



**TAX  
ALERT**

***Taxability of Royalty  
payable to State  
Government on  
extraction of natural  
resource***



### Taxability of Royalty payable to State Government on extraction of natural resource

Prior to 1<sup>st</sup> April, 2016, “Support services” provided by Government or Local Authority to Business Entities were taxable, as it was specifically excluded from the negative list. [Section 66D(a)(iv)].

“Support Service” had been defined under Section 65B(49) which means:-

“Infrastructural, operational, administrative, logistic, marketing or any other support of any kind comprising functions that entities carry out in ordinary course of operations themselves but may obtain as services by outsourcing from others for any reason whatsoever and shall include advertisement and promotion, construction or works contract, renting of immovable property, security, testing and analysis;”

However, the Finance Act 2015 substituted the words “**Support Services**” by the words “**Any services**”. This change has been made effective from 1<sup>st</sup> April, 2016 vide Notification No. 6/2016-ST, dated 18<sup>th</sup> Feb, 2016.

In the light of above changes, question arises as to whether “Royalty payable to the State Government on extraction of natural resource” shall be considered as **Service** and accordingly service tax shall be applicable to a business entity on a reverse charge ? In this note we have analyzed the aspect of service tax payable on royalty with in-depth analysis as below :

Section 65B(44) defines service to mean “any activity for consideration carried out by a person for another and includes a declared service”.

The activity here can be considered as renting of immovable property, being mines. On carefully reading the definition of **renting** under Section 65B(41) it means “**Allowing, permitting or granting access, entry, occupation, use or any such facility, wholly or partly, in an immovable property, with or without the transfer of possession or control of the said immovable property and includes letting, leasing, licensing or other similar arrangements in respect of immovable property**” Definition of **immovable property** under old section of Service Tax **includes a vacant land solely used for agriculture, aquaculture, farming, forestry, animal husbandry, mining purposes**”. On reading the two definition in consonance the “**right of extraction of natural resource is an activity**” and Royalty is a consideration in return.



While analyzing term Royalty in different perspective, two different school of thoughts exist, while one says that Royalty is a Tax and other says it is not a Tax. The Supreme Court in the case of the India Cement Ltd., etc. vs. State of Tamil Nadu, etc. (AIR 1990 SC 85) held that royalty is a tax, whereas in Hingir Rampur Coal Co. Ltd. vs.

State of Orissa (1961 (2) 3 CR 537) Justice Wanchoo stated that right to receive royalty is a mineral right and cannot be considered as tax. Of course both these judgment dealt by Hon'ble Supreme Court was in respect of MMDR Act, however, the principal arising out of the said judgment can always be applied in the present scenario. This is simply for the reason that service tax cannot be levied on any tax levied by State or Central Government, hence, if royalty is considered as tax, there is no application of service tax and if otherwise, it may be taxed as renting of immovable property. We understand that the divergent views of Supreme Court is presently pending before the larger bench and hence subjudice.

With specific clarification being made by CBEC vide its circular 192/02/2016-ST dated 13<sup>th</sup> April, 2016, whereby they have specified that service tax shall be payable on Royalty.

In the light of above, we understand that a business entity have couple of choices i.e. a) pay service tax on royalty under RCM and enjoy its Cenvat credit resulting in minor cash flow impact or b) not to pay service tax considering royalty as tax and make necessary representation before the Board to obtain clarification.

### **Liability to pay Service Tax**

Service Tax shall be payable by the **Service Recipient** under **Reverse Charge Mechanism** [Notification no. 30/2012- ST dated 20<sup>th</sup> June,2012 as amended by Notification no. 18/2016-ST dated 1<sup>st</sup> March, 2016]

### **Point of Taxation [POT]**

Scenarios	Payment Date	Relevant Rule of POT Rules,2011	Taxability
Scenario-1	Before 1.04.2016	Rule5	Not taxable
Scenario-2	After 1.04.2016	Rule 7	Taxable

### **Availment of Cenvat Credit**

Cenvat Credit shall be availed after payment of Service Tax in terms of 1<sup>st</sup> proviso to Rule 4(7) of Cenvat Credit Rules, 2004.