

Director cannot be penalised when the lapse is on the part of the company – Bombay HC

16 August 2022



Summary:

The Bombay High Court (HC) has held that a show cause notice imposing a penalty cannot be issued against an ex-director due to a lapse on the part of the company. The HC observed that there has to be a specific act attributed to a director or the person allegedly in control of the management of the company, to the effect that such a person was responsible for the acts committed by or on behalf of the company. In the present case, the entire charge undisputedly is levelled against the company for not fulfilling the export obligations. Further, in the notice issued to the company no details about a lapse on the part of the director were specified. Therefore, such proceedings initiated against the ex-director for lapse on the company's part are contrary to the principle of vicarious liability and are *void-ab-initio*.

Facts of the case

- The petitioner¹ is the wife of a practising advocate². The late advocate was an independent, non-executive director of the company³ and was not involved in the day-to-day affairs of the company. He had subsequently resigned and fulfilled all the statutory compliances⁴.
- The company defaulted in fulfilling the export obligations as prescribed at the time of issue of Advance Import licences.
- Further, the authorities held that, since the company did not submit the MODVAT reversal certificate⁵, no export was made against the licence.
- Therefore, adjudication orders were passed holding the company as a defaulter under the Foreign Trade (Development and Regulation) Act, 1992 (FTDR Act).
- The order-imposing penalty was addressed to the company and was also forwarded to the ex-director on the

ground that, even after his resignation his name was still appearing in the Import Export Code (IEC) of the company.

- Therefore, the petitioner filed a writ before the Bombay HC challenging the impugned order.

Bombay HC observations and ruling⁶:

- **Lapse on the part of the company for non-fulfilment of obligations:** The company was under an obligation to comply with requirements under the FTDR Act or the Foreign Trade Policy. Hence, it is to be primarily accused of lapse. Further, the order was passed for penal actions against ex-directors and the company. However, the order did not specify the role of each director contributing to such lapse. Thus, it is a clear contradiction of the principle of vicarious liability.
- **A clear violation of principles of natural justice:** The SCN was issued to the company, and neither of the notices

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² Late Shri Anand S. Bhatt

³ TPI India Ltd

⁴ Under the provisions of the Sick Industrial Companies (Special Provisions Act), 1955 (SICA) by

the Board of Industrial and Financial Reconstruction (BIFR), New Delhi.

⁵ As per Circular 108/19/95-Central Excise

⁶ Writ Petition No. 325 of 2009 dated 8 July 2022

were issued to the director. Further, the director was not given an opportunity of being heard at the time of the impugned order, whereby the aforesaid penalty was imposed on him. Thus, it is a clear violation of the principles of natural justice. Therefore, the proceedings initiated against the ex-director are *void-ab-initio*.

- **The penalty cannot be sustained:** The HC has placed reliance on the decision⁷ of Gujarat HC, wherein it was held that if no SCN is issued to the directors against the penalty imposed and no opportunity of hearing is granted, then the consequential orders shall be nullified. Accordingly, the HC has passed the present order in line with the decision of the Gujarat HC.

Our comments:

The present ruling is welcome and is likely to set precedence in similar matters.

The Delhi HC⁸ had held that the director cannot be vicariously or jointly liable for service tax dues of a company in the absence of a specific provision and given a company's separate legal personality. The HC had further held that the onus of proof shall remain on the department/respondents to show that a director is personally liable for the dues of the company at the stage of issuing SCN.

However, it is pertinent to note that the GST law⁹ provides that where any tax, interest or penalty is due from a private company and the same cannot be recovered from the company, then the directors of such company shall be jointly and severally liable for payment of such dues. It further provides that the director shall be liable unless he proves that the non-recovery cannot be attributed to any gross neglect, misfeasance or breach of duty on his part in relation to the affairs of the company.

Thus, the GST laws shifting the onus on the director in such cases is contrary to the settled legal principles and needs a relook.

⁷ Om Vir Singh

⁸ in the case of Sanjiv kumar mittal

⁹ Section 89 of the CGST Act, 2017

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