Premium

'Royalty is not a tax': How Supreme Court recognised states' powers to tax mining activities

Royalty is not a tax, the Supreme Court has ruled. States have the power to tax mining activities. How did this long-pending matter reach a nine-judge

Constitution Bench; what issues did the judges consider?

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An open cast coal mine of the Central Coalfields (CCL) subsidiary of Coal India Limited, located in Chatra district in Jharkhand. (Express Photo by Partha Paul)

India's states have the power to tax mining activities, and collecting "royalties" from mining leaseholders is entirely separate from, and does not interfere with, the power to impose taxes, a nine-judge Constitution Bench ruled on Thursday.

Following the judgment, states can generate additional revenues in the form of taxes on mining activities and on the land used to conduct these activities.

The case, Mineral Area Development Authority v M/s Steel Authority of India, which had been pending for more than a quarter century, was decided by an 8-1 split. Chief Justice of India D Y Chandrachud authored the majority opinion for himself and Justices Hrishikesh Roy, Abhay S Oka, J B Pardiwala, Manoj Misra, Ujjal Bhuyan, Satish Chandra Sharma, and Augustine George Masih. Justice B V Nagarathna gave a dissenting opinion.

How did this matter reach the nine-judge Bench?

Royalties refer to the fees paid to the owner of a product in exchange for the [illegible] to use that product. For example, if a movie studio wants to use an existing [illegible] music by a specific artist in their new film, they will have to pay a royalty fe[illegible] goes to the artist.

Section 9 of the Mines and Minerals (Development and Regulation) Act, 1957 (MMDRA) requires those who obtain leases to conduct mining activities to "pay royalty in respect of any mineral removed" to the individual or corporation who leased the land to them.

This raises a question: If a state government is the entity leasing the land to a leaseholder, does this make royalties under the MMDRA a form of tax?

The Supreme Court answered this question for the first time in India Cement Ltd v State of Tamil Nadu (1989). A seven-judge Bench heard a challenge by the company to a Tamil Nadu law imposing a cess — a tax levied in addition to the normally taxable amount — on land revenues, including royalties.

The court held that states only have the power to collect royalties, not to impose taxes on mining activities. It said that the Centre has overriding authority over "regulation of mines and mineral development" under Entry 54 of the Union List to the extent provided by law (MMDRA in this case), and that states do not have the power to impose further taxes on the subject.

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"We are of the opinion that royalty is a tax, and as such a cess on royalty being a tax on royalty, is beyond the competence of the State Legislature because s. 9 of the Central Act covers the field," the court said.

The statement "royalty is a tax", however, triggered events that led to the formation of a nine-judge Bench at the Supreme Court.

In 2004, in a similar case dealing with cesses on land and mining activities (State of West Bengal v Kesoram Industries Ltd), a five-judge Constitution Bench held that there was a typographical error in the India Cement decision — and that the phrase "royalty is a tax" should be read as "cess on royalty is a tax".

The court said: "The words 'cess on' appear to have been inadvertently or erroneously omitted while typing the text of judgement… (in the preceding paragraphs) their Lordships have held that 'royalty' is not a tax". However, as the Bench in Kesoram Industries was smaller than the one in India Cement, the court could not overrule and rectify the position.

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Fast forward to 2011 and the Mineral Area Development Authority case — w court was already 12 years into hearing a challenge to a Bihar law imposing on land revenue from mineral-bearing lands.

The court took note of the apparent conflict between Kesoram Industries and India Cement — which had direct ramifications on the case before it. It decided to refer the matter to a nine-judge Bench to finally settle the legal position.

So why did the majority in Thursday's decision hold that royalty not a tax?

The majority held that a royalty is not a tax because there is a "conceptual difference" between royalties and taxes. Royalties are based on specific contracts or agreements between the mining leaseholder and the lessor (the person who leases the property) who can even be a private party.

Also, taxes are meant for public purposes such as welfare schemes and creating public infrastructure, whereas the payment of royalties is to a lessor in exchange "for parting with their exclusive privileges in the minerals".

And why did the court find that states have the power to tax 'mineral development'?

The second aspect that the court considered was whether states have the power to tax mineral development activities, or whether such taxes are the sole province of the Centre under the MMDRA. This friction can be traced to the Seventh Schedule of the Constitution.

Under the State List, states are given the exclusive power to make laws relating to "Taxes on mineral rights subject to any limitations imposed by Parliament by law relating to mineral development" (Entry 50). However, Entry 54 of the Union List gives the Centre the power over "Regulation of mines and mineral development to the extent to which… is declared by Parliament by law to be expedient in the public interest".

According to the India Cement position, the royalty collected by state governments under the MMDRA would be in the form of a tax which "covers the field", barring any further taxes from being imposed. However, the court in Mineral Area Development Authority held that royalty is not a tax. As a result, "royalty w be comprehended within the meaning of the expression 'taxes on mineral r (under Entry 50 of the State List). Effectively, the court held that the MMDRA only gives states another revenue stream through royalties, and does not interfere with states' powers to impose taxes under Entry 50.

The court also held that Parliament's powers under Entry 54 of the Union List do not extend to imposing taxes, as that power exclusively rests with state legislatures. However, Entry 50 allows Parliament to place "any limitations" on states' power to impose taxes, which the court held "may include even a 'prohibition'" against imposing taxes.

The court did not limit states' power to tax mineral development activities to Entry 50, though. It held that the state also had the power to tax the land where mines and quarries are located as it includes "(i) all types of lands; and (ii) covers everything under or over land". These taxes, the court held, "will not be affected by the MMDR Act".

Why did Justice Nagarathna dissent?

Justice Nagarathna disagreed with the majority on both these counts.

She held that royalties under the MMDRA must be considered a tax in the interest of mineral development in the country. She held that the purpose of the MMDRA was to spur mineral development and mining activities, and this aim would be defeated if states were given the power to impose additional levies and cesses (different types of taxes) on top of the royalties they collect.

Justice Nagarathna also held that states' powers to impose taxes were "denuded" after the MMDRA was passed, as it gives states the power to collect taxes in the form of royalties, and otherwise gives Parliament and the Centre complete control over mineral development.

Lastly, she held that Entry 49 of the State List does not give states the power to tax mineral-bearing land.

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