What does Kerala High Court say in Indian Medical Association case?

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One disturbing phenomenon in tax legislations is the Damocles sword of retrospective amendments. Any law is an experiment and tax law is no exception. Any drafting error or omission found in the taxing statue, either observed during its implementation or identified by the courts, can always be corrected and there is no quarrel about the rights of the Parliament / State Legislature to do such course corrections, prospectively. But, when such corrections are done at a later date, with retrospective effect, it creates lot of uncertainty in the matter of taxation, unplanned outgo on account of taxes leaving a dent on profits earned and sometimes, the additional demand on account of retrospective amendments may well be more than the earnings. It also makes one wonder, is it worth pursuing a litigation at all against the mighty Government, as the Government can always overcome the judgement by a retrospective amendment. One recent example of such retrospective overreach is the amendment in sub-section (5) of Section 17 of the GST Act, to overcome the recent judgement of the Hon'ble Supreme Court in Safari Retreat case, in the matter of eligibility for Input Tax Credit for construction related goods and services.

The concept of "mutuality of interest" has a long history in the field of taxation. Be it sale of goods or provision of service, at least two persons are required, viz., seller and buyer and provider of service and recipient of service. One cannot sell to himself and one cannot provide service to himself. When various clubs and associations are formed for the mutual benefit of its members and if such clubs or association provides any goods or services to its members, it is long understood that it would not constitute sale or service, as the club or association, though incorporated as a separate entity is nothing but a collective of its members and there cannot be a sale or service by a club or association, to its members.

This principle has been time and reiterated in various decisions of High Courts and the Supreme Court. There has always been attempts to overcome the effect of such judgements by making a deeming fiction in the taxing statutes to overcome the doctrine of "mutuality of interest".

When GST was introduced from 1st July 2017, such a deeming fiction was failed to be created and later, by way of a retrospective amendment, clause (aa) was introduced in sub-section (1) of Section 7 of the GST Act, whereby a club or association on the one hand and its members on the other hand are deemed to be distinctive persons and the activities or transaction between them was declared as a supply and hence GST was payable.

The above provision and the retrospective effect given to it with effect from 01.07.2017 were challenged before the Kerala High Court by the Indian Medical Association. A learned single judge of the Court, in his judgement dated 23.07.2024, while upholding the constitutional validity of the above amendment, held the retrospective effect given to it as bad. In other words, the amendment was upheld prospectively.

Both, the IMA and the Government filed appeals before the Division bench of the Hon'ble Kerala High Court, which came to be disposed of recently, by a judgment of the Division bench on 11th April 2025.

The Division Bench has held that the principle of "mutuality of interest" is constitutionally recognized by various judgements of the Supreme Court. So, if at all this principle has to be overcome, the same is possible only by way of a constitutional amendment and a mere amendment in the GST law is not sufficient. The Court also referred to the 46th constitutional amendment, whereby a principle of "deemed sale" was brought in through Article 366 (29A) to overcome various judgements, interpreting the constitutional term "sale".

Though the amendment in Section 7 of the GST Act itself has thus been struck down, for the record, the Court has also held that any retrospective amendment in tax laws, creating liabilities is also bad.

Notwithstanding the fear lingering in one's mind, whether this judgement also will be overruled by a retrospective constitutional amendment, be that as it may, the immediate effect of this judgment are :

(i) Any club or association, whether incorporated as an entity or not cannot be said to making any supply of goods or services to its own members and such transactions would not be liable to GST.

(ii) Can the club or association claim refund of the taxes already collected from its members and paid to Government? Though normally refunds are not allowed under tax law, if such tax is collected from another person (referred to as unjust enrichment), since the club or association and its members are not treated as distinct persons, it cannot be said that the tax has been collected from any other person and hence the doctrine of unjust enrichment cannot apply here. So, the club or association should be entitled to claim refund of taxes paid so far.

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