

Bombay Chamber of Commerce and Industry

Representations for reducing surcharge on Association of Persons to 10%/15%

1. Background

Taxation of a joint venture, depends upon the agreement between the parties, forming the joint venture. If the joint venture is established in the form of a partnership firm or as a company, it is taxed accordingly i.e. as a partnership or as a company. But in all other cases, a joint venture is treated as an association of persons (AOP) or a body of individuals (BOI). From the income tax perspective, if two or more persons join hands to carry on a business but do not constitute a partnership they may be assessed as an AOP.

In connection with infrastructure projects, a consortium of contractors is often formed to implement complex projects, particularly in Engineering, Procurement and construction (“EPC”) contracts and Turnkey Projects primarily due to the requirement of expertise, and specialised resources in each specific area. The members in the consortium may or may not have clear demarcation of scope of work and they might be independent third parties or affiliated entities of a particular group.

Leading EPC companies in India provide turnkey solutions for construction of roads, bridges, fully integrated rail & metro systems, commercial building & airports and setting up power generation plants, power transmission & distribution systems, etc. Such EPC companies have formed number of Joint Ventures in India in the form of AOP’s with various partners (both overseas and local) for the purposes of bidding and execution of contracts. Such AOPs are formed for a temporary period for the specific project. In most large projects like road, rail, power, etc, the bids floated by statutory authorities have pre-condition qualification for presence of international qualified partner or presence of international partner is inevitable due to international bidding process. The AOP structure is preferred in view of relationship not constituting partnership and/or corporate form being unsuitable for short term projects.

The Finance (No.2) Act 2019 increased the surcharge rate for Individuals, HUF, AOPs, BOIs and AOPs. From AY 2020-21, an enhanced surcharge is levied on such taxpayers as under:

- 25 percent if taxable income is between Rs. 2 Cr to Rs. 5 Cr
- 37 percent if taxable income exceeds Rs. 5 Cr

Thus, the surcharge rate which was initially increased to 15 percent for AOPs vide Finance Act 2016 has been increased to 37 percent vide Union Budget 2019.

As such increase in surcharge has adverse impact on the infrastructure sector as well as on Indian companies, which are members of AOPs in infrastructure sector with determinate shares, a representation is made below for your kind consideration

to reduce the surcharge to 10%/15% as it prevailed prior to increase by Finance (No.2) Act 2019.

2. Representation before CBDT

Increasing number of AOPs

- There has been a significant increase in the number of AOPs in India since 2013. According to data, the number of returns filed by AOPs by the end 2017 has been doubled to 2.07 lacs since 2013. Indian companies are required to form an AOP for leveraging upon the expertise and capital requirements for critical infrastructure projects. Such AOPs are formed as a part of the contractual arrangement with project owners. *Thus, AOP is primarily formed due to commercial and business considerations rather than for the purposes of taxation.*

Boost in the infrastructure sector

- Infrastructure is the fundamental enabler for growth. Recognising this, the government has laid down its Infrastructure Vision and Goals 2025 under which the Hon'ble Prime Minister has made a commitment of Rs 100 lakh crore under the National Infrastructure Pipeline (NIP). The investment under NIP would be made in more than 6500 infrastructure projects across sectors over the next five years. The new projects will include housing and water supply, affordable and clean energy, healthcare, airports, transportation and logistics, highways, digital services, health, education and project preparation facility for infrastructure projects to name a few.
- Further, India's vision for "Atmanirbhar Bharat" based on five significant economic pillars, includes infrastructure as one of the key pillars that will propel India towards growth with self-reliance. Several new schemes, projects and opportunities are envisioned under Atmanirbhar Bharat such as affordable housing, renewable energy, entire value chain of electricity generation (including coal mining) and distribution, to name a few. Even in the strategic sectors such as defence, space and atomic energy, participation of private and foreign sectors has been announced. Investment opportunities have also been created for agricultural infrastructure which will give a fillip to scientific storage facilities.
- The government has also taken specific measures to incentivise foreign investment. For instance, investments in notified infrastructure sectors by Sovereign Wealth Funds of foreign governments, will be allowed full tax exemption on interest, dividend and capital gains income, subject to the conditions specified.
- The thrust to infrastructure development and quality of services will lead to greater urbanisation and increased employment opportunities that, in turn, will fuel domestic demand and growth. It will also improve the ease of living and provide equitable access to infrastructure for all, thereby making growth more inclusive.

- As AOP is a preferred mode of operation for several infrastructure companies which operate in India and abroad, higher surcharge on AOPs is counter-productive and adversely dampens the efforts to attract investments in the infrastructure space through debt, equity or hybrid instruments. The increase in surcharge in an ad-hoc basis may be perceived as an uncertain tax environment by potential investors. AOP being a business entity, it seems levy of higher surcharge intended for 'super rich' taxpayers is an unintentional anomaly which needs to be corrected.

Taxation of AOPs

- While AOPs are taxed at base rate of maximum 30% which is same as partnership firms and LLPs, the surcharge rate differs between the two.
- The surcharge on firms/LLPs is 12% on income above Rs. 1 Cr. The surcharge rate for AOPs upto F.Y. 2018-19 was 10% for income between Rs. 50 lakh to Rs. 1 Cr and 15% for income above Rs. 1 Cr. However, from F.Y. 2019-20, the surcharge rate has been increased to 25% for income between Rs. 2 Cr to Rs. 5 Cr and 37% for income above Rs. 5 Cr
- The enhancement of surcharge on AOPs is an unintended fall out of enhancement of surcharge on individuals and HUFs. This is because AOPs are placed in same category as individuals/HUFs. While the intention was to levy higher tax on 'super rich' individuals earning more than Rs. 2 Cr in a year, it has also increased the surcharge for AOPs formed for business purposes by companies.
- As stated earlier, AOPs are formed for bidding and executing specific projects by pooling together expertise and specialised resources in specific areas by different entities. They cannot be used as vehicles for holding income generating assets. There are specific provisions regulating contribution on formation and withdrawal of assets on dissolution of AOPs to address any tax avoidance measures adopted by parties.
- Practically in majority of cases most AOPs may not be holding any asset within their fold since equipment and assets required for construction of infrastructure generally belong to individual members of AOP or may be outsourced. At best, there may be very few assets (-say, movables like machineries or vehicles) which may be held by AOP which are required to be transferred to the members on dissolution of AOP.
- From the taxation perspective, prior to the amendment in the law by Finance Act 1987, the settled legal position was that, a partnership firm/AOP is not a distinct legal entity and the partnership property in law belongs to all the partners constituting the firm/AOP, though the partnership firm /AOP may possess a tax personality distinct from the persons constituting it. Therefore, on dissolution, as the firm has no separate rights of its own in the partnership/AOP assets, there is no question of any extinguishment of the firm/AOP's rights amounting to a transfer of assets within the meaning of s. 2(47) of the Act.

27 July 2020

- However, with a view to block such escape routes for avoiding capital gains tax, Section 45(3) and Section 45(4) were inserted in the Act by Finance Act 1987 to deem pooling of assets by partners in to the firm/AOP and distribution of assets by the firm/AOP to partners on dissolution or otherwise, as transfers for tax purposes, even though there would be none under the general law of partnership.
- Moreover, the taxation rules when an AOP is dissolved is also covered by section 177 of the Income Tax Act, 1961, wherein the Income Tax Officer shall make an assessment of the total income of the association of persons as if no such discontinuance or dissolution had taken place and all the provisions of the Income tax Act, including the provisions relating to the levy of a penalty shall apply to such assessment.

Adverse impact of increase in surcharge

- The higher surcharge rate of 37 percent leads to additional tax burden on Indian companies, which are members of the AOP formed for infrastructure projects. Therefore, it also discourages domestic companies to invest in the infrastructure sector / projects.
- Therefore, considering the requirement of the economy and the fact that infrastructure creates maximum employment in the country, the additional surcharge is a stern deterrent to the overall vision of the government to boost infrastructure as a growth vehicle to make India a self-reliant nation.

3. Recommendations

- The introduction of such high surcharge on AOPs appears to be unintentional fall out of measure to levy 'super rich' tax on rich individuals. It has discouraged investment in infrastructure projects in India which is not warranted.
- Therefore, we request the Government to kindly accept our representation above and reduce the surcharge on AOPs to level of 10%/15% as it was prior to enhancement by Finance (No.2) Act 2019. However, if a complete rollback is not possible, a specific carve out for infrastructure sector or relief to Indian Companies, in their capacity as member of AOP, by allowing their share of income in the AOP to be subject to surcharge rate applicable to Indian companies (i.e. 7% / 12%) instead of the enhanced surcharge rate for AOPs i.e. 25% / 37% may be considered.