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# SC rules that royalty is not in the nature of ‘tax’ or ‘impost’; affirms states’ right to recover past tax dues effective from 1 April 2005

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## Summary

In a majority judgment, the 9-judge bench of the Supreme Court (SC) has held that royalty and dead rent do not qualify as taxes or impositions. The SC acknowledged the conceptual differences between royalty and tax. Royalty is a consideration for parting with mineral extraction rights and compensation towards the loss of mineral value, while tax is a sovereign imposition based on a taxable event. Thus, the SC concluded that payments made under a contract to the state government for exclusive privileges and rights are not in the nature of ‘impost’ or ‘tax’ under Article 366(28) of the Constitution of India. The SC has also stated that the states have the authority to impose taxes on mineral rights, and the Union law does not restrict this power.

The SC has held that the judgement shall have retrospective effect from 1 April 2005, and demands would be payable over a 12-year period starting from **1 April 2026**. However, the SC has waived off the interest and penalty on the demands made for the period before 25 July 2024 for all the assesses.


## Background

- The Mines and Minerals (Development and Regulation) Act, 1957 (MMDR Act), enacted by the Parliament under Entry 54 of List I (Union List), is a comprehensive code for regulating mines and mineral development. Section 9 of the MMDR Act mandates that mining leaseholders must pay royalty on the minerals extracted or consumed.
- The SC, in the case of *India Cement Ltd.*[1], had held that ‘royalty is a tax’ and that state legislatures lack the competence to levy taxes on mineral rights, as the MMDR Act covers this. On the contrary, the SC, in the case of *Kesoram Industries Ltd.*[2], correcting the inadvertent error in the *India Cement* case, had clarified that ‘royalty is not a tax.’
- Following these decisions, some states exercised their legislative powers to impose taxes on mineral-bearing land and other levies, such as environment and health cess. The constitutional validity of these state levies was challenged before the jurisdictional high courts for being beyond the legislative competence of the state legislatures. The Patna HC, in the case of *Mineral Area Development Authority*, relying on the SC’s judgement in the *India Cements* case, had quashed such levy for not being within the legislative competence of the state.
- In an appeal before the SC, the 3-judge bench observed the contradiction between *India Cements* and *Kesoram*, and referred the issue before the 9-judge bench to primarily determine the true nature of royalty.

## Submissions of petitioners

- It was contended that royalty, as mandated by Section 9 of the MMDR Act, is a consideration for parting with the right to work the mine and extract minerals, vested either in the government or a private person.
- It does not meet the 'tax' or an 'impost' criteria and cannot be construed as a tax on minerals or mineral rights.

[1] (1990) 1 SCC 12
[2] (2004) 10 SCC 201

- ‘Taxes on lands and buildings’ as specified under Entry 49 of List II should be broadly construed to include mineral-bearing lands. The value of minerals can be used to tax such lands since minerals are part and parcel of land until extraction is done.
- It was argued that the MMDR Act does not explicitly limit the state legislatures’ competence to impose tax on mineral rights. Accordingly, being distinct from tax, royalty does not limit the state’s plenary powers to impose tax under Entry 50 of List II.
- Any limitations on the states' taxing power must be explicitly imposed by the Parliament through law and cannot be inferred or delegated. Therefore, states, as proprietors of minerals, have the sovereign right to receive royalty and impose taxes on minerals.

## Submissions of respondents

- On the contrary, the department averred that royalty is a consideration for granting permission to work and extract minerals. Any levy relating to mineral development, irrespective of whether it is designated as a tax, would limit the state’s taxing powers.
- The MMDR Act is a comprehensive code governing all mineral regulation and development aspects, including levies like royalty. Royalty essentially is in the nature of a tax on mineral rights, considering both are exactions by the sovereign in the exercise of their statutory powers. Thus, taxes on mineral rights must be understood as charges related to mineral development. Since the MMDR Act encompasses all such levies, it precludes the states from imposing additional charges.
- It was contended that allowing states to impose taxes based on mineral values would undermine the Union’s authority under Entry 54 of List I and disrupt uniform mineral development. In the case of a conflict between Union and state laws, the Union’s power prevails. Therefore, the MMDR Act’s regulation and levies on minerals would take precedence over state-imposed taxes under Entry 50 of List II. Accordingly, it restricts the states’ ability to impose additional charges or taxes on mineral rights.
- Furthermore, both Entry 54 of List I and Entry 50 of List II form a cohesive framework and must be read in consonance. Taxing mineral rights involves a narrow focus, and the MMDR Act already regulates this. The phrase “any limitations” in Entry 50 of List II includes all levies connected to mineral development under the MMDR Act. The tax measure must relate to the nature of the tax.
- In India, all minerals belong to the state. Owning land does not give the owner a right to the minerals in the soil. Thus, the owner of mineral-rich land cannot be taxed based on the value of the minerals in the soil. This further emphasises that the Parliament’s comprehensive regulation under the MMDR Act curtails the states' power to tax.

## SC’s observations and judgement (CA Nos. 4056-4064/1999; order dated 25 July 2024 and dated 14 August 2024)

### Royalty and dead rent do not fulfil the characteristics of ‘tax’ or ‘impost’

- **Compensation by lessee to lessor:** Upon an in-depth evaluation of the provisions of the MMDR Act, the SC elucidated that ‘Royalty’ is a payment in the nature of compensation by the lessee to the lessor (government or private owner) for extracting minerals from the land, which flows from the mining lease and is generally determined on the basis of the quantity of minerals removed.
- **Royalty is a contractual obligation:** The compulsion of royalty depends on contractual conditions between the lessor and lessee, and such payment is not for public purposes; instead, it is an ‘exclusive use’ charge stemming from the lease agreement. Accordingly, such contractual payments/consideration due to the government is a proprietary payment for parting with minerals. It differs from dead rent, which ensures a fixed income even if the mine is idle.
- **Tax is imposed by authority of law:** On the other hand, taxes are compulsory exactions by way of sovereign imposition for public purposes, enforceable by law, without a direct quid pro quo. Based on the analysis, the SC affirmed the position established in *Kesoram* and held that royalty, foreclosed by lease deed, is a contractual payment, not a tax. Similarly, dead rent, which ensures regular income, also does not qualify as a tax.
- **Decision in India Cement case incorrect:** The SC has concluded that the observation in the India Cement case that royalty is a tax is erroneous, as both royalty and dead rent do not fulfil the characteristics of tax or impost.

### Parliament can limit the state’s power to tax mineral rights

- The SC explained that the subject of regulating mines and mineral development is found in Entry 23 of List II, with the Parliament having overriding control under Entry 54 of List I when deemed expedient in the public interest. Entry 54 of List I requires the Parliament to declare its control, the public interest, and the extent of regulation.
- The term 'regulation' includes management by rules or laws, and 'mine' consists of any excavation for obtaining minerals. Accordingly, mineral development encompasses exploitation, reducing waste, and environmental regulation. The MMDR Act details the regulation of mining operations and the development of minerals.
- The Constitution distinguishes between the regulation of mines (Entry 23 of List II) and taxes on mineral rights (Entry 50 of List II). Entry 50 of List II is subject to limitations the Parliament imposed on mineral development under Entry 54 of List I.
- However, the taxation powers of the state are distinct and cannot be implied under regulatory entries. Key court decisions[3] have affirmed that parliamentary legislation under Entry 54 denudes the state's power under Entry 23 to the extent specified by the Parliament. However, such decisions do not reflect that the MMDR Act imposes specific limitations on taxes on mineral rights under Entry 50 of List II.
- The term 'mineral rights' includes the right to extract, win, and remove minerals; taxes on these rights are distinct from duties on minerals produced. The state's taxing powers under Entry 50 are exclusive and can only be limited by express provisions in a parliamentary law related to mineral development. The MMDR Act's scheme does not itself serve as a limitation on state taxation powers.
- The parliament can impose any limitations, including prohibition, on the state taxing powers under Entry 50, provided it is done through a law. The principle of federal supremacy does not apply here, as there is no direct conflict between the Union's regulatory powers and the state's taxing powers.
- Conclusively, while the parliament can limit the state's power to tax mineral rights, it must do so explicitly through legislation related to mineral development. The MMDR Act does not currently impose such limitations, and the state's power to tax mineral rights remains unless expressly curtailed by the Parliament.

### Reasonable nexus between 'measure' and 'levy' necessary to impose tax

- The legislature's discretion in selecting tax subjects and measures is broad, provided it adheres to constitutional principles. States can classify and tax lands, including mineral-bearing lands, based on their use and productivity. States can levy taxes on mineral-bearing lands, and measures like royalty can be used, provided there is a reasonable nexus between the measure and the nature of the tax. The MMDR Act does not limit the legislative competence of states to tax lands under Entry 49 of List II.
- The distinction between the nature and measure of tax is crucial. While the measure can relate to income or yield, it does not change the nature of the tax. The MMDR Act's provisions emphasise that royalty payments linked to mineral yield can serve as valid measures for taxing mineral-bearing lands. Though not income per se, royalties are directly connected to mineral yield and can be used to measure taxes on mineral-bearing land, contrary to earlier restrictive interpretations.

### Decision will have a retrospective effect from 1 April 2005 onwards

- The SC delved into the doctrine of 'prospective overruling', which permits the declaration of a new rule while limiting its application to future situations, thereby avoiding the retrospective application of new legal principles to deter injustice or hardships.
- The SC categorically explained that the doctrine would not apply in cases where the legislative competence of legislature is upheld, considering the presumption of constitutionality in favour of the statutory enactment premised on the theory that legislation represents the will of the people and cannot be interfered with unless it transgresses constitutional principles.
- Considering the divergent and conflicting rulings in the *India Cement* and *Kesoram* cases, the SC has resolved the conflict by holding that royalty is not in the nature of tax and the state legislature is empowered to impose cess on royalty. Accordingly, the SC stated that giving the judgement a prospective effect would invalidate relevant taxing legislations based on the position of law, which has been overruled, resulting in a refund of the amount collected by the state.
- In concordance, the SC rejected the plea for prospective application of the decision, stating that states may levy or renew tax demands. However, seeking a balanced approach to reconciling the conflicting interests of the state governments and businesses, the SC stated that these would not apply to transactions before 1 April 2005, and the payment of the demands should be staggered over 12 years starting from **1 April 2026**. Moreover, any interest or penalties for the prior period's demands should be waived.

## Our comments

The taxability of royalty has been one of the contentious issues in the erstwhile service tax regime, and the same situation continued even in the GST regime. Due to the pendency of the SC's verdict, interim stays were granted against the levy/collection of service tax on royalty. Even under the GST regime, the SC stayed the levy of GST @ 18% on royalty on mining leases until further orders, in the case of *Lakhwinder Singh*.

With this decision, the SC has put to rest the long-standing dispute while clarifying the nature of royalty and dead rent, distinguishing them from taxes, and reinforcing the legislative boundaries between the state and union powers regarding mineral rights and taxation.

This judgement will have significant implications under the GST regime since royalty and dead rent are not taxes or impositions but rather 'considerations' for the right to extract minerals. Hence, these payments could be treated as a 'supply of services' liable to GST. Furthermore, the SC has denied the prospective application of the judgement, which is likely to cause financial hardship for businesses involved in royalty payments, with probable demands arising under both the erstwhile service tax regime and the current GST regime.


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