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Concept of Mutuality – A Real Concern

- Contributed by CA Sri Harsha

The recent decision of three-member bench of Honourable Supreme Court in the matter of Calcutta Club Limited[1] with respect to the concept of mutuality in tax laws has ignited more concerns rather settling the dust. The said decision has great impact on the current goods and service tax regime, (GST) where the clubs might take this judgement as a precedent and stop paying tax, which may give birth to another round of decades of litigation. This article tries to deal with the concept of Mutuality and its applicability under the GST regime.

History of Taxation based on the concept of Mutuality :

There is a lot of history on taxation pertaining to taxation based on mutuality whether incorporated or unincorporated. The state taxation authorities considering the need for resources and to put a check to tax evasion, have always tried to tax on such kind of transactions which are not normally understood as 'sale'. One of such items being, the tax on supply of goods by a club (incorporated or not) to its members for cash, deferred payment or other valuable consideration. The tax on the said transaction compelled such clubs to approach various courts. The main line of defence for the clubs was that they operate on principle of mutuality and basis such principle there would not be any tax on supplies made to its members. The principle of mutuality, in simple words, means, 'No man can trade with himself; he cannot make, in what is its true sense or meaning, taxable profit by dealing with himself'. Since in the case of club, there would be complete identity between the contributors and beneficiaries, there cannot be any profit by dealing with oneself. In other words, the underlining philosophy of principle of mutuality is that there are no two persons involved and there is always one only. In the absence of two persons, which is prerequisite for any tax[2] to be applicable, the clubs always argued that they are not subject to tax.

Amending the State Tax laws without amending the Constitution – A Futile Exercise:

Understanding this, the state tax authorities started amending their respective tax laws, stating that a club is a dealer, the activity of club is a business (even though there is no profit motive) and also including the activity of supply of goods by clubs to its members for a consideration in the definition of 'sale'. Despite amendments to the said expressions in their respective state laws, the clubs had approached courts stating that the tax authorities cannot by just amending the definition of 'sale' in their acts propose tax on such transactions, when the expression 'sale' used in Entry 54 of List II[3] still refers to normal meaning of 'sale'. Eventually the matters have reached the Honourable Supreme Court and in one of the matters of Young Men's Indian Association[4], the Court has held that there is no transfer of property from one to another in spite of definition contained in the sales tax law. We will come back in a moment to this.

Prior to this judgement a three-member bench[5] of Supreme Court had an occasion to deal with taxation of supplies made by co-operative society (which is registered co-operative society) to its members in this

[1] [2019] 110 taxmann.com 47 (SC)
[2] Unless specific language is brought in tax laws stating that both of them are distinct
[3] Schedule VII to Constitution of India
[4] 1970 (1) Supreme Court Cases 462
[5] Where Justice J C Shah was one of the members

matter of Enfield India Co-operative Canteen Limited[6]. The Court has held that the expression 'sale' which is used in Entry 54 of List II has to be understood in its widest terms to include sales made by club. Also, the Court proceeded to state a registered society is a body corporate with power to hold property and cannot be assumed that property which it holds is property of which its members are owners paving a way to, thinking that the clubs/societies once being incorporated become distinct from its members. It also made a remark stating that in case of unincorporated club, there is no distinction among members and club and in such cases, there could not be any sale in absence of two separate persons. Also, it stated that if an incorporated club can substantiate on facts that it acts as an agent of the members, then the principle of mutuality still holds good and there cannot be any tax, despite of the fact of incorporation. Since there was nothing to show them that the society is acting as agent or trustee, the tax was held to be applicable in that case.

Now, let's go back to the matter of Young Men's Indian Association (supra), the six member-bench of Supreme Court has distinguished the judgement of Enfield India Co-operative Canteen Limited (supra) where in it was stated that if the club even though a distinct legal entity is only acting as an agent for its members in matters of supply of various preparations to them no sale would be involved as element of transfer would be completely absent.

Further, Justice J C Shah has passed a dissenting judgment[7] in Young Men's India Association (supra), wherein he has highlighted that the reliance placed on the English judgements in the matter of Graff v Evans and Trebanog Working Men's Club and Institute Limited vs Macdonald to understand the principle of mutuality do not apply to the taxation statues, as such judgments were pertaining to the matter of quasi-criminal nature.

He also stated that liability to tax of the transaction strictly depends upon its legal form. If an incorporated members clubs supplies its property to its members at a fixed tariff, the transaction would be sale even though the transaction is on no-profit basis. Where, however, the club is merely acting on behalf of the members to make available to them refreshments, beverages and other articles, the transaction will not be regarded as sale, for the club is the agency through which the members have arranged that the refreshments, beverages and other articles should be made available. *The test in each case is whether the club transfers property belonging to it for a price or the club acts as agent for making available property belonging to its members.* As the facts involved in Young Men's India Association indicated that the association is not transferring the property belonging to them but was merely acting as agent for and on behalf of members, there would not be any tax was concluded by Justice J C Shah.

61st Law Commission Report:

Having lost the issue before the Supreme Court in the matter of Young Men's Indian Association, the Ministry of Law and Justice has made a reference to Law Commission to provide a report on certain problems connected with the levy of tax on sale of goods. The Law Commission vide its 61st Report on May 1974 has stated, two aspects amongst other. One, it re-emphasised[8] the view of Justice J C Shah as far as the taxation of supplies made by unincorporated clubs. Two, it stated, the tax cannot be levied on supplies made by incorporated clubs unless the expression 'tax on sale' as existing in Entry 54 of List II is amended to include such sales in its ambit by amending Constitution. Finally, the Law Commission

[6] (1968) 2 SCR 421

[7] Having held that Graff v Evans and related judgments do not apply to the taxation statutes in the matter of Enfield India Co-operative Canteen Limited, has gone on record to make his dissenting judgment to such limited extent.

[8] No specific dissent on the judgment was made in the report

recommended no amendment to Constitution on the reason that the clubs or association would not be large and may discourage the co-operative movement.

46th Amendment Act:

However, the Government has proceeded with amendment to Constitution of India vide The Constitution (Forty Sixth Amendment) Act, 1982, to introduce a new definition for the expression 'tax on sale or purchase of goods'. A new article in the form of 366(29-A) has been introduced to lay down the meaning of the said expression, wherein six instances of sale which are not normally understood as sale are brought in. One of the such entries, deals with, a tax on supply of goods by an unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuable consideration.

Para 3 of Statement of Objects and Reasons appended to Constitution (Forty Sixth Amendment) Act, 1982 specifically states that 'Similarly, while sale by a registered club or other association of persons (the club or association of persons having corporate status) to its members is taxable, sales by an unincorporated club or association of persons to its members is not taxable as such club or association, in law, has no separate existence from that of the members'. In light of such understanding that in case of incorporated clubs, since the members and club are distinct (for the sole reason of being incorporated), the Government may have thought there is no specific requirement to mention in the expression of 'tax on sale or purchase of goods' that sale made by incorporated associations to its members also as an instance. Since the Law Commission and Justice J C Shah has made observations that the unincorporated clubs and its members are same, the Government has chosen to specifically mention that sales made by unincorporated club in the ambit of expression 'tax on sale or purchase of goods'.

Understanding Calcutta Club Limited:
(Sales Tax)

With this brief history, let us now proceed to dissect the current judgment of Supreme Court in the matter of Calcutta Club Limited (supra).

Before Tribunal and High Court:

The sales tax authorities had issued notice proposing tax on the sales made by Calcutta Club Limited (Calcutta Club) to its members. The notices were appealed before the Tribunal stating that there could not be any tax because the Calcutta Club is acting as an agent to its members and there is only reimbursement of expenses and no consideration. The Tribunal after referring to various judgments has held that there cannot be any tax on sales made by Calcutta Club to its permanent members since the suppliers and recipients are same persons and there is no exchange of consideration. The Revenue has filed a writ petition before High Court challenging the order of Tribunal. The High Court opined that the decision in the matters of Automobile Association of Eastern India[9] is not a precedent and on reading of 46th Amendment Act and definition in sales tax law, sale of goods by Club to its members would be exigible to tax ***but in the case in hand, the drinks and beverages were purchased from the market by Club as agent of members. The High Court further opined that in the factual matrix the element of mutuality is not obliterated and held that no tax is payable by Calcutta Club for sales made to its members.***

Before Division Bench of Supreme Court:

The Revenue took the matter before the Division Bench of Supreme Court. The Division Bench after referring to various judgments on principal of mutuality has stated that the decisions of the Supreme

[9] (2002) 40 STA 154 (SC) - wherein it was held by Supreme Court post amendment to Constitution, the levy of tax can be sustained and for the period prior to the amendment, since the decision in the matter of Young Men's India Association has not answered the question as to whether tax is payable and no adjudication has been made to such an extent, it directed the appellants to pursue the remedies available

Court in the matter of Fateh Maidan Club[10] and Cosmopolitan Club[11] have drawn a distinction when a club acts as an agent of its members and when the property of club is transferred to its members (please recall the observation of Justice J C Shah in his dissenting opinion in the matter of Young Men's Indian Association). The Division Bench continued to state that the said distinction even though accepted in the said two judgments, however the said decisions do not elucidate and clearly expound, ***when the club is stated and could be held as acting as an agent of the members and therefore, would not be construed as a party which had sold the goods. These are significant and relevant facets which much be elucidated and clarified so that there is no ambiguity in appreciating and understanding the aforesaid concepts 'acting as an agent of the members' or when the property is transferred in the goods sold to the members.***

Basis above, the Division Bench has referred the matter to the larger bench in view of the law laid down in Cosmopolitan Club (supra) and Fateh Maidan Club (supra), since none of the judgments really lay down whether the doctrine of mutuality would apply or not but proceed on the said principle relying on earlier judgments. Accordingly, the Division Bench has referred the matter to the larger bench to answer specifically as to whether the doctrine of mutuality is still applicable to incorporated clubs or any clubs after the 46th Amendment Act and whether the judgment of Young Men's Indian Association still holds good after the 46th Amendment Act.

Before Larger Bench of Supreme Court:

The Larger Bench after referring to Graff v Evans (supra), Trebanog Working Men's Club and Institute Limited v Macdonald (supra), 61st Law Commission Report, 46th Amendment Act, Young Men's Indian Association (supra), Enfield India Co-operative Canteen Limited (supra) has held that if at all the 46th Amendment Act tried to bring any sale in its ambit, it is the sale by unincorporated club to its members and not the incorporated clubs. This is for the reason that Article 366(29-A)(e) only deals with tax on supply of goods by unincorporated association or body of persons and not incorporated associations.

The Larger Bench brushed aside the argument of Revenue's reliance on the definition of 'person' and stating that incorporated clubs by incorporation would be distinct from its members and hence there is no necessity to include them in the ambit of Article 366 (29-A)(e), by holding that concept of separate legal entity as applicable to normal companies would not be applicable for clubs even though they are incorporated. The Larger Bench has placed reliance on Trebanog Working Men's Club and Cricket Club of India Limited v Bombay Labour Union[12] to support their conclusion that a corporate structure would not create a distinctness between the members and club. However, the Larger Bench has not distinguished the concept of separate legal entity as recognized by Supreme Court in the matter of Enfield India Limited Co-operative Canteen Limited (supra).

Further, the Larger Bench has stated that the 46th Amendment Act has not dealt with the legal principle enunciated by Supreme Court in the matter of Young Men's Indian Association[13] in entirety and proceeded to make an amendment based on a limited perspective. understanding. The understanding of framers that sales made by incorporated club to its members as taxable is incorrect and accordingly incorporated clubs are not in the ambit of Article 3666(29-A)(e) .

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[10] (2017) 5 Supreme Court Cases 638

[11] (2017) 5 Supreme Court Cases 635

[12] (1969) 1 SCR 600

[13] The said judgment has held that there cannot be tax on two grounds. One the definition of 'tax on sale' as per the Constitution is not in sync with the definition of 'sale' as per sales tax laws. Two, even though the club is incorporated and treated as distinct entity, so long as the club acts as agent or trustee to its members, the principal of mutuality does not get lost. 46th Amendment has only addressed one aspect, the definition of 'sale' and left the other one unaddressed.

Then reverting to the position of taxability on supplies made by unincorporated club to its members, the Larger Bench stated that the definition of 'consideration' as per the Indian Contract Act, 1872 recognises two different persons and since the Young Men's Indian Association has held that in light of doctrine of mutuality, there is no transaction between club and its members, there cannot be any sale of goods to itself and conclude that the ratio of Young Men's Indian Association has not been done away with by the limited fiction introduced by Article 366 (29-A)(e).

Further, the larger bench based on certain definitions under Income Tax Act, 1961 has stressed that if at all the principle of mutuality is to be excluded, then specific language as used in Income Tax Act, 1961 has to be used and failure of doing so in Article 366(29-A)(e), the principal still holds good for the purposes of sales tax.

Understanding Ranchi Club Limited & Sport Club of Gujarat Limited:
(Service Tax)

Along with Calcutta Club Limited, the Larger Bench is also asked to decide the applicability of service tax in case of provision of services by Clubs to its members. The issue in both the matters was that the clubs principal plea was that there are no two separate persons for the purpose of levy of service tax and also placed reliance on Young Men's Indian Association (supra) stated before respective High Courts that there is no service tax payable.

The Revenue before the Larger Bench argued that the definition of 'club or association' excludes anybody established or constituted by or under any law for the time being in force and the clubs or association cannot be said that they are established or constituted and accordingly they fall out of the exclusion limb and liable for tax. The Larger Bench set aside such argument by stating that the expression 'constituted' takes care of the clubs or association which are constituted under respective acts even though they may not be said to be established. Hence, the Larger Bench held that there is no obligation on clubs or association which are incorporated to pay service tax on services provided to its members (this is not because of principle of mutuality, but because of specific exclusion in the taxable service).

However, things have changed after the advent of negative list which was effective from 01.07.2012. Post introduction of negative list, the definition of 'service' was made wide in its ambit to cover every possible economic activity. Explanation 3 was inserted to definition of 'service' in Section 65B(44) of Finance Act, 1994 to state that in case of unincorporated associations or body of persons and their members are statutorily to be treated as distinct persons.

The Larger Bench when dealing with taxation of services provided by club to its members post negative list has stated that since the language used in Explanation 3 only deals with unincorporated clubs or association and does not deal with incorporated clubs, the levy of tax for services provided by incorporated club may not exist since it may be assumed that the legislature has continued with pre-2012 scheme of not taxing clubs when they are in the incorporated form.

However, the decision is silent about the taxability of services provided by unincorporated clubs to its members in light of the Explanation 3 to Section 65B(44).

Unanswered Questions:

For Calcutta Club Limited – Sales Tax:

- The Larger Bench devoted most part to incorporated clubs since they were the majority and held that they are not covered in the ambit of Article 366(29-A). While so there is no clear answer as to why there would not be any tax in case of unincorporated club to its members even after the

46th Amendment. The answer if one may derive is by way of reference to definition of 'consideration' and reliance on Young Men's Indian Association (a judgment which was pertaining to period prior to 46th Amendment). Hence, to this extent the judgment may be needed to be revisited.

- The basic feature that the members and club are distinct, once the club is incorporated cannot be dispensed with especially, when unincorporated associations or clubs are treated as different from its members for the taxation purposes. The brushing away of the basic feature of separate legal entity by the larger bench may be questioned in the subsequent judgments of Supreme Court.

- Further, the Larger Bench has nowhere made an extensive analysis on the aspect for which a reference is made by Division Bench, that is under what circumstances, the club is treated as an agent and when it is said to be there is a transfer of property in goods from club., a long period of litigation is awaited

For Ranchi Club Limited & Sports Club of Gujarat Limited – Service Tax:

Pre-Negative List:

- There was no discussion on taxability of services provided by unincorporated clubs or association to its members, since both Ranchi Club and Sport Club are incorporated entities. The reasoning of Justice J C Shah in the matter of Enfield India Co-operative Canteen Limited (supra) may apply here and can be stated that in case of unincorporated club, the club and members are same and in absence of two different persons and in absence of deeming provision as existed for the purposes of sales tax in light of Article 366 (29-A)(e), there would not be any tax which may be payable by unincorporated clubs or association. This position would also have to be seen in conjunction with the explanation to Section 65(121) which specifically states that taxable service would include services provided by unincorporated association or body of persons to members. However, there is nothing in statute which would bring on to say that unincorporated association and members thereof are two distinct persons. Hence, the position as settled in the matter of Enfield India Co-operative Canteen Limited (supra) may be still pressed.

Post-Negative List:

- Once negative list is introduced, the definition of 'service' is laid down in a wider ambit to bring in every possible economic activity to tax. In light of the paradigm shift in taxation, the larger bench's view that the services provided by club in its incorporated form is not taxable as in line with pre-2012 scheme may come up for challenge in future. This is for the reason post 2012, what is stated is not taxable and everything else is taxable. The reasoning that the clubs are acting as an agent to its members would be a safer bet to make the incorporated clubs out of tax net .

- The decision is silent about the taxability of services provided by unincorporated clubs to its members. This is important because there existed a specific language in form of Explanation 3 to Section 65B(44) to treat the unincorporated clubs and its members as distinct persons.

Applying the Judgment to GST[14] regime:

Applying the ratio of the larger bench judgment to GST regime would be quite a challenging task

The definition of 'business' as provided under Section 2(17) of CT Act[15] has been defined to provide that any provision by a club, association, society, or any such body of the facilities or benefits to its members shall be considered to a 'business'. In this definition, unlike Article 366(29-A)(e) or the provisions of erstwhile value added tax/service tax law, the language is not limited to unincorporated clubs or associations.

However, the term 'supply' as laid down vide Section 7 of CT Act does not have any such express provision to deem that the clubs or associations and its members are treated as distinct persons for the purpose of 'supply' and for other provisions of the Act. On the contrary, under the erstwhile service tax law, the Explanation 3 to the definition of 'service' sought to provide that unincorporated club or association and its members are treated as distinct persons.

Further, the term 'person' as defined under Section 2(84) of CT Act is similar to the definition contained in erstwhile value added tax/service tax law, and has not provided that mutual entities and their members are different or distinct persons for the purpose of GST law. ***Therefore, in this context the issue that would arise is whether express provision in the definition of 'business' alone is sufficient to bring members' club or association supplying goods or services to its members within the ambit of supply?***

The answer may be 'yes', because, the challenge as existed in sales tax regime was inconsistency between the definition of 'sale' as per the sales tax laws and Entry 54 of List II. Because of which, there was a requirement to amend the Constitution to iron out such inconsistencies. However, under GST laws, there is no such inconsistency.

Further, Section 7(1A) of CT Act provides certain activities or transactions which constitute as supply under sub-section (1) of section 7 would be listed in schedule II which shall be either treated as supply of goods or supply of services as referred in the said schedule. Clause 7 of this schedule provide that the supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuation considered would be considered as supply of goods. In this clause the language used is limited to 'unincorporated association or body of persons'. Further, this clause is limited to supply of goods and is not extended to services.

Further, the exemptions under Entry 77 and 77A of NN 12/17-CT(R) provides for an exemption for specified services undertaken by an unincorporated body or a non-profit entity registered under any law. The use of the phrase 'non-profit entity registered under any law' may signify that services of both unincorporated and incorporated associations are subject to tax, but exemption is extended for the services specified in the said entries.

Let's summarise:

- The expression 'business' includes in its ambit any provision by club, association, society, or any such body of the facilities or benefits to its members. This in a way signifies that club and members are different and not the same.
- The meaning of 'supply' does not specifically state that provision of goods or services by club, association, society or any such body to its members as 'supply'. However, the language used

[14] Goods and Services Tax

[15] Central Goods & Services Tax Act, 2017 – A reference to this act means a simultaneous reference to State Goods & Services Tax Act, 2017, unless expressly stated otherwise.

therein is *'**all forms** of supply of goods or services or both **such as** …..'*. Hence, it may be argued that the expression 'such as' is meant to illustrate and covers the supplies made by club to its members even though a specific mention was not made therein. This is especially, when the definition of 'sale' in erstwhile laws specifically included such activities (leaving the taxability aspect apart).

- Entry 7 of Schedule II specifies that supply of goods by any unincorporated association or body of persons to a member thereof for cash, deferred payment or other valuation considered would be considered as supply of goods. Hence, the legislature made it clear that if an unincorporated association or body of persons supply goods, then such supply shall be treated as supply of goods. This entry resolves two issues. One, it states that the unincorporated associations or body of persons engaged in supply of goods will be treated as supply of goods and all provisions of CT Act qua goods will be applicable to such transactions. In all other instances, the supplies will be treated as services and taxable as services.

- Exemption is carved out for unincorporated or non-profit entities engaged in provision of certain services subject to certain conditions is provide vide Entry 77 and 77A of NN 12/17-CT(R). This also signifies that un-incorporated entities and incorporated entities are treated as separate from its members and there is enough language akin to Income Tax Act, 1961 to exclude the principle of mutuality.

We also believe that every argument taken above can be set aside by taking diametrically opposite line of argument and we respect the same and also recognise that there is a lot of under supply of language and inconsistencies in the language used which signifies an abundant room for clarifications and litigations.

Applying concept of Agency or Trustee between Clubs and Members – GST regime:

Schedule I read with Section 7(1) of CT Act provides for activities to be treated as supply even if made without consideration, clause 3 provided to treat the supply of goods between agent and principal with or without consideration as deemed supply. Upon perusal of this clause, the supply of goods by an agent to the principal would be deemed to be a supply when the agent undertakes to receive such goods on behalf of the principal. This clause also does not cover services within its ambit.

In case of supplies by members' club or association to its members, the said club or association could be said to be an agent of the members. Such club or association operating on principle of mutuality can be said to have received the goods from vendors on behalf of their members and subsequently said to have supplied the said goods to the members.

The term 'agent' has been defined under Section 2(5) of the CT Act to mean a person, including a factor, broker, commission agent, arhatia, del credere agent, an auctioneer or any other mercantile agent, by whatever name called, who carries on the business of supply or receipt of goods or services or both on behalf of another. The said definition is meant to include all kinds of consignment agents that operate in a normal commercial supply chain and it does by any means indicate mutual entities within its ambit. Thus going by the definition of 'agent' and clause 3 of schedule I may not be relevant to the context of members' club or association supplying goods or services to their members.

Conclusion:

Hence, one may argue that the judgment does not directly have an impact on the taxation under GST laws or argue that judgment has direct impact on taxation under GST laws. In our view, there would certainly be an impact in cases where the club is acting as an agent to its members. In all such cases, the larger bench decision would still apply, and the principle of mutuality holds good unless specifically excluded by using language, which is absent in GST laws. Hence, in all cases, where it can be substantiated that club is acting as the agent of its members, the taxation would fail under GST laws.

However, the challenge is as to when it can be said that club carries activities as an agent of its members, which the larger bench ought to have dealt with but failed to do so in detail. This becomes a billion-dollar question and lead to lot of litigation around this aspect. The Supreme Court in any upcoming matter on this aspect has to consider the above aspect in order to settle the dust.