

EY Tax Alert

Karnataka HC holds hosting the game of rummy on online platform is not in the nature of betting or gambling

Executive summary

This tax alert summarizes the recent ruling¹ of the Karnataka High Court (HC) on whether online games, such as rummy, played with or without stakes, tantamount to “betting” or “gambling”.

Petitioner in the present case is an online intermediary company, operating technology platforms that allow users to play online games, such as rummy, against each other, and charges a certain percentage of buy-in amount as its platform fee.

Revenue issued show cause notice (SCN) on the petitioner alleging that it is involved in betting/ gambling and is misclassifying its supplies to its customer as services instead of actionable claims (*i.e.*, goods). Further, the taxable value declared by it is also incorrect. Aggrieved, petitioner filed writ petitions before the Karnataka HC.

The key observations of the HC are summarized below:

- ▶ Entry 6 of Schedule III to the Central Goods and Services Tax Act, 2017 (CGST Act), taking actionable claims out of the purview of supply, would clearly apply to games of skill and only games of chance such as lottery, betting and gambling would be taxable.
- ▶ A game of mixed chance and skill is not gambling if it is substantially and preponderantly a game of skill and not of chance.
- ▶ The game of rummy is not one where the outcome of an event is being predicted. It is a game where predominantly skill is exercised to control the outcome of the game. Further, there is no difference between offline and online rummy.
- ▶ The expressions “Betting” and “Gambling” having become *nomen juris*, are applicable for the purpose of GST also and consequently, the said words are not applicable to online rummy, whether played with stakes or without stakes.

Accordingly, HC allowed the writ petitions and quashed the SCN issued by Revenue considering the same as illegal, arbitrary and without jurisdiction or authority of law.

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¹ 2023-TIOL-531-HC-KAR-GST

Background

- ▶ Petitioner in the present case is an online intermediary company, who runs technology platforms that allow users to play online games, such as rummy, against each other and charges a certain percentage of buy-in amount as its platform fee.
- ▶ In November 2021, Revenue undertook search and seizure operations on the premises of the petitioner, during which, various documents and devices were seized.
- ▶ Consequently, bank accounts of the petitioner were attached under Section 83 of the Central Goods and Services Tax Act, 2017 (CGST Act).
- ▶ Revenue alleged that the petitioner was involved in betting/ gambling and is misclassifying its supplies to its customer as services under SAC 998439 instead of actionable claims (*i.e.*, goods). Further, the taxable value declared by it is also incorrect.
- ▶ Aggrieved, petitioner filed writ petition before the Karnataka High Court (HC) challenging the aforesaid actions of the Revenue. HC passed an interim order permitting petitioner to operate the bank accounts for limited purposes mentioned in the order. Further, it directed that no precipitative action can be taken against the petitioner.
- ▶ Subsequently, Revenue issued intimation notice under Section 74(5) of the CGST Act, calling upon petitioner to deposit the amount of tax alleged to be evaded, along with interest and penalty. The same was followed by a show cause notice (SCN) under Section 74(1).
- ▶ The above notices were also challenged by the petitioner before the HC by way of separate writ petitions.
- ▶ The main issue that arose for consideration before the HC in these petitions were whether online games, such as rummy, played with or without stakes, tantamount to “gambling or betting” as contemplated in Entry 6 of Schedule III to the CGST Act.

Petitioner’s contentions

- ▶ The basic construct of an online skill-based game facilitated by petitioner is that it has no role or influence insofar as the playing of the games are concerned and it merely hosts such games. The players choose the games based on the amount they want to stake to match their skills against other players who want to play for a similar amount.

For example, “A” and “B” have downloaded the mobile application of the Petitioner and intend to play a game of rummy against each other. As per the construct of the game, A and B have to deposit INR 200 each for participation in the game. The winner at the end of the

game gets INR 360 as winnings. For allowing A and B to use its platform, petitioner would charge INR 20 each from A and B (*i.e.*, INR 40 in total).

During the course of the game, INR 360 is held by the petitioner in a designated account and on this amount, it has no lien or right. The money is transferred back to the winner at the end of the game. The same is also reflected in the terms and conditions of the gameplays.

Therefore, what the petitioner retains is INR 40, on which it has been depositing tax.

As per the impugned SCN, the entire buy-in amount (*i.e.*, INR 400 in the above example) is alleged to be the income of the petitioner chargeable to Goods and Services Tax (GST) as betting or gambling.

- ▶ More than 96% of the games played on the platform is “rummy” which is a “game of skill” as held in judgments of the Supreme Court (SC) and various HCs. The character of rummy being a game of skill does not change when it is played online.
- ▶ It is well settled that “games of skill” played with monetary stakes does not partake the character of betting. The term “betting and gambling” cannot be artificially bifurcated by the Revenue to carve out an exception by stating that “games of skill” played with monetary stakes can also partake the character of betting and hence, be taxable at the rate of 28%.
- ▶ The Impugned SCN is premised on the fact that the petitioner is involved in the supply of “actionable claim” which is *ex-facie* erroneous. Actionable claim, if any, is between the players, which is also not taxable under GST laws since actionable claims are excluded from the ambit of GST (except for lottery, betting and gambling).
- ▶ The Impugned SCN is in gross violation of the law laid down by the Division Bench of the Karnataka HC in the case of All India Gaming Federation vs. State of Karnataka & Ors² wherein it was held that a game which involves substantial amount of skill is not gambling. Further, a game of skill does not cease to be one even when played with stakes.
- ▶ Therefore, the said SCN is completely fallacious, perverse, and without jurisdiction or authority of law and the same is vitiated with malice and deserves to be quashed.
- ▶ Petitioner relied on various other judgements of SC and HCs to support its above contentions.

Revenue’s contentions

- ▶ The platform of the petitioner allows players to place stakes and bet on the outcome of such games of rummy. In addition to this, petitioner is making profits and gains from such games, which according to the SC in the case of State of Andhra Pradesh vs. K. Satyanarayana & Ors.³, would amount to betting and gambling.

² 2022 SCC Online Kar 435 (DB)

³ AIR 1968 SC 825

- ▶ The contention of the petitioner that the game of rummy played on its platform is a game of skill deserves to be rejected. To the contrary, it is nothing but a pure game of chance.
- ▶ According to the SC⁴, there is a threefold test to determine whether a particular game is a game of chance or of skill. Firstly, it has to be identified on the facts and circumstances of each case. Secondly, the underlying facts must disclose that the success in the game preponderantly depends on skill or chance. Thirdly, the skill must be discernible from the superior knowledge, training, attention, experience and adroitness of the player.

In the present facts of the case, the only criteria to enter a particular table on the platform is to stake a particular amount. Further, the platform does not record or disclose the skill level of a player to all the players seated at a table. Therefore, when skill is not the qualifying criteria, the success of the game principally depends on chance and not skill. Accordingly, in the facts and circumstances, the game of rummy is a game of chance.

- ▶ Further, the commission retained by the petitioner is nothing but profits from the stakes placed on the outcome of games of rummy. Assuming but not admitting that rummy played on petitioner's platform is a game of skill, playing it with stakes and the petitioner making profits from such stakes would still be betting as per the Satyanarayana's case (*supra*).
- ▶ The judgment of Karnataka HC in All India Gaming Federation (*supra*) will have no applicability as what was decided was only the *vires* of the amendment carried out in the Karnataka Police Act, 1963, treating games of skill on par with games of chance.

Taking note that they fell under different categories and ought not to have been treated as same, HC struck down the amendment. The Court never had the occasion to examine on a factual basis as to whether the underlying games were of chance or skill.

When such is the case, the contention of the petitioner that the issue is decided against the Revenue in the light of this decision, deserves to be rejected.

High Court's ruling

- ▶ As per Entry No. 6 of Schedule III to the CGST Act, actionable claims except lottery, betting and gambling are neither considered as supply of goods nor services.
- ▶ The question that arises in the present case is whether a game of skill, either wholly or predominantly, can be classified as lottery, betting and gambling if such elements are involved in the said game of skill.
- ▶ The scope of "betting and gambling" came to be considered by the SC in State of Bombay vs. RMD

Chamarbaugwala⁵ wherein the Court followed its decision in RMD Chamarbaugwala vs. Union of India⁶ and excluded games of skill (where success depends on skill to a substantial degree) from the scope of gambling.

- ▶ Though Section 2(17) of the CGST Act recognizes even wagering contracts as business, but that in itself would not mean that lottery, betting and gambling are the same as games of skill.
- ▶ 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.
- ▶ A game of mixed chance and skill is gambling, if it is substantially and preponderantly a game of chance and not of skill. Conversely, a game of mixed chance and skill is not gambling, if it is substantially and preponderantly a game of skill and not of chance.
- ▶ The game of rummy is not one where the outcome of an event is being predicted. It is a game where predominantly skill is exercised to control the outcome of the game. When the outcome of a game is dependent substantially or preponderantly on skill, staking on such game does not amount to betting or gambling.

Further, there is no difference between offline/ physical rummy and online rummy. Both are substantially and preponderantly games of skill and not of chance.

- ▶ The Revenue's contention that Satyanarayana's case (*supra*) is a clear enunciation of law that games of skill played with stakes amounts to gambling and that when the club makes a profit, it amounts to the offence of running a common gambling house, is wholly erroneous.

As per the said case, the offence of being a "common gambling house" is attracted when the club itself is concerned with the outcome of the game. Petitioner herein is not interested on the outcome of a game. Irrespective of who wins, the petitioner collects a percentage of the amounts staked as its platform fees / commission for providing its services as an intermediary.

- ▶ Further, a careful perusal of the ratio laid down by Karnataka HC in All India Gaming Federation's case (*supra*), will indicate that the said judgment is neither *per incuriam* nor *sub-silentio* as contended by the Revenue.
- ▶ The expressions "Betting" and "Gambling" having become *nomen juris*, are applicable for the purpose of GST also and consequently, the said words are not applicable to online rummy, whether played with stakes or without stakes.
- ▶ Accordingly, writ petitions filed by petitioners are allowed and impugned SCN is quashed being illegal, arbitrary and without jurisdiction or authority of law.

⁴ (1996)2 SCC 226

⁵ AIR 1957 SC 699

⁶ AIR 1957 SC 628

Comments

- a. HC has re-iterated the principles differentiating the “game of chance” from “game of skill” as laid down by various judgements of SC and other HCs. Considering the stakes involved, Revenue may prefer further appeal before the SC.
- b. Basis the observations of the HC, online platforms hosting various games involving stakes, may need to analyze whether such games qualify as game of chance or game of skill and pay tax accordingly.
- c. Taxpayers who have paid tax on the entire buy-in amount considering the game of skill as betting or gambling, may evaluate the possibility of refund basis this judgement.

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