Education cess charged under Chapter-II of the Finance Act, is not an allowable deduction under section 37(1) of the I.T.Act, 1961

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Sometime back, one of my clients approached me with a query whether education cess presently charged along with the income-tax and surcharge, could be claimed as a deduction under section 37(1) of the Income-Tax Act, 1961 (the Act). The aforesaid query was raised, because some Income-Tax Advisor provided the aforesaid client with an Opinion that the aforesaid education cess is allowable as a deduction under section 37(1) of the Act. In support of the aforesaid Opinion, the Income-Tax Advisor had placed reliance on the Supreme Court judgement in the case of *Jaipuria Samla Amalgamated Collieries Ltd Vs CIT [1971] 82 ITR 580 (SC)* and an old Circular of the CBDT, viz. Circular No.91 / 58 / 66 – ITJ (19), dt.18.5.1967.

At the outset, it must be stated that the aforesaid view has been provided by the Income-Tax Advisor, without taking into consideration the relevant provisions of Chapter II of the Finance Act, the correct interpretation of the aforesaid judgement of the Supreme Court in the case of *Jaipuria Samla Amalgamated Collieries Ltd Vs CIT [1971] 82 ITR 580 (SC)* and also other relevant legal precedents. Therefore, the aforesaid Opinion is totally erroneous and ill-conceived.

The correct view in this regard is that the education cess presently charged, along with income-tax and surcharge under Chapter II of the Finance Act, is not allowable as a deduction under section 37(1) of the Act. This view is based on the relevant provisions of the Income-Tax Act, 1961, the relevant provisions of the Finance Act, as also the relevant legal precedents. The same are discussed as follows :

I. Section 40(a)(ii) – Amounts not deductible.

In the first place, it will be appropriate to refer to the provisions of section 40(a)(ii) of the Act. For the sake of ready reference, the same is reproduced as follows :

40. Amounts not deductible.

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;

From the aforesaid provisions of section 40(a)(ii), it is quite clear that any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed as proportion of, or otherwise on the basis of any such profits and gains, will not be allowable as a deduction in the computation of income chargeable under the head "*Profits and gains of business or profession*". It may also be stated here that even rate or tax assessed as a proportion of or otherwise on the basis of any such profits and gains, also falls within the mischief of section 40(a)(ii) of the Act.

II. The relevant provisions of Chapter II of the Finance Act

Chapter II of every Finance Act provides "*Rates of income-tax*" chargeable for the relevant assessment year. For the sake of convenience, we may refer to the Finance (No.2) Act, 2014. Chapter II of the aforesaid Finance Act, viz. section 2 thereof, containing sub-sections (1) to (13) thereof, deals with "*Rates of income-tax*".

At the outset, it may be stated that education cess charged under Chapter II of the Finance Act, as an additional surcharge is nothing but part of the tax chargeable under the Act and accordingly, the same is not allowable as a deduction, in view of the provisions of section 40(a)(ii) of the Act.

In the present context, in the first place, it must be noted that there are two types of education cess under Chapter II of the Finance Act, viz :

(i) Education Cess on income-tax, calculated at the rate of 2% of income-tax and surcharge, as laid down under sub-section (11) of section 2 of the aforesaid Chapter-II of the Finance Act, and

(ii) "*Secondary and Higher Education Cess on income-tax*", calculated at the rate of 1% of income-tax and surcharge, as laid down under sub-section (12) of section 2 of the aforesaid Chapter-II of the Finance Act.

Before we proceed further in the matter, it must be noted that both the aforesaid education cess are charged under sub-sections (11) and (12) of section 2 of Chapter II of the Finance Act. In this regard, it is relevant to state that the heading of the aforesaid Chapter II is "*Rates of income-tax"* and the heading of section 2 of the aforesaid Chapter II is "*Income-Tax*". It is, thus, very clear that education cess charged under sub-sections (11) and (12) of section 2 of Chapter II of the Finance Act, is a part of income-tax chargeable thereunder.

The relevant provisions of the aforesaid Chapter II of the Finance Act, may be discussed as follows :

1. Sub-section (1) of section 2 of Chapter II of the Finance Act.

In the first place, it is relevant to refer to and reproduce sub-section (1) of section 2 of the aforesaid Chapter II, which is reproduced as follows :

"***2. Income-tax.***

(1) Subject to the provisions of sub-sections (2) and (3), for the assessment year commencing on the 1st day of April, 2014, income-tax shall be charged at the rates specified in Part I of the First Schedule and ***such tax shall be increased by a surcharge****, for purposes of the Union, calculated in each case in the manner provided therein*." [Emphasis added]

From the aforesaid provisions of section 2(1), it may be seen that income-tax shall be charged at the rates specified in Part I of the First Schedule and such tax **shall be increased by a surcharge** for the purposes of the Union, calculated in each case in the manner provided therein. **Thus, surcharge is nothing but a part of the tax.**

2. Sub-section (11) of section 2 of Chapter II of the Finance Act.

We may now refer to sub-section (11) of section 2 of Chapter II of the Finance Act, which is reproduced as follows :

"(11) The amount of income-tax as specified in sub-sections (1) to (10) and as increased by the applicable surcharge, for purposes of the Union, calculated in the manner provided therein, ***shall be further increased by an additional surcharge****, for 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:"* [Emphasis added]

From the aforesaid provisions of section 2(11), it is quite clear that the amount of income-tax as specified in sub-sections (1) to (10) and as increased by the applicable surcharge, for purposes of the Union, **shall be further increased by an additional surcharge**, for 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.

3. Sub-section (12) of section 2 of Chapter II of the Finance Act.

In the present context, sub-section (12) of section 2 is also relevant, which is reproduced as follows :

"(12) The amount of income-tax as specified in sub-sections (1) to (10) and as increased by the applicable surcharge, for purposes of the Union, calculated in the manner provided therein, ***shall also be increased by an additional surcharge****, for purposes of the Union, to be called the "****Secondary and Higher Education Cess on income-tax****", calculated at the rate of one per cent of such income-tax and surcharge so as to fulfil the commitment of the Government to provide and finance secondary and higher education:"* [Emphasis added]

From the aforesaid provisions of section 2(12), it may be seen that the amount of income-tax as specified in sub-sections (1) to (10) and as increased by the applicable surcharge, for purposes of the Union, **shall also be increased by an additional surcharge**, for purposes

of the Union, to be called the "*Secondary and higher education Cess on income-tax*", calculated at the rate of one per cent of such income-tax and surcharge, so as to fulfil the commitment of the Government to provide and finance secondary and higher education.

From the aforesaid provisions of sub-sections (1), (11) and (12) of section 2, it is clearly established that –

(i) Income-tax shall be charged at the rates specified in Part I of the First Schedule and such tax shall be increased by a surcharge for the purposes of the Union.

It is, thus, clear that surcharge is nothing but part of the income-tax.

(ii) Further, as per sub-section 2(11), the amount of income-tax shall be further increased by an additional surcharge for the purposes of the Union to be called the "*Education Cess on income-tax"*.

It is, thus, quite clear that the aforesaid education cess is nothing but additional surcharge.

(iii) Similarly, as per the provisions of section 2(12), the amount of income-tax shall also be increased by an additional surcharge for the purposes of the Union to be called the "*Secondary and higher education Cess on income-tax"*.

Thus, the aforesaid education cess is also nothing but additional surcharge.

From the aforesaid discussion, it is clearly established that education cess is nothing but part of income-tax chargeable under the provisions of the Act and accordingly, the same clearly falls within the mischief of section 40(a)(ii) and accordingly, the same cannot be allowed as a deduction in the computation of income chargeable under the head "*Profits and gains of business or profession"*.

III. Relevant legal precedents, in support of the view that education cess is not an allowable deduction under section 37(1) of the Act.

We may now refer to some relevant legal precedents which support the view that the education cess presently charged, along with income-tax and surcharge is not allowable as a deduction under section 37(1) of the Act. The same are discussed as follows :

1. *A.V.Thomas & Co.Ltd Vs CIT [1986] 159 ITR 431 (Ker)(FB).*

The aforesaid judgement relates to the issue whether **surtax** is a charge on income and a levy on the profits and gains of business and whether the same could be allowed as a deduction under section 37 of the Act, r.w.s.40(a)(ii) of the Act.

It was held in this case that surtax is an application of profits and gains of business after they have been earned and it is not an expenditure laid out or expended for the purposes of business and therefore, not an allowable deduction.

It was also held that –

(i) Income-tax is not an expenditure laid out for the purposes of the business. On the contrary, it is paid out of the profits. It is an application of the profits after they have been earned. Taxes, such as, excess profits tax, super tax, **surcharge** or surtax are charges on profits. There is no statutory provision allowing deduction of such expenditure.

(ii) On the other hand, where taxes such as sales-tax or excise duty have been paid, or liability incurred therefor, they are not cases of application of the income, but expenditure incurred for the purpose of carrying on the business and, therefore, deductible in computing profits and gains of business. Liability to pay sales-tax or excise duty or similar tax does not depend upon whether profits are made or not

(iii) Surtax which is levied on the excess chargeable profits is a levy on the total income computed under the Income-Tax Act after it is adjusted in accordance with the machinery provided for it under the Surtax Act. In the nature of this tax, it is a levy on the basis of the profits or gains of the business. It is an application of the profits or gains of the business after they have been earned. Like in the case of income-tax or super tax, so in the case of surtax, any sum paid on account of such levy is not an expenditure laid out or expended for the purposes of the business. Whether or not it comes within the express prohibition under the statute, it is not an allowable deduction under section 37 of the Income-Tax Act, 1961.

(iv) Therefore, whether or not the amount in question, comes within the express prohibition contained in section 40(a)(ii), the claim for deduction of surtax in computing the total income of an assessee, is not allowable.

It may also be stated here that the aforesaid judgement of Kerala High Court has been affirmed by the Supreme Court, in the case of *Smith Kline and French (India) Ltd Vs CIT [1996] 219 ITR 581 (SC).*

It may also be stated here that in the aforesaid judgement of the Supreme Court, the case of *Jaipuria Samla Amalgamated Collieries Ltd Vs CIT [1971] 82 ITR 580 (SC),* has also been considered.

The aforesaid criteria applied by the Kerala High Court to the charge of surtax is equally applicable to the charge of education cess, in view of the following reasons :

(a) Both types of education cess are charged under section 2 of Chapter II of the Finance Act, as an additional surcharge and the same are calculated at the rate of 2% and 1% of income-tax plus surcharge, respectively.

(b) As per section 2(1) of Chapter II of the Finance Act, income-tax shall be charged at the rates specified in Part I of the First Schedule **and such tax shall be increased by a surcharge** for the purposes of Union, calculated in each case in the manner provided therein. **Thus, surcharge is nothing but a part of the tax.**

(c) Thus, education cess is a levy on the total income, computed under the Income-Tax Act. It is an application of the profits and gains of the business, after they have been earned.

(d) Therefore, any amount paid on account of education cess is not an expenditure laid out or expended for the purposes of the business.

In view of the aforesaid reasons, it is clearly established that education cess is a part of income-tax charged under the Act and therefore, the same cannot be allowed as a deduction in the computation of total income, irrespective of the fact whether or not, it comes within the expressed prohibition contained in section 40(a)(ii) of the Act.

2. *Sundaram Industries Ltd Vs CIT [1986] 159 ITR 646 (Mad)*

It was held in this case that surtax imposed by the Companies (Profits) Surtax Act, 1964, is an additional tax imposed and the subject-matter of charge is to be computed taking the total income of the assessee computed under the Income-Tax Act, 1961, as the basis. The liability to pay surtax arises on the determination of the profits, in accordance with the

provisions of the Income-Tax Act and therefore, for the purpose of determination of the profits which are the subject-matter of the tax to be levied, the surtax itself cannot be deducted. Accordingly, surtax is not an allowable deduction under section 37 of the Income-Tax Act, 1961.

It may also be stated here that in the aforesaid judgement, it is clearly held that surtax is nothing but additional income-tax.

It may, thus, be seen that in the light of the aforesaid judgement also, education cess is not an allowable deduction under section 37(1) of the Act.

3. *Orissa Cement Ltd Vs CIT [1993] 200 ITR 636 (Del)*

In this case, one of the issues before the High Court was claim of deduction of surtax under section 37 of the Act. It was held that surtax being tax on profits or gains of business is not deductible under section 37 of the Act.

It was also held that payment of surtax under the Companies (Profits) Surtax Act, 1964, is not allowable as a deduction under section 37 of the Income-Tax Act, 1961. Surtax is not paid for the conduct of the business and it is not incidental to the carrying on of the business. The surtax is paid if the assessee has earned income. The payment of surtax is nothing more than an apportionment of the profits after they have arisen. This payment is not a charge on the profits of the company but is an allocation or an apportionment which is made thereafter. The fact that this payment is not relatable to the carrying on of the business of the assessee is evident from the fact that if the assessee suffers a loss or does not have any chargeable profits then no surtax is payable but the assessee can carry on his business activity. The payment is to be made only in the event of chargeable profits being there and not otherwise.

In this judgement, the judgement of the Supreme Court, in the case of *Jaipuria Samla Amalgamated Collieries Ltd Vs CIT [1971] 82 ITR 580 (SC),* has been distinguished.

Keeping in view the aforesaid criteria, it may be very emphatically stated that education cess is not paid for the conduct of the business and it is not incidental to the carrying on of the business. The education cess is paid if the assessee has earned income. The payment of education cess is nothing more than an apportionment of the profits, after they have arisen. This payment is not a charge on the profits of the assessee, but is an allocation or an apportionment which is made thereafter. The fact that the payment of education cess is

not relatable to the carrying on of the business of the assessee is evident from the fact that if the assessee suffers a loss or does not have any chargeable profits, then no education cess is payable, but the assessee can carry on his business activity. The payment of education cess is to be made only in the event of chargeable profits being there and not otherwise. It is, thus, absolutely clear that the aforesaid judgement of Delhi High Court also supports the view that education cess is not an allowable deduction under section 37(1) of the Act.

4. *Smith Kline and French (India) Ltd Vs CIT [1996] 219 ITR 581 (SC).*

The issue in this case before the Supreme Court was whether surtax is deductible under section 37, r.w.s.40(a)(ii) of the Act. It was held in this case that section 40 of the Act opens with a *non-obstante* clause "*notwithstanding anything to the contrary in sections 30 to 39*", which means that even if any amount is entitled to deduction in any of the provisions contained in sections 30 to 39, it will be disallowed if it falls, *inter alia*, within section 40(a)(ii), which states that 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, will not be deductible.

It was, therefore, concluded that surtax levied under the Companies (Profits) Surtax Act, 1964, squarely falls within the mischief of section 40(a)(ii) of the Act and cannot be allowed as a deduction while computing the business income of the assessee under the provisions of the Income-Tax Act.

In this case, the relevant observations of the Supreme Court, in the case of *Jaipuria Samla Amalgamated Collieries Ltd Vs CIT [1971] 82 ITR 580 (SC),* have been considered and distinguished.

From the aforesaid judgement of the Supreme Court also, it is clear that education cess being a levy on the profits or gains of the business or profession, will not be deductible in the computation of total income.

5. *Sesa Goa Ltd Vs JCIT [2013] 60 SOT 121 (Panaji) : 35 CCH 516 (Panaji Trib)*

This is a direct judgement on the issue under consideration, delivered by Panaji Bench of the Tribunal.

It was held in this case that the education cess and secondary higher education cess levied by the assessee has been collected as part of the income-tax and the provisions of section

40(a)(ic) and (ii) are clearly applicable and the assessee was not entitled for the deduction. The said payment was not a fee but is a tax. In case of fees, payment is made against getting certain benefit or services while tax is imposed by the Government and is levied for which the person who pay the tax is not promised in return to get any benefit or service. The assessee is not getting any benefit or services in return by making the payment towards the education cess and secondary higher education cess. Therefore, it cannot be said that it is an expenditure incurred wholly and exclusively for the purpose of the business and is not part of tax. Accordingly, the disallowance of Rs.19,72,00,814/- was confirmed.

Thus, it was clearly held that education and higher education cess paid by the assessee is not allowable as deduction under section 37(1) of the Act.

All the aforesaid legal precedents fully support the view that the education cess is not allowable as a deduction under section 37(1) of the Act, r.w.s.40(a)(ii) of the Act, by any stretch of imagination.

IV. Even the judgement of the Supreme Court in the case of *Jaipuria Samla Amalgamated Collieries Ltd Vs CIT [1971] 82 ITR 580 (SC),* does not support the view that education cess is an allowable deduction under section 37(1) of the Act.

As regards the judgement in the case of *Jaipuria Samla Amalgamated Collieries Ltd Vs CIT [1971] 82 ITR 580 (SC),* the same is not applicable in the present context. In this case, the assessee who carried on the business of raising coal from coal mines and selling it, paid **road and public works cess under the Bengal Cess Act, 1880 and education cess under the Bengal (Rural) Primary Tax Act, 1930, in relation to the coal mines, which it had taken on lease.** The cess was leviable under the respective statutes on the annual net profits to be calculated on the average annual net profits for the last three years, for which the accounts had been made up. The question was whether these cesses paid by the assessee were levied on the basis of profits, within the meaning of section 10(4) of the Income-Tax Act, 1922.

It was held that the profits arrived at, according to the provisions of the two cess Acts could not be equated to the profits which were determined under section 10 of the Act and therefore,

section 10(4) was not attracted and the cesses paid by the assessee were allowable as a deduction in computing its business profits.

It was further held that the words "*Profits and gains of any business, profession or vocation*" under section 10(4) of the Act, in the context, have reference only to profits or gains as determined under section 10 and cannot cover the net profits or gains arrived at or determined in a manner other than that provided by section 10. **In other words, section 10(4) excludes only tax or cess or rate, the assessment of which would follow the determination or assessment of profits or gains of any business, profession or vocation in accordance with the provisions of section 10 of the Act.**

From the aforesaid discussion, it may be clearly seen that the issue before the Supreme Court in the aforesaid case was deduction in respect of "*road and public works cess*", under the Bengal Cess Act, 1880 and "*education cess"* under the Bengal (Rural) Primary Tax Act, 1930, in relation to the coal mines which the assessee had taken on lease. Thus, the aforesaid cess is not a cess levied as part of the tax under the Income-Tax Act.

In this regard, it may also be stated that even as per the aforesaid judgement, section 10(4) of the 1922 Act, excludes only tax or cess or rate, the assessment of which would follow the determination or assessment of profits or gains of any business, profession or vocation, in accordance with the provisions of section 10 of the Act. Thus, it is quite clear that any cess, the assessment or determination of which is based on the profits or gains of business, computed in accordance with the provisions of the Act, could not be allowed as a deduction.

It is, thus, clearly established that the aforesaid judgement of the Apex Court does not, at all, support the view that the education cess presently levied under the Income-Tax Act, 1961 could be allowed as a deduction under section 37 of the Act.

V. Circular No.91 / 58 / 66 – ITJ (19), dt.18.5.1967, is totally irrelevant in the present context.

As regards the Circular No.91 / 58 / 66 – ITJ (19), dt.18.5.1967, the same is also not applicable in the present context. As per the aforesaid Circular, the effect of omission of the word "*cess*" from section 40(a)(ii) is that only taxes paid are to be disallowed in the assessments for the years 1962-63, onwards. In this regard, in the first place, it has to be stated that "*cess*", as contemplated in the aforesaid Circular, relates to the cess which is leviable under some other Statutes and which is a charge on the profits of the assessee, as in the aforesaid case of

Jaipuria Samla Amalgamated Collieries Ltd Vs CIT [1971] 82 ITR 580 (SC). Secondly, the present education cess has been levied much much after the date of the aforesaid Circular and more importantly, the education cess, as contemplated under the relevant Finance Act, is nothing but a part of income-tax, chargeable under the provisions of the Act. Therefore, the aforesaid Circular is not relevant in the present context.

In this context, it must also be stated that one should not be guided simply by the nomenclature of the levy. What is relevant is the nature of the levy under consideration. In other words, just because the word "*Cess*" is used in the term "*Education cess*", the same cannot indicate the correct nature of the levy, as contemplated under sub-sections (11) and (12) of section 2 of Chapter II of the relevant Finance Act. Therefore, the correct nature of the levy by way of "*Education cess*", has got to be interpreted in the light of the aforesaid provisions of Chapter II of the relevant Finance Act.

VI. Conclusion :

In the light of the discussion in the preceding paragraphs, it is clearly established that –

1. Education cess, as contemplated under the Chapter II of the Finance Act is nothing but additional surcharge which, in turn, is nothing but tax chargeable under the Act.

2. The education cess is nothing more than an apportionment of profits after they have arisen. In other words, it is not a charge on the profits, but an allocation or an apportionment which is made thereafter.

   Besides, the education cess is not relatable to the carrying on of the business of the assessee, because if the assessee suffers a loss or does not have any chargeable profits, then no education cess is payable but the assessee can carry on his business activity. In other words, the education cess is chargeable only in the event of chargeable profits being there and not otherwise.

3. The relevant legal precedents already cited clearly establish that education cess very much falls within the mischief of section 40(a)(ii) of the Act and therefore, the same is not allowable as a deduction under section 37(1) of the Act.

4. The judgement of the Apex Court, in the case *of Jaipuria Samla Amalgamated Collieries Ltd Vs CIT [1971] 82 ITR 580 (SC)*, is not, at all, relevant in the present context, because the same is totally distinguishable on facts.

5. As regards Circular No.91 / 58 / 66 – ITJ (19), dt.18.5.1967, the same will also not support the view that education cess is an allowable deduction under section 37(1) of the Act.

From the aforesaid discussion, it may be seen that the underlying idea relating to the provisions of section 40(a)(ii) of the Act, is that tax, surcharge or education cess paid on the profits would be a payment out of profits, by way of application thereof, rather than a payment made in order to earn profits, so as to be a deductible expenditure.

In the light of the aforesaid reasons, it is clearly established that education cess is not an allowable deduction under section 37(1), r.w.s.40(a)(ii) of the Act.

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