CBDT clarifies on taxability of consortium members in the case of EPC contracts and turnkey projects

A consortium of contractors is often formed to implement large infrastructure projects, particularly in Engineering, Procurement and Construction (EPC) contracts and turnkey projects. The tax authorities in many cases have taken a position that such a consortium constitutes an Association of Persons (AOP). However, the taxpayer takes a contrary stand. This has led to litigation particularly in those cases where each member of the consortium, although jointly and severally liable to the contractee, has a clear distinction and role of work, responsibilities and liabilities of the consortium members.

The term AOP has not been defined under the Income-tax Act, 1961 (the Act). The issue as to what constitutes an AOP was considered by the Supreme Court in some cases. Although certain guidelines were prescribed in this regard, the court observed that there is no formula of the universal application so as to conclusively decide the existence of an AOP and it would rather depend upon the particular facts and circumstances of a case. In the specific context of the EPC contracts/turnkey projects, there are several contrary rulings of various courts on what constitutes an AOP.

With a view to avoid tax disputes and to have consistency in approach while handling these cases, the Central Board of Direct Taxes (CBDT) issued a Circular\(^1\) clarifying that a consortium arrangement for executing EPC/turnkey contracts which have the following attributes may not be treated as an AOP:

- Where each member is independently responsible for executing its part of work through its own resources and also bears the risk of its scope of work and each member incurs expenditure only in its specified area of work
- Each member earns profit or incurs losses based on performance of the contract falling strictly within its scope of work
- Men and materials used for any area of work are under the risk and control of respective consortium members
- Control and management of the consortium are not unified, and common management is only for the inter-se coordination between the consortium members for administrative convenience.

\(^1\) Circular No. 07/2016, dated 7 March 2016
The CBDT also clarifies that there may be other additional factors also which may justify that a consortium is not an AOP, and the same shall depend upon the specific facts and circumstances of a particular case, which needs to be taken into consideration while taking a view in the matter.

Further, this Circular shall not apply where all or some of the members of a consortium are Associated Enterprises (AEs) under Section 92A of the Income-tax Act, 1961 (the Act). In such cases the AO shall decide whether an AOP is formed or not, keeping in view relevant provisions of the Act and judicial precedents on the issue.

**Our comments**

The CBDT Circular provides clarity with respect to long drawn litigation on taxability of consortium members in the case of EPC contracts and turnkey projects. This is a welcome move by the CBDT, and it will help to reduce litigation on this issue. However, the Circular does not apply to cases where all or some of the members of a consortium are AEs.
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