LKS UPDATE

An e-update to clients from Lakshmikumaran & Sridharan

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INDIRECT TAX

Game of skill like 'Rummy' is not gambling or betting, even if played with stakes

Payment of an amount towards participating in a game as prize pool is not 'supply'

UPDATE NO. 26 OF 2023

Lakshmikumaran & Sridharan attorneys

exceeding expectations
SINCE 1985

"The judgment reiterates the legal position in relation to skill-based gaming intermediaries and international best practices on taxation. A positive affirmation on GGR method of valuation on actual value addition by the platform service provider. The judgment brings in a sigh of relief to gaming sector facing GST investigation on method of valuation and discounts offered to customers. The verdict is in line with the recognition of gaming platform providers as intermediaries facilitating the transaction by the MeitY under new self regulatory and TDS regime. This will have a positive impact on GST Council to consider valuation for online skill games based on Gross Gaming revenue (GGR), which is internationally accepted. As Hon'ble Finance Minister observed, stability in tax policy will boost investment in the sector."

L. Badri Narayanan,
Executive Partner, LKS

BRIEF FACTS

Various Writ Petitions were filed by M/s. Gameskraft Technologies Pvt. Ltd. (**'Petitioner'**), an Online Intermediary Company which provides technology platforms that allows its users to play skill based online games against each other, challenging attachment orders, an intimation notice, and a show cause notice issued by the Department.

It had been alleged by the department that the Petitioner is involved in 'betting / gambling' and supplies 'actionable claims' chargeable to GST on the full value of contest entry amount at the rate of 28% GST. It was also alleged that the petitioner is guilty of evasion of GST by misclassifying their supply as services under SAC 998439 instead of actionable claims which are goods and mis-declaring their taxable value. The showcause notice also had allegations in relation to the discounts and time of supply.

Further, Intervention Applications were filed by the Intervenors i.e., All India Gaming Federation ('AIGF') and E-Gaming Federation (EGF) who were supporting the contentions of the petitioners and aggrieved by the actions of the Department, to the extent that the department sought to tax full value of contest entry amount @ 28%.

ISSUE

Whether online games which are preponderantly based on skill and not on chance if played with stakes amount to 'gambling or betting' as contemplated in Entry 6 of Schedule III of the GST Act, 2017, and therefore chargeable to GST?

PETITIONER'S / INTERVENOR'S CONTENTIONS IN BRIEF-

- Entry 6, Schedule III (ACTIVITIES OR TRANSACTIONS WHICH SHALL BE TREATED NEITHER AS A SUPPLY OF GOODS NOR A SUPPLY OF SERVICES) of the CGST Act, 2017 only incudes 'betting' and 'gambling' as they are recognized to be '*games of chance*' for taxation purposes under the GST regime, Games offered on the platform of the Petitioner are *games of skill*' and therefore do not amount to betting and gambling. Hence, the GST Department does not have the jurisdiction to issue the said showcause notice.

- The distinction between *'Games of skill'* from that of *'Games of chance'* is essential as recognized by statutes and interpreted by judicial pronouncements with the application of the 'predominance' test where a game of mere skill would mean that the element of skill is higher than the element of chance, which is essential to ascertain the true nature of the game.

- States have competence over Games of Chance and not Games of Skill by virtue of Entry 34 of List II of the Constitution of India.

- The expression *'gaming'* does not merit any reexamination, since it has become *nomen juris*, in view of *State of Andhra Pradesh* v. *K. Satyanarayana & Ors* - AIR 1968 SC 825 wherein it was held that Gaming is the act or practice of gambling on a game of chance and that it is staking on chance where chance is the controlling factor and the said definition applies uniformly to all gaming legislations. This position has been reiterated by the Hon'ble High Courts in various decisions pertaining to gaming.

- It is no longer *res integra* that '*wagering' or 'betting*' on a game of skill is not '*gambling*' since the outcome depends on the "*substantial degree of skill*" of the players.

- Placing reliance on *Dr. K. R. Lakshmanan* v. State of *Tamil Nadu* - (1996) 2 SCC 226, it was observed that competitions involving substantial skill or predominantly skill are "*business activities*" that stand protected under Article 19 (1) (g) of the Constitution.

- Tax on competitions where success depends preponderantly on skill, is not governed under the then Entry 62 which included betting and gambling, but will be a tax under Entry 60 of List II, i.e., as a trade activity.

- Rummy played with stakes has been judicially permitted and is not considered as '*gaming' or 'gambling*'.

- There is an element of '*chance*' in each game and a '*game of skill*', may not necessarily be such an activity where "skill" must always prevail; however where in an activity the "*exercise of skill*" can control the '*chance'* element involved in the particular activity, such that the better skilled would prevail more often than not, such activity qualifies as a game of skill.

- Countering the contention of the department, who referred to the decision of *State of Andhra Pradesh* v. *K. Satyanarayana & Ors* - AIR 1968 SC 825 to state that making a profit or gain by charging players for playing rummy on the platform is impermissible and that rummy played for stakes is an offence, the petitioners contended that the said contention was misconceived and untenable since the club in question was a 'members club' and what was possibly illegal was charging a heavy charge on the members for playing in card room for the purposes of making a profit or gain and the said scenario could not be extended to the petitioner company's platform. The petitioners in their writ petition relied on the said decision to submit that rummy is preponderantly a game of skill.

DEPARTMENT'S CONTENTIONS IN BRIEF:

- Reliance was placed on *State of Andhra Pradesh* v. *K. Satyanarayana & Ors* - AIR 1968 SC 825 to contend that the Petitioner charges platform fee / commission resulting in profit and gains by allowing players of online rummy to place stakes and bet on the outcome of such games which would amount to betting and gambling.

- Orders have been passed by High Courts in relation to various gaming companies in numerous matters in writ jurisdiction, where no factual investigations were conducted and therefore do not hold any precedential value.

- The decision of the Apex Court in *M.J. Sivani and Ors.* v. *State of Karnataka* – (1995) 6 SCC 289 was brought to the notice of the court which enumerated the dictionary meaning of 'gaming' and contended that playing a game which is preponderantly of skill played with either money or stakes amounts to gambling.

- The judgment of the Karnataka High Court in *All India Gaming Federation* v *State of Karnataka & Ors* – (2022) SCC OnLine Kar 435 (DB) will have no applicability to the present facts of the case as the decision was vires of the 2021 Amendment treating Games of Skill on par with Games of Chance, but were ought to have been treated as falling under different categories.

DECISION:

- The Hon'ble Court held that payment of an amount towards participating in a game as prize pool is not 'supply' in terms of the CGST Act and excluded from the ambit of 'betting' and 'gambling'.

- The Hon'ble High Court relied upon past jurisprudence and held that there is a distinct difference between '*games of skill*' and '*games of chance*.' Referring to the decision of the Division Bench of the Karnataka High Court in *All India Gaming Federation* v *State of Karnataka & Ors* – (2022) SCC OnLine Kar 435 (DB), the Court held that games such as rummy, etc. whether played online or physical, with or without stakes would be games of skill which would be determined through the application of the test of predominance.

- The Court observed that though Section 2(17) of the CGST Act recognises wagering contracts as included in the term 'business', but that in itself would not mean that lottery, betting and gambling are the same as that of games of skill.

- The meaning of the terms "lottery, betting and gambling" as contemplated in Entry 6 of Schedule III of the CGST Act should be construed *nomen juris* in the light of the decisions of the Hon'ble Supreme Court, the Karnataka High Court and other High Courts which do not include games of skill.

- Further, the Court held that Entry 6 in Schedule III to the CGST Act taking actionable claims out of the purview of supply of goods or services would clearly apply to games of skill; and only games of chance such as lottery, betting and gambling would be taxable.

- Taxation of games of skill is outside the scope of the term "supply" in view of Section 7(2) of the CGST Act, 2017 read with Schedule III of the Act.

- The Court had the following observations on a game of chance/ skill being 'gambling' :

Game of Chance / Skill	Whether gambling or not
A game of chance whether played with stakes	Gambling
A game of skill whether played with stakes or without stakes	Not Gambling

A game of mixed chance and skill if substantially and preponderantly a game of chance and not of skill	Gambling
A game of mixed chance and skill if substantially and preponderantly a game of skill and not of chance	Not Gambling
Rummy whether played with stakes or without stakes	Not Gambling
Online / Electronic / Digital Rummy whether played with stakes or without stakes	Not Gambling
Other Online / Electronic / Digital games which are also substantially and preponderantly games of skill and not of chance	Not Gambling

- The Court further held that 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.

- The expressions, *'Betting' and 'Gambling'* having become nomen juris, the same are applicable for the purpose of GST also and consequently, the words, *'Betting' and 'Gambling'* contained in Entry 6 of Schedule III to the CGST Act are not applicable to Online/Electronic/Digital Rummy, whether played with stakes or without stakes as well as to any other Online / Electronic / Digital games which are also substantially and preponderantly games of skill;

- Consequently, the Court quashed the impugned Show Cause Notice issued by the department to the petitioners and rendered it to be illegal, arbitrary and without jurisdiction or authority of law.

LKS COMMENTS

The Hon'ble Court held that the 'prize pool' shall not be a 'supply' in terms of Section 7 of the CGST Act, 2017, without delving into the aspect of valuation of games of skill. The aforesaid decision reiterates the legal position in relation to online skill-based gaming intermediaries and international best practices on taxation.

The judgement is in tandem with the new self-regulatory and TDS regime introduced by the MeitY which attributes recognition to gaming platforms as intermediaries facilitating transactions, and paves the way forward for the online gaming industry in a positive direction. The GST Council, which is currently deliberating over the valuation for online skill games based on Gross Gaming revenue (GGR), which is an internationally accepted practise, shall take into consideration the principles laid down in the *Gamseskraft* matter in order to balance the interests of the industry and the revenue authorities alike.

The Group of Ministries on Casino, Race courses and Online Gaming (GoM), which submitted its report on issues surrounding valuation and rate of taxation pertaining to online gaming in the 47th meeting of the GST Council relied heavily on the judgement of the Hon'ble Supreme Court in *Skill Lotto Solutions Pvt. Ltd.* v. *Union of India and Ors* [2020 (43) G.S.T.L.289 (S.C), to conclude that online gaming involves supply of actionable claim and should therefore be taxed as in the case of lottery. Equating online gaming to casino and race-courses, the GoM also stated uniform taxes should be levied on online gaming holding that the three activities involve the elements of betting and gambling.

The GoM, which has submitted its second report to the GST Council in December 2022 and is yet to be made available in the public domain, will have to be re-examined in the light of the judgement of the Hon'ble Karnataka High Court which has categorically stated that only games of chance such as lottery, betting and gambling would be taxable and should be differentiated from games of skill.

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