

EY Tax Alert

SC upholds legislative power of States to impose taxes on mineral rights

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Executive summary

This Tax Alert summarizes a recent ruling of the Supreme Court (SC)¹ on the distribution of legislative powers between Union and States on the taxation of mineral rights.

Nine-judge bench of the SC by a majority (8:1) held that:

- ▶ Parliament cannot impose taxes on mineral rights under Entry 54 of List I of the Constitution of India.
- ▶ The State legislatures are competent to levy tax on mineral-bearing land under Entry 49 of List II and can adopt the mineral produce or royalty as the measure to tax mineral-bearing lands.
- ▶ Royalty is a consideration paid by the lessee to the lessor of mining lease for enjoyment of mineral rights and to compensate for the loss of value of minerals suffered by the owner.
- ▶ Parliament cannot resort to its residuary powers to tax mineral rights when the subject matter is specifically enumerated in Entry 50 of the State List.
- ▶ Prescription of royalty rates u/s 9 of the Mines and Minerals (Development and Regulation) Act, 1957 (MMDR Act) by Central Government does not make it a "compulsory exaction by public authority for public purposes".
- ▶ While MMDR Act regulates the exercise of the proprietary rights in the minerals in the larger public interest, the lease deed is ultimately entered between the State Government (or the private person) and the lessee.
- ▶ A consideration paid under a contract to the State Government for acquiring exclusive privileges and rights with respect to a particular activity cannot be termed as an "impost" or "tax" under Article 366(28) of the Constitution of India.

¹ TS-287-SC-2024-NT

Background

- ▶ Article 245 of the Constitution of India provides that Parliament and State Legislature may make laws for the whole or any part of the territory of India and for the whole or any part of the State, respectively.
- ▶ Article 246 confers power on Parliament and State Legislature to make laws with respect to any of the matters enumerated in List I (Union List) and List II (State List) of the Seventh Schedule of the Constitution, respectively. The exclusive power of the State under List II is subject to the exclusive legislative powers of Parliament under List I.
- ▶ Entries of List I and List II, which are relevant have been reproduced below:
 - ▶ Entry 54 of List I - Regulation of mines and mineral development to the extent to which such regulation and development under the control of the Union is declared by Parliament by law to be expedient in the public interest.
 - ▶ Entry 23 of List II - Regulation of mines and mineral development subject to the provisions of List I with respect to regulation and development under the control of the Union.
 - ▶ Entry 49 of List II – Taxes on lands and buildings.
 - ▶ Entry 50 of List II - Taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development.
- ▶ In exercise of its legislative powers under Article 246 read with Entry 54 of List I, Parliament enacted the Mines and Minerals (Development and Regulation) Act, 1957 (MMDR Act).
- ▶ MMDR Act seeks to provide for the regulation of mines and development of minerals under the control of the Union. Section 9 provides that the holder of a mining lease shall pay royalty in respect of any mineral removed or consumed from the leased area at the specified rates.
- ▶ In *India Cement v. State of Tamil Nadu*² a seven-Judge bench of the Supreme Court (SC) held that royalty paid under MMDR Act, is tax and the State Legislatures lack competence to levy taxes on mineral rights because the subject matter is covered by the MMDR Act. The Court also held that royalty cannot be used by the State as a measure of tax on mineral-bearing lands under Entry 49 of List II.
- ▶ Later, in case of *State of West Bengal v. Kesoram Industries Ltd.*³, a five-Judge bench observed that the decision in *India Cement* stemmed from an inadvertent error and clarified that royalty is not a tax.

- ▶ Subsequently, States exercised their legislative powers to impose taxes on mineral-bearing land in pursuance of Entry 49 of List II by applying the mineral value or royalty as the measure of tax.
- ▶ A writ petition was filed before the Patna High Court (HC) challenging the validity of the Bihar Coal Mining Area Development Authority (Amendment) Act, 1992 and the Bihar Mineral Area Development Authority (Land Use Tax) Rules, 1994, which levied tax on land being used for mining.
- ▶ Relying on *India Cement* decision, the HC allowed the petition by holding that the tax was not within the scope of Entry 49 of List II. The said judgement assailed before the SC.
- ▶ On 30 March 2011, SC's bench of three Judges noticed the divergence between *India Cement* and *Kesoram* rulings and referred the case to a Bench of nine Judges to provide a decisive ruling.

Supreme Court's Ruling

Majority Decision of eight Judges

Whether royalty paid under Section 9 of MMDR Act is a tax?

- ▶ Royalty is a contractual consideration paid by the mining lessee to the lessor for enjoyment of mineral rights and to compensate for the loss of value of minerals suffered by the owner of the minerals.
- ▶ The lessee's failure to pay royalty constitutes a breach of the contract terms, thereby entitling the lessor to terminate the lease and initiate recovery proceedings against the lessee.
- ▶ The payments made to the Government cannot be deemed to be a tax merely because the statute provides for their recovery as arrears.
- ▶ Section 9 of the MMDR Act statutorily regulates lessor's right to receive consideration in the form of royalty from the lessee for removing or carrying away minerals from the leased area. Prior to the enactment of the MMDR Act, such a condition was treated as part of a mining lease and was regulated by the terms of lease agreement.
- ▶ The fact that the rates of royalty are prescribed under Section 9 of the MMDR Act does not make it a "compulsory exaction by public authority for public purposes". The demand is not made by a public authority, but the lessor (which can either be the State Government or a private party). The payment is not for public purposes, but a consideration paid to the lessor for parting with their exclusive privileges in the minerals.
- ▶ The principles applicable to royalty also applies to dead rent since:

² (1990) 1 SCC 12

³ (2004) 10 SCC 201

- ▶ Dead rent is imposed in the exercise of the proprietary right (and not a sovereign right) by the lessor to ensure that the lessee works the mine and does not keep it idle.
- ▶ The liability to pay dead rent flows from the terms of the mining lease.
- ▶ The dead rent is an alternate to royalty. If the rates of royalty are higher than dead rent, the lessee is required to pay the former and not the latter.
- ▶ The Central Government prescribes the dead rent not in the exercise of its sovereign right, but as a regulatory measure to ensure uniformity of rates.

Royalty and “taxes on mineral rights”

- ▶ Since royalty is not a tax, the same cannot be comprehended within the meaning of the expression “taxes on mineral rights” as given under Entry 50 of List II.
- ▶ The scope of taxes on mineral rights includes taxes on the right to extract minerals. Taxes on mineral rights also take within their fold other aspects relating to the exercise of mineral rights such as working the mines and dispatching minerals from the leased area.

Parliament cannot impose taxes on mineral rights

- ▶ Entry 54 of List I is a regulatory entry dealing with the regulation of mines and mineral development. Entry 23 of List II also encompasses the “regulation of mines and mineral development” as a legislative field for the states. The States’ domain under Entry 23 of List II is subject to the limitations created by Entry 54 of List I.
- ▶ Despite the positioning of Entry 23 in List II, the Constitution has specifically enumerated the taxing field with respect to mineral rights in Entry 50 of List II.
- ▶ If the framers had intended that taxes on mineral rights would be subsumed in the general entry covering the regulation of mines and mineral development, namely, Entry 23, there would have been no reason to provide for a specific taxing entry on mineral rights in Entry 50.
- ▶ Therefore, just as the field of taxing mineral rights does not fall under Entry 23 of List II, it does not fall under Entry 54 of List I, which uses similar language and is not a taxing entry.
- ▶ Further, Parliament cannot resort to its residuary powers to tax mineral rights when the subject matter is specifically enumerated in Entry 50 of List II.

Entry 50 of List II does not constitute an exception to Sundararamier principle

- ▶ The structure of the legislative entries in the three Lists of the Seventh Schedule follows an express and deliberate pattern. The entries are classified into general and taxing entries. In the Union List, Entries 1 to 81 enumerate general subject matters while Entries 82 to 92C pertain to the powers of taxation. Similarly, Entries 1 to 45 in the State List enumerate the general entries and Entries 46 to 63 provide for taxing entries.
- ▶ In *M P V Sundararamier & Co. v. State of Andhra Pradesh*⁴, SC held that the taxing entries are enumerated separately from the general entries in Lists I and II of the Seventh Schedule. The field of taxation cannot be derived from regulatory legislative entries and has to be derived from a specified taxing entry.

Scope of the expression “any limitations” under Entry 50 of List II

- ▶ The framers of the Constitution intended to empower Parliament to impose “all” and “every” possible limitation on the taxing powers of the State in the interests of mineral development, which may include even a “prohibition”.
- ▶ The MMDR Act as it stands has not imposed any limitations on Entry 50 of List II.
- ▶ The limitations imposed by Parliament in a law relating to mineral development with respect to Entry 50 of List II do not operate on Entry 49 of List II (taxes on lands and buildings) because there is no specific stipulation under the Constitution to that effect.
- ▶ Entries 49 and 50 of List II deal with distinct subject matters and operate in different fields.

Competence of State legislatures to levy tax on mineral-bearing land

- ▶ The expression “lands” contained in Entry 49 of List II means all kinds of lands irrespective of the use to which the land is put. It includes not only the surface but everything under and over the surface.
- Accordingly, mineral-bearing land also falls within the definition of “lands” under Entry 49 - List II.
- ▶ A tax on lands and buildings is a tax on lands and buildings as units. The expression “tax on lands and buildings as a unit” is used to distinguish composite taxes which involve imposition of tax cumulatively on all assets such as under Entry 86 of List I (Taxes on the capital value of the assets, exclusive of agricultural land, of individuals and companies; taxes on the capital of companies).

⁴ (1958) 1 SCR 1422

- ▶ Tax is not concerned with the division of interest in the building or land.
- ▶ A tax levied on the activity or service rendered on or in connection with lands and buildings does not fall within the description of taxes on lands and buildings under Entry 49 of List II.
- ▶ However, the Judge concurred with the majority opinion that the scope of the expression “any limitations” under Entry 50 of List II is wide enough to include the imposition of restriction, conditions, principles as well as a prohibition by Parliament by law.

Mineral produce or royalty can be used as the measure to tax mineral-bearing lands

- ▶ The nexus between the measure and levy of tax need not be “direct and immediate”. The nexus has to be “reasonable” and must have some relationship with the nature of levy. The reasonability of the nexus will largely depend upon the nature of the tax and the means available with the legislature to design the measure of the tax.
- ▶ The income or yield of land can be adopted as a measure for taxation. Royalty, being directly related to the yield of mineral-bearing land, cannot be said to be indirectly connected to the land.
- ▶ Therefore, the yield of a mineral bearing land, either in terms of the quantity of mineral produced or the rates of royalty, can be used as a measure to tax the mineral bearing land under Entry 49 of List II.

Dissenting Decision of one Judge

- ▶ Royalty determined under Section 9 of the MMDR Act is in the nature of a tax.

It is not merely a contractual payment but a statutory levy under Section 9 and 9A (relating to dead rent) of MMDR Act.

The liability to pay royalty does not arise purely out of the contractual conditions of a binding lease.

- ▶ Entry 50 of List II is an exception to the Sundararamier principle since it is a unique Entry - the only taxation Entry in Lists I and II where the taxing power of a State legislature has been subjected to “any limitations imposed by Parliament by law relating to mineral development”.
- ▶ Section 9 (royalty), 9A (dead rent) and 25 (recovery of royalty) of the MMDR Act denude or limit the scope of Entry 50 of List II and therefore, the State Legislatures have no legislative competence to levy any other tax, impost or fee on the exercise of mineral rights.
- ▶ Entry 49 of List II does not cover taxes on mineral bearing lands. States can tax those mineral bearing lands which are not covered within the scope of MMDR Act, 1957 (*i.e.*, minor minerals) under Entry 50 of List II as tax on exercise of mineral rights.
- ▶ The yield of mineral bearing lands, in terms of quantity of mineral produced or royalty paid cannot be used as a measure to tax mineral bearing lands under Entry 49 of List II. If so, Entry 50 of List II would be rendered redundant.

Comments

- a. The nine-judge bench majority ruling resolves a protracted conflict and enhances the autonomy of the States in matters of taxation concerning mineral rights and lands rich in minerals.
- b. The ruling is likely to have a potential impact both under Service Tax and GST wherein the businesses challenged the levy on mineral royalty on the ground that royalty is a tax, and accordingly, not susceptible to Service tax/ GST. Whether the judgement will be applied in all cases retrospectively or prospectively, will need to be seen.
- c. Further, it may likely resolve the dispute regarding taxability of renting of immovable property and other land related rights under Service tax and GST basis the constitutional powers.

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