

## SC allows the foreign tax credit for dividend exempt under Oman's Domestic Tax Law

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## Summary

Tax sparing is a tax treaty provision whereby a resident state agrees to grant relief from taxation with respect to source state taxes that have not actually been paid (i.e. taxes that have been 'spared'). The India-Oman Tax Treaty (Oman Tax Treaty) contains tax sparing provisions.

As per these provisions in the Oman Tax Treaty, an Indian resident can claim the benefit of foreign tax credit (FTC) in their India tax return even if the income was not actually taxed in Oman, on account of any 'tax incentive' granted to promote economic development.

The Hon'ble Supreme Court (SC), in this case, has allowed FTC in respect of dividend income earned by taxpayer from joint venture in Oman, which was exempt from tax as per Oman Tax Laws.

## Facts of the case

- The taxpayer was a multistate co-operative society registered in India. It entered into a joint venture (25% shareholding in equity shares) with Oman Oil Company to form Oman Fertilizer Company SAOC (JV), a registered company in Oman.
- The taxpayer established a branch office (registered as a company) in Oman to oversee its investment in the JV. The taxpayer claimed that the branch office is its Permanent Establishment (PE) in Oman as per the Oman Tax Treaty.
- For the assessment year under consideration, the taxpayer received dividend income from the JV.
- The dividend amount was paid by the JV to the PE, which remitted the dividend to the taxpayer.
- This dividend was offered to tax by the taxpayer in India. However, no taxes were paid by the taxpayer in Oman on account of specific exemption as per Oman Tax Laws<sup>1</sup>.
- The taxpayer claimed FTC as per the Act, read with the Oman Tax Treaty<sup>2</sup>.
- While the FTC claim was allowed by the Assessing Officer (AO), the Principal Commissioner of Income Tax (PCIT) revised the order of the AO<sup>3</sup> and denied the taxpayer's FTC claim.

## Key observations of the PCIT

- Article 25(4) of the Oman Tax Treaty provides a deeming fiction whereby tax payable includes tax incentive granted under the Oman Tax Law, which is designed to promote economic development.

<sup>1</sup> Article 8(bis) of the Income tax law of Oman

<sup>2</sup> Article 11, 7 and 25(4) of the Oman tax treaty

<sup>3</sup> Under section 263 of the Act

- Since the term ‘tax incentive’ was neither defined in the Oman Tax Treaty nor in the Income Tax Act, 1961 (the Act), the PCIT held that the meaning of tax incentive must be inferred from Indian law.
- The PCIT held that tax incentive is a **deduction from taxable income**. Considering that under the Oman Tax Laws, the dividend income was exempt and not includible in the total income, it cannot be said that this exemption was granted for the purpose of tax incentive for promoting economic development.
- Further, the PE recorded its share of profit in JV in its books even though a portion of this was not distributed to the shareholders, and PE offered to tax only the dividend income in Oman. The PCIT observed that the entire share of profit recorded in PE’s books of accounts should be included in the taxpayer’s global income<sup>4</sup>.

### Tribunal’s order

- On appeal, the Tribunal allowed the taxpayer’s appeal and held that the PCIT’s order was without jurisdiction and not sustainable in law.
- Further, the Tribunal observed that the undistributed profit reflected in the PE’s books of accounts cannot be taxed since only real income can be brought to tax.
- The Department filed an appeal against the aforesaid Tribunal’s order before the Delhi High Court (HC).

### Brief summary of HC’s order

- Key observations of the HC are as under:
  - The AO had looked into the relevant facts, made inquiries with respect to dividend income, exemption, etc. and also considered the explanation of the Omani authorities<sup>5</sup> in this regard.
  - HC placed reliance on the various judicial precedents<sup>6</sup> and held that revision of assessment order was not sustainable in law.
  - HC held that the clarification issued by the Omani authorities<sup>5</sup>, wherein they clarified that the exemption was for promoting economic development, has to be regarded as conclusive.
  - In case the Indian tax authorities had any doubts, they should have addressed them to Omani authorities, directly or through diplomatic channels. The PCIT has erred by not following this protocol.
- Based thereon, HC upheld the Tribunal’s findings and held that the taxpayer should be allowed credit for FTC claimed.

<sup>4</sup> As per Section 4 and 5 of the Act

<sup>5</sup> ie. Sultanate of Oman, Ministry of Finance, Secretariat General for Taxation, Muscat vide letter dated 11 December 2000

<sup>6</sup> Gee Vee Enterprises vs. ACT, Delhi-I & Ors (1975) (99 ITR 375) (Delhi HC) and CIT vs. Gabriel India (1993) (203 ITR 108) (Bombay HC)

## SC's ruling

- The SC held that:
  - Based on the letter of the Omani authorities<sup>5</sup>, it is clear that the dividend distributed by all companies (including the tax-exempt companies) would be exempt in the hands of the recipient<sup>1</sup>. The intent of the Government of Oman in providing this exemption is to achieve its object of promoting development within Oman by attracting investments.
  - Article 8(bis) of Oman Tax Laws exempts dividend received by the taxpayer from its PE in Oman. Since the taxpayer has invested in the project by setting up a PE in Oman, it is aiding to promote economic development in Oman.
- There is no substance in the Department's argument that the aforesaid letter issued by Omani authorities was not issued by a competent Omani authority and has no statutory force.
- The Department could not demonstrate why the provisions contained in Article 25 of the Oman Tax Treaty and Article 8 (bis) of the Oman Tax Laws would not be applicable in this case.
- SC upheld the HC's order granting the taxpayer credit for the FTC claimed.

## Our comments

It is important to note that the term 'tax incentive' is neither defined in the Act nor the Oman Tax Treaty.

SC has accepted the interpretation provided by the administrative authority of the tax treaty partner (i.e. Omani authorities) on the rationale and intent of the Oman tax provisions in question and applied that in the interpretation of the Oman Tax Treaty. The Omani authorities had clarified that these provisions were 'incentive to promote economic development'.

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