

EY Tax Alert

Supreme Court upholds constitutional validity of GST (Compensation to States) Act, 2017 and denies utilization of Clean Energy Cess against payment of Compensation Cess

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Executive summary

This Tax Alert summarizes a recent ruling of the Supreme Court (SC)¹ dealing with the constitutional validity of the Goods and Services Tax (Compensation to States) Act, 2017 and the set off of Clean Energy Cess already paid on stock as on 30 June 2017 against payment of Compensation Cess.

The assessee challenged the constitutional validity of the GST (Compensation to States) Act before the Delhi High Court (HC). Vide interim order, the Delhi HC allowed the assessee to not make payment of Compensation Cess in respect of stock of coal on which it has already paid Clean Energy Cess.

The Revenue department filed the petition before SC against the interim order of Delhi HC².

- ▶ The SC held that:
 - ▶ The Compensation Cess Act is not beyond the legislative competence of Parliament.
 - ▶ The Compensation Cess Act does not violate nor is against the objective of Constitution Amendment Act, 2016. The levy of Compensation Cess is an increment to GST which is permissible in law.
 - ▶ The assessee is not entitled for any set off of payment made towards Clean Energy Cess in payment of Compensation Cess.

¹ 2018-VIL-27-SC

² 2017-VIL-426-DEL

Background and facts

- ▶ The assessee is a trader of imported and Indian coal.
- ▶ In terms of the Finance Act, 2010 with effect from 1 July 2010, the assessee was required to pay Clean Energy Cess on Coal at the time of sale of coal.
- ▶ With the introduction of Goods and Services Tax (GST) from 1 July 2017, Clean Energy Cess was abolished and Compensation Cess has been levied under the GST (Compensation to States) Act, 2017 (hereinafter referred as Compensation Cess Act).
- ▶ The assessee challenged the constitutional validity of the Compensation Cess Act before Delhi High Court (HC).
- ▶ Delhi HC granted interim relief to the assessee stating that it is not required to make any further payment in respect of stock of coal on which it has already paid Clean Energy Cess.
- ▶ The Revenue challenged the interim order of Delhi HC before Supreme Court (SC).
- ▶ The issues which arose for consideration before the SC were:
 - ▶ Whether the Compensation Cess Act is beyond the legislative competence of the Parliament?
 - ▶ Whether the Compensation Cess Act violates and is against the objective of the Constitution Amendment Act, 2016?
 - ▶ Whether the Compensation Cess Act is a colorable legislation?
 - ▶ Whether levy of Compensation Cess and GST on the same taxing event is permissible in law?
 - ▶ Whether on the basis of Clean Energy Cess paid by the assessee till 30 June 2017, the assessee is entitled for set off while making payment of Compensation Cess?

Revenue's Contention

- ▶ The Revenue contended that cess is a special kind of tax and if the legislature is competent to levy the main tax, i.e. GST under Article 246A of the Constitution, then legislative competence of levying the cess flows from the very same power to levy the tax itself. The phrase used in Article 246A "with respect to" has wide implications and will cover the cess in its ambit.
- ▶ Revenue emphasized that Article 270 of the Constitution empowers the Parliament to levy any cess for a specific purpose. Further, Entry 97 of List I of Seventh Schedule to the Constitution grants a residuary power to the Union to levy a tax.
- ▶ The Revenue argued that Clean Energy Cess paid by the assessee should not be allowed as set off against Compensation Cess as both are levied on entirely different transactions and both are for entirely different purpose.

Assessee's Contention

- ▶ The assessee argued that the Constitution Amendment Act, 2016 was enacted with the intent to consolidate a number of indirect taxes levied by the Union and States and to reduce the tax by giving concurrent taxing powers to Union and States for levying GST on every transaction of supply of goods or services.
- ▶ The aforesaid amendment had a clear objective that with the introduction of GST, not only the indirect taxes, but also the cesses and surcharges levied on goods and services shall be subsumed. By Taxation Laws (Amendment) Act, 2017, various enactments levying various types of cesses were repealed including the Clean Energy Cess on coal.
- ▶ Thus, the Compensation Cess Act is repugnant to and transgress the mandate of the Constitution Amendment Act, 2016. The impugned legislation is a colorable legislation lacking legislative competence.
- ▶ The assessee contended that Section 18 of the Constitution Amendment Act, 2016 does not empower the Parliament to levy cess and tax as it only empowers the Parliament to make law to provide compensation to the States for loss of revenue arising on account of implementation of GST for a period of 5 years.
- ▶ The assessee stated that Clause 18 of the Constitution Amendment Bill, 2014 which contemplated an additional tax on supply of goods did not find place in the Constitution Amendment Act, 2016. Thus, it infers that the Constitution Amendment did not contemplate levy of an additional tax on goods and services.
- ▶ The assessee submitted that there cannot be two levies, one under the CGST Act and another under Compensation Cess Act, on the same taxable event and the same subject.
- ▶ The assessee further submitted that the stock lying as on 30 June 2017 has suffered Clean Energy Cess. Levying Compensation cess on the same stock of coal will amount to double taxation. Thus, even if the Compensation Cess Act is found to be within legislative competency, the assessee should be permitted to set off the cess already paid on the stock lying as on 30 June 2017.

Supreme Court ruling

- ▶ SC took into account the provisions of the Constitution Amendment Bill, 2014, and the Constitution Amendment Act, 2016, and noticed that Clause 18 of the Bill was not incorporated in the Act and Clause 19 of the Bill found place as Section 18 of the Act.
- ▶ SC considered the dictionary meaning of the term 'cess' and after referring to various judgments³, concluded that a cess is a tax levied for some special purpose and it may be levied as an increment to an existing tax.

³ *Shinde Brothers vs. Deputy Commissioner, Raichur* (AIR 1967 SC 1512), *India Cement Ltd. vs. State of Tamil Nadu* ((1990) 1 SCC 12), *Vijaylaxmi Rice Mills vs. Commercial Officers, Palakol* ((2006) 6 SCC 763)

- ▶ Further, the SC relied on its own decision in the case of Harbhajan Singh Dhillon⁴ wherein it was held that the only question to be asked while examining the legislative competence of Parliament with regard to a particular enactment is: "Is the matter sought to be legislated or included in List II or in List III or is the tax sought to be levied mentioned in List II or in List III?".
- ▶ SC observed that there is no entry in List II or List III of Seventh Schedule which refer to the levy of Compensation Cess. Article 248 read with Articles 246 and 246A clearly indicate that residuary power of legislation lies with the Parliament.
- ▶ SC noted that Article 270 of the Constitution empowers Parliament to levy any cess by law. Section 18 of the Constitution Amendment Act, 2016 expressly empowers the Parliament to provide compensation to the states "by law" on the recommendation of GST Council. Thus, Compensation Cess Act is not beyond the legislative competence of the Parliament.
- ▶ SC observed that the expression used in Article 246A is "power to make laws with respect to goods and services tax". The power to make law, thus, is not general power related to a general entry rather it specifically relates to goods and services tax.
- ▶ The Constitution Amendment Act, 2016 was passed to subsume various taxes, surcharges and cesses into one tax but the constitutional provision does not indicate that henceforth no surcharge or cess shall be levied.
- ▶ SC further stated that two taxes/imposts which are separate and distinct imposts and on two different aspects of a transaction are permissible as "in law there is no overlapping"⁵.
- ▶ SC observed that while Clean Energy Cess was levied for the purposes of financing and promoting clean energy initiatives and funding research in the area of clean energy, Compensation Cess is levied to provide compensation to the States for the loss of revenue arising on account of implementation of GST.
- ▶ Further, the distribution between the Union and States of the Clean Energy Cess and Compensation Cess so collected are also different. The Clean Energy Cess was to be used for the purposes of the Union and not to be distributed to the States whereas States Compensation Cess has to be wholly distributed amongst the States.
- ▶ Giving credit or set off is legislative policy which had to be reflected in the legislative scheme. Compensation Cess Act or Rules framed thereunder does not indicate giving of any credit or set off of the Clean Energy Cess already paid till 30.06.2017. Thus, set off of Clean Energy Cess for payment of Compensation cess cannot be allowed.
- ▶ Basis above, the SC has held that:
 - ▶ The Compensation Cess Act is not beyond the legislative competence of Parliament.
 - ▶ Compensation Cess Act does not violate nor is against the objective of Constitution Amendment Act, 2016.
- ▶ Compensation Cess Act is not a colorable legislation.
- ▶ Levy of Compensation Cess is an increment to goods and services tax which is permissible in law.
- ▶ The petitioner is not entitled for any set off of payments made towards Clean Energy Cess in payment of Compensation to States Cess.

Comments

The apex court judgment overruling and bringing finality to the interim order passed by the Division Bench of Delhi High Court, would leave the taxpayers to suffer the additional burden of Compensation Cess in respect of stock transitioned to GST regime.

Considering the legislative framework, and as reiterated by the Court, the taxpayer has no remedy to seek allowance of the credit of Clean Energy Cess in absence of any provisions contained in the Compensation Cess Act. GST Council does not seem to have considered such issue for recommending amendment to the Act and allowing relief to the industry.

⁴(1971) 2 SCC 779

⁵Federation of Hotel & Restaurant Associate of India. Vs. UOI ((1989) 3 SCC 634) and Avinder Singh Vs. State of Punjab ((1979) 1 SCC 137)

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