GOODS AND SERVICE TAX ON ONLINE SKILL GAMING: A CONSTITUTIONAL PERSPECTIVE

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Abstract: *In light of the rapid growth and the consequent regulatory focus on the taxing of online gaming in India, this paper discusses the CGST (Amendment) Act, 2023 and the amendment in CGST Rules that mark a shift from a Gross Gaming Revenue model to a turnover model of taxation and impose a uniform tax on games of skill and chance. It analyses the compatibility of this shift with our GST regime, undertakes a policy analysis of its economic desirability by drawing from the experiences of other jurisdictions, and challenges its constitutionality by showing that imposing an onerous burden that could lead to operators shutting down online skill gaming services, a protected trade under Article 19(1)(g), amounts to colourable legislation and violates the manifest arbitrariness doctrine under Article 14.*

INTRODUCTION

Online gaming is one of the most rapidly growing industries in India's digital economy. The World Economic Forum valued India's gaming industry at USD 930 million in February 2021 and projected its growth to reach a valuation of USD 3.8 billion by 2024.[1] India is currently the fifth-largest online gaming market in the world,[2] and the industry is expected to record a tremendous surge due to increased foreign direct investment, high internet penetration rates and a significant younger population.[3] This has led to a recognition of the online gaming industry as being an important source of revenue for the public exchequer. [4] Since revenue generation is an important goal of tax regimes, an appropriate regulatory and taxation policy conducive to its growth must be carefully considered.

Online gaming is subject to both direct and indirect taxation. Income tax is levied on the winnings earned by players while the Goods and Service Tax ("GST") is levied on online platform operators. In the pre-GST regime, online skill gaming was treated as an OIDAR service different from gambling and was taxed on a Gross Gaming Revenue model ("GGR").[5] This was carried forward under the GST regime through differential tax rates for games of skill and chance.[6] While games of skill were taxed under a GGR model, games of chance (or 'gambling') were taxed on the full-face value under a turnover model.

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[1] Rajan Navani, 'Why India's gaming industry is on the rise' (*WeForum*, 24 February 2021) <https://www.weforum.org/agenda/2021/02/why-india-s-gaming-industry-is-on-the-rise/> accessed April 22, 2023.

[2] Ernst & Young, 'Online gaming in India – The GST conundrum' (*E&Y*, 2021) <https://www.ey.com/en_in/media-entertainment/online-gaming-in-india-the-gst-conundrum> accessed April 22, 2023.

[3] ibid.

[4] For example, in January 2023, the Ministry of Electronics and Information Technology invited public consultation on the draft amendments to the IT (Intermediary Guidelines and Digital Media Ethics Code) Rules, 2021 in relation to online gaming. The draft amendments envisaged due diligence requirements for online gaming intermediaries as well as the creation of self-regulatory bodies.

[5] Service Tax Rules, 1994, §2(1)(ccd)(xiv) (Online Information and Database Access or Retrieval Services means services whose delivery is mediated by information technology over the internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention).

[6] Currently, Online skill gaming operators pay GST at a rate of 18% on Gross Gaming Revenue/Platform fees under Chapter Heading 998439 that pertains to Other Online Content. On the other hand, Gambling And Betting Services Including Similar Online Services are covered under Chapter Heading 999692 and are taxed at 28%.

However, after intense deliberation within the GST Council over a prolonged period,[7] recent changes have been introduced to the taxing regime of online gaming causing a shift from GGR to a turnover model and obfuscating the distinction between online skill gaming and gambling. This shift is brought about by the Central Goods and Services Tax (Amendment) Act, 2023 which *inter alia* identifies electronic platforms as suppliers of actionable claims (including a liability to pay tax for such supply) and the Central Goods and Services Tax (Third Amendment) Rules, 2023 which introduces Rule 31B making the value of supply of online gaming the total amount deposited with the gaming operator. In this paper, we argue that such a shift will drastically impact the online gaming industry and is not only undesirable from a policy perspective but may also be liable to be struck down from a constitutional standpoint.

This paper is divided into four parts. Part I breaks down the distinction between games of skill and chance, the causes and resulting implications of this distinction in determining the taxable base, and the amendments introduced to the CGST Act and Rules. This is followed by a policy analysis in Part II, examining the economic implications of taxing the entire stake value, over and above the consideration that the operator actually receives as commission. It presents a comparative analysis of global best practices in gaming taxation and concludes that the proposed model may lead to commercial unworkability of the industry, forcing gaming operators to either shut down or move into grey markets. Part III argues that Section 15(5) of the CGST Act is unconstitutional for excessively delegating power to the executive without laying down any guidance for its exercise, and that Rule 31B is inconsistent with Section 15(1) and Section 7 of the parent act and is therefore liable to be struck down. Part IV extends this analysis to show that such a *de-facto* ban on gaming operators constitutes colourable legislation and is arbitrary therefore rendering it unconstitutional under Articles 19 and 21.

I. BACK TO BASICS: WHAT'S DIFFERENT ABOUT TAXING GAMING?

A. Game for a Gamble? The Skill-Chance Distinction and its Relevance to Taxation

The online gaming industry comprises two types of games; games of skill (referred to as 'gaming' in this paper) and games of chance (referred to as 'gambling'). Until recently, these two categories have been subject to different rates of taxation and different methods of valuing

[7] Discussion on taxing online gaming began in the 35th GST Council in June 2019 where the issue was referred to the Fitment committee.

the taxable base.

Games of chance including lottery, betting and gambling have been viewed as social evils and regulatory policy has been designed to limit their spread.[8] They are further regarded as *res extra commercium* by the Supreme Court and therefore not deserving of protection under the right to free trade contained in Article 19(1)(g).[9] Conversely, the Supreme Court and several High Courts have recognized that games of skill must be protected under Article 19.[10] This is why states are permitted to ban gambling, whereas an outright ban on online skill gaming faces a more stringent constitutional challenge as has been seen in the recent rulings of the Madras,[11] Karnataka,[12] and Kerala High Courts.[13] The Madras High Court explicitly drew this distinction, pointing out that while a ban on gambling and betting which had the potential to be ruinous to the public was justified, a total prohibition on even games of skill without adequate evidence to prove such a need was manifestly arbitrary.[14]

Fantasy games,[15] poker,[16] and rummy[17] have all been deemed as games of skill by various courts, even though there continue to be uncertainties, especially concerning activities

[8] Varun Srikanth & Arun Binoy Mattamana, 'Regulating Online gambling: The Indian perspective' (2011) 27(2) Computer Law and Security Review <https://www.infona.pl/resource/bwmeta1.element.elsevier-ac1ce2f3-2072-3ffc-9865-34d29f49a8b6> accessed April 22, 2023; *See also* Sally Gainsbury, *Internet Gambling Current Research Findings and Implications* (Springer, 2012) 60.

[9] *State of Bombay v. R.M.D. Chamarbaugwala* AIR 1957 SC 699; *B.R. Enterprises v. State of U.P* (1999) 9 SCC 700; *Union of India v. Martin Lottery Agencies Limited* (2009) 12 SCC 209.

[10] *K.R. Lakshmanan v. State of T.N* (1996) 2 SCC 226; *All India Gaming Federation v. State of Karnataka* (2022) SCC Online Kar 435 (Karnataka High Court); *Junglee Games India Private Limited v. State of T.N* (2021) SCC Online Mad 2762 (Madras High Court); *Head Digital Works (P) Ltd. v. State of Kerala* (2021) SCC Online Ker 3592 (Kerala High Court). *See also M.J. Sivani v. State of Karnataka*, (1995) 6 SCC 289. *See also* T. Nishit, 'Games of Skill vis-a-vis Article 19(1)(g) of the Indian Constitution' (2020) 1(2) Global Sports Policy Review <https://www.g-spr.com/volume-1-issue-2> accessed April 22, 2023.

[11] *Junglee Games India Private Limited* (n 10).

[12] *All India Gaming Federation* (n 10).

[13] *Head Digital Works (P) Ltd* (n 10).

[14] *Junglee Games India Private Limited* (n 10). *See also* Soumyarendra Barik, 'Bill banning Online gambling gets Tamil Nadu Guv's nod despite Centre's new gaming rules' (*Indian Express*, April 11, 2023) <https://indianexpress.com/article/business/bill-banning-Online-gambling-gets-approval-despite-governments-notification-on-new-gaming-rules-8549377/> accessed April 22, 2023. The Tamil Nadu Legislature has recently passed a bill banning Online gambling including games where chance predominates over skill.

[15] *Gurdeep Singh Sachar v. Union of India* (2019) SCC Online Bom 13059 (Bombay High Court); *Varun Gumber v. UT, Chandigarh* (2017) SCC Online P&H 5372 (Punjab and Haryana High Court); *Chandresh Sankhla v. State of Rajasthan* (2020) SCC Online Raj 264 (Rajasthan High Court).

[16] *Indian Poker Association (IRA) v. State of Karnataka* (2013) SCC Online Kar 8536 (Karnataka High Court).

[17] *State of A.P. v. K. Satyanarayana* (1968) 2 SCR 387; *K.R. Lakshmanan* (n 10).

like poker.[18] While the application of the 'preponderance test'[19] to differentiate between games of skill and chance is rife with contradictions, the existence of such a distinction is uncontested.[20] This paper does not attempt to determine what constitutes a game of skill and limits itself to arguing that online skill gaming should not be taxed at a 28% turnover model.

B. The CGST (Amendment) Act, 2023: A shift from Gross Gaming Revenue to Turnover Model of Taxation

In online games, the participants or users place bets or 'stakes' that are pooled by the gaming operator. A relatively small participation or rake fee is deducted by the platform from each of these stakes as its commission, while the remaining amount is redistributed among the winners as the 'prize pool'. Various jurisdictions across the world employ different models of taxation to determine what the taxable base must be i.e., GGR where only the rake fee is taxed, or the turnover model where the entire transaction value including the prize pool is taxed. This is because of the difference in view over what constitutes 'consumption'. We may distinguish between the personal consumption view of gambling, where "the thrill of placing the bet amounts to consumption of a service" and the social consumption view, according to which "the transfer of money between gamblers has no consumption, just a transfer of purchasing power" and the only service provided is the mediation of a game by the operator.[21] While the former justifies placing a tax on the entire stake value, the latter supports a GGR model of taxation.

Previously, under Rule 31A(3) of the CGST Rules, 2017, games of chance fell under a turnover model of taxation, while games of skill were taxed under a GGR model.[22] Apart from the differential taxable base on which the GST is levied, there were also different rates of taxation, with 28% tax on games of chance and 18% on games of skill. However, much to the

[18] *Dominance Games Pvt. Ltd. v. State of Gujarat* (2017) SCC Online Guj 1838 (Gujarat High Court). The Gujarat High Court recently held that poker is a game of chance. This decision has been challenged before the Division Bench and is pending since 2018).

[19] *K. Satyanarayana* (n 17).

[20] Jay Satya, 'Legality of Poker and Other Games of Skill: A Critical Analysis of India's Gaming Laws' (2012) 5(1) NUJS Law Review <http://nujslawreview.org/2016/12/04/legality-of-poker-and-other-games-of-skill-a-critical-analysis-of-indias-gaming-laws/> accessed April 23, 2023.

[21] Fabiola Annacondia and Laura Mattes Alonso, *VAT and Financial Services: Comparative Law and Economic Perspectives* (Robert F. van Brederode & Richard Krever, 2017) 373-374.

[22] Central Goods and Services Tax (CGST) Rules, 2017, §31A(3), *inserted vide* Notification no. 03/2018 (w.e.f. January 23, 2018).

industry's surprise, the recent amendments to the CGST Act and Rules have introduced extensive changes in three core components of the tax—the taxable event, value, and rate.

Firstly, while the taxable event was previously understood to be the 'supply of services' in online money gaming,[23] the recent amendments make the taxable event the 'supply of an actionable claim' itself. Paragraph 6 of Schedule III only included "lottery, betting and gambling" as activities on whom a levy of tax on actionable claims was permitted. However, this stands amended with the insertion of the phrase "specified actionable claims", which is defined in the newly inserted Section 2(102A) of the CGST Act as including "online money gaming".[24] In turn, 'online money gaming' is defined under the amended Section 2(80B) as a game played for stakes of any kind irrespective of "whether or not its outcome or performance is based on skill, chance or both." Thus, a joint reading of the amendment in effect enables a tax on the supply of actionable claims (i.e., the stakes or bets used in games) as opposed to the service provided.

It has been argued that gaming companies are not suppliers of actionable claims, but merely supply the service of providing a platform.[25] It was individuals who could then make use of this platform to give rise to actionable claims between themselves. To address this argument, the definition of "supplier" was itself amended, with a proviso being inserted into Section 105 of the CGST Act stating that a person who organizes and arranges specified actionable claims (read as deposits to participate in online games), "shall be deemed to be a supplier of such actionable claims" and "liable to pay tax in relation to the supply of such actionable claims."

Secondly, the value of tax or taxable base has been changed from 'rake fees' or 'commission' to the entire deposit made by a player to the platform. Previously, rather than total deposits, only the amount retained by the operator as participation fees was included in the value of supply.[26] However, the taxable base for online gaming has changed pursuant to

[23] *Gameskraft Technologies (P) Ltd. v. Directorate General of Goods Services Tax Intelligence*, 2023 SCC OnLine Kar 18 [34].

[24] The Central Goods and Services Tax (Amendment) Act, 2023, §2,4.

[25] Priyansh Verma, 'Dream11 challenges GST notice in Bombay HC' (*The Financial Express*, 27 September, 2023) < https://www.financialexpress.com/business/brandwagon-dream11-challenges-gst-notice-in-bombay-hc-3255869/> accessed October 22, 2023.

[26] *Bangalore Turf Club Ltd. v. State of Karnataka*, 2021 SCC OnLine Kar 12607.

Rule 31B inserted through executive notification.[27] Under Rule 31B, the value of supply of online gaming is defined as the "total amount paid or payable to or deposited with supplier" with a proviso that bars any refund of such deposit from being deductible. Thus, we see a shift from the GGR model to the turnover model of taxation for online gaming.

Lastly, the rate of tax for online gaming has changed from 18% to 28% by grouping gaming and gambling in the same category. While the 51st Council clarified that the tax will not be levied on every individual bet placed, but on the amount paid during entry or Contest Entry Amount ("CEA"),[28] this paper presents a policy, legal and constitutional analysis of why even such a turnover model at 28% for online skill gaming would be a death knell for the gaming industry and is therefore undesirable, unworkable and unconstitutional.

II. ECONOMIC IMPLICATIONS OF A TURNOVER MODEL: THE HOUSE ALWAYS LOSES

A. Commercial Unworkability of the Turnover Model in India

This part of the paper highlights the extent to which the proposed turnover model of 28% will result in making online gaming commercially unworkable for operators, forcing many operators to shut down, and resulting in a significant drain of potential revenue from the industry. The following table illustrates the differential levy of taxes on online gaming prior to the amendments:

	Games of Skill [GGR]	**Games of Chance [turnover]**
Stake value	100	100
Rake fee (at 10%)	10	10
Tax	1.8 (18% tax on Rs.10)	28 (28% tax on Rs.100)

Table 1: Distinction between a GGR and turnover models of taxation

Presently, most private operators only retain 5-10% of the amount as rake fees while the rest is given back as prize money to attract customers.[29] Therefore, under the current system,

[27] Central Goods and Services Tax (Third Amendment) Rules, 2023, inserted by Notification No. 51/2023-Central Tax dated 29-09-2023.

[28] Minutes of the 51st Meeting of the GST Council held on 2nd August, 2023 [3.39].

[29] Vainavi Mahendra, 'The GST Conundrum in Gaming Industry: How the 28% tax on contest fee will end the

a shift from an 18% GGR tax to a 28% turnover tax, would in effect increase the tax burden on the service provider from Rs. 1.8 to Rs. 28 for every Rs. 100 stakes, i.e., over a 1000% increase. To remain profitable under such a turnover tax model, the burden of the tax would be shifted to consumers by increasing the rake fees to at least 30% (higher than the 28% tax on stakes) for the operator to make a minimal profit. Ideally, to cover the expenses of running online gaming systems, the rake fees would have to be higher than that.

In effect, for every Rs. 100 that a player has, Rs. 70 is the maximum bet that one can place. Further, any winnings that the player makes will be taxed at 30% under Section 194BA of the Income Tax Act, 1961. By making the cost of participating a third of the potential winnings, and the total tax burden even more in the event of the player making a profit, the amendments make online gaming unattractive to players and result in gaming platforms becoming commercially unviable.

This is further evidenced from the Copenhagen Economics Analysis which details that a tax that exceeds 20% on *rake fees* would in the majority of cases lead to operators shifting to grey markets.[30] It is critical to note that a tax levied at 28%, apart from being higher than the prescribed 20%, is levied on the *stake value* and not the rake fees, a significantly higher principal amount. The decision of the Karnataka High Court in *Gameskraft* where a Show Cause Notice for payment of Rs. 21,000 crores against the gaming platform was quashed serves to reaffirm this argument.[31]

By imposing a higher levy on a higher sum, the tax would either result in driving the online gaming industry out of business[32] or would result in a grey market where operators can

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gaming industry's growth' (*The Financial Express*, 30 August, 2022) <https://www.financialexpress.com/business/brandwagon-the-gst-conundrum-in-gaming-industry-how-the-28-tax-on-contest-fee-will-end-the-gaming-industrys-growth-2648828/> accessed April 22, 2023.

[30] Copenhagen Economics Stockholm, 'Licensing system for Online gambling Which tax-rate yields both high channelization and high tax revenues?' (*Copanhagen Economics*, 2016) <https://copenhageneconomics.com/publication/licensing-system-for-online-gambling/#:~:text=Tax%2Drates%20of%2015%2D20,operators%20outside%20the%20system%20instead> accessed April 22, 2023. The Copenhagen Report analyses the licensing systems across 14 European countries, from well-off economies such as the United Kingdom to middle-income nations like Lithuania to establish and compare tax rates that result in high channelling revenue for the state, making it one of the most comprehensive studies on gaming tax. The average of 20% rake fees tax has been further corroborated by Ernst & Young's comparative study of taxes, which also recognizes the Copenhagen Report.

[31] *Gameskraft Technologies (P) Ltd. (n 23)* [325].

[32] Lakshmikumaran & Sridharan Attorneys, 'Report on Taxation of the Digital Economy: International Best Practices in GST for Online Gaming' (*Lakshmikumaran & Sridharan Attorneys*, 2022) <https://www.lakshmisri.com/MediaTypes/Documents/International-Taxation-Practices-on-Online-Gaming.pdf> accessed April 22, 2023; *See also* Meyyappan Nagappan, 'GST changes can sink MeitY's and PM's

function on cheaper rake fees. Both these outcomes would result in operators not being taxed at all. The implications of this are not insignificant. The industry which was expected to generate over 95 million dollars in foreign direct investment will likely plunge if such a tax is implemented. Therefore, contrary to the Revenue Secretary's assumptions about generating Rs. 20,000 crores in tax,[33] in an attempt to charge an imposing revenue, the state would be left with significantly fewer operators to tax.

B. Beyond our Shores: Global Best Practices in Gaming Taxation

The severely detrimental impact of the turnover model has been experienced by several other jurisdictions. When Germany introduced a 5% tax on turnover, Betfair Group withdrew its sports betting exchange from the state citing unviability, despite Germany being Europe's largest economy.[34] William Hill, Britain's largest bookmaker, also withdrew services from Germany owing to the tax.[35] In its annual 2020 report, BetMGM noted that a proposal by Germany to introduce a 5.3% turnover tax on online poker and slots "would make certain parts of the market uneconomic for many operators."[36]

IBIA's report comparing countries with a turnover tax vis-à-vis countries with a GGR model notes how those with turnover taxes result in a low number of legally licensed operators and low consumer activity channelled into regulated markets.[37] Poland which operates on a 12% turnover tax has struggled to attract companies, with over 60% of the Polish gaming industry currently under an unlicensed grey market.[38] Portugal similarly imposes an 8% turnover tax which has resulted in less than 70% of consumers accessing licensed online

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vision of India as a gaming superpower', (*The Times of India*, 29 January, 2023) <https://timesofindia.indiatimes.com/blogs/voices/gst-changes-can-sink-meitys-and-pms-vision-of-india-as-a-gaming-superpower/> accessed April 27, 2023.

[33] The Economic Times, '28% GST on online gaming to yield Rs 20,000 cr annually: Revenue Secretary" (*The Economic Times*, 13 July 2023) < https://economictimes.indiatimes.com/news/economy/finance/28-gst-on-online-gaming-to-yield-rs-20000-cr-annually-revenue-secretary/articleshow/101727621.cms> accessed July 27, 2023.

[34] Keith Weir, 'Betfair pulls back from Germany over gambling tax' (Reuters, November 7 2012) <https://www.reuters.com/article/uk-betfair-germany-idUKBRE8A61DH20121107> accessed April 26, 2023.

[35] ibid.

[36] Entain Group, 'Entain PLC Annual Report 2020' (Entain, 2021) <https://entaingroup.com/wp-content/uploads/2021/05/Entain-2020-Annual-Report.pdf> accessed April 26, 2023.

[37] International Betting Integrity Association, 'An Optimum Betting Market: A Regulatory, Fiscal & Integrity Assessment (IBIA, 2021) <https://ibia.bet/wp-content/uploads/2021/08/IBIA-An-Optimum-Betting-Market.pdf> accessed April 26, 2023.

[38] Daniel O'Boyle, 'Polish licensed betting turnover grows to PLN6.7bn in 2019' (*IGaming Buisness*, January 13, 2020) <https://igamingbusiness.com/finance/polish-licensed-betting-turnover-grows-to-pln6-7bn-in-2019/> accessed April 26, 2023.

operators, with most instead opting for offshore online betting operators, thus resulting in a significant loss of revenue for the state.[39]

The unworkability of turnover tax has in the past driven players out of the market. This pushed countries like the United Kingdom, France and Italy to transition to a GGR model of taxation. It is only when the UK shifted from a turnover tax to a GGR tax, that the Big Four (Ladbrokes, William Hill, Coral and the Tote) agreed to transfer operations back to the UK, thus contributing to the UK's revenue rather than evading taxes through offshore business operations.[40] There was a significant decline in the extent of illegal bookmaking activity post the change to a GGR model.

Under the turnover model, France was unable to sustain even a meagre tax of 1.8% on the value of wagers and has introduced an amendment to shift to a GGR model.[41] The Court of Auditors in October 2016 noted that French taxation was burdensome because it was using the stake value as the taxable base.[42] The L'Autorité de Régulation des Jeux En Ligne ("ARJEL") in its report also details how the tax on stakes prevented the balanced development of the market.[43] The French Senate noted that operators were "taxed on sums which they do not receive", making the tax punitive in nature.[44]

Malta also replaced its turnover tax of 0.5% with a 5% GGR model which combined with other deregulatory measures, has made it an attractive destination with over a hundred licensed operators in the country.[45] The need to prevent the operation of an illicit market is also why the GGR is followed by most countries including Austria, Singapore, the UK, Sweden, Estonia and many states in the US, all of which impose a levy on the participation or rake fees retained by the gaming operator.[46]

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[39] International Betting Integrity Association (n 37).

[40] David Paton and others, 'A Policy Response to the E-Commerce Revolution: The Case of Betting Taxation in the UK' (2002) 112 (480) The Economic Journal < https://onlinelibrary.wiley.com/doi/abs/10.1111/1468-0297.00045> last accessed April 22, 2023.

[41]Annabelle Richard & Diane Mullenex, 'Gaming in France: overview' (*UK Practical Law*, 1 October, 2020) <https://uk.practicallaw.thomsonreuters.com/9-634-4247> accessed April 22, 2023.

[42] Lakshmikumaran (n 32) [22].

[43] Daniel O'Boyle, 'Fench Senate approves shift to GGR tax for gambling' (*Igaming Business*, 13 December 2019*)* <https://igamingbusiness.com/casino-games/french-senate-approves-shift-to-ggr-tax-for-gambling/> accessed on April 22, 2023.

[44] Lakshmikumaran (n 32) [24].

[45] International Betting Integrity Association (n 37).

[46] ibid.

Additionally, apart from the global practices on the taxable base for a gaming levy, it is also important to note that those countries who have imposed a turnover tax such as Malta, Germany, Poland, Portugal, France, etc. did so at negligible rates ranging from 1.8% to 12%. Even these rates remained unsustainable causing a widespread flight of operators from the market. A rate as high as 28% would certainly have as adverse an effect, if not worse, on the Indian market.

III. THE *VIRES* OF RULE 31B AND SECTION 15(5) OF THE CGST ACT: UNUSED DEPOSITS AND EXCESSIVE DELEGATION

Before the GST regime, states were empowered to collect taxes on the sale of goods under Entry 54 in List II of the Seventh Schedule. In *State of Rajasthan v. Rajasthan Chemists Assn.*, the Supreme Court dealt with a situation where tax was levied on the maximum retail price (MRP) of goods during the first point of sale, i.e., by a manufacturer/wholesaler to a retailer.[47] Holding that the taxable base must relate to the actual transaction of the sale and not the price at which a sale might take place in future, the Supreme Court declared this provision *ultra vires*.[48] This emphasis on a tax being imposed on the *actual* value of transactions carried on to the GST regime as seen in Section 15(1).

However, the Government changed this position by inserting Rule 31B which taxes all deposits made to the operator, even before they are used in a game, meaning that it not only taxes a sum never earned by the gaming operator, but also taxes a sum not used by a player. In this regard, we argue *firstly*, that Rule 31B violates the general principle behind calculating the value of taxable supply under Section 15(1) of the CGST Act and is therefore *ultra vires*. However, Rule 31B may be justified by invoking Section 15(5) which grants vast and unfettered power to the executive to define what would constitute the value of taxable supply of online gaming. If so, we argue *secondly*, that Section 15(5) is unconstitutional for excessively delegating power to the Government. *Thirdly*, we argue that regardless of whether Section 15(5) is declared unconstitutional, the proviso to Rule 31B which includes unused deposits in calculating the value of supply is *ultra vires* Section 7 of the CGST Act.

A. Rule 31B is *ultra vires* Section 15(1) of the CGST Act

[47] *State of Rajasthan v. Rajasthan Chemists Assn* (2006) 6 SCC 773.

[48] ibid.

Since the transition from the GGR model to the turnover model of taxation was effectuated by Rule 31B introduced by the Government, it constitutes subordinate or delegated legislation, which does not carry the same degree of immunity which is enjoyed by a statute passed by a competent Legislature.[49]

Section 15(1) defines the transaction value of supply as the price *actually* paid or payable for the supply of goods or services. Since the initial money contributed by the players is held by the operator only for a brief period, in a fiduciary role, and is then given back as prize money to the competitors, it must be excluded from the calculation of the value of supply. A similar conclusion was reached by the Karnataka High Court in the context of horse racing,[50] as well as the Bombay High Court in the context of fantasy sports.[51] Even foreign jurisprudence on the issue hints at a similar conclusion. In the context of games of chance such as Bingo, the European Court of Justice also held that when a specific portion of the stakes placed are given out as winnings, then the consideration is only the amount actually retained by the operator.[52]

However, the Karnataka High Court has stayed the *Bangalore Turf Club* decision, while the central Government has simultaneously notified Rule 31B which defines the value of supply of online gaming as the "total amount paid or payable to or deposited with supplier". This means that the entire money players use—of which the operator extracts only a small amount—will be regarded as the taxable base. Taxing the total amount and not the amount actually paid to the supplier as commission reflects an imposition of a turnover model of taxation, and is blatantly at odds with Section 15(1). Legally, doing so may only be justified by invoking Section 15(5) which grants vast and unfettered power to the executive to define what would constitute the value of supply of online gaming. In the next sections, we argue that Section 15(5) is unconstitutional for excessively delegating power to the Government in an unguided manner.

B. Section 15(5) of the CGST Act suffers from the vice of excessive delegation and is unconstitutional

[49] *Indian Express Newspapers (Bombay) (P) Ltd. v. Union of India* (1985) 1 SCC 641 [75].

[50] Bangalore Turf Club Ltd (n 26).

[51] Gurdeep Singh Sachar (n 15).

[52] *H. J. Glawe Spiel- und Unterhaltungsgeräte Aufstellungsgesellschaft mbH & Co. KG v. Finanzamt Hamburg-Barmbek-Uhlenhorst*, CJEU Case C-38/93 (1994); *See also International Bingo Technology S.A. v. Tribunal Económico-Administrativo Regional de Cataluña (TEARC)*, CJEU Case C-377/11 (2012); *Metropol Spielstätten Unternehmerge-sellschaft (haftungsbeschränkt) v. Finanzamt Hamburg-Bergedorf*, CJEU Case C-440/12 (2013).

While Section 15(1) states that the value of supply shall be the transaction value (the price actually paid for the supply), Section 15(4) states that "where the value of the supply of goods or services or both cannot be determined under sub-section (1), the same shall be determined in such manner as may be prescribed." This allows the Government to prescribe rules to determine the value of supply in line with the principle of Section 15(1), which is that transaction value should be the basis of calculating the taxable base. However, Section 15(5) goes further to say that "[n]otwithstanding anything contained in sub-section (1) or sub-section (4), the value of such supplies as may be notified by the Government on the recommendations of the Council shall be determined in such manner as may be prescribed." This provision is markedly different from Section 15(4) because it no longer binds the government to the principle behind Section 15(1). In this part of the paper, we argue that conferring such vast power to the executive without prescribing any guidance, standard, or principle for its exercise suffers from the vice of excessive delegation and is therefore unconstitutional.

In one of its first pronouncements on delegated legislation, *In Re Delhi Laws Act, 1912*, the Supreme Court held that while the legislature could grant authority to adopt rules to carry the statute into operation, it should establish "policy and principles providing the rule of conduct" and that broad rule-making powers may only be given in "cases of emergency like war."[53] In *Hamdard Dawakhana v. Union of India*, the Court held that the words "or any other disease or condition which may be specified" in Section 3 of the Drugs and Magic Remedies (Objectionable Advertisement) Act, 1954 suffered from the vice of excessive delegation because "the words impugned are vague' and the parliament without prescribing any standard or principle had conferred uncanalised and uncontrolled power to the executive."[54] Even though the legislature has a great deal of flexibility in matters of taxation,[55] the Supreme Court in *Corpn. of Calcutta v. Liberty Cinema,* while recognizing that the power to fix rates of taxes can be left to another body, ruled that the legislature must provide guidance for such fixation.[56] Building on this principle laid down in *Liberty Cinema,* the Guwahati High Court in *ITC Ltd. v. State of Assam* declared a provision of the Assam Entry Tax that delegated power to the executive to determine the rate of tax invalid because "the Legislature has completely failed to either fix the upper ceiling limits or provide guidelines for choosing the rate of tax," and this

[53] *Delhi Laws Act, 1912, In Re*, 1951 SCC 568.

[54] *Hamdard Dawakhana v. Union of India*, 1959 SCC OnLine SC 38.

[55] *Orient Weaving Mills (P.) Ltd. v. Union of India,* AIR 1963 SC 98.

[56] *Corpn. of Calcutta v. Liberty Cinema,* 1964 SCC OnLine SC 65.

made the provision suffer from the vice of excessive delegation.[57]

While no case deals with excessive delegation of power to determine the value of supply, the principles applicable to the rate of tax can be imported. Section 15(4) delegates power that is guided by the principle established in Section 15(1), whereas the same power is delegated in Section 15(5) without any such guidance—a single but significant difference. Further, the value of taxable supply in the CGST Act is only addressed in Section 15, meaning that no other part of the Act prescribes any guidance on how the value is to be determined. This allows the Government to exercise uncontrolled power and discretion. Much like how the Guwahati High Court regarded the failure to fix upper ceiling limits and provide guidelines for choosing the rate of tax as being excessive delegation, so also the failure to prescribe a method or policy for determining how the value of taxable supply is to be calculated suffers from the same vice. Therefore, Section 15(5) must be declared unconstitutional and any notifications resulting from it must be declared invalid.[58]

C. The proviso to Rule 31B is *ultra vires* Section 7 of the CGST Act

Even if the constitutionality of Section 15(5) was upheld, if Rule 31B breaches other provisions of the CGST Act, it can be rendered invalid for being *ultra vires*. Section 164 of the CGST Act empowers the Government to make rules, by way of notification, for all matters which are required to be made or may be made for carrying out the provisions of the CGST Act. The rules dealing with the value of supply are contained in Chapter IV of the CGST Rules, 2017, in which Rule 31 states that the value of supply shall be determined using reasonable means consistent with the principles and general provisions of Section 15. However, Rule 31B, which was inserted by the government in exercise of the powers conferred by Section 164 starts with the words "[n]otwithstanding anything contained in this chapter," showing the departure from the general principles of calculating the value of supply in Section 15(1).[59] Such departure can only be justified by invoking Section 15(5), in which case Rule 31B has immunity from the application of Section 15(1) and 15(4) but not from other provisions of the CGST Act.

The definition of supply under Section 7 of the CGST Act requires there to be "consideration". The definition of consideration under Section 2(31) of the CGST Act contains

[57] *ITC Ltd. v. State of Assam,* 2006 SCC OnLine Gau 367, [33,38].

[58] *Chintamanrao v. State of M.P.,* 1950 SCC 695 [15].

[59] Central Goods and Services Tax (Third Amendment) Rules, 2023, inserted by Notification No. 51/2023-Central Tax dated 29-09-2023.

a proviso which states that "a deposit given in respect of the supply of goods or services or both shall not be considered as payment made for such supply *unless the supplier applies such deposit as consideration for the said supply* (emphasis supplied)". The proviso to Rule 31B includes "player not using the amount paid or deposited with the supplier for participating in any event" in determining the value of supply of online money gaming. Consider the following example—a player deposits Rs. 10,000 in a gaming wallet. Since the deposit is by itself taxed, 28% would be levied on the entirety of Rs. 10,000. However, if the participant uses only Rs. 4,000 and subsequently decides to withdraw Rs. 6,000 from the gaming platform, no longer being willing to participate in the game, the proviso to Rule 31B would imply that even such a withdrawal is not deductible for tax purposes. In essence, even though the supplier has not applied the deposited Rs. 6,000 as consideration, it would be included in the value of supply, and the player would be subject to a tax levy of Rs. 2,800. This goes directly against Section 7 of the CGST Act, and to that extent, Rule 31B is *ultra vires* the parent Act and is liable to be struck down.

IV. ASSAILING THE CONSTITUTIONALITY OF THE TURNOVER TAX

This part of the paper starts by showing that the Supreme Court has in recent times read down a provision in a taxing statute for being unconstitutional, despite the traditional narrative of economic hardship playing no role in determining the validity of a taxing statute. Thereafter, we argue that since the amendments result in so high a burden that will *de-facto* lead to the closing of several operators because of commercial unworkability, the proposed changes amount to colourable legislation and violate the manifest arbitrariness doctrine of Article 14 of the Constitution.

A. Taxation Laws, Economic Hardship and the Doctrine of Permissible Policy

Indian jurisprudence has established that economic hardship can play no role in determining the validity of a taxation statute as India follows a permissible policy of taxation granting the legislature wide freedom in this regard, including to pick and choose the objects and even rates of taxation.[60] It has also been established that the mere possibility of the abuse does not make

[60] *Union of India v. VKC Footsteps India Pvt. Ltd*, 2021 SCC Online SC 706 [76,124]; *East India Tobacco Co. v. State of A.P*, (1963) 1 SCR 404 [4]; *Khyerbari Tea Co. v. State of Assam*, (1964) 5 SCR 975; *Commr. Of Customs v. Dilip Kumar & Co* (2018) 9 SCC 1; *State of M.P. v. Bhopal Sugar Industries Ltd* (1964) 6 SCR 846; *Hoechst Pharmaceuticals Ltd. v. State of Bihar*, (1983) 4 SCC 45 [82]; *See also* Karthik Sundaram, *Tax, Constitution and the Supreme Court* (OakBridge, 2019) 117-138.

a tax unconstitutional,[61] and the judiciary must act with deference to the Legislature when dealing with the constitutionality of taxing provisions.[62] Nevertheless, the policy cannot be arbitrary or discriminatory, as was empathetically noted by Justice Nariman in *CIT v. Pepsi Foods* while reading down Section 254(2A) of the Income Tax Act for offending Article 14.[63] The judgment also distinguished between 'eligibility to tax' as was the subject before the Court in *Dilip Kumar*, and a frontal challenge to the constitutional validity of a provision from a tax statute.[64]

Earlier cases dealing with legislative discretion in taxing statutes also acknowledge this limitation or boundary which cannot be crossed no matter how permissible a taxation policy India follows.[65] This line of reasoning was most clearly elucidated in *Spences Hotel v. West Bengal*, which affirmatively cited Cooley on Taxation and held that taxes which "cannot be deemed in any just sense proportional in their effect on those who are to bear the public charges" will be subject to review by courts, who "can interpose and arrest the course of legislation by declaring such enactments void."[66] Therefore, we see the Supreme Court has demonstrated a willingness to interfere in a taxation statute if it violates fundamental rights. Following from such jurisprudence, we argue that under both the grounds presented—colourable legislation, and manifest arbitrariness—the Council's decision breached the threshold of permissive policy, rendering the tax liable to be struck down.

B. Effect of Turnover Tax: Grey Markets and Colourable Legislation

The Supreme Court in *K.C. Gajapati Narayan Deo v. State of Orissa* held that where there are limitations on legislative authority in the shape of fundamental rights, then "disguised, covert and indirect" transgressions on such rights through apparently valid legislation would be

[61] Indian Express Newspapers (Bombay) (P) Ltd. (n 49) (The Supreme Court cited with approval the observation by Justice Reed in his dissenting opionion in Robert Murdock, Jr. v. Commonwealth of Pennsylvania (City of Jeannette) [319 US 105]).

[62] *Murthy Match Works v. The Asstt. Collector of Central Excise*, (1974) 4 SCC 428 [14].

[63] *CIT v. Pepsi Foods Ltd* (2021) 7 SCC 413.

[64] ibid [29].

[65] *Suraj Mall Mohta and Co. v. A.V. Visvanatha Sastri*, (1955) 1 SCR 448. The Supreme Court struck down Section 5(4) of the Taxation on Income (Investigation Commission) Act, 1947 as discriminatory and offending Article 14 on the ground that the procedure prescribed was substantially more prejudicial and more drastic to the assessee than the procedure contained in the Indian Income Tax Act, 1922.; *Anant Mills Co. Ltd. v. State of Gujarat*, (1975) 2 SCC 175; *Kerala Hotel and Restaurant Assn. v. State of Kerala*, (1990) 2 SCC 502.

[66] *Spences Hotel (P) Ltd. v. State of W.B.*, (1991) 2 SCC 154 [26,27].

deemed colourable legislation.[67] In other words, constitutional prohibitions cannot be circumvented through indirect means, i.e., you cannot do indirectly what you are prohibited from doing directly.

In *Federation of Hotel and Restaurant Assn.*, it has been established that a taxing statute cannot, *per se*, be a restriction of the freedom under Article 19(1)(g).[68] However, in *Ujjam Bai v. Uttar Pradesh*, on the question of a sales tax's restriction of Article 19(1)(g), it was held that when a law, "though disguised as a taxation law, is, in substance a law which is intended *to destroy or even burden trade* [emphasis supplied]", it would amount to a colourable legislation, contravening Article 19(1)(g).[69]

With respect to online gaming, there are over six decades of jurisprudence starting with *R.M.D Chamarbaugwalla v. Union of India*, which have established that while games of chance are deemed *res extra commercium* and lack protection under Article 19(1)(g), a game of skill is a protected trade.[70] Leading decisions including *Andhra Pradesh v. Satyanarayana* and *Lakshmanan v. Tamil Nadu* reinforce this position.[71] While numerous studies and decisions note that prominent online games such as fantasy sports and rummy are skill gaming,[72] this paper does not venture into such a deep analysis. Instead, assuming *prima facie* that a host of games fall within the ambit of online skill gaming, this part of the paper argues that a 28% turnover tax falls foul of the doctrine of colourable legislation.

To determine whether a particular legislation is colourable or not, the court would have to "examine the *operation and effect* of the impugned legislation" and for the same purpose, take into account "any public general knowledge which the Court would take judicial notice."[73] Courts have held that the intent or motive of the legislature in exercising its power was not relevant in determining the constitutionality of the legislation.[74] Therefore, to determine

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[67] *Sri Sri Sri K.C. Gajapati Narayan Deo v. State of Orissa* (1954) SCR 1 [9].

[68] *Federation of Hotel and Restaurant Assn. of India v. Union of India*, (1989) 3 SCC 634 [62]; *See also Pankaj Jain Agencies v. Union of India*, (1994) 5 SCC 198 [22].

[69] *Ujjam Bai v. State of Uttar Pradesh*, AIR 1962 SC 1621.

[70] *R.M.D. Chamarbaugwalla* (n 9).

[71] *State of A.P. v. Pusuluri Satyanarayana Murthy*, (2001) 10 SCC 458; K.*R. Lakshmanan* (n 10).

[72] The Internet and Mobile Association of India & Ikigai Law, 'Unpacking a Billion Dollar Industry: Digital Games and Sports in India' (*The Internet and Mobile Association of India & Ikigai Law*, 2021) <https://www.ikigailaw.com/wp-content/uploads/2021/03/IL-and-IAMAI_Digital-gaming-report_02032021.pdf> accessed April 22, 2023.

[73] *K.C. Gajapati Narayana Deo v. State of Orissa*, 1953 SCC OnLine Ori 2 (Orissa High Court).

[74] ibid [99].

whether the tax constitutes colourable legislation, one would have to analyse the effect of the legislation, including general knowledge about its consequences and the constitutionality of such an effect.

As previously explained in Part II, a 28% tax on the entire transaction value "burdens trade"[75] by making operators commercially unviable and forcing them out of business. Therefore, in effect, a 28% turnover tax is a complete ban on trade. Given such a prohibition of a protected trade under Article 19(1)(g) is generally not permitted, the key issue is whether such a policy meets the threshold of "reasonable restrictions" under Article 19(6). While the apex court has held that "reasonable restrictions" under 19(6) also include total prohibitions, the threshold for such a prohibition is high.

As per *Cooverjee v. Excise Commissioner,* the state has the right to prohibit trades which are "illegal or immoral or injurious to the health and welfare of the public".[76] Examples of permitted prohibitions include trades in noxious goods, trafficking in women, counterfeit coins and pornographic or obscene films and literature.[77] The Court held that protection would be granted only to those businesses "legitimately pursued in a civilised society being not abhorrent to the generally accepted standards of its morality."[78] While a survey of all cases that enable such a prohibition is not within the scope of this paper, the examples illustrate a high threshold of proven injury to justify a total ban of activities.

Such a high bar is also reflected in the doctrine of proportionality—i.e., a reasonable restriction must not be arbitrary or excessive, beyond "what is required in the interests of the public."[79] Given a total ban is a restriction of the highest degree, a high threshold of injury must be established to justify completely banning skill games altogether. The treatment of gaming as a sin good due to its allegedly injurious character and immorality appears to be the prime justification for the imposition of such an onerous tax.[80] However, this justification does not

[75] *Ujjam Bai* (n 69).

[76] *Cooverjee B. Bharucha v. Excise Commr., Ajmer*, 1954 SCR 873.

[77] *Khoday Distilleries Ltd. v. State of Karnataka*, (1996) 10 SCC 304.

[78] ibid.

[79] *Chintaman Rao* (n. 39); *see also Modern Dental College & Research Centre v. State of M.P.,* (2016) 7 SCC 353.

[80] Gaurab Das, 'India's likely 28% GST on gaming companies set to kill many players, hurt FDIs: WinZo Co-founder Rathore' *The Economic Times* (19 June, 2023) < https://economictimes.indiatimes.com/industry/media/entertainment/indias-likely-28-gst-on-gaming-companies-set-to-kill-many-players-hurt-fdis-winzo-co-founder-rathore/articleshow/101096380.cms> last accessed October

meet the high threshold required to establish a total prohibition on online gaming (including a *de-facto* ban through an excessive gaming tax).

It is important to revisit the three independent decisions of the Madras, Kerala and Karnataka High Courts all of which struck down a ban on online gaming by conclusively rebutting a presumption that online gaming can be treated as a sin good, in the same vein as gambling.[81] While the state in all three cases claimed that several families are ruined because of online games, with addiction and mental health issues being primary concerns, all three courts held that a total ban was unreasonable to meet such challenges.

The Karnataka High Court, after extensively surveying national and international reports on the effects of online gaming, concluded that it would be premature to presume that internet gaming has deleterious effects and that recent studies show how online gaming does not inherently encourage addiction. It held that more reasonable efforts should be taken to prevent problem gambling rather than resorting to a total ban.[82]

The Madras High Court went further and held that apart from the relatively innocuous nature of online gaming, skilled players had a right to exploit their skills to make a living.[83] It held that while every game including professional sports inherently included an element of luck in it, each individual had talents and skills in different activities—some in cricket, and some in poker. Much like a total prohibition of cricket is impermissible, or a game of football played for a cash prize would be unreasonable, it ruled that a game of skill involving stakes must also not be the subject of a total ban.[84] Similar to the Karnataka High Court, it concluded that in the absence of sufficient scientific or empirical data to suggest that skill gaming is deleterious, a paternalistic ban would not be justified.[85] While the Kerala High Court dealt with a narrower question on prohibiting online rummy, it reached a similar conclusion that this would amount

22, 2023; The Wire, 'A 28% Tax on Online Gaming Will Wipe out the Industry, Lead to Job Losses, Say Experts, *The Wire* (12 July 2023) <https://thewire.in/business/a-28-tax-on-online-gaming-will-wipe-out-the-industry-lead-to-job-losses-say-experts> last aaccessed October 22, 2023; Ashish Goel, 'Sinful Tax' *The Telegraph India* (2 October, 2023) last accessed on October 22, 2023; Abhishek Malhotra, 'GST on the entire prize pool in online gaming a step too far' *The Times of India*, (31 January 2023) < https://timesofindia.indiatimes.com/blogs/voices/gst-on-the-entire-prize-pool-in-online-gaming-a-step-too-far/> last accessed on October 22, 2023.

[81] *All India Gaming Federation* (n 10); *Junglee Games India Private Limited* (n 10); *Head Digital Works (P) Ltd*. (n 10).

[82] *All India Gaming Federation* (n 10).

[83] *Junglee Games India Private Limited* (n 10).

[84] ibid.

[85] ibid.

to a disproportionate restriction on Article 19(1)(g).[86]

Further, the Karnataka High Court affirmatively cited *Express Newspapers* to hold that much like that case, online games have "elements of expression and therefore enjoy regulatable protection under Article 19(1)(a)." It is critical to note that *Express Newspapers* further established that taxing statutes may be invalidated if they are openly confiscatory or a colourable device to confiscate.[87] In that case, while the primary issue concerned freedom of the press, the Court went into the question of whether the tax has been shown to be so burdensome as to warrant its being struck down. In the case of gaming tax, the fault lines of such a burdensome tax amounting to a *de-facto* ban on online gaming are already evident given how Fantok and One World Nation have halted their business while Quizy has permanently shut down their operations.[88] The retrospective application of the tax has led to Delta Corp receiving a tax notice *three times* its market capitalization, with tax demands worth over 1.5 lakh crore being served on gaming platforms.[89] Thus, given an online skill gaming entity is also entitled to protections under Article 19(1)(g), a prohibition on such a business by imposing a tax burdensome to trade amounts to colourable legislation.

C. Manifest Arbitrariness of the Turnover Tax

The journey from the 'classification test' or the 'old doctrine' beginning with *Anwar Ali Sarkar* to the 'arbitrariness test' or the 'new doctrine' solidified in *Shayara Bano* has been a long and winding path, with many questions still left unanswered and interpretative strategies unexplored.[90] While the arbitrariness standard dates back to *EP Royappa* and Justice Bhagwati,[91] its application to plenary legislation is a much more recent phenomenon. This non-comparative dimension of equality was resurrected by Justice Nariman in *Shayara Bano v.*

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[86] *Head Digital Works* (P) Ltd. (n 10).

[87] *Indian Express Newspapers (Bombay) (P) Ltd*. (n 49) [69], *See also Ujjam Bai* (n 69).

[88] Harsh Upadhyay, '28% GST on online real money games: 3 layoffs, 3 shutdowns, what's next?' (*Entrackr*, August 25 2023) < https://entrackr.com/2023/08/28-gst-on-online-real-money-games-3-layoffs-3-shutdowns-whats-next/> last accessed on 22 October, 2023.

[89] Vikas Dhoot, 'GST Council affirms 28% tax on online betting from October 1', (*The Hindu*, 8 October 2023) <https://www.thehindu.com/business/Economy/gst-council-affirms-28-tax-on-online-betting-from-october-1/article67393435.ece> accessed October 25, 2023.

[90] Lalit Panda, 'Rationality by any other Name: Common Principles for an Evolving Equality Code' (2021) 10 Indian Journal of Constitutional Law <https://ijcl.nalsar.ac.in/wp-content/uploads/2021/11/Panda_IJCL_volume10_2021-1.pdf> accessed April 22, 2023; Tarunabh Khaitan, 'Equality: Legislative Review under Article 14' in Sujit Choudhry, Madhav Khosla, and Pratap Bhanu Mehta (eds), *The Oxford Handbook of the Indian Constitution* (Oxford University Press, 2017).

[91] *E.P Royappa v. State of T.N*, (1974) 4 SCC 3.

Union of India which held that a law would be manifestly arbitrary if it was done "capriciously, irrationally and/or without determining principle" or if it was "excessive and disproportionate".[92]

While subordinate legislation does not enjoy the same degree of immunity as plenary legislation,[93] the difference in standard to be applied while determining constitutionality is unclear. *Shayara Bano* set a significantly high threshold for invoking the manifest arbitrariness doctrine, stating that it would be a ground to strike down both, plenary and subordinate legislation.[94] Yet, years of jurisprudence show that the standard used to invalidate delegated legislation on grounds of arbitrariness has been lower than the threshold set out in *Shayara Bano*. Relying on cases like *S.G. Jaisinghani v. Union of India*,[95] Abhinav Chandrchud writes that, in the context of the arbitrariness test, the standards which apply to delegated legislation differ from those which apply to primary legislation.[96] Others have argued that Chief Justice D.Y. Chandrachud's dilution of substantive due process in *Puttaswamy*[97] has resulted in setting a much higher threshold for invalidating plenary legislation on the ground of manifest arbitrariness as compared to subordinate legislation.[98] Regardless of whether subordinate legislation faces a lower standard of arbitrariness, we argue that Rule 31B is manifestly arbitrary and meets the standard set out in judgments post *Shayara Bano*.

Practitioners and academicians have had mixed views about the manifest arbitrariness doctrine. While it is largely welcomed as being progressive, it has also received a fair share of criticism for its vagueness and the lack of clarity on its contours.[99] Concerns of judicial encroachment on the legislative domain have been raised as the Supreme Court is yet to determine a coherent, objective standard for the application of the test, often leading to judges

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[92] *Shayara Bano v. Union of India*, (2017) 9 SCC 1.

[93] *Indian Express Newspapers (Bombay) (P) Ltd.* (n 49) [75].

[94] ibid [101].

[95] *S.G. Jaisinghani v. Union of India*, 1967 SCC OnLine SC 6.

[96] Abhinav Chandrachud, 'How Legitimate is Non-Arbitrariness? Constitutional Invalidation in the light of Mardia Chemicals v. Union of India', (2008) 2 Indian J. Const. L <http://www.commonlii.org/in/journals/INJlConLaw/2008/6.html> last accessed on April 22, 2022.

[97] *K.S. Puttaswamy (Privacy-9J.) v. Union of India,* (2017) 10 SCC 1.

[98] *See* Eklavya Dwivedi, 'The Doctrine Of "Manifest Arbitrariness" – A Critique' (*India Law Journal*) <https://www.indialawjournal.org/the-doctrine-of-manifest-arbitrariness.php> accessed October 25, 2023.

[99] Dhruva Gandhi and Sahil Raveen, 'Hindustan Constructions – Another Instance of the Failings of Manifest Arbitrariness' (*Iconlawphil,* 6 May 2020) <https://indconlawphil.wordpress.com/2020/05/06/rethinking-manifest-arbitrariness-in-article-14-part-i-introducing-the-argument/> accessed April 22, 2023.

importing their personal biases under the pretext of applying the arbitrariness test.[100]

While this test was initially applied in public law cases such as *Navtej Singh Johar*,[101] gradually its application was expanded to commercial law disputes concerning IBC proceedings,[102] and arbitration procedures.[103] For instance, in *Hindustan Construction v. NHPC*, the Supreme Court held that allowing the award of an arbitral tribunal to be stayed immediately on the mere filing of a Section 34 application would be manifestly arbitrary.[104] The basis for arriving at this conclusion relies on the court documenting the excessive impact such a policy would have on the award-holders, in terms of the delay in arbitration proceedings, the potential insolvency of award-holders who are unable to make prompt payments based on the award, deprivation of the benefits of the award, etc.[105] In *Essar Chemicals* as well, the mandatory requirement to complete the insolvency process within 330 days was struck down since it resulted in hardships for creditors to a degree that met the 'excessive or disproportionate' criteria.[106]

In recent years, the manifest arbitrariness doctrine has been used to read down clauses of tax provisions as well. In *Reliance Industries*, the court held that a section of Gujarat's VAT Act which excluded the 4-year time period between the date of the decision of the High Court against the revenue department up to the date of the Supreme Court's decision in favour of the department from the period of limitation to enable the department to issue a revision notice for the assessment of tax was manifestly arbitrary.[107] Similar to the *Essar Chemicals* case, this was deemed to create hardships for the dealer. In *Pepsi Foods*, the Court dealt with the constitutionality of Section 244 of the Income Tax Act, under which an appeal is automatically vacated in favour of the revenue department, for no fault of the assessee-appellant. The Court found this to have a "capricious, irrational and disproportionate" impact on the assessee and struck down the provision for being manifestly arbitrary.[108]

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[100] Anup Surendranath, 'Developments in Equality Jurisprudence, The Courts & The Constitution'2019 in Review, NALSAR University of Law, 26th January, 2020.

[101] *Navtej Singh Johar v. Union of India* (2018) 10 SCC 1.

[102] *Essar Steel India Ltd. Committee of Creditors v. Satish Kumar Gupta*, (2020) 8 SCC 531.

[103] *Hindustan Construction Co. Ltd. v. NHPC Ltd*, (2020) 4 SCC 310.

[104] ibid.

[105] ibid.

[106] *Essar Steel India Ltd. Committee of Creditors v. Satish Kumar Gupta*, (2020) 8 SCC 531.

[107] *Reliance Industries Ltd. v. State of Gujarat*, 2020 SCC OnLine Guj 694.

[108] *Pepsi Foods Ltd* (n 63).

Even before the pronouncement in *Shayara Bano*, the Supreme Court in *Mardia Chemicals* struck down Section 17(2) of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interests Act, 2002 which mandated the deposit of 75% of claimed amount as a precondition to hearing an appeal by the Debt Recovery Tribunal as being "onerous, oppressive, unreasonable, arbitrary and hence violative of Article 14 of the Constitution".[109] All these cases show that Courts recognize and apply the arbitrariness standard to invalidate commercial legislations that impose disproportionate or excessive hardship without adequate reason. In 2021, the doctrine was expanded further to include both substantive and procedural challenges to tax statutes.[110]

In determining the arbitrariness of the tax, it is important to note that we should consider the true incidence of a 28% turnover tax, rather than merely viewing it as a 28% tax on a service. This is comparable to the situation in *Patel Gordhandas Hargovindas v. Municipal Commr.*, where the Supreme Court went into determining the annual value of land for the purpose of taxation.[111] The basis of such tax was the annual letting value of the land ascertained by taking into account the actual rent where the land is let, or where it was not let, by taking into account the hypothetical tenancy. Where neither of these methods could be applied, the annual value was calculated as being a 'suitable percentage' of capital value, on which tax was then applied. The Municipal Corporation framed Rule 350A which levied tax at 1% on the valuation based upon capital value itself, rather than determining the annual value and then taxing it. The Court declared Rule 350A *ultra vires* the parent Act because it changed the taxable base from annual value, meaning the amount earned from the land, to the capital value of the land itself.

In doing so, the Court emphatically rejected the argument that it makes no difference given that it is possible to arrive at the same figure by either of these methods. It gave the example of a land whose capital value is Rs. 100 on which a tax of 1% would work out to Rs. 1. The same figure can be arrived at by the other method; assuming that 4% is the annual yield, the annual value of the land, the capital value of which is Rs. 100, will be Rs. 4. A rate levied at 25% will give the same figure, namely Rs. 1. However, even though it is mathematically possible to arrive at the same amount, the Court held that:

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[109] *Mardia Chemicals Ltd. v. Union of India*, (2004) 4 SCC 311.

[110] *Pepsi Foods Ltd* (n 63) [16].

[111] *Patel Gordhandas Hargovindas v. Municipal Commr.*, 1963 SCC OnLine SC 57.

> If the law enjoins that the rate should be fixed on the annual value of lands and buildings, the municipality cannot fix it on the capital value, and then justify it on the ground that the same result could be arrived at by fixing a higher percentage as the rate in case it was fixed in the right way on the annual value. Further by fixing the rate as a percentage of the capital value directly, the real incidence of the levy is camouflaged. In the example which we have given above, the incidence appears as if it is only 1 percent but in actual fact the incidence is 25 percent of the annual value. Further if it is open to the municipality to fix the rate directly on the capital value at 1 percent it will be equally open to it to fix it, say at 10 percent, which would, taking again the same example, mean that the rate would be 25 [sic] per cent of the annual value, and this clearly brings out the camouflage. Now a rate as 10 percent of the capital value may not appear extortionate but a rate at 250 percent of the annual value would be impossible to sustain and might even be considered as confiscatory taxation. This shows the vice in the camouflage that results from imposing the rate at a percentage of the capital value and not at a percentage of the annual value as it should be (emphasis supplied).[112]

While we acknowledge that the above case concerns direct tax, whereas the GST is an indirect tax whose burden can be passed on to consumers, it is important to take note of the underlying principle that one should not camouflage the incidence of tax in online gaming. A sum of Rs. 100 on which a tax of 28% is levied would work out to Rs. 28. The same figure can be arrived at by taxing the price actually paid by the GGR method; assuming that the operator charges 10% rake fees, the taxable base on a sum of Rs. 100 will be Rs. 10. A rate levied at 280% will give the same figure, namely Rs. 28. However, imposing a rate of 280% brings out the camouflage and may be considered extortionate, confiscatory, and impossible to sustain.

To withstand such a tax, the burden would inevitably be passed on to consumers. In order to make profits, let us assume the platform charges 40% rake fee (above the 28% taxed). For every Rs. 100 bet being placed, the operator earns Rs. 40, of which Rs. 28 is paid as tax to

[112] ibid [34].

the state.[113] This leaves the operator with Rs. 12 as the net revenue, accounting for the tax paid (not accounting for costs of operation of providing the service). Even under such a system where the operator remains viable after charging a high rake fee at around half the bet value, extracting Rs. 28 from a service provider who earns Rs. 40 as revenue in effect amounts to a 70% tax burden on the gaming platform.

The only way to reduce such an onerous imposition is to increase the rake fees even further than the 40% levied and pass on even more of the tax burden to the consumer. In fact, even if the operator charges Rs. 50 (50% of base value) as the rake fees, and a tax of Rs. 28 is levied, it still amounts to a 56% burden on the actual revenue (Rs. 50) retained by the operator. However, under that system, instead of the operator shutting down due to a high tax, they would shut down due to consumers' unwillingness to pay such a high participation fee and have most of their stakes be taxed instead of placed in the game. Thus, regardless of the extent to which the burden of tax is passed on to participants, the platform would remain unviable.

In this regard, even assuming that gaming is a sin good, a 28% tax is much more than the sin tax presently levied on other goods known to be injurious to public health such as cigarettes. The total rate of tax on cigarettes (including GST and the National Calamity Contingent Duty) is at most 52.7% of the final retail price.[114] Soft drinks such as Pepsi and Coke, again deemed to be 'sin goods', are taxed at the 40% slab (a 28% GST plus a 12% compensation cess), which is viewed as one of the highest rates of tax globally.[115] These taxes are designed to discourage the use of cigarettes or soft drinks, and yet the imposition of burden is at most 52% of the amount received per unit sold. On the other hand, online gaming is subject to a burden of over 70% of the amount an operator receives under the amended regime, clearly indicating that the tax would not simply discourage online gaming, but make entities commercially unviable. Thus, a tax which forces operators to shut down either due to the brunt of facing the tax or due to consumers no longer finding the cost of participation viable is a

[113] It is important to caveat here that a 40% rake fees which makes the operator viable, is also a generous assumption, considering how as we noted above, operators presently do not charge such high rake fees given it disincentivises players to participate. Thus, either operators are forced to charge high commissions pushing players to the grey market, or operators themselves shift to unregulated grey markets given the imposing costs of participation under the proposed system.

[114] Krishna Veera Vanamali, 'What is sin tax? What is it imposed on?' (*Business Standard*, 14 February 2022) <https://www.business-standard.com/podcast/finance/what-is-sin-tax-what-are-they-imposed-on-1220214000441.html> accessed April 22, 2023.

[115] John Sarkar, 'Local soft drink players move to 160ml packs to offset higher GST' (*The Times of India*, 12 April, 2022) <https://timesofindia.indiatimes.com/business/india-business/local-soft-drink-players-move-to-160ml-packs-to- offset-higher-gst/articleshow/90790326.cms> accessed April 22, 2023.

disproportionate burden imposed on platforms and is therefore manifestly arbitrary.

As explained in Part II, there is no cogent reason considering online skill gaming is not a demerit good, making such an imposition manifestly arbitrary. The lack of cogency becomes even more evident when we consider the 60-year jurisprudence differentiating games of skill and chance. While states have wide authority to determine tax slabs, importing a 28% turnover tax applied to discourage gambling, a sin good recognized by courts as deleterious and injurious to public morals, to online gaming, recognized by courts as an avenue for exercising diverse skills of individuals is grossly arbitrary. In fact, in *Skill Lotto*, the Supreme Court held that such a turnover tax on gambling was justified given how gambling constituted *res extra commercium*, while gaming did not, therefore enabling states to have regulations (which included taxation) at such high rates.[116] This justification does not extend to online gaming. Consequently, a 28% tax is manifestly arbitrary.

CONCLUSION

With the massive surge in the online gaming industry and building revenue expectations, taxation of online gaming is a high-stakes issue. To ensure its continued growth, India needs to implement an effective regulatory and taxation policy that balances the interests of all stakeholders. In doing so, determining an appropriate taxable base—is of crucial importance. Adopting a 28% turnover tax without differentiating between gaming and gambling, will likely stunt the growth of the industry and push operators towards grey markets, as has been the experience with other nations.

These changes do not merely cause hardship to gaming operators, but render their business commercially unworkable. Since online gaming is a protected trade under Article 19(1)(g), a law that *de-facto* forces its shutting down can be seen as colourable legislation that indirectly achieves an impermissible end. The amendments would also fall foul of Article 14 of the Constitution under the manifest arbitrariness standard, for being excessive and disproportionate in their impact. Thus, the changes are not only economically undesirable but also legally unsound and constitutionally infirm. To preserve and boost the growth of the online gaming industry, India must retain the GGR model of taxation.

[116] *Skill Lotto Solutions (P) Ltd. v. Union of India*, (2021) 15 SCC 667 [76-77].