

EY Tax Alert

HC holds penalty imposed under Section 122 is a civil liability

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Executive summary

This Tax Alert summarizes recent ruling of the Allahabad High Court (HC)¹ on whether the penalty leviable under Section 122 of the Central Goods and Services Tax Act, 2017 (CGST Act) is civil or criminal in nature. Further, whether dropping of proceedings under Section 74 of CGST Act will *ipso facto abate* the proceedings under Section 122.

The key observations of the HC are:

- ▶ Section 74 is a charging and a machinery provision for the recovery of tax assessed and imposition of penalty. Section 122 is a penal provision aimed at curbing evasion of taxes. Both the charging Sections are required to be interpreted strictly.
- ▶ *Mens rea* is essential in criminal law, but in civil matters like taxation, it is irrelevant for imposing civil liability.
- ▶ For imposition of penalty, a statute shall determine whether *mens rea* is required or not. For offences involving prosecution under a statute, *mens rea* or guilty intent is a *sine qua non*.
- ▶ Unlike Section 122, offences under Section 132 are far more serious in nature and therefore, the legislature has chosen to impose criminal punishment for the same.

Accordingly, penalty imposed under section 122 is a civil liability and the offences can be adjudicated by the proper officer or adjudicating officer.

Further, when SCN is issued both under Section 73/ 74 and also under Section 122 against the main person, dropping of proceedings under Section 73/ 74 would not automatically result in dropping of proceedings under Section 122 as the proceedings are with respect to contravention of two different offences.

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Background

- ▶ Petitioner, engaged in manufacturing of fast-moving consumer goods, is alleged of being indulged in circular trading without actual supply or receipt of goods.

A show-cause notice (SCN) was issued under Section 74 of the Central Goods and Services Tax Act, 2017 (CGST Act) proposing tax demand along with penalty under Section 122.

- ▶ Subsequently, tax demands under Section 74 were dropped in adjudication order, but penalty was confirmed under Section 122.
- ▶ Aggrieved, the petitioner filed writ petition before the Allahabad High Court (HC).
- ▶ The HC framed the following two questions for consideration:
 - ▶ Whether the “proper officer or adjudicating officer” has the power to adjudicate on the penalty provision under Section 122 of the CGST Act?
 - ▶ Whether dropping of proceedings under Section 74 will *ipso facto* abate the proceedings under Section 122 of the CGST Act?

High Court Ruling

Meaning of offence and penalty

- ▶ The word “offence” does not necessarily under all circumstances mean a crime that is required to be tried by the criminal court. A contravention of a rule/law wherein criminal proceedings are not initiated but only penalty is imposed for the purpose of deterrence would also amount to an offence.
- ▶ Penalty may be imposed in cases where there is a simple violation of a law or for omission to do a particular act without there being any *mens rea*. On the other hand, penalty may also be imposed for serious contravention of the law with or without *mens rea* that may amount to an offence for the purpose of deterrence and punishment.
- ▶ A statute may provide for further punishment by prosecution for the same offence/contravention, if the legislature deems it necessary.

Interpretation of Statutes

- ▶ Section 74 at once is a charging and a machinery provision for the recovery of tax assessed and imposition of penalty.
- ▶ Section 122 is a penal provision aimed at curbing evasion of taxes.
- ▶ Both Sections 74 and 122 being charging sections are required to be interpreted strictly and plain

meaning to the word used therein should be provided by the courts.

Penalty in Tax Delinquency Cases

- ▶ *Mens rea* is an essential element in criminal law for prosecuting an accused whereas in civil matters such as taxation *mens rea* is irrelevant for imposing civil liability.
- ▶ The object of the legislature in enacting a penalty provision is not to provide for punishment under criminal law but to provide a deterrent penalty.
- ▶ *Corpus Juris Secundum* states that “a penalty imposed for a tax delinquency is a civil obligation, remedial and coercive in its nature and is far different from the penalty for a crime or a fine or a forfeiture provided as punishment for violation of criminal and penal laws”.
- ▶ It is the scheme of a particular statute that shall determine whether for imposition of penalty there is a requirement for *men rea* or not. However, when a taxing statute speaks of prosecution, for those offences *mens rea* or guilty intent is a *sine qua non*.

Difference between section 122 and section 132

- ▶ Section 132 lists out only nine offences in contradiction to Section 122 of the CGST Act that enumerates twenty-one offences.
- ▶ Offences under Section 132 are far more serious in nature and therefore the legislature has chosen to impose criminal punishment for the same.
- ▶ Proviso to section 138 provides that compounding shall be allowed only after making payment of tax, interest and penalty involved in such offences. This is an indication that the legislature never intended to treat Section 122 as an offence prosecutable and punishable by way of a criminal trial.

Dropping of proceedings under section 74

- ▶ From a reading of the Circular no. 171/03/2022-GST dated July 6, 2022, it is clear that the contravention under Section 73/ 74 need not necessarily be a contravention covered under Section 122 of the CGST Act.
- ▶ When SCN is issued against the main person u/s 73/74 and also against the main person u/s 122, dropping of proceedings u/s 73/74 would not automatically result in dropping of proceedings u/s 122 against the main person as the proceedings are with respect to contravention of two different offences.

Conclusion

- ▶ The proceeding under Section 122 is to be adjudicated by the adjudicating officer and is not required to undergo prosecution.

- ▶ Abatement of proceedings under Section 74 of the CGST Act does not *ipso facto* abate the proceedings under Section 122 which are for completely different offences.

Comments

- a. CBIC issued Circular 171/03/2022-GST dated 6 July 2022 clarifying tax and penal implications for transactions involving fake invoices.
- b. Section 75(13) of CGST Act provides that where any penalty is imposed under section 73 or section 74 or section 74A, no penalty for the same act or omission shall be imposed on the same person under any other provision of the Act.

Our offices

Ahmedabad

22nd Floor, B Wing, Privilon
Ambli BRT Road, Behind Iskcon Temple
Off SG Highway
Ahmedabad - 380 059
Tel: + 91 79 6608 3800

8th Floor, Building No. 14A
Block 14, Zone 1
Brigade International Financial Centre
GIFT City SEZ
Gandhinagar - 382355, Gujarat
Tel +91 79 6608 3800

Bengaluru

12th & 13th Floor
"UB City", Canberra Block
No.24 Vittal Mallia Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground & 1st Floor
11, 'A' wing
Divyasree Chambers
Langford Town
Bengaluru - 560 025
Tel: + 91 80 6727 5000

3rd & 4th Floor
MARKSQUARE
#61, St. Mark's Road
Shantala Nagar
Bengaluru - 560 001
Tel: + 91 80 6727 5000

1st & 8th Floor, Tower A
Prestige Shantiniketan
Mahadevapura Post
Whitefield,
Bengaluru - 560 048
Tel: + 91 80 6727 5000

Bhubaneswar

8th Floor, O-Hub, Tower A
Chandaka SEZ, Bhubaneswar
Odisha - 751024
Tel: + 91 674 274 4490

Chandigarh

Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A
Industrial & Business Park, Phase-I
Chandigarh - 160 002
Tel: + 91 172 6717800

Chennai

6th & 7th Floor, A Block,
Tidel Park, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR

Aikyam
Ground Floor
67, Institutional Area
Sector 44, Gurugram - 122 003
Haryana
Tel: +91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
Gautam Budh Nagar, U.P.
Noida - 201 304
Tel: + 91 120 671 7000

Hyderabad

THE SKYVIEW 10
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jaipur

9th floor, Jewel of India
Horizon Tower, JLN Marg
Opp Jaipur Stock Exchange
Jaipur, Rajasthan - 302018

Kochi

9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

Kolkata

22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

Mumbai

14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

3rd Floor, Unit No 301
Building No. 1
MindSpace Airoli West (Gigaplex)
Located at Plot No. IT-5
MIDC Knowledge Corridor
Airoli (West)
Navi Mumbai - 400708
Tel: + 91 22 6192 0003

Altimus, 18th Floor
Pandurang Budhkar Marg
Worli, Mumbai - 400 018
Tel: +91 22 6192 0503

Pune

C-401, 4th Floor
Panchshil Tech Park, Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

10th Floor, Smartworks
M-Agile, Pan Card Club Road
Baner, Taluka Haveli
Pune - 411 045
Tel: + 91 20 4912 6800

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