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Consortium creates an association of person and income from it as a whole, taxable in India

In brief

Recently, in the decision of Alstom Transport SA[1], the Authority for Advance Rulings (AAR) held that the income of the applicant [who along with other members of the consortium formed an association of persons (AOP)] from the entire contract is taxable in India.

Facts

- The assessee was a tax resident of France.
- The Bangalore Metro Rail Corporation Ltd. (BMRC) floated a tender for design, manufacture, supply, installation, testing and commissioning of signalling, train control and communication systems.
- The assessee along with its subsidiaries Alstom Projects India Ltd. (APIL), Thales Security Solutions and Services, SA, Portugal (Thales) and Sumitomo Corporation, Japan (Sumitomo) entered into a consortium agreement (They are jointly called 'the parties').

[1] Alstom Transport SA, *In re* [TS-387-AAR-2012]

- As per the terms of the contract, the parties were to be jointly and severally bound by the terms of the tender and liable to the BMRC for performing obligations under the contract.
- The contract was to implement the design, manufacture, supply, install, test and commission signalling, train-control and communication system for the BMRC project.

Issues

- Whether the amounts received or receivable by the applicant for design, manufacture, supply, installation, testing and commissioning of signalling, train control and communication system including supply of spares are chargeable to tax in India under the provisions of the Income-tax Act, 1961 (the Act) and the Double Taxation Avoidance Agreement (tax treaty) between India and France?

- Whether the amounts received or receivable by the applicant under the BMRC contract, for offshore services are chargeable to tax in India under the provisions of the Act and the India-France tax treaty?

Revenue's contentions

- The tender floated by the BMRC was a composite tender.

- The contract provided for lumpsum payment and cast joint and several liabilities on the consortium for carrying out the work. A contract has to be read as a whole for the purpose which it is entered into and there was no occasion to deal with offshore supply separately.

- Consortium members who came forward to bid, formed an association of persons (AOP) within the meaning of section 2(31) of the Act.

- There was clearly a common purpose and management in their association. The intention was to undertake an activity to earn profits.

- Two of the consortium members were also the subsidiaries of the applicant. Hence, the consortium members including the applicant are liable to be assessed as an AOP and the income from the transaction was chargeable to tax in India.

Applicant's contentions

- The assessee contended that the design and supply of equipment by the applicant took place outside India and being an offshore transaction, income is not chargeable to tax in the country.

- The title for goods passed and payment received outside India and no part of the income either arose in or can be deemed to arise in the country. On formation of the AOP, the applicant submitted that to determine its creation, their relationship *inter se,* their obligations to one another and their rights against one another was relevant. Their joint and several liabilities to the tenderer or the joint obligation i*n perform*ance of the contract will not be relevant.

- The parties came together to meet obligations under the contract.

Case law relied by the applicant

- The assessee placed strong reliance on the Supreme Court's (SC) decision in the cases of Ishikawajima–Harima Heavy Industries Ltd.[2], Hyundai Heavy Industries Co. Ltd.[3] and the AAR Ruling in the case of Hyosung Corporation[4].

- In Ishikawajima–Harima Heavy Industries Ltd. (above), the SC held that where the property in the goods passed as well as the consideration is paid outside India; the profit will not be subject to tax in the country. For offshore services, they were rendered entirely outside India. The services had nothing to do with the permanent establishment (PE) of the Japanese company in India. Therefore, the services could not be attributed to the PE and the income from the services was not taxable in India. The services, in this case, were inextricably linked to the supply of goods. Hence, they were to be treated in the same manner as goods.

- In Hyundai Heavy Industries Co. Ltd. (above), the SC held that profits arising outside India from Korean operations, i.e., designing and fabrication, are not liable to tax in the country. According to the SC, not the entire profits of the company came from its business connection in India, i.e. PE, will be taxable but only for profits having economic nexus with the Indian PE.

- In Hyosung Corporation, it was held that receipts from offshore supply contract cannot be taxed under the Act and a percentage of income cannot be subjected to tax by reason that certain operations - post supply of goods, took place in India.

[2] Harima Heavy Industries Ltd. *v.* DIT [2007]288 ITR 408 (SC)
[3] CIT *v.* Hyundai Heavy Industries Co Ltd. [2007]291 ITR 482 (SC)
[4] Hyosung Corporation *v.* DIT [AAR/773/2008]

AAR ruling

- The AAR relied on the SC ruling in the case of Vodafone International Holdings BV[5] that it is the task of the revenue or court to ascertain the legal nature of the transaction. While doing this, it has to look at the transaction as a whole and not to adopt a dissecting approach. The AAR held that the approach adopted in Ishikawajima–Harima Heavy Industries Ltd. (above) now stands disapproved or overruled, if not expressly, definitely by clear implication.

- The basic principle in interpretation of a contract is to read it as a whole and to construe all its terms in the context of the object sought to be achieved and the purpose sought to be attained by the implementation of the contract.

- Only because the members divided the obligations among themselves, it could not alter the status they acquired (as an AOP), while entering into a contract with a common purpose and incurring a joint liability.

- The contract was for installing the signalling and communication system for the metro rail and not for the supply of offshore equipment. Thus such a contract will have to be read as a whole and is not capable of splitting up.

- The AAR relied on its ruling in Linde AG[6] and Roxar Maximum[7] wherein it was held that a contract for the design, manufacture, supply, installation, testing and commissioning of equipment cannot be split into separate parts consisting of independent supply or sale of goods and for installation at the work site, leading to the commissioning and so on.

[5] Vodafone International Holdings BV *v.*UOI and another [2012]341 ITR 1 (SC)
[6] Linde AG, Linde Engineering Division *v.* DIT [TS-170-AAR-2012]
[7] Roxar Maximum Reservoir Performance WLL, *In re* [TS-301-AAR-2012]

- The source of the receipt in this case, is the contract with the BMRC and not the contract *inter se* or the understanding among the members of the consortium. The receipt arises out of that transaction.

- It is relevant to consider the legal rights and obligations arising out of and undertaken under that transaction (contract with BMRC) to determine the status of the consortium as a person.

- The members had jointly prepared the bid and had come together for executing the project if their tender was accepted. They were jointly responsible for performing the entire work. The common object was to perform the contract and earn income. Considering this, the AAR accordingly upheld the revenue's contention that the consortium was liable to be taxed as an AOP.

Conclusion

This ruling adds to the precedents being set by the AAR that Companies coming together as a consortium to undertake supply of equipment and services constitute an AOP and should be taxed for the whole income. The AAR continues to rely on the recent Vodafone judgement of the SC and suggests a 'look at' approach rather than a 'look through' approach.

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