BEFORE THE AUTHORITY FOR ADVANCE RULINGS (INCOME TAX)
NEW DELHI

23rd Day of March, 2010

PRESENT

Mr.Justice P.V.Reddi (Chairman)
Mr.J.Khosla (Member)

A.A.R. Nos 798-799 of 2008

Name & address of the applicant	:	**M/s Hyundai Rotem Co., Korea** In Application No. (AAR/798/2008) **M/s Mitsubishi Co., Japan** In Application No. (AAR/799/2008)
Commissioner concerned	:	DIT(International Taxation), New Delhi
Present for the applicant	:	Mr. N. Venkatraman, Sr. Advocate Mr. Satish Aggarwal, CA Mr. Vikrant Suri, CA Mr. Atul Awasthi, CA
Present for the Department	:	Mr. Sushil Kumar, Addl. DIT(IT) Range- 3 Mr. Ashish Kumar, Addl. DIT(IT) Range-1

R U L I N G

(By Hon'ble Chairman)

1. These applications are filed by two members of a Consortium which was formed to bid and execute a project for Delhi Metro Rail Corporation (for short '**DMRC'**). DMRC issued tender inviting bids under the International Competitive Bidding for Mass Rapid Transport System-Phase II Contract/Tender RS3 for design, manufacture, supply, testing, commissioning, training and transfer of technology of 156 Standard Gauge Electrical Multiple Units ('EMUs').

1.2. For the purpose of bidding for the Contract RS3, Mitsubishi Corporation, Japan (MC), Hyundai Rotem Company[1], Korea ('Rotem'), Mitsubishi Electric Corporation, Japan ('MELCO') and BEML Limited, India ('BEML') entered into a Consortium Agreement (members collectively referred to as 'MRMB Consortium') on 26th April, 2007. As per the terms of the Consortium Agreement, MC was appointed as the 'consortium leader'. MRMB—Consortium thereafter submitted the bid to DMRC on 30th April, 2007..

1.3. For execution of the project, the Consortium Agreement provides for constitution of project board comprising of project directors from each member for the overall planning, organizing and directing the complete execution of the project in an efficient manner. Under the Agreement, each member's responsibility is that (1) Rotem would be responsible for the Mechanical works; (2) MELCO would be responsible for the Electrical works; and (3) BEML would be responsible for the Localization works. Further, MC as consortium leader would be responsible for project coordination, commercial management, contract administration, legal administration, providing bank guarantees and collecting payments from DMRC.

1.4. DMRC accepted the price proposal submitted by MRMB Consortium in relation to the Contract RS3 and awarded the same

[1] Formerly known as Rotem Company

to the MRMB Consortium vide its Letter of Acceptance dated 30th August, 2007. The contract RS3 was signed between DMRC and the MRMB Consortium on 19th October, 2007 for design, manufacture, supply, testing, commissioning, training and transfer of technology of 156 Standard Gauge EMUs (the number 156 subsequently increased to 192). Lump sum consideration for the supply of 192 EMUs was stipulated to be JPY 23,156,536,549 and INR 5,021,742,872 which is apportioned among various cost centers, and further apportioned amongst various milestones.

1.5. The Consortium members entered into a Supplementary Consortium Agreement ('SCA') on 6th June, 2008. The role and the participation percentage of each member is separately defined in the SCA. As per the SCA, the participation percentage among the consortium members for Contract RS3 is: MC – 3.40%; Rotem -57.00%; Melco-21.90%; and BEML- 17.70%. The original ratio was: 3.40%, 35.10%, 21.50% and 17.70% respectively. The SCA was approved by DMRC on 1st August, 2008. As per the modalities agreed to between the consortium members, BEML is the supplier of EMUs to DMRC while Rotem /MELCO/ MC are responsible for supplying equipments/materials to BEML. Accordingly, BEML would raise invoice on DMRC for supply of EMUs while MC/Rotem/ MELCO would raise invoices on BEML for supplies made to it. For collecting payments from DMRC on behalf

of BEML, MC is responsible and the amount so collected is distributed among the consortium members in the pre-agreed ratio. Further, Rotem has established a Project Office ('PO') at New Delhi to execute the contract RS3.

2. On the basis of the above facts, the following question is raised for seeking advance ruling:

> *On the facts and in the circumstances of the case, whether the consortium of Mitsubishi Corporation, Japan (MC), Hyundai Rotem Company, Korea (Rotem), Mitsubishi Electric Corporation, Japan (MELCO) and BEML Limited, India ('BEML') [referred to as 'MRMB Consortium'], for the purpose of bidding and executing the contract RS3 of Delhi Metro Rail Corporation ('DMRC'), could be assessed as independent companies under section 2(31)(iii) of the Income-tax Act, 1961 ('the Act') in India or as an Association of Persons ('AOP') under section 2(31)(v) of the Act.*

3. According to the applicant, the Consortium of MC, Rotem, MELCO and BEML formed for the purpose of bidding and executing the Contract RS3 awarded by DMRC does not constitute an AOP for the purposes of the Act especially for the reason that there is no agreement to share profits and losses or to jointly incur any expenditure. The Revenue has contested the stand taken by the applicant and contended that the Consortium has all the attributes of AOP as clarified in the ruling of this Authority in *GeoConsult GHBH*.

4. As noted earlier, the two applicants, namely MC and Rotem together with MELCO and BEML (an Indian company) have formed a consortium and agreed to jointly participate in the global tender invited by DMRC for the aforesaid contract. A Consortium

agreement was entered into on 26th April, 2007 broadly agreeing to the terms and conditions under which the parties shall pursue and execute the project. MC was appointed as the Consortium's Leader. MC looks after commercial management and project coordination work. It has the authority to negotiate, finalize and submit all the documents required to be submitted by the consortium and to act as the Official Liaison Officer for the consortium. MC as the Consortium Leader has also been authorized to "incur liabilities and receive any instructions, payments for and on behalf of any or all member firms of the Consortium in regard to all matters related to this project and the bidding therefor". Rotem is designated as the technical leader of the project. It is responsible for the detailed design development, manufacture, supply, testing and commissioning of mechanical portions (rolling stock). MELCO (Mitsubishi Electric Corporation, Japan) is responsible for design, manufacture, supply, testing and commissioning of the propulsion and other electrical equipments of the rolling stock. BEML (Bharat Earth Movers Ltd.) is responsible for local manufacturing and supply of rolling stock except those entrusted to MELCO. The percentage of participation among the parties has been agreed upon as noted earlier. A Supplementary Consortium Agreement was entered into varying the percentage. Both these Consortium Agreements have been placed before DMRC and the letter of approval for the latter is also on record.

5. The Contract Agreement – RS3 was executed in Delhi on 19th October, 2007 between DMRC and the Consortium. The names and description of consortium members are set out in the preamble and they are collectively referred to as the 'contractor'. All the members signed the Agreement. They are jointly and severally liable for the undertaking of the contract. The obligations of the 'contractor' are specified to be to perform efficiently all the work to design, manufacture, supply, testing, commissioning, training and transfer of technology of 156 (revised to 192) standard gauge electrical multiple units (passenger rolling stock) and to supply spares, O&M manual and to supply or provide all equipment, materials, labour and other facilities requisite for the successful completion of the works. The lump sum consideration payable in Indian rupees and Japanese yen are specified. The other terms such as key dates for completion of works, price variation etc. are also incorporated in the contract document. The detailed terms and conditions of the contract are to be found in the tender documents, General conditions of contract etc.

6. The question is whether a collaborative effort on the part of two or more parties who combine themselves to form a joint venture or a consortium to undertake contract works or other commercial activities would give rise in law to an 'association of persons' is not free from difficulty. There is no definition of AOP in the Income-tax Act or under the general law. The fact that AOP

differs from the partnership and it falls short of partnership is recognized in law; but the degree of distinction is not clear. Whether or not a combination of persons or entities for undertaking the business venture would give rise to AOP depends on the facts and circumstances relating to a given contract or transaction. There is no hard and fast rule or clear-cut definition. Various relevant factors have to be weighed to reach the conclusion. Even few differences in facts may make a difference in reaching the conclusion.

7. In the oft-quoted decision of *CIT v/s Indira Balakrishna*[2], the Supreme Court observed: In *in re B.N.Elias Derbyshire, C.J., rightly pointed out that the word "associate" means, according to the Oxford Dictionary, "to join in common purpose, or to join in an action." Therefore, an association of persons must be one in which two words occur in a section which imposes a tax on income, the association must be one the object of which is to produce income, profits or gains. This was the view expressed by Beaumont, C.J. in Commissioner of Income-tax v. Lakshmidas Devidas and also In re Dwarakanath Harischandra Pitale."*

In *CIT vs. C. Karunakaran and others*[3] , a division bench of Kerala High Court observed:

[2] 39 ITR 546

[3] 170 ITR 426

> **"***These observations show that wherever individuals employ their assets in a joint enterprise with a view to make profit, though not as partners, they constitute an association of persons by reason of their common purpose or common action. In such an enterprise, the distinction between a firm and an association of persons may often be thin and sometimes very obscure."*

8. There are two decisions of this Authority – one in *Van Oord Acz BV*[4] and *GeoConsult ZT GMBH*[5]. In the former case, the conclusion was reached that the joint venture did not satisfy the criteria of AOP. However, in *GeoConsult* case a different conclusion was reached after distinguishing the case of *Van Oord*. In *GeoConsult*, *inter alia,* this Authority has taken a view that the sharing in profits and losses is not an essential requisite of AOP and it is enough if with the objective of making profits, the parties share gross receipts in an agreed percentage. In the present case also the parties have agreed to share the total contract price payable as per specified milestones in agreed ratio and they are not concerned with each other's profits or losses. It is submitted by

[4] 248 ITR 399

[5] 304 ITR 283

the learned Senior Counsel for the applicant that the sharing of profits, not merely gross receipts, is essential even in the case of AOP; as otherwise, it would lead to certain anomalies and give rise to practical difficulties in accounting and filing returns. Further, it is pointed out that the decision of the Supreme Court in *N.V. Shanmugham and Co. vs CIT*[6] (relied on by this Authroity in *GeoConsult* case) did not lay down a clear proposition that there need not be a division of profits among the members of AOP. The factual context in which certain observations were made therein has to be appreciated before applying the ratio of the said decision. The contention of the counsel for the applicant is not without force. However, without deviating from the view taken in *GeoConsult* that division of profits and losses as in the case of partnership is not necessary to infer an AOP, we shall consider the question whether on taking stock of the other features and terms of the contract, the conclusion can be legitimately reached that there was an AOP in the present case. We have to see whether the instant case falls more within the ratio of the ruling of this Authority in *Van Oord* or the later ruling in *GeoConsult.*

9. The points which go to support the plea of AOP are these: the formation of consortium and joint participation of the consortium members in the tender process; the bids having been submitted by the Consortium; the execution of a single contract; the nomination

[6] 81 ITR 310 (SC)

of Consortium Leader and constitution of a project Board comprising of Project Director of each member for the overall planning, organizing and controlling the execution of the project; lump sum consideration and payments made from time to time in the name of the Consortium Leader (*i.e.* MC); bank guarantee (performance guarantee) on behalf of MRMB Consortium; joint and several liability towards the client-DMRC, the risk and cost by reason of defect or damage cast on the contractor (consortium) and not on individual members; insurance of plant and rolling stock etc. in the joint names of employer and contractor. These are also the points broadly projected by the Revenue in addition to some other minor aspects.

10. As against these features, the points which rule out the inference of AOP may be noted. The first and foremost thing is that the nature of work undertaken and capable of being executed by each party is very much different and the scope of work assigned to one party cannot be undertaken or relocated to another. For instance, Rotem is concerned with mechanical portion of work, whereas MELCO is concerned with electrical portion and MC looks after project coordination and commercial management which is primarily non-technical in nature. They have different skill-sets. That is why the evaluation was also done by DMRC separately in relation to each member. Interchangeability or re-assignment of work and overseeing each other's work is not possible. Each does

not act as an agent of the other [vide clause 15 of SCA]. In *Faqir Chand Gulati's* case[7] that is one of the tests applied in determining the character of a joint venture. One more important point is that the original bid amount has been reduced and the participation ratio has been varied on account of each party agreeing for a certain percentage of discount on its own. As pointed out by the applicant's counsel, it was not an across the board discount or reduction. Each member worked out its own independent percentage of discount as a result of which the bid amount got reduced. The Revenue relied on the fact that the performance guarantee was given by MRMB Consortium. Though it is so, the fact remains that DMRC insisted on a separate guarantee and undertaking from the parent company of each member [as seen from clause 4.2.3 of GCC]. Above all, there is a specific declaration in SCA that "nothing in the agreement is intended or shall be construed as creating a partnership, joint venture or any other legal entity among the parties". These are all features apart from the profits and losses being borne by the individual members themselves and common expenditure not being incurred by them. The joint and several liabilities towards the employer has been apparently introduced as a safeguard to DMRC to have better hold over the Consortium members. What exactly is the scope and effect of such a clause on the non-defaulting

[7] (2008) 10 SCC 345

member who cannot oversee the work of the other is not free from doubt.

12. On an overall consideration and adopting a holistic approach, we are unable to reach the conclusion that in this case, the Consortium can be treated as AOP and be assessed accordingly. The factors which rule out the inference are more glaring and conspicuous than the factors which support the inference.

13. Let us compare the facts of the present case with those in *GeoConsult.* In the case of *GeoConsult,* clause 2.1 of the JV agreement clearly states that the members have established a joint venture being an unincorporated association under the name of GC – RITES, Secon JV for the purpose of entering into the Services Agreement with the client and performing all the services to be undertaken for the project by virtue of that Agreement. This is one of the points relied on at para 13. There is no such specific declaration in the agreement with which we are concerned. Merely coming together and acting in cooperation with each other for the purpose of executing the work while each member carries on its own scope of work independently does not reasonably lead to the conclusion that an AOP has been formed. Then, in regard to the scope of work, there was no doubt division of work between the members of JV in the case of *GeoConsult*. But, the nature of work broadly was providing project consultancy services relating to

project preparation comprising project management and design responsibility. Each of the three firms had the skills to do these services and in fact assistance and support was agreed to be provided to each other, as seen from the clauses of the Agreement referred to therein. Further, as per clause 8.3 of the JV agreement, each member shall have unrestricted access to any work carried out by other members of JV (vide para 14 of the ruling in *GeoConsult).* Moreover, the work of one member could be reassigned to the other in case of breach, as per 12.4 of JV Agreement. Then, clause 12 of the JV agreement in *GeoConsult* provided that in case of insolvency of a member, the other members were to be irrevocably appointed to act for that member in the matter of performance of the Agreement, "being jointly and severally responsible on his behalf". The fact situation in the present case is materially different. The scope of work of each member of MRMB consortium is specifically defined and it is mutually exclusive to each other. There can be no interchangeability or overlapping of the work to any substantial extent. The nature of work performed by each member is qualitatively different and each member has distinct skills. The access to the work carried on by others or providing assistance to another does not arise here. The question of substitution of the other JV member in place of an insolvent member does not also arise in the present case. One more distinction is that joint and

several responsibility inter se among the JV partners was contemplated therein. In this context, reference may be made to paragraph 16 of the ruling of Chairman, which is extracted below:

> *"The integral connection between the JV Members and their joint accountability to the client as well as their inter se accountability is further discernible from clause 12 which bears the caption "Member in default". Cl. 12.1 provides that in the event of insolvency of a member, the other members are irrecovably appointed to act for that member in the matter of performance of the agreement "being jointly and severely responsible on his behalf". The obligation of a member to indemnify the other member in case of delay or failure to fulfil its obligations (vide cl. 12.2) and the stipulation inCl. 12.7 to the effect that the sums received by JV towards payment for the work done by defaulting member shall be used to compensate any loss or damage resulting from the default of that Member are other indicators of the commonness and unity of the enterprise formed for the purpose of executing the works under the Services Agreement."*

13.1. Then, there was no provision in *GeoConsult* which records the fact that the intention of the parties was not to create a partnership, joint venture or any other legal entity among the consortium members. This aspect was also taken into account in *GeoConsult.* Further, a clause similar to clause 15 of SCA which says that each consortium member shall be operating on its

account and shall not act as an agent on behalf of the other members is not to be found in *GeoConsult* agreement.

14. Now, we shall make a comparative analysis of the facts in *Van Oord* and in the present case. In the case of *Van Oord,* just as in the present case, the parties have specifically provided in the Agreement that each party will bear its own loss and retain its profits separately. There was also specific declaration as in the present case that it was not their intention to create a joint venture to carry on business in common. Just as in the present case, the applicant therein had undertaken separate scope of work according to its technical skills and executed it independent of HCC, the other JV partner. There was no control and connection between the work done by the applicant and the HCC. It was observed that the intention was not to carry out any business in common and the applicant. Each one had independent and designated role to play. The factual position is almost the same here which is reinforced by the clause that members shall be operating on their account and will not be acting as an agent of the other member of Consortium. It was observed in *Van Oord* case that the association of applicant-Company with HCC was undoubtedly for mutual benefit, but that association did not make them a single assessable unit. The situation is also the same here. We are of the view that the present case is more in line with *Van Oord* than *GeoConsult.*

15. Then, the arguments were addressed by the learned Counsel for the applicant on the point whether it is a case of diversion of income by overriding title. There is no need to express any view on this aspect. So also, section 167(B) which is a provision for ascertaining the income of AOP members, which has been referred to by the learned departmental representative, need not be discussed as it has no bearing on the basic issue whether on the facts of the case, an AOP exists.

16. In the light of above discussion, it is ruled that the MRMB Consortium cannot be treated as Association of Persons for the purposes of assessment under the Income-tax Act, 1961 and the applicants can only be subjected to taxation on the basis that they are separate taxable entities. Accordingly, the question is answered.

Accordingly, the ruling is given and pronounced on this the 23rd Day of March, 2010.

Sd/-
(J. Khosla)
Member

Sd/-
(P.V. Reddi)
Chairman

F.No. AAR/798-799/2008 **dated 29/03/2010**

This copy is certified to be a true copy of the Ruling and is sent to:

1. The applicant
2. The Director of Income-tax (International Taxation), New Delhi.

Sd/-
(Batsala Jha Yadav)
Addl. Commissioner of Income-tax, AAR