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Facts

ZM, a limited partnership formed in Cayman Islands, proposes to incorporate a subsidiary in Mauritius (P Ltd) which will hold a Global Business Category 1 Licence. P Ltd will invest in an Indian company which would be engaged in the business of development of a Special Economic Zone (SEZ) in India, under the Special Economic Zones Act. Section 80-IAB of the Indian Income Tax Act 1961 allows a deduction in respect of profits and gains derived from development of a SEZ. Additionally, Section 115-O of the said Act grants an exemption to undertakings engaged in the development of a SEZ from dividend distribution tax payable at 16.995% on distribution of dividends. The Mauritius company will hold 49% interest in the Indian company.

Point in issue

Whether, in relation to the profits and gains derived by the Indian company from its business of developing a Special Economic Zone in India, P Ltd is eligible for a tax sparing credit under Regulation 9 (1) of the Income Tax (Foreign Tax Credit) Regulations 1996 in respect of Indian profits tax which would otherwise have been payable but for the exemption effectively given as a result of the enactment of Section 80-IAB and Section 115-O of the Indian Income Tax Act

Ruling

Regulation 9 (1) of the Income Tax (Foreign Tax Credit) Regulations 1996 of the Income Tax Act 1995 provides that, where the Director-General is satisfied that provisions have been introduced in the law of a foreign country with a view to promoting industrial, commercial, scientific, educational or other development in that country and that under those provisions income has been exempted from tax which would otherwise have been chargeable to foreign tax, "he shall allow a credit for the amount of foreign tax which would have been chargeable had those provisions not been enacted." A similar tax sparing clause has been provided in the Mauritius-India tax treaty. Section 80-IAB of the Indian Income Tax Act does not satisfy the above conditions since no relief is provided either by exemption of income or by reduction in the amount of income tax payable. However, Section 115-O provides for an exemption of tax on distributed profits derived by enterprises operating in a SEZ. In accordance with the provisions of Section 115-O of the Indian Income Tax Act 1961 P Ltd will be eligible for a tax sparing credit in respect of the dividend distribution tax which would otherwise have been payable.

The tax sparing credit, however, will be limited to and in the proportion of the share of interest of P Ltd in the Indian company.