

HC lays criteria to identify AOP;relies on ratio of 'Ishikawajima-Harima' for taxability of offshore supplies

Summary – The High Court of Delhi in a recent case of Linde AG, Linde Engineering Division., (the Assessee) held that in absence of sufficient degree of joint action between consortium members in either execution or management of project, consortium would not be deemed as an AOP for purposes of Income-tax Act. The fact that the contractual obligations of one of consortium member were not limited to merely supplying equipment, but were for due performance of the entire Contract, would not necessarily imply that the entire income relatable to the Contract could be deemed to accrue or arise in India. The taxable income in execution of a contract may arise at several stages and the same would have to be considered on the anvil of territorial nexus.

Facts

- (a) The petitioners had filed the present petition to quash the ruling of the Authority for Advance Rulings ('Authority'). By the said ruling, the Authority had held that the Consortium of 'Linde' and 'Samsung' constituted an Association of Persons ('AOP') and the income derived therefrom by 'Linde' from offshore supply of goods and for rendering of offshore services were taxable in India.
- (b) Thus, the issues which were required to be considered in the this petition were:
- i. Whether Linde and Samsung constituted an AOP within the meaning of 'person' as defined under section 2(31) of the Act? and,
- ii. Whether income of Linde from supply of goods outside India and for rendering services outside India was taxable in India?

• The High Court held as under:

On issue of Constitution of AOP

- (1) An association can be considered as a separate taxable entity (i.e, an AOP), if it exhibits the following essential features:
- (a) Two or more persons must constitute it.
- (b) The constituent members must have come together for a common purpose.

- (c) The association must move by common action and there must be some scheme of common management.
- (d) The cooperation and association amongst the constituent members must not be perfunctory and/or merely in form. The association amongst members must be real and substantial which is sufficient to treat the association as a separate homogenous taxable entity;
- (2) 'Linde' and 'Samsung' had joined together to:
 - (a) Bid for the contract;
 - (b) Present a façade of a consortium for execution of the contract and accept joint and several liability for due performance of the contract and completion of the project; and

Put in place a management structure for inter se coordination and execution of the project. However, in all other respects, both Linde and Samsung were independent of each other and were responsible for their own deliverables under the Contract, without reference to each other;

The fact that 'Linde' and 'Samsung' agreed to be jointly and severally liable for due performance of the Contract only indicated that they had accepted a contractual obligation towards a third party, the same would not by itself lead to a conclusion that the said members had formed an AOP.

In order to consider independent agencies as an AOP, it is necessary that they should form a joint enterprise with a greater level of common management. An element of mutual agency and joint action for mutual purpose are also necessary. Mere obligation to exchange information between independent agencies, for co-ordinating their independent tasks would not result in an inference that the agencies had constituted an Association of Persons.

'Linde' and 'Samsung' had neither shared costs nor the risks. Both managed their own deliverables. Thus, the facts of this case did not indicate a sufficient degree of joint action between 'Linde' and 'Samsung' in either execution or management of the project to justify a conclusion that they had formed an AOP and, thus, the Authority had erred in concluding so.

On issue of taxability in India

The fact, that the contractual obligations of Linde were not limited to merely supplying equipment, but were for due performance of the entire Contract, would not necessarily imply that the entire income which was relatable to the Contract could be deemed to have accrued or arisen in India;

The Supreme Court in the case of Ishikawajima-Harima Heavy Industries Ltd. v. DIT [2007] 158 TAXMAN 259 (SC) had considered this aspect and held that merely because a project was a turnkey project would not necessarily imply that for the purposes of taxability, the entire contract had to be considered as an integrated one. The taxable income in execution of a contract may arise at several stages and the same would have to be considered on the anvil of territorial nexus.

The Supreme Court held that for the purposes of determining the taxability, it was necessary to enquire into where the income sought to be taxed had accrued or arisen. The impugned ruling of Authority was, thus, clearly contrary to the decision of the Supreme Court in Ishikawajima-Harima Heavy Industries (*supra*).

Explanation 1(a) to Section 9(1)(i) of the Act clearly embodies the principle of apportionment. In cases where all the operations of business are not carried out in India, the income arising therefrom is required to be apportioned and only that portion of income which is reasonably attributable to operations carried on in India would fall within the net of tax in India under Section 9(1)(i) of the Act;

In the facts of the present case, where the equipment and material were manufactured and procured outside India, the income attributable to the supply thereof could only be brought to tax if it was found that the said income arose through or from a business connection in India. However, in view of the decision of the Supreme Court in Ishikawajima-Harima Heavy Industries (*supra*) it could not be concluded that the Contract provided a "business connection" in India and, accordingly, the Offshore Supplies could not be brought to tax under the Act. In view of the foregoing discussion, the impugned ruling was to be set aside and the case was to be remanded to the Authority for deciding the same afresh and in accordance with the views expressed herein.