eJournal of Tax Research (2021) vol. 19, no. 1, pp. 97-120

Earmarked taxes: an Indian case study

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Abstract

Earmarked taxes called cesses are mandatory taxes specifically collected for earmarked public purposes. This article looks at the conceptual understanding of earmarking and then uses the Indian experience as a case study to examine how earmarking works in practice and the ensuing challenges. The article also explains the standards that a cess tax must fulfil under Indian law to be constitutionally valid while highlighting how the cess laws fare in this regard. Having demonstrated the gaps, the article presents the jurisprudence on cess taxes developed by the constitutional courts. The authors conclude by advocating the need for a rights-based analysis of earmarking.

Key words: cesses, earmarked taxes, earmarking, hypothecation, India, taxpayer rights

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1. INTRODUCTION

Taxes are compulsory contributions collected by governments to augment revenues. Proceeds from taxes are meant to be used for the common good of the public and thus, no individual taxpayer has the entitlement to ask for a specific reciprocal benefit out of that revenue.[1] Governments can choose to apply tax proceeds for any public purpose(s) as deemed fit. Taxes are understood as an inherent attribute of sovereignty which grants governments larger latitude in matters of taxation.[2]

Tax systems of most countries comprise a varied mix of direct and indirect taxes. The Indian tax regime is no different.[3] A closer perusal of the Indian scenario reveals that India also has hypothecated (earmarked) taxes called cesses under the broader umbrella of direct and indirect taxes.

Earmarking is the act of setting aside revenues for specific public purposes unlike general fund financing where budgetary proceeds may be used for any public purpose. Earmarking is prevalent in other countries too, such as the United States of America[4] and Australia.[5] In the Indian context, the term 'cess' is used to describe a levy for 'specific purposes' as described under Article 270[6] of the Indian Constitution. It is thus, an instance of an earmarked tax constitutionally permitted to be levied in India.

It would be germane to begin the inquiry in this article as to the challenges involved in such imposts in India by setting out the difference between a cess tax (cess in the nature of a tax), tax *simpliciter*[7] and fee. The answer lies in the key difference that proceeds from a cess tax are earmarked for 'specific purposes'[8] while proceeds from a tax *simpliciter* are not earmarked and can be used for any public purpose. The distinction between a cess tax and a fee *simpliciter* rests on a different criterion. A person

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[1] *The Commissioner, Hindu Religious Endowments, Madras v Sri Lakshmindra Thirtha Swamiar of Sri Shirur Mutt* reported in [1954] All India Reporter 282 (16 March 1954) [49]-[50] (Supreme Court of India) (citing Latham CJ of the High Court of Australia in *Matthews v Chicory Marketing Board* (1938) 60 CLR 263, 276).

[2] *Jindal Stainless Ltd v State of Haryana* reported in [2017] 12 Supreme Court Cases 1 (11 November 2016) 128 [14] (Supreme Court of India); *Commissioner of Income Tax, Udaipur, Rajasthan v McDowell and Co Ltd* reported in [2009] 10 Supreme Court Cases 755 (Supreme Court of India).

[3] See Ministry of Finance, Government of India, *Tax Revenue* (Receipts Budget 2016-2017, New Delhi), https://www.indiabudget.gov.in/budget2018-2019/ub2018-19/rec/allrec.pdf.

[4] In the United States of America, state governments raise about 27 per cent of their revenues through various earmarked taxes: Jacob Funk Kirkegaard, 'Earmarked Revenues: How the European Union Can Learn from US Budgeting Experience' (Peterson Institute for International Economics Policy Brief 18-2, January 2018) 8, https://www.piie.com/system/files/documents/pb18-2.pdf.

[5] In Australia the national (Commonwealth) government has introduced earmarked measures such as the Medicare levy, Gun buy back levy and Ansett ticket levy: Robert Carling, 'Tax Earmarking: Is It Good Practice?' (Centre for Independent Studies Policy Monograph 75, 2007), https://www.cis.org.au/app/uploads/2015/07/pm75.pdf.

[6] *Constitution of India 1950* (India) art 270(1) (*Constitution of India*):

> All taxes and duties referred to in the Union List, except the duties and taxes referred to in articles 268, 269 and 269A, respectively, surcharge on taxes and duties referred to in Article 271 and any cess levied for specific purposes under any law made by Parliament shall be levied and collected by the Government of India and shall be distributed between the Union and the States in the manner provided in clause (2).

[7] Income tax, corporate tax, excise duty, service tax are examples of taxes *simpliciter*. Such taxes are collected for raising revenue for general public purposes. Proceeds from such taxes form part of the Consolidated Fund of India and are distributed among the Union and State governments based on recommendations of the Finance Commission following the provisions of the Constitution.

[8] *Constitution of India*, above n 6.

contributing to a cess tax is not entitled to a *quid pro quo* reciprocal benefit while an individual paying a fee is entitled to it. The common feature of a cess tax and a fee is that the collected sums are to be used for the pledged purpose or identified service, respectively.

A previous historical study of cess taxes levied by the federal government (the Union government) between 1950 and 2016 by one of the present authors revealed a surge in cess taxes over the past few decades and under-utilisation and diversion of cess proceeds for purposes other than the earmarked purpose, concluding that there has been a lack of accountability and transparency with respect to the appropriation and utilisation of amounts collected from Union cess taxes.[9] The study presented two reasons for the popularity of cess taxes with successive Union governments. First, amounts raised by the Union government in the form of cess taxes are not shared with State governments. Cess taxes were thus an easy route for the Union government to raise revenues. However, poor administration of funds has resulted in short transfer and non-utilisation. Secondly, through the route of cess taxes, Union governments have been imposing cess taxes on purposes exclusively reserved for the State governments in the State List.[10]

The earlier study reveals the popularity of cess taxes despite the poor track record of utilisation by successive governments. This shows the gap in the constitutional mandate of earmarked taxes and the ground reality of implementation. A rights-based approach would allow us to recognise taxpayers as holders of rights, in terms of accountability and transparency in the imposition, administration and utilisation of cess taxes. This would, in turn, facilitate bridging the gap.

This article is meant to be a follow-on inquiry into the concept of earmarking by analysing the legal and constitutional implications of the way earmarking has been implemented in India. Hence, the article does not consider in any detail: (a) cess taxes imposed by the State governments; and (b) cess taxes in the nature of fees imposed by Union governments and State governments.

Section 2 elaborates on the conceptual understanding of earmarking, its merits and demerits and then uses the Indian experience as a case study to examine how the earmarking has worked in practice. Section 3 explains the standards that a cess tax has to fulfil to be constitutionally valid while highlighting how the cess laws fare in this regard. Having demonstrated the gaps, section 4 presents the jurisprudence on cess taxes developed by the constitutional courts. Section 5 concludes the discussion by advocating the need for a rights-based analysis of earmarking.

The article draws on observations by authors who have studied the phenomenon of earmarking abroad, but the legal analysis is restricted to the Indian context, more

[9] The study quotes examples of short transfer/appropriation of proceeds of seven Union cess taxes (oil cess, research and development cess, automobile cess, sugar cess, clean energy (environment) cess, primary education cess and road cess/additional excise duty). Moreover, the study cites lack of transparency regarding the proceeds from the secondary and higher education cess and diversion of proceeds from the research and development cess: Ashrita Kotha, 'Cesses in the Indian Tax Regime: A Historical Analysis', in Peter Harris and Dominic de Cogan (eds), *Studies in the History of Tax Law, Vol 8* (Hart Publishing, 2017) 483.

[10] The Seventh Schedule of the Constitution distributes legislative entries including tax entries between the Union government and State governments. Matters in the exclusive domain of the Union government and State governments are enumerated in the Union List and State List respectively. Residuary matters including tax matters are within the power of the Union government.

particularly in light of the constitutional mandate of Article 270. The absence of studies on the legal implications of the Indian experience relating to cess taxes constitutes the literature gap that the article seeks to address.

2. EARMARKING OF TAXES

2.1 What is earmarking?

Earmarking has been defined to be the act of allocating specific tax revenues to fund a specific public service within fiscal systems collecting multiple taxes applied for varied purposes.[11] The specific purpose is to be made public through the charging legislation, even before the taxes have been collected. This is the most important characteristic of an earmarked tax.[12] Earmarking operates like a 'spending promise' from the government.[13] Hypothecation is synonymous with earmarking.

A report by the Tax Foundation states that earmarking can happen in two ways: in one scenario where legislative control is retained through the intervention of enacting appropriation Acts and in another where earmarking happens directly without the need for any parliamentary approval by way of appropriation Acts.[14]

2.2 Kinds of earmarked taxes

Existing literature has classified earmarked taxes into four categories. The categorisation is based on two features: (a) the tax base, and (b) the earmarked purpose.

McCleary has classified earmarked taxes into four categories based on whether its tax base and earmarked purpose are narrow or broad.[15] The first category constitutes taxes with a narrow base and narrow purpose. The contributors are also the beneficiaries of the earmarked tax which is described to be a case of 'strong earmarking' or a manifestation of the benefit theory. The other three categories are where: (a) a narrow base is applied towards a broad purpose; (b) a broad base is applied towards a narrow purpose, and (c) a broad base is applied towards a broad purpose. These categories reveal 'weaker earmarking' as the objective of setting aside fixed revenues is mixed with that of redistribution and social welfare. Also, the benefit principle is lacking in these three models.

In her writings on earmarking and the public choice theory referred to above, Camic has classified earmarked taxes using the matrix of the degree of concentration or diffusion of the cost and benefit of the tax. The cost looks at the tax base while the benefit looks at those who stand to gain from the collections of the tax. The four categories are as follows: (a) taxes with diffused costs and diffused benefits; (b) taxes with diffused costs and concentrated benefits; (c) taxes with concentrated costs and diffused benefits, and lastly, (d) taxes with concentrated costs and concentrated benefits.

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[11] James Buchanan, 'The Economics of Earmarked Taxes' (1963) 71(5) *Journal of Political Economy* 457, 457-458.
[12] Susannah Camic, 'Earmarking: The Potential Benefits' (2006) 4(1) *Pittsburgh Tax Review* 55, 60.
[13] Susannah Camic Tahk, 'Public Choice Theory and Earmarked Taxes' (2015) 68(4) *Tax Law Review* 755, 768.
[14] Tax Foundation, *Earmarked State Taxes* (Tax Foundation, 1955) 4.
[15] William McCleary, 'The Earmarking of Government Revenue: A Review of Some World Bank Experience' (1991) 6(1) *The World Bank Research Observer* 81, 82-84.

Both authors classify earmarked taxes along similar lines. The first factor of classification, that is, the tax base, is common to both. The second matrix is also related. McCleary's use of purpose is akin to Camic's use of beneficiaries as the breadth of the purpose dictates how diffused or concentrated the beneficiary group is.

We concur with these authors that a narrow base and narrow purpose, amongst other features, demonstrates strong earmarking. None of the Indian earmarked taxes bear a strict correlation between beneficiaries and contributors which is why this aspect is not relevant for classification of the taxes forming part of this case study. Nevertheless, there must be some nexus between the contributors and beneficiaries to legitimise the levy of any cess tax.

2.3 Earmarking classification: Indian case study

The classification by McCleary and Camic can be used in the Indian context as well. Unlike the American context studied by Camic, this study only looks at earmarked taxes imposed by the Union (national) government.

Cess taxes imposed in India have historically been imposed for three kinds of purposes: (a) industry/trade specific cesses garnering funds for growth of the chosen industry or trade; (b) labour welfare cesses, raising revenue for labour welfare within specific industries, and (c) cesses with broad based and general welfare purposes.[16]

In relation to the kinds of tax base and specific purposes currently used in India, the tax base adopted for a majority of earmarked taxes, that is in categories (a) and (b) above, has been excise duty, which is an indirect tax applied on the taxable event of manufacture of goods. Only from the early 2000s, when category (c) cesses were imposed, was the choice of tax base extended to other indirect taxes such as service tax, customs duty and direct taxes such as income tax and corporation tax.[17]

As most of the cess taxes have been applied on the indirect tax base of excise duty,[18] the ultimate burden/cost could be shifted to the end consumer. At first therefore, it seems that all costs are diffused because of the large tax base. Based on the similarity between all cess taxes in terms of the possibility of shifting the ultimate burden, for the purposes of classification only the first point of tax is considered here.

In the case of industry/trade cess taxes, where the taxes have been applied as an add-on to excise duties, the taxable event is the manufacture of tea, rubber, etc. The beneficiaries are the concerned industry/trade at large. There is an identifiable and narrow contributor base and well-defined narrow purpose which limits the utilisation of proceeds to the development of the trade/industry. Also, there is some nexus between the contributors and beneficiaries as the former are manufacturers or consumers in the industry and the latter are also the manufacturers and the consumers, ultimately.

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[16] Kotha, 'Cesses in the Indian Tax Regime', above n 9, 499-501.
[17] Ibid 492.
[18] Historically, a majority of cess taxes were levied on the tax base of Union Excise Duty as can be seen from the Receipts Budget of the Union government. Heading 5.07 enumerates ten cess taxes administered by the Department of Revenue and six administered by other departments which form a majority of cess taxes levied by the Union government: Ministry of Finance, Government of India, *Tax Revenue* (Receipts Budget 2019-2020, New Delhi), https://www.indiabudget.gov.in/doc/rec/tr.pdf.

The labour welfare cess taxes have been levied on the owners of the mines and the proceeds are to be spent for the welfare of labourers within the specific mining industry. Here again, there is a narrow contributor base being the owners of particular mines (such as limestone, manganese, etc.) and the beneficiaries the labourers in the concerned industry. There is a link between the contributors and the beneficiaries as all belong to the concerned mining industry.

Hence, from the Indian experience, it would appear that the industry/trade cess taxes and labour welfare cess taxes are examples of strong earmarking using the classification of McCleary and Camic. However, as the legal and constitutional analysis in the later sections shows, these earmarked taxes also may not constitute examples of strong earmarking after all.

The third kinds of purposes adopted reveal *weaker earmarking*. Take for instance, the Swachh Bharat Cess[19] ('Clean India Cess'), krishi kalyan cess[20] ('Agricultural Welfare Cess') and infrastructure cess[21] which have been imposed on all taxable services for broad purposes such as promotion of hygiene and sanitation, agriculture and farmer welfare and infrastructure, respectively. The contributors are all consumers of taxable services and the beneficiaries are the public at large as the benefits of better sanitation, agriculture and infrastructure, accrue to the public at large. The correlation between the contributors and beneficiaries is extremely weak. The description of the purposes has also been done in a wide and open-ended manner which corroborates the understanding that the benefits are diffused. Another prominent example of a levy that comes under this category is the primary education[22] and secondary and higher education cess[23] as the levy has been collected across various tax bases (such as service tax, income tax, customs duty) and the purpose extends to facilitation of education to the public at large.

2.4 Merits and demerits of earmarking

Available literature points to certain merits and demerits of the practice of earmarking. Economists and lawyers have been divided in their opinion on the efficacy of earmarked taxes.

Earmarking has certain positive outcomes. First, the earmarking exercise identifies the maximum funds available for utilisation on the specific purposes which prevents any wastage or tapping into general budgetary funds.[24]

Secondly, the act of earmarking safeguards support for the chosen purposes in the face of any financial exigencies (internal or external), change in government, coalition politics, etc.[25] Also, earmarking results in governments promising to fund such purposes

[19] *The Finance Act 2015* (India) Act No 20 of 2015, s 119 (*Finance Act 2015*).
[20] *The Finance Act 2016* (India) Act No 28 of 2016, s 161 (*Finance Act 2016*).
[21] Ibid, s 162.
[22] *The Finance Act 2004* (India) Act No 23 of 2004, s 91-95.
[23] *The Finance Act 2007* (India) Act No 22 of 2007, s 2(12).
[24] Bingyuang Hsiung, 'A Note on Earmarked Taxation' (2001) 29(3) *Public Finance Review* 223, 227.
[25] Ranjit S Teja, 'The Case for Earmarked Taxes' (1988) 35(3) *Staff Papers (International Monetary Fund)* 523, 531; McCleary, above n 15, 85; Jeremy Jackson, 'Tax Earmarking, Party Politics and Gubernatorial Veto: Theory and Evidence from US States' (2013) 155 *Public Choice* 1, 2.

for years to come even in the absence of a strict legal obligation on account of symbolic and institutional reasons.[26]

Thirdly, in countries where tax compliance is poor on account of lack of credibility, earmarked taxes can help change this perception. If the government can demonstrate that the tax collected will be spent for pledged purposes, there are better chances that the community will pay the said taxes.[27] It is relatively easier for the government to correlate collection and expenditure when there is a targeted contributor base and set of beneficiaries.[28] This could possibly lead to increased revenues for the government.[29]

Fourthly, some believe that earmarking is justified because it applies the benefit principle.[30] The benefit principle connotes that the very set of contributors is also the beneficiary group of the tax collections.

Fifthly, earmarked taxes provide better information on the amounts collected and spent which could help policy-makers design and monitor tax systems better and advocacy groups to hold the government responsible for the earmarking.[31]

On the flipside, earmarking also has some drawbacks.

First, it has been observed that the practice impedes legislative control as no appropriation bills are passed by the Parliament for usage of the earmarked funds.

Secondly, in practice, earmarking may involve setting aside an indefinite amount of money unlike budgetary allocation where specific sums of money are allocated based on estimated needs. The pledging of funds in advance precludes the opportunity of adjusting allocations depending on needs as and when they arise and actual revenue collections.[32] Further, when there are pressing needs, due to the lack of availability of the earmarked funds, there is pressure on whatever sources remain.[33]

Thirdly, even for the earmarked purposes, considering the earmarked funds are pledged in advance, the sums have not been adjusted to current levels of inflation, which means that the government may still have to depend on additional budgetary allocations (apart from the earmarked funds).[34]

Fourthly, the act of locking-in funds for specific purposes leads to 'misallocation of resources'; some purposes receive excessively disproportionate amounts while others do not get the necessary attention and support.[35]

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[26] Camic, 'Earmarking: The Potential Benefits', above n 12, 63-77.
[27] Teja, above n 25, 531; McCleary, above n 15, 85.
[28] Ashrita Prasad Kotha, 'Indian Cess Taxes: A Call for Accountability', *Tax Justice Network* (Blog Post, 11 December 2017), https://www.taxjustice.net/2017/12/11/indian-cess-taxes-call-accountability-guest-blog/.
[29] Camic, 'Earmarking: The Potential Benefits', above n 12, 78.
[30] Elizabeth Deran, 'Earmarking and Expenditures: A Survey and a New Test' (1965) 18(4) *National Tax Journal* 354, 357.
[31] Camic, 'Earmarking: The Potential Benefits', above n 12, 59.
[32] Hsiung, above n 24, 229.
[33] Camic, 'Earmarked State Taxes', above n 14, 20.
[34] McCleary, above n 15, 90.
[35] Deran, above n 30, 357.

Fifthly, even though earmarking has been supported on the basis of benefit theory, practically, this is far from true.[36]

Sixthly, in practice, these provisions appear to remain on the statute books even after the purpose ceases to remain a pressing concern.[37]

2.5 Merits and demerits in practice: Indian case study

In India, the process of earmarking entails parliamentary intervention and thus, the demerit relating to lack of parliamentary oversight may not apply here. The law mandates that no tax can be imposed without legislative authority.[38] Thus, the Parliament passes an independent Act imposing a cess for an earmarked purpose or by way of a provision in the relevant Finance Act. The proceeds are credited into the Union government's exchequer termed as the Consolidated Fund of India.[39] For withdrawal of funds from the Consolidated Fund of India, an appropriation Act needs to be passed in the Union Parliament.[40] The appropriation Acts are money bills which must be introduced in the lower House of the Parliament. The upper House of the Parliament must return the bill within 14 days with recommendations that are not binding in nature.[41]

In practice, there is parliamentary approval for the imposition of every new cess. However, introduction of cesses in more recent years through a single section of the Finance Act[42] creates doubt as to whether there is effective and meaningful deliberation on the cess tax proposals.

Earmarking of purposes has ensured that funds are available despite change in governments.[43] However, as a corollary, sometimes levies have stayed on with apparently no requirement as the funds have not been transferred for the designated purpose.[44] Additionally, benefit theory is not at play as contributors are not necessarily the beneficiaries, as highlighted through examples in the following section.

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[36] McCleary, above n 15, 101.
[37] Deran, above n 30, 357.
[38] *Constitution of India*, above n 6, art 265.
[39] The Consolidated Fund of India is the fund where all tax monies are deposited and maintained. On the other hand, a Public Account is maintained for all public monies that the government holds as a beneficiary, on behalf of the public, as per Article 266(2). The Public Account is used for sums such as the Provident Fund, etc.: *Constitution of India*, above n 6, art 266(1).
[40] Ibid, art 114.
[41] Ibid, art 110.
[42] For example, the Swachh Bharat/Hygiene Cess was levied through a single provision in the Finance Act: *Finance Act 2015*, above n 19, s 119.
[43] A number of cesses imposed in the 1950s such as the rubber cess, coffee cess, tea cess, salt cess and cotton cess were in force for about 50 years until they were repealed more recently in 2016-2017.
[44] See the Comptroller and Auditor General's report auditing Union Government's accounts for the 2016-2017 fiscal year which refers to short transfers in the case of the research and development cess, Swachh Bharat Cess/Hygiene Cess, sugar cess, tea cess, primary education cess, clean energy cess, road cess and Krishi Kalyan Cess/Farmer Welfare Cess: Comptroller and Auditor General, India, *Report No 44 of 2017 – Financial Audit, Accounts of the Union Government, 2016-17*, ch 2 ('Comments on Finance Accounts') 51, 51-56 [2.3.1]-[2.3.6], https://cag.gov.in/uploads/download_audit_report/2017/Chapter_2_Comments_on_Finance_Accounts_of_Report_No.44_of_2017_-_Financial_Audit_on_Accounts_of_the_Union_Government.pdf.

Earmarking has not avoided the need for additional budgetary allocation. For example, the primary education cess now modified as the health and education cess[45] does not prevent the need for budgetary allocations for various health and education initiatives.[46] When governments choose such broad and general welfare purposes this is bound to happen. This gives the impression that the earmarking exercise is merely symbolic and a proxy for pushing the agenda for certain chosen initiatives.

3. EARMARKED TAXES UNDER THE INDIAN CONSTITUTION

The power to tax is an inherent attribute of the sovereign. Undoubtedly, the sovereign has the prerogative to choose the class of persons to be taxed, the tax base and tax rate. In the case of a cess tax, the sovereign also has the privilege of identifying the earmarked purpose.

However, as a tax can only be brought in through the means of a statute,[47] the law must be valid in the eyes of the law. Every tax law must: (a) be within the legislative competence of the relevant legislature;[48] (b) not be violative of any fundamental rights contained in Part III of the Constitution,[49] and (c) not be expressly prohibited under any other tax specific articles of the Constitution.[50] The legal validity of the cess taxes will now be tested on these grounds.

As an initial point, it can be noted that many countries across the world have published taxpayers'/citizens' charters that recognise the rights of taxpayers. Typically, taxpayers' charters guarantee taxpayers' rights such as the right to be informed of the tax liability, right to appeal, right to certainty, etc. The apex body of direct taxes in India (Central Board of Direct Taxes) has issued a taxpayers' charter guaranteeing 14 rights. The rights enumerated include the right to a fair and just system, to hold authorities accountable, to provide complete and accurate information, etc.[51] The citizens' charter issued by the apex indirect tax department in India does not enumerate rights of taxpayers or cess taxpayers. Nevertheless, the department commits to work with 'objectivity and transparency'.[52] These undertakings by the executive are important to bear in mind while considering the irregularities and improprieties in administering cesses and furthering the rights-based approach.

3.1 Cess taxes must conform to Article 270

Article 270 provides that when the Union government imposes cesses for 'specific purposes', the revenues are to remain at their exclusive disposal and outside the divisible pool of tax revenues. The reference to cesses in Article 270 came in through the

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[45] *The Finance Act 2018* (India) Act No 13 of 2018, s 2(13).
[46] Ministry of Finance, Government of India, 'Summary of Budget 2018-2019' (Print Release, Press Information Bureau, 1 February 2018), https://pib.gov.in/Pressreleaseshare.aspx?PRID=1518569.
[47] *Constitution of India*, above n 6, art 265.
[48] Ibid, art 246, sch 7.
[49] Ibid, art 13.
[50] See, eg, ibid, arts 276(2), 285, 286, 304(a).
[51] Income Tax Department, Government of India, *Taxpayers' Charter*, https://www.incometaxindia.gov.in/Documents/taxpayer-charter.pdf.
[52] Central Board of Indirect Taxes and Customs, Government of India, 'Citizen Charter' (1 December 2008), https://www.cbic.gov.in/htdocs-cbec/whoweare/ctzen-chtre#:~:text=This%20Charter%20is%20the%20declaration,trade%2C%20industry%20and%20other%20stakeholders.

Eightieth Constitution Amendment Act, 2000. Even prior to the amendment, the Supreme Court's interpretation demonstrates that cess taxes are levied for a specific administrative expense.[53] In the absence of a constitutional exception, successive Finance Commissions[54] have treated cess taxes as a separate 'bucket' of revenues, not meant to be shared with State governments. For example, the Fourth Finance Commission opined that sharing proceeds with State governments would be undesirable as a purpose had already been earmarked.[55] Even after the introduction of the Goods and Services Tax (GST),[56] cesses are excluded from the divisible pool of tax revenues. Hence, there is consistency in the understanding of the concept and treatment of cess taxes.

The rationale for the differential treatment hinges on the 'specific purposes' championed by the cess taxes. Hence, it is important to analyse the phrase and whether the various cess taxes conform to the constitutional mandate.

3.1.1 Understanding 'specific purposes' by contrasting cess and surcharge

The term 'specific purposes' is not defined or explained in the Constitution. In order to understand the scope of the phrase, it is useful to look at the concept of surcharge which is another levy coming under the exception in Article 270.

A surcharge is an increase in duties or taxes 'for the purposes of the Union Government' as described in Article 271[57] of the Constitution. The nature of a surcharge and its characteristic features have been explained in similar terms by the Supreme Court in *Sarojini Tea Co (P) Ltd v Collector of Dibrugarh*.[58] An example of a surcharge is

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[53] Hon Justice Hidayatullah, as expressed in his dissenting opinions rendered in the matter of *Shinde Bros v Deputy Commissioner Raichur and Others* reported in [1967] 1 Supreme Court Reports 548 (26 September 1966) (Supreme Court of India) and *Guruswamy and Co v State of Mysore* reported in MANU/SC/0193/1966 (26 September 1966) (Supreme Court of India). The dissenting views were adopted by the majority in *India Cement Ltd v State of Tamil Nadu* reported in [1990] 1 Supreme Court Cases 12 (25 October 1989) 23 [19], [20] (Supreme Court of India).

[54] The Finance Commissions are independent bodies envisaged under Article 280 of the Constitution of India to recommend the horizontal and vertical devolution of tax revenues for a period of five fiscal years. Currently the Fifteenth Finance Commission has been appointed under the chairmanship of Mr N K Singh. The Commission has made recommendations for five years starting 1 April 2020. The Commission has recommended reducing dependence on cesses as it impacts the divisible pool available to the State governments. The Commission has reiterated that the spirit of a cess is to be available for a specific purpose and provide requisite impetus to a particular sector/area. Most importantly, the Commission has highlighted that the Union government merely acts as a custodian of funds collected from cesses. See Finance Commission of India, *Fifteenth Finance Commission: Report* (Volume I: Main Report, New Delhi, 2020) ch III, 67, 95-96 and ch XI, 347.

[55] Finance Commission of India, *Fourth Finance Commission: Report* (New Delhi, 1965) ch VI, 24 [48].

[56] GST was introduced on 1 July 2017 by way of an amendment to the Constitution as part of a significant indirect tax reform in India. The reform introduced a new tax base of goods and services that gives the Union and State governments concurrent power of taxation. Key objectives of the reform were to tackle the cascading effects in existing indirect taxes (excise duties, customs duties) and to replace various existing indirect taxes at the federal, state and municipal level.

[57] *Constitution of India*, above n 6, art 271.

> Notwithstanding anything in Articles 269 and 270, Parliament may at any time increase any of the duties or taxes referred to in those articles except the goods and services tax under article 246A, by a surcharge for purposes of the Union and the whole proceeds of any such surcharge shall form part of the Consolidated Fund of India.

[58] *Sarojini Tea Co (P) Ltd v Collector of Dibrugarh* reported in [1992] 2 Supreme Court Cases 156 (24 January 1992) 164 [17] (Supreme Court of India).

individuals being required to pay an extra 15 per cent tax on their income tax liability if they earn more than INR 10,000,000 annually.[59]

A surcharge is essentially a tax-on-tax liability owed otherwise.[60] Being a tax, the levy is not accompanied by an end purpose, pledged at the time of collection. Owing to the exception under Article 270, the proceeds can be used by the Union government for any purposes. Given that the nature of the levy is a tax, the purpose cannot be a private purpose but must be a public purpose.

The phrase 'purposes of the Union Government' used in the context of a surcharge in Article 271 must be contrasted with 'specific purposes' under Article 270 dealing with cess taxes. The former denotes the power of the Union government to appropriate the proceeds for any public purpose, as deemed fit, after the imposition of the levy. However, under the latter category the Union government's power to utilise the proceeds is circumscribed by the scope of the earmarked purpose, defined and enumerated by the cess legislation. The cess proceeds thus, cannot be used for any and every public purpose, in disregard for the stipulated end purpose. If any other interpretation were to be attributed it would mar the constitutional intent in maintaining a distinction between a tax *simpliciter*, a cess tax and a surcharge.

3.1.2 'Specific purposes': condition precedent for levy, maintenance and utilisation of a cess tax

Article 270 lays down the general rule that the taxes collected by the Union government must be shared with the State governments based on the recommendations of the Finance Commission. One of the exceptions to this rule involves cess taxes because the cesses are collected for 'specific purposes'. The funds from the cesses are retained by the Union government for appropriation and disbursement and thus, the role of the Finance Commission is also not envisaged here.[61] Hence, all steps in the 'life cycle' of a cess tax, from conception, levy, collection and maintenance to utilisation of proceeds must conform to fulfilling the threshold spelt out by 'specific purposes'. If cess money is not spent for the earmarked purpose or is shared with State governments without going through the Finance Commission recommendations, it would amount to a violation of the Article 270 mandate.

We explain the ambit of 'specific purposes' through four limbs: (i) the levy should not be a revenue raising measure; (ii) there must be a clear and detailed set of specific purposes; (iii) a budget must be drawn, and (iv) the proceeds must be earmarked in financial accounts and utilised accordingly.

First, a cess tax should not be a general revenue raising measure but must be targeted towards a specified end purpose. This view can be supported through Justice Hidayatullah's description of a cess tax as a levy for a 'special administrative expense'. Hence, a cess tax should not be just for any earmarked purpose but also for some object

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[59] *The Finance Act 2017* (India) Act No 3 of 2017, s 3(a).

[60] For example, say an individual earns an annual income of INR 10 million that is subject to an income tax of 30 per cent and a surcharge of 10 per cent. The income tax payable would be INR 3 million and the surcharge would be 10 per cent of the tax liability which is INR 0.3 million.

[61] While this article does not consider in detail the alternate scenario of the Union government replacing a cess tax with a tax *simpliciter*, a limited point on consequences is made here. If the measure was instead a tax *simpliciter,* the proceeds would form part of the Consolidated Fund of India and distributed (among the Union government and the State governments) based on the recommendations of the Finance Commission. The exception applicable to cess taxes under Article 270 of the Constitution would no longer be available.

which merits a special pledging of funds. Also, it is expected that resort to cess taxes is made cautiously and that there is some justification for the additional levy, over and above the existing tax. The reason for this is that the Union government has the power in any event to raise revenues without committing monies to any specific expense, through the route of tax *simpliciter* or even surcharge.

One levy which is a revenue raising measure under the garb of a cess is the GST Compensation Cess[62] levied over and above the newly introduced GST. The contributors under the GST Compensation Cess are the consumers of stipulated goods and services.[63] The beneficiary of the proceeds is not the contributor but any State government incurring losses on account of the implementation of the GST.[64] Once the monies are given to the State governments, the administration is free to use it for any need including narrowing the fiscal deficit.

In McCleary's language the levy can be classified as a 'general tax' for raising revenues.[65] In the absence of earmarking, the levy is just a tax on tax. Moreover, even if one were to think of the GST Compensation Cess as a tax on tax,[66] there are further problems.

A tax on tax or surcharge over and above the GST is prohibited under Article 271.[67] Additionally, if the levy was indeed a tax, the proceeds should be distributed based on the recommendations of the Finance Commission. However, the mechanism adopted for distributing the proceeds of the GST Compensation Cess is unusual. During the term of the levy, the proceeds will be distributed among the State governments incurring losses based on a prescribed formula specified in the *Goods and Services Tax (Compensation to States) Act, 2017*. Upon the lapse of five years, 50 per cent of the remaining proceeds are to be transferred to the Union government. The remaining 50 per cent is to be divided among the State governments based on their revenue collections in the fifth year of the imposition of the levy.[68] Cess taxes are kept outside the divisible pool under Article 270 and are thus at the exclusive disposal of the Union government. However, here it is peculiar that the proceeds are shared with State governments, contrary to the directive in Article 270. Bypassing the mandate of Article 270 and the recommendations of the Finance Commission through a statutory formula may open up this levy to further legal challenges.

Secondly, a cess tax must be accompanied by a detailed and clear set of 'specific purposes' to enable earmarking. Unfortunately, the recent trend has been to give a very

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[62] *Goods and Services Tax (Compensation to States) Act 2017* (India) Act No 15 of 2017, s 8 (*Goods and Services Tax Act*).
[63] Some items that are subject to the GST Compensation Cess are pan masala, tobacco and manufactured tobacco substitutes including tobacco products, aerated waters and motor cars: ibid s 8(2), sch.
[64] Ibid.
[65] McCleary, above n 15.
[66] A two-judge bench of the Supreme Court upheld the constitutional validity of the GST Compensation Cess. The Court found the GST Compensation Cess to be a tax but never examined the issues of the statutory formula for distribution, violation of Article 271 if the levy was just a tax and whether the earmarked purpose was specific: *Union of India and Anr v Mohit Minerals Pvt Ltd* reported in [2019] 2 Supreme Court Cases 599 (3 October 2018) (Supreme Court of India). A review petition was filed by the respondent which was dismissed by the Supreme Court: *Mohit Mineral Pvt. Ltd v Union of India & Anr*, Review Petition (C) no 2718 of 2019 dated 21 January 2020.
[67] *Constitution of India*, above n 6.
[68] *Goods and Services Tax Act*, above n 62, s 10.

brief description of the earmarked purposes. For example, section 119 of *Finance Act, 2015* which has imposed the Clean India Cess describes the purpose as being to 'promote and finance Swachh Bharat initiatives and any related purpose thereto'. The term 'any related purpose thereto' is vague and uncertain. For example, huge sums have been booked for advertising expenses of the Swachh Bharat ('Clean India') campaign under which the Hygiene Cess was introduced. The expenses for print media, radio and television advertisements are being put under the information, education and communication aspects of the scheme.[69] Whether or not expenditure of such a nature is justified as being for the earmarked purpose is questionable, particularly when there was no well-defined purpose in the charging legislation. Moreover, the accompanying guidelines[70] and statements by ministers[71] have led to mixed signalling of the scope of the earmarked purpose.

Thirdly, it would seem that the process of earmarking would entail drawing up a budget of required funds, based on which the rate and duration of the levy is fixed. While there may not be a mathematical equivalence between the funding required and the proceeds raised, it is expected that some calculation revealing the funding requirement is being carried out. Such forethought would also mean that the levy would not be imposed for an arbitrary or indefinite period. However, it is unfortunate that no such action plan or budget is shared when announcing earmarked taxes in India.

Ordinarily, Indian cess tax laws do not come with sunset clauses. The *Goods and Services Tax (Compensation to States) Act, 2017* appears to collect the levy for the 'transition period',[72] defined to be the first five years of implementation of the GST. However, the charging section states that the levy may be collected 'for a period of five years or for such period as may be prescribed by the Council'.[73] This cannot be considered a strict sunset clause but it at least necessitates an approval process from the GST Council[74] and an accompanying legislative amendment if extension is contemplated.

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[69] Aroon Deep, 'Swachh Bharat Spent Rs 530 Crore on Publicity in Three Years – But Little on Grassroots Awareness', *Scroll.in* (22 November 2017), https://scroll.in/article/857030/centre-spent-rs-530-crores-in-3-years-on-swachh-bharat-publicity-but-has-little-to-show-for-it (accessed 7 June 2021).

[70] The objectives are identified as accelerating sanitation coverage in rural areas, developing community managed sanitation systems and motivating communities to adopt sustainable sanitation practices: Ministry of Drinking Water and Sanitation, *Guidelines for Swachh Bharat Mission (Gramin)* (31 December 2018) 9, https://jalshakti-ddws.gov.in/sites/default/files/SBM(G)_Guidelines.pdf.

[71] The Urban Development Minister, Hon Mr Naidu, states that the Government has a three-pronged strategy of educating the public, creating infrastructure and penalising errant members of the public as a last resort: Press Trust of India, 'Can't Penalise without Creating Awareness on Swachh Bharat: Government', *India.com* (11 March 2016), https://www.india.com/news/india/cant-penalise-without-creating-awareness-on-swachh-bharat-government-1024335/ (accessed 7 June 2021).

[72] *Goods and Services Tax Act*, above n 62, section 2(r) defines the transition period to be a period of five years from the transition date and section 2(q) defines transition date to mean, in respect of any State, the date on which the State Goods and Services Tax Act of the concerned State comes into force.

[73] *Goods and Services Tax Act*, above n 62, s 8(1).

[74] The GST Council is a constitutional body appointed under Article 279A of the Constitution of India for making recommendations on issues relating to GST. The Chairman of the GST Council is the Union Finance Minister and the other members are the Union State Minister of Finance and Ministers of Finance of all the State Governments. The GST Council makes recommendations to the Union government and State governments on important issues related to GST such as the goods and services that may be subjected to or exempted from GST, model GST Laws, GST rates including the floor rates with bands and special rates for raising additional resources during natural calamities and disasters.

Fourthly, proceeds from cess taxes are to be earmarked in the financial accounts as well as utilised for the earmarked purpose. The Constitution provides that all cess tax proceeds must be deposited into the Consolidated Fund of India.[75] However, to uphold the true spirit of earmarking, monies from cess taxes must be segregated within the Consolidated Fund of India, by not only using separate accounting codes but also creating dedicated sub-funds. Once the dedicated sub-funds are set up, the money must be appropriated and actually utilised for the earmarked purpose.

In practice, separate sub-funds are not being created in the charging statutes that impose earmarked taxes. For example, the Hygiene Cess was imposed through a single provision which simply stipulated[76] that funds were to be credited to the Consolidated Fund of India and appropriated therefrom.

If the cess tax is levied, maintained or utilised in a way that is contrary to the 'specific purposes' it would amount to a violation of the Constitution. Moreover, it could be argued that cess taxes not bearing the earmarking prerequisite become relegated to a tax *simpliciter*. As a consequence, the proceeds must be shared with State governments based on the Finance Commission's recommendations as the monies are tax revenues which form part of the divisible pool.

3.1.3 Legislative dilution of utilisation of cess proceeds outside the 'specific purpose'

In order to uphold the spirit of 'specific purposes' the laws charging cess taxes must mandate that the proceeds from the cess, minus amounts spent in collecting the cess, are to be utilised only for the earmarked purpose. For example, section 3 of the *Sugar Development Fund Act, 1982* provides that all proceeds minus the monies spent towards collection 'shall, after due appropriation made by Parliament by law, be credited to the Fund'.

The problem is that some statutes leave the utilisation for the 'specific purposes' to the discretion of the Union government.[77] For example, section 4 of the *Research and Development Cess Act, 1986* provides that, once the concerned cess is collected and deposited in the Consolidated Fund of India, 'the Central Government may, if Parliament by appropriation made by law in this behalf so provides, pay to the Development Bank, from time to time, from out of such proceeds (after deducting the cost of collection), such sums of money as it may think fit for being utilised for the purposes of the Fund'.

It appears that upon the passing of an appropriation Act by the Parliament, the disbursal of funds to the concerned agency (the Development Bank, in the instant case) is subject to the additional action by the Union government. Moreover, the quantum of the funds to be released also seems to depend on the discretion of the Union government.

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[75] *Constitution of India*, above n 6, art 266(1).

[76] *Finance Act 2015*, above n 19, s 119(4):

> The proceeds of the Swachh Bharat Cess levied under sub-section (2) shall first be credited to the Consolidated Fund of India and the Central Government may, after due appropriation made by Parliament by law in this behalf, utilise such sums of money of the Swachh Bharat Cess for such purposes specified in sub-section (2), as it may consider necessary.

[77] See *Central Road Fund Act 2000* (India) Act No 54 of 2000, s 4; *Rubber Act 1947* (India) Act No 24 of 1947, s 12(7); *The Beedi Workers Welfare Fund Act 1976* (India) Act no. 62 of 1976, s 3(a).

Such wide discretion is nothing but a colourable exercise of power inasmuch as what cannot be done directly cannot be done indirectly. The Union government cannot use the proceeds from cess taxes for general purposes under Article 270. Thus, it cannot do so through legislation levying a cess tax for a specific purpose but permitting its use for general purposes.

3.2 Legislative competence of cess tax statutes

The power to enact laws is demarcated among the different spheres of Government through the Union List, State List and Concurrent List in the Seventh Schedule to the Constitution. The Parliament has the power to introduce laws on subjects mentioned in the Union List and Concurrent List.[78] For a tax statute, the concerned Government must rely on a tax specific entry therein. However, this limitation does not apply to the Union government owing to the residuary powers vested in it.[79]

Cess taxes provide an interesting case study for legislative competence because there are two elements at play here – the tax base and the earmarked purpose. The question that needs consideration is, when the Union government is enacting a cess statute, is it enough that the tax base is covered in the Union List, but the purpose is in another List? It appears not.

The Supreme Court has differentiated between the power to impose a tax and the power to regulate. For example, the Supreme Court held that when a State government imposed a cess in reasonable limits the Union government's power to regulate or control the same industry is not automatically interfered with.[80] When the State government collected taxes the monies were not required to be shared with the Union government and thus the Finance Commission was not involved.

However, the situation is different in the case of cess taxes levied by the Union government. Owing to the constitutional protection, once a cess tax is imposed by the Union government the proceeds are to be retained and spent exclusively by it. As the proceeds are to be used by the Union government there is no need for horizontal or vertical distribution and thus cess taxes need not go through the recommendations of the Finance Commission. The Union government only has power to spend for purposes contained in the Union List. When the purpose is not in the Union List but is in the State List instead, the Union government can neither legislate in case of cess taxes, nor incur expenses on such purposes. Hence, if the purpose is mentioned elsewhere that would lead to an anomalous situation.

The next question is whether the residuary power of the Union government empowers it to impose not just taxes *simpliciter* but also cess taxes. The analysis would remain the same if the Union government invokes its residuary powers when the purpose is contained in the State List. Where the purpose is completely absent from the Seventh Schedule, it may be tenable for the Union Parliament to impose the cess legislation.

Several cess taxes are being levied by the Parliament on tax bases contained in the Union List but for specific purposes which relate to entries provided for in the State List. This

[78] *Constitution of India*, above n 6, arts 245, 254.
[79] *Constitution of India*, above n 6, sch 7, Union List, entry 97.
[80] *State of West Bengal v Kesoram Industries* reported in [2005] All India Reporter 1646 (15 January 2004) (Supreme Court of India).

is an extremely dangerous scenario as it leads to a vulnerable situation and unprecedented financial dependency of the State governments on the Union government. An instance is the Hygiene Cess which was imposed for promoting and financing the Clean India initiatives which is the Union government's campaign to achieve universal sanitation coverage.[81] Sanitation is covered by Entry 6[82] of the State List. Likewise, agriculture is mentioned in Entry 14[83] of the State List while the Farmer Welfare Cess has been imposed by the Union government.

A request filed by the authors under the *Right to Information Act, 2005* revealed that proceeds from the Hygiene Cess are being shared by the Union government to different State governments and that the levels of spending vary vastly. Details of the spending as of 30 June 2017 as disclosed by the Ministry of Drinking Water and Sanitation, Union government of India, are set out in the Appendix.[84] Given the constitutional scheme, Union tax proceeds were either to be shared with State governments if arising out of taxes *simpliciter* or kept aside if the levies were cess taxes. The Union government has labelled the measures as the latter to keep it outside the purview of the Finance Commission but has ultimately resorted to sharing the proceeds with different State governments on its own guidelines. This model of sharing bypasses the role of the Finance Commission which was crucial to the cooperative federalist model envisaged under the Constitution.

Cess laws such as those imposing Hygiene Cess and the Farmer Welfare Cess should be held invalid for lack of legislative competence.

4. JUDICIAL RESPONSE TO EARMARKED TAXES IN INDIA

In light of the above analysis as to the provisions of the Constitution in relation to cess taxes, it is important to examine what the response of the judiciary has been, in relation to the concept of a cess tax as well as legal issues pertaining thereto.

4.1 Features of a cess tax

The early court decisions on cess taxes state that the term may be still in vogue in Ireland[85] and may have meant 'a rate levied by a local authority and for local purposes' in England. However, now the word cess has been replaced in those countries by rate

[81] The Clean India campaign is run by the Ministry of Drinking Water and Sanitation. The objectives and vision of the Clean India campaign are available at: Department of Drinking Water and Sanitation, 'Swachh Bharat Mission – About Us' (5 May 2020), http://swachhbharatmission.gov.in/SBMCMS/about-us.htm (accessed 7 June 2021).

[82] 'Public health and sanitation; hospitals and dispensaries.'

[83] 'Agriculture, including agricultural education and research, protection against pests and prevention of plant diseases.'

[84] A right to information application filed by the first author with the Ministry of Drinking Water and Sanitation reveals a discrepancy in utilisation (based on allocation) of cess proceeds. The response from the Ministry refers to Swachh Bharat Mission (Grameen) Guidelines which further detail that allocation is made on demands raised by the State government after final scrutiny by the Union Ministry. It is not clear what parameters dictate the final allocation approval by the Union government – need for funds, political interests, grant based on a 'first come, first served' basis, etc. While complete discretion on how to use the funds should ideally lie with the State governments because hygiene and sanitation comes under their purview, this allocation structure belies exclusive regulation or control by the State government machinery.

[85] *Shinde Bros v Deputy Commissioner Raichur and Others* reported in [1967] 1 Supreme Court Reports 548 (26 September 1966) (Supreme Court of India); *Guruswamy and Co v State of Mysore* reported in MANU/SC/0193/1966 (26 September 1966) (Supreme Court of India).

and is described as a tax for a specific object[86] or special administrative expense,[87] as identified in the name. The examples quoted in the decisions are those of health cess, education cess, etc.

While these decisions refer to a cess as being a tax, it must not be forgotten that a cess may bear the characteristics of either a tax or a fee. Whether it would constitute a tax or a fee would depend ultimately on the facts at hand. For example, if a cess is in the nature of a tax, then the proceeds must form a part of the Consolidated Fund of India. On the other hand, if a cess shares the attributes of a fee, the funds are kept separately for rendering the service to the fee payer.[88]

The High Court studied the nature of the rubber cess introduced under section 12 of the *Rubber Act, 1947* and stated it to be in the nature of a tax. The cess was described as a duty of excise, imposed on articles manufactured in India. The funds from the cess were to be used for research, training of students, providing technical advice to growers, etc. The 'pith and substance and dominant purpose' of the levy was to develop the rubber industry which connotes a public purpose rather than a specific facility to a person. The funds were to be first credited into the Consolidated Fund of India and then appropriated for the identified purpose into an earmarked fund. All these factors demonstrated that the levy bore the characteristics of a tax and not a fee.[89]

On the other hand, the Supreme Court considered the cess levied under the *Orissa Mining Areas Development Fund Act, 1952* and held it to be a fee as the monies were not part of the Consolidated Fund of India. There was a correlation between the cess and the purpose for which it was levied. The cess was levied against the persons owning mines in the notified area and the funds were to be used to render specific services to the said class by developing the notified area.[90]

4.2 Specific purpose

The earmarked purpose of a cess tax must be for the benefit of the public.[91] While there is no need to identify a *quid pro quo* to the contributor, the funds have to be used for the collective good of the society by spending for the promised earmarked purpose.

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[86] *Daulat Ram v Municipal Committee* reported in [1941] All India Reporter 40 (14 June 1040) 43 [9] (Lahore High Court).

[87] This was the view of Justice Hidayatullah expressed in his dissenting opinions rendered in *Shinde Bros v Deputy Commissioner Raichur and Others* reported in [1967] 1 Supreme Court Reports 548 (26 September 1966) (Supreme Court of India) and *Guruswamy and Co v State of Mysore* reported in MANU/SC/0193/1966 (26 September 1966) (Supreme Court of India). As noted at n 53, above, in *India Cement Ltd v State of Tamil Nadu* reported in [1990] 1 Supreme Court Cases 12 (25 October 1989) 23 [19], [20] (Supreme Court of India) the dissenting views of Hidayatullah J. were adopted by the majority noting that there was no disagreement among the Judges on this aspect.

[88] *Hingir-Rampur Coal Co Ltd v State of Orissa* reported in [1961] All India Reporter 459 (21 November 1960) 3 [9] (Supreme Court of India). In *N Balaraju v The Hyderabad Municipal Corporation* [1960] All India Reporter 234 (12 August 1959) (Andhra Pradesh High Court of India) the Court spoke of cess and tax interchangeably. However, that appears to be an error in light of the Supreme Court precedents quoted here.

[89] *Shri Krishna Rubber Works v Union of India* reported in [1971] 73 Bombay Law Reporter 496 (30 November 1970) 504 [22]-[23] (Bombay High Court of India).

[90] *Hingir-Rampur Coal Co Ltd v State of Orissa* reported in [1961] All India Reporter 459 (21 November 1960) 7 [18].

[91] *Shri Krishna Rubber Works v Union of India* reported in [1971] 73 Bombay Law Reporter 496 (30 November 1970).

The purpose for imposing a cess must not be vague or uncertain, as it could lead to a claim of excessive delegation of power. The purpose of the Iron Ore Mines Labour Welfare cess was to fund measures for, *inter alia*, improvement of standard of living including housing and nutrition, public health and sanitation, provision of water supplies, education, etc.[92] The Supreme Court held that the purpose was specific in nature.[93]

The language in some cess tax statutes also refer to surcharge, despite the difference in the concept. For example, section 91 of the *Finance Act, 2004* 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 universalized quality basic education'.

This language can cause problems, as can be seen from remarks which have been made by the Supreme Court. In *SRD Nutrients Private Limited v Commissioner of Central Excise, Guwahati*,[94] the Supreme Court observed that primary education and higher education cess are surcharges. The Court was not called upon to decide the nature of the cess; the limited question was in respect of a manufacturer's eligibility for refund of primary education cess and secondary and higher education cess paid during clearance of goods. The issue of refund could have been decided simply by interpreting the applicable sections of the *Finance Act, 2004* which provide 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. As the remarks of the judges were not central to deciding the question at hand, it would be necessary to argue that the comments are *obiter dicta*.[95] However, even *obiter* observations of the Supreme Court may be relied upon by the High Courts, further diverting from the clear language of the Constitution. There are also other statutes[96] containing such language adding to the chaotic situation.

There is some hope as a clearer view was expressed by the Delhi High Court in *Cellular Operators Association* v *Union of India & Anr*[97] which held that primary education cess and secondary and higher education cess were in the nature of taxes and not fees but could not be treated as excise duty or service tax. The Court held that the levies were 'specific cesses for the objective and purpose specified'.

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[92] *Iron Ore Mines Labour Welfare Cess Act 1961* (India) Act No 58 of 1961, s 3.

[93] *V Nagappa v Iron Ore Mines Cess Commissioner* reported in [1973] 2 Supreme Court Cases 1 (10 April 1973) (Supreme Court of India).

[94] *SRD Nutrients (P) Ltd v CCE* reported in [2018] 1 Supreme Court Cases 105 (Supreme Court of India).

[95] Ashrita Prasad Kotha, 'The Distinction between Cess and Surcharge is Significant for a Taxpayer' (2018) 53(8) *Economic and Political Weekly*.

[96] See section 136 of *Finance Act 2007*, above n 23, imposing secondary and higher education cess, which describes the levy as:

> surcharge for purposes of the Union, a cess to be called the Secondary and Higher Education Cess, to fulfil the commitment of the Government to provide and finance secondary and higher education.

See also *Finance Act 2016*, above n 20, s 184(2), pertaining to Income Disclosure Scheme, which imposed a tax of 30 per cent and:

> 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.

[97] *Cellular Operators Association of India and Others v Union of India* (Unreported, Delhi High Court of India, Writ Petition (Civil) No 7837/2016, 15 February 2018).

4.3 Earmarking of proceeds

Once collected, the proceeds of a cess must be credited into the Consolidated Fund of India.[98] However, within the Consolidated Fund of India the proceeds must be earmarked. If the proceeds are merged with the other monies in the Consolidated Fund of India the legislation would be rendered unconstitutional.[99]

The Supreme Court has observed that a cess tax contains an inherent check as it should be possible to correlate the collected amount with the amount required for the specific purpose.[100] The Supreme Court has observed that earmarking must be accompanied by reports and accounts demonstrating transparency in maintenance of funds.[101]

Such reports and accounts must be available in the public domain to achieve the said purpose. This is the very essence of the earmarking exercise and when earmarking is done appropriately, the levies could prove to be good policy tools.

4.4 Non-appropriation/utilisation of proceeds

In *Vijayalashmi Rice Mills v Commercial Tax Officers*[102] the Supreme Court described a cess as being a special kind of tax as proceeds have to be used for the specific purpose. By way of illustration, the Court explains that a health cess must be used for building hospitals, giving medicines to the poor, etc. Proceeds must thus be used for the earmarked purpose and not diverted for any other purpose.[103]

In another instance, the Supreme Court has had to consider a situation where over INR 270,000 million collected as Building and other Construction Workers Welfare cess has been lying unutilised. Essentially, less than 10 per cent of the collected funds had been spent, and the amount spent was also for purposes other than the identified purpose.[104] The Court passed a series of orders taking strong objection to the state of affairs. The Court admonished the government, stating that 'it would be perhaps more appropriate not to collect this money since it is not being utilised for the benefit of the persons for whom it is collected, but for other purposes'. The Supreme Court directed the Delhi Government, which had spent money on advertisements, to refund the same as it had nothing to do with worker welfare.[105] As the money was not being transferred to the welfare board set up under the relevant legislation, the Court ordered transfer of funds within a prescribed time frame.[106]

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[98] *Constitution of India*, above n 6, art 266(1).
[99] *Sharma Transports v State of Karnataka* reported in [2005] Indian Law Reporter Karnataka Series (18 November 2004) 80, 92 [19], 94 [24], 95 [25], 95 [28] (Karnataka High Court of India).
[100] *V Nagappa v Iron Ore Mines Cess Commissioner* reported in [1973] 2 Supreme Court Cases 1 (10 April 1973) (Supreme Court of India) 7 [16].
[101] *V Nagappa v Iron Ore Mines Cess Commissioner* reported in [1973] 2 Supreme Court Cases 1 (10 April 1973) (Supreme Court of India) 7 [16].
[102] *Vijayalashmi Rice Mill v Commercial Tax Officers, Palakol*, reported in [2006] 6 Supreme Court Cases 763 (7 August 2006) 768 [13] (Supreme Court of India).
[103] *Vyapar Mandal v The Municipal Board* reported in [1989] Allahabad Law Journal 1372, 133 [47], 134 [50] (Allahabad High Court of India).
[104] *National Campaign Commtt, C L, Labour v Union of India* (Unreported, Supreme Court of India, Conmt. Pet. (C) No 52/2013 in Writ Petition (C) No 318/2006, 30 October 2017).
[105] *National Campaign Commtt, C L, Labour v Union of India* (Unreported, Supreme Court of India, Conmt. Pet. (C) No 52/2013 in Writ Petition (C) No 318/2006, 21 August 2015).
[106] *National Campaign Commtt, C L, Labour v Union of India* (Unreported, Supreme Court of India, Conmt. Pet. (C) No 52/2013 in Writ Petition (C) No 318/2006, 8 May 2017); *National Campaign Commtt, C L,*

The cess in question has been determined to bear the characteristics of a fee. The common feature between a cess bearing the characteristics of a fee and a cess tax is that the proceeds ought to be utilised for a specific purpose. Hence, a similar judicial response is warranted even for non-utilisation of cess tax funds.

On the other hand, the Karnataka High Court has observed that the proceeds of a cess in the nature of a tax may be used for any public purpose including the earmarked purpose as it is part of the Consolidated Fund of India.[107] Such conclusion is contrary to the spirit of a cess tax treating it rather like a tax *simpliciter*.

The Kerala High Court has held that when considering the constitutional validity of a cess statute it would be 'inappropriate and indeed illegitimate' to enquire into whether the application of proceeds collected under the legislation conforms to the provisions of the Constitution.[108] This reading is problematic as non-utilisation for the earmarked purpose should lead to violation of Article 270.

5. CONCLUDING THOUGHTS: NEED FOR A RIGHTS-BASED ANALYSIS

The foregoing discussion, which is one of the first accounts of its kind, highlights the legal discrepancies in the levy and administration of earmarked taxes in India. Earmarked taxes, levied and utilised in the true spirit, can bring in transparency and accountability and in turn, enhance tax compliance. However, the lack of strong earmarking in practice, use of open-ended and vague language with respect to defining purposes, governmental discretion in disbursing funds for earmarked purposes and entering the domain reserved for State governments are some of the prominent legal and constitutional issues the study reveals.

Given the gaps between the theoretical understanding and the actual reality of cesses, there is a need for a rights-based analysis of earmarked taxes. The rights-based perspective to different fields of study aims to look at the issue with rights at the core. Rights are entitlements (not) to perform certain actions, or (not) to be in certain states; or entitlements that others (not) perform certain actions or (not) be in certain states.[109]

Hohfeldian analysis includes the two primary incidents of right and privilege; *right* attaches an obligation on some party to do or not to do something, *privilege* on the other hand does not attach such an obligation.[110] Rights are enforceable whereas privileges are not. Hohfeld explains the two concepts using the example of a car parking garage, where the reserved parking spot creates a right in favour of the person who has the reserved parking pass, whereas the general parking spot only creates a privilege in favour of all. Hohfeld distinguishes the two concepts based on the attachment to a '*corollary duty*' in case of a right. In the case of the person holding a reserved car parking spot, everyone but that person has a duty not to park their car in that spot, thus

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Labour v Union of India (Unreported, Supreme Court of India, Conmt. Pet. (C) No 52/2013 in Writ Petition (C) No 318/2006, 2 August 2017).

[107] *Commissioner of Central Excise, Customs and Service Tax v Shree Renuka Sugars Ltd* reported in [2014] 302 Excise Law Times Karnataka 33 (6 August 2013) 40 [26] (Karnataka High Court of India).

[108] *Raja Oil Mills Chovva, Cannanore v Union of India* reported in [1969] All India Reporter 176 (23 May 1968) 177 [6] (Kerala High Court of India).

[109] Leif Wenar, 'Rights', *The Stanford Encyclopedia of Philosophy* (Fall 2015 edition), https://plato.stanford.edu/archives/fall2015/entries/rights/ (accessed 7 June 2021).

[110] Wesley Newcomb Hohfeld, *Fundamental Legal Conceptions As Applied in Judicial Reasoning* (W Cook ed, Yale University Press, 1919).

it a right. By contrast, in the case of general car parking spots, everyone can park their car in the spot and no one bears a correlative duty.

Applying the rights-based analysis to earmarked taxes, it is necessary to evaluate the individual and/or collective rights arising from earmarking. A starting point could be to identify the rights of cess taxpayers and corollary duties of the government. Since the earmarked taxes are levied for 'specific purposes' and on a particular set of people, the cess taxpayers would have a right to seek utilisation of the earmarked funds. This right to demand that the monies be spent for the 'specific purposes' would exist even in the absence of a *quid pro quo* benefit. This identifies cess taxpayers as a class distinct from payers of taxes and fees *simpliciter*. This analysis in turn ensures an obligation on the government to ensure full and transparent utilisation of earmarked monies.

For instance, the INR 940,000 million in funds collected through the secondary and higher education cess tax since 2007 are lying in the Consolidated Fund of India. This is alarming because the funds have not been transferred or utilised despite a relevant sub-fund having been created in August 2017.[111] The cess continues to be levied as a newly-branded health and education cess. Access to education is a real challenge in India and contributors rightfully expect the money to be utilised for bridging the existing gaps. Unfortunately, this is not the case. In such situation, it is argued that cess taxpayers have the right to seek utilisation of the earmarked monies. Acknowledging and adopting the rights-based discourse is the first step in realising the rights and identifying adequate remedies.

In fact, there is no better time to advocate for a rights-based analysis of earmarking. The statutes under which the Hygiene Cess, Farmer Welfare Cess and Infrastructure cess were levied were repealed when the GST regime was introduced in 2017. The repeal of a statute does not affect the rights or obligations accrued or incurred under the respective enactments.[112] Hence, the cess payers should be able to exercise the right to question whether the monies have been spent for the 'specific purposes'.

Most importantly, an effort to move governments towards delivery of good governance through transparent usage of cess proceeds can be used to build credibility of the tax system and increase voluntary compliance. Identifying cess taxpayers as a separate class also prompts us to ask further questions – for example, whether the cess should be imposed on direct or indirect taxes, as this decision has a progressive or regressive impact on the payer. In the Indian context, most earmarked taxes are consumption-based taxes. In a country where the proportion of indirect taxes outweighs the direct taxes, cess taxes add fuel to the fire. It is thus time to conceptualise cess taxes in a manner that suits the Indian context.

A corollary to the rights-based approach is an identification of the unequivocal duty of the Union government to collect, earmark and utilise monies from cess taxes for the earmarked purposes. Realisation of the rights can be ensured when different arms of the government fulfil their respective duties. The legislature must pass enactments with detailed earmarked purposes and justifications for imposing a cess rather than a tax,

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[111] Comptroller and Auditor General of India, *Report No 2 of 2019 – Financial Audit, Accounts of the Union Government, 2017-18*, 7, https://cag.gov.in/webroot/uploads/download_audit_report/2019/Report_No_2_of_2019_Accounts_of_the_Union_Government_Financial_Audit.pdf.

[112] *General Clauses Act 1897* (India) Act No 10 of 1897, s 6.

estimated reverse calculations to substantiate the chosen tax rate, mechanisms for ensuring earmarking and utilisation, and a requirement for annual publication of collection and expenditure data and sunset clauses.

In order to ensure effective earmarking and utilisation, adequate administrative machinery and officers must be identified, separate sub-funds must be created within the Consolidated Fund of India and each of such sub-funds should have minor accounting codes so that the usage of funds can be traced. The executive must support strict compliance with the earmarked taxing statutes, make no expenses without the necessary appropriation Acts, and administer the disbursement and expenditure of proceeds in a transparent and timely manner with suitable accountability mechanisms in case it is not able to fulfil its duties. It would be a positive step if the tax departments specifically identified cess taxpayer rights in the taxpayers'/citizens' charters.

The judiciary must also rise to the occasion and strike down an earmarked tax statute when there is lack of legislative competence and/or evidence of mismanagement of funds. The levying of cesses through a vague provision in the Finance Act with an open-ended purpose, and unclear justification, utilisation time frame, and administrative checks and balances should be called out. An analysis of the precedents by the various High Court and Supreme Court decisions shows that the rights-based jurisprudence is not always reflected in the outcomes. While on the one hand the Supreme Court has reprimanded a State government for diverting or not utilising cess funds in one instance, the Karnataka High Court has considered a cess tax as simply another tax, permitting the proceeds to be spent for any public purpose. These kinds of judicial precedents do a complete disservice to the earmarking of taxes. However, to be fair, a number of issues highlighted here have not yet been posed clearly before the courts. It can only be hoped that when the courts have occasion to decide the more nuanced issues, it will not be a lost opportunity.

APPENDIX

The authors had submitted a request under the *Right to Information Act, 2005* in 2017 seeking disclosure of details pertaining to the collection and allocation of the proceeds from the Hygiene Cess. A response was received from the Ministry of Drinking Water and Sanitation, Union government of India in July 2017.

The disclosure stated that an amount of INR 24,000 million was allocated in the Financial Year 2015-16 (at the second supplementary stage) and INR 100,000 million in Financial Year 2016-17 under the Budget which was allocated to State governments as per the Swachh Bharat Mission (Gramin) Guidelines. As sanitation is within the purview of the State governments, the programme is implemented by State governments through the local self-governments. The details of expenditure of the Hygiene Cess as between the States for the year 2015-16, 2016-17 and 2017-18 are set out in the Table below.

Expenditure of Hygiene Cess, 2015-16, 2016-17 and 2017-18 (INR million)

Name of the States/UTs	2015 - 16	2016 - 17	2017 - 18 (as on 30.06.2017)
Andaman & Nicobar	24.00	30.00	50.00
Andhra Pradesh	657.94	3422.14	1652.00
Arunachal Pradesh	265.15	650.94	665.50
Assam	1726.04	7475.84	3006.55
Bihar	239.20	1318.64	0.00
Chhattisgarh	609.36	5844.65	3207.45
Goa	0.00	0.00	0.00
Gujarat	3436.99	7512.29	0.00
Haryana	23.86	687.91	0.00
Himachal Pradesh	0.00	1173.00	0.00
Jammu & Kashmir	0.00	595.13	739.11
Jharkhand	803.67	4554.64	1846.08
Karnataka	886.02	4195.61	1138.28
Kerala	0.00	1962.76	0.00
Madhya Pradesh	208.55	12107.67	3695.58
Maharashtra	2866.19	5289.42	4776.64
Manipur	0.00	544.86	0.00
Meghalaya	131.87	757.04	0.00
Mizoram	0.00	109.85	0.00
Nagaland	0.00	641.19	0.00
Odisha	2493.95	8636.45	2412.00
Puducherry	24	0.00	44.43
Punjab	147.97	1970.21	1326.06
Rajasthan	5093.55	7773.01	2916.57

Name of the States/UTs	2015 - 16	2016 - 17	2017 - 18 (as on 30.06.2017)
Sikkim	41.93	70.38	12.09
Tamil Nadu	440.31	5370.19	2428.70
Telangana	0.00	1357.18	706.26
Tripura	235.01	249.80	0.00
Uttar Pradesh	1026.94	8533.29	5209.83
Uttarakhand	85.51	3480.50	1320.31
West Bengal	1373.89	6405.02	2510.46