THE POWER OF BEING UNDERSTOOD

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Newsflash – Delhi ITAT allows set off of PE's business loss against HO's Technical Service Income

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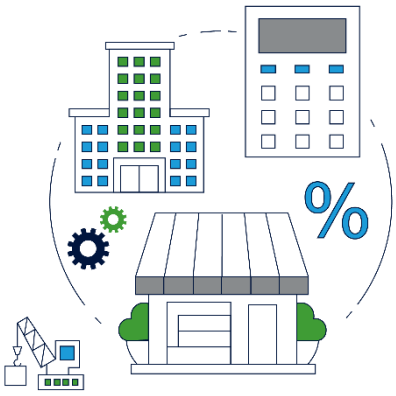
1.0 Background

1.1 Recently, the Hon'ble Bench of Income Tax Appellate Tribunal of Delhi ('Hon'ble ITAT') in the case of **Hyosung Corporation vs ACIT (ITA No.2943/DEL/2023)** delivered a vital judgement related to set off of losses of Permanent Establishment ("PE") in India against the income earned from Fees for Technical Services ('FTS') which is not effectively connected with the PE in India.



1.2 The ruling covers the provisions related to setoff of losses of PE in India in the absence of explicit provisions in the Double Tax Avoidance Agreement ('DTAA' or 'Treaty') between India and Korea.

2.0 Facts of the Case

2.1 Hyosung Corporation ('Head Office ('HO')' or 'the Assessed') is a foreign company incorporated under the laws of Republic of Korea, which functions in a variety of industrial and technology areas and had a Permanent Establishment ('PE') in India which is engaged in the business of power business.

2.2 During the Assessment Year ('AY') 2021-22 the PE of the Assessee had a business loss of INR 4,81,02,640. Further, the HO has earned income from FTS by providing services to its in India clients directly amounting to INR 60,19,976. While filing the return of income, the Assessee had adjusted the business losses of PE against the income under the head other sources comprising of FTS income and interest of income tax refund, as per the provisions section 71 of the Income Tax Act, 1961 (hereinafter referred to as 'the IT Act').

The details of Return of Income of are summarized as under for ready reference.

Particulars	Head of Income	Income/(Loss) in INR
Business Income attributable to PE	Profits and gains from business and profession ('PGBP')	(4,81,02,640)
Income from FTS earned by HO	Other sources (*Tax under section 115(1)(b) (10%*)	60,19,976
Interest on Income Tax Refund	Other sources	1,22,69,604
Business Loss carried forward to further years		(2,98,13,060)

Particulars	Head of Income	Income/(Loss) in INR
Total Taxable Income		**NIL**
Income Tax payable		NIL
Less: Tax Deducted at Source ('TDS')		(63,41,430)
Income Tax Payable / (Refund)		**(63,41,430)**

2.3 During the assessment proceedings, the Assessing Officer ('AO') has rejected such set off of business losses of PE against the income from other sources (i.e. FTS Income and Interest on income tax refund) of HO.

2.4 Being Aggrieved with the order of the AO (passed after considering the directions of the Hon'ble Dispute Resolution Panel ('DRP')), the Assessee preferred an appeal before the Hon'ble ITAT.

3.0 Contentions of the Assessee

3.1 The Assessee submitted that the set off of losses under the head Profit and gains from business or profession ('PGBP') is allowed to be set off from the head Income from Other Sources as per section 71 of the IT Act. The reliance was placed on various judicial precedents[1]. It was also emphasized that set off of such business losses from the income of FTS is allowed as per the Income Tax return filing utility (i.e. Form ITR-6).

3.2 As per the provisions of the IT Act, the PE in India belongs to HO only and cannot be considered as distinct separate entity, therefore inter head set off of losses should be allowed as provided under section 71 of the IT Act based on a judicial precedent[2].

3.3 It was submitted that there is no specific bar on set off of losses under section 115A(1)(b) of the IT Act and the section only deals with the determination of tax rates in case of FTS income sourced in India by the Assessee.

3.4 The Assessee referred to the explanation to section 9(1)(v) of the IT Act which specifically provides, for considering the PE and HO as two different entities, whereas no such distinction is provided under section 72 of the IT Act *(which deals with provisions regarding carry forward and set-off of business losses)*.

4.0 Contentions of the Revenue

4.1 The Revenue contended that as per Article 7 of DTAA, set off of business loss of PE with the income of HO is not allowed as royalty and FTS income cannot be attributed to PE without any connection. The Revenue also argued that income of the two (i.e. PE and HO)

[1] IBM India Pvt. Ltd. in ITA Nos.489 to 498/Bang/2013, Hitachi Zosen Corporation vs. DCIT (1999) 68 ITD 235 (Mum.), Prudential Assurance Co. Ltd. vs. ADIT (2012) 19 taxmann 292 (Mum) and DCIT vs. Channel V Music Networks Ltd. (2022) 143 taxmann.com 41 (Mumbai-Trib.)

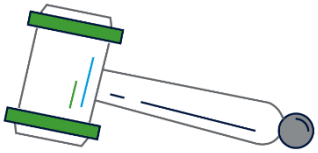
[2] Sumitomo Mitsui Banking Corporation vs. DDIT (2012) 19 taxmann 364 (Mumbai)(SB)

practically separate entities cannot be set off against each other gains/loss. The reliance was placed on judicial precedents[3].

4.2 It was contented that the income from business is determined as per section 28 to 44 of the IT Act whereas the income of the PE is determined as per section 44DA of the Act. Further, it was contended that section 115A of the IT Act is applied for non-PE entities and the income is chargeable to tax on a gross basis. Therefore, the income/ loss attributable to PE should not be allowed to adjust from the income of FTS.

5.0 Decision of the Hon'ble ITAT

5.1 Process of determination of income: The Hon'ble ITAT noted that income should be determined under six heads of income as per section 14 of the IT Act as per which the income tax is chargeable on the net income, and not chargeable to tax separately for each head of income.



Further, the net income is to be determined after applying the provisions of the section 70 and 71 of the IT Act which provides for intra head adjustment and inter head adjustment respectively. Accordingly, if there is loss sustained in any year under one head of income, it should be set off against income under another head of income in that year subject to the conditions prescribed under section 70 and 71 of the IT Act. Accordingly, total income is to be determined after setting off of loss and allowing deductions (in accordance with chapter VIA to XI of the IT Act) and thereafter income tax to be charged on the total income.

5.2 Two stream of income to be treated as one income for the taxation purpose: The Hon'ble ITAT observed that in the present case, the Assessee had two streams of income i.e. from the services rendered to its clients through its PE in India *(governed by article 7 of DTAA)* and another is by providing services to its clients directly *(governed by article 12 of DTAA)*. However, both the stream of income falls under the head business income as far as the Assessee is concerned. Hence, it is only classification and interplay between the two articles of the DTAA.

Accordingly, the Hon'ble ITAT held that since both the incomes were sourced through India and just because the income is chargeable to tax under special provisions, it does not change the determination of income as per the provisions of the IT Act.

5.3 Impact and applicability of section 44DA and 115A of the IT Act: The Hon'ble ITAT noted that the Assessee has earned income from FTS directly and not through its PE and hence, section 44DA of the IT Act is not applicable in the present case.

5.4 The Hon'ble ITAT further thoroughly examined the applicability of section 115A of the IT Act and observed that for the applicability of the said section, the first step is the 'determination

[3] M/s. Iveco Spa, Italy vs. ADIT in ITA No.5696/Del/2012 and Samsung Heavy Industries Co. Ltd. vs. DIT 42 taxmann.com 140

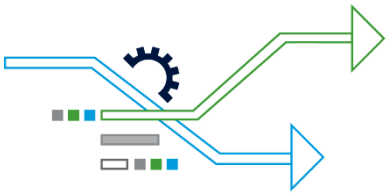
of total income' and if the same includes income from FTS, then it will be chargeable at a special rate on a gross basis.

5.5 The Hon'ble ITAT to further substantiate the point, has observed that in case the legislature intends to restrict set off of losses, it specifies the restriction specifically under the provisions of section 115A(3) of the IT Act. The Hon'ble ITAT highlights that legislature has mentioned such restrictions specifically under section 115BBDA(2) and 115BBH(2) of the IT Act. However, section 115A is silent in this respect and hence, the Assessee is eligible to set-off the loss of its PE against the FTS income earned in India.

5.6 Thereafter, the Hon'ble ITAT placed reliance on the case of **Foramer S.A**[4] wherein the issue of computation and allowability of depreciation has been dealt with and it was the held that in the absence of method of computation of depreciation in the applicable tax treaty, the relevant provision of the IT Act (i.e. section 32 read with section 43(6) of the IT Act) to be referred. Accordingly, the Assessee is entitled to apply the provisions of the IT Act, to the extent relevant provisions are not provided in treaty and they are more beneficial to the Assessee.

5.7 Basis the above, the Hon'ble ITAT concluded that since the provisions of set off of inter head adjustment of income are not present in the DTAA, the Assessee being a foreign national has the liberty to follow the provisions of the IT Act, to the extent it is beneficial to it. Accordingly, the Hon'ble ITAT allowed the Assessee's appeal by upholding the set off of business losses of PE in India with the income from FTS income earned by the Assessee directly through India.

6.0 Our Comments



The decision of the Delhi ITAT marks a significant interpretative development in the taxation of non-resident entities operating through a PE in India. The Tribunal's recognition that the assessee being a single taxable entity in India, is entitled to compute its total income after applying the provisions of inter-head set off under sections 70 and 71 of the IT Act. Thus, the fact that the assessee is deriving business income attributable to a PE in India and has also earned FTS income independently does not result in the existence of two distinct taxable persons.

Further, the Delhi ITAT's ruling provides guidance on computation mechanism in relation to the determination of income, claim of expenses/ deductions etc. in cases where the tax treaties are silent. This ruling reiterates the principle that the Assessee is entitled to apply the relevant provisions provided under the IT Act if they are more beneficial.

This ruling may likely guide similar disputes in future and could provide relief to many non-resident taxpayers with operations in India.

[4] (1995) 52 ITD 115 (Delhi)

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This Newsflash provides an overview of judgement passed by the Delhi ITAT in which it allows business loss of PE to be set – off against income of HO directly. It may be noted that nothing contained in this Newsflash should be regarded as our opinion and facts of each case will need to be analyzed to ascertain thereof and appropriate professional advice should be sought for applicability of legal provisions based on specific facts. We are not responsible for any liability arising from any statements or errors contained in this Newsflash.

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