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Taxation on Mineral Rights: Decoding the Hon'ble Supreme Court's verdict in Mineral Area Development Authority & Anr. versus M/S Steel Authority of India & Anr. and its impact on Industries and Revenue of States

A. Introduction

The landmark decision of the Hon'ble Supreme Court in *Mineral Area Development Authority & Anr. versus M/S Steel Authority of India & Anr.* resolved a prolonged legal conundrum concerning distribution of legislative powers between the Union and the States over taxation of mineral rights. A bench headed by Chief Justice D.Y. Chandrachud delivered a majority judgment (8:1), ruling that legislative power to tax mineral rights vests with State legislatures.

A brief history of the present dispute can be traced back to the enactment of the Mines and Minerals (Development and Regulation) Act, 1957 ("**MMDR Act**") by the Parliament to effectuate Entry 54 of List I of the Constitution. Section 9 of the said Act provides that the holder of a mining lease shall pay royalty with respect to any mineral removed or consumed from the leased area at specified rates. The litigation spurred when States started imposing cess and taxes on top of the royalty levied by the Central Government. Two divergent views were rendered by the Hon'ble Court in the cases of *India Cement Ltd. v. State of Tamil Nadu*[1] and *State of West Bengal v. Kesoram Industries Ltd.*,[2] which led to the convening of a nine-judge bench to resolve the dispute. The core issue before the bench was to examine whether royalty, as imposed by MMDR Act is tax and if so, whether the State Legislature is competent to impose tax on mineral rights.

B. Royalty is not tax

The Hon'ble Supreme Court, in *India Cement (supra)* held that royalty is tax and the imposition of cess on royalties has the effect of amending the Second Schedule (rates of royalty in respect of minerals) of the Act. The same was found to be *ultra vires* Section 9(3) of the MMDR Act. In contrast, the latter decision rendered by the Hon'ble Supreme Court in *Kesoram Industries (supra)* held that the decision in *India cement (supra)* was based on a typographical error and that royalty is not tax, but rather, is a payment made to the owner of land, who may or may not be the State. Owing to these divergent views, the first issue before the nine-judge bench was whether royalty is tax.

[1] (1990) 1 SCC 12.
[2] (2004) 10 SCC 201.

As per the majority opinion, the fundamental difference between tax and royalty lies in the source from which each of them flow. While the power to charge/levy royalty flows from the lease instrument, the power to tax flows from a law. Further, royalty is paid by the lessee to the lessor/proprietor as consideration, since the lessor parts with his right to utilise the minerals sourced from the mine. On the other hand, imposition of tax requires the sanction of the sovereign and is preceded by the occurrence of a taxable event as determined by law. While the rates of royalty are decided by the Central Government, the rates of royalty are to be paid to the lessor as per the rates agreed to in the lease instrument. In a plethora of decisions, ranging from *State of H.P. v. Gujarat Ambuja Cement Ltd*.[3] and *Indsil Hydro Power & Manganese Ltd. v. State of Kerala*,[4] the court has consistently reiterated the settled principle that royalty is a consideration which is paid for enjoyment of rights flowing from the agreement between the lessor and the lessee. Therefore, the royalty does not satisfy the constituent elements of a tax. Hence, the law laid down in *India Cement (supra)* was overruled to the extent to which it held that royalty constitutes tax.

Hon'ble Justice B.V. Nagarathna penned a contrary view in her dissenting opinion. She propounded that royalty fulfils all requisite elements for it to be classified as tax, since the rates thereof were determined by the Second Schedule to the MMDR Act. She held that legislative competence can either flow from List I or List II of the Seventh Schedule. Hon'ble Justice B.V. Nagarathna held that despite the fact that the language of Section 9 of the MMDR Act does not resemble the language of a legislative provision imposing tax, the legislative intent behind the same is exactly that of it being a taxation provision.

C. Fiscal Federal Relation

Federalism is one of the basic features of the Indian Constitution. Indian States are sovereign to legislate within the legislative competence assigned to them. Therefore, it is the duty of Constitutional courts to interpret the scheme of distribution of powers and maintain a delicate balance of power between the federal units. True interpretation of the relationship between Entry 54 of List I, Entry 23 and 50 of List II was another issue for consideration before the Hon'ble Court. The majority was of the view that though it is now settled that the subject of regulating mines and mineral development as enumerated in Entry 23 of List II is subject to the laws enacted by the Parliament under Entry 54 of List I, such limitations shall not limit the taxing competence of the State under Entry 50 of the List II in absence of any specific law.

The reasoning given by the majority was that Entry 54 of List I has three prerequisites: (i) Parliament must enact a law, (ii) the law must declare that it is in public interest to regulate mines and mineral development, and (iii) the law must specify the extent of such regulation. When such a law is enacted, it only limits the State Legislature's power under Entry 23 of List II to the extent of Parliamentary coverage and not Entry 50 of List II, which is a special entry. The Supreme Court in *MPV Sundararamier & Co. v. State of Andhra Pradesh*[5] held that legislative powers relating to taxation are distinct from general powers to legislate on a subject. In the Seventh Schedule, entries are categorized into two,

[3] (2005) 6 SCC 499.
[4] (2021) 10 SCC 165 [56].
[5] 1958 SCC OnLine SC 22.

i.e., general and taxing entries. Relying on this principle, the majority held that Entry 50 of List II does not constitute an exception to the position of law laid down in *MPV Sundararamier (supra)*. The legislative power to tax mineral rights vests with State legislatures. Parliament does not enjoy legislative competence to tax mineral rights under Entry 54 of List I, for the reason that it is a general entry. Since the power to tax mineral rights is enumerated in Entry 50 of List II, the Parliament cannot employ its residuary powers with respect to that subject-matter either.

However, Hon'ble Justice B.V. Nagarathna in her dissent has stated that the expression *"subject to any limitations imposed by Parliament by law relating to mineral development"* in Entry 50 of List II *pro tanto* subjects the entry to Entry 54 of List I. The use of the term *"any limitations"* implies that the taxing entry under Entry 50 of List II would be subordinate to a non-taxing or regulatory entry like Entry 54 of List I. Given the significance of Entry 54 of List I, which also overrides Entry 23 of List II, Entry 50 of List II though is distinct, since it is the only taxation entry in Lists I and II where the taxing power of State legislatures is provided however, it is still subject to *"any limitations imposed by Parliament by law relating to mineral development."* In the opinion of Hon'ble Justice, the dictum in *M.P.V. Sundararamier(supra)* does not address Entry 50 of List II and, therefore, has no bearing on the present issue.

D. Scope of the MMDR Act: A Constraint on States' Taxing Authority?

With the aforesaid interpretation of the entries, the issues which were to be decided by the Hon'ble Supreme Court were whether the MMDR Act satisfies the requirement of *"any limitation"* under Entry 50 of List II and whether it restricts the taxing powers of states under the same Entry. The majority in their opinion, has held that the MMDR Act prescribes the methods and processes for the exercise or grant of rights to mines and minerals by the owner of these rights. Although it significantly reduces the states' legislative powers regarding the regulation of mines and mineral development under Entry 23 of List II, Entry 50 of List II specifies that states' taxing powers over mineral rights are subject to *"any limitations"* imposed by the Parliament through a law related to mineral development.

However, the majority was of the view that inability of state governments to alter mining lease terms should not be interpreted as a complete erosion of their powers over mineral regulation and taxation. While Entry 50 of List II allows the Parliament to limit the states' taxing authority, it must do so "*by law*" relating to mineral development. This means that the Parliament must explicitly specify any limitations on states' taxing powers by way of a statutory framework. The MMDR Act lacks specific provisions which limit the states' power to tax mineral rights, and its structure cannot be interpreted to imply such restrictions. Arguments based on the theory of implied limitations and constitutional silences were held to be inapplicable in this case, as Entry 50 of List II clearly outlines the conditions under which limitations can be imposed. Therefore, it was held that the MMDR Act does not impose any limitations on the states' taxing powers over mineral rights under Entry 50 of List II.

Hon'ble Justice B.V. Nagarathna dissented and clarified that the use of the term *"any limitations"* as envisaged under Enty 50 of List II must be given the widest possible interpretation, indicating that such restrictions on taxing power can take any form, so long as they are enacted by Parliament through provisions of the MMDR Act and the rules made thereunder. This effectively limits the scope of the taxing power as enshrined under Entry 50 of List II.

E. Power of States to tax mineral bearing land under Entry 49 of List II

Ordinarily, the rights of the owner of a piece of land extend to everything in, on, or over land. In English law, therefore, the owner of a piece of land is entitled to all mines that lie beneath their land. Under the Seventh Schedule, Entry 49 to List II deals with the levy of a tax on land and buildings, though it does not mention of any use to which the land or building is put. The majority was of the view that competence of States to legislate over land under Entry 49 of List II would, in no circumstance, be affected by the provisions of the MMDR Act. The Hon'ble Supreme Court held, in consonance with English law, that while the expression 'land' as used in Entry 49 includes all land, regardless of the use to which it is put. Land shall also include everything under and over the surface. Further, legislative competence of the States to tax would not be hampered by the use to which the said land is put. Therefore, the Hon'ble Supreme Court re-affirmed the principle that the contents of Entries 49 and 50 of List II are distinguishable from one another, and that the term 'land' as used in Entry 49 encompasses within itself, 'mineral bearing lands'. The yield of mineral bearing land, in terms of the quantity of mineral produced or the royalty, can be used as measure to tax the land under Entry 49 of List II.

In her dissent, Hon'ble Justice B.V. Nagarathna held that Entry 49 of List II of the Seventh Schedule has to be given the widest meaning. However, State Governments cannot enjoy legislative competence to tax land as well as mineral rights, which specifically is a domain of the Central Government under the MMRD Act. The reasoning behind the said decision was that since there was no value attributable to simply the land of a mineral bearing area, after subtracting the minerals. The land bearing minerals could not be taxed twice, under Entries 49 and 50 of List II, since taxation entries are mutually exclusive of one another when they fall under the same List. Entry 49 cannot act as a fall-back mechanism to escape the provision of Entry 50.

F. Retrospective Application of the Judgement

The Hon'ble Supreme Court rejected the prayer of the Respondents/assessee to invoke the principle of prospective overruling, stating that it does not apply in cases where competence of legislatures to enact certain laws is upheld. However, considering the possible impact on the industry, the Hon'ble Court has arrived at a pragmatic solution and has also set a cut-off date for retrospective application of its judgment under Article 142 of the Constitution. It allowed the levy of taxes on transactions occurring only after 1 April 2005. This cut-off date corresponds with the judgment in *Kesoram Industries (supra)*. Additionally, the Court ruled that no interest or penalties could be imposed on taxes due before 25 July 2024. To further alleviate the financial burden on taxpayers, the Court directed that tax payments be staggered in instalments over twelve years, starting from 1 April 2026.

G. Potential Impact on Industries and revenue of the States

The Hon'ble Court, while deciding the retrospective application of the judgment was cognizant of the fact that due to pendency of the instant case, interest on the pending demands due from assessees may be substantial in comparison to their total net worth. Therefore, to ease the burden on the industry, interest and penalty on the assessees have been waived off. Though the Hon'ble Court has tried to balance equities by such waiver and has provided a window of twelve years for clearing dues,

it is an undeniable fact that in States where the legislation imposing taxes/cess on mineral rights was struck down in view of *India Cement (supra)*, neither have taxes been charged, nor have they been recovered from the consumer. Giving States the right to renew their demand will surely put unnecessary financial strain on mining companies, who will in turn have to coup up monies from their current revenue. Furthermore, under the new regime, States are allowed to levy taxes on mineral rights and mineral bearing land which will add to the cost of mineral extraction, thereby affecting the consumers and global competition in mineral supply. Another potential impact is that the Central Government had significantly increased royalty rates manifold since 1991, in order to compensate states for revenue losses post the *India Cement* judgment.[6] This makes the retrospective application of the judgment contentious, as States had already endeavoured to address these losses through increased amounts of royalties, which have already been paid by mining companies.

On the other hand, the judgment has brought great relief to mineral-rich States, most of which were under financial distress and were compelled to depend upon the Central Government for funds. Further, post-*Kesoram Industries (Supra)*, states like Chhattisgarh, Madhya Pradesh and West Bengal enacted laws to collect tax on royalty which still remain in force. On the contrary, similar laws in Bihar and Odisha were struck down by the respective High Courts due to legislative incompetence, thus creating an imbalance between States in terms of revenue generation. With the ruling of this Hon'ble Court in the instant case, all States may levy or renew demands of tax, if any, pertaining to Entries 49 and 50 of List II, which will bring States at par with one another.

Lastly, it can be said that the dissenting view of Hon'ble Justice B. V. Nagarathna leaves room for future discussion on the subject. Pertinently, the Central Government had filed a petition seeking review of the judgment on the ground that the Hon'ble Supreme Court has ignored practical implications of the judgment at the macroeconomic level, which is an error apparent on the face of the record. The Centre, in the review, had also contended that if the interpretation of Entry 49 of List II is to be accepted, the entire federal regime as enshrined under the Constitution would collapse[7]. However, the Supreme Court dismissed the petitions seeking review of the judgment, in which the majority bench observed that there is no apparent error on the face of the record citing the Supreme Court Rules, 2013 with the sole dissent of Justice B.V. Nagarathna. The far-reaching implications of this judgement will open new avenues for interdisciplinary research, bridging the gap between legal theory, environmental economics and public policy.

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[6] *Centre can lower royalties to minimise impact on mining companies post Supreme Court ruling: Ambit Capital,* THE ECONOMIC TIMES (Aug.20, 2024, 02:32 PM), https://economictimes.indiatimes.com/industry/indl-goods/svs/metals-mining/centre-can-lower-royalties-to-minimise-impact-on-mining-companies-post-supreme-court-ruling-ambit-capital/articleshow/112649543.cms

[7] Centre seeks review of Supreme Court's 8:1 ruling upholding power of states to tax minerals: 'Ignores macro-economic impact' : https://indianexpress.com/article/india/centre-supreme-court-review-mineral-royalty-judgment-9563559