Tax Flash News

29 September 2023

Foreign Tax credit is allowed in India on taxes on dividend which would have been paid but exempted under the Omani Tax Law - Supreme Court

Executive summary

Tax sparing credit, in the context of a tax treaty, gives benefit to the resident country not only for taxes paid in the source country but also for taxes that would have been paid but exempted in the source country due to certain incentives.

In some of the cases, the tax department has rejected the claim of tax sparing credit on the ground that no tax was paid in the foreign country.

Recently, the Supreme Court in the case of Krishak Bharti Cooperative Ltd[1] (the taxpayer) dealt with the tax sparing credit benefit under the India-Oman tax treaty (tax treaty) and held that the taxpayer is eligible for foreign tax credit (FTC) relating to taxes on dividend which would have been paid but exempted in Oman due to incentive provisions under the Omani Tax Law[2].

Facts of the case

- The taxpayer, a multi-state co-operative society, was registered in India under the Ministry of Agriculture and Co-operation. It entered into a Joint Venture (JV) with Oman Oil Company to form Oman Fertilizer Company (OMIFCO), a registered company in Oman.
- The taxpayer held a 25 per cent share in OMIFCO. The JV manufactures fertilizers, which were purchased by the Central Government. The taxpayer also established a branch office in Oman to oversee its investment in OMIFCO which constituted a PE in Oman.
- The taxpayer received dividend income from OMIFCO through its PE in Oman. No tax was paid in Oman on such income by virtue of exemption under the Omani Tax Laws. Such dividend was offered to tax in India, and the taxpayer claimed FTC on such dividend income under Article 25(4) of the tax treaty.
- The Assessing Officer (AO) allowed FTC for the aforesaid tax. Subsequently, the Principal Commissioner of Income Tax (PCIT) revised[3] the order of the AO and disallowed FTC credit. The PCIT held that Article 25 of Omani tax laws was not applicable as there was a tax payable on dividend in Oman that was not paid.
- The Income-tax Appellate Tribunal quashed the order of the PCIT and held that the taxpayer was entitled to claim FTC. The High Court upheld the decision of the Tribunal allowing the taxpayer's appeal.

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[1] PCIT v. Krishak Bharti Cooperative Ltd (Civil Appeal No. 836 of 2018) (SC) – Taxsutra.com

[2] Under Article 8 of the 'Company Income Tax Law' of Oman, dividend forms part of the gross income chargeable to tax. The tax law of Oman provides income tax exemption to companies undertaking certain identified economic activities considered essential for the country's economic development with a view to encouraging investments in such sectors.

[3] Under Section 263

Supreme Court's decision

- As per the incentive provisions in the Omani Tax Laws, dividends distributed by all companies, including the tax-exempt companies would be exempt from payment of income tax in the hands of the recipients. The same was also confirmed in the letter of the Omani Finance Ministry.

- The Government of Oman provided the above exemption to achieve its aim of promoting economic development within Oman by attracting investments.

- Since the taxpayer had invested in the project by setting up a PE in Oman and as the JV was registered as a separate company under Omani laws, it was aiding in promoting economic development within Oman and achieving the object of the exemption provisions as per the Omani Tax Laws.

- Thus, Omani Tax Laws exempts dividend received by the taxpayer from its PE in Oman.

- Article 25(2) of the tax treaty provides that India shall allow a deduction from the tax on the income of Indian resident, an amount equal to the income tax paid in Oman, whether directly or by deduction. Further, Article 25(4) clarifies that the tax payable in Oman shall be deemed to include the tax that would have been payable but not paid because of the tax incentive granted under the laws of the Contracting State and which are designed to promote development.

- Accordingly, the taxpayer was entitled to claim tax payable in Oman which was otherwise exempted due to incentive provisions.

- The Omani Finance Ministry also concluded that tax would be payable on dividend income earned by the PE of the Indian Investors, as it would form part of their gross income under Article 8, if not for the tax exemption provided under Article 8(bis) of the Omani tax laws.

- Accordingly, the tax department's argument was not correct that the taxpayer would not get FTC as Article 25 was not applicable since there was a tax payable on a dividend in Oman that was not paid.

- Insofar as the argument of the tax department concerning the taxpayer not having PE in Oman, the High Court observed that the taxpayer's establishment in Oman has been treated as a PE from the very inception up to 2011.

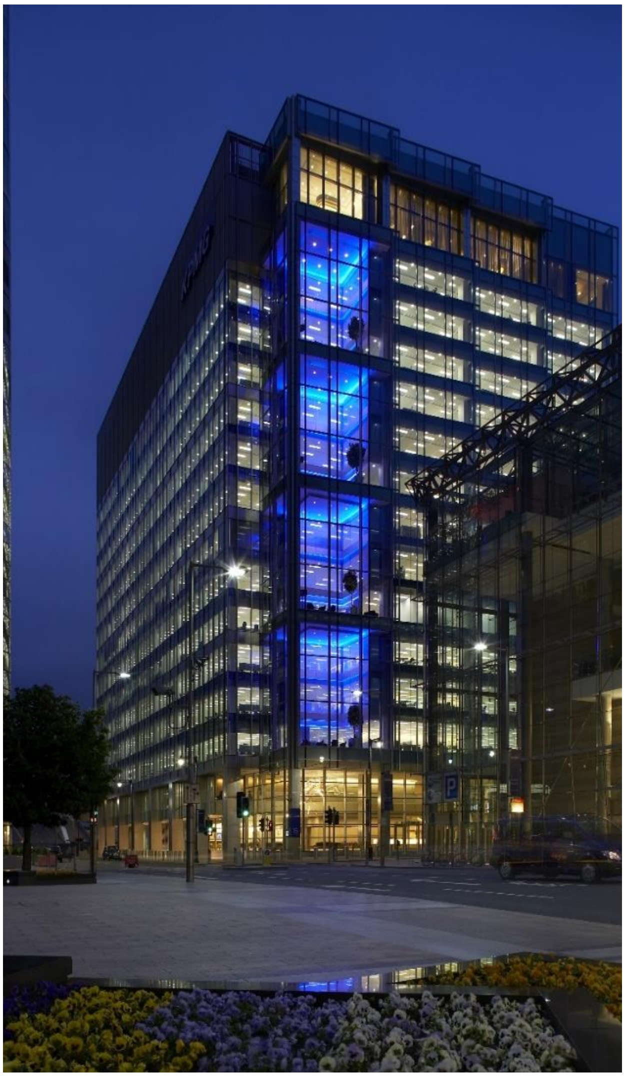
- There was no reason as to why all of a sudden, the taxpayer's establishment in Oman would not be treated as a PE when for about 10 years it was so treated.

- The letter provided by the Omani Finance Ministry did not introduce any new provision in the Omani Tax Laws.

- The tax department was not able to demonstrate why the provisions contained in Article 25 of the tax treaty and the exemption provisions under the Omani Tax Laws would not be applicable to the taxpayer.

Our comments

This is an important decision of the Supreme Court resolving an issue of tax sparing credit available under the India-Oman tax treaty. This decision will provide relief to the taxpayers in the cases where the tax department has been denying a genuine tax credit. While planning, the taxpayers should consider the tax sparing credit which is available in a few Indian tax treaties like France and Jordan.



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