

(2001) 04 KAR CK 0069
In the Karnataka High Court
Case No : S.T.R.P. No's. 2 and 37 of 1997

Chetana Enterprises

APPELLANT

Vs

State of Karnataka

RESPONDENT

Date of Decision : 02-04-2001

Acts Referred:

Citation : (2001) 3 KCCR 114 SN : (2001) 123 STC 251

Hon'ble Judges : R. Gururajan, J;M.F. Saldanha, J

Bench : Division Bench

Advocate : R.V. Prasad and K. Hema Kumar, for Vasan Associates, for the Appellant; B. Anand, A.G.A., for the Respondent

Final Decision : Allowed

Judgement

M.F. Saldanha, J.—These petitions throw up for decision a point of law that is not only unusual and interesting but one which is extremely fine or rather subtle. The majority of the facts are not in dispute. The petitions concern two assessment years and they are 1992-93 and 1993-94.

2. The charge against the petitioners is identical, viz., that they ought not to have filed the declaration in form 37 in respect of the products that are the subject-matter of the dispute, viz., tamarind kernel (seeds) and tamarind powder. Admittedly, the assessees were purchasing the seeds in question and putting them through a process whereby they have been converted into powder. It was their contention that the seeds constitute an input in the manufacturing process of the tamarind powder and consequently, they filed the declaration in form 37 which entitled them to a lower rate of taxation, viz., 4 per cent instead of 8 per cent. The litigation went through different stages with which we are not really concerned because admittedly, the petitioners have paid the tax at the higher rate in view of the fact that the various court decisions which were fluctuating were applied by the department and the petitioners have in fact paid the tax at the higher rate. The present petitions concern only one facet of the law, viz., the fact that the petitioners have been penalised u/s 5-A(2)(v) of the

Act on the ground that they had made a misdeclaration for the two years in question and the obvious implication is that through such a misdeclaration the petitioners had attempted to evade the payment of tax. The section prescribes a heavy penalty which is equivalent to the amount of tax involved and for the first of the two assessment years they have been visited with a penalty amounting to double the amount of tax involved, viz., Rs. 5,26,162. For the second year, the penalty was initially an amount equivalent to twice the amount of tax involved but at the appellate stage, on the verification of relevant data the appellate authority reduced the penalty to Rs. 3,59,095. These orders were confirmed by the Tribunal and it is against the decision of the Tribunal in these two appeals that the present petitions have been preferred.

3. The defence plea is a very unusual one. According to the petitioners they were guided entirely and solely by the decision of the Karnataka High Court which held the field at that point of time and on the basis of the ratio of this decision, the petitioners contend that they were fully justified in having filed the declaration under form 37. The petitioners' learned counsel in the course of the hearing has reinforced this submission with several arguments.

4. Firstly, what he points out is that the petitioners cannot be saddled with any penalty unless it is demonstrated that there was a conscious infringement. Learned counsel argues that there has not been any contumacious desire to breach the law or to evade the provisions of the law. What the learned counsel points out to us is that if the case law on the point were to be examined that even as of the year 1992 at the point of time when the petitioners filed their declaration, that the factual and legal position were both far from certain. According to him the question as to what constitutes an input and what constitutes a manufacturing process had been the subject-matter of vigorous debate before both the High Court and the Supreme Court and from time to time the courts have laid down different principles, the end result being that it was not really possible to ascertain as to how one arrives at a correct conclusion with regard to the application of these two concepts. Basically, the submission canvassed is that the safest course open to the assessee at that point of time was to be guided by the law as laid down by the jurisdictional High Court, viz., Karnataka High Court and the learned counsel hastens to add that merely because the decision may have been overruled and watered down subsequently that it can never give rise to a situation whereby a party who has followed the law is penalised for following the law. This argument is put forward more as grievance than defence or more as a justification than as an explanation, for what the learned counsel is essentially driving at is an issue of some consequence, viz., that penalties are prescribed in the case of offences or breaches that are established and that if on the special set of facts or circumstances the party is acting in good faith and this good faith is absolutely exemplified by the fact that the party was guided by the law as interpreted by the High Court, that in such an exceptional situation there can be no warrant for the imposition of penalty.

5. A slightly a different angle to the same argument emerged from the reliance on the Supreme Court decision reported in Hindustan Steel Ltd. Vs. State of Orissa, in the Hindustan Steel Ltd. case, where the court had gone to the extent of absolving a party principally on the ground that it was demonstrated to the satisfaction of the court that there was no dishonest intention and no contumacious disregard for law. The Supreme Court had observed as follows :

"Under the Act penalty may be imposed for failure to register as a dealer : Section 9(1) read with Section 25(1)(a) of the Act. But 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 obligation. 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 a consideration of all the relevant circumstances. Even if a minimum penalty is 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 belief that the offender is not liable to act in the manner prescribed by the statute. Those in charge of the affairs of the company in failing to register the company as a dealer acted in the honest and genuine belief that the company was not a dealer. Granting that they erred, no case for imposing penalty was made out."

6. The petitioners' learned counsel then drew our attention to a division Bench decision of this High Court in [1983] 54 STC 341 SC, (the Elestone Estates and Industries Ltd. case), where the Division Bench of this High Court following the ratio in Hindustan Steel Ltd. Vs. State of Orissa, , held that in the absence of conscious disregard for the law and the deliberate intention to evade the provisions thereof that a penalty was unjustified. What we need to emphasise is that in that particular decision the division Bench laid down important principle that the imposition of a penalty even in the case of taxation statutes is discretionary not only with regard to the aspect of quantum but more importantly with regard to the question as to whether the imposition of penalty itself is warranted or not and we would like to reproduce the observations of the division Bench which are as follows :

"4. In B. Narasimha Bhandary and Sons Vs. The State of Karnataka, , it was held that even for default in payment of advance tax in every month Section 12-B(3) is attracted. The primary question to be considered, therefore, is whether there was a proper discretion exercised by the assessing officer in levying the penalty in question. In Manilal Monaji Somayya Vs. The Commercial Tax Officer, Gokak and Another, , a Bench of this Court of which one of us was a member has observed :

"The Act provides for imposition of penalty for failure to pay every month the advance tax on the dealer's taxable turnover during the preceding month. But the liability to pay penalty does not arise merely upon proof of default in payment of tax in advance every month. As observed by the Supreme Court in *Hindustan Steel Ltd. Vs. State of Orissa*, , 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 obligation. 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 a consideration of all the relevant circumstances."

Under Section 12-B(3) of the Act, the authority may levy penalty in a sum not exceeding one and a half times of the amount of tax so paid falls short of the tax payable for the month or for the whole year, as the case may be. It is not known on what basis the assessing authority has levied the penalty in a sum of Bs. 22,346. Neither the show cause notice issued to the company nor the order made thereon gives us any reasons for levying that penalty. The order of the first appellate authority also gives no guidance in this respect. The Tribunal, however, has calculated the penalty at the rate specified u/s 13 of the Act. But Section 13 appears to be not applicable to levy of penalty u/s 12-B(3). Section 13 is attracted when there is delay in the payment of tax due and thereunder the defaulter shall be automatically liable to pay a penalty equal to one per cent of the amount of tax remaining unpaid for each month for the first three months, and 2 1/2 per cent of such amount for each month subsequent to the first three months. These rates cannot form the basis for imposing penalty u/s 12-B(3).

5. The power conferred u/s 12-B(3) is penal in nature. The authority should exercise the power judicially and on a consideration of all the relevant circumstances. In each case, the authority must first examine after a reasonable opportunity to the party whether there was good or sufficient cause for the default committed and if not, whether the party has acted in conscious disregard of its obligation and acted deliberately in defiance of law. If the party is guilty of such conduct, then the authority must examine the question as to the amount to be levied as penalty. Section 12-B(3) provides for the levy of maximum penalty. In the very nature of the power conferred, there cannot be any set formula to govern every case. Nor there could be any such formula to cover the defaults in different months of a single case. The power must be exercised reasonably depending upon the circumstances of each case."

7. Lastly, what the learned counsel submitted with some degree of emphasis was that it is equally necessary while arriving at a decision as to whether a party has genuinely and bona fide erred or whether the party has effectively been dishonest or came out with a "clever" defence. One of the tests applicable would

be to ascertain as to what the exact nature of the controversy was. In this context, an indirect reference was made to a decision of the Kerala High Court reported in Deputy Commissioner of Sales Tax Vs. Sulaiman, , for the limited purpose of demonstrating that where the distinction made even by the court is virtually hair splitting that the courts will have no understand the genuine difficulty in which an assessee or the legal advisors are placed while arriving at the fine distinctions and that therefore, it is all the more important that the facts are very carefully assessed and in all those cases where it is demonstrated that the assessee has acted in good faith and there was valid and cogent ground for having made declaration in question that the harsh consequence of a penalty should not be visited on the assessee. In conclusion, what was contended was that the penalty orders were unjustified in the facts and circumstances of this case and consequently that they should be set aside.

8. The learned Government Advocate submitted that the defence pleaded is nothing more than a clever cover-up for an attempt to evade tax. According to him, a simple analysis of the various court cases would indicate that the principles in respect of what constitutes an input and what could pass for a manufacturing process are well defined and it is his contention that once it is held that the petitioners have made a misdeclaration that the consequence, viz., the imposition of penalty are automatic. The learned Government Advocate places very heavy reliance on the seven-Judge decision of the Supreme Court reported in R.S. Joshi, Sales Tax Officer, Gujarat and Others Vs. Ajit Mills Limited and Another, wherein the Supreme Court was dealing with a situation in which certain excess tax had been collected by the dealers. That was essentially a case where the force of some of the provisions had been called into question and while considering that aspect of the law, both the learned Judges Krishna Iyer, J., who spoke on behalf of the majority and Kailasam, J., who delivered the dissenting judgment recorded the same conclusion, viz., that as far as breaches of the tax statutes are concerned mens rea is irrelevant in so far as an offence is an offence and extraneous circumstances could only be pleaded for the purpose of bringing down the quantum of punishment. The learned Government Advocate's argument proceeds on the footing that once it had been held that the declaration filed by the petitioners was wrong, about which there can be no dispute, they cannot plead that they were misled and least of all by a judicial decision. His submission is that all these circumstances are relevant only for the purpose of considering the quantum of punishment and that since the penalty imposed corresponds to the minimum prescribed u/s 5-A of the Act that the petitioners have virtually no case. The learned Government Advocate was quite vehement in his argument when he contended that if the courts were to uphold the present defence that it would be virtually opening the flood-gates in so far as every party who make a misstatement in-relation to tax declarations would take shelter behind the plea of good faith on the ground that they were misled by perhaps some decision of some court. His submission was that on the simple facts of the present case where the petitioners were dealing with the tamarind kernel and

tamarind powder, that there was no ambiguity with regard to the legal position and from the fact that the petitioners filed a wrong declaration that it must be presumed that it is for a purpose other than an honest one because by doing so they were benefiting to a large extent in so far as it would bring down to half the tax otherwise payable. The learned Government Advocate went to the extent of submitting that the section makes the penalty automatic and that even the court would have no discretion in the matter of imposition of penalty once the breach is established. His submission was that this Court must confirm the orders and refuse interference.

9. We need to record that we are more than conscious of the fact that in cases relating to payment of tax that the courts do come across a large number of situations where the defence pleaded is very ingenious. We also need to take cognizance of the fact that oftentimes the party attempts to get away with the particular situation in the hope that it will not be detected and that consequently the courts must be extremely cautious in upholding the defence whereby it is demonstrated that a breach has taken place and the party tries to put forward virtually holistic defences. We need to also accept the premise as pointed out by learned Government Advocate that where there is statutory duty to act in a particular manner, viz., that the assessee is required to file a declaration that is honest, complete and in consonance of requirements of law that a breach would be ipso facto punishable. For example while filing personal tax returns a person can never be allowed to get away with the contention that the assessee was acting bona fide but was ignorant or mislead. The real question is as to whether this aspect of the law is to be applied mechanically with a level of inflexibility and as was sought to be contended by the learned Government Advocate in this proceeding, without making any ground for exceptions. While we do concede that in the majority of cases there can be no question of the courts considering any leeway, that there may be genuine situations in which it becomes necessary for the courts to admit to an exception. We are guided in this regard to some extent by the observations of the Supreme Court in the decision reported in AIR 1979 SC 1803 (*Organo Chemical Industries v. Union of India*), wherein the Supreme Court had occasion to refer to its observations in *R.S. Joshi, Sales Tax Officer, Gujarat and Others Vs. Ajit Mills Limited and Another*, which is the seven Judges decision referred to by us supra. While considering the various facets of the concept relating to penalty, damages, fine, etc., the Supreme Court did have occasion to go behind the philosophy. It is really that concept which requires to be applied in the present situation and on the unusual facts of the present case.

10. The petitioners herein would have been virtually out of court if it was demonstrated that they had acted on the basis of their own so called decision or best judgment, but the entire complexion of the case changes when the petitioners were able to demonstrate that they have acted entirely on a decision of none other than this very High Court. When the law had been interpreted by the High Court and the assessee has proceeded on the lines as laid down in that decision, it would then be impossible to hold that there was any ulterior,

improper or dishonest motive, nor it would be permissible for this Court to conclude that the assessee had acted in disregard to law. One is also required to take cognizance of the fact that the nature of the controversy was so very fine, viz., the question as to whether tamarind kernel turned into tamarind powder was equitable with the same product or whether they constitute two separate items and it is in this background that we uphold the defence that has been pleaded on behalf of the petitioners that when they filed the declaration under form 37 that they have acted bona fide and that there is no shade of even the slightest of any ulterior or mala fide motives. In our considered view, this aspect of the law is required to be taken cognizance of and applied only in those of the cases, perhaps a few or a microscopic minority of them, wherein the mechanical application of law and the arbitrary imposition of penalty would not be justified as a matter of course. While the opposite position holds good in the larger majority of cases, we need to observe that the courts should be very judicious, very slow and careful while examining as to whether the defence pleaded is honest, whether it is genuine and more importantly whether it is absolutely bona fide.

11. There is a subtle angle of the law which we need to go into, viz., the fact that since Section 5-A prescribes a very heavy penalty, that it is quite implicit from the legislative intent that the objective is with a view to come down heavily on attempts of misleading the authorities but more importantly causing tax evasion and loss to the exchequer. It becomes all the more important, before imposition of a penalty for the courts to apply what the Supreme Court has repeatedly defined as the objective test and if it can be demonstrated that on the defence pleaded, there is enough material for the courts to conclude that it would be wrong to hold that there was an attempted evasion, then the imposition of the penalty itself would be unjustified.

12. Having regard to the unusual facts of the present case and the circumstances in which the declarations were filed, we need to also observe that the situation that has arisen here was more than exceptional. In so far as we are unable to come across a single reported decision in which there is a parallel to the present proceeding. It is for this reason that we have meticulously considered both the facts as also the law on the point virtually threadbare and in our considered view, the law does admit to an exception, which, as we have pointed out can only be justified in very special circumstances.

13. Having regard to the aforesaid situation, the imposition of the penalty as far as the petitioners are concerned for both the assessment years in question was unjustified. We accordingly quash and set aside the orders imposing the penalty and direct that the sum to be refunded to the petitioners. The department should ascertain as to how much of the amount has been tendered and the petitioners shall be entitled to the refund to that extent.

14. In the result, the petitioners succeed. The points raised in this petition are answered in favour of the petitioners and against the Revenue. The petitions to

stand disposed of on merits. In the circumstances of the case there shall be no order as to costs.