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PENALTY UNDER GST LAW AND ABSENCE OF *MENS REA*

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Abstract:

Evasion of tax generates a parallel economy working against the national interest. Naturally stringent laws against the same became necessary.[1] For imposing penalty "*mens rea*" was considered necessary and discretion in imposing the same was conferred on the authorities. As time advanced, the element of "*mens rea*" in imposing penalties against tax evasion is often taken away.[2] The role of discretion on the part of authorities in imposing penalties has become less and less.[3] For example, the main penalty provisions in the *Central Goods and Service Tax Act, 2017* do not invest the authority imposing penalty with discretion and the power to consider *mens rea*.[4] The authority is bound to impose penalty in the given situation.[5] The reason for such harsh law without conferring discretion is the severe nature of the acts or omissions committed by the assessee.[6] The Legislature therefore imposes deterrent laws.[7] However, the operation of such provisions sometimes leads to patent injustice. In the course of working of such penalty provisions, even innocent and bona fide persons are trapped in the net of penalties.[8] Even if there is no guilty intention or *mens rea* on the part of the assessee, the authorities are forced to levy the mandatory penalties. The view that the discretionary powers of the authorities in imposing penalties should be taken away is unrealistic. This paper briefly analyses the lack of discretion and absence of *mens rea* in imposing penalties invoking Sections 122 and 125 of the *Central Goods and Service Tax Act, 2017*.

Index Terms **– Evasion – Penalty – GST Law – Taxation – Mens rea**

1 Cf. Sayre, "Public Welfare Offences", 33 Col. L. Rev. 55, quoted from Leelakrishnan, P., *Legal Aspects of Stage Carriage Licensing in India*, Sterling Publishers Pvt. Ltd, 1979.

2 State of Gujarat and Another v. M/s Saw Pipes Ltd AIR 2023 SC 2113.

3 Vasulal v. Additional Sales Tax Officer, 2004 (3) K.L.T. 162.

4 Sections 122, 125 of Central Goods and Service Tax Act, 2017

5 *supra* note 2.

6 Parameshwaran, K., Power of Taxation Under The Constitution, Eastern Book Company, Lucknow, 1987 p.1.

7 Shree Bhagwati Steel Rolling Mills (M/s) v. Commssioner of Central Excise and Another 2016 (3) SCC 643 para 36.

8 Id. at para 36

DISCRETION IN IMPOSING PENALTY UNDER THE CENTRAL GOODS AND SERVICE TAX ACT, 2017

The new GST Law was introduced for unification of Indian indirect tax system.[9] The *Central Goods and Service Tax Act, 2017* provides for imposing penalty by virtue of Section 122 of the Act enlisting *twenty one* situations by which a "*taxable person*" comes within its purview. The Section states that if any of those *twenty one* situations arises, the delinquent "*shall*" be liable to pay penalty as stated in that section. Besides, any person, who contravenes any of the provisions of the *Central Goods and Service Tax Act, 2017* or the Rules made thereunder (for which no penalty is separately provided) "*shall*" also be liable to pay penalty under Section 125 of the Act. However, the penalty prescribed under Section 125 "*may extend to"* Twenty Five Thousand Rupees, indicating that the fixation of the quantum of penalty under section 125 is discretionary to some extent. The quantum of penalty has to be fixed by following the "*general disciplines*" related to penalty laid down in Section 126 of the *Central Goods and Service Tax Act, 2017*. However, Section 126(6) stipulates that the general disciplines prescribed by the said Section shall not apply to such cases where penalty specified under the *Central Goods and Service Tax Act* is a fixed sum or expressed as a fixed percentage. Therefore the general disciplines related to penalty mentioned in Section 126 are not applicable, if the same is a fixed sum or a fixed percentage.

Even though, Section 122 of the Act is mandatory for specified offences, on a plain reading, it will appear that the authority has no discretion in not levying penalty or deciding the quantum of penalty. If the circumstances warrant, levy of "*amount equivalent to tax*" by way of penalty is mandatory.[10] Even if the breach is technical breach, *mens rea* has no relevance in imposing of penalty under Section 122 of the Act.[11]

Section 122(1A), 122(2) and Sections 73 and 74 of the *Central Goods and Service Tax Act* also provide for mandatory penalty. The Authority is not given discretion in quantifying the amount of penalty.

MENS REA AND ABSENCE OF DISCRETION IN TAX LAW

The exercise of discretion ensures application of the mind to the issue at hand.[12] This means conscious choices in decision making.[13] Hence, the term *'discretion'* when qualified by the word, *'administrative'* has got specific meaning.[14] Administrative discretion can be said to be choosing from amongst the various alternatives in accordance with rules of reason and justice.[15] It is not based on personal whims or caprice.[16]

The discretionary power as is known is prone to abuse. Sir William Wade remarked that rule of law does not demand elimination of "*wide discretionary power*". But the law should be able to control exercise of discretion.[17] No doubt, tax law in India gives enormous discretion to the authorities. Abuse of such discretion is inherent in the process, as fairness in action very often remains as an ideal and not a practical reality. The discretionary power is being widely abused for private gains or by way of abuse of process rather than safeguarding public interest.

The large scale tax evasion necessitated more deterrent treatment. The old machinery was found to be thoroughly inadequate to deal with hardcore evaders who get shelter under the twists and turns of the administrative process and under the umbrella of judicial process.

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9 Enforced with effect from 22-6-2017.

10 See Section 122 of CGST Act.

11 See. M.K. Pushparanjini v. The Sales Tax Officer, (2003) 11 K.T.R. 527 (Ker).

12 Emperor v. Sibnath Banerji A.I.R. 1945 P.C. 156.

13 Jagnath v. State of Orissa., A.I.R. 1966 S.C. 1140.

14 See Jain, M.P. & Jain, S.N., Principles of Administrative Law, Tripathi, 4th Edition at P 325.

15 Discretion implies a choice of possible courses of action or inaction. Davis, K.C., Discretionary Justice (1969), p.4; de Smith S.A., Judicial Review of Administrative Action (1973) p.246 as quoted in Leelakrishnan, P., Legal Aspects of Stage Carriage Licensing in India, Sterling Publishers Pvt. Ltd, New Delhi, 1st Ed, p. 87.

16 See Associated Provincial Picture Houses Ltd. V. Wednesbury Corpn., (1947) 2 All. E. R. 680.

17 Wade, Sir William, and Forsyth, Christopher, Administrative Law, Clarendon Press, Oxford, 7th Ed.p. 718.

The Legislature therefore started thinking of a legal mechanism by which discretionary power is dispensed with in imposing penalty in respect of certain offences. When the default is proved, the penalty prescribed in the statute will be the inevitable consequence.[18] The officer imposing penalty will have no discretion.[19] A few argue that the same may reduce corrupt practice as the authority is left with no option to reduce the penalty for default in all cases alike. In other words, penalty is made automatic or mechanical. There is no scope for any explanation by the affected person for getting the quantum of penalty nullified or minimized. This sort of severe penalty will be confined, of course, to extreme cases of dishonesty on the part of the assessee. The Indian Supreme court in **State of Gujarat and Another v. M/s Saw Pipes Ltd**[20] considered penalty imposed under Section 45 and 47 of the *Gujarat Sales Tax Act, 1970* and concluded that penalty there under is a statutory penalty since the phrase used is "*shall be levied*."[21] According to the Apex Court, the moment it is found that a dealer is deemed to have failed, there shall be levied a penalty of one and a half times. It is held that there is no discretion with the assessing officer either to levy or not to levy. Hence according to the court there is no question of considering any *mens rea* on the part of the assessee / dealer.[22]

While considering penalty under Section 43A of the Competition Act, 2002 the Supreme Court of India in **Competition Commission of India v. Thomas Cook (India) Limited and Another**[23] held that penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act is established and hence intention of the parties committing such violations becomes wholly irrelevant. The Apex Court categorically concluded that unless the language of the statute specifically indicates the need to establish the requirement of *mens rea*, it will be unnecessary to ascertain as to whether such a violation was intentional or not.[24]

However, the critics would say that absence of discretion, whatever is the justification, tantamount to too much break on the wheel.[25] No doubt '*mens rea'* connotes a criminal concept that projects a certain state of mind.[26] It refers to evil intention or guilty mind.[27] Sometimes it means mere knowledge of wrongful act.[28] The traditional jurisprudential thinking nurtures the idea that the offender should have guilty mind in order to fix a criminal liability.[29] When an offence contains a built in *mens rea* element the offence is punishable only when *mens rea* is proved by the authority that makes the charge.[30] However the sweep of this doctrine stands reduced by passage of time.[31] Modern statutes started creating offences where guilty mind of the offender is not considered essential at all.[32] Such, a new category of offences are called '*public welfare offences'*. These eliminated requirement of proof of *mens rea*.[33]

18 Commissioner of I.T v. A.K. Das. (1970) I.T.R. 31.

19 Gujarat Travancore Agency v. Commissioner., (1989) 177 I.T.R. 455.

20 *supra* note 2.

21 *supra* note 2 at para 6.4

22 *supra* note 2 at para 6.4

23 2018 (6) SCC 549.

24 See also State of Gujarat v. Arecelor Mittal Nippon Steel India Limited; 2022(6) SCC 459, Chairman, SEBI v. Shriram Mutual Fund and Another; 2006 (5) SCC 361, Guljag Industries v. Commercial Taxes Officer 2007 (7) SCC 269.

25 See generally V.L.Dutt v. Commissioner of Income Tax (1976) 103 I.T.R. 634.

26 In Sarjoo Prasad v. State of Uttar Pradesh A.I.R. 1961 S.C. 631. Court observed that, "*Mens rea is an essential ingredient of a criminal offence*."

27 State of Maharashtra v. Mayer Hans George., A.I.R. 1965 S.C.722.

28 Ibid.

29 Ibid.

30 State of Gujarat v. D. Pande., A.I.R. 1971 S.C. 866.

31 See generally, Najmi, Mohamed, "*Concept of mens rea in food adultration cases*."[1982] C.U.L.R. 122.

32 Sayre, F. B., "*Public Welfare Offences*", 33 Col. L. Rev. 55. quoted from Leelakrishnan, P., Legal Aspects of Stage Carriage Licensing in India, Sterling Publishers Pvt. Ltd, 1979.p. 164.

33 Ibid.

All fiscal statutes, apart from monetary penalty, provide for conviction, imprisonment or fine for statutory violations. In such cases, invariably, proof of "*guilty mind*" is absolutely necessary. The reason is not far to seek. The terms such as "*knowingly*", "*dishonestly*" and "*wilfully*" implies the need for *mens rea* as a prerequisite for imposing penalty. It is therefore possible to take the view that being a purely penal provision, the proof of *mens rea* is necessary to punish the offender. No doubt, *mens rea* in some form or other is considered necessary for taking prosecution steps under the *Central Goods and Service Tax Act.*

However, partial acceptance of the concept is visible in a few statutes. Now, there is no universal presumption of *mens rea*.[34] If the Legislature desires exclusion of guilty mind in defining an offence, there is no legal inhibition for the same.[35] The statute either clearly or by necessary implication can rule out *mens rea* as a constituent part of crime.[36] In order to find out whether for imposing a particular penalty concept of *mens rea* is applicable, one has to analyse the language of the provision and also nature of the penalty imposed.[37]

LEGAL STANDARDS IN OTHER COUNTRIES

A look at the penal provisions of revenue laws of different countries would show that such countries adopt variable standards. In the United Kingdom, Australia, Canada, New Zealand and South Africa, the liability of the tax payers in respect of penalty is absolute. The Courts in those countries do not consider "*state of mind*" when trying such offences making penal liability strict. In Canada, no discretion was left to the Court to limit the quantum till recently. In **Rex V. Thompson Manufacturing Company**[38] the Court refused to accept the accused's plea and held that n*o discretion was left to the Judge to limit the number of days for which the penalty was to be imposed or to reduce the amount of penalty.*[39] The Nova Scotia Supreme Court took a similar view in **King V. Smith**[40] and held that the *Magistrate's discretion as to the amount of the fine is not an unrestricted one. It is to be exercised within the limits prescribed in that behalf. If Parliament had fixed the exact penalty, then there are no limits prescribed.....".*[41]

However, a contrary view was taken by the Alberta Supreme Court. It refused to follow earlier cases on the point. The Court in **Rex v. Bell**[42] held that, the Court had discretion to award a lesser fine. This view, however does not find support in later rulings by the same Court. In **R v. Smith**[43] the Ontario High Court held that the Magistrate does not have the Jurisdiction to impose a greater or lesser fine than $25 on a charge showing one day's default under the *Canadian Income Tax Act*. In Britain the revenue need not prove the guilty intention of the accused unless expressly provided in the statute. In **Rex V. Caron**[44] the Court rejected the accused's plea and held him responsible for the offence holding that i*n fiscal law omission in itself constitutes the whole offence, regardless of any question of intent.* The position in South Africa is not different. The judiciary has taken the view that proof of *mens rea* is not necessary.

The proof of guilty intention on the part of the defaulter is considered necessary in imposing penalty under the USA revenue jurisprudence.[45] This is the fundamental difference between American revenue laws and revenue laws of Britain, South Africa, Canada, Australia etc. In the USA, therefore, in absence of proof of adequate *mens rea*, the offender will not be penalised. The

34 Ibid.

35 See Chennai Textile v. State of Tamil Nadu, (2002) 10 K.T.R. 76 (Mad).

36 Mullapudi v. Union of India (1(75) 99 I.T.R. 448.

37 See Observations made by Dr Justice A. S. Anand in Director of Enforcement v. M.C.T.M Corpn Pvt. Ltd. A.I.R. 1969 S.C. 1100. paras 7-13.

38 (1920) 47 Ontario Law Report 103.

39 Id, at p.140.

40 (1923) 38 Can. Crim. Case 327.

41 Id., at p. 331.

42 (1925) 42 Can. Cr. Case 241.

43 (1958) 120 Can. Cr. Case 241.

44 (1948) 91 Can. Cr. Cases 389.

45 See Internal Revenue Code, 1954, Section 7202 and 7203.

failure of the accused, in other words, should be "*wilful*" to impose penalty. Statutes in the USA almost prescribe "*willfulness*" as an element necessary to impose punishments.[46] However, it is to be noted that Courts in the United States have interpreted the scope and ambit of the term "*wilful*" in a different way.

However, the 4th Circuit Court in the USA in **U.S. v.Ostendorff**[47] took different meaning to the concept of *mens rea*. Accordingly wilfulness could be inferred, if there is careless disregard of a statutory provision.[48] A similar stand was taken by the 9th Circuit Court in **Edward V. U.S,**[49] wherein the Court refused to accept the defense that the appellant was busy with other matters and simply overlooked to file a return. The Court observed that it cannot be a valid and acceptable answer to the charge of '*wilful failure*' to file a return.

In **Abdul V. United States**[50] an important question of law came up for decision of Ninth Circuit Court, namely, the differences between the degree of '*wilfulness'* required when used in defense of felonies and misdemeanors. The U.S. District Court acquitted the accused on the felony charges; however convicted him on the misdemeanors on the ground that he knew that he was required to submit a return in time, but nevertheless failed to file it. This fact was held sufficient to convert the appellant for misdemeanor because the two charges required different degrees of wilfulness. The Circuit Court approved the view taken by the trial Court on the point of '*wilfulness'*. The Court relied on an earlier Judgement in **Spies V. Unites States**[51] in passing the aforementioned Judgement.[52]

According to the American Courts different standards and degrees of '*wilfulness'* is required for conviction for different offences. In **Edward V. U.S.**[53] the Court made a distinction with regard to the degree of '*wilfulness'* i.e., evil state of mind required for conviction of the felony of fraud and false statement and attempt to evade or defeat tax.[54]

Nevertheless, the above view was disapproved by the 5th Circuit Court in **Haner V. Unites States**.[55] It rejected the claim of revenue that the word '*wilful'* meant something less when used in a statutory misdemeanor than when used in a felony. According to the 5th Circuit Court, the same standard of proof is needed, irrespective of its use in any context. Similar view is taken in **United States V. MC. Gonigal**[56] wherein the Court opined that *in order for a criminal act to be wilful, it must not only be committed deliberately and knowingly, but with a bad motive or evil intent.*[57] Hence, the consistent stand taken by the U.S. Courts is that the revenue is bound to establish beyond doubt that the accused committed the specific offence deliberately with the intention to defraud revenue.

MENS REA IN TAX LAWS IN INDIA:

While drafting penal provisions in tax laws in India a mid-way or middle course was adopted by the Legislature. The Indian approach is midway between what is followed in the United Kingdom, Australia, Canada etc on the one hand and in the U.S. on the other. Therefore, in India neither an absolute liability is imposed, nor a detailed search is made into the evaders' evil state of mind. Most revenue statutes in India provide for '*reasonable cause or excuse'* as a defense to

46 *Ibid*.
47 (1967) (C. A. 4), 371 F (2d), 729.
48 *Id*., at p. 731.
49 (1967)(C.A.9), 375 F (2d), 862.
50 (1958)(C.A.9), 254 F (2d), 292.
51 (1943), 317 U.S. 492, at pp. 497.
52 *Id*., at p. 498.
53 (1967) (CA.9) 375 F (2d), 862.
54 *Id*., at p. 867.
55 (1963) (C.A.5), 315 F, (2d) 792.
56 1963 (DC-Del), 214 F, Suppl. 621.
57 *Id*., at p. 622 (para 1).

penalty to discharge his statutory obligation under the Act.[58] The discretionary nature of penalty imposed in taxing statues in India depends on the particular terminology used in the provision.[59] The language and terms used in a provision finds answer to the question whether the penalty proceedings should be dropped or should necessarily be imposed.[60] The nature of penalty to be imposed depends on the facts of the case as well as the provisions in the Act.[61] If the authority has no discretion, the penalty will have to be imposed in cases where default is proved to have been committed.[62] The provisions and penalties under the CGST Act have to be analysed in this background. In fact, the application of concept of *mens rea* in imposing penalty depends upon the nature of penalty provided for. The important point to be considered while examining the position is whether a statute by implication excludes *mens rea* for the levy of penalty provided in these statutes. In order to answer these vital point, one has to analyse whether such penalty proceedings is of criminal in nature, civil in nature, quasi-criminal in nature or in the nature of an additional tax. However, this seems to be a difficult task.

Various Courts in India seem to have different opinions in respect of very same provisions in statute. Some Courts have categorical held that penalty provisions in the taxing statutes are criminal in nature.[63] Few others have opined that they are civil in nature.[64] That is, it is a mere imposition of an additional tax.[65] Some others have categorized it as quasi-criminal.[66]

Criminal nature of penalty in taxation:

Economic offences and penalty provisions in tax laws are usually classified as crimes against society.[67] Hence, some tax jurists classify such offences as purely criminal in nature.[68] The protagonists of such view apply almost all principles of criminal jurisprudence including *mens rea* to such proceedings.[69] In this connection, it may be worthwhile to examine some of the important decisions supporting the view that the penalty proceedings under tax laws are criminal in nature.

The Bombay High Court while considering the nature of penalty proceedings under Section 28(1)(c) of the *Indian Income Tax Act 1922* (corresponding to Section 27(1)(c) of the *Income Tax Act 1961*) as early as in 1959 in **CIT Ahmedabad V. Gokuldas Harvallabadas**[70] held that, the nature of such proceedings is of criminal nature. In this judgment, the Court stressed the need for strict standard of proof in such proceedings.[71] The *Patna High Court* later in the case of **C.I.T Bihar and Orissa V. Mohan Mallah**[72] remarked that, the proceedings under Section 28 of the *Income Tax Act, 1922* were penal proceedings. According to the Court, the burden to prove the case lies upon the revenue. The Madras High Court, in **Ganambika Mills Ltd. V. C.I.T. Madras**[73]**,** took similar stand while dealing with Section 28(1)(c) of the *Income Tax Act of 1922*, which

58 Bai Lalitha v. Tata Iron., 8 I.T.R. 337.

59 See, Chadurvedi, K, and Kothary, P., The Principles of Sales Tax Laws, Wadhwa And Company, Nagpur, Fifth Edition.p. 1388.

60 See Hiralal v. State (1955) 6 S.T.C. 662 (All).

61 See Mareddi v. ITO (1957) 31 ITR 678 at p. 682.

62 See Chennai Textile v. State of Tamil Nadu, (2002) 10 K.T.R. 76 (Mad).

63 CIT v. Gokuldas AIR 1959 Bom 96; Baghavandas v. CIT, (1962) 45 ITR 566.

64 CIT MP v Champalal.A.I.R. 1969 M.P. 72.

65 *Ibid*.

66 Bhajuram v. CIT, A.I.R. 1970 Orissa 38, 40 at para 5.

67 See, Chadurvedi, K, and Kothary, P., The Principles of Sales Tax Laws, Wadhwa And Company, Nagpur, Fifth Edition. p. 1388.

68 Baghavandas v. CIT, 45 I.T.R. 566 (1962).

69 *Ibid*.

70 AIR 1959 Bom 96.

71 *Id*., at p. 97. (para 3).

72 (1964) 54 I.T.R. 499.

73 A.I.R. 1969 M.P. 72.

contemplated penal proceedings. The *Madhya Pradesh High Court* in **C.I.T. M.P v. Punjabhai Shah**[74] followed this pattern.[75]

The *Gujarat High Court*, in **C.I.T. Gujarat V. L.H. Vohra**[76] observed that, the provision relating to penalty was essentially criminal in nature. The *High Court of Kerala* also had the occasion to consider a similar situation in **Money and Co. V. C.I.T. Kerala**[77] wherein it took the view that burden of proof is on the revenue. The Calcutta High Court in **C.I.T. Calcutta V. Anwar Ali**[78] also took similar view.[79] The *Patna High Court* also expressed identical views in **Muralidhar Jejpal V. C.I.T Patna**.[80] However, it may be noted that later decisions of various Courts have taken a different stand.

Civil Nature of Penalty in Taxation

The supporters of the view that penalty proceedings are civil in nature try to substantiate that there is basically no difference between a '*tax'* and '*penalty'*.[81] According to them, like taxes, penalty is imposed as a part of the '*machinery of assessment'*.[82] They describe penalty as an additional tax imposed in certain circumstances in cases where assesses commit wrong. The constitutional source for both penalty and tax is the same. One of the earliest decisions on the point is **Collector of Malabar.V. Erummal Hajee.**[83] In that case, the Hon'ble Supreme Court considered the nature of revenue penalty. The assessee in that case was arrested, in pursuance of a warrant issued by the *Collector of Malabar* under the *Revenue Recovery Act* for failure to pay income tax. The main question, which came up before the Court, was whether there had been violation of right of personal liberty. Rejecting assessee's contention, the Court held that tax is only a civil debt payable to the Government. Therefore, the penalty leviable for non-payment of tax is similar to that of a penalty in a civil case.[84]

Similar question was elaborately considered by the Indian Supreme Court in **C.A. Abraham V. I.T.O. Kottayam.**[85] The Court identified penalty as an additional tax and observed that it is *imposed in view of the dishonest contumacious conduct of the assessee".*[86] In spite of the aforementioned view, the *Madhya Pradesh High Court* took a different stand in **C.I.T. MP V. Champalal**[87] and held that, a penalty proceeding is not a proceeding for the imposition of additional tax.

The controversy reached its heights when the Supreme Court of India in **C.I.T. V. Anwar Ali**[88] considered the impact of **C.A. Abraham's case.**[89] The observation in **C.A. Abraham's case**[90] that penalty under *Income Tax Act* is an additional tax was re-considered by the Court. It concluded that the observations made by it in **C.A. Abraham's case**[91] were in a different context. However, the Court refrained from expressing any opinion as far as penalty under Income Tax Act

74 A.I.R. 1968 M.P. 103.
75 *Id*., at p. 106 (para 6).
76 (1965) 56 I.T.R. Guj. 126.
77 (1963) 47 I.T.R. 787.
78 A.I.R. 1968 Cal. 345.
79 Id. at 352 at para 25
80 (1961) 42 I.T.R. Guj. 126.
81 See Dwaraka Prasad. V. CIT, 25 ITR 40.
82 *Ibid*.
83 (1957) 32 I.T.R. 124 (S.C).
84 *Ibid*.
85 A.I.R. 1961 S.C. 609.
86 *Ibid*.
87 A.I.R. 1969 M.P. 72.
88 A.I.R. 1970 S.C. 1782.
89 A.I.R. 1961 S.C. 609.
90 *Ibid*.
91 *Ibid*.

was concerned. As regards the nature of penalties under the Sales Tax Law, the Court observed that it is quasi-criminal in nature.

However, in **Khemka & Co.v. State of Maharashtra**[92]**,** the levy of penalty for default in payment of tax was challenged. A Constitution Bench by majority view held that p*enalty is in addition to tax and is a liability under the Act.* The Full Bench of *Punjab and Haryana High Court* in **Commissioner of Income Tax, Patiala V. M/s. Patram Das**[93] examined various decisions on the point. The Court went a step further and held that penalty provision under Section 271(1) (a) of the *Income Tax Act, 1961* is in essence civil in nature being a coercive and remedial process to ensure speedy collection of taxes. The doctrine of *mens rea* is not applicable to such penalty proceedings.

The position is made clearer by the *Supreme Court of India* in **Gujarat Travancore Agency V. Commissioner of Income Tax.**[94] The main issue before the Court was whether *mens rea* is an essential element of the imposition of penalty for the failure to file return under Section 271(1)(a) of the *Income Tax Act, 1961*. The assessee had explained the reason for such failure. The reason stated was that, he was under the bona fide belief that he had no assessable income and accordingly he had not filed returns earlier also. The *Apex Court* examined the provision and observed that u*nless there is something in the language of statute indicating the need to establish the element of mens rea, it is generally sufficient to prove that a default in complying with the statues has occurred.* Affirming the Full Bench decision of the *Hon'ble High Court of Kerala* in **Commissioner of Income Tax V. Gujarat Travancore Agency**[95], the Court held that element of *mens rea* is not required to be proved in the proceedings taken by the Income Tax Officer under Section 271(1)(a) of the *Income Tax Act*.[96]

The decision on the above lines describes penalty under various tax laws as additional tax. They declare that unless there is a specific language of the statute indicating the need to establish the element of *mens era*, it is not necessary for establishing a tax offence.[97] In this view, in order to impose penalty the only requirement is violation of tax law. If this view prevails, judicial scrutiny of the provision concerning penalty become a limited one. The strict view of penalty must be confined to enactment dispensing with the element of *mens rea* clearly.

Quasi-criminal nature of Penalty in Taxation

There is another school of thought which considers that penalty in tax laws is neither criminal nor civil. The supporters of this view consider it as quasi criminal. Decisions of Courts also lend support for this view.[98] The *Supreme Court of India* lays down this view in **Hindusthan Steels Ltd. V. State of Orissa.**[99] The revenue had imposed penalty for failure to take out registration under the *Orissa Sales Tax Act*. The Assessee explained he has not taken registration under the Act, on the bona fide belief that they are not dealers. The revenue contented that the supplies made by the assessee were sales and therefore company is a '*dealer'*. The revenue imposed penalty for not taking out registration under the *Orissa Sales Tax Act*. The Supreme Court on these facts observed that *the liability to pay penalty does not arise merely upon proof of default in registering as a dealer. An order imposing penalty for failure to carry out a statutory obligation is the result of a quasi-criminal proceeding and penalty will not ordinarily be imposed unless the party obliged either acted deliberately in defiance of law or was guilty of conduct contumacious or dishonest, or acted in conscious disregard of its obligations. Penalty will not also be imposed merely because it is lawful to do so. Whether penalty should be imposed for failure to perform a statutory obligation is a matter of discretion of the authority to be exercised judicially and on consideration of all relevant circumstances.*[100] The Court went on a step further and observed that e*ven if a minimum penalty is*

92 (1975) 35 S.T.C. 571, 581 (S.C).

93 A.I.R. 1982 Punj 1

94 (1989) 177 I.T.R. 455.

95 [1976] 103 I.T.R. 149 [F.B]

96 Gujarat Travancore Agency V. Commissioner of Income Tax,(1989) 177 I.T.R. 455.

97 *Id*., at p. 458.

98 See R. Prasad v. I.T.A. Tribunal, A.I.R. 1970 All 620 at 630 (para 27).

99 [1970] 25 S.T.C. 211.

100 *Id*., at p. 214.

prescribed, the authority competent to impose the penalty, will be justified in refusing to impose penalty when there is a technical or venial breach of the provisions of the Act or where the breach flows from a bona fide behalf that the offender is not liable to act in the manner prescribed by the statute.[101]

It is pertinent to note that, the Hon'ble Supreme Court in the aforementioned decision has not adverted to its earlier judgement in **Abraham v. Income Tax Officer**[102], which had taken a different stand. In fact in **Abraham's case**[103], the Hon'ble Supreme Court has declared that no *mens rea* is required for levy of penalty. Whereas, in **Hindustan Steels case**[104], the Hon'ble Supreme Court adopted the theory of *mens rea* as a pre-condition for levy of penalty under the Sales Tax Law. The view taken in **Hindustan Steels Case**[105] was later adopted by the Hon'ble Supreme Court of India in **Cement Marketing Co. V. Assistant Commissioner of Sales Tax**,[106] wherein it is observed that w*here the assesses does not include a particular item in taxable turnover under a bona fide belief that he is not liable so to include it, it would be right to conclude the return as false return inverting imposition of penalty.* [107]

The observations made in **Hindustan Steel Ltd. Case**[108] was referred to and approved in a subsequent Supreme Court decision namely **Shiv Dutt Rai Fatch Chand V. Union of India**[109] wherein it was concluded that *the order levying penalty is quasi judicial in nature. The considerations, which should weigh with the authorities while imposing penalty are well known and have been settled by many decisions.* ***Hindustan Steel Ltd. V. State of Orissa***[110] *is one such decision".*

The Hon'ble Supreme Court in **Commissioner of Income Tax V. Jeevan Lal**[111] observed that *if the assesses establishes that his failure to return the correct income was not on account of any fraud or any gross wilful neglect on his part, it is evident, no penalty can be levied.*[112]

It can be seen that the nature of proceeding under Section 122 of CGST Act is penal in the sense that its consequences are intended to be an effective deterrent, with a view to put a stop to practices, which the legislature considers to be against the public interest. It is quasi-criminal in nature.

Hence, the Courts in India has interpreted various revenue laws and has held that some provisions are civil, some provisions are criminal and some others are quasi criminal in nature. The reasonable conclusion that can be made from these judicial decisions is that the element of discretion conferred on the authorities depends on the language used in the statutory provisions. The scope of discretion in relation to a provision in tax law solely depends on the intention of the Legislature discernable from the language used in the Statute.

PENALTY PROVISIONS IN CGST ACT

The word "*shall*" used in Section 122 of the Central goods and Service Tax Act, instead of word "*may*" makes the provision somewhat different. In the said provision, there is no stipulation of *mens rea* in imposing penalty against offences. The dismal consequence is that the assessing as well as Intelligence authorities is levying huge penalties. This has created a puzzling and perplexing

101 *Id*., at p 214.
102 A.I.R. 1961 S.C. 609.
103 *Ibid*.
104 [1970] 25 S.T.C. 211.
105 *Ibid*.
106 (1980) 45 S.T.C. 197.
107 *Ibid*.
108 [1970] 25 S.T.C. 211.
109 (1983) 53 S.T.C. 289 (S.C).
110 [1970] 25 S.T.C. 211.
111 (1994) 205 I.T.R. 244.
112 *Ibid*.

situation in the business circle. Imposition of penalty without consideration the nature of offence and the paying capacity of the dealer lead to closure of business. That indeed creates more economic problems in the society than the problem arising out of revenue collection.

The imposition of penalty in CGST under Section 122 of the Act automatically appears to be unreasonable.[113] The imposition of maximum penalty without considering the element of *mens rea* on the part of the assessee is unjust.[114] Absence of discretionary power in the exercise of statutory provision suffers from the vice of unreasonable impost.[115]

Nobody argues that the offender should be set free. Breach of law should be penalised. But is it not necessary to decide whether the person on whom it is imposed is really at fault? If he is able to demonstrate that the error was due to some circumstances in which he played no role he shall not be penalised. Sometimes he may not have control over the circumstances leading to errors in accounting. Suppose he is able to show that he played no part in the episode leading to dishonesty, it is not proper to impose heavy penalty.

It is axiomatic that unreasonableness is violative of Article 14 of the Indian Constitution. When a statutory provision, works glaring and shaking injustice, what is the remedy? The Court has a duty to interpret the provision so as to make it constitutionally valid.[116] Such an interpretation would remove manifest absurdity. In order to achieve this end, the Courts sometimes used the well known and accepted technique of "*reading down*"[117] the provision by substituting the word "*may*" instead of "*shall*" in the relevant section. If such an interpretation is adopted, there would be sufficient "*discretion*" to decide each case on merit. It is to be borne in mind that, the use of the word '*shall'* in a statute, though generally taken in a mandatory sense, it is not always so according to decided cases.[118] The question as to whether a provision is mandatory or directory necessarily depends upon the intent of the Legislature[119] and not upon the language in which it is clothed.[120] It is pertinent to note that, the exact intention and object of the Legislature must govern, and these are to be ascertained not only from the phraseology of the provision but also considering its nature, its design and the consequences which should follow from constructing it one way or other.[121]

In **Ajit Singh V. The State of Punjab**[122] the Hon'ble Supreme Court remarked that inorder to determine whether a provision is mandatory or directory, there is no general rule which may help. It is the duty of the Court to try to get at the real intention of the Legislature by carefully attending to the whole scope of the statute to be constructed. The Court held that, the use of the expression '*shall'* is not considered decisive and the question whether a provision is mandatory or directory depends upon the intent of the Legislature and not upon the language alone.[123]

It is true that there is no bar against the Legislature providing statutory offences. But it must take in principles of justice in the case at hand. It is submitted that, the concept of statutory offence does not mean punishing the innocent. Absolute liability in economic offences shall be imposed only on a person who has defied law with guilty intention to defraud revenue. If penalty is imposed on the innocent, that will necessary lead to distress and even stoppage of business. It has the power to destroy the trading activities. Trade and commerce is the lifeblood of the country as envisaged in Article 19, 286 and 301 etc. of the Constitution of India.

Penalty is not an amount collected and kept by dealers. Even *Goods and Service Tax* cannot be collected at times from the consumers due to heavy competition. If an assessee is made liable to

113 *Ibid*.

114 *Id*., at para 6.

115 *Id*., at para 6.

116 All Saints High School v. State of A.P, A.I.R. 1980 S.C. 1042.

117 *Ibid*.

118 State of Punjab v. Shamlal (1976) 1 S.C.C. 719.

119 Sarathi. Vepa .P., *The Interpretation of Statutes*, Eastern Book Company. P. 458.

120 Satya Narain v. Dhuja Ram, (1974) 4 S.C.C. 237.

121 G.C. Patel v. Agriculture Produce Market Committee (1975) 2 S.C.C. 482.

122 (1983) 2 S.C.C. 217.

123 *Ibid*.

pay huge penalty, it becomes a matter of his survival. Several manufacturing units and industrial units who produce goods for sale may lead to untimely closure if demand beyond paying capacity of the parties is created.

The levy should necessarily be fair and reasonable. It must comply with well-known cannons of taxation. It shall not be oppressive. That is why the Supreme Court has laid down that an order to impose penalty for failure to carry out statutory obligation is the result of a quasi-criminal proceedings, and penalty will not ordinarily be imposed unless the party obliged either acted deliberately in defiance of law or was guilty of conduct contumacious or dishonest, or acted in conscious disregard of his obligation.[124] The Supreme Court has repeatedly taken the stand that penalty should be a matter of discretion of the authority. It shall be exercised judicially on a consideration of all relevant circumstances.[125] The Court makes it clear that even if minimum penalty is prescribed, the authority competent to impose penalty would be justified in refusing to impose penalty when there is a *"technical or venial breach of the provisions of the Act."*[126]

The larger bench ruling in **Hindustan steel**[127] case absorbs wholesome principles. But the view of the Supreme Court has not been considered in the **Gujarat Travancore Agency case**.[128] However the Apex Court while disposing **State of Gujarat and Another v/s M/s Saw Pipes Ltd**[129] noticed the distinction noted by the Supreme Court in **Shriram Mutual Fund case**[130] from that of in **Hindustan Steel Case**.

No Court or authority can visualise all situations that may emerge from time to time in the working of a penal provision. It should therefore be left open to the authorities for making decisions taking into account peculiar circumstances of each case.

If the Court read the word "*may*" in the place of "*shall*" in Section 122, the provision would be congenial and comprehensive enough to meet all contingencies. There is no need to limit the exercise of discretion in the eye of the law.

HIGHLIGHTS AND SUGGESTIONS

The exercise of "*discretion*" in adjudicatory process in the realm of tax law has vital role to play. If discretion is not allowed by the statute or the same is not judiciously employed in adjudication, those who are engaged in trading as well as in the statutory adjudication will be left without proper judicial sensibility in the administrative and adjudicatory process. In the absence of discretionary power the functions of adjudicatory authority becomes mechanical. Excessive and arbitrary exaction of penalty or tax will definitely have a strangulating effect in the economical condition. Too much burden of indirect tax may lead to stoppage of business or service activities. The imposition of penalty shall not be like "*killing the golden goose*". The justification stated for exclusion of discretionary power in imposing penalty does not stand to reason.

The claim that mandatory penalty would reduce corruption of administration has no rationale. Corruption of administration has to be stopped with stubborn hand, and not by taking away discretion and ignoring realities in commercial activities. The total absence of discretion leads to too much break on the wheel. Equal treatment of unequal certainly works injustice. A *bona fide* claim of exemption by an honest person or a legal dispute relating to the rate of tax applicable to a commodity which is bound to occur due to semantic reasons etc shall not be basis for imposing penalty. Moreover unreasonable penalty will be hit by Article 14 of the Constitution of India.

The use of the word '*shall'* in a statute, though generally taken in a mandatory sense, does not necessarily mean that in every case it shall have that effect. It is submitted that, the word "*shall*" used in Section 122 of the *Central Goods and Services Tax Act, 2017* has to be read down as "*may*", in order to make the provision congenial and reasonable. This could be achieved by adopting a

124 Hindustan Steel Ltd v. State of Orrissa., A.I.R. 1970 S.C. 253 at p. 256.

125 *Ibid*.

126 *Ibid*.

127 *Ibid*.

128 177 I.T.R. 455.

129 *supra* note 2.

130 2006 (5) SCC 361.

liberal interpretation of the provision applying the judicial technique of "*reading down*" the statutory provision. Those who support the view that the penalty under Section 122 of the CGST Act is without *mens rea* argue that it is a statutory offence created without the requirement of *mens rea*. Such a view is anchored on the Supreme Court decision in **Gujarat Travancore Agency case**[131] which came to the conclusion that mandatory penalties are sustainable. The said decision was based on an analysis of Section 211(1)(a) of the *Income Tax Act, 1961* which has no comparison with Section 122 of the CGST Act. In that case, it was held that, penalty is tenable without any *mens rea* being established if the statue so provides. Section 122 of the CGST Act stands on a different footing. The earlier three Judge Bench decision of the Supreme Court, in **Hindustan Steel Ltd. Case**[132], which took a different stand, is befitting to be considered in this case. In that case, the Apex Court adopted the theory of *mens rea* as a pre-condition for levy of penalty under the Sales Tax Law. Hence, the judgment in **Gujarat Travancore Agency case**[133] is applicable in the context of that case only and cannot be followed in the context of Section 122 of the CGST Act. The view taken in **State of Gujarat and Another v. M/s Saw Pipes Ltd**[134] distinguishing **Hindustan Steel Ltd case**[135] and holding that phrase *"shall be levied"* used in penalty provisions will determine whether *mens rea* on the part of the assessee will have to be taken note of does not appear to be correct. The Supreme Court's view, in **Ajit Singh V. The State of Punjab**[136] that in order to determine whether a provision is mandatory or directory, there is no general rule which may be helpful is also noteworthy. The Court held that the use of the expression '*shall'* is not considered decisive and the question whether a provision is mandatory or directory depends upon the intent of the Legislature and not upon the language alone. The Court could have achieved better result by declaring that the provision is discretionary and not mandatory. If the Court had substituted the word "*may*" in the place of "*shall*" in the Section the judgment would have been congenial enough to impart justice avoiding arbitrariness, if any. Hence interpretation on the above lines investing discretion with the authorities will be justifiable while interpreting Sections 122 and 125 of the *Central Goods and Service Tax Act, 2017*.

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131 Gujarat Travancore Agency v. Commissioner., (1989) 177 I.T.R. 455.

132 [1970] 25 S.T.C. 211.

133 *supra* note 131.

134 AIR 2023 SC 2113

135 [1970] 25 S.T.C. 211.

136 (1983) 2 S.C.C. 217.