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## Indirect Tax

April 29, 2025

### Kerala High Court Strikes Down GST Provisions Taxing Club-Member Transactions as Unconstitutional

#### Snapshot

In a landmark ruling, the Kerala High Court struck down the provisions of Section 2(17)(e), Section 7(1)(aa), and the Explanation thereto under the CGST Act, 2017 and the KGST Act, 2017<sup>2</sup>, declaring them unconstitutional and void. The Court held that these provisions are ultra vires Articles 246A, 366(12A), and 265 of the Constitution of India, and beyond the legislative competence of Parliament and State Legislatures in their current form.

Section 7(1)(aa), introduced by Section 108 of the Finance Act, 2021, sought to override the doctrine of mutuality by deeming a person (such as a club, society, or association) and its members or constituents as distinct legal entities. It further stated that any transaction between them shall be treated as a taxable "supply" under GST. This deeming fiction directly contradicted well-established judicial precedents, including the Supreme Court's ruling in Calcutta Club Ltd. (2019), which upheld mutuality and held that no supply arises in transactions within such associations.

The Court held that these amendments artificially expanded the scope of 'supply', thereby impermissibly altering the fundamental constitutional construct of GST, which is a tax on transactions between two distinct persons. The Court emphasized that unless the Constitution itself is amended to override the principle of mutuality, the legislature cannot, through a mere statutory amendment, bring such intra-member transactions under the tax net.

Accordingly, the Court quashed the retrospective application of the amendment and restored the pre-existing legal position that transactions between clubs/associations and their members are not taxable under GST, thereby reaffirming the doctrine of mutuality.

#### Background & Context

The Kerala State Branch of the Indian Medical Association (IMA)<sup>3</sup> operates various mutual benefit schemes for its member-doctors, including Social Security Schemes, Professional Disability Support Scheme, Professional Protection Scheme, Kerala Health Scheme, and others. These schemes function as self-help systems where members contribute admission fees and annual subscriptions to create funds that provide financial assistance to fellow doctors and their families in cases of death, disability, legal issues, and specified diseases.

The Petitioner considered its activities exempt from Goods and Services Tax (GST) based on the principle of "mutuality" – a well-established doctrine recognized by courts that precludes taxation on transactions between an association and its members since they are considered a single entity. However, amended to Sections 2(17)(e) and 7(1)(aa) of both the Central and Kerala GST Acts, introducing provisions that:

- Deemed activities between an association and its members as taxable "supply"
- Explicitly treated associations and their members as separate persons
- Applied these changes retroactively from July 1, 2017 (the date of GST implementation)

Facing potential tax demands and enforcement actions, the petitioner filed a writ petition

<sup>1</sup> Central goods and Service Tax Act, 2017

<sup>2</sup> Kerala Goods and Services Tax Act, 2017

<sup>3</sup> Hereinafter referred to as "Petitioner"

challenging the constitutional validity of these amendments. The Single Judge upheld the amendments but struck down their retroactive application, leading to appeals by both parties to the divisional Bench of the Court.

### Petitioners' Arguments

#### Violation of doctrine of mutuality:

The petitioners<sup>4</sup> contended that Section 7(1) (aa) of the CGST Act, 2017, is unconstitutional as it infringes upon the doctrine of mutuality a well-established legal and tax principle which asserts that no person or entity can engage in a taxable transaction with oneself. This doctrine, grounded in the idea that an association and its members are not distinct legal entities for the purpose of taxation, excludes transactions between members of a club, society, or association from the scope of "supply," as these are internal dealings rather than exchanges between separate parties. However, Section 7(1) (aa), introduced through the Finance Act, 2021, artificially treats clubs and their members as distinct persons, thereby overriding the mutuality principle. In support of this argument, the Indian Medical Association (IMA) referred to the landmark judgment in *Calcutta Club Ltd. v. State of West Bengal* (2019)<sup>5</sup>, where the Hon'ble Supreme Court upheld the doctrine of mutuality even in the post-46th Constitutional Amendment context. Additionally, the petitioner relied on *Ranchi Club v. Chief Commissioner of Central Excise & Service Tax* (2012)<sup>6</sup>, which reinforced the position that a valid "supply" under tax laws necessitates the presence of two distinct persons. By deeming intra-association transactions as taxable supplies, the 2021 amendment not only disregards judicial precedent but also impermissibly broadens the constitutional scope of the term "supply," thereby violating the core principle of mutuality.

#### Aspect of GST being on "supply":

The petitioner contended that the constitutional framework under Article 246A read with Article 366(12A) permits the imposition of GST only on a "supply of goods or services or both" between two distinct persons. The plain and ordinary meaning of "supply" presupposes a transaction between one person and another; it excludes the notion of a supply by a person to oneself. Accordingly, in the context of clubs or associations operating under the principle of mutuality, where the entity and its members are one and the same, no "supply" as constitutionally envisaged can be said to occur. The petitioner further argued that the legislative competence conferred by the Constitution does not extend to artificially deeming such mutual transactions as taxable supplies. Attempting to do so by statutory fiction—such as through the insertion of Section 7(1)(aa) of the CGST Act via the Finance Act, 2021—is an impermissible expansion of the taxing power, which must remain confined to its constitutional contours. Relying on the ratio laid down in *Gannon Dunkerley*<sup>7</sup> and *Calcutta Club Ltd. (Supra)*, the petitioner emphasized that legislative power under the Constitution cannot be broadened through mere statutory definitions when the meaning of the term "supply" is already settled in law. Thus, any attempt to expand the constitutional scope of "supply" via a statutory amendment amounts to a legislative overreach and violates the doctrine of mutuality embedded in Indian jurisprudence.

<sup>4</sup> Indian Medical Association, Kerala State Branch V/s Union Of India - W.A.NO.1659 OF 2024

<sup>5</sup> [2019 (29) GSTL 545 (SC)]

<sup>6</sup> 2012 SCC OnLine 306 : (2012) 51 VST 369]

<sup>7</sup> [AIR 1958 SC 560]

### Enlarging scope of “supply” by amending Section 7 of CGST Act without amending Constitution:

The petitioner contended that the insertion of Section 7(1)(aa) of the CGST Act, 2017, which deems transactions between clubs/associations and their members as ‘supply’ liable to GST, amounts to an impermissible enlargement of the scope of ‘supply’ under the Act through statutory amendment. It was argued that such an expansion particularly one that disregards the well-established principle of mutuality can only be effectuated through a constitutional amendment, not mere legislative intervention. The petitioner emphasized that the 46th Amendment to the Constitution, which addressed only the supply of goods by unincorporated associations to members, left the domain of services untouched, thereby preserving the doctrine of mutuality for service-related transactions. Consequently, it was asserted that the deeming fiction created under Section 7(1)(aa), in the absence of any corresponding constitutional amendment, is unconstitutional and ultra vires the powers conferred under Article 246A read with Article 366(12A) of the Constitution, and hence, incapable of overriding the principle of mutuality as upheld by the Supreme Court in *Calcutta Club Ltd.* and other precedents.

### Challenge to retrospective application:

The petitioners strongly opposed the retrospective application of Section 7(1)(aa) of the CGST Act, 2017, introduced via the Finance Act, 2021. They submitted that while retrospective legislation may be permissible in taxation, it cannot transgress constitutional limits by being unreasonable, arbitrary, or confiscatory, thereby violating Articles 14 and 19(1)(g) of the Constitution. The amendment, they argued, introduced a new levy by overturning the long-settled doctrine of mutuality, which had consistently excluded transactions between clubs or

associations and their members from the scope of taxation.

This new levy, retrospectively made effective from 1st July 2017, resulted in substantial unforeseen prejudice to the petitioner association, which had not collected any GST from its members for prior years, acting on a bona fide understanding of settled law, particularly the Supreme Court's ruling in *Calcutta Club Ltd (Supra)*. The resultant Show Cause Notices (SCNs) demanded significant sums, interest, and penalties, including personal penalties on past office bearers. Therefore, the petitioners contended the same were oppressive and in violation of legitimate expectations.

They further contended that the amendment though styled as a “clarification” was in substance a significant and substantive departure from pre-existing law, cloaked in deceptive legislative language. Citing precedents such as *Jayam & Co. v. Assistant Commissioner*<sup>8</sup> and *Martin Lottery Agencies Ltd.*<sup>9</sup>, the petitioners maintained that a substantive change cannot be passed off as a clarificatory one and retrospectively imposed.

Finally, the petitioners relied on the Shome Committee Report and the Damodaran Committee Report, both of which condemned retrospective tax laws as damaging to investor confidence and violative of fairness and the rule of law. They asserted that such retroactive tax provisions should only be invoked in the rarest of rare cases, and not to rewrite settled legal principles dating back decades. Hence, they urged the Court to strike down the retrospective effect as being manifestly arbitrary, disproportionate, and in gross violation of constitutional norms.

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<sup>8</sup> [(2016) 15 SCC 125]

<sup>9</sup> [(2009) 12 SCC 209]



### Respondents' Arguments (Department's Position)

#### Legislative power under Article 246A:

The Respondents' submitted that Article 246A of the Constitution confers a plenary and independent legislative power upon Parliament and State Legislatures to enact laws with respect to Goods and Services Tax. It was argued that this special provision, introduced by the Constitution (101st Amendment) Act, operates notwithstanding Articles 246 and 254, thereby creating a distinct constitutional foundation for GST, unconstrained by earlier legislative limitations.

He further contended that neither Article 246A nor Article 366(12A) imposes any restriction or limitation on the power of the legislature to define or expand the meaning of "supply." Consequently, the Parliament is well within its constitutional mandate to amend Section 7 of the CGST Act and to insert Section 7(1)(aa), which deems transactions between clubs/associations and their members as taxable supplies. This statutory expansion, it was argued, is a legitimate legislative exercise and not ultra vires, as the field is wide open for the legislature to identify the nature of taxable transactions and the persons subject to GST.

In support of this argument, reliance was placed on precedents such as *Karnataka Bank v. State of Andhra Pradesh*<sup>10</sup> and *State of Madhya Pradesh v. Rakesh Kohli*<sup>11</sup>, to assert that in the field of taxation, the legislature enjoys a wider latitude and that courts should be slow to strike down tax laws unless they suffer from clear constitutional infirmity.

#### Retrospective Amendment:

The respondents defended the retrospective application of Section 7(1)(aa) of the CGST Act, contending that it was introduced as a clarificatory

provision to reinforce the original legislative intent and to curb potential tax avoidance. The respondent further submitted that retrospective taxation is a well-recognised legislative tool and is constitutionally valid so long as it serves a legitimate public interest and remains within the bounds of legislative competence.

They argued that the amendment was intended to clarify the taxability of transactions between clubs/associations and their members, which had already been envisaged under the original scheme of GST laws through Section 7(1)(a) and Section 2(17)(e). It was further submitted that the Finance Act, 2021, by inserting Section 7(1)(aa) with retrospective effect from 1st July 2017, was merely seeking to affirm and clarify the tax treatment of such transactions, rather than to impose a wholly new levy.

#### Doctrine of mutuality not absolute:

The respondents contended that the doctrine of mutuality, though well-recognised in judicial pronouncements, does not enjoy the status of a constitutional mandate. It was argued that mutuality is a common law principle, evolved through case law, and as such, can be overridden or modified by a valid piece of legislation enacted under constitutional authority.

The respondents submitted that with the advent of Article 246A through the 101st Constitutional Amendment, the Parliament and State Legislatures have been vested with plenary powers to enact GST laws, including defining and expanding the concept of "supply." As such, the deeming fiction introduced through Section 7(1)(aa) which treats transactions between a club or association and its members as taxable falls squarely within the legislature's competence and represents a legitimate legislative departure from the mutuality principle.

<sup>10</sup> [(2008) 2 SCC 254]

<sup>11</sup> [(2012) 6 SC C 312]

It was further asserted that Article 366(12A), which defines “goods and services tax” as a tax on the supply of goods or services or both, does not restrict the legislature from determining the scope of supply, including the identification of the “persons” involved in such transactions. Therefore, by enacting a deeming provision that treats the association and its members as distinct for taxation purposes, the legislature has validly exercised its authority, and the doctrine of mutuality cannot be relied upon to challenge the constitutional vires of such legislation.

### **No violation of fundamental rights:**

The respondents submitted that the insertion of Section 7(1) (aa) of the CGST Act does not violate the constitutional guarantees under Articles 14, 19(1)(g), 265 or 300A. It was contended that the said provision was enacted pursuant to the legislative competence conferred under Article 246A and was aimed at clarifying the tax treatment of supplies between associations and their members, thereby ensuring tax uniformity and preventing revenue leakage.

The respondents argued that there is always a presumption in favour of the constitutionality of tax legislation, and that courts must defer to legislative wisdom unless there is a manifest constitutional infirmity. They emphasized that mere hardship or economic impact cannot be a ground to invalidate a fiscal statute, especially when the legislative object is to protect the tax base and ensure comprehensive coverage of taxable transactions.

It was also argued that the amendment does not impose any arbitrary or irrational classification, nor does it curtail any fundamental right to carry on trade or profession under Article 19(1)(g). The imposition of GST on specified transactions was a reasonable restriction in the interest of revenue and applied uniformly across similarly placed entities. Hence, there was no infringement of Article 14 (equality),

Article 265 (no tax without authority of law), or Article 300A (right to property). The respondents relied on settled jurisprudence to assert that in taxation matters, the legislature enjoys wide latitude, and the amendment in question withstands constitutional scrutiny on all counts.

### **High Court's Analysis and Ruling**

#### **Examination of GST Constitutional Scheme:**

The Hon'ble High Court undertook a detailed examination of the constitutional architecture governing GST, with particular reference to Article 246A, which empowers both Parliament and State Legislatures to make laws with respect to the Goods and Services Tax. The Court observed that the expression “supply” as used in Article 366(12A) and Article 246A must be interpreted in its ordinary and commonly accepted legal sense, and not in an artificially expanded manner.

The Court accepted the petitioner's contention that the Constitution does not permit the legislature to statutorily expand the scope of its own legislative power. It reiterated the settled constitutional principle that the power to legislate stems from the Constitution itself, and hence, any attempt by the legislature to enlarge the meaning of “supply” by creating deeming fictions—such as those under Section 7(1)(aa) of the CGST Act—cannot override or extend the constitutional definition or scope of legislative competence.

The Hon'ble Court emphasized that the Constitution, while empowering legislatures to tax “supply of goods or services or both,” does not contemplate a tax on self-supply or intra-person transactions, which was the mischief sought to be covered by the impugned amendment. Therefore, it held that such a statutory provision, insofar as it purports to alter the scope of constitutional terms or principles, must be tested against the source of the legislature's power,

and cannot survive if it seeks to unilaterally redefine the ambit of the Constitution itself.

### **Doctrine of mutuality:**

The Hon'ble High Court reaffirmed the doctrine of mutuality as a well-established principle in Indian jurisprudence, holding that for a transaction to qualify as a "supply" or "service" under GST law, there must exist two distinct persons—a supplier and a recipient. The Court relied on the authoritative judgment of the Supreme Court in *State of West Bengal v. Calcutta Club Ltd* (Supra). Wherein it was categorically held that transactions between a club or association and its members are not subject to sales tax or service tax, as such entities are not separate and distinct in the eyes of law.

The Court observed that the principle of mutuality recognizes that an association and its members form a single legal entity for the purposes of internal transactions, and that no supply can be said to take place from oneself to oneself. It was further held that this principle continued to apply even after the 46th Constitutional Amendment, which had extended the scope of "tax on sale or purchase of goods" to include supplies by unincorporated associations to their members—but only in relation to goods, and not services.

Importantly, the Court concurred with the petitioner's submission that mutuality remains undisturbed in the realm of services, and that any deviation from this established constitutional position would require an express constitutional amendment, not merely a statutory deeming fiction such as that found in Section 7(1)(aa) of the CGST Act. In doing so, the Court held that the mutuality doctrine is a substantive legal limitation that cannot be unilaterally overridden by legislative ingenuity in tax statutes.

### **Ultra Vires amendment:**

The Hon'ble Court held that the retrospective insertion of Section 7(1)(aa) of the CGST Act, 2017, introduced via the Finance Act, 2021, was ultra vires the Constitution, as it artificially expanded the scope of "supply" in a manner inconsistent with the constitutional framework under Article 246A, Article 366(12A), and Article 265.

The Court observed that the concept of "supply" under Article 366(12A) must be interpreted in accordance with its ordinary legal meaning, which necessarily contemplates a transaction between two distinct persons. By introducing a deeming fiction to treat clubs or associations and their members as separate entities for the purpose of taxation, Section 7(1)(aa) sought to override the well-established principle of mutuality, which had been constitutionally acknowledged and preserved, particularly with respect to services, even after the 46th Amendment.

The court held that a statutory amendment cannot expand or modify the scope of legislative competence as defined by the Constitution. Any such attempt to redefine constitutional expressions like "supply" must be undertaken through a constitutional amendment, not through legislation enacted under powers conferred by the very Constitution it seeks to reinterpret. As such, the Court ruled that the retrospective operation of Section 7(1)(aa) was unconstitutional, being beyond the scope of authority granted to the legislature, and in direct contravention of Article 265, which prohibits taxation without authority of law.

### **Strikes down constitutional validity of amendments:**

The Hon'ble Court categorically rejected the respondents' contention that the legislature could override the doctrine of mutuality by way of



statutory amendments. The Court held that mutuality is not merely a common law principle, but one that is deeply interwoven with constitutional concepts—particularly Articles 246A, 366(12A), and 265—and therefore cannot be legislatively displaced without a corresponding constitutional amendment.

Court note that artificial expansion of the taxing power, especially with retrospective effect, was not only ultra vires the Constitution but also violative of principles of fairness and legitimate expectation, the Court struck down Section 2(17)(e), Section 7(1)(aa), and the Explanation as unconstitutional and void.

### Rulings

#### **Retrospective GST levy Quashed:**

The Kerala High Court struck down the retrospective imposition of GST on services rendered by clubs and associations to their own members under Section 7(1)(aa) of the CGST Act. The Court held that retrospective application of the 2021 amendment, effective from 01.07.2017, is unconstitutional, being contrary to the principles of fairness, certainty, and the rule of law.

#### **Provisions declared unconstitutional:**

The Court declared the provisions of Section as Section 2(17)(e) Section 7(1)(aa) and the Explanation thereto (in both the CGST and KGST Acts) And ultra vires the Constitution and void Further, It is held that these provisions impermissibly expanded the definition of “supply”, in violation of the constitutional mandate under Article 246A and Article 366(12A). The deeming fiction of considering clubs and their members as distinct persons, for taxation purposes, was found to be beyond legislative competence.

#### **Doctrine of mutuality upheld:**

The judgment reinforced the doctrine of mutuality, recognising that no supply of goods or services can arise between an association and its members as there is no distinction in identity. Relying heavily on the Supreme Court’s decision in Calcutta Club Ltd. (2019) and earlier precedents, the Court held that the law must respect the principle that mutual associations are self-contained and cannot be taxed for internal dealings.

### KCM Comments

The Kerala High Court's decision striking down the constitutional validity of Section 2(17)(e), Section 7(1)(aa), and the Explanation thereto under the CGST and SGST Acts carries significant implications for the GST regime.

As a result of the judgment, GST shall no longer be leviable on services provided by clubs and associations to their members, reaffirming the principle of mutuality. However, it is important to underscore that this relief is confined to services; GST would continue to apply in cases involving the supply of goods by such clubs or associations to their members, as mutuality has not been extended to goods under the existing constitutional and statutory framework.

Where tax has already been discharged under the now-invalidated provisions, and where the incidence

of tax has not been passed on to the members (i.e., tax burden not transferred), affected persons may explore the remedy of seeking a refund of the tax paid, treating such payments as payments made under a mistake of law. However, refund claims will be subject to conditions prescribed under Section 54 of the CGST Act and related judicial precedents on unjust enrichment.

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### Locations

#### Ahmedabad

**Arpit Jain**

Level 11, Tower B,  
Ratnaakar Nine Square,  
Vastrapur,  
Ahmedabad - 380 015

Phone: +91 79 4910 2200  
[arpit.jain@kcmehta.com](mailto:arpit.jain@kcmehta.com)

#### Bengaluru

**Dhaval Trivedi**

4/1, Rudra Chambers, First  
Floor, 4<sup>th</sup> Main, B/W 8<sup>th</sup> & 9<sup>th</sup>  
Cross Road, Malleshwaram,  
Bengaluru - 560 003

Phone: +91 80 2356 1880  
[dhaval.trivedi@kcmehta.com](mailto:dhaval.trivedi@kcmehta.com)

#### Mumbai

**Bhadresh Vyas**

315, The Summit Business Bay,  
Nr. WEH Metro Station,  
Gundavali, Andheri East,  
Mumbai - 400 069

Phone: +91 22 2612 5834  
[bhadresh.vyas@kcmehta.com](mailto:bhadresh.vyas@kcmehta.com)

#### Vadodara

**Milin Mehta**

Meghdhanush,  
Race Course,  
Vadodara - 390 007

Phone: +91 265 2440 400  
[milin.mehta@kcmehta.com](mailto:milin.mehta@kcmehta.com)