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Cess or Surcharge: The Distinction is Significant for the Taxpayer

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Cess tax is a very important tool in the hands of the taxpayer to make the government accountable. A surcharge is more of a reserve taxing power in the hands of the government to garner funds exclusively for its own purpose. The two should not be confused.

In *M/S SRD Nutrients Private Limited v Commissioner of Central Excise, Guwahati* (2017), the Supreme Court was called upon to decide whether the manufacturer was entitled to a refund of primary education cess and secondary and higher education cess paid during clearance of goods. There was no dispute regarding the excise duty which had been paid by the manufacturer, as it had been duly refunded pursuant to an exemption notification. Hence, the limited question pertained to the manufacturer's eligibility for refund.

Primary education cess was imposed on income tax, excise duty, customs duty and service tax through the Finance (No 2) Act, 2004. Secondary and higher education cess was imposed on excise duty, customs duty and service tax through the Finance Act, 2007. Currently, both cesses are only being collected on income tax and customs duty as the other

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levies were subsumed into service tax and excise duty, ahead of the implementation of goods and services tax.

The two-judge bench consisting of Justice A K Sikri and Justice Ashok Bhushan decided in favour of the manufacturer. While deciding so, the judges went on to observe that primary education and higher education cess are surcharges. The Court's remarks are problematic as they seem to determine the nature of the levy without citing any reasons. Also, a closer reading makes it clear that there was no real need for deciding the nature to answer the narrow question before the Court. Knowing whether the cesses in question constitute cesses or surcharges is crucial because it has implications for all taxpayers who have been paying the levies for over a decade now.

The Difference between Cess and Surcharge

A cess may be in the nature of a tax or a fee but it is imposed for a specific purpose, as identified in the charging legislation. Article 270 of the Constitution describes a cess. A tax is a compulsory contribution collected by the government from the public at large and is to be used for a public purpose. On the other hand, a fee is imposed by the government for a specific facility or service being provided or rendered.

Cesses may be levied by the union or state governments. Cesses are named after the identified purpose; the purpose itself must be certain and for public good. In the case of a cess which has the attributes of a tax (cess tax), while the taxpayer does not have the right to ask for a reciprocal benefit, the proceeds ought to be spent only for the earmarked purpose. In simple words, a cess tax is an earmarked tax.

On the other hand, a surcharge is a tax on tax imposed for the purposes of the union. A surcharge is dealt with under Article 271 of the Constitution. An example of surcharge is one where individuals earning more than ₹1,00,00,000 annually are required to pay an extra sum amounting to 15% on their income tax under Section 3(a) of the Finance Act, 2017.

The proceeds collected from a surcharge and a cess levied by the union form part of the Consolidated Fund of India. The funds need not be shared with the State governments and are thus at the exclusive disposal of the union government.

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Hence, it can be seen that the Constitution makes a distinction between a cess and a surcharge and the two cannot be used interchangeably.

Education Cess: Cess or Surcharge?

The title of the levy uses the terminology of cess. Moreover, the title indicating the purpose shows the ingredient of a cess. However, the section of the Finance Act, 2004 which imposes education cess employs confusing language. Section 81 states that

> there shall be levied … as surcharge for the purposes of the Union, a cess to be called the education cess, to fulfil the commitment of the Government to provide and finance universalised quality basic education.

The section refers to both cess and surcharge in the same sentence without realising that there exists a difference between the two categories of levies under the Constitution. Similar language also occurs in Section 136 of the Finance Act, 2007 which imposes secondary and higher education cess.

These legislations are not the only ones that have this usage. Another recent example is Section 184(2) of Finance Act, 2016 pertaining to Income Disclosure Scheme which imposed a tax of 30% which would be increased by

> a surcharge, for the purposes of the Union, to be called the Krishi Kalyan Cess on tax calculated at the rate of twenty-five per cent of such tax so as to fulfil the commitment of the Government for the welfare of the farmers.

Considering that the difference between cess and surcharge is whether the proceeds will be utilised for any purpose of the union or for a dedicated pre-identified public purpose, the text of the statutes must be drafted with utmost care and caution. That said, as the cesses at hand are stipulated to be for the purposes of the union while also identifying a specific

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purpose (that is, provision of quality basic education), the levies must be interpreted to be cess taxes using the rule of harmonious construction. This would avoid absurdity and not render the constitutional distinction between cess and surcharge redundant.

This also appears to be the understanding of the union government which has classified education and higher education cess under different accounting heads, separate from the one used for surcharge. The minor accounting heads for education cess and higher education cess on income tax are 504 and 505 respectively, while the one for surcharge on income tax is 103.

Court's Reasoning

The issue of refund could have been decided simply by interpreting the applicable sections of the Finance Act, 2004 which say that the education cess is payable on aggregate duties of excise. If no duties of excise are payable, the cess amount would also be nil. No wonder, arguments from the counsels have also not been recorded in the judgment. Hence, the judges went on to make observations which were not needed in the first place.

The remarks are made in a very matter-of-fact manner without quoting any reasons or precedents. For example, paragraph three of the judgment states

> It so happened that vide Finance Act, 2004, the Education Cess and Higher Education Cess were also imposed, which are surcharge on the excise duty.

The statement itself is factually incorrect as secondary and higher education cess came in only through the Finance Act, 2007. It also shows how the Court never conducted any independent analysis of the nature of secondary and higher education cess.

In order to circumvent the consequences of such remarks, one would have to argue that these observations are just obiter dicta (judge's opinion not essential to the decision making) with no binding effect. While it may be possible to do, it is just counterproductive.

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Why is the Distinction Significant for the Taxpayer?

Labelling the levy as a surcharge implies that word cess in the title is a misnomer. But the problem runs much deeper. If the levy is in the nature of a cess, we can demand transparency and accountability on the usage of the proceeds for the end purpose. If it is a surcharge, the government may just say that the money can be used for any purpose. The latter would be very convenient for the government and it belies our expectation that we have been paying for the cause of education, all these years.

The issue is not just an apparent one, but a real one. The Comptroller and Auditor General's report for the union government's accounts for financial year 2013–14 mentions the abject lack of transparency of accounts and utilisation of amounts relating to the secondary higher education cess. For the period between 2006 and 2014, the total collection of secondary higher education cess was a whopping ₹52,268.65 crore. The same report reveals that ₹11,402 crore collected as primary education cess between 2004–05 and 2013–14 had not even been transferred to the dedicated fund called Prarambhik Shiksha Kosh (Indian Audit and Accounts Department 2015).

Need for Jurisprudence on Cess Taxes

Cess tax is a very important tool in the hands of the taxpayer to make the government accountable. A surcharge is more of a reserve taxing power in the hands of the government to garner funds exclusively for its own purpose. The two should not be confused.

Cess taxes are an area that have already witnessed some troubling precedents. For example, the Karnataka High Court observed in *Commissioner of Customs v Shree Renuka Sugars Ltd* (2014) that the proceeds of a cess tax need not be used exclusively for the earmarked purpose, but may be used for any other public purpose as well. The proceeds are a part of the Consolidated Fund of India. The Kerala High Court held in *Raja Oil Mills Chovva, Cannanore v Union of India* (1969) that it would be "inappropriate and indeed illegitimate to hold an enquiry into the manner in which the funds raised by an Act would be dealt with when the Court is considering the question about the validity of the Act itself."

It is time for the courts to set the record straight, interpret the statutes, and establish jurisprudence on cess taxes by recognising that a name does matter after all.

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