

The Member (Budget)
Central Board of Excise and Customs
North Block
New Delhi

Sub: Levy of Service Tax on Royalties

Sir,

The CBEC (TRU II) while clarifying on scope of various services provided by the Government to business entities also mentioned about Government's intent to tax royalties on Minerals. This has caused considerable amount of uncertainty as to whether it indicates government's intention to tax royalties on Minerals like Coal, Iron, Alumina etc., that is, other than on royalty levied on Oil and Gas or any payment by the nomenclature of royalty, including on royalty on oil and gas mined from oil fields.

We wish to point out that Royalty on Oil and Gas is levied under Section 6A of The Oilfields (Regulation and Development) Act 1948. This Act terms the royalty payable thereunder as a 'levy' and its measure is limited to the actual quantum of mineral oil obtained or produced. Like any taxing statute, it has a charging provision [section 6A], provisions for granting exemption [6A(5)], imposition of penalties, by way of imprisonment for failure to pay [section 9(1)], power of enter and inspect any mine [section 11(1)(a)], order production of any document [section 11(1)(b)], etc. and examine any person [section 11(1)(c)], besides the Rule making powers in terms of which the Petroleum & Natural Gas Rules, 1959, have been framed.

Grant of mining rights is not dependent on payment of royalty by the licensee. In fact, it is only the holder of a mining license who has to pay the royalty. Mining license is a pre-condition for payment of royalty and not vice versa. Therefore, being levied under the charging provisions of a Central legislation without a corresponding provision obligating the Government to render any service, or carry out any activity, **royalties under ORDA, 1948 are in the nature of tax** and not consideration for any service performed or to be performed by the Government so as to fall within the ambit of Service Tax levy.

In its true sense, royalty payable under this ORDA, 1948 is the value of the mineral oil which belonged to the Government and which the exploring consortium is to deposit with the government. Over this part of the production, the exploring consortium had no proprietary right from inception as no such right was ever parted with by the Government in favour of the Exploring Consortium and hence this royalty is NOT a consideration for any service.

It may be pointed out that the issue whether royalty on minerals is a tax or not is not settled and the same has been referred to Nine Member Bench of Supreme Court in the case of Mineral Area Development Authority Vs SAIL [(2011) 4 SCC 4500] and to this extent the matter is *sub-judice* before the Supreme Court in the context of Mines and Minerals (Development and Regulation) Act, 1957, (MMDRA for short).

It may also be pointed out that E&P industry is a high risk capital intensive business. The government recognizes the same and has at various stages through various documents provided assurances of fiscal stability to attract investments by guaranteeing assured economic benefits. This is incorporated in the new Exploration Business Policy (1999) as well as in each of the Production Sharing Contracts entered into by the government.

It may be pointed out that even in the notice inviting tenders under the New Exploration Policy, payment of royalties is mentioned in the portion relating to taxes and duties.

In view of the above, any levy of service tax on royalty payments now would, therefore, work as a retrograde levy since it would impact the distribution of revenue and assured economic benefits of contracts that were entered in the past. In addition, such levy would also impact fresh investments into the sector.

Thus we feel both on grounds of law as well equity there is little case made for the levy of service tax on royalties levied on Oil and gas production.

We shall be grateful if you grant us a personal hearing to explain the matter in detail along with relevant support documents.

Thanking you,

Yours faithfully,



Rajiv Bahl
Director (Finance, Taxation & Legal)

Copy: JS (TRU II) CBEC