

Jumbo Trumpets...

When 'royalty' itself is tax, service tax not applicable under reverse charge

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Context: Any service provided by Government or a local authority to business entities was made liable for service tax under reverse charge with effect from 01.04.2016. The appellant was granted 'Petroleum Mining Lease' by State government against charges payable in the form of royalty, dead rent and surface rent. Considering the activity as 'assignment of right to use natural resources' qualifying as service provided by Government for a consideration in the form royalty, the respondent demanded Service Tax on the amounts paid as royalty by the appellant under Reverse Charge Mechanism. When the levy was introduced, Notification No. 25/2012-ST granted conditional exemption where right to use was assigned by the government before 01.04.2016. The condition prescribed eligibility for exemption only when nature of payment for assignment is on one-time charge, payable, in full upfront or in instalments.

Legal back ground of 'royalty' dispute:

The issue regarding nature of royalty had come up for consideration before various High Courts and Supreme Court on several occasions. A date of present appeal before CESTAT, there exists two legal positions:



In 1989, in the matter of India Cements Ltd Vs. State of Tamilnadu, AIR 1990 SC 8, 7 judge bench of Supreme Court held royalty is 'tax' ; Until then, almost all judicial decisions were of the view that royalty paid was not a tax.

In 2004, 5 judge bench in State of West Bengal Vs. Kesoram Industries AIR 2005 1646, held decision in the India Cement, there was a typographical error and that royalty was not a 'tax'.

In 2011, the matter has been referred to 9 judge bench of Supreme Court in the matter of Mineral Area Development Authority Vs. Steel Authority of India 2011 4 SCC 450, observing the conflicting decisions of 1990 and 2004.

In 2023, vide judgment in Union Territory of Ladakh Vs. J & K National Conference, CIVIL APPEAL No. 5707 OF 2023, it has been settled with respect to review in general that, when a matter is pending for review before Hon'ble Supreme Court, all matters may be decided on basis of the law as it stands. It is not open, unless specifically directed by Supreme Court, to await an outcome of a reference or a review petition.

For the Petitioner

- Relying on above legal position, it has been contended by the Petitioner that, the quasi judicial authorities are bound by the judgment in India Cements case and hence 'royalty' is to be construed as 'tax' ;
- The identification shall be between **fee for license**, which is regulatory and **fee for service**, which is compensatory. In present case, it is fee for license and hence regulatory and therefore there is no service involved.



- The service is not falling under 'Assignment' since assignment has no reversionary rights, which is contravened here as land is reverting back to government;
- The transaction happened prior to date of levy and hence the periodical payments are eligible for exemption granted under Notification 25/2012-ST for one time payments prior to 01.04.16
- Since mineral rights is the domain of State government, the Central Government is not empowered to levy tax on mineral rights.

For the respondents, it has been argued that

- Royalty is in the nature of consideration for a service of assignment of rights as held in the case of Kesoram Industries by a 5 Judge bench in the year 2005;
- The activity is classifiable as 'service' under Section 65B (44) and 'taxable service' under Section 65B (51) of the Finance Act, 1994 and is liable for reverse charge from 01.04.2016.
- Periodic collection of royalty is liable to tax from 01.04.2016;
- The oil field regulation Act, 1948 uses expressions 'royalty' and 'tax' separately, therefore royalty is not tax.
- The noticee not entitled to exemption as periodical payments varies from month to month depending on measure of amount taken for royalty



Held:

Following the 7 Judge Bench decision of the Hon'ble Supreme Court in the case of India Cements, the Hon'ble CESTAT, Chennai held that royalty is a tax and not consideration for services and that the demand of Service Tax on royalty is not sustainable. Further, the Hon'ble Tribunal made the following observations

- The nature of 'Royalty' is a hybrid of both regulatory and compensatory. However, from the provisions contained in Oilfields (Regulation and Development) Act, 1948 and Petroleum and Natural Gas Rules, 1959, it is inferred that royalty is more of a regulatory fee than compensatory;
- Being dominantly in the nature of regulatory fee, royalty does not fit into the definition of consideration for the services provided, as under the Service Tax law.
- The document conferring right to use natural resources on the appellant is not in the nature of 'assignment of right to use' but 'lease' which is likely to fall under 'renting of immovable property services.' In the case of renting of immovable property services, the liability to pay Service Tax is on forward charge basis, even if the services are provided by government to business entities.
- An exemption notification cannot create duty liability;

Accordingly, it was held that the demand of Service Tax on royalty cannot sustain and that it requires to be set aside.

**M/s. Oil and Natural Gas Corporation Ltd. Vs. The
Commissioner of GST and Central Excise - 2024-TIOL-44-
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