Mutuality concept defeated by the retrospective amendment under GST?

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The taxability of the transactions between the club and its members has been quite a long judicial story right from the year 1970 when the Supreme Court decided in the case of Young Men's Indian Association[1] that there is no sales tax liability on such transactions. This led to the 46th amendment to the Constitution deeming '*tax on the sale or purchase of goods*' to include '*tax on the supply of goods by any unincorporated association or body of persons to a member'*, trying to give power to the States to levy tax on such transactions. Subsequently, there were decisions which held that the 46th amendment is of no rescue as the concept of mutuality still survives. Such a conclusion given under the service tax and the sales tax laws, it had been opined by various experts that this would hold ground even under the GST law whereby the clubs, whether incorporated or not, would also not be liable to GST.

Then came the master stroke (as expected always) of the Government - proposing a retrospective amendment in the GST law deeming such transactions as supply and also deeming the club and its members to be separate persons. The story until now is no less that a daily soap or a web series wherein the balance keeps shifting from one person (Government) to the other (the taxpayer). Though the script is always written in such a way that finally the hero (the Government) wins!!

In this article we would be analysing the validity of the retrospective amendment in light of the events that have taken place right from the Sales tax regime till date and whether finally the hero has done enough to be declared a winner or is it that 'Picture abhi baaki hai mere dost!'!

Reason for the 46th amendment

Before we get into the retrospective amendment proposed under GST, let us look into the reason for the 46th amendment, which is a key factor to the entire story. The term 'dealer' was defined u/s 2(g) of the Madras General Sales Tax Act, 1959 which also included (by way of an explanation) a cooperative society, a club, a firm or **any association which sells goods to its members**. Further, 'sale' was defined u/s 2(n) of such Act which included (by way of an explanation) the transfer of property involved in the **supply or distribution of goods by a society** (including a cooperative society) club, firm or any association **to its members**, for cash, or for deferred payment, or other valuable consideration, whether or not in the course of business.

It is clear that the Sales Tax Act did deem 'dealer' and 'sale' to include the society and the transactions between the society and the member, respectively, in order to levy sales tax. In spite of this, in the case of Cosmopolitan Club, Madras v. District Commercial Tax Officer, Triplicane[2] and various other decisions it was held, if **there is no transfer of property** involved in the supply or distribution of goods by a club, it **would not fall** within Explanation I contained in the definition of sale in s. 2(n) nor can the club be regarded as a dealer within s. 2(g) read with Explanation 1.

Further, the English decision in the case of *Graff* v. *Evans* had held that the transactions between the member and the club are not a sale because there is no transfer of property. This is because these kind of transactions have to be looked as - a part of the common property being appropriated to the separate use of the members, and the member makes a corresponding contribution from his separate property to the common fund. Thereby, the liquor which a member obtains from the common store is on payment of money to the common fund and in general sense does not constitute a sale.

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[1] (1970) 1 SCC 462

[2] AIR 1952 Mad 814

Also, it was held by the Supreme Court in the case of *Gannon Dunkerley*[3] (in a different context), that the expression "sale of goods" as used in the entries in the Seventh Schedule to the Constitution has the same meaning as in the Sale of Goods Act, 1930 i.e. *A contract of sale of goods is a contract whereby the **seller transfers or agrees to transfer the property** in goods to the buyer for a price*.

Thereby, meaning that even though there were deeming fictions in the Sales Tax Act, since 'sale' as understood commonly would not include the transaction between the club and its member, as there is no transfer of property, levy was held invalid in the case of Young Mens' Indian Association *supra.* This was for the reason that the State Legislature is competent to legislate only under Entry 54, List II of the 7th Schedule to the Constitution i.e. '*Taxes on the sale or purchase of goods other than……*', and that the deeming fiction created in the Sale Tax Act has extended the meaning of 'sale' to include transactions, which in common understanding would not amount to sale. Thereby, it was held that the explanation in the definitions referred to above are ultra-vires as the State does not have power to levy tax on such transaction.

Thus, the State was considered incompetent to levy tax on the said transaction leading to the 46th amendment deeming the 'tax on the sale or purchase of goods' to include tax on the supply of goods by any unincorporated association or body of persons to a member, in order to give power to the State to levy tax on these transactions.

Decision in the case of Calcutta Club[4] – 46th amendment not sufficient

In this case the levy of sales tax and service tax on the transactions between the club (whether incorporated or un-incorporated) and its members was held invalid for the reason that the club and its members are still one and cannot be regarded as two separate persons (i.e. principle of mutuality), even after the 46th amendment. Since there are no 2 persons involved, due to which there can be no consideration as well, the levy of sales tax and service tax was held invalid.

The Government knew that this decision could very well be applicable to the GST scenario, as there was no provision under GST which deems the club/society and its members as 2 separate persons and no provision exists which deems the said transaction as a supply. Hence, to overcome this, the GST law is sought to be amended to deem the transactions between the club/society and its members as a supply and also to deem them to be separate persons.

Further, whenever notified, this amendment would be effective from 1st Jul 2017 (i.e. retrospective). By this amendment, the shortcomings pointed in Calcutta Club *supra* are sought to be rectified i.e. to overcome the principle of mutuality and deeming such transaction to be a supply. Is this enough or is there anything which is still missing? To answer this, let us analyse the validity of this retrospective amendment.

Validity of retrospective amendment

It has been held by various Courts that the legislature can make retrospective amendments. In the case of *Rai Ramkrishna* v. *The State of Bihar* : (1963) 50 ITR 171 (SC), the Supreme Court held that where the Legislature can make a valid law, it may provide not only for the prospective operation of the material provisions of the said law, but it can also provide for the retrospective operation of the said provisions.

[3] A.I.R. 1958 S.C. 560
[4] 2019-TIOL-449-SC-ST-LB

While it is recognised that the powers of the State to levy tax and enact fiscal laws are wide, the laws framed cannot be so irrational as to fall foul of Article 14 (Equality before law) or 19(1)(g) (right to practice any profession, or to carry out any occupation, trade or business) of the Constitution. Such retrospective amendment cannot be unreasonable. This is the one ground on which the retrospective amendment can be struck down.

Let us see whether the following could be a reason for invalidating the retrospective amendment in the present case:

a. The amendment is done merely to invalidate the Court's ruling in the case of Calcutta Club *supra*
b. The amendment is unreasonable since GST is an indirect tax and the taxpayer has now lost the opportunity of collecting it from the recipient
c. Unreasonable because of the length of time it goes back to
d. The amendment is not within the legislative power

Invalidating the Court's ruling

Can it be argued that merely because the proposed retrospective amendment under GST is only to invalidate the Supreme Court's decision and is in the nature of overruling the said decision, it is invalid since it is trying to overrule the Court's decision?

In this regard, it is to be understood that in making this change, the Legislature does not "statutorily overrule" the Courts decision. Overruling assumes that a contrary decision is given on the same facts or law. Where the law has been changed and is no longer the same, there is no question of the Legislature overruling this Court.

It has been held in the case of National Agricultural Co-operative Marketing Federation of India Ltd. & Anr.v UoI[5] **making a retrospective amendment is not like overruling the Court's decision. If the invalidity pointed by the Court is removed then it is a valid law.** As has been held in Ujagar Prints V. Union of India, a competent legislature can always validate a law which has been declared by courts to be invalid, provided the infirmities and vitiating infactors noticed in the declaratory judgment are removed or cured. Such a validating law can also be made retrospective. If in the light of such validating and curative exercise made by the legislature granting legislative competence the earlier judgment becomes irrelevant and unenforceable, that cannot be called an impermissible legislative overruling of the judicial decision. All that the legislature does is to usher in a valid law with retrospective effect in the light of which the earlier judgment becomes irrelevant.

Thereby, merely because the proposed retrospective amendment is invalidating the Court's judgment in the case of Calcutta Club, it cannot be held to be invalid.

Unreasonable as no recourse to recover – GST being an indirect tax

Can it be said that - GST being an indirect tax, whereby the club could have collected GST from the members, but now since the Act has been amended retrospectively to collect the tax from the clubs, who will not be able to collect from its members for the past period, the retrospective operation of the amendment is unreasonable?

In the case of In *J.K. Jute Mills Co. Ltd.* v. *The State of Uttar Pradesh* : AIR 1961 SC 1534, the Supreme Court had held that it is no doubt true that a sales tax is, according to accepted notions, intended to

[5] Appeal (civil) 6170 of 2001

be passed on to the buyer, and provisions authorising and regulating the collection of sales tax by the seller from the purchaser are a usual feature of sales tax legislation. But it is not an essential characteristic of a sales tax that the seller must have the right to pass it on to the consumer, nor is the power of the Legislature to impose a tax on sales conditional on its making a provision for sellers to collect the tax from the purchasers. Whether a law should be enacted, imposing a sales tax, or validating the imposition of sales tax, when the seller is not in a position to pass it on to the consumer, is a matter of policy and does not affect the competence of the Legislature.

Thereby meaning that merely since the club/society will not be in a position to recover the tax from the members now for the past period, the retrospective amendment cannot be held to be invalid as the legislative competence to levy is not dependent on this factor and the option to recover from the member is only a convenience and business feasibility. Thereby, the retrospective amendment cannot be questioned on the ground of being unreasonable for this reason.

However, any penalty or interest should not be levied for the non-payment of tax prior to this retrospective amendment as was held in the case of Rama Vision Limited vs CCE, Meerut (S.C) 2005 (181) ELT 201 (SC) and Star India Private Limited vs CCE, Mumbai & Goa (S.C) 2006 (1) S.T.R. 73 (S.C.) since it is permissible for the legislature to retrospectively legislate, though such retrospectivity is normally not permissible to create an offence retrospectively.

Amendment unreasonable because of the length of time it goes back to?

Just for the reason that the amendment in the GST Act would be effective from 1st Jul 2017 which is almost more than 4 years back, whether it can be held that the said retrospective amendment is invalid? No. In the case of *Rai Ramkrishna and Others* v*. State of Bihar supra* the Supreme Court has pointed out that if the retrospective feature of a law is arbitrary and burdensome, the statute will not be sustained and the reasonableness of each retrospective statute will depend on the circumstances of each case; and the test of the length of time covered by the retrospective operation cannot, by itself, necessarily be a decisive test. There have been retrospective amendments which have gone back by 30 years or even more and such amendments have not been considered to be invalid.

Thereby, this could also not invalidate the retrospective amendment. However, the saving part in this is that the period of limitation mentioned in the Acts for the department to litigate an issue would still be operational i.e. in the case of Central Excise Act the time limit mentioned in section 11A would still be applicable. However, this is not of much use under GST as the due date of filing of the Annual Return has been extended so many times that the period of limitation is still alive for the department to pick the issue with the clubs, etc.

Thereby, it can be seen that any retrospective amendment to be struck off on the ground of being unreasonable has to be much more unreasonable and affecting the rights of the citizen than those discussed above. It has to violate Article 14 (Equality before law) or 19(1)(g) (right to practice any profession, or to carry out any occupation, trade or business) of the Constitution.

Amendment is within the legislative power?

This is the last, though the most important aspect to be examined in the present case. If the legislature **lacks power** to enact the law which it is proposing to bring in force retrospectively, then the said retrospective amendment cannot be held to be valid.

In the case of *Shri Prithvi Cotton Mills Ltd.* v. *Broach Borough Municipality* : (1969) 2 SCC 283 = 2000 (123) E.L.T. 3 (S.C.), it was held "*Before we examine Section 3 to find out whether it is effective in its purpose or not we may say a few words about validating statutes in general. When a Legislature sets out to validate a tax declared by a court to be illegally collected under an ineffective or an invalid law, the cause for ineffectiveness or invalidity must be removed before validation can be said to take place effectively. The most important condition, of course, is that* ***the legislature must possess the power to impose the tax, for, if it does not, the action must ever remain ineffective and illegal***."

At this juncture, it would be important to notice the need for the 46th amendment to the Constitution (discussed in the initial paras in this article). In that case, even though the Sales Tax Act had the deeming fiction under 'dealer' and 'sale' definitions, it was still considered to be insufficient since 'sale' as understood commonly will not include the transaction between the club and its members. Thereby requiring an amendment to the Constitution. The object clause of the 46th amendment considered that only when such amendment is made, the transaction between the club and its members can be considered as a part of 'sale of goods'.

Another aspect to note in the 46th amendment is that it was done only with respect to the supply of goods and **not for services**. Thereby, could it be said that merely by amending the GST Act to include the transactions between the club and its members as a supply, can it be said that such a transaction is a service as it is understood in the common parlance? Maybe not!

Service, though defined in the Constitution to include everything other than goods can still not be considered to include everything under the Universe but has to include all those things that in general are considered to be a service. Thus, it can be said that mere amendment of the GST Act (which may have done away with the mutuality principle by deeming the club and its members to be different persons), would not be sufficient to levy tax on the transactions between the club and its members not involving goods, since the Constitution vide Article 246A gives power only to levy tax on supply of goods and services. This transaction not being a service as understood generally, there is no legislative power to levy GST on this transaction unless there is another amendment to the Constitution similar to the 46th amendment.

It is required that such an amendment should deem the transactions between the members and the club to be a supply. If such a deeming fiction is introduced, this along with the deeming fiction in GST to consider the club and its members as distinct persons could survive the levy of GST on the said transaction.

However, taking this stand would mean another sequel to the already concluded story and could take a very long time to be settled under the GST era. The clubs/associations, etc. who do not wish to be part of this battle could consider collecting and paying the taxes for the future and for the past could consider paying it under protest to explore the possibility of a refund in case of a favourable judgment, without any retrospective amendment though!

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