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## **Liability of a Director of the Company under GST Act**

From the day GST has been introduced in India (01-07-2017) there are two prominent news regarding it (i) malfunctioning of GST Portal and (ii) detection of interstate rackets regarding wrong claim of ITC and its refund. Recently Hon'ble Apex Court regarding malfunctioning of the GST Portal had to confine its direction to the Central Government to resolve the technical glitches in the online filing Goods and Service Tax.

On the second anvil this article will deliberate. Firstly, Section 89 of the GST Act provides for liability of a Director of Company :-

- (1) Notwithstanding anything contained in the Companies Act, 2013 where any tax, interest or penalty due from a private company in respect of any supply of goods or services or both for any period cannot be recovered, then, every person who was a director of the private company during such period shall, jointly and severally, be liable for the payment of such tax, interest or penalty 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.
- (2) Where a private company is converted into a public company and the tax, interest or penalty in respect of any supply of goods or services or both for any period during which such company was a private company cannot be recovered before such conversion, then, nothing contained in sub-section (1) shall apply to any person who was a director of such private company in relation to any tax, interest or penalty in respect of such supply of goods or services or both of such private company.

On a conjoint reading of Section 89 sub-section (1) & (2) it is clear that liability can be fastened on a Director of a Private Limited Company, however, it automatically releases the responsibility of a Director of the Limited Company under the GST Act.

Both sub-section (1) & (2) fasten the Liability on the Director of a Private Limited Company, but no where defined it in the said Act.

## Corporate Veil -

In case of company, there is a corporate veil which in reasonable cases protect Director of the Company other responsible official. The concept of corporate veil was considered by the Hon'ble Apex Court, a passage from the judgement is reproduced hereinbelow :

**In Naresh Chander Gupta vs. The District Magistrate And Others, 2003 (Vol. 22) 358 -**

In the Delhi Development Authority case (supra), the Supreme Court, following its decision in Tata Engineering and Locomotive Company Ltd. vs. State of Bihar AIR 1965 SC 40 observed :-

The law as stated by Palmer and Gower has been approved by this Court in Tata Engineering and Locomotive Company Limited vs. State of Bihar (1964) 6 SCR 895 : (AIR 1965 SC 40). The following passage from the decision is apposite (para 27 of AIR) :

Gower has classified seven categories of cases where the veil of a corporate body has been lifted. But it would not be possible to evolve a rational, consistent and inflexible principle which can be invoked in determining the question as to whether the veil of the corporation should be lifted or not. Broadly stated, where fraud is intended to be prevented, or trading with an enemy is sought to be defeated, the veil of a corporation is lifted by judicial decisions and the shareholders are held to be the persons who actually work for the corporation.

Further, the Supreme Court also observed that the concept of corporate entity was evolved to encourage and promote trade and commerce but not to commit illegalities or to defraud people. Where, therefore, the corporate character is employed for the purpose of committing illegality or for defrauding others, the Court would ignore the corporate character and will look at the reality behind the corporate veil so as to enable it to pass appropriate orders to do justice between the parties concerned. The Supreme Court also observed quoting 'Gower's Modern Company Law' - "where the protection of public interest is of paramount importance or where the company has been formed to evade obligation imposed by the law, the Court will disregard the corporate veil."

Finally, in **State of U.P. vs. Renusagar Power Co. 1988 (4) SCC 59** the Supreme Court observed :

It is high time to reiterate that in the expanding of horizon of modern jurisprudence, lifting of corporate veil is permissible. Its frontiers are unlimited. It must, however, depend primarily on the realities of the situation. The aim of the legislation is to do justice to all the parties. *The horizon of the doctrine of lifting of corporate veil is expanding.*

The Hon'ble Allahabad High Court following the referred decisions along with other decision in case of **Meekin Transmission Ltd. Kanpur vs. State of U.P. and Others** [2008 NTN (vol. 36) 107] specifically laid down :

- (1) Company is a distinct and separate juristic personality having its own rights of right of property etc;
- (2) The shareholders have no interest in any particular asset of the company or the property of the company except of participating in profits, if any, when the company decides to divide them or to claim his share when the company is wound down in accordance with the articles of the company;
- (3) A company is distinct from its Board of Directors who cannot enforce a right in their individual capacity, which belongs to the Company (*TELCO vs. State of Bihar*, AIR 1965 SC 40).
- (4) The liability of the company simultaneously is also not the liability of shareholders. The shareholders cannot be make liable under a decree against a company has held in *Nihal Chand vs. Kharak Singh Sunder Singh*, (1936) 2 Company Cases 418 and *Harihar Prasad vs. Bansi Missir*, (1932) 6 Company Cases 32.

Doctrine of Piercing of Veil (Lifting the Corporate Veil): Exception to the Law of Separate Entity:

The aforesaid doctrine of separate juristic personality of the Company, however, with the passage of time has been subjected to certain exceptions, sometimes on account of specific provisions of the statute, and, sometimes by judicial pronouncements.

The most important exception in this regard is that of “piercing the veil” or “lifting the corporate veil” to find out who is the real person, beneficiary or in controlling position of the Company.

One of the most important circumstance in which the veil has been lifted is the cases of fraud or improper conduct of the promoters. Where dummy companies were incorporated by a promoter and his family members to conceal profits and avoid tax liability, the

separate entity of the Company has been ignored by looking through the veil and identifying those individuals who have devised such method for their own benefits.

Hon. Apex Court in *Juggilal Kamlapat vs. Commissioner of Income Tax*, AIR 1969 SC 932 it was found that three brothers who were partners in the assessee firm were carrying on the managing agency in a dominant capacity in the guise of a limited company. The court held that the corporate entity has to be disregarded if it is used for tax evasion or to circumvent tax obligation or to perpetrate fraud.

When a Director is responsible under the GST Act ?

- ◆ Misfeasance
- ◆ Breach of Duty
- ◆ Gross Negligence

In both sub-section (1) and (2) of section 89 three words specifically mentioned where liability can be fastened on Director of Company.

### **Misfeasance —**

The improper doing an act which a person might lawfully do; a wrongful and injurious exercise of law authority, or the doing of the lawful authority, or the doing of the lawful act in an unlawful manner.

It may involve to some extent the idea of not doing, as where an agent, while engaged in the performance of his undertaking, does not do something which it was his duty to do under the circumstances, as, for instance, when he does not exercise that care which a due regard to the rights of others may require.

**According to** Section 235 of Companies Act, 1956 misfeasance is in the nature of a breach of trust, i.e. something by which the company's property has been wasted, the acts which are covered by the section are acts which are wrongful according to established rules of law or equity done by the person charged in his capacity as promoter, director etc. where a breach of duty has been committed which in fact has resulted in a misapplication of the company's property such a transaction would be within the mischief of the section. A simple act of negligence would not fall within the section. The misfeasance contemplated in Sec. 235 is one which result in loss.

[ *V. Ganesan vs. Brahmayya & Co.*, MLJ : QD (1961-1965) Vol. I C 1994 : (1964) 1 MLJ 405 : (1964) 1 Comp LJ 262 [Companies Act (1 of 1956), S. 235]

### **Breach of Duty —**

Violation of legal obligations according to *Random House Dictionary* it means

**to break or act contrary to law, promise, New Webster's Dictionary** defines it as violation faith or trust, widely it may be understood as - **Failure to do one's duty, to execute any office, employment, trust in proper time or proper manner.**

### **Gross Negligence —**

This word covers many walks of life including action or inaction by a person in performing its duties. Negligence is "the absence of proper care, caution and diligence; or such care, caution and diligence, as under the circumstances reasonable and ordinary prudence would require to be exercised". It includes the omission to do something which a reasonable man is expected to do or a prudent man is expected to do.

**[State of Maharashtra vs. Kanchanmala Vijaysing Shirke (1995) 5 SCC 659]**

'**Negligence**' would mean careless conduct in commission or omission of an act connoting duty, breach and damage suffered by a person to whom the plaintiff owes a duty of care, is crucial to understand the nature and scope of tort of negligence.

**[Rajkot Municipal Corporation vs. Manjulben Jayantilal Nakum, AIR (2002) SC 2865]**

The Hon. Apex Court in the case reported as **Municipal of Greater Bombay vs. Laxman Iyer, (2008) 8 SCC 731 para 6** discussed this word, in following words :

Though there is no statutory definition, in common parlance 'negligence' is categorised as either composite or contributory. It is first necessary to find out what is a negligent act. Negligence is omission of duty caused either by an omission to do something which a reasonable man guided upon those considerations who ordinarily by reason of conduct of human affairs would do or obligated to, or by doing something which a prudent or reasonable man would not do. Negligence does not always mean absolute carelessness, but want of such a degree of care as is required in particular circumstances. Negligence is failure to observe, for the protection of the interests of another person, the degree of care, precaution and vigilance which the circumstances justly demand, whereby such other person suffers injury. The idea of negligence and duty are strictly correlative.

Negligence means either subjectively a careless state of mind, or objectively careless conduct. Negligence is not an absolute term, but is a relative one; it is rather a comparative term.

'**Negligence**' means either subjectively a careless state of mind, or objectively careless conduct. It is not an absolute term but is a relative one; it is rather a comparative term. In determining whether negligence exists in a particular case, all the attending and surrounding facts and circumstances have to be taken into account.

'**Negligence**' is the breach of duty caused by omission to do something which a reasonable man in ordinary conduct of human affairs would do or doing something which a prudent and reasonable man would not do.

**[Jacob Mathew vs. State of Punjab, AIR 2005 SC 3180]**

'**Negligence**' is conduct which falls below the standard established for the protection of others against unreasonable risk.

**[Naresh Giri vs. State of M.P. (2008) 1 SCC 791, 796, para 11]**

### **Conclusions :**

Having tested the Section 89, as above, it is clear that it has been very loosely drafted as it to phase to mention other important officers of the company and perhaps it may fail to get hold of ITC frauds. Therefore, it should be redrafted.