

EY Tax Alert

Karnataka HC holds HSNS Cess framework unconstitutional due to manner of Cess calculation

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Executive summary

This Tax Alert summarizes a recent ruling of the Karnataka High Court (HC)¹ on the constitutional validity of Health Security se National Security Cess Act, 2025 (HSNS Cess Act), the Health Security se National Security Cess Rules, 2026 (HSNS Cess Rules) and the notifications issued thereunder.

The key observations of the HC are:

- The taxable event under the HSNS Cess framework is ownership or possession of installed machines and not supply of goods or services, which is the taxable event under GST. Accordingly, Article 246A of the Constitution, which deals with levy of GST, is not applicable. Further, the impugned levy is not a surcharge under Article 271.
- Article 246(1) read with Entry 97 of List I of the Seventh Schedule confers residuary legislative powers on Parliament, including the power to impose a tax not mentioned in List II or List III. Therefore, the challenge of lack of legislative competence is without merit.
- However, the cess liability is determined with reference to the maximum rated speed of the machine and corresponding weight of the specified goods packed in a pouch, tin or container. Machines operating on different production capacities within the same slab are required to pay the same cess.
- The manner in which the HSNS Cess Act and the HSNS Cess Rules levy the cess is unreasonable and vague, as it is based on assumption of quantity manufactured instead of actual quantity manufactured.

Basis above, while the HC upheld the Union Government's power to promulgate a law to levy cess, it held that the HSNS Cess Act was unconstitutional to the extent the manner of levy and computation violated Article 14 of the Constitution.

¹ 2026-VIL-744-KAR

Background

- The petitioners are manufacturers and suppliers of pan masala falling under Tariff Item 2106 90 20 of the Customs Tariff Act, 1975. The processed pan masala is packed in pouches using pouch packing machines and sold at retail sales price.
- In 2025, Parliament enacted the Health Security se National Security Cess Act, 2025 (HSNS Cess Act) to augment resources for meeting expenditure on national security and public health. The Act was brought into force from 1 February 2026², and the Health Security se National Security Cess Rules, 2026 (HSNS Cess Rules) were notified to provide the procedure for declaration, quantification, collection and payment of cess.³
- Under the HSNS Cess framework, cess is levied on taxable persons owning, possessing, operating, managing or otherwise controlling machines, or undertaking any process for manufacture or production of specified goods, including pan masala.
- The cess is computed with reference to the machines installed or processes undertaken, the maximum rated speed or capacity, and the weight of goods packed in pouches, tins or containers. Thus, the levy is linked to machine capacity and prescribed slabs, rather than the actual quantity manufactured.
- The petitioners challenged the constitutional validity of the HSNS Cess Act, the HSNS Cess Rules and the notifications issued thereunder, before the Karnataka High Court (HC).

Petitioner's contention

- The Constitution (One Hundred and First Amendment) Act, 2016 introduced Article 246A into the Constitution of India, empowering Parliament and State Legislatures to make laws with respect to Goods and Services Tax (GST).

Further, Article 279A provided for the constitution of the GST Council, empowered to make recommendations to the Union or the State with respect to taxes, cesses and surcharges levied by the Union or the State Government.

To levy and collect GST on inter-state trade and commerce, Article 269A was introduced.
- Pursuant to the Constitutional amendment, the Central Goods and Services Tax Act, 2017 (CGST Act) and Integrated Goods and Services Tax Act, 2017 (IGST Act) came into force with effect from 1 July 2017.

Pan Masala, falling under Tariff Item 2106 90 20 of the Customs Tariff Act, 1975, became subject to GST under the rate notifications issued under GST law.
- Article 271 of the Constitution of India empowers Parliament to increase duties or taxes referred to in Articles 269 and 270 by way of a surcharge for Union purposes.

However, such surcharge power cannot be exercised

on GST under Article 246A.

- No duty or tax on pan masala could be increased by borrowing power under Article 271, as the only tax applicable at present is GST, which is excluded under Article 271.
- Further, the Central Government enacted the law to levy cess on the number of machines one possesses and the number of pouches they produce. The cess cannot be levied on deemed production. At best, it can be levied on the actual production.
- Moreover, to plug leakage or tax evasion in a particular sector, an Act is promulgated. To plug leakage in one enactment, another enactment should not be brought in, notwithstanding it being taxed in those regimes.

With the impugned Act, the manufacturing and supply of pan masala are now taxed under two regimes, viz., HSNS Cess and GST.
- Thus, the impugned Act and Rules levying cess are unconstitutional, thereby rendering all consequential actions illegal and contrary to law.

Revenue's contention

- The HSNS Cess imposed under the impugned Act is neither a surcharge, nor a GST or tax. Accordingly, Articles 246A and 271 are inapplicable, and the GST Council has no jurisdiction over the cess.
- Article 246 of the Constitution outlines the division of legislative powers between the Union and the States, with separate entries in the Union List (List I), State List (List II) and Concurrent List (List III) contained in the Seventh Schedule, specifying their respective taxing powers and areas of legislative competence.

Entry 97 of List I empowers parliament to make laws or impose tax on any matters not mentioned under the Concurrent list or the State list.
- Pan Masala is a commodity that stands in a class of its own, as it has severe adverse public health consequences and is one of the most evasion-prone commodity sectors.
- Thus, the twin imperatives, i.e., public health and revenue protection, form the constitutional and policy foundation of the HSNS Cess framework.
- Thus, the impugned Act is a valid exercise in Parliament's plenary power under Article 246(1) read with Entry 97.
- Further, post introduction of GST, pan masala was levied with GST along with GST compensation cess at ad-valorem rates.
- Despite high applicable tax rates, revenue collected from the pan masala sector had consistently fallen far below the reasonable estimates of the sector's productive capacity, which was clearly indicative of continuing large-scale evasion.
- To address the revenue leakage, a capacity-based approach is adopted.

The taxable event in the impugned Act is operated on ownership of machines, which cannot be suppressed,

² Notification No. S.O. 6153(E), dated 31 December 2025

³ Notification No. 01/2026 - HSNS Cess, G.S.R. 02(E), dated 1 January 2026

unlike transaction-based taxation under the GST framework.

Thus, the levy under HSNS Cess law is on machine ownership and not on production or deemed production.

- Further, Section 5(7) of the HSNS Cess Act read with Rule 15 provides for abatement of cess only where a machine or manual process unit remained inoperative for a continuous period of 15 days or more, subject to prescribed conditions.

The minimum threshold of 15 continuous days for grant of abatement is a deliberate anti-evasion policy to eliminate bogus claims for shorter periods.

- Thus, the impugned HSNS Cess framework cannot be said to be in violation of Articles 14 or 19(1)(g), i.e., to practice any profession, or to carry on any occupation, trade or business, of the Constitution of India.

Equity would be that, having regard to the pan masala industry's negative externalities on public health, including link to cancer, and its association with tax evasion, the Act must be held to be a valid piece of legislation.

HC's Ruling

- Section 4 of the HSNS Cess Act prescribes the power to levy and collect cess from every taxable person on the machines installed or other processes undertaken for the manufacture or production of specified goods.

The cess is leviable in addition to any other duties or taxes chargeable under any law for the time being in force.

- The phrase taxable person includes any person who owns, possesses, operates, manages or otherwise controls a machine, or undertakes any process resulting in the manufacture or production of specified goods.
- The mechanism for computation is stipulated in Section 5. In the case of machine-based manufacture, the cess is determined with reference to:
 - the maximum rated speed of the machine measured in number of pouches, tins or containers per minute;
 - the corresponding weight of goods packed in each pouch, tin or container; and
 - at the monthly amount prescribed in Table 1 of Schedule II.
- The cess payable would be the aggregate of the cess calculated for each machine installed in a factory.
- Rule 12 of HSNS Cess Rules provides that the monthly cess shall be calculated as per Table 1 of Schedule II to the Act.

Schedule II classifies cess liability on the basis of machine-speed slabs (up to 500, 501-1000, 1001-1500 and above 1500 pouches per minute) and weight categories of the specified goods.

- If one has a machine that can produce 500 pouches per minute, it is the same cess even if the said machine produces 250 pouches per minute, assuming the weight per pouch is the same.

This clearly indicates that all the manufacturers who produce up to 500 pouches per minute are required to pay similar duty.

- While permitting abatement of Cess under Rule 15 of HSNS Cess Rules, the Rule fails to consider suspension of manufacturing for periods shorter than 15 days, which may occur due to various reasons, including breakdown of machinery, non-availability of raw materials or labour, and factory maintenance.
- Where the machinery remains inoperative for less than 15 days, the manufacturer continues to be liable to pay cess, thereby adding to the losses already suffered due to suspension of manufacturing activity.
- The prescription of a minimum period proceeds solely with the presumption that petitioners are likely to indulge in tax evasion.

Administrative difficulties in preventing tax evasion cannot, by themselves, justify the prescription of such an arbitrary threshold under the Rules.

- A reading of the HSNS Cess law framework indicates that the taxable event is the ownership or possession of the installed machine and not on the supply of goods and services which is a taxable event under GST. Thus, Article 246A is not applicable.
- Further, the Constitution itself indicates that a surcharge cannot be imposed upon goods and services that are already taxed in terms of Article 246A, the impugned cess is also not a surcharge under Article 271.
- Article 246(1) read with entry 97 of List I vests Parliament with the residuary power to legislate on any matter not enumerated in List II or List III, including the power to impose any tax not mentioned in either of those Lists.
- Therefore, the allegation of lack of legislative competence to enact the impugned Act and the Rules is without merit and deserves to be rejected.
- The manner in which the Act and the Rules levy the cess is held to be unreasonable and vague as it is based on an assumption of quantity manufactured, instead of actual quantity manufactured, it is failing the tenets of Article 14 and to that extent, the Act is held to be unconstitutional.
- Thus, while upholding the power of the Union of India to promulgate law to levy cess, its execution is found to be in violation of Article 14 of the Constitution.

Comments

- a. Taxpayers engaged in similar businesses may need to reassess ongoing compliance and tax payment positions under the HSNS Cess law. Further, those who have discharged cess may evaluate the possibility of filing refund claims for amounts already paid, subject to unjust enrichment principles.
- b. It remains to be seen whether the Government challenges the HC ruling before the Supreme Court or amends the HSNS Cess Act and Rules in line with the observations of the court.
- c. Impact of this ruling may need to be tested in other cases involving levy mechanisms where tax or cess is computed on a presumptive, notional or deemed basis, rather than with reference to actual value, quantity, production or transaction realities.

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