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KARNATAKA HIGH COURT QUASHES INR 21,000 CRORE (~US$ 3 BILLION) GST DEMAND; CLARIFIES GST POSITION ON ONLINE GAMING

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Facts and Background

In a landmark judgment with far reaching consequences on the online gaming sector in India, a single judge bench of the Karnataka High Court (High Court), in the matter of *Gameskraft Technologies Private Limited* (GTPL), has quashed and set aside a INR 21,000 crore (~USD 3 Billion) goods and services tax (GST) show cause notice (SCN) against GTPL – the biggest tax notice ever issued in India, as per some reports.

GTPL was represented by *Khaitan & Co.* in this matter, starting from the investigation stage.

While the core issue involved in this case pertains to the online gaming sector, this 325-page judgment issued by Hon'ble Justice S.R. Krishna Kumar touches upon on various first principles of law (for example, validation of the legal strategy to seek judicial review right at the outset against a demand without basis in law, doctrine of precedents, correct application of legal doctrines like *per incuriam* and *sub silentio etc*).

Vis a vis applicability of GST on online gaming, the High Court has effectively validated the industry-practice adopted by the Indian online gaming sector of paying GST at 18% rate only on the platform fee / revenue earned by the online gaming companies instead of paying GST on the entire amount of bets placed on the such companies' online platforms; this industry practice is also aligned with the tax position adopted in majority of the countries globally.

The High Court has laid down the following key conclusions specific to the gaming industry:

i There is a clear difference between games of skill and games of chance. Games such as lottery, betting and gambling are not the same as games of skill, even though Section 2(17) of the Central Goods and Services Tax Act, 2017 (CGST Act) includes wagering contracts in the term "*business*";

ii "Lottery, betting and gambling" as contemplated in Entry 6 of Schedule III of the CGST Act is *nomen juris* and do not include games of skill. Consequently, the said words, 'betting' and 'gambling' contained in Entry 6 of Schedule III to the CGST Act are not applicable to online / electronic / digital rummy or any other game which are substantially and preponderantly games of skill, whether played with monetary stakes or not;

iii Entry 6 in Schedule III to the CGST Act, taking actionable claims out of the purview of GST, would clearly apply to games of skill and only games of chance such as lottery, betting and gambling would be excluded from such exception;

iv A game of chance when played with monetary stakes is gambling but a game of skill whether played with stakes or without is not gambling. A game of mixed chance and skill is gambling if it is substantially and preponderantly a game of chance and not of skill. A game of mixed chance and skill is not gambling, if it is substantially and preponderantly a game of skill and not of chance;

v Rummy is substantially and preponderantly a game of skill and not of chance. Rummy whether played with stakes or without stakes is not gambling. There is no difference between offline / physical rummy and online / electronic / digital rummy and both are substantially and preponderantly games of skill and not of chance. online / electronic / digital rummy whether played with stakes or without stakes is not gambling;

vi Even other online / electronic / digital games which are also substantially and preponderantly games of skill and not of chance are also not gambling;

vii The expressions, 'betting' and 'gambling' having become *nomen juris* are applicable for the purpose of GST also; and

viii The subject online / electronic / digital rummy game and other online / electronic / digital games played on GTPL's platforms are not taxable as 'betting' and 'gambling' under the CGST Act and Central Goods and Services Tax Act, 2017 (CGST Rules) or under the impugned show cause notice, as contended by the GST authorities.

In addition to the above points specific to the gaming industry, the High Court has also clarified and reiterated the following critical legal principles:

a. Ratio Decidendi – This was a key question before the court even though the legal principle of *ratio decidendi* has been examined in various case laws both in India and abroad. However, there was peculiar situation in the present case, where same set of case laws were being relied upon by both GTPL and the GST authorities in support of their arguments. Therefore, the question before the bench was specifically to ascertain the *ratio decidendi* of the cited judgments. In order to do so, the High Court relied on the judgment of the Supreme Court in *Career Institute Educational Society vs. Om Shree Thakurji Educational, Society* [SLP(C) Nos.7455-7456/2023 dated 24.04.2023]. The Supreme Court in turn had referred to the following two judgments which are said to be the tests for determining the *ratio decidendi*:

   i *State of Gujarat & Ors. vs. Utility Users' Welfare Association & Ors*, decided by the Gujarat High Court – to test whether a particular proposition of law is to be treated as the ratio decidendi of the case, the proposition is to be inversed, *i.e.,* to remove from the text of the judgment as if it did not exist (Inversion Test). If the conclusion of the case would still have been the same even without examining the proposition, then it cannot be regarded as the *ratio decidendi* of the case.

   ii *Jayant Verma & Ors. vs. Union of India & Ors.*, decided by the Supreme Court – Referring to the earlier decision of the Supreme Court in the case of in *Dalbir Singh & Ors. vs. State of Punjab*, to state that it is not the findings of material facts, direct and inferential, but the statements of the principles of law applicable to the legal problems disclosed by the facts, which is the vital element in the decision and operates as a precedent. Even the conclusion does not operate as a precedent, albeit operates as *res judicata*. Thus, it is not everything said by a judge when giving judgment that constitutes a precedent. The only thing in a judge's decision binding as a legal precedent is the principle upon which the case is decided and, for this reason, it is important to analyse a decision and isolate from it the obiter dicta.

b. Judgment has to be read as whole, cherry-picking stray sentences is not allowed – The parties are not allowed to rely upon isolated paragraphs in a judgment to ascertain the ratio of the case. Paragraphs have to be read in context of the preceding paragraphs to ascertain its true meaning. It has been held that cherry picking of stray sentences from the judgments of various courts and trying to build up a non-existent case out of nothing amounts to splitting hairs and clutching at straws which cannot be countenanced and is impermissible in law.

c. Exceptions to the 'alternate remedy' limitation vis-à-vis writ petitions against show cause notices – It has been reiterated that in the following circumstances, the court can interfere with a show cause notice in exercise its discretion under Article 226 of the Constitution of India:

i Notice is without jurisdiction;

ii Notice is in abuse of process of law;

iii Notice issued after inordinate delay;

iv Notice is illusory in nature;

v Notice issued with premeditation or prejudgment;

vi Vires of an enactment is challenged;

vii Violation of principles of natural justice;

viii Notice is barred by limitation;

ix Authority is incompetent to issue notice as per statutes governing it;

x Allegation that notice is mala fide; or

xi Infringement of Fundamental Rights.

d. Universal legal concepts that are *nomen juris*, are not dependant on facts and wordings of statute – In specific context of "game of skill" the High Court held that competitions wherein success depends on a substantial degree of exercise of skill are not gambling in nature. Therefore, *de hors* the definition of prize competition, the said legal principle that "*a competition, success wherein does not depend to a substantial degree upon the exercise of skill is now recognised to be of a gambling nature*" will remain constant and universal in its application. It has further been held that when words acquire a technical meaning because of their authoritative construction by superior courts, they must be understood in that sense when used in a similar context in subsequent legislations.

e. *Sub-silentio* and *per-incurium* - Only because a specific paragraph in a precedent has not been excerpted by a court does not mean that a precedent has not been considered in its entirety. By that logic, if the entirety of a precedent-judgment is not excerpted in a subsequent judgment, the subsequent judgment will become automatically *sub silentio* and *per incuriam* which is a completely absurd proposition.

Background - steps leading to this judgment

This litigation has a chequered history and is an outcome of multiple proceedings and hotly contested arguments. The genesis is discussed below:

a. Officials of the Directorate General of Goods and Services Tax Intelligence, Delhi (DGGSTI) conducted a search and seizure proceeding at the premises of GTPL and its executives / founders / consultants in November 2021.

b. On 17 November 2021, the DGGSTI issued a provisional attachment order under Section 83 of the CGST Act attaching all the bank accounts of GTPL, thereby in effect completely incapacitating GTPL from conducting its business operations.

c. GTPL filed a statutory objection against the provisional attachment orders. The provisional attachment order was upheld vide order dated 30 November 2021. There was no reasoning as such provided to justify the drastic action.

d. GTPL challenged the aforesaid order before the High Court and submitted that the order confirming the provisional attachment and the provisional attachment orders itself was contrary to various directions issued by Central Board of Indirect Taxes & Customs (CBIC) and also contrary to the judicial dicta of various High Courts and Supreme Court. An interim order was issued on 3 December 2021 granting interim relief to GTPL.

e. Thereafter, an Intimation Notice (a precursor to a show cause notice under GST laws) under the provisions of CGST Act was issued, whereby a demand of INR 21,000 crores was created on the following grounds:

   i GTPL misclassified its supply as services. GTPL was involved in the supply of 'actionable claim' which is goods.

   ii GST ought to have been paid under Rule 31A of the Central Goods and Services Tax Rules (the aforementioned special valuation provision under GST which is applicable only to 'betting and gambling') on the entire 'buy-in' amount at the rate of 28%, instead of 18% only on the platform fees which was being paid by GTPL.

f. GTPL challenged the Intimation Notice by way of filing a second writ petition. *Vide* order dated 23 September 2022, the High Court stayed the operation of the Intimation Notice, till the pendency of the writ petition.

g. During the pendency of the second writ petition and despite the above stay against the Intimation Notice in the second writ, the GST department went ahead and issued the SCN on 23 September 2022, on the very same day when the above stay order in the second writ petition was passed. The SCN also proposed to levy personal penalty in some cases. This SCN was also challenged by GTPL by way of a third set of writ petitions – it is in these petitions that the subject judgment has been pronounced.

h. Since this was an issue that affected the entire online gaming sector in India, two industry associations of gaming companies, *All India Gaming Federation* and *E-Gaming Federation*, intervened in this last set of writ petitions by GTPL to present the viewpoint of the online gaming industry, as a whole.

Key arguments of the GST department supporting the GST demand of INR 21,000 Crores from GTPL

a. That GTPL supplied 'actionable claims' as opposed to rendering of facilitation services in the form of chance to win in 'betting and gambling'.

b. To overcome the argument that 'betting and gambling' connotes only those games which are 'games of chance' the GST department attempted the following:

- A new argument that even if one participates in a 'game of skill', but stakes money on the outcome thereof, it will still amount to 'betting and gambling'. This new argument was based on the Department's reading of a few paragraphs from the judgment in the case of State of Bombay v. RMD Chamarbaugwaala & Anr. (AIR 1957 SC 699).

  and

- Relying upon a few lines from the judgement of the Supreme Court in the case of State of Andhra Pradesh v K. Satyanarayana & Ors [1968 (2) SCR 226] (*which stated that if an establishment/club where rummy and other card games are played made profits from the said games, the offence of running a "common gambling house" under the relevant State Gambling statute could be brought home*) to argue that since GTPL earns significant profits from its transactions, GTPL can be said to be involved in 'betting and gambling'.

In furtherance of the above arguments, it was argued by the GST department that favourable earlier judgements as relied upon by GTPL lacked precedential value in as much as they were *sub silentio* or *per incuriam* since these judgments did not take into account the above reading of those specific lines/paragraphs of the *Chamarbaugwaala* and *Satyanarayana* judgments as canvassed by the GST authorities.

These arguments were rejected by the High Court after enunciating and clarifying the law surrounding doctrine of precedent as well as principles of *ratio decidendi*, *sub silentio* or *per incuriam* (as mentioned above).

Comment

This verdict of the High Court is a clear vindication of the business model adopted by the Indian online gaming companies who facilitate games of skill on their platforms and should mitigate investor concerns. The clarity in legal position as ushered in by this judgment is expected to pave the way for constructive dialogues between the online gaming sector and the GST authorities and will hopefully form the basis of a progressive long term GST position for the industry, aligned with global best-practices.

Such certainty of tax position coupled with Government of India's recent decision to regulate this space in a 'light-touch' manner that eliminates regulatory uncertainty should go a long way to encourage rapid growth of the online gaming sector in India along with significant employment generation.

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**This is the team from the Firm which represented Gameskraft in this matter starting from the investigation stage in November 2021, through the multiple petitions filed in Karnataka High Court including the final one leading to quashing of the SCN*

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