You are successfully logged in ×

Retrospective Amendment in GST laws – A classic Case of Legislative Overreach?

May 10, 2021

Rajat Bose
Partner, Shardul Amarchand Mangaldas & Co

Ankita Bhasin
Principal Associate

Shohini Bhattacharya
Associate

The government had proposed to retrospectively amend the definition of 'supply' – the taxable event under the Goods and Services Tax (GST) laws in the Finance Bill, 2021 (which has now been enacted as an Act). As per the amendment, the activities and transactions, by a person, other than an individual, to its member or constituents or *vice-versa*, for cash, deferred payment or other valuable consideration has been retrospectively brought under the definition of supply.

A direct fall out of this proposal is that supply of goods or services by clubs or associations to its members for cash, deferred payment or other valuable consideration will take the color of supply and be taxable. While this amendment in itself is unnerving in the wake of the string of judicial precedents that exist on the doctrine of mutuality, what hits harder is the fact that the amendment has been made retrospective from 1 July 2017.

To fully understand the doctrine of mutuality, it is important to roll back to the Service tax regime and analyze the taxability of transactions between clubs and association and its members and constituents.

Service tax was levied on club or association services from June 2005 onwards. Clubs or association was defined to mean any person or body of persons providing services, facilities or advantages, for a subscription or any amount to its members. After the introduction of the negative list based taxation under Service tax, explanation to the term "service" was inserted to include, services provided by unincorporated body or a non-profit entity registered under any law to its own members by way of reimbursement of charges or share of contribution, within its ambit.

The concept of taxability including the amendment as provided above was challenged in light of the established concept of "principles of mutuality" in the case of ***State of West Bengal & Ors. v Calcutta Club Limited [TS-779-SC-2019-VAT].*** The decision which was passed in the context of the erstwhile Service Tax regime, discussed at length the doctrine of 'principal of mutuality'. The primary issue that was placed before the Hon'ble court was if the doctrine of mutuality was still applicable after the 46th Amendment to Article 366(29-A) of the Constitution of India. Post the amendment, a clause was added, that provided that tax on purchase or sale of goods includes a tax on the supply of goods by any unincorporated association or body of persons to a member for cash, deferred payment or another valuable consideration. The court observed that the 46th Amendment used the expression "any unincorporated association or body of persons", which made it clear that it was only the clubs which were not in a corporate form that were sought to be brought within the tax net. The court clarified that the intention of the legislature was not to tax all clubs which would discourage their association. It was also observed that the allegation of tax evasion was without any basis as, owing to the principle of mutuality such clubs/associations and its members are to be treated as the same person. The court reviewed the definitions under the service tax regime pre 1 July 2012 and post 1 July 2012 and arrived at its decision on the basis that if there are no members, there is no club and vice-versa. The Hon'ble Supreme Court, thus observed as under -

" it is settled law that if the persons carrying on a trade do so in such a way that they and the customers are the same persons, no profits or gains are yielded by the trade for tax purposes and therefore no assessment in respect of the trade can be made. Any surplus resulting from this form of trading represents only the extent to which the contributions of the participators have proved to be in excess of requirements. Such a surplus is regarded as their own money and returnable to them. In order that this exempting element of mutuality should exist it is essential that the profits should be capable of coming back at some time and in some form to the persons to whom the goods were sold or the services rendered....

Downloaded by niharikar@avianwe.com at 10/05/21 04:00pm

The contributors to the common fund and the participators in the surplus must be an identical body. That does not mean that each member should contribute to the common fund or that each member should participate in the surplus or get back from the surplus precisely what he has paid.' The Madras, Andhra Pradesh and Kerala High Courts have held that the test of mutuality does not require that the contributors to the common fund should willy-nilly distribute the surplus amongst themselves: it is enough if they have a right of disposal over the surplus, and in exercise of that right they may agree that on winding up the surplus will be transferred to a similar association or used for some charitable objects."

GSTSUTRA

The scope of the 'principle of mutuality' was narrowed down by the Hon'ble Supreme Court in the case of *Yum! Restaurants (Marketing) (P) Ltd. Vs. Commissioner of Income Tax, Delhi [Civil Appeal No. 2847 of 2010].* In this case, the court examined the doctrine of mutuality tracing the origin to the principle that a man cannot engage in business with himself and held that, for the doctrine to succeed, it is necessary to show that there existed no profit motive to regard the 'surplus' as 'income' under the provisions of the Income Tax Act, 1961. The Court followed the test laid down in the *English and Scottish Joint Co-operative Wholesale Society Ltd. v. Commissioner of Agricultural Tax, Assam[Privy Council Appeal No. 75 of 1946],* that had proposed for the first time ever, the conditions to meet the principle of mutuality -

(a) oneness of the contributors to the fund and the recipients from the fund,

(b) that the entity is constituted merely for the convenience and common benefit of the members, and

(c) impossibility that contributors derive profit from the contributions made by them to a fund which could only be expended or returned to themselves.

The court placing reliance on these factors was of the view that the transaction would be taxable as the condition of receiving the benefits from the funds was not being satisfied. It is noteworthy, that though Yum Foods dealt with income tax, it did not take into account the decision of *Calcutta Club Case.*

For the concept of mutuality to succeed it is essential that the surplus should be capable of coming back at some time and in some form to the persons to whom the goods/services were sold/provided. Such a surplus will then be treated as their own money.

Relying on the ratio of the above mentioned judgment, it can be said that the classification of service for the transaction between members and co-operative societies itself is *ultravires* under the operation of the principles of mutuality.

The same question was once again raised under the GST regime wherein there were several controversial views until finally Maharashtra Appellate Authority for Advance Ruling (AAAR) in the ***Rotary Club of Mumbai Queens Necklace*** **case [TS-1299-AAAR-2019-NT]** held that the amount collected as membership subscription and admission fees from members is not liable for GST as the same do not amount to supply of services.

However, the reasoning of Maharashtra AAAR was not so much based on the doctrine of mutuality as it was on the scope of definition of 'supply' under the GST Act. The Maharashtra AAAR held that the income so collected from members of such organizations was not incurred towards any business activity but for meeting various administrative expenditure. Accordingly, the activity of collection of fees/subscription for meeting expenses squarely falls outside the purview of supply as defined under Section 7 of the GST Act, 2017.

As a matter of fact, clubs/associations have since 1 July 2017 not discharged GST liability. It is indeed surprising that the retrospective amendment nearly 4 years after introduction of GST, has been proposed despite being aware of the consequences that it will pose for the associations. The first and foremost being tracing the transactions with the members, imputing a value and thereafter depositing GST along with applicable interest. The members in all likelihood will not be bearing the burden of the GST and the same will be a hit to the pockets of the clubs/associations. In addition to the commercial challenges that this amendment rakes up, this amendment also hits at the core of the doctrine of the 'separation of powers' – a constitutionally prescribed pillar.

The odds are that this amendment will be challenged sooner than later and in our view before going into the issue on merits, the challenge will be made to the retrospective effect that is proposed to be given to this artificial definition. However, till such decision, the clubs and associations should be ready to receive notices to discharge the GST liability with effect from 1 July 2017.

Downloaded by niharikar@avianwe.com at 10/05/21 04:00pm