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TAX ALERT

Impact analysis of GST on Mining Sector

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OVERVIEW

The current Indirect tax regime in India provides for a complex tax environment due to multiplicity of taxes, complicated compliance obligations and tax cascading. Under the proposed GST regime, all the key Indirect tax legislations would be subsumed (*<u>except for few taxes such as duty on Electricity, Royalty on extraction of minerals from mines, etc.</u>*). In Goods and Service Tax Act the tax is levied on the supply of goods and supply of services which is different from the taxable events of the current regime that is manufacture, sale or provisions of service.

The minerals and mining sector in India is governed by the Mines Act, 1952 along with the Mines and Minerals Development and Regulation Act (MMDR), 1957. The mines and minerals development and regulation is undertaken as per the MMDR Act under the control of the union. As per Section 9 of the MMDR Act, 1957 the holder of a mining lease granted before or after the commencement of this act shall pay **royalty** in respect of any minerals removed or consumed. The Mines Act, 1952 lays down the rules and regulation in relation to the safety of the labour, regulation for carrying out mining activities and the management of mines.

<u>Backdrop of the Mining Sector:</u>

India currently produces nearly 89 minerals under different groups such as Fuel minerals, metallic minerals, non metallic minerals, atomic minerals etc. The mining sector organizations are engaged in either merchant mining sector or mining cum manufacturing sector.

In general sense the mining sector involves the following activities:

- ✓ Survey and Exploration of minerals
- ✓ Excavation of mines
- ✓ Demolition of mines
- ✓ Earth moving services
- ✓ Mining of minerals
- ✓ Handling of minerals extracted
- ✓ Transportation of minerals

The current Indirect Taxes are levied as follows:

Various Taxes	Merchant Mining Sector	Mining cum Manufacturing Sector
Excise Duty on outward supply	Not Applicable	Applicable
VAT/CST on outward supply	Applicable	Applicable
Service Tax on services consumed	Applicable	Applicable

<u>Under the Current Tax Structure:</u>

The mining sector incurs service tax and royalty as the procurement costs:

- The mining companies may attract **service tax** for the services relevant to the mining industry such as exploration, mineral production, handling, transportation etc. A manufacturer and/or service provider paying service tax on procurement of services are allowed to take credit of same and it is set off against their Service tax or Excise liability. However, no credits are available to primary producers or miners, who are neither service providers nor manufacturers but simply a traders. Exporters are allowed to claim a refund of tax paid on procurement in various forms.

- **Royalty** on mining is collected by the State Government from the business entities in relation to the lease of the mines granted to them.

  The Supreme Court, in *India Cement Ltd. v. State of Tamilnadu and others (AIR 1990 SC 85)* had held that royalty is a tax and its payment is for the use of land. The judgment had relied on the concept that royalty was attributed to the extracted mineral created due to interaction among land, capital and labour, each of which possesses some definite intrinsic economic value. In this sense, royalty was viewed as a kind of tax linked either directly or indirectly to the intrinsic economic value of a mineral realized through sale by the leassee.

  Though the Hon'ble Supreme Court subsequently doubted the correctness of the above referred judgments and referred the case as to **"whether royalty is tax or not" to a larger bench of nine judges and the same is yet to be pronounced** and therefore the judgment of India Cement Limited can be considered as the law as on date. If the Supreme Court decides that royalty is in nature of tax then both excise duty and service tax cannot be levied, since there cannot be tax on tax.

- The grant for the mining lease rights is one of the methods of assignment of rights to use any natural resources and the consideration that is paid by the lease holder is royalty as fixed by the State Government at the time of grant of lease. This royalty which is in the nature of the annual amount payable to the state government are seemingly subject to **service tax.**

The mining industry incurs excise duty; value added tax and central sales tax as the output tax liability:

- In case of merchant miners as the extraction does not amount to manufacture there is no **excise duty** liability as output tax. In case of mining cum manufacturing sector if any further processing of the minerals so extracted from the mines is undertaken in order to remove the impurities from the minerals or any other value addition process are being undertaken then the same would attract excise duty.

- The Value Added Tax (VAT) is levied on the sale of goods within the state. The mines output are subject to VAT, miners are allowed to take the credit of the vat paid on their inputs if any. The VAT cost flows from the mining company to the manufacturer and then to the distributor and reseller.

A table showing the tax liability and corresponding cenvat credit on the mining sector:

Particulars	Merchant Mining Sector		Mining Cum Manufacturing Sector	
	Tax levied	Cenvat credit Available	Tax levied	Cenvat credit Available
Services Consumed				
Exploration of Mines	✓	X	✓	✓
Handling of Mines	✓	X	✓	✓
Transportation of Mines	✓	X	✓	✓
Grant for mining lease	✓	X	✓	✓
Excise duty on outward supply	X	X	✓	✓
Value Added Tax on outward supply	✓	✓	✓	✓

<u>Analysis under the Goods and Service Tax:</u>

The Constitutional Amendment Bill has deleted only the VAT, Entry Tax and Entertainment Tax from the state lists and Excise duty and Service Tax from the union list. As per Section 3, of the GST Model Law, 2016 the Goods and Service Tax is levied on the supply of goods and services. Various supplies of services such as exploration, mineral production, handling, transportation and the supply of the minerals to consumers would attract GST. Under GST there would be output taxes at the time of supply of output of the mines but at the same time the input tax cost incurred by the miners would be allowed as credit.

The same can be shown it the help of the following table under GST regime:

Particulars	Merchant Mining Sector		Mining Cum Manufacturing Sector	
	Tax levied	Input Credit Available	Tax levied	Input Credit Available
Supply of Services				
Exploration of Mines	✓	✓	✓	✓
Handling of Mines	✓	✓	✓	✓
Transportation of Mines	✓	✓	✓	✓
Grant for mining lease	✓	✓	✓	✓
Outward supply - Intrastate	✓	✓	✓	✓
Outward supply - Interstate	✓	✓	✓	✓

As per schedule IV of the Goods and Service Tax Act, the consideration paid by the lease holder to the State Government for the grant of the lease of the mines in form of royalty would be chargeable to GST. However, as explained earlier, the matter is to be decided by nine member bench of Hon'ble Supreme Court as to whether royalty is a tax or not. Thus, if it concluded that is it in the nature of tax, GST on same cannot be levied. Thus, as far as GST laws are concerned, there would be GST on the amount of Royalty paid but since Royalty itself is not within the frame work of GST, credit of royalty paid to the State Government becomes a cost of miner, whether merchant or manufacturer.

CONCLUSION

The various activities of mining which is chargeable to service tax under the current regime would attract tax at the rate of 15% whereas supply of these services under GST would be taxed at the rate of around 18% which is higher than the current tax rate on the same. Thus, there would be additional cash from of 3%, however, with seamless credit available all across the net tax cost forming part of final product should decrease.

Royalty paid on mineral is not subsumed under GST, thus same shall be an additional cost for the business entity. Thus, it is advisable that the Royalty shall be considered as part & parcel of GST enabling business entity to claim its set off against their GST liability to avoid cascading effect.

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