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### Indian AOP taxable at the rate applicable to a foreign company

Where shares of members of an AOP are indeterminate, the AOP is taxable at a rate applicable to its member foreign company, which is more than the maximum marginal rate.

On 21 October 2019, Chennai ITAT<sup>1</sup> held that since the agreements entered between the members of the Association of Persons (AOP) were silent on the share of profits of the members, the shares were indeterminate and hence the total income of the AOP shall be taxable at the rate applicable to the foreign company, which was a member of the AOP.

### Facts of the case

- The taxpayer is a joint venture formed by two parties namely Consolidated Construction Consortium Limited (CCCL) and M/s. Herve Pomerleau International Inc (HPI), a company registered in Canada, to execute a contract of Airport Authority of India for expansion of Chennai Airport.
- The taxpayer filed its return of income for assessment year (AY) 2010-11, declaring the total income of Rs. 20,79,54,470 and the assessment was completed under section 143(3) of the Act, accepting the returned income.
- The tax officer noticed that taxes have been charged at maximum marginal rate on income attributable to Indian AOP, as against the rate applicable to foreign companies i.e. 42.23 percent and reopened the assessment under section 147 of the Act.
- The tax officer held that the individual shares of the members of the AOP were indeterminate and that the tax should be levied under proviso to section 167B(1) of the Act.
- Section 167B(1) provides that where the individual shares of the members of an AOP or body of individuals (BOI) in whole or any part of the income of such AOP or BOI are indeterminate or unknown, tax shall be charged on the total income of the AOP or BOI at the maximum marginal rate. Further, the proviso to section 167B(1) provides that where the total income of any member of such AOP or BOI is chargeable to tax at a rate which is higher than the maximum marginal rate, tax shall be charged on the total income of the AOP or BOI at such higher rate.
- An appeal was preferred by the taxpayer before the CIT(A).
- The CIT(A) dismissed the appeal of the taxpayer after considering the submissions made by the assessee and perusal of the relevant clauses of Consortium Agreement, profit sharing agreement, etc.
- The taxpayer preferred an appeal before the ITAT.
- Before the ITAT, the taxpayer submitted that as per the clause of Memorandum of Understanding (MOU) entered into between the parties and profit sharing agreement, it was clear that the profit sharing ratios of the members of the MOU were determined and therefore tax should be levied under section 167B(2) of the Act.

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<sup>1</sup> M/s. Herve Pomerleau International CCCL Joint Venture ( ITA Nos.1008/CHNY.2017, 17, 18, 19/CHNY/2019 for AY 2010-11 to 2013-14) (Decision dated 21 October 2019)

- Section 167B(2)(i) of the Act *inter alia* relates to cases where shares of AOP or BOI are determinate. As per section 167B(2)(i) in case of an AOP or BOI, if the total income of any member (excluding his share from such AOP or BOI) exceeds the maximum amount which is not chargeable to tax in the case of that member, tax shall be charged on the total income of AOP or BOI at maximum marginal rate.

## Decision of the ITAT

- The ITAT observed that in order to determine the applicability of provisions of section 167B of the Act, it was essential to decide whether the shares of the members of the AOP are indeterminate or unknown.
- The ITAT perused the long-term agreement, MOU and the profit sharing agreement between the parties and observed that these agreements were silent on the profit sharing ratio of the members of the AOP. The ITAT observed that even the Consortium Agreement entered between HPI and CCCL was silent as to the shares of the profits of the AOP.
- Further, the ITAT observed that the profit sharing agreement states that profit before tax arising on the above project would be finally determined after completion of the project and it further mentioned that, HPI shall be paid guaranteed profit share in the form of 2 percent of the contract price.
- The ITAT held that on the basis of cumulative consideration of the terms of the three agreements (i.e. long term agreement, MOU and profit sharing agreement), it was clear that the parties have not agreed as to the shares of the profits of the AOP.
- The ITAT elucidated that the term "share of net profit" implies "share in the net profits" which is an interest in the profits and implies a participation in the profits and losses.
- The ITAT noted that the member of AOP i.e. HPL was entitled to 2 percent of the project cost, regardless of the fact whether the AOP made profits or losses and such amount was a charge against the profits of the taxpayer, but not a share in profits.
- Thus, the ITAT held that shares of members of the AOP were indeterminate and unknown, and therefore the provisions of 167B(1) were applicable. The ITAT held that tax shall be charged on the total income of the AOP at the rate of 42.23 percent applicable to the non-resident member of the AOP.

## Our comments

The taxation of an AOP / BOI has been a subject matter of litigation for many years. The moot point of the litigation revolves around the question i.e. whether the shares of the members in an AOP or BOI are determinate or indeterminate or unknown? On a similar issue the Bombay High Court<sup>2</sup> held that where shares of members of AOP were indeterminate at least in part, whole of such income of such AOP was to be taxed at maximum marginal rate. The Bombay High Court observed that the members in the AOP did not have knowledge of their share in the AOP, thereby concluding that the shares of the members were indeterminate or unknown.

These judicial precedents indicate that amongst other factors relevant for deciding whether shares in AOP or BOI are determinate or indeterminate, a crucial factor is whether the profit sharing agreements, consortium agreements, etc. between the members of AOP or BOI contain the clause relating to profit sharing of the members of AOP or BOI.

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<sup>2</sup> Laxmi Fruit Company v. CIT (2018) 99 taxmann.com 429 (Bombay)



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