PETROFED

Ref. No.: PF/9
May 16, 2016

Dr. Hasmukh Adhia
Revenue Secretary
Ministry of Finance
Department of Revenue
Room No. 128-A, North Block
New Delhi

**Sub: Service Tax on Services Provided by the Government or Local Authorities to Business Entities**

Dear Sir,

Union Budget 2016-17 had, among others, made a landmark change by excluding from the Negative List specified in section 66D of the Finance Act, 1994, all services provided by the Government or a local authority to business entities, thus taxing all services provided by a Government or local authority, unless exempted. This exclusion from the Negative List has become effective from April 1, 2016. Moreover, the payment of tax on such services has been reverse charged.

These provisions had caused a lot of concern in trade and industry largely arising out of the ambiguity in these taxing provisions. As a result, a clarification was issued by CBEC on 13th April, 2016 on the issue of applicability of service tax on services rendered by the Government. This move to provide a clarification has come at the right time and is well appreciated by trade and industry.

However, there is one aspect of the circular dated 13.04.2016 that we would like to highlight which, we feel, runs contrary to the established position of law and, if implemented, could have serious repercussions for various sectors of economy including the one we represent viz. Exploration and Production of Oil & Natural Gas. In serial no. 9 of the circular while responding to the query *"Whether Service Tax is payable on yearly installments due after 1.4.2016 in respect of spectrum assigned before 1.4.2016"*, it has been stated that the exemption given by notification No. 25/2012 - ST dated 20.06.2012 as amended by notification No. 22/2016-ST dated 13.4.2016 would not be applicable to **"monthly payments with respect to the coal extracted from the coal mine or royalty payable on extracted coal which shall be taxable".**



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This has caused some confusion, as, though the question related to only a declared service of "assignment by the Government of the Right to Use the Radio Frequency Spectrum", the answer seems to have traversed beyond this question by observing that royalty on extracted coal, is also taxable, even though the assignment of a Right to extract Coal is not a Declared service.

While we do not wish to comment upon the taxability or otherwise of Royalty payable on extracted coal, as such Royalty is governed by the Mines & Minerals (Development & Regulation) Act, 1957, we are addressing this representation only for seeking clarity with regard to the Royalty levied under the Oil (Regulation and Development) Act, 1948.

PetroFed recommends that the Govt. may review the position and issue necessary clarification to set right the contrary position so emerging in the interest of exploration and production of Oil and Natural gas in the country.

A detailed representation drawn up by PetroFed is enclosed for your kind consideration.

We urge you to kindly get the matter examined and advise your office to issue appropriate clarification which will be of immense help in settling the doubts.

Thanking you,

Yours faithfully,

Dr. R. K. Malhotra
Director General

Encl.: as above

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## Service Tax on Services Provided by the Government or Local Authorities to Business Entities

1. Union Budget 2016-17 had, among others, made a landmark change by excluding from the Negative List specified in section 66D of the Finance Act, 1994, all services provided by the Government or a local authority to business entities, thus taxing all services provided by a Government or local authority, unless exempted. This exclusion from the Negative List has become effective from April 1, 2016. Moreover, the payment of tax on such services has been reverse charged.

2. These provisions had caused a lot of concern in trade and industry largely arising out of the ambiguity in these taxing provisions. As a result, a clarification was issued by CBEC on 13th April, 2016 on the issue of applicability of service tax on services rendered by the Government. This move to provide a clarification has come at the right time and is well appreciated by trade and industry.

3. However, there is one aspect of the circular dated 13.04.2016 that we would like to highlight which, we feel, runs contrary to the established position of law and, if implemented, could have serious repercussions for various sectors of economy including the one we represent viz. Exploration and Production of Oil & Natural Gas.

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5. The highlighted portion of the answer, as extracted above has caused some confusion, as, though the question related to only a declared service of "assignment by the Government of the Right to Use the Radio Frequency Spectrum", the answer seems to have traversed beyond this question by observing that royalty on extracted coal, is also taxable, even though the assignment of a Right to extract Coal is not a Declared service.

6. While we do not wish to comment upon the taxability or otherwise of Royalty payable on extracted coal, as such Royalty is governed by the Mines & Minerals (Development & Regulation) Act, 1957, (MMDRA, 1957 for short), we are addressing this representation only for seeking clarity with regard to the Royalty levied under the Oil (Regulation and Development) Act, 1948, (ORDA, 1948 for short).

7. Needless to say, all Royalties cannot, merely by reason of their nomenclature as Royalty, become taxable. As has been clarified in reply to Question No.5, the name given to a payment is not determinative of its true nature. This is also

the view taken by the Constitution Bench of the Supreme Court in the case of Corporation of Calcutta and Anr. vs. Liberty Cinema reported in AIR (1965) SC 1107 as also in Inderjeet Singh Sial and Anr. v. Karamchand Thapar and Ors. [1995] 6 SCC 166 and State of HP vs. Mahendrapal (1999) 4 SCC 43.

8. Since the Clarification dated 13.04.2016 has been issued in the backdrop of some statutory amendments made to section 66E, we are extracting herein below the said amendment (section 147 of the Finance Bill, 2016) by which a clause (j) was inserted in the said section 66E: -

> *"147. In the 1994 Act, in section 66E, after clause (i), the following clause shall be inserted, namely:—*
>
> *"(j) assignment by the Government of the right to use the radio-frequency spectrum and subsequent transfers thereof."*

9. Since the deeming fiction in section 66E covers only one natural resource i.e. Radio-Frequency Spectrum, the same is irrelevant for the purpose of deciding the taxability of Royalty on mineral oils, payable under the ORDA, 1948. The issue of taxability of any amount payable to the Government in relation to natural resources, other than Radio-Frequency Spectrum, will therefore need to be tested and decided with reference to the charging provisions of the Finance Act, 1994, which postulates a levy of tax only on considerations paid as a *quid pro quo* for services rendered by the Government. The circular dated 13.04.2016 also recognizes in reply to Question No.3, that not all payments made by a business entity to the Government, are liable to service tax, and emphasizes in reply to Question No.5 that in order to be taxable, such payments must be for getting a service in return i.e. these should be a *quid pro quo* for the services received. In other words, what is sought to be taxed are only such levies which are in the nature of compensatory fees for services, ***and not*** taxes or ***consideration representing sale value of Government property.*** If this test is applied to the Royalty payable under the ORDA, 1948 it will be clear that the same is not taxable as it is not a consideration paid for any service rendered by the Government, but is either a tax being a compulsory exaction or alternatively a Reddendum, representing money value of Government property. In neither situation will such royalty be taxable. The reasons for this view are detailed herein below.

10. In terms of Article 297 of the Constitution of India, all minerals underlying the ocean within the territorial water or the continental shelf or the exclusive economic zone of India, shall vest in the Union and shall be held for the purposes of the Union. The same Article is extracted below for ease of reference.

> *"Article 297. Things of value within territorial waters or continental shelf and resources of the exclusive economic zone to vest in the Union - (1) All lands, minerals and other things of value underlying the ocean within the territorial waters, or the*

*continental shelf, or the exclusive economic zone, of India shall vest in the Union and be held for the purposes of the Union."*

11. Similarly, as regards Mineral oil resources beneath the land mass of India, the Union has been held to be the owner by the Constitution Bench of the Supreme Court in Association of Natural Gas v. Union of India (2004) 4 SCC 489.

12. Being the sole owner of the mineral oils and by virtue of powers conferred upon the Union under Entry 53 of the Seventh Schedule of the Constitution of India the Union has levied Royalty on the production of mineral oil (i.e. crude oil as well as natural gas) under the ORDA, 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 statue, 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.

13. It may kindly be noted that ORDA 1948 provides for various kinds of payments to be made to the Government namely fees for application [section 5(2)(a)], rent [section 5(2)(d)], compensation [7(2)(b)] and royalty [section 6A]. While fees and rent may be regarded as compensatory in nature as grant of mining rights is contingent upon payment of such sums, the same thing cannot be said about royalty and compensation. 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 a 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.

14. We may mention here that in the context of a different legislation i.e. Mines and Minerals (Development and Regulation) Act, 1957, (MMDRA for short) the question whether Royalty payable under section 9 of that Act is in the nature of a tax or not, is pending consideration before a 9 judges Bench of the Supreme Court in the case of Mineral Area Development Authority etc. vs. Steel Authority of India and Ors. reported in (2011) 4 SCC 450. This question has arisen in the context of a controversy whether the state had the necessary constitutional power under Entry 50 of List II of the Seventh Schedule of the Constitution of India to levy cess on minerals (other than petroleum oils) when the Union had already exercised its powers under entry 54 of List I of the Seventh Schedule of the Constitution of India. The reference pending before the 9 judges bench is therefore strictly in the context of the peculiar constitutional provisions relating to MMRDA, 1957 in entry 54 of list I and therefore the decision in that case will not have any bearing on the question of

whether royalty under the ORDA 1948 is a tax or not. The MMDRA, 1957 and ORDA, 1948 being two different legislations, the view that may be taken by the Supreme Court in that case will not apply to the Royalty payable under ORDA, 1948. As such, the question relating to the true nature of Royalty under the ORDA, 1948 needs to be decided with reference to the provisions of ORDA, 1948 alone. For the reasons mentioned above, given the constitutional power under which the ORDA, 1948 is enacted as well as the scheme of the Act and the machinery provisions provided thereunder, it is clear that the Royalty payable under the ORDA, 1948 is nothing but a tax.

15. Even if Royalty under ORDA, 1948 is not considered as a tax, it cannot, merely, by virtue of this reason, assume the character of a payment made against a quid pro quo for a service rendered by the Government. Royalties which are neither a consideration for any service nor tax, can fall into a third category of Reddendum which represents sale value of Government property. The meaning of the term Reddendum has been explained by the Supreme Court in the case of Inderjeet Singh Sial and Anr. v. Karamchand Thapar and Ors. [1995] 6 SCC 166, in the following words:

> *"In its primary and natural sense 'royalty', in the legal world, is known as the equivalent or translation of jura regalia or jura regia. Royal rights and prerogatives of a sovereign are covered thereunder. In its secondary sense the word 'royalty' would signify, as in mining leases, that part of the* ***reddendum****, variable though, payable in cash or kind, for rights and privileges obtained. It is found in the clause of the deed by which the grantor reserves something to himself out of that which he grants. But "What is in a name? A rose by any other name would smell as sweet." So said Shakespeare."*

16. The proposition that Royalty payable to the sovereign is a **reddendum** was reiterated by the Supreme court in State of HP vs Raja Mahendrapal (1999) 4 SCC 43 (vide para 23) quoted below:

> *"22. In its primary and natural sense 'royalty', in the legal world, is known as the equivalent or translation of jura regalia or jura regia. Royal rights and prerogatives of a sovereign are covered thereunder. In its secondary sense the word 'royalty' would signify, as in mining leases, that part of the* ***reddendum****, variable though, payable in cash or kind, for rights and privileges obtained. It is found in the clause of the deed by which the grantor reserves something to himself out of that which he grants. But "What is in a name? A rose by any other name would smell as sweet." So said Shakespeare.*
>
> *23. The Court further held that the commodity goes by its value and not by the wrapper in which it is packed. If the thought is clear, its translation in words, spoken or written, may more often than not, tend to be faulty. The same substance under the*

*facts of the particular case has to be understood before applying it in legal manner. This Court has very clearly held that royalty in general connotes the State's share in the goods upon which the rights of its exploitation are conferred upon any person or the group of persons."*

17. The following definition of Royalty in the Strouds judicial dictionary was quoted with approval by a 5 judges bench if the Supreme Court in the case of The State of West Bengal vs. Kesoram Industries Ltd. and Ors. Reported in AIR 2005 (SC) 1646:

> *"Stroud's Judicial Dictionary of Words and Phrases (Sixth Edition, 2000, Vol.3, page 2341) - "the word "royalties" signifies, in mining leases, that part of the redendum which is variable, and depends upon the quantity of minerals gotten or the agreed payment to a patentee on every article made according to the patent. Rights or privileges for which remuneration is payable in the form of a royalty."*

18. In other words, if the ORDA, 1948 requires payment of a Royalty of 10% of the mineral oil produced, it actually means that the Government has given right to the exploring consortium to carry away only 90% of the production reserving 10 % of the production to itself. The 10% of the production of mineral oil thus always belonged to the Government, by virtue of Article 297 of the Constitution and Entry 53 of List I of the 7th Schedule and payment of royalty is nothing but payment of the money value of that property which always belonged to the Government and in respect of which the user was never given any right.

19. In its true sense therefore ***the royalty payable under this ORDA, 1948 is the value of the mineral oil which belonged to the Government*** and which the exploring consortium was authorized to sell as a trustee and agent for the Government.

20. 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. The interest of the exploring consortium, in the example given above was confined only to the remainder 90% of the produce and in lieu of that interest such exploring consortium are obliged to bear 100% of the mining cost.

21. In view of the above, we request you to validate our above understanding and issue a suitable clarification in the matter.

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