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Doctrine of Mutuality and GST

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ABSTRACT

There has been a long existing tussle between the tax authorities and the tax payers on the issue of mutuality. Where the authorities have often tried to find ways to impose the tax burden on mutual concerns, the taxpayers have been avoiding the tax net using the long established Doctrine of Mutuality. Although this debate in the erstwhile (service tax) regime was only put to rest recently by the Hon'ble Supreme Court, this dispute is carried forward in the GST regime too. In this article, I have tried to argue that the Doctrine of Mutuality is applicable under the GST law, and although the authorities have tried to do away with this doctrine under the GST, the law is not appropriately drafted thereby failing to achieve the desired objective. This article is divided in 3 parts, where in the part I introduces the Doctrine of Mutuality and its evolution. Part II analyses the Doctrine in light of provisions under the GST law. Part III discusses the Constitutional position with respect to GST law and its impact on applicability of Doctrine of Mutuality.

Keywords: *Indirect tax; GST; Doctrine of mutuality; Constitution of India.*

1.0 Introduction

Taxation system in India is categorized in two broad categories, namely direct tax and indirect tax[1]. Direct taxes are taxes that are paid by taxpayers directly into the government treasury. In other words, the burden of direct taxes is directly borne by the tax payer and it cannot be transferred to a third party[2]. On the other hand, indirect taxes are those taxes paid by a person through another[3]. Therefore, indirect taxes require at least two parties, for the tax to be called an indirect tax. The Goods and Service Tax is an example of an indirect tax, wherein the end consumer pays the tax, however it is collected by the seller (supplier) and the supplier pays the tax into the government treasury.

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In other words, GST is a recipient based tax[4]. Onset of the GST law substantially changed the indirect taxation system in India. Prior to the GST law, India had multiple indirect taxes such as Central Excise Duty, Service tax, VAT (partially subsumed), octroi tax, entry tax, etc., which are now brought under the GST regime.

As is discussed earlier, indirect tax essentially involves two parties. One may argue that tax laid on imports does not satisfy the condition of requirement of two parties, since it is the same person who imports and receives the goods in India. A logical answer to this is that GST is a recipient-based tax, wherein the final receiver of the goods is required to pay the tax. In this case, the importer is the recipient of the goods in India, the order for which was placed with a foreign entity. Since tax cannot be paid by a foreign entity, the recipient becomes liable to pay tax on the goods imported for practical purposes.

On the other hand, there are certain entities, like a club or cooperative society, etc., which are nothing but a collective identity of its members, that act for and on behalf of the members and therefore are the same as the members. Therefore, the common law courts ruled that entities like a club or a cooperative society is nothing but a group or association of members contributing for their own common good and utilizing goods or services at their own expense[5]. On this account, it seemed unreasonable to levy tax on transaction where an individual (i.e. a member) is dealing with another form of himself (i.e., a club). Therefore, the common law courts created an exception, by doing away with the legal fiction of separation of identity in such cases, for the purposes of taxation, since otherwise it would mean that a person is being taxed for transferring money from one pocket to another. This Doctrine was propounded by Lord Watson in the following words: "When a number of individuals agree to contribute funds for a common purpose, such as the payment of annuities or of capital sums, to some or all of them, on the occurrence of events certain or uncertain, and stipulate that their contributions, so far as not required for that purpose, shall be repaid to them, I cannot conceive why they should be regarded as traders, or why contributions returned to them should be regarded as profits"[6].

It can be gathered from this principle that a Mutuality transaction it is required to fulfil all the four elements:

a) A fund must be for a specific group of individuals;
b) Such fund must be created by contributions from members;
c) The fund must be utilized for the common interest of all members only; and
d) If such fund, or a part of it remains unutilized, it must be returned to the members.

The aforesaid principles have also been laid down in by the Hon'ble Supreme Court in *Chelmsford Club v. CIT*[7]. This Doctrine is based on the reasoning that no man

can trade with himself and it is widely applied in almost all tax laws[8]. Since a group of members raising certain funds from within themselves, using it for their own benefit, essentially means they are dealing amongst themselves, and any transaction undertaken by such group or body of persons is exempted from being taxed under the laws of the land. The Doctrine of Mutuality exempts a certain category of persons from being taxed, as long as their character of a mutual association is retained and there is no element of commerciality[9].

The Doctrine of Mutuality is an extension to the principle of *Qui facit per alium facit per se* i.e., he who acts through another does the act himself, which is a cardinal principle of agency. Members of clubs/organizations of mutual association merely use the club/cooperative society as means to fulfil their own needs and requirements. It is just a structure that is acting on behalf of its members, for the members themselves.

2.0 Doctrine of Mutuality and GST Law

Since the onset of the GST Law, many indirect taxes have been subsumed by it. This gave rise to a crucial question, as to whether the doctrines and principles under other indirect taxes is applicable under GST as well? In order to assess this, it is essential to analyse the provisions under the GST law.

As discussed earlier, GST is a recipient based tax i.e., its burden is ultimately upon the end consumer. Secondly, GST is levied on "Supply" of goods and services. Supply is not defined under the GST law, but section 7 of the Central Goods and Service Tax (CGST) Act lays down the scope of supply to include "sale", "transfer", "barter", "exchange", "licence", "rental", "lease" or disposal made or agreed to be made for a consideration by a person "in the course or furtherance of business"; this section also includes import of services to be treated as supply[10]. From the above statements, it is amply clear that levying of GST requires at least two persons. For an activity to be treated as supply, it is required to satisfy six essential criteria, namely 1. Supply of goods or services. Supply of anything other than goods or services does not attract GST; 2. Supply should be made for a consideration; 3. Supply should be made in the course or furtherance of business; 4. Supply should be made by a taxable person; 5. Supply should be a taxable supply; 6. Supply should be made within the taxable territory[11]. Only if all the above-mentioned criteria are satisfied, can GST be levied on a transaction. The two most important criterions are that a supply must be made for a "consideration" and that such supply should be made "in course of business". However, Schedule I of the CGST Act lists certain activities that are treated as "supply" even when such activities are done without consideration, however these activities must have been done "in the course of

business"[12]. Therefore it becomes essential to analyse the terms "consideration" and "business" as provided in the CGST Act to determine if the activities undertaken by entities such as clubs, cooperative societies, etc., are eligible to seek the benefit of Doctrine of Mutuality under the GST law.

"Business" is defined under s. 2 (17)[13] of the Act. The definition is given an inclusive meaning, to include a broad array of activities within its ambit. Clause (e) of the section also includes provision of the facilities or benefits by a club, association, society, or any such body (for a subscription or any other consideration) to its members. Therefore, it appears that the activities undertaken by a club or association, etc., are treated to be business under the GST law. Moving further to the second test of "supply", i.e., "Consideration". "Consideration" is defined in s. 2(31)[14]. Clause (a) of the said section lays down that consideration is any payment made or to be made in money or otherwise for supply of goods or services or both by the recipient or any other person. It is pertinent to note that consideration flows from one person to another. In this case, it is obvious that there must be two separate entities, for a person cannot pay consideration to oneself. The courts have in its previous decisions, often held that a member's club or similar entities are the same as its members[15]. Therefore, it can be said that any amount paid by a member to its club or society, does not amount to payment of consideration, since the two are one and the same and one cannot pay consideration to oneself.

2.1 Supplier and recipient conundrum

GST is a recipient based tax. Furthermore, it's an indirect tax, meaning that it requires at least two persons, for GST to be levied. In other words, GST cannot be applied on a single person transaction. With this premise in mind, let us discuss the persons involved in a transaction leviable to GST. The two persons in a transaction include a supplier and a recipient. The GST law defines a "recipient" in s. 2(93)[16] to mean a person who is liable to pay consideration for availing any goods or services or both. In case where there is no consideration payable, then the person who receives such goods or services is a recipient. A key point to note herein, is that the definition includes an agent acting on behalf of the recipient to be termed as a recipient. "Agent" is defined in s. 2(5)[17] to mean a person who merely carries on business of supply or receipt of goods or services or both on behalf of another. The term "supplier" in s. 2(105) of the CGST Act is defined as a person who is supplying certain goods or services or both. In other words, the agent receiving goods on behalf of the principle is also a recipient. The question the arises, as to what happens when an agent who receives certain goods on behalf of the principle and subsequently gives it to the principle[18]. In this case, one would argue that the position is clearly laid out in Schedule I entry 3(b), that such

transaction is deemed to be a supply, even when made without consideration[19]. However, this may not necessarily be the case, and one is required to look into the intention of the legislature behind the said provision. The purpose of this provision was to ensure avoidance of tax evasion by persons through principle agent relationship. For instance, a person from Maharashtra may order goods from Gujarat and get them delivered to his agent in Gujarat, who would then supply the goods to his principle, thereby evading taxes.

Assuming if the aforesaid entry was applicable to Mutuality transactions, it would mean that the principal will be taxed twice, once when the goods are actually purchased by the agent, and second time when such goods are merely availed from the agent. In other words, it simply means that the principal is made to pay taxes for availing his own goods. It is absolutely unreasonable and even absurd that a person is being taxed for availing/using his own goods. It was only to do away with such absurdity, that the Doctrine of Mutuality was devised by the common law courts, which was subsequently adopted by courts worldwide.

It is essential to note that the definitions of both, "supplier" as well as "recipient" nowhere mentions that a member and an association or like entities shall be distinct persons. Merely because an "association of persons" is included under the definition of "person" does not imply that such persons are distinct persons. Therefore, as a general principle of interpretation of a taxing statute, the benefit of doubt in case of ambiguity must be given in favour of the assesse. Hence, GST must not be applicable in case of clubs, associations, cooperative societies, etc..

2.2 Activities deemed to be supply

Schedule I and Schedule II deal with activities that are deemed to be supply of goods and services. Clause 7 of Schedule II deems supply of "goods" by any "unincorporated" association or body of persons to a member thereof for cash, deferred payment or other valuable consideration to be treated as taxable under the GST law[20]. Therefore, it can be observed that the ambit of the term "supply" has been kept very broad, to include almost any and every transaction within the definition of supply. However, it must be noted that this clause finds its source from 366 (29A) and is replicated verbatim herein[21]. The Hon'ble Supreme Court in Calcutta club case keenly observed that clause (e) of Article 366(29A) only ropes in unincorporated entities. This was done based on the presumption that incorporated entities were already within the tax net, which was negated by the Hon'ble Supreme Court and clarified that the incorporated entities were not already within scope of the tax[22]. This created an odd situation wherein the unincorporated entities, performing the same functions are liable to pay tax on goods

supplied to its own members, whereas the incorporated entities are exempted from paying the tax.

Furthermore, only supply of "goods" by such unincorporated association or body of persons to its members has been sought to be brought under the tax net of GST. Although one may argue that Schedule II para 5 (e)[23] covers the aspect pertaining to services, however it does not specify that the same is applicable to association or body of persons providing services to its members. In absence of such specific provision to that effect, it cannot be presumed to include such category of persons, since essentially such an association or body of persons and the members are one and the same, and one cannot agree to provide services to oneself. In absence of a specific provision mandating taxing of supply of services by unincorporated associations or body of persons to its members, such transactions cannot be subjected to GST. This creates a niche class of persons who are firstly unincorporated and secondly supplying goods to its members. Therefore, selectively charging GST for supply of goods is unreasonable. I believe this cannot be the intended purpose of a legislation to target a specific sub-category of persons for the levy of GST, without any reasonable classification. This is violative of the Constitutional provisions of Article 14, and hence, must be unconstitutional.

3.0 Constitution of India vis-à-vis GST Law

GST authorities have regularly relied on Article 366 (29A) of the Constitution of India to deny the benefit of Doctrine of Mutuality to the GST law[24]. Therefore, it is essential to assess the validity of Article 366(29A) which was introduced in the context of service tax[25]. The amendment was introduced to include certain entities that were exempted under the service tax regime, to broaden the applicability of service tax by overturning certain decisions of the Supreme court[26]. To this effect, the Parliament listed down 6 transactions and termed them to be "deemed sales", thereby liable to service tax. One such deeming provision intended to include supply of goods by an unincorporated body or association of persons to its members[27] This gave rise to a massive debate, as to whether this amendment had done away with the doctrine of mutuality, which was recently put to rest by Hon'ble Supreme Court in *State of West Bengal & Ors. v. Calcutta Club Limited*[28]. While analysing the 46th amendment and the provisions of Article 366(29A), the Hon'ble Supreme Court rightly answered the question in negative. Meaning thereby, that although the amendment attempted to do away with the Doctrine of Mutuality, it failed to do so, and the same continues to apply post the 46th Amendment act which introduced (29A) under Article 366.

The Hon'ble Supreme Court took note of English law precedents like the case of *Graff v. Evans*[29] and *Trebanog Working Men's Club and Institute Ltd. v. Macdonald*[30] to state that a member could be the vendor as well as the purchaser. Moreover, the form of a club is irrelevant as long as it is holding the property as an agent, for and on behalf of the members[31]. The Court went a step further to substantiate this point by relying on the case of *Cricket Club of India Ltd. v. Bombay Labour Union*[32] wherein the Hon'ble Supreme Court had observed that although the CCIL was incorporated under the companies act, the Industrial Disputes act was not applicable to the same due to the nature of its activities and membership process. The court treated it to be a member's club and a "self-serving institution." Subsequently, the court referred to the decision in *Bangalore Club v. Commissioner of Income Tax and Anr*[33]. wherein the concept of Mutuality is discussed in detail and went on to hold that where there is a commonality between contributors of funds and participators in the activity, a complete identity between the two is then established[34]. Furthermore, the court held that since the members perform the activities of the club for themselves, the fact that they incorporate a legal entity to do it for them makes no difference[35].

Therefore it is clear that the Hon'ble Supreme Court has cleared the air of confusion with respect to applicability of Doctrine of Mutuality to clubs, associations, etc.. although one may argue that the decision of Calcutta Club's case was with respect to service tax, and has no applicability under the GST regime. Moreover, the GST law has either done away with many of the concepts such as "sale", or overcome the lacuna in the erstwhile laws, such as the definition of "goods", which did not bare the fruits as desired by the 46th Amendment. However, it is essential to note that although the GST law has done away with the previous lacuna, it has come with its own set of flaws, as pointed above, which still leads to similar conclusion as to applicability of the Doctrine of Mutuality.

4.0 Conclusion

The tax authorities have come a long way from the previous service tax regime post enactment of the GST law. However, it seems that the authorities are forcing tax in certain areas in order to boost its own revenue. Similar case is the attempt to tax association or body of persons and its members. In doing so, the authorities are required to go beyond the long established doctrines of equity as well as create deeming provisions the go beyond logic in order to suit its own interests.

On the basis of analysis provided above, the doctrine of Mutuality must be applicable even under GST, since presently, as the law stands, it is not as iron clad as it

purports itself to be. The GST law falters on the same count where the Service tax did, i.e., on including only "unincorporated" association or body of persons within the tax net. Secondly, the definition of recipient as well as supplier fails to mention if members and association or body of persons are distinct entities and the same cannot be presumed merely on the basis of s. 2(84)(f). Thirdly, since the supplier as well as the recipient are not distinct persons, there cannot be a supply. Assuming that both recipient and supplier are considered to be distinct persons, yet relying upon the case of *State of West Bengal v. Calcutta*.

Endnotes

1. (Invest India, 2020)
2. *Id*
3. *Id*
4. Central Board of Excise & Customs, p. 1; Invest India, 2020
5. Styles (Surveyor of Taxes) v. New York Life Insurance Company, 1889
6. *Id*
7. 2000) 243 ITR 89 (SC); the Hon'ble Supreme Court laid down tests for mutuality as follows
(i) The contributors to the fund are the same persons who are also the recipients from the fund.
(ii) The entity is incorporated only for the convenience of the members i.e. the object should not be to earn profit.
(iii) There is an impossibility that the contributors would derive profit from an activity where they are the contributors as well as the recipients of the funds
8. (Chelmsford Club v. CIT (2000) 243 ITR 89 (SC), 2000) (Bangalore Club v. Commissioner of Income Tax and Anr. (2013) 5 SCC 509, 2013 Income Tax Case]; (State of West Bengal v. Calcutta Club Association 2019 SCC OnLine SC 1291, 2019) [Service tax
9. (ITO, Jaipur v. Jaipur Club Ltd, Jaipur, Income Tax Appellate Tribunal, Jaipur, 2013
10. The Central Goods And Services Tax Act, 2017 (NO. 12 OF 2017), s. 7, CGST Act.
11. (Central Board Of Excise & Customs
12. The Central Goods And Services Tax Act, 2017 (NO. 12 OF 2017), Schedule I, CGST Act
13. The Central Goods And Services Tax Act, 2017 (NO. 12 OF 2017), s. 2, Clause 17, sub-clause (e), CGST Act
14. The Central Goods And Services Tax Act, 2017 (NO. 12 OF 2017), s. 2, Clause 31, sub-clause (a), CGST Act.
15. (Bangalore Club v. Commissioner of Income Tax and Anr. (2013) 5 SCC 509, 2013); (Thomas (Inspector of Taxes) v. Richard Evans & Co. Ltd. (1927) 1 K.B. 33, 1927)
16. The Central Goods And Services Tax Act, 2017 (NO. 12 OF 2017), s. 2, Clause 93, CGST Act

17. The Central Goods And Services Tax Act, 2017 (NO. 12 OF 2017), s. 2, Clause 5, CGST Act.
18. The Central Goods And Services Tax Act, 2017 (NO. 12 OF 2017), s. 2, Clause 105, CGST Act
19. The Central Goods And Services Tax Act, 2017 (NO. 12 OF 2017), Schedule I, Entry 3, clause (b), CGST Act.
20. The Central Goods And Services Tax Act, 2017 (NO. 12 OF 2017), Schedule II, Clause 7, CGST Act.
21. Constitution of India, Nov. 26, 1949, Art. 366(29A)(e) (Ind)
22. State of West Bengal v. Calcutta Club Association 2019 SCC OnLine SC 1291, 2019
23. 5. Supply of services: The following shall be treated as supply of services, namely:— (e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act;
24. IN RE: Rotary Club Of Mumbai Airman Point, 2019 ACR 463 AAR Maharashtra); (Vaishnavi Splendour Homeowners Welfare Association KAR/AAAR/Appeal-10/2019-20).
25. The Constitution (Forty-sixth Amendment) Act, 1982, Statement of Objects and Reasons
26. *Id*
27. The Central Goods And Services Tax Act, 2017 (NO. 12 OF 2017), Schedule II, Clause 7, CGST Act
28. 2019 SCC OnLine SC 1291
29. (1882) 8 Q.B. 373
30. (1940) 1 K.B. 576
31. *State of West Bengal v. Calcutta Club Limited*, ¶ 26 & 27, 2019 SCC OnLine SC 1291
32. (1969) 1 SCR 600
33. (2013) 5 SCC 509
34. State of West Bengal v. Calcutta Club Association 2019 SCC OnLine SC 1291, 2019
35. *Id*