

## [Navigating Penalties and Interest: Exploring Limits and Authority in the Mahindra & Mahindra Case](#)



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### [Introduction](#)

The Honorable Supreme Court has ruled on interest levability on customs duties and their complexities. In a precise judgment, the Supreme Court decided a dispute involving interest and penalties on additional customs duties. This judgment affects enterprises, revenue departments, and taxpayers beyond legal boundaries. In the face of complex import laws, the Supreme Court's denial of a Special Leave Petition (SLP) underlines the importance of legislative requirements in taxes. The court's rejection of a revenue department's request opens the door to re-evaluation, refunds, and maybe a larger discussion on Integrated Goods and Services Tax (IGST) and its levy. This article unravels the case's legal complexities and probable customs repercussions.

### [Facts & Background](#)

**Background:** The petitioner manufactures vehicles in India. Petitioner made four Settlement Commission petitions to settle four cases.

**Cases:** Applications connected to:

1. Import through M/s. UK Omni Design International
2. Import through M/s. Fuji Tech Inc. Japan
3. Miyazu Seisakusho Co. imports. Limited, Japan, Sumitomo Corporation, Japan, and Durr Systems GmbH, Germany
4. Import through M/s. Renault, France.

Show cause notice accused the petitioner of not disclosing the entire amount due for imported models. This was alleged to be a misdeclaration to avoid customs.

**Specific Demands:** The first show cause notice sought Rs. 33,16,621/- in differential customs duty. A differential customs duty of Rs. 3,91,69,685/- was claimed in the second show cause notice. A differential customs duty of Rs. 1,41,53,468/- was claimed in the third show cause notice. A differential customs duty of Rs. 4,04,567/- was claimed in the fourth show cause notice.

**Previous Orders:** Respondent no. 2 (The Settlement Commission) determined customs tax responsibility from the first show cause notice in a final order on January 29/31, 2008. Interest at 10% was necessary, while penalties above Rs. 1,00,000 were waived. The second case assessed customs tax, and 10% interest, and waived penalties over Rs. 10,000,000. Immunity from prosecution. The third notice produced a similar ruling with 10% interest and a waived penalty above Rs. 5,00,000. Immunity from prosecution was given. The fourth notice orders customs duty, 10% interest, and protection from penalty and punishment.

**Initial Writ Petitions:** The petitioner filed four writs in this Court against respondent no. 2's (The Settlement Commission) rulings. The writ petitions were dismissed on September 4, 2008. The Court overturned 10% interest and penalty orders on customs tax over basic duty. Respondent No. 2 (The Settlement Commission) was ordered to reexamine the cases. Respondent No. 2 (The Settlement Commission) had a final hearing on November 19, 2008, after the remand. A similar final order was issued on January 5, 2009. This order reaffirmed the writ petitions' previously disputed decisions and reasoning. The automobile manufacturer petitioned the Settlement Commission to resolve customs tax misdeclaration claims. After writ petitions disputed initial orders, the Court remanded to the Settlement Commission. A new order similar to the first rulings followed the review, prompting the legal challenge.

## Issues & Concerns

Can interest and penalties be imposed on the demand for Customs Additional Duty, Special Additional Duty (SAD), and surcharge?

## Cases Referred

➤ **Union of India v. Asahi India & Safety Glass Ltd. (Para 9)**

*Citation: 2015 (320) E.L.T. 179/[2015] 57 GST 497/58 taxmann.com 237 (SC)*

The petitioner's point in this case was that while challenging a Settlement Commission order under Article 226, the court should look into whether the Commission's procedure is legal and whether the order conforms to the law. The court's review is not about the decision itself but about the process.

➤ **Collector v. Orient Fabrics (P.) Ltd. (Para 23, 31, 32)**

*Citation: 2003 (158) E.L.T. 545/2003 taxmann.com 68 (SC)*

The Supreme Court interpreted Section 3(3) of the Additional Duties of Excise (Goods of Special Importance) Act, 1957, similar to Sections 3 and 3A of the Customs Tariff Act, 1975, and Section 90(4) of the Finance Act, 2000. In this instance, the Supreme Court ruled that the Act did not penalize violations or confiscate items. Penalties need legal justification. An amendment eventually contained comparable sanctions, but it didn't apply to the Court case.

➤ **Jain Brothers v. Union of India (Para 30)**

*Citation: AIR 1970 SC 778*

In the Jain Brothers case, the Supreme Court established that penalties are not just a continuation of the process of assessing taxes. Instead, they carry the same weight as an extra tax. It means that penalties aren't simply a consequence of the assessment process, nor are they just a way to enforce tax rules. They are a separate responsibility under the law.

The Supreme Court is highlighting that penalties in tax matters aren't just a procedural outcome of tax assessment but carry the weight of an additional financial obligation under the law.

➤ **Indo Swiss Embroidery Industries Ltd. v. Commissioner (Para 31)**

*Citation: 2017 (356) E.L.T. 226/[2017] 84 taxmann.com 128 (Bom.)*

The key argument was that the ADE (T&TA) Act did not allow interest or penalties. The court cited and followed the Supreme Court's Orient Fabrics ruling. The Orient Fabrics decision concluded that Section 3 of that Act's extra excise duties couldn't be subject to interest or penalties without express restrictions. The court said tax laws should be severely construed. The court concluded that Section 11AC and Section 11AB of the Central Excise Act did not apply since the ADE (T&TA) Act did not provide for interest and penalties. In plain terms, the court was discussing interest and penalties for excess excise duty. The court ruled that these interest and penalty charges couldn't be enforced because the statute didn't specify them. This case followed an earlier ruling that tax regulations must be properly construed. Thus, the Central Excise Act's penalty and interest sections didn't apply.

➤ **Khemka & Co. (Agencies) (P.) Ltd. v. State of Maharashtra (Para 22)**

*Citation: [1975] 2 SCC 22*

In this case, the issue was whether individuals subject to the Central Sales Tax Act of 1956 could be penalized according to the rules of the State Sales Tax Act. The petitioner argued that since the Central Act doesn't have a provision for imposing penalties for delays or defaults in tax payment, penalizing them under the State Sales Tax Act would be unlawful.

The Revenue argued that penalties for defaults in tax payment, as outlined in the State Sales Tax Act, should apply to tax payments and collections under the Central Sales Tax Act. They claimed that this is a natural part of the process. The Supreme Court ruled that penalties are legally mandated and are separate from taxes. They are an additional obligation as set by the law.

To establish this obligation, three conditions must be met:

- I. There must be a section in the law that defines this obligation.
- II. The law must lay out provisions for assessing the obligation.
- III. The law must provide means for enforcing these tax-related provisions.

The Court concluded that a specific section in the law is required to create the obligation for penalties to be imposed.

➤ **Commissioner v. Ukai Pradesh Sahakari Khand Udyog Mandli Ltd.(Para 25)**

*Citation: 2011 (271) E.L.T. 32 (Guj.)*

The Gujarat High Court addressed the Central Excise Act and the Sugar Export Promotion Act, of 1958. The court ruled that late tax payments may only be assessed interest if the tax legislation explicitly allows it. Subsection (4) of Section 7 of the Sugar Export Promotion Act. This section states that the Central Excise Act's regulations and requirements apply to the imposition and collection of excise or any other sum stated in that section, just as they do to sugar duty and other Central Government payments. This is identical to Section 3(6) and Section 3A(4) of the Customs

Tariff Act, 1975. In this instance, the court clarified that interest can only be applied to late tax payments if the tax legislation explicitly allows it. The Sugar Export Promotion Act didn't allow interest on late tax payments, the court decided. The court ruled that sub-section (4) of Section 7 of the Act did not allow interest since there was no stated regulation in the Act. According to the court's judgment, late tax payments cannot be charged interest or penalties unless the law allows it. Interest could not be levied since the legislation was unclear. This emphasizes the need for clear legal regulations for late tax payments.

➤ **Union of India v. Valecha Engineering Ltd. (Para 31)**

*Citation: 2010 (249) E.L.T. 167 (Bom.)*

Valecha Engineering case addressed charging interest on extra customs tax under Section 3 and special additional duty under Section 3A of the Customs Tariff Act. The court stated that interest and penalties can only be assessed if the law allows it. In paragraph 30 of the case, the court stated that interest rules are tools that assist the process run smoothly. In plain terms, the court accepted that interest regulations are more about correcting mistakes than charging or penalizing.

➤ **Hyderabad Industries Ltd. v. Union of India (Para 36)**

*Citation: 1999 (108) E.L.T. 321 (SC)*

In Hyderabad Industries Ltd. v. Union of India, the Supreme Court examined Section 12 of the 1962 Customs Act and Section 3 of the 1975 Customs Tariff Act. The question was concerning import customs duty. Section 12 of the Customs Act discusses Indian import duties. It references 1975 Customs Tariff Act rates. Section 12 of the Customs Act simply references the Customs Tariff Act's customs duty rates. An extra levy called Countervailing levy (CVD) under Section 3 of the Customs Tariff Act works differently. The excise duty on identical goods in India is linked to this CVD. This form of charge is covered under Section 3 of the Customs Tariff Act, not Section 12. The Court stated that customs duties are controlled by independent legislation. The Customs Tariff Act and Customs Act are separate. Both laws tax imports, but they work separately. The Customs Tariff Act can impose a tariff separate from the Customs Act. The Court stated that customs duty can be imposed under several laws, and for extra levies like CVD, the Customs Tariff Act is the key statute to evaluate. The two laws determine import customs duty separately but function together.

## Court Observations

The concise summary of the court's observations is as follows:-

- **Jurisdiction Issue:** The court determined that imposing interest and penalty on a customs duty demand was improper and beyond the legal authority of the authorities. They lacked jurisdiction due to the specific circumstances of the case.
- **Incorrect Section:** The court found that a specific section (Section 28AB) of the Customs Act wasn't applicable because there was no determination of duty under Section 28(2). Thus, the Act couldn't be used to impose interest and penalties.
- **Authority Limitation:** The court rejected a respondent's argument that they could decide settlement terms, including interest and penalty. This claim exceeded the authority granted by the Customs Act.
- **Misused Law Reference:** The court addressed the mistaken reliance on Section 127C of the Customs Act to impose interest. It clarified that Settlement Commission orders must align with Customs Act provisions, without exceeding them.

- **No Valid Reason for Interest:** The court emphasized that merely gaining financially from incorrect duty rates wasn't enough reason to demand interest. Without clear legal provisions, benefiting financially didn't warrant interest payment.
- **Interest and Penalty Invalidated:** Consequently, the court declared the Commission's decision to impose interest and penalty null. The petitioner wasn't obliged to pay the interest and penalty amounts.
- **Refund and Bank Guarantee:** The court directed authorities to refund the penalty the petitioner paid, along with any applicable interest. Additionally, any provided bank guarantees were to be cancelled and returned.

In essence, the court decided that the authorities lacked proper legal grounds to impose interest and penalty. They found that certain sections of the Customs Act were misinterpreted, leading to an unjust demand. The court quashed the interest and penalty, ordered the refund of the penalty, and instructed the return of the provided bank guarantees.

## Conclusion

The Settlement Commission cannot charge interest when there is no law backing that interest charged. This limitation occurs when an importer profited from underpaying duty. Settlement Commission orders cannot be selectively accepted or rejected. If the Commission's order violates the law, the courts should intervene. Section 90(1) of the Finance Act, 2000, and Sections 3(1) and 3A(1) of the Customs Tariff Act, 1975, control CVD, SAD, and surcharge rates. These sections supersede the 1962 Customs Act Section 12. Importantly, surcharge, CVD, and SAD interest and penalties are not explicitly stated. Penalties without legal foundation are illegal. The 1962 Customs Act's assessment, collection, and enforcement methods cannot be used for 1975 Customs Tariff Act fines and interest. Penalties as extra taxes must be backed by clear and explicit legislative authority under the Constitution. The application of fines and interest is substantive, not procedural. When particular legislative requirements are lacking, duty collection procedures cannot recover penalties and interest for delayed tax payments. Penalties, which are supplemental taxes, must be set by legislation.

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