

Education cess is not disallowable u/s 40(a)(ii) of the Income-tax Act, 1961

Question under consideration

Whether education cess levied on the income tax is allowed as a deduction while computing Income from Business or Profession.

Provisions of the Income-tax Act, 1961 (Act)

Section 40(a)(ii) of the Act provides for expenses which are not deductible while computing Income under the head Business and Profession *as under*;

“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.”

As per section 2(43) of the Act, *Tax means income-tax chargeable under the provisions of this Act, and in relation to any other assessment year income-tax and super-tax chargeable under the provisions of this Act includes the fringe benefit tax payable under section 115WA.*

On the plain reading of this section, it is clear that income tax paid shall not be allowed as the deduction. However, the question arises whether the words *“any rate or tax levied”* include the amount of education cess levied on the income tax?

CBDT Circular dated 18/05/1967 regarding the issue under consideration

The Central Board of Direct Tax has issued a circular No.91/58/66-ITJ (19), dated 18/05/1967 in respect of the subject matter as under;

SECTION 40(a)(ii) OF THE INCOME-TAX ACT, 1961- BUSINESS DISALLOWANCE-TAXES - RATE OR TAX LEVIED ON PROFITS - OMISSION OF WORD “CESS” FROM CLAUSE (a)(ii) - EFFECT OF SECTION 40 - ONLY TAXES PAID ARE TO BE DISALLOWED

1. *Recently a case has come to the notice of the Board where the ITO has disallowed the ‘cess’ paid by the assessee on the ground that there has been no material change in the provisions of s. 10(4) of the old Act and 40(a)(ii) of the new Act.*

2. *The view of the ITO is not correct. Clause 40(a)(ii) of the IT 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.

3. *The board desire that the changed position may please be brought to the notice of all the income-tax officers so that further litigation on this account may be avoided.*

Judicial pronouncements covering the issue

In favour of the Taxpayers

The **Bombay High Court** in Sesa Goa Limited ITA No.17 and 18 of 2013 has held that education cess is allowable expenditure as word "cess" is conspicuously absent under the provisions of section 40(a)(ii) of the Income tax Act, 1961. The Bombay High Court came to the conclusion based on the following points:

- a. The Select committee of the Parliament decided to omit the word "cess" from section 40(a)(ii) from the Income Tax Bill, 1961.
- b. The Circular No. F. No.91/58/66-ITJ(19), issued by the CBDT which clarifies that the word "cess" has been omitted from Section 40(a)(ii) and only taxes paid are to be disallowed in the assessments for the years 1962-63 and onwards. Further, the CBDT circular, is binding upon the authorities under the Act, like Assessing Officer and the first Appellate Authority.
- c. The High Court discussed that under 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'. However in the corresponding section 40(a)(ii) of the Income-tax Act, 1961 the expression "cess" is quite conspicuous by its absence.
- d. Further, the High Court relied on various judicial pronouncements for interpretation of the language of law.

Moreover the education cess has been allowed as a deduction while computing Income under the head Business and Profession in the following judicial decisions on the basis of above points:

- i) Chambal Fertilizers and Chemicals Ltd vs CIT in Income Tax Appeal No.52/2018, dated 31/07/2018 (Rajasthan High Court)
- ii) DCIT vs Graphite India Ltd (ITA No.472 and 474 Co. No.64 and 66/Kol/2018 dated 22/11/2019) (Calcutta ITAT)
- iii) Aditya Birla Nuvo Limited vs ACIT (ITA No. 4220/2015, dated 24/02/2020) (Mumbai ITAT)
- iv) TATA Steel Limited vs ACIT (ITA No. 5616/2012, dated 06/11/2019) (Mumbai ITAT)
- v) Voltas Limited vs ACIT (ITA No. 6612/Mum/2018, dated 30/06/2020) (Mumbai ITAT)

In favour of Revenue

In case of **Everest Industries Ltd** [2018] 90 taxmann.com 330, **Mumbai Tribunal** held that the education cess is nothing other than income tax and accordingly it was held that education cess is disallowable u/s 40(a)(ii) of the Act.

In case of **Kalimati Investment Co Ltd** ITA No. 4508/Mum/2010, **Mumbai Tribunal** held that education cess is part of tax and constitutes part of tax which falls u/s 40(a)(ii) and hence education cess was not allowed as a deduction.

Observations

In order to claim any expenditure while computing the Income under the head Business and Profession, one has to satisfy the following conditions:

- The said expense should fall under the provisions of deductions as specified from section 30 to 37 of the Act.
- The said expense should not be disallowed under section 40/40A of the Act.

In order to claim any expense under the provisions of section 37 of the Act, then following conditions need to be satisfied:

- The nature of expenditure should not be capital
- The expenditure should not be personal expense of the taxpayer
- Expense should be incurred wholly for the purpose of business

The nature of education cess paid by the taxpayer cannot be termed as capital in nature as payment of cess would not bring any future benefit to the taxpayer.

The payment of cess cannot be termed as a personal expense of the taxpayer as payment of cess would not endure any personal benefit to the taxpayer.

The education cess paid by the taxpayer is nothing but an expenditure paid by the taxpayer because of having Income chargeable under the head Business or Profession and hence it can be treated as an expense incurred wholly for the purpose of business and should be allowed as a deduction u/s 37 of the Act.

As far as the second condition is concerned, that the expenditure should not be disallowed under section 40/40A of the Act. In this connection, the department's contention has always been that education cess is nothing but tax and accordingly should fall under the provisions of section 40(a)(ii) of the Act and accordingly the same cannot be allowed as a deduction while computing Income from Business or profession.

However, while carefully going through the provisions of section 40(a)(ii), cess is not covered under that section and moreover tax is exclusively defined u/s 2(43) which again does not include cess by any means. Thus taxpayer can very well rely on the above mentioned CBDT circular as well as recent judicial decisions from Tribunal as well as High Courts and conclude that the expenditure of education cess cannot be disallowed under section 40(a)(ii) of the Act.

Conclusion

In light of the above, one can conclude that education cess levied on income tax cannot be disallowed under section 40(a)(ii) and should be allowed as a deduction while computing Income under the head Business or Profession on the basis of the recent judicial decisions.

Needless to mention, considering the issue under consideration has travelled up to Tribunal and High Courts and the fact that there have been conflicting decisions in the past, litigation on the subject matter cannot be entirely ruled out.

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