajasthan High Court ruling in the case of *Chambal Fertilizers (supra)*. In fact, even the Bombay High Court in the case of *Sesa Goa (supra)* has placed emphatic reliance on the aforesaid ruling, while also noting, though erroneously, that the ruling of the Rajasthan High Court has been accepted by the Revenue<sup>7</sup>.

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5616/Mum/2012; decided on 06.11.2019]; DCIT vs. Graphite India Limited [I.T.A. Nos.472 & 474 & C.O. Nos.64 & 66/Kol/2018; decided on 22.11.2019]; DCIT vs. McNally Bharat Engineering Ltd. [I.T.A Nos.147 & 109 & C.O. Nos.35 & 36/Kol/2018; decided on 22.11.2019]; DCIT vs. Peerless General Finance and Investment and Co. Ltd. [I.T.A. Nos.1469 & 1470/Kol/2019; decided on 05.12.2019]; Sicpa India Private Ltd. vs. Addl. CIT [I.T.A. No.704/Kol/2015; decided on 31.01.2020]

<sup>7</sup> In fact, the ruling of the Rajasthan High Court in the case of *Chambal Fertilizers (supra)* was not accepted by the Revenue – against the same, Special Leave Petition bearing SLP(C) No.7379/2019 was preferred by the Revenue, wherein vide order dated 11.03.2019 notice was issued on this very same issue [the said SLP was however thereafter dismissed on law tax effect].

Considered in this light, the present issue is one which requires conclusive adjudication and redressal by the Apex Court to put the controversy to rest. At the same time, considering the divergent nature and disputed contours of the question, and more particularly the judgment of the Bombay High Court, the taxpayer may consider to make the claim to keep the same alive after making full and complete disclosures.

For any details and clarifications, please feel free to write to:

**Mr. Rohit Jain** : [rohit@vaishlaw.com](mailto:rohit@vaishlaw.com)

**Mr. Aniket D. Agrawal** : [aniket.agrawal@vaishlaw.com](mailto:aniket.agrawal@vaishlaw.com)