

Unincorporated JVs are a facade for AOPs

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The ambiguity relating to taxability of unincorporated joint ventures under the Income Tax Act, 1961 was clarified to some extent in the case of M/s Hyundai Rotem Co., Korea and Anr. v/s DIT (Judgment dated:29th March, 2010). The case laid down guidance on the circumstances in which the unincorporated joint venture or a consortium is to be treated as a **separate taxable entity** (*i.e. association of persons (AOP)*) under the provisions of the ITA.

Review of the case:

Mitsubishi Corporation, Japan (MC), Hyundai Rotem Company, Korea (Rotem), Mitsubishi Electric Corporation, Japan (MELCO) and BEML Limited, (BEML) formed a consortium (referred to as MRMB consortium) to successfully bid and execute a project for Delhi Metro Rail Corporation (DMRC). In the consortium agreement MC was appointed as the consortium leader. Under the agreement each member was given specific responsibilities however they formed a board together to ensure overall planning and execution of the project

The question raised for seeking advanced ruling was whether the consortium could be assessed as independent company u/s 2(31)(iii) of the Income Tax Act, 1961 (IT Act) or as an AOP under Section 2(31)(v) of the IT Act.

Judgment & Analysis:

There is no definition of AOP in the IT Act or general law. Whether or not combination of persons or joint venture would give rise to AOP, is to be determined by the facts of the cases. As pointed out in CIT vs Indira Balakrishna, (39 ITR 546 SC) it was held that the word “associate” means to come together for a common purpose or common action. Association is one where there is an object to produce income or gains. When parties deploy their assets in joint enterprise with a view to make profits it constitutes an AOP. This ruling laid down the five requisites for an AOP which are: (a) there must be two or more persons, (b) they must voluntarily come together, (c) there must be a purpose of producing or earning income, (d) combination in joint venture; and (e) some kind of scheme for common management. However, explanation to Section 2(31) negates the object of deriving income, profits or gains as a requisites for being an AOP, The explanation to Section 2(31) is being reproduced below –

Explanation.—For the purposes of this clause, an association of persons or a body of individuals or a local authority or an artificial juridical person shall be deemed to be a person, whether or not such person or body or authority or juridical person was formed or established or incorporated with the object of deriving income, profits or gains. Thus two

entities would be deemed to be AOP even if they do not have a profit motive if other conditions are satisfied that is they come together for a common purpose or for a common action.

Further references were drawn to other similar cases of Van Oord Acz. BV (2001 248 ITR 399 AAR), Geoconsult ZT GmbH (2008 304 ITR 283 AAR), Indira Balkrishna (supra) wherein, while in the case of Geoconsult, the decision went in favour of the Revenue in holding that there was an AOP, in the other two cases, the decisions were in favour of the applicants.

While in Van Oord case though income was received jointly, there was no intention to carry out common business and the job was to be carried out by the parties on the basis of individual skills and capability. The parties agreed to execute the job together for better co-operation in their relationship with the principal. Though there was an element of mutual benefit but the agreement clearly laid the intent of the parties was not to be associated for common business and they agreed to bear profits and losses arising from the performance of their requisite contracts, thus the parties were not held to be single assessable unit and liable to tax as an AOP. However in case of Geoconsult the parties were jointly and severally liable for the work undertaken and it became a single assessable unit because of the structure of the agreement and the intent conveyed

In a similar case of Hyosung Corporation (2009 314 ITR 343 AAR) though because of the overall responsibility assumed by Hyosung there was no involvement in the Indian parties contract but there was lack of commonality of purpose, hence it was not held to be an AOP.

In the present case the Parties are sharing gross receipts and not profits. There is no interchangeability of work as the contract was assigned looking at their individual skill sets and none of the parties are acting as agent to the other. Besides this, the supplementary consortium agreement states that the agreement is not to be construed as partnership, joint venture or any other legal entity among the parties. In the light of the discussion it was ruled that MRMB Consortium was not an AOP

While in the present case the intent of the parties was clear to gain mutual benefit out of the association but there was not agreement to share the profit or losses or incur expenditure jointly. While there was a commonality of purpose but it was ring fenced by each ones obligations and rights in the contract as a whole and hence there was no commingling of interests

So, if the intent and the object of joint venture conveys commingling of interest and there is an intent to move towards a common objective whether or not that objective is to make profits the Joint Venture would be classified as an AOP. Whereas where the intent of the parties is to come together as an arrangement to achieve an objective benefitting both the parties mutually shall not qualify to be an AOP and shall be taxable in the hands of the co-venturers. This means that the profits arising from the venture shall be appropriated and not be liable to be taxed as a separate entity.

AOP in itself is a separate taxable entity and the losses incurred by the AOP can only be carried forward in the hands of the AOP. So this ruling by the AAR will serve to provide a clarificatory basis to parties that form consortiums and unincorporated joint ventures and will assist such consortiums to structure their agreements and arrangements to obtain the desired tax treatment.