Tax Hotline

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JOINT VENTURE IN INDIA? BE READY TO PAY HIGHER RATE OF TAX!

The Authority for Advance Ruling ("**Authority**") recently pronounced a ruling in an application filed by M/s Geoconsult ZT GMBH ("**Geoconsult**"), concluding that a joint venture can be treated as an association of persons ("**AOP**") and is liable to be assessed as such under the Income Tax Act, 1961("**ITA**").

WHAT IS AN AOP?

Section 2(31) of the ITA defines the term 'person' to include an association of persons or a body of individuals, whether incorporated or not[1]. The Supreme Court of India has held[2] that in order to constitute an association, persons must join in a common purpose or common action and the object of the association must be to produce income. Thus, a consortium formed by two or more companies could be chargeable to tax as an AOP. Section 6(2) of the ITA also provides an AOP shall be considered to be resident in India, except in cases where the whole of the management and control of the affairs of the AOP is situated outside India. Thus, an AOP is considered to be resident in India even if a fraction of its control and management is situated in India. This is important since a resident is taxed in India on its worldwide income[3].

FACTS OF THE CURRENT CASE:

Geoconsult is a company incorporated in Austria. Geoconsult formed a joint venture ("**JV**") with two Indian companies – (a) M/S Rites Ltd. India ("Rites") and (b) M/s. Secon Pvt. Ltd., India ("**Secon**"). The JV was awarded a tender to provide project consultancy services by Himachal Pradesh Road and other Infrastructure Development Corporation Ltd. ("**HPRIDC**") for Phase I and II for the development of seven tunnels in Shimla and other parts of the State and to carry out the implementation of the same. Geoconsult sought a ruling on the questions framed by it – one related to the applicability of Article 12 of the DTAA (Fees for Technical services) and the other related to the existence of a Permanent Establishment ("**PE**") in India. However, the Revenue put forth a preliminary contention that the JV was infact liable to tax as an AOP under the provisions of the ITA. The primary question for determination, therefore, was whether the JV was an AOP within the meaning of ITA.

CONTENTIONS RAISED BY THE REVENUE:

It was the case of the Revenue that the JV entity be assessed as an AOP in India on the receipts from HPRIDC and therefore, be made liable to be tax at 41% on net basis, inclusive of the share of Geoconsult.

Revenue based its arguments on the Joint Venture Agreement entered into between Geoconsult, Rites and Secon and also the Services Agreement entered into between the JV and the HPRIDC (collectively called the "**Agreements**") and pointed out that the two agreements read together would lead to the conclusion that the JV fulfilled all criteria that is, common purpose, common action and the object to produce income to be classified as an AOP. The Revenue also referred to the Agreements to emphasize that the members of the JV were jointly and severally responsible for the completion of the project and that the detailed allocation of work was proof that the partners of the JV shared work responsibilities amongst themselves.

CONTENTIONS RAISED BY THE APPLICANT:

The applicant strongly contended that the JV cannot be regarded as an AOP, primarily because of the fact that the contract had been awarded to the JV for the convenience of execution and placed reliance upon the ruling given by the Authority in *Van-Oord Acz. Bv, In Re*[4]. The Counsel further emphasized that individual scope of work for each member had been separately identified and that it clearly limited the 'nature of co-operation' to the extent of co-ordination only for the satisfactory completion of the whole project.

The applicant laid great stress on the fact that there was no profit sharing and that each member of JV made its own investment and maintained its own separate accounts and also received payments separately. It was the applicant's case that there was only 'sharing of revenue' and no 'sharing of profits' and that each member in the consortium had executed a 'stand-alone' and independent portion of the over-all contract for the client and the only purpose of associating together was the client's insistence for the same.

The applicant also put forth the argument that the gross revenue itself was directly paid to the each member, so no taxable income was earned by the JV and therefore, even in case the JV is classified as an AOP, there was no reason to tax it at the entity level.

RULING:

The Authority heard both the parties and thereafter ruled that the JV partners had 'associated' themselves with a 'common design' to provide consultancy services for the development of tunnels. The Authority observed that the contract between HPRIDC and JV was sufficient indication of coming together of the three entities with the common purpose of executing the work entrusted to the JV. The Authority distinguished the facts of Van *Oord Acz. BV*, which was relied upon by the applicant, as in that case the agreement between the JV partners expressly provided that the parties agreed that there was no intention to carry on business in common with a view to earn profits. Dealing with the issue of detailed allocation of work, the Authority made a simple observation to the effect that such demarcation of duties did not in any way affect the integrity of the association.

With respect to the division of profits, the Authority laid down that the payments must be deemed, in law, to have been made to and received by the JV as a unit, although the members had authorized HPRIDC to issue cheques to the individual accounts based on invoices.

ANALYSIS:

This decision of the Authority will increase the need for exercising due caution at the time of entering into JV agreements since the adverse tax implications of being assessed as an AOP could make forming joint ventures more expensive. Typically, each member of the AOP is charged to tax on its share of income from the AOP (if the share is determinate); however, if any member of the AOP has any other income, the entire income of the AOP is charged to tax at the maximum marginal rate of tax of 33.99%. Further, in the event that any member of the AOP is charged to tax on its share of income at a rate higher than the maximum marginal rate of tax, tax is charged on that portion of the income of the AOP which relates to the share of that member, at the higher rate, and the balance income of the AOP is taxed at the maximum marginal rate of tax[5].

The draconian provisions of the ITA could result in an AOP getting taxed at a higher rate of tax, than what the individual members would have paid on their respective shares of income from the AOP. In the current case, the AAR has not considered the provisions of Section 167B(2) of the ITA and instead charged to tax the entire income of the AOP at a higher rate of tax. This interpretation of the relevant sections of the ITA could lead to tax officers taxing joint ventures in India at a higher rate of 42.23%[6].

- Neha Sinha & Parul Jain

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1. Subclause (v) of Section 2(31)
2. CIT v. Indira Balkrishna 39 ITR 546
3. Section 5(1) of the ITA
4. AAR No. 469 of 1999
5. Section 167B(2) of the ITA
6. Current rate of tax for a foreign enterprise

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SIAC 2025 Rules: Key changes & Implications

February 18, 2025