

LOSSES IN JAPAN CAN BE SET OFF AGAINST INDIAN PROFITS

MUMBAI: Corporates and banks have been allowed to use losses suffered by 'overseas branches' to lower the tax outgo in India.

So far, taxes had to be paid on the full profit generated in India, irrespective of whether the foreign branches posted a loss. From now on, the taxable income in India will go down to the extent of losses suffered abroad.

This follows an order by the Income-Tax Appellate Tribunal (ITAT), Pune. The tribunal has ruled that losses incurred by the foreign operations of an Indian company have to be allowed as a deduction from its profits here, even though the profits earned abroad continue to remain exclusively taxable in the foreign country under the terms of Double Taxation Avoidance Agreement (DTAA).

This puts corporates in a win-win situation. What it means is that if overseas operations show profit, corporates will not have to pay additional tax in India, but only in the country where the operations are located. But corporates can take advantage of losses from overseas operations to reduce their tax liability in India.

The ruling, applying to overseas branches but not subsidiaries, was rendered by the Pune Bench of ITAT comprising CL Sethi and Pramod Kumar in the case of Patni Computer Systems, a Pune-based software company with a branch office in Japan.

After incurring a loss of Rs 53 lakh in its Japan operations, Patni Computer Systems had claimed the loss would be deducted from the company's overall profits taxable in India. The assessing officer declined the adjustment noting that since profit from the Japan office is exclusively taxable in the island nation, the loss incurred there could not be adjusted against profits in India.

The commissioner (appeals) held that the entire income of the company — whether earned in India or abroad — is taxable in India, and therefore losses in Japan are to be adjusted against its domestic profits. The assessing officer appealed against this order before the ITAT.

The tribunal held losses in Japan are to be adjusted against profits in India, whether or not the profits in Japan are taxable here. It also held the Indian company will get a deduction for its overseas profits twice — once in its assessment in India and the next time when it makes profits in Japan, which in tax parlance is called 'double dip of losses'.

The argument given by the tribunal was that once an income becomes taxable by a foreign government with which New Delhi has a tax treaty, India loses its right to tax the same unless the agreement has a specific provision that income can be taxed in both the countries. Therefore, when an income is taxed abroad, it can not be taxed in India. Yet, when a company makes a loss abroad, it can be adjusted against profits in India because the provisions of DTAA cannot be thrust upon the Indian company. The tax treaty applies only when it is more beneficial to the taxpayer.

The tribunal observed that a double dip of losses, howsoever undesirable and unintended, is in consonance with the prevailing legal position. It also said that "the present legal position is also somewhat anomalous inasmuch as the scheme of tax credits under the various tax treaties, which India has entered into, has become unworkable to a large extent due to availability of tax exemption to most of the foreign income of Indian residents, which is taxed in the source country — something which was obviously not envisaged when these treaties were entered into".

But "the remedy, however, does not lie with us", it noted. Tax professionals perceive this as a subtle hint on the need for legislative amendments.

Double dip of losses can unreasonably enrich the Indian corporate and deny tax revenues to the national exchequer. But experts think this is the correct position of law. According to PwC's head of taxation Dinesh Kanabar, the overseas losses (in this case, Japan) should be set off against the profit in India, and if the Japanese tax authorities allow a set-off against the profits made in subsequent years, that's their problem. Senior chartered accountant TP Ostwal said, "The order is in tune with the principles of international taxation."

There was a similar case in India, but in a reverse form. Sometime ago, the Mumbai tribunal had held that losses suffered in India by Belgian firm Jan Benil would not be set off against profits in Belgium. But the order was later recalled.