Taxation of Joint Venture Business

267 ITR (Jour.) p. 11(Part – 1)

- By S.K. Tyagi

Presently we have been witnessing a very different trend in relation to the real-estate development. Earlier, a builder would go for outright purchase of a piece of land from the land-lord and develop the same at his own cost and risk. The scenario in this regard is undergoing a change. The land-lord also desires to have a share in the profit of the project being undertaken by the builder and developer. On his part, the builder and developer desire(s) to share his risk in the development of the project. This change in the trend in relation to real-estate development, is giving rise to a new concept of Joint Venture between the land-lord and the builder / developer, for the purpose of the development of immovable properties.

It is often the case that the builder / developer is either a limited company or a partnership firm, whereas the land owner is either an individual or an HUF or a partnership firm.

The question which is often being asked is as to the status of such a Joint Venture for the purpose of income-tax and the tax-treatment of various tax-incentives in the case of such a Joint Venture. Such tax-incentives are provided under Section 80-IA(4)(iii) and Section 80-IB(10) of the Income-Tax Act, 1961. Another issue which often arises is regarding the tax-liability of a member of an association of persons (AOP), if such a Joint Venture is assessed in the status of an AOP.

In order to answer all the aforesaid queries, the relevant provisions of the Income-Tax Act and case-law, will have to be closely examined. The same are discussed as follows:-

1. **Definitions of the words 'assessee' and 'person'– Section 2(7) and Section 2(31) of the Income-Tax Act**

As per Section 80-IA(1), the benefits of Section 80-IA, are available to an assessee. Similarly, as per Section 80-IB(1), the benefits of Section 80-IB are available to an assessee. The word "assessee", is defined under Section 2(7), as a person by whom any tax or any other sum of money is payable under this Act, etc.

The word **'person'** is defined under Section 2(31), which is reproduced as follows:-

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Section 2 (31)"person" includes—

(*i*)an individual

(*ii*)a Hindu undivided family

(*iii*)a company,

(*iv*)a firm

(*v*)an association of persons or a body of individuals whether incorporated or not,

(*vi*)a local authority, and

(*vii*)every artificial juridical person, not falling within any of the preceding sub-clauses.

Explanation.—For the purposes of this clause, an association of persons or a body of individuals or a local authority or an artificial juridical person shall be deemed to be a person, whether or not such person or body or authority or juridical person was formed or established or incorporated with the object of deriving income, profits or gains.

From the aforesaid provisions of Section 2(31), it may be seen that a Joint Venture would be covered under clause (v) of Section 2(31), as an association of persons or AOP, for short.

2. Meaning of the term 'Association of persons'

We have now to understand the meaning of the term 'Association of persons' or 'AOP'. As per the Law Lexicon by P.R. Aiyer p.158, the term "AOP" has been defined as follows:-

(i) An association of persons must be one in which two or more persons join in a common purpose or common action, and as the words occur in a Section which imposes tax on income, the association must be one the object of which is to produce income, profits or gains-*C.I.T. Vs. Smt. Indira Balakrishnan, [1960] 39 ITR 546,551 (S.C.)*

When the business of the import and distribution of cloth was done by a group on a joint basis, when the sales and the profits were ascertained on a joint basis and then distributed according to the capital contributed by each member of the group, the fact that the Deputy Commissioner of the District had appointed the members constituting of the group to import and distribute the cloth in the District does not make any difference in finding this group as the "association of persons"-*C.I.T. Vs. Buldana District Main Cloth Importers Group, [1961] 42 ITR 172(S.C.).*

(ii) Association of persons can be formed only when two or more individuals voluntarily combine together for a certain purpose. *G. Murugesan & Brothers Vs. C.I.T. [1973] 88 ITR 432(S.C.)*

(iii) The term 'association of persons', means an association in which two or more persons join in a common purpose or common action, and as the words occur in a Section which imposes a tax on income, the association be one, the object of which is to produce income, profits or gains. *N..V. Shanmugam & Co. Vs. C.I.T. [1971] 81 ITR 310 (S.C.).*

The term "AOP" has also been dealt with in a number of judgements under Income-tax Act. An 'AOP' must be one in which two or more persons join in a common purpose or common action, and as the words occur in a Section which imposes tax on income , the association must be one, the object of which is to produce income, profits or gains – *CIT Vs. Indira Balakrishnan [1960] 39 ITR 546, 551 (SC)*

Some of the other cases laying down tests or providing criteria of association of persons, are as follows-

(i) *G. Murugesan & Bros. Vs. C.I.T.[1973] 88 ITR 432 (SC)*
It was held in this case that to constitute an AOP two or more individuals voluntarily combine together for a certain purpose.

(ii) *C. Ag. I.T. Vs. Raja Ratan Gopal [1966]59 ITR 728 (SC) and Mohamed Noorullah Vs. C.I.T. [1961] 42 ITR 115(SC)*
It was held in these cases that to constitute and AOP two or more persons should have joined in the promotion of a **joint enterprise** with the object of producing income, profits or gains.

(iii) *C.I.T. Vs. N.V. Shanmugham & Co. [1966] 62 ITR 701 (Mad.)*
It was held in this case that the association need not necessarily be on the basis of a contract; consent and understanding may be presumed.

(iv) *C.I.T. Vs. C. Karunakaran [1988] 170 ITR 426, 429-430 (Ker.)*
It was held in this case 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.

(v) *G.N. Sunanda Vs. C.I.T [1988] 174 ITR 664, 666 (Karn)*
It was held in this case that to constitute and AOP there must be a joining together in a common venture, the object of which is to produce income, profits or gains.

(vi) *C.I.T. Vs. Chandmal Rajgarhia, [1995] 213 ITR 789, 793 (Pat)*

It was held in this case that the essential criterian that attracts the label of 'association of persons' in the Income-tax Department is the unity of the income-making purpose rather than the unity of title in the income yielding asset.

(vii) *Sardar Harvinder Singh Sehgal Vs. Asst. CIT[1997] 227 ITR 512,531 (Gauh)*

It was held in this case that in order to constitute an association of persons, they must join in a common purpose or common action and the object of the association must be to produce income.

From the aforesaid discussion, it may be seen that an 'association of persons' means an association in which two or more **persons** join in a common purpose or common action. The word 'person' herein is very significant, as 'person' may mean any entity as defined in Section 2(31) of the Income-tax Act. In other words, individuals, HUFs, companies or firms, etc. may be members of such A.O.P.

3. An important judgement – Birla Tyres Vs. JCIT [2003] 80 TTJ 915 (Cal.-T) (T.M.)

Recently, the issue relating to the status of an AOP came up for consideration in the case of ***Birla Tyres Vs. JCIT [2003] 80 TTJ 915 (Cal.-T) (TM)***. The main issue involved in the aforesaid case was whether loss in the case of an AOP could be carried forward and adjusted against the income of the following years.

It was held in this case that conjoint reading of Section 67A and other relevant provisions of the Act, indicates that an AOP is an independent assessable entity, different and distinct from its members. In this case, the AOP was constituted by four members which were companies viz. (i) M/s Century Textiles Inds. Ltd. (ii) M/s Kesoram Inds. Ltd. (iii) M/s Jayashree Tea & Inds. Ltd. (iv) M/s Bharat General & Textiles Inds. Ltd. The aforesaid AOP has been treated as an independent taxable entity distinct from its members. It may be seen in this case that the AOP in question, was constituted by four companies.

In the aforesaid context, it was held by the Tribunal that as an AOP is an independent assessable entity, different and distinct from its members, its loss can be set off only against its own profits and not against the profits of its members. It was further held that there is nothing in the Act for dis-qualification of AOP from taking the benefit of the provisions of Sections 71,72 etc., in its own assessment.

The aforesaid judgement of the ITAT fully supports the view that an AOP is an independent taxable entity quite different and distinct from its members, which could be individuals, HUFs, firms, companies or even other AOPs, etc.

4. Meaning of the term 'Joint Venture'

As per Concise Oxford Dictionary, ninth edition, 'adventure' means an enterprise, a commercial speculation whereas 'venture' means risky enterprise, commercial speculation. Thus, for our purpose, there would be no difference between the terms 'adventure' and 'venture'. In other words, the terms 'joint adventure' and 'joint venture' will have the same or similar meaning in the given context. The term 'joint adventure' has been defined on pp.1002 of the Law Lexicon by P.R. Aiyer.

(i) **Joint adventure**

A joint adventure is a limited partnership; not limited in a statutory sense as to liability, but as to its scope and duration.

A joint adventure is an enterprise undertaken by several persons jointly (Cyclopedic L.Dict).

"A commercial enterprise by several persons jointly" (English L. Dict.) "A commercial or maritime enterprise undertaken by several persons jointly." (Black's Law Dictionary)

(ii) **Joint adventure & partnership**

The subject of joint adventures is of comparatively modern origin. It was unknown at common law, being regarded as within the principles governing partnerships. One distinction lies in the fact that while a partnership is ordinarily formed for the transaction of a general business of a particular kind, a joint adventure relates to a single transaction, although the latter may comprehend a business to be continued for a period of years. Another distinction is that a corporation incapable of becoming a partner may bind itself by a contract for a joint adventure, the purposes of which are within those of the corporation.

From the aforesaid definition of joint adventure it may be seen that joint adventure is a limited partnership but not exactly a partnership. In a joint venture the liability of the members/partners is unlimited as in the case of a firm but its scope and duration are limited.

5. The incentive deduction will be available to such Joint Venture

As already explained, such Joint Venture business will be assessable in the status of an AOP.

In this context, it will be necessary to look at the definition of the term 'assessee', as defined under Section 2(7) of the Income-Tax Act, 1961. As per Section 2(7) 'assessee' means **a person** by whom any tax or any other sum of money is payable under the Income-Tax Act. As per Section 2(31) of the Income-Tax Act, the word 'person', includes an AOP.

The deductions under Section 80-IA and Section 80-IB are available to an **assessee**, subject to certain conditions. Thus, it is clear that a Joint Venture assessable in the status of an AOP, will be entitled to the deductions under Section 80-IA (4) (iii) and Section 80-IB (10) etc. of the Income-Tax Act, 1961.

6. Whether share of a member in the income of a Joint Venture business, taxed in the status of an AOP, will again be taxed in the hands of the members.

In order to answer this query, a number of the provisions of the Income-Tax Act, falling under different Chapters thereof, will have to be examined. These provisions may be listed as follows:-

(i) Section 66, with the heading "Total income", falling under Chapter – VI.

(ii) Section 67A, with the heading " Method of computing a member's share in income of association of persons (AOP) or body of individuals (BOI)", falling under Chapter – VI.

(iii) Section 86, with the heading "Share of member of an association of persons or body of individuals in the income of the association or body", falling under Chapter - VII.

(iv) Section 110, with the heading, "Determination of tax where total income includes income on which no tax is payable", falling under Chapter - XII.

(v) Section 167B, with the heading, "Charge of tax where shares of members in association of persons or body of individuals unknown, etc", falling under Chapter - XV.

It may be seen from the heading of Section 67A that it deals with the computation of a member's share in the income of the association of persons (AOP) or Body of individuals (BOI)

First proviso (a) to Section 86

The heading of Section 86 is – "*share of a member of an 'Association of persons' or 'Body of individuals' in the income of the association or body."* As the heading of Section 86 suggests, it deals with the charge of income-tax on the share of a member of an AOP / BOI, in the income of such AOP/BOI. For our purpose, proviso (a) to Section 86 is relevant. As per the aforesaid proviso (a), where the AOP/BOI is chargeable to tax on its total income at the maximum marginal rate or any higher rate under any of the provisions of the Act, the share of a member computed as aforesaid, shall not be included in its total income.

Second proviso to Section 86

In this context, the second proviso to Section 86 is also very relevant. As per the aforesaid proviso where no income-tax is chargeable on the total income of AOP/BOI, the share of a member computed as aforesaid shall be chargeable to tax as part of his total income. In this context, the meaning of the expression 'where no

income-tax is chargeable on the total income of the AOP/BOI', is relevant. The aforesaid expression means, incomes which do not form part of the total income. In this connection, it may be stated that a deduction or relief under Section 80-IA, Section 80-IB, Section 80-I and Section 80-J, cannot be said to be income, profits and gains, not includible in the total income. In support of this proposition, reliance may be placed on the judgement in the case of *Second ITO Vs. Stumpp, Schuele & Somappa P. Ltd. [1997] 106 ITR 399 (Karn.).*

The aforesaid judgement of the Karnataka High Court was affirmed by the Apex Court in the case of *Second ITO Vs. Stumpp Schuele & Somappa P. Ltd. [1991] 187 ITR 108 (S.C.)*

Thus, the deductions available under Sections 80-IA and 80-IB do not pose any problem in this respect. Otherwise also, if the total income of an AOP is entitled to deduction under Section 80-IA or Section 80-IB, then the question of any tax-liability on the share of a member in the income of the AOP, will not arise, as the income of the AOP or BOI would be Nil.

Tax-implications of the provisions of Section167B -'charge of tax where shares of members in AOP or BOI are known, etc.'

From the provisions of Section 167B, it may be seen that Section 167B(1) deals with charge of tax, where the individual shares of the members of an AOP / BOI, in the whole or any part of income of such AOP /. BOI, are in-determinate or unknown. In such a case, income-tax is charged on the total income of the AOP/BOI at the maximum marginal rate.

Section 167B(2), however, deals with cases, which do not fall under aforesaid Section 167B(1). In other words, Section 167B(2) deals with cases where the shares of the members of the AOP / BOI are determinate or known. As per Section 167B(2)(i), where the total income of any member of an AOP / BOI, for the previous year, excluding the share from such AOP / 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 the AOP / BOI, at the maximum marginal rate.

The term "maximum marginal rate" is defined under Section 2(29C) of the Act, and it means the rate of income-tax (including surcharge on income-tax, if any) applicable in relation to the highest slab of income in the case of an individual , AOP or BOI, as specified in the Finance Act of the relevant year. It may be clarified here that when maximum marginal rate is charged on an income, no basic exemption is allowed in respect of the income and the benefit of lower rate of taxation on the lower slabs of income, is also not available in such a case.

It may be reiterated here that where the AOP / BOI, is chargeable to tax on its total income at the maximum marginal rate or any higher rate under any of the provisions of the Act, then as per clause(a) of the first proviso to Section 86, the share of a member of such AOP / BOI, shall not be included in its / his total income**.**

7. Conclusion

In the light of the aforesaid discussion, it may be concluded that-

(a) Income of a Joint Venture project, may be assessed in the status of an 'Association of persons' under the Income-Tax Act.

(b) The deductions under Section 80-IA or Section 80-IB, etc., will be available to such a Joint Venture assessable in the status of an AOP.

(c) No share of income of such AOP, fully deductible under Section 80-IA or 80-IB, would be liable to tax again in the hands of the members thereof.

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