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Development Council

SEZs in India

Major Leap Forward

Background Paper

SEZs in India

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This Background paper is intended to provide an overview of Special Economic Zones legislation and other related regulations in India.

Every effort has been made to ensure that the contents are accurate at the time of writing. However, readers should always seek specific expert advice before acting on the information provided.

Foreword

“India’s recent prosperity has largely been driven by the growth of the services sector. While all developed countries have moved from agriculture to manufacturing to services, India leapfrogged from agriculture to services. However with over 65% of India’s population living in rural areas, majority of whom surviving on subsistence farming, the alternate employment possibilities are a must. This can only be in the manufacturing sector since the majority of the rural population would not fit into the services sector. Lack of adequate infrastructure for education and skill building institutions can never lead to a sustainable growth.

For India’s favorable demographics to pay dividend the industrial sector has to grow, manufacturing jobs have to be created – India must aim to become a Global manufacturing hub. Government policies must support this and our tax policy must incentivize this. More so since the myriad hassles to set-up and do business in India are a big disincentive. This is the only way to attract Global Manufacturing.

SEZs clearly provide an answer where the private sector has been incentivized to expend large amounts to develop world-class industrial and social infrastructure which was typically done by the Government. The Government should convey to the global manufacturing community by actions, its intent to make India a ‘global manufacturing hub’ by providing a stable and hassle-free regulatory and tax environment.

The Government owes it to the nation to propagate the SEZ policy, duly passed by the parliament in a coherent, clear and stable manner and implement the same in a facilitative way to ensure its success.”

Vivek Mehra
Executive Director
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India

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Glossary

AC	Approval Committee
BoA	Board of Approval
BPO	Business Process Outsourcing
CG	Central Government
CIT	Commissioner of Income Tax
DC	Development Commissioner of the SEZ
DDT	Dividend Distribution Tax
DTA	Domestic Tariff Area
EEFC	Exchange Earner Foreign Currency
EHTP	Electronic Hardware Technology Park
EOU	Export Oriented Units
EPCG	Export Promotion Capital Goods
EPZ	Export Processing Zone
EXIM	Export Import
FDI	Foreign Direct Investment
FTP	Foreign Trade Policy
FTWZ	Free Trade Warehousing Zone
FTZ	Free Trade Zone
GDP	Gross Domestic Product
GoI	Government of India
IFSC	International Financial Services Center
IMF	International Monetary Fund
IT	Information Technology
ITES	Information Technology Enabled Serviecs
LoA	Letter of Approval
MAT	Mininmum Alternate Tax
MoC	Ministry of Commerce
MoU	Memorandum of Understanding
NFE	Net Foreign Exchange
NRI	Non-resident Indian
OBU	Offshore Banking Unit
PIO	Person of Indian Origin
PIT	Personal Income Tax
QR	Quantitative Restriction
R&D	Research & Development
RBI	Reserve Bank of India
SEEPZ	Santacruz Electronics Export Processing Zone
SEZ	Special Economic Zone
SG	State Government
STP	SoftwareTechnlogy Park
UAC	Unit Approval Committee
VAT	Value Added Tax
WTO	World Trade Organization

Introduction

Meaning

Conceptually, **Special Economic Zone** (**SEZ**) is a geographical region that has economic laws different from a country's generally applicable economic laws, with the underlying objective being an increase in economic growth and activity through increased foreign investment. SEZs have been established in several countries across the globe including the People's Republic of China, India, Jordan, Poland, Kazakhstan, Philippines and Russia. According to World Bank estimates, as of 2007 there are more than 3,000 projects taking place in SEZs in 120 countries worldwide.

Globally, establishment of SEZs have revolved around achieving the following basic objectives:

- Economic growth and development – through exports and backward integration
- Foreign Investment
- Infrastructure development
- Employment generation
- Up-gradation of managerial and technical skills

Achievement of the above objectives through SEZs is typically facilitated through the following -

- Income tax Holidays
- Hassle Free Environment
- Exemption from Indirect duties and taxes
- No currency restrictions
- Relaxed foreign investment norms
- Excellent infrastructure facilities

Evolution of SEZs - Worldwide

Origin : From Industrial Parks to SEZs

The concept of ***"special zones"*** is not new. The first industrial park was set up in 1896 in Manchester. ***"Free trade zones"***, designed to promote free trade, were a post-second world war idea, beginning in Hong Kong, spreading elsewhere thereafter.

The first export processing zone (EPZ), designed to liberalize both the trade and investment environment, was operationalised in Ireland in 1960. Many developing countries adopted the EPZ model, though not much action was seen on this front after the 90s.

Chinese Experience

SEZs made their debut in 1979-80 when China embarked on their SEZ experiment. China's objective was much wider than trade and investment promotion - it tried to open its essentially closed economy and experiment with foreign investment, and chose the SEZ framework as a dominant instrument of policy. Key changes were first tested in a few SEZ "pilot areas" before being introduced elsewhere. ***SEZs can serve a similar purpose as crucibles of radical reform in India, given our large population, social disparities and high dislocation potential of radical reform***. Later, countries of the Soviet bloc experimented with the SEZ concept, mainly with a view to using FDI to solve their unemployment problem.

It is in China that the concept of SEZ turned out to be the most successful. There, open zones were gradually extended from the South and coastal areas (which were originally opened to market economics) to the inland regions. ***The Chinese Government continues to increase the number of open zones, which now number around 1,500***. These have been given many different names: coastal economic open zones, economic and technological development zones, new areas, free trade zones, high technology development zones, etc.

The flow into different open areas kept changing. In the 1980s, Shenzen (north of Hong Kong) and Xiamen (opposite Taiwan) were most important. By the 1990s seven coastal SEZs gained importance, and attracted 80% of the foreign investment flow into China.

Chinese SEZs have the following distinguishing features:

a) The geographical area of the SEZ is astronomically large. (Shenzen - 327 sq. Km, Zhunan - 121 sq km, Xiamen - 131 sq km, Hainan - 34000 sq km (largest SEZ covering an entire island), Shantou : 234 sq km)

   The designated SEZ territory is usually a portion of a larger municipality (for instance, while the entire Shantou is 2064 sq km, the Shantou SEZ is 234 sq km).

b) They are not just industrial parks. Rather, they are entire section of cities or areas containing all the usual community features such as residential areas, commercial and recreational facilities, transport infrastructure, education, health and other social services. This helps to avoid many of the social problems experienced by less organic zones. City-scale zones have the advantage of promoting a more comprehensive and integrated investment profile and facilitating backward and forward linkages between zone locators and local enterprises.

c) SEZs usually enjoy more freedom than other special zones in China. There's minimal bureaucratic interference and easy entry/exit procedures. The SEZ authority is independently managed.

d) Fiscal Incentives / Key Tax Concessions.

- The zones constitute separate customs areas. Production inputs, raw materials and intermediate goods may be imported duty-free.
- Corporate income tax benefits
- Foreign funded enterprises / joint ventures are taxed at a reduced enterprise tax rate of 15% (against a national rate of 33%). For units with 70% of products exported, and for high-tech industries, enterprise tax rate is 10%;
- Tax holidays may be available depending upon the degree of export activity. For units scheduled to operate for 10 years, there is exemption from tax for first two profit-making years, followed by 50% tax during next three years. For units scheduled to operate for 15 years, there is exemption from tax for first five profit-making years, followed by 50% tax during next five years[1].
- Exemption from import duty on imported items used for investment in the unit, and inputs for exported items.
- Cheap land was made available to SEZ projects

In China, SEZs acted as major FDI boosters, which surged from very low levels in 1980 and just over $3.5 billion in 1990 (when these zones were in the take-off phase), to current levels of $50 billion. The free zones have absorbed nearly 25% of the country's cumulative FDI. The FDI into the SEZ area has also triggered significant domestic investment.

The total area of the five major SEZs in China is less than 1% of the whole country, but the GDP of these zones accounts for more than 7% of China's GDP, a fifth of the country's trade, and one-fifth of FDI. The rate of growth of these zones has been double the national average.

Mainly because of the SEZs and other open zones, foreign investment has been a crucial element of industrial development in China. Enterprises with foreign investment employed about 18 million people (10 million in Guangdong province alone) and generated exports worth $75 billion in 1997, some 41 per cent of total exports that year.

Most of the FDI flow, it may be noted, has come from the neighboring Chinese dominated countries of Taiwan and Hong Kong. While China had this advantage, which is not so easy to replicate elsewhere, it can also be argued that the SEZ policy, which China fine-tuned to foreign investors' requirement, was the important catalyst to that country's FDI success. However, this should not take away from the spectacular success of the Chinese SEZ experience. Chinese expats invested in the SEZs not on account of some patriotic sense, but because these investments made good economic sense. If India has a similar package to offer, NRIs (who may be at par with the Chinese in terms of affluence, if not better) will not shun more lucrative investment opportunities to invest in India.

[1]Under Indian law, a presumption seems to be made that the unit will continue to operate indefinitely, and tax holidays are not linked to the life of the unit. The Chinese have prudently ensured that for short-lived units, the government is able to collect full tax for half the life, and for longer lived ones, for at least one third of its life. Two important corollaries follow: (a) units would probably be required to give an undertaking as to how long they will operate (probably, with tax refund provisions for violating this undertaking) (b) units are incentivised to operate for longer durations, as the tax breaks are better for the units with longer operating lives

Evolution of SEZs - India

Focus on Export Promotion

SEZs represent the latest, and best, thinking so far on India's export policy.

Since the 60s, India has seen the emergence of several initiatives to boost exports, some good, some bad, some indifferent. Notable amongst these are:

a) Export Processing Zone (EPZ) Scheme

b) Export Oriented Units (EOU) Scheme

c) Software Technology Park (STP) Scheme

d) Electronic Hardware Technology Park (EHTP) Scheme

e) Export Promotion Capital Goods (EPCG) Scheme

f) Advance Licensing and Deemed Exports Scheme

g) Free Trade Zone(FTZ) Scheme

Past schemes of promoting exports have hardly paid off. All India has to show after a decade and a half of export processing zones, export-oriented units and other measures outlined above is a measly share of less than 1% of world exports. This, as is widely accepted within the Government, is quite insignificant for a country of our size and capabilities.

It was early 2000 when the then Union Commerce and Industry Minister, the late Murasoli Maran, undertook a trip to China to get first-hand experience of how China had come to become the darling of foreign investors. Included in his itinerary was a visit to SEZs, which led the announcement of SEZs in India through the annual Export-Import (EXIM) Policy of March 2000. It is now almost eight years since the concept has been part of India's economic policy. The country not only has greenfield SEZs, but also has the erstwhile export processing zones / Free trade Zones converted into SEZs.

The SEZ policy not only represents the most ambitious of export boosting efforts, but it goes much further, in that ***it seeks to radically change the environment for exports and FDI***, by offering a trouble-free business-friendly environment and world class infrastructure.

It allows the Government to experiment with radical economic reform on a localized basis, introducing reforms that are difficult to implement at the national level, given the country's large size and social disparities.

India's SEZ policy can be looked at as the logical outcome of developments in India's export-import policy in recent years. Trade policy reforms over the last decade have moved towards providing

- an export-friendly environment

- simplified procedures
- better input availability
- quality / technology up gradation
- Improved competitiveness.

Underlining this, recent modifications in the EXIM policy (over the last 4-5 years) have focused on four major areas:

a) In the first place, efforts have been made towards removing restrictive export import regulations. An important first step in this regard was the proposal to set up SEZs.

b) Secondly, conscious steps have been initiated to ensure that the process of trade liberalization in India remains aligned to the norms of multilateral trading agreements. Thus, the incentive structure for exporters has been recast to make it consistent with India's commitments to WTO. Tariff changes and Quantitative Restriction (QR) reforms in accordance with WTO commitments have been made.

c) Thirdly, measures have been initiated to simplify and decentralize the procedures associated with the administration of foreign trade. The current SEZ framework brings this factor to the fore.

d) Lastly, policy announcements have been made to provide special incentives to certain categories of Indian exports.

Importantly, the EXIM policy (now the Foreign Trade Policy) also seeks to motivate and involve State Governments in export-promotion efforts.

With SEZs acting as the engines of growth, the underlying policy objective of the Central Government was to increase India's economic growth and activity through increased foreign investment. For achieving this objective, the Government encouraged and enabled the establishment of SEZs by the State governments themselves, or in the private or joint sector in association with the State governments.

Meanwhile, a lot of time was spent in evolving an all-encompassing legislation called the Special Economic Zones Bill, which was introduced in Parliament and passed subsequently. The Special Economic Zones Act, 2005, got the Presidential imprimatur on June 23, 2005 and got notified on 10th February 2006. This led to a tremendous surge in interest for the launch of SEZs, as is evident from the growing number of big industrial houses applying to the Board of Approval for putting up SEZs in many areas.

Mr. Kamal Nath, Minister of Commerce & Industry while tabling the bill in Parliament said, *'It is anticipated that the new law would trigger a large flow of foreign direct investment as well as domestic investment in infrastructure and productive capacity leading to creation of new employment opportunities.'*

He also added, *'introduction and passage of this Bill will provide confidence and stability to domestic and foreign investors and signal the government's commitment to the SEZ policy framework. It is expected that many large format, multi-product SEZs that have so far been unable to achieve financial closure will now quickly move towards such closure.'*

The above statement made by Mr. Kamal Nath has already been vindicated by the amount of exports/ fresh employment generated in SEZs. As per recent figures, out of the 462 formal approvals granted for setting up of SEZs, 222 SEZs have been notified as on date and a total investment of Rs. 69,350 crores has been made in the notified SEZs as on 31st March 2008. Total incremental employment generated in SEZs after the enactment of SEZ Act and Rules is more than 2 lakh persons. Physical exports from the SEZs in 2007-08 were Rs. 66,638 crores, which indicate a growth of 92% over the previous year. The export projection by MoC for the year 2008-09 stands at Rs. 1,25,950 crores.

Comparison of Models Used Globally

Worldwide SEZ Models	India	Shenzhen, China*	Jebel Ali, Dubai*	Hamriyah Free Zone, Sharjah*	Poland*
Location	Spread across the country	Guang Dong Province	35 Km from Dubai city	Situated by the Hamriyah Port, Sharjah	14 SEZs spread across the country
Area	268 Sq. kms for 222 notified SEZs	327 Sq.Km	100 Sq.Km	24.5 million Sqm (Approx.)	26.7 Sq. kms for all SEZs
Economic Activity Focus	Manufacturing - Telecom - Shoes - Textile - Steel - Automobiles Services - IT/ITES/BPO - R & D - Biotech - Aviation	Hi-Tech Products Real estate Finance Telecom R & D	Trading Light manufacturing	Heavy and light industries involved in manufacturing, processing and assembly of goods for the local market as well as for re-export	Semi Conductors Telecom Automobiles
Fiscal Incentives for Units	100% corporate tax exemption for first 5 years 50% corporate tax exemption for the next 10 years Indirect tax exemptions Stamp duty exemptions	100% exemption for first 2 years on corporate tax 50% exemption for the next 3 years Reduced loan interest rates, water/electricity Charges	No corporate Tax No income tax No other duties	100% foreign company ownership 100% import & export tax exemption 100% exemption from all commercial levies 100% repatriation of capital & profits 100% exemption from Corporate & Personal income taxes	Regional aid (public subsidy) of between 50 and 65% of the investment value provided through an exemption from Corporate Income Tax (CIT) or Personal Income Tax (PIT) Companies investing in the SEZs are often granted exemptions from real estate tax by local authorities and can count on free assistance with all formalities related to the intended investment

** Information based on secondary sources.*

The SEZ policy across the globe has been fine-tuned over a period of time to meet foreign investors' requirement and has been an important catalyst to FDI success. If we want to make India a Global manufacturing hub, we need to improve the environment for manufacturing. Given the current political and economic set-up, improving conditions nationwide for manufacturing will be difficult.

Hence, it may be a better strategy for India to create the enabling environment in pockets through SEZs with high quality infrastructure, a liberal and supportive business policy environment, providing necessary push which the manufacturing sector urgently requires. SEZs can be particularly helpful for small and mid-sized entities which cannot afford to set up captive infrastructure facilities like large Indian companies to house their units in the SEZs with state of the art infrastructure facilities and at the same time share the costs in a large group. Thus, this tried and tested policy, in its current customized form, could certainly put India in a win-win situation.

SEZs – Major Leap Forward

SEZs – Engines of Economic Growth

The Special Economic Zone policy was promulgated by the Government of India in year 2000 to correct the shortcomings of the EPZs like size, infrastructure constraints, location handicaps and lack of policy framework. This policy aimed to make the SEZs engines of economic growth, supported by quality infrastructure and complemented by an attractive fiscal package and a plethora of sops like:

Tangible benefits

- Contribution to respective State's GDP
- Employment generation (Direct & Indirect)
- Creation of world class self contained infrastructure
- Improve fiscal position of the state due to consequential benefits- cascading effect on economic activity
- Increase in State's revenues from VAT, Property taxes, Stamp Duty etc.

Intangible benefits

- National and International recognition as Preferred Investment Destination
- Facilitates urbanization – shift from agriculture to industry
- Creation of high quality social infrastructure
- Reduction in pressure on existing urban infrastructure
- Better standard of living
- Improved competitiveness of the local industry
- Absorption of latest technology and managerial capabilities
- Environmental benefits from planned developments.
- Rehabilitation of Project Affected Persons

India this time, must not fail to encash the benefits that SEZs could bring to the country. India must try to emulate the success of Chinese SEZ model, but by customizing their model to our specific requirements. For example, sectors where India has inherent strengths, like IT and gems & jewellery - the manpower requirements for which only being available in cities where large areas are difficult/not possible - must definitely be encouraged without getting into apprehensions about their numbers, lower land area requirement etc., in the interest of quick implementation of SEZs.

SEZs – Vehicle for Job Creation

SEZs as vehicle for Job Creation – Reaping the demographic dividend

India needs to convert its demographic profile into a beneficial cycle of creating productive jobs for the rising work force resulting into higher savings, which in turn leads to investments and economic growth.

India's median age is just under 25 years which means that there are over 500 million people below 25 years of age. Two-thirds of these 500 million are supported by the agricultural sector, a sector which contributes just 21 per cent to the GDP. These people have rising aspirations and must find jobs in manufacturing and services sectors. If substantial job creation does not take place, it would have serious, if not disastrous, social and economic implications for the country.

SEZs are job creators - it is estimated that close to 15,00,000 jobs by end of 2010 would be created by SEZs. Can India afford to forego this opportunity?

Manufacturing needs a leg up - SEZs are the answer

Poor infrastructure, an interfering administration and unfriendly tax law environment, and unfavorable labor laws are some of the factors affecting manufacturing competitiveness in India. This is reflected in India's poor ranking on the list of global goods exporting countries. In 2005, India's share in world goods exports was under 1 per cent, which is lower than many other small economies including Thailand and Indonesia.

It has become imperative for India to improve its manufacturing environment. Given the current political and economic set-up, improving conditions nationwide for manufacturing will be difficult. Hence, it may be a better strategy for India to create the enabling environment in pockets - high quality infrastructure, a liberal and supportive business policy environment, which will give the necessary push to manufacturing growth. SEZs can be particularly helpful for small and mid-sized entities, which cannot afford to set up captive infrastructure facilities like large Indian companies but can share the costs in a large group. Lastly, it can help attract foreign capital and technology.

SEZs – Means to attract Mobile Investors & Infrastructure Development

Attract International Capital – Mobile Investors!

National borders have lost importance in the global competition for international investment capital. There is a global competition between countries for international investment capital more intensively in recent years. India can become a global manufacturing hub inviting mobile investors to set up manufacturing base in India for worldwide exports from the beneficial tax and other incentives available in the SEZs. If India fails to woo the mobile investments, there are other low cost countries waiting in the wings. The SEZs are ideally suited for attracting International investors – not only from big investors but also mid-sized investors.

"Indian SEZs will be engines of growth, supported by quality infrastructure and complemented by an attractive fiscal package with the minimum possible regulations", says Kamal Nath. Given the country's poor infrastructure, sorry state of public finances and huge unemployment, getting private investment in infrastructure and attracting huge amounts of foreign direct investment (FDI) especially into labor intensive manufacturing sectors is the prime objectives of the policy makers. This becomes more important, since India has been ranked at a disappointing 134^{th} on the ease of doing business in the latest World Bank-IMF listing. Thus, the Indian policy makers need to take radical and bold changes to emerge as a global investment hotspot.

SEZs have emerged as a perfect tool to do away with the above infrastructure and social woes of the country.

Infrastructure Development

Modern infrastructures are the arteries of commerce within a country. Commerce requires roads, rail lines, sea ports, airports, and reliable sources of energy at reasonable prices or else, goods cannot be transported rapidly, production is interrupted, the supply chain collapses, and the economy suffers. Similarly a well functioning communications system is a prerequisite for investment; in today's global markets, if companies lack reliable communications, they cannot operate.

The infrastructural development within SEZ has been very widely defined, to mean all facilities needed for development, operation and maintenance of an SEZ including industrial, business and social amenities like roads, buildings, sewerage and effluent treatment facilities, solid waste management facilities, ports, airports, railways, transport system, generation and distribution of power, gas and other forms of energy, telecommunication, networks and social & recreational infrastructure like hospitals, hotels, educational institutions, residential and business complexes etc.

The beauty of SEZs is that this infrastructure would be created by the private sector, through private funding.

Social Infrastructure

With a large-scale migration of population from rural to urban areas taking place, there is also a need to ensure adequate social infrastructure like houses, hospitals, schools etc. This aspect is often ignored by critics of the SEZs on the grounds that in the garb of developing non-processing areas in SEZs, developers would actually be conducting real estate business.

SEZ: Does size matter?

Detractors of the SEZ policy often take issue with the minimum land area requirements for sector-specific SEZs. They point out to Chinese SEZs which are massive, and point out that India is going wrong in allowing sectors like IT, gems & jewellery etc. to have small sized SEZs. The fact is, the development of large, multi-product SEZs will requires a lot of time. We have the example of China where several big SEZ projects were approved in the 1980s anticipating investment of approximately $30 billion. These SEZs became fully operational only towards the end of the 1990s because of the size.

The pertinent question is, can we afford to wait that long? An IT SEZ, for example, does not need large land area – it could very well work out of a multi-storied building. Therefore, a sector with lower minimum land area requirement could have an operational SEZ in a quicker time-frame, even in cities – where land is scarce but manpower is available.

An IT SEZ could be developed and made operational within a period of six months from the date of notification. IT companies are using SEZ units for EPOs (Engineering Process Outsourcing). The world class technical training that these IT companies will be required to impart to its employees would ignite knowledge revolution resulting into exponential progression of our economy.

According to the McKinsey report 2005, out of the total global market size of $300 billion in IT and BPO industry, the Indian IT and BPO industry share is at $22 billion. The IT Specific SEZs in India can help capture more than 50 per cent of this opportunity. IT SEZs will play an important role towards this and the policy must provide an enabling environment. We have to see our requirements and the resources available to us and then refine our policy. A one-size-fit-all approach may not be the best one for India.

Revenue loss to the government?

A lot is being said about revenue loss to the government due to the tax holidays given to the SEZ developer and units. We now need to step back and look at the issue like this: clearly, the government will only lose in case the government gains. Only if the SEZs are a success, does the government stand to lose revenue. But then again, success of SEZs would mean generation of so much additional economic activity that the revenue gains from additional economic activity would be many times the revenue loss.

Competition in Industrial Land

Industrial land, particularly developed with good infrastructure has been a scarce commodity in India. With the number of SEZs coming up, a lot of land would be developed. Moreover, competition between developers would ensure better operation and maintenance of the infrastructure for investors looking for units in SEZs.

The Challenge

The main challenge to SEZs and consequent achievement of high growth rate in India lies in all arms of the government, working together to make the implementation of this policy a success and last but not the least, for the government to provide the necessary connectivity infrastructure linking the SEZs to markets, to sources of materials and to points of exit i.e. Ports and airports.

Current Status in India

Current Status in India

In India, a policy was introduced on April 1, 2000 for setting up of Special Economic Zones with a view to provide an internationally competitive and hassle- free environment for exports. The policy provides for setting up of SEZ's in the public, private, joint sector or by State Governments. It was also envisaged that some of the existing Export Processing Zones would be converted into Special Economic Zones. Accordingly, the Government had converted the following seven EPZs into SEZs.

The performance of the seven converted SEZs is given below:

Functioning EPZs converted into SEZs

	Kandla* *(Multi Product)*	***SEEPZ**** *(Electronics and Gems & Jewellery)*	***Cochin**** *(Multi Product)*	***Falta**** *(Multi Product)*	***Madras**** *(Multi Product)*	***Vizag**** *(Multi Product)*	***NOIDA**** *(Multi Product)*	***TOTAL***
Set up in	1965	1975	1986	1986	1986	1986	1994	
Converted into SEZ on	01.11.2000			01.01.2003				
Exports (2007-08) (Rs. Crs)	2,298.42	11,328.1	4,706.9	1,204.55	3,280.88	1,233.7	17,118.31	**41,170.86**
Total Investment (2007-08) (Rs. Crs)	375.6	789.44	505.82	393.9	671.67	488.06	675	**3,899.49**
Area (Acres)	1000	93	103	280	261	360	310	**2407**
Employment (In Number)	19,002	85,103	11,374	11,600	29,195	4,200	33,000	**1,93,474**

** Source SEZ India website*

The following SEZs were established prior to the SEZ Act in addition to the EPZs converted into SEZs given above; these SEZs have experienced exponential growth in investment, exports and employment in the recent past. A snapshot of these SEZs is tabulated below:

State Govt. / Private SEZ's established prior to SEZ Act

Figures *(2007-08)*	***Surat SEZ**** *(Multi Product)*	***Manikanchan SEZ**** *(Gems & Jewellery)*	***Jaipur SEZ**** *(Gems & Jewellery)*	***Indore SEZ**** *(Multi Product)*	***Jodhpur SEZ**** *(Handicrafts)*	***WIPRO SEZ**** *(Software Development)*
Set up in	*1994*	*2004*	*2004*	*2004*	*2005*	*2005*
Converted into SEZ on	*1/11/2000*	*Notified in 2004*	*Notified on 1/7/2003*	*Notified on 1/8/2003*	*Notified on 8/9/2003*	*Notified on 18/3/2005*
Exports (Rs. Crs)	*12,444*	*1,775*	*296.015*	*457.98*	*30.33*	*366*
Total Investment (Rs. Crs)	*277*	*46.16*	*101.21*	*551.71*	*27.4*	*22.96*
Area (Acres)	*100*	*5*	*110*	*2600*	*180.94*	*16*
Employment (In Number)	*9,300*	*1,729*	*2,441*	*4,838*	*265*	*3,948*

Figures (2007-08)	***Mahindra City SEZ**** *(IT)*	***Mahindra City SEZ**** *(Auto)*	***Mahindra City SEZ**** *(Textiles)*	***Nokia SEZ**** *(IT Hardware)*	***Surat SEZ**** *(Multi Product)*
Set up in	2005	2006	2005	2006	2006
Converted into SEZ on	Notified on 26/10/2004	Notified on 26/10/2004	Notified on 26/10/2004	Notified on 17/8/2005	Notified on 23/6/2005
Exports (Rs. Crs	763.19	41.55	26.8	13,253.8	6.07
Total Investment (Rs. Crs)	631.33	243.34	34.1	1823.33	79.3
Area (Acres)	665.68	50.94	86.71	85.37	56.64
Employment (In Number)	6,153	451	844	13,623	1116

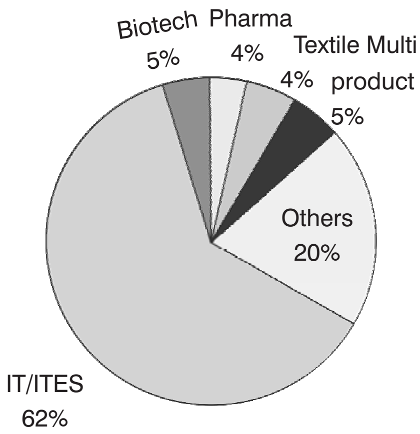
** Source SEZ India website*

In addition, about 462 SEZs have been formally approved and about 135 in-principle approvals have been granted post enactment of SEZ Act 2005 and SEZ Rules 2006.Out of the 462 formally approved SEZs, about 222 SEZs have been notified by the Central Government. The SEZs are being established across the country and in various sectors; the state-wise and sector-wise distribution of SEZs is given below.

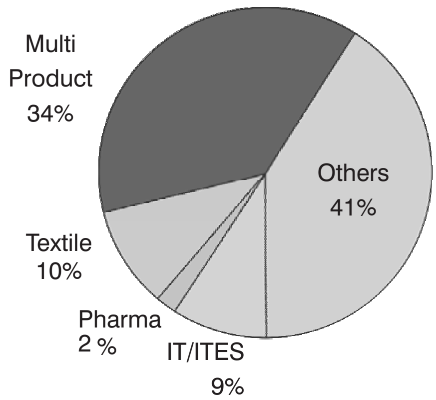
SEZs in India - Sector wise Distribution

Sectors	Formal approvals	In-principle approvals	Notified SEZs
Agro	3	2	1
Auto and related	3	4	1
Aviation/Aerospace	1	1	0
Beach and Mineral	1	1	0
Bio-tech	21	1	14
Building Product material	1	1	0
Ceramic and Glasses	1	0	0
Electronic Hardware/Products	3	4	3
Engineering/ Metallurgical Engg.	19	11	11
Food Processing	4	2	3
Footwear/Leather	7	2	4
FTWZ	4	6	1
Games and Jewellery	9	4	2
Handicrafts	4	1	1
IT/ITES/Semiconductor	289	12	147
Metal/Stainless Steel/ Aluminium	6	5	3
Multi-Product	21	51	10
Multi-Services/Services	14	8	4
Non-Conventional Energy	1	0	1
Other	8	8	2
Petrochemicals and Petro	1	1	1
Pharma/chemicals	20	3	13
Plastic processing	0	1	0
Port/Airport based Multi Product	7	0	2
Power/alternate energy	4	1	1
Textiles/Apparel/Wool	17	13	8
Writing and Printing paper mills	1	0	1
GRAND TOTAL	**462**	**135**	**222**

Formal



In-principle



The above sector wise distribution of SEZ's clearly shows that majority of the formal approvals granted have been in IT/ITES sector which comprises nearly 62% of the total formal approvals granted till date. This can be as a result of India's growing prowess in the IT/ITES Sector and availability of trained manpower which is resulting in outsourcing of such activities to India. Another possible reason could be the small size of such SEZs as compared to sector specific/multi-product SEZs which results in speedier land acquisition/aggregation for SEZ Development. The high number of formal approvals of IT/ITES Sector has also resulted in a high share of such SEZs in the notified SEZ category (67%).

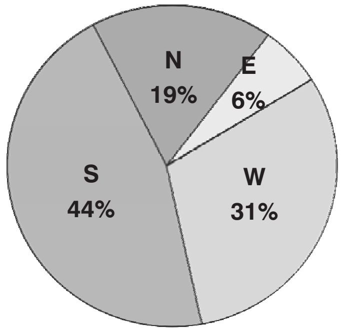
Other prominent sectors include; Biotech, Textiles, Pharma, Engineering etc in addition to 21 formally approved multi-product SEZs.

In terms of in-principle approvals, large multi-product SEZ's have a share of more than 50% followed by textile/ biotech sectors. The SEZ BoA is not granting any in-principle approval to proposals for IT/ITES Sector.

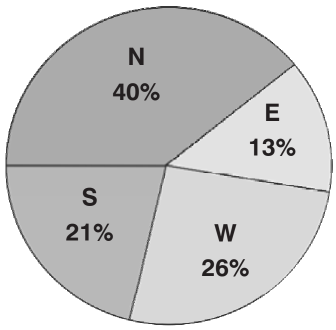
SEZs in India - Statewise Distribution

State	Formal approvals	In-principle approvals	Notified SEZs
Andhra Pradesh	75	3	54
Chandigarh	2	0	2
Chattisgarh	1	2	0
Dadra & Nagar Haveli	4	0	0
Delhi	2	0	0
Goa	7	0	3
Gujarat	39	9	19
Haryana	38	17	18
Himachal Pradesh	0	2	0
Jharkhand	1	0	1
Karnataka	42	9	20
Kerala	121	1	8
Madhya Pradesh	13	5	3
Maharashtra	89	37	27
Nagaland	2	0	0
Orissa	9	4	4
Pondicherry	1	0	0
Punjab	7	8	2
Rajasthan	8	9	4
Tamil Nadu	59	12	40
Uttar Pradesh	26	4	10
Uttaranchal	3	0	1
West Bengal	22	13	6
GRAND TOTAL	**462**	**135**	**222**

Formal



In-principle



State wise distribution of formally approved SEZs clearly shows the pro-activeness of the Southern states in attracting investors and mobilizing investments in terms of granting State Government recommendation. Although western states are not far-behind there is still some catching up to do. The northern and eastern states are lagging way behind in terms of providing the right environment for the investors to get their proposals formally approved and notified. This is substantiated by the fact that in case of in-principle approvals the northern states have a share of almost 40%.

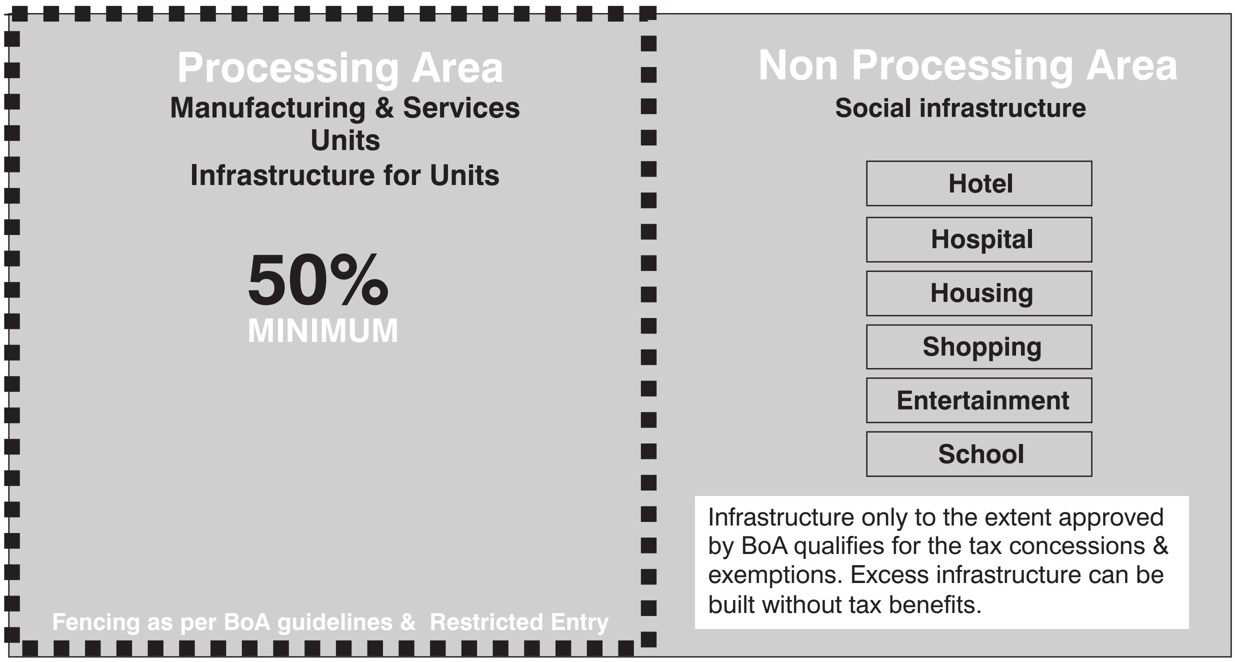
On the basis of the above, the northern and eastern states need to take pro-active steps in order to encourage investors to consider their states for investment. Measures which could be taken are:

- Enactment of State SEZ Act/Policy in line with Central SEZ Act providing benefits to investors
- Single window facility
- Proper screening procedure for granting State Government recommendation to SEZ proposals
- Proper grievance addressal mechanism for investors

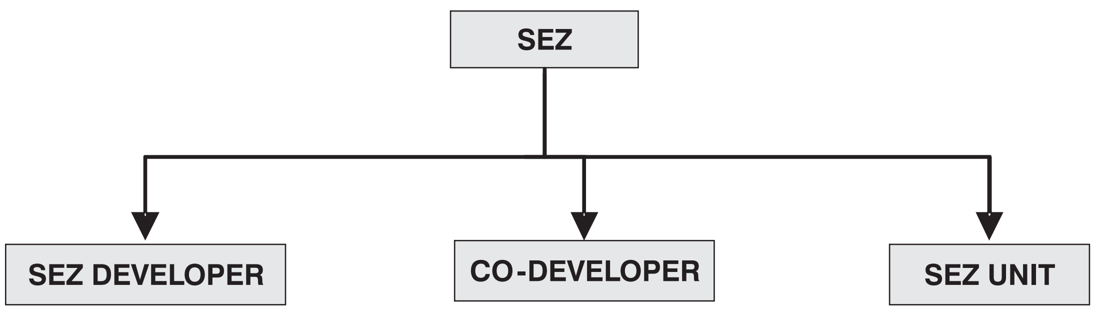
Legislative Framework - The Act and the Rules

Bird's Eye View of SEZ

Before we get into the important regulatory provisions contained in the SEZ Act and SEZ Rules, we need to understand the SEZ set-up including the entities engaged. The same has been explained below through a diagrammatic representation.



Entities in SEZ



"Developer" means a person who, or a State Government which, has been granted by the Central Government a letter of approval under sub-section (10) of section 3 and includes an Authority and a Co-Developer for setting up the SEZ

"Co-Developer" means a person who, or a State Government which, has been granted by the Central Government a letter of approval under sub-section (12) of section 3. for providing infrastructure facilities or for carrying out authorized operations in a notified SEZ".

A Unit approved by the Unit Approval Committee to engage in manufacturing or services activities from within the SEZ."

Notes:

1. The Developer or Co-Developer shall have at least twenty-six per cent of the equity in the entity proposing to create business, residential or recreational facilities in a SEZ in case such development is proposed to be carried out through a separate entity or a special purpose vehicle being a company formed and registered under the Companies Act, 1956 (1 of 1956)

2. An SEZ Developer may allot land in the processing area on lease basis to any person desiring to create infrastructure facilities for use by the prospective units.

Special Economic Zone Act, 2005

"An Act to provide for the establishment, development and management of the Special Economic Zones for the promotion of exports and for matters connected therewith or incidental thereto."

Special Economic Zone Act, 2005 ('The Act'), which was partially notified on February 10, 2006, is a self contained legislation encompassing the framework of Special Economic Zones ('SEZs'). Post notification of the Act a host of legislations and underlying rules and regulations have ceased to govern the SEZs and units therein, namely:

a) Foreign Trade Policy 2004-09 notified under Foreign Trade (Development & Regulation) Act, 1992;

b) Chapter XA of the Customs Act, 1962; and

c) SEZ Rules and Regulations notified under Chapter XA of the Customs Act, 1962.

The Act also makes modifications in a number of other legislations including –

- Income-tax Act, 1961
- Insurance Act, 1938
- Banking regulation Act, 1949
- Indian Stamp Act, 1899

SALIENT FEATURES OF THE SEZ ACT 2005

- The Act has over-riding effect over all other laws, for the time being in force.
- The Central Government is empowered to direct non / modified applicability of Central Acts (except labour matters) to SEZs and units therein.
- State Governments have been empowered to enact laws / notify policies for grant of fiscal and other concessions.
- SEZ shall be deemed to be a territory outside the customs territory of India.
- SEZ shall be deemed to be a port, airport, inland container depot, land station and land customs stations, as the case may be, under the Customs Act, 1962.

IMPORTANT DEFINITIONS IN THE ACT

- **'Special Economic Zone'** means a Special Economic Zone notified under this Act and includes a Free Trade and Warehousing Zone (FTWZ) and existing Special Economic Zone.

- **‘Developer’** means a person who has been given permission by the Central Government to develop the SEZ. In case one person does not have enough land to meet the minimum area requirements, more than one person may apply for developer status and each such person shall be deemed to be a developer in respect the land owned by such person.

- **‘Co-developer’** is a person who develops infrastructure facilities or undertakes authorised operations after entering into agreement with developer and obtaining requisite approval of the Central Government.

- **‘Unit’** means a unit set up within the SEZ.

- **‘Domestic Tariff Area’** means the whole of India (including the territorial waters and continental shelf) but does not include the areas of the Special Economic Zones.

- **‘Board of Approval’ (BoA)** is the body setup for -
  - granting / rejecting proposals for establishment of the SEZs;
  - granting approval of authorised operations to be carried out in the SEZ by developer;
  - granting of approval to developers or units for foreign collaborations and foreign direct investments, (including investments by a person resident outside India), in the SEZ for its development, operation and maintenance;
  - granting / rejecting of proposal for providing infrastructure facilities in a SEZ
  - suspension approval granted to a developer and appointment of administrator
  - disposing of appeals arising from decisions of the Approval Committee

- **‘Approval Committee’ (AC)** means a committee setup in each SEZ for the purpose of
  - accepting / rejecting proposals for setting up SEZ Unit
  - monitor compliance with conditions mentioned in approval letter
  - approve import/procurement of goods from Domestic Tariff Area (DTA) and outside India

- **‘Development Commissioner’ (DC)** is an officer of the GOI who is the nodal officer for that SEZ.

- **‘Authorised Operations’** means activities approved by the BoA / Development Commissioner. Presently, SEZ Rules expressly specify what constitutes authorised operations.

- **‘Export’** definition expanded to include supply of goods/ provision of services:
  - From DTA to a SEZ unit or developer; or
  - From one SEZ unit to another or developer in the same SEZ or different SEZ
  - Supply outside India

- **‘Import’** apart from including bringing of goods and service from outside India, it also includes receipts by a SEZ unit / developer from another SEZ unit or developer of same SEZ or a different SEZ.

- **‘Services’** means such tradable services which
  - are covered under the General Agreement on Trade in Services annexed as IB to the Agreement establishing the World Trade Organisation concluded at Marrakesh on 15 April, 1994
  - may be prescribed by the Central Government for the purposes of this Act, and
  - earn foreign exchange.

- **‘SEZ Authority’** means an Authority to undertake requisite measures for development, operation and management setup by the government of India
- **‘Free Trade and Warehousing Zone’** means a SEZ where mainly trading and warehousing activities are carried out.
- **‘Offshore Banking Unit’ (OBU)** means a bank branch located in the SEZ which has obtained requisite approvals under the Banking Regulation Act
- **‘International Financial Services Centre’ (IFSC)** means an International Financial Services Centre approved by the Central Government.

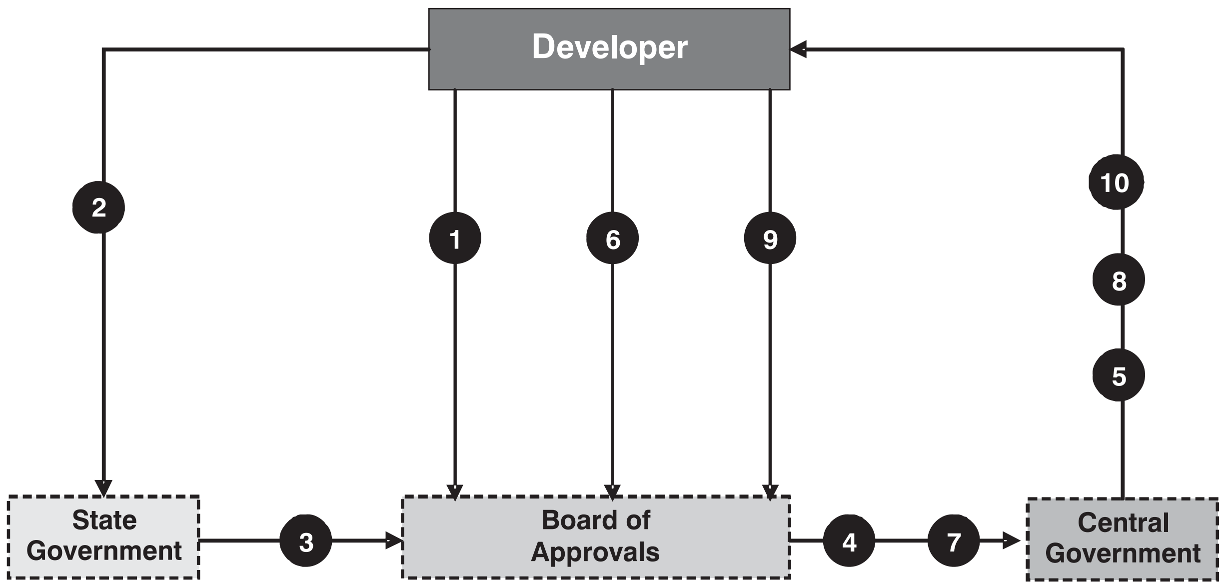
SEZ Developer/ Co-Developer

Relevant Provisions for SEZ Developers

PROCESS FOR APPROVAL OF SEZ

Option 1 : In-principal approval – Is not granted in case of IT/ITES SEZ

- If the developer does not have right (freehold / lease/ developmental rights)) over the land including the possession, he can apply for “in-principal approval”
- State Government recommendations – a must before BoA considers the case
- At present – no in-principal approvals considered for IT/ITES Sector SEZs
- Application to be made in Form A along with other documents
- Developer to fulfill minimum investment or net worth criteria

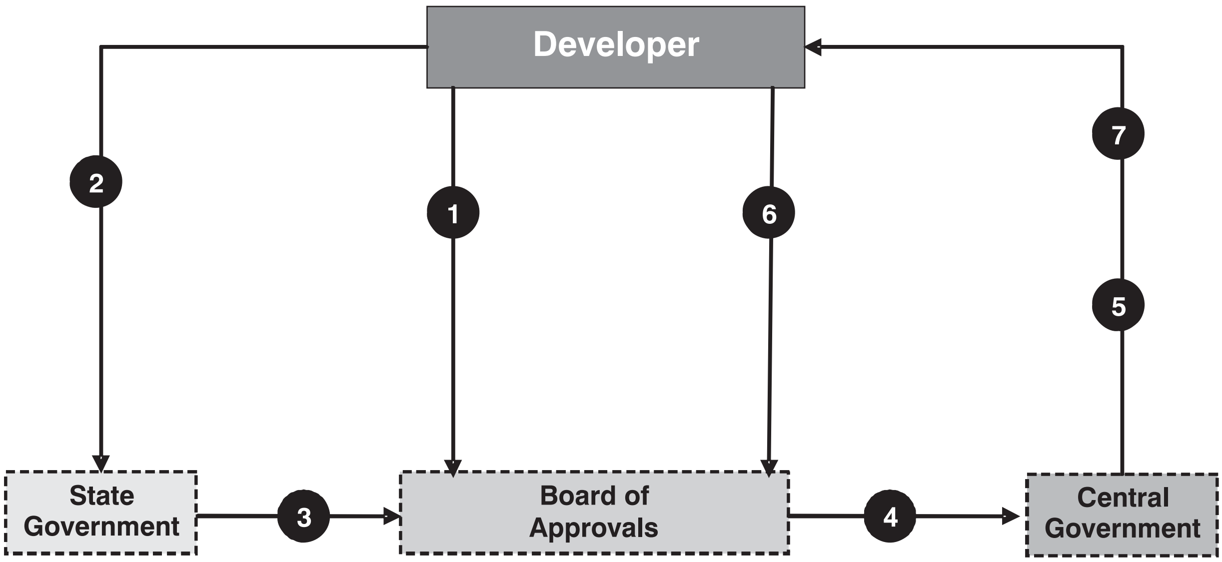


1. Developer submits proposal to BoA along with details of land identified
2. Developer approaches SG for recommendation to CG and grant of fiscal and other benefits
3. SG recommends the proposal to CG
4. BoA considers the case in meeting and recommends “in-principal” approval.

5. MoC grants “in-principal” approval to Developer.
6. After land acquisition, Developer again approaches BoA with details of land, proofs of legal right and possession for formal approval
7. BoA considers the case in meeting and recommends “formal” approval to Developer.
8. MoC grants “formal” approval to Developer.
9. Developer furnishes land and other documents for notification. DC visits site and submits site verification report to MoC.
10. MoC notifies the SEZ and appoints DC for the SEZ

Option 2 : Formal approval

- If the developer does have right (freehold / lease/ developmental rights) over the land including the possession, he can apply for "formal approval".
- If the land is leased, lease period should be minimum 20 years
- State Government recommendations – a must before BoA considers the case
- Application to be made in Form A along with other documents
- Developer to fulfill minimum investment or net worth criteria



1. Developer submits proposal to BoA along with details of land and possession proof
2. Developer approaches SG for recommendation to CG and grant of fiscal and other benefits
3. SG recommends the proposal to CG
4. BoA considers the case in meeting and recommends "formal" approval.
5. MoC grants "formal" approval to Developer.
6. Developer furnishes land and other documents for notification. DC visits site and submits site verification report to MoC.
7. MoC notifies the SEZ and appoints DC for the SEZ

Minimum land area requirement for establishment of SEZ (Rule 5)

- Land to be contiguous with no public thoroughfare. BoA can relax this requirement on merits. (Rule 7)
- Land to be vacant on the date of application. (Rule 7)
- Developer to have either freehold/ development / lease rights (>20 years) on the land (Rule 7)
- For formal approval, land must be in the possession of the developer

Type of SEZ	General area (Hectares)	Specified area* (Hectares)	Remarks
Multi Product	1000	200	Cap on maximum area of a SEZ at 5000 hectaes
Multi Services	100	50	
Port/Airport based	100	50	Can be multi product/multi services / FTWZ
Sector Specific	100	50	
Free Trade Warehousing Zone (FTWZ)	40	40	Min. 100,000 sq. mt. built-up processing area required Can be a part of Multi Product/Sector Specific SEZ
Electronics hardware and software, including ITES	10	10	Min. 100,000 sq. mt. built-up processing are required
Bio-tec Non-Conventional Energy	10	10	Min. 40,000 sq. mt. built-up processing are required
Games & Jewellery	10	10	Min. 50,000 sq. mt. built-up processing area required

1 Hectare = 2.47 Acres

**Specified areas are Assam, Meghalaya, Nagaland, Arunachal Pradesh, Mizoram, Tripura, Himachal Pradesh, Uttranchal, Sikkim, J&K, Goa and UTs*

Processing and non-processing area (Rule 5 & 11)

- Units and core infrastructure to be located in the Processing area
- Allotment of space/infrastructure in the processing area only to unit holding valid LoA from the DC [Rule 11(5)]
- Processing area shall have specified entry and exit points and shall be fully secured by taking such measures as may be approved by BoA. [Rule 11(2)]
- DC – the authority for demarcation of processing and non-processing area [Rule 11(3)]

- Entry to processing area restricted [Rule 11(4)]
- Lease period shall not be less than 5 years but lease rights would be co-terminus with validity of LoA [Rule 11(5)]
- Non-processing area to house social and other infrastructure (residence, hotel, hospital, recreational, retail, commercial etc.)
- Authorised operations in the non-processing area as approved by the BoA to be eligible for all tax / duty benefits

Net worth / Minimum investment requirements

One of the qualifying criteria for SEZ developer application is Minimum Investment or Net worth criteria. For this purpose, net worth of the Promoter Company & all Group companies & Flagship companies is also counted. The developer needs to meet ANY ONE of the following criteria:

Type of SEZ	Net worth criteria (Rs. Cr.)	Minimum Investment (Rs. Cr.)
Sector Specific and others	50	250
Multi-product	250	1000

Joint development

Proviso to Section 3(10):

> *"Provided that the Central Government may, on the basis of approval of the Board, approve more than one Developer in a Special Economic Zone in cases where one Developer does not have in his possession the minimum area of contiguous land, as may be prescribed, for setting up a Special Economic Zone and in such cases, each Developer shall be considered as a Developer in respect of the land in his possession."*

An earlier application by two developers to establish an IT/ITES SEZ (minimum land area required – 10 Hectares) jointly was negated by the BoA. In that case, one developer was having more than 10 hectares of land in his name and possession and the other developer was having less than 10 hectares of land in his name and possession. The BoA took the view that the Joint Development avenue is available only in cases where each of the proposed joint developer does not hold minimum land area required for establishment of an SEZ. In this case, one developer had more than 10 hectares in his name and possession and therefore, the benefit of the proviso cannot be extended.

Thus, if each of the proposed joint developer holds and possesses less than minimum required land, Joint Development is possible.

However, since after the refusal in the above case by the BoA, no application has been filed under the above proviso and as a result, though the provision exists in the law, there is no Joint Developer approved by BoA as such till date.

Relevant Provisions For SEZ Co-Developers

SEZ Co-Developer

Section 2(f) of the Act defines Co-Developer and Section 3(11) specifies the purpose for which Co-Developer can be approved.

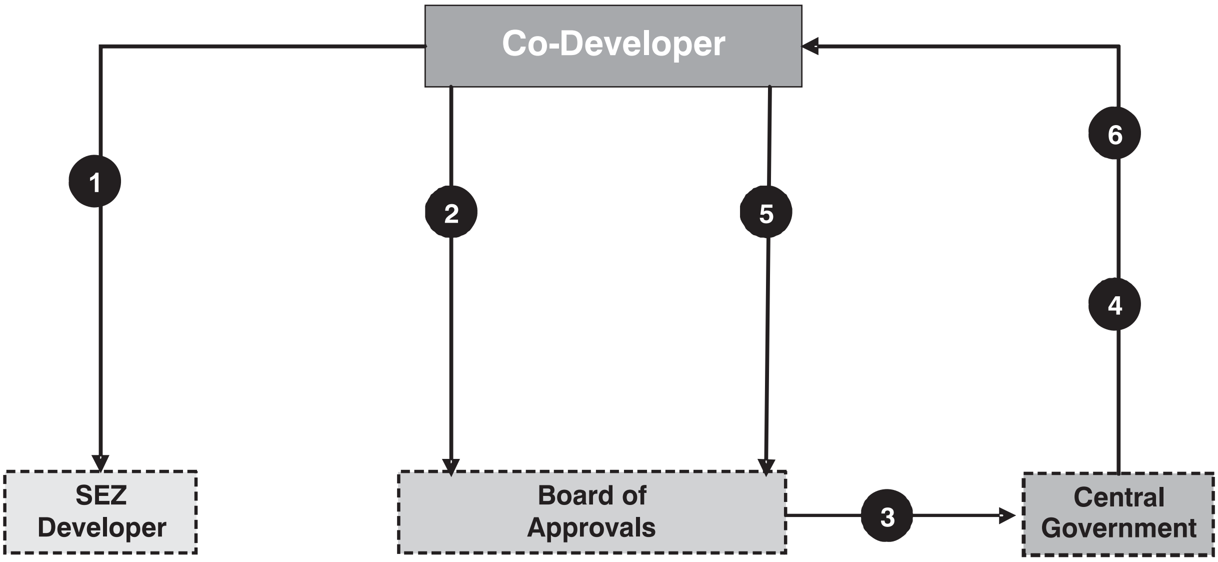
Any person who intends to provide any infrastructure facilities in the identified area in the SEZ or wants to undertake authorized operations can apply to the BoA for approval as Co-Developer. Therefore, Co-Developer can be appointed for provision of infrastructure facilities in the processing area as well as non-processing area of the SEZ. Once approved, status of Co-Developer is equal to that of a “Developer” in all respect and he is entitled to all the benefits / concessions that a developer is entitled to.

The Act & Rules do not place any restriction on number of co-developers for an SEZ. Therefore, there can be more than one co-developer in an SEZ providing / developing/ maintaining infrastructure in different part / area of the SEZ. (e.g. a co-developer for each of Hotel, Residential, Commercial, Power, Waste Management, Factory building etc.)

Co-Developer is required to enter into Co-Development agreement with the Developer which forms part of the SEZ approval granted to the Co-Developer. Normally, land is given on lease to the Co-Developer for the identified area and Co-Developer develops infrastructure in the same. However, it is not necessary that the land should always be leased to the Co-Developer. Based on the commercial considerations, there can be case to appoint a Co-Developer without lease of the land/other infrastructure.

This window also allows planning avenues for any developer to retain control of the asset / construction in the SEZ. Normally, when the letter of approval to unit is cancelled or at the time of exiting from the SEZ, the lease of the unit with developer expires [Rule 5(4)] and the unit has to hand over the infrastructure /built-up space to the developer.

Co-Developer approval process



1. Co-Developer enters into a co-developer agreement with the approved SEZ Developer of a notified SEZ.

2. Co-Developer submits its application to the BoA with all the required documents.

3. BoA recommends approval of the Co-Developer application to the Central Government

4. MoC grants approval to Co-Developer.

5. Co-Developer approaches the BoA for approval of the authorized operations proposed to be undertaken in the SEZ by the Co-Developer. BoA recommends the approval to MoC subsequently.

6. MoC grants approval of the authorized operations to the Co-Developer.

TAX BENEFITS TO DEVELOPER / CO-DEVELOPER

Corporate tax exemption - Section 80IAB of Income-tax Act

100% exemption from Income-tax on profits derived from development of the SEZ

- Exemption available for 10 consecutive years out of block of first 15 years starting from the year in which SEZ is notified.

- If the operations and maintenance of SEZ is transferred to another developer (including co-developer), the transferee developer (including co-developer) shall be entitled to deduction under this section for the balance period.

DDT exemption - Section 115-O(6) Income-tax Act

Developer is exempted from payment of DDT. There is no end date specified. Therefore, as of now, the exemption is perpetual.

MAT exemption - Section 115JB(6) Income-tax Act

Developer is exempted from payment of MAT. There is no end date specified. Therefore, as of now, the exemption is perpetual.

Indirect-tax benefits on "authorized operations" – Rule 27

- No Customs duty – on import of Capital Goods, consumables, spares, etc.
- No Excise Duty – on local procurement of Capital Goods, consumable, spares, etc.
- No Service Tax on authorised operations
- No Central Sales Tax on input goods, consumables, spares, etc.
- Exemption from local taxes
  (VAT/Sales Tax, Octroi, Entry-tax, Electricity duty etc. as per State SEZ Act / Policy)

Exemption from Stamp Duty

- Stamp duty exemption as per State Stamp Duty legislation
- Many states have exempted all transactions in a notified SEZ from stamp duty
- Some states have exempted only transactions relating to processing area from stamp duty

Non Processing Area – List of Authorized Operations

S. No	Operations	IT/ITES, Bio-technology & Gems & Jewellery SEZ		Sector Specific SEZs		Multi Product SEZs	
		Automatic Route	Approval Route	Automatic Route	Approval Route	Automatic Route	Approval Route
1	Roads with Street lighting, Signals and Signage						
2	Water treatment plant, water supply lines (dedicated lines up to source), sewage lines, storm water drains and water channels of appropriate capacity	√	-	√	-	√	-
3	Sewage and garbage disposal plant, pipelines and other necessary infrastructure for sewage and garbage disposal, Sewage treatment plants	√	-	√	-	√	-
4	Electrical, Gas and Petroleum Natural Gas Distribution Network including necessary sub-stations of appropriate capacity, pipeline network etc.	√	-	√	-	√	-
5	Effluent treatment plant and pipelines and other infrastructure for Effluent treatment	X	-	√	-	√	-
6	Telecom and other communications facilities including internet connectivity	√	-	√	-	√	-
7	Rain water harvesting plant	√	-	√	-	X	-
8	Air conditioning of processing area	√	-	X	-	X	-
9	Fire protection system with sprinklers, fire and smoke detectors	√	-	X	-	X	-
10	Landscaping and water bodies	√	-	√	-	√	-
11	Boundary wall	√	-	√	-	√	-

S. No	Operations	IT/ITES, Bio-technology & Gems & Jewellery SEZ		Sector Specific SEZs		Multi Product SEZs	
		Automatic Route	Approval Route	Automatic Route	Approval Route	Automatic Route	Approval Route
12	Built up processing area not less than minimum prescribed	√	-	X	-	X	-
13	Office space for Customs and Security staff not exceeding 500 sq.m.	√	-	√	-	√	-
14	Wi Fi and / or Wi max Services	X	-	√	-	√	-
15	Drip and Micro irrigation systems	X	-	√	-	√	-
16	Factory sheds in processing area	X	-	√	-	√	-
17	Playground	X	-	X	-	√	-
18	Office space/Shopping arcade/ Retail space/ multiplexes	-	1,000 sqm.* multiplex	-	50,000 sqm.*	-	2,00,000 sqm.*
19	House/service apartments		10000		7500 units 7,50,000		25000 units 25,00,000 sqm*
20	Hotel	NA	100 rooms 10,000 sqm				250 rooms 25,000 sqm
21	Hospital, Clinic & Medical Centers	-	NA	-	100 bed	-	250 bed
22	School/Educational institute	-	NA	-	25000 sqm		2,50,000 sqm

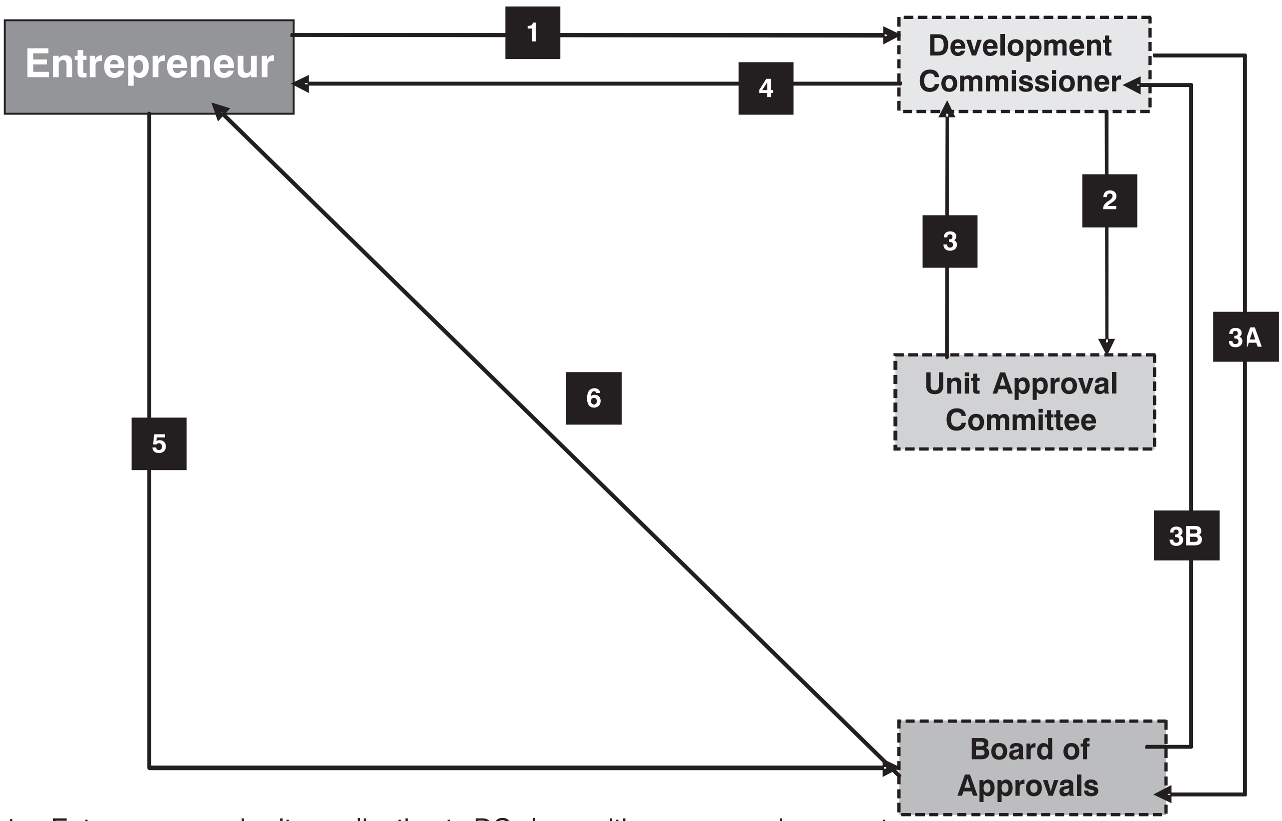
* As per Notification No.F.1/7/2006-EPZ dated October 27, 2006 and PIB Release

SEZ Units

Relevant Provisions for the SEZ Units

Process for approval of SEZ unit

- Consolidated application to the UAC in Form F



1. Entrepreneur submits application to DC along with necessary documents
2. DC forwards the application to UAC after scrutiny
3. UAC considers the application in the meeting and conveys decision to the DC

3A If the proposal involves FDI under non-automatic route or in case where Industrial license is necessary, DC forwards the application to BoA after scrutiny

3B BoA conveys the decision to DC

4. DC communicates the decision to the entrepreneur
5. If the UAC decision is not acceptable to the Entrepreneur, appeal can be made to BoA
6. BoA on appeal considers the case and conveys the decision to the entrepreneur

SOME IMPORTANT PROVISIONS RELATING TO SEZ UNIT

- Single window clearance - Consolidated application to the UAC in Form F
- Unit can undertake service activities apart from manufacturing activities. Under FTP, units were allowed to undertake only notified services and even the tax benefit was allowed only on services notified – which were typically computer related IT/ITES services. Services are defined exhaustively under Rule 76. Corporate-tax benefits are also now allowed on profit from export of all such services.
- Branch of a foreign company can undertake manufacturing activities in accordance with the provisions of without prior approval of the RBI [Rule 19(7)]
- Job work for overseas principal allowed. [Rule 18(6)]
- No minimum export commitment on Units.
- Units only to be net foreign exchange earner at the end of 5 year period and every 5 years thereafter. [Rule 52 & 53]
- Validity of lease of land/facility by unit from developer to be for a minimum of 5 years [Rule 11(5)]

NET FOREIGN EXCHANGE EARNING (RULE 52 & 53)

To sustain existence in the SEZ, units have only one obligation to achieve i.e. to be net foreign exchange (NFE) earner. This requirement is only for the unit and not developer.

NFE is calculated cumulatively for a period of 5 years from the date of commencement of manufacture or provision of services. NFE is calculated as per the following formula:

Positive Net Foreign Exchange = A – B > 0

Where:

A : is Free on Board value of Exports and permitted DTA sales

B : is the sum total of

- Cost Insurance Freight value of imported inputs (RM, intermediates, components, consumables, parts etc.) and the CIF value of all imported capital goods and the value of all payments made in foreign exchange by way of export commission, royalty, fees, dividends, interest on external commercial borrowings during the first five years
- Value of goods procured from another SEZ or EOU or EHTP or STP unit or from bonded warehouse etc.
- Pro-rata CIF value of capital goods, imported duty free or leased from a leasing company, received free of cost and or on loan basis or on transfer for the period they remain with the unit.

Certain supplies made to the DTA are also counted for the purpose of fulfillment of NFE criteria. Some of them are:

- Supplies against EEFC A/c. or inward remittances
- Supplies of ITA-1 items (telecom, IT hardware, software etc.)
- Supplies to –
  - Power projects & refineries
  - EPCG license holders or against advance licenses
  - Projects financed by international funding agencies
  - Projects notified for zero customs duty
  - Other SEZ / EOU / STP / EHTP unit
  - FTWZ against foreign currency

Performance of the unit is periodically monitored by the UAC. If the UAC finds that the unit has not achieved NFE positive, the unit is liable for penal action by the DC (such as payment of appropriate duties on goods admitted to SEZ along with applicable interest, if any)

UAC can also grant extension of time limit beyond 5 year period if the unit fails to achieve NFE positive status due to genuine difficulties.

Trading from SEZ

Trading is a permitted activity and included in the definition of "services". [Rule 76]

It was brought to the notice of the Government that this window could be utilized by units to source goods domestically at cheap rate and exports the same at very high value over which they can claim corporate tax exemption – which was not the intention of the Government.

Immediately, internal instruction was issued by MoC to all the DCs not to approve any units for undertaking the "trading" business before the issue is considered by the BoA and EGoM and pending further instructions.

Amendments to Rules followed vide notification dated August 10, 2006. Following explanation was added to Rule 76 :

> *"The expression "trading", for the purposes of Second Schedule of the Act, shall mean import for the purposes of re-export"*

This amendment has an effect of denying the corporate tax benefits to the unit engaged in the business of local sourcing and exporting. Only profits earned from the business of import for the purposes of re-export is entitled to corporate tax benefits. The rule does not debar a unit from undertaking the trading activity per se (domestic sourcing and export), it only denies tax benefit on such activities.

Exit and Closure

- A Unit may opt out of SEZ with approval of DC. Such exit from the SEZ shall be subject to payment of applicable duties on the imported or indigenous capital goods, raw materials, components, consumables, spares and finished goods in stock.
- If the unit has not achieved positive NFE, the exit shall be subject to applicable penalty.

Tax Benefits to Unit

Corporate tax deduction - Section 10AA of Income-tax Act

- Unit entitled to income-tax deduction on profits derived from export of goods / services as under :
  - 100% for first 5 years;
  - 50% for next 5 years; and
  - Up to 50% for further 5 years subject to creation of specified reserve
- Exemption available only on "export" profits. Proportionate profit relating to DTA or "Deemed Export" liable to be taxed at applicable tax rate.
- Unit eligible for deduction from the year in which it starts manufacturing / services.

MAT exemption - Section 115JB(6) Income-tax Act

- Unit is exempted from payment of MAT.
- There is no end date specified for this exemption. Therefore, as of now, the exemption is perpetual.

Indirect-tax benefits on "authorized operations" – Rule 27

- No Customs duty – on import of Raw Material, Capital Goods, consumables, spares etc.
- No Excise Duty – on local procurement of Raw Material, Capital Goods, consumable, spares etc.
- No Service Tax on services for authorised operations
- No Central Sales Tax on input goods, consumables, spares etc.
- Exemption from local taxes

  (VAT/Sales Tax, Octroi, Entry-tax, Electricity duty etc. as per State SEZ Act / Policy)

Exemption from Stamp Duty

- Stamp duty exemption as per State Stamp Duty legislation

State Regulatory Regime

State SEZ Regulatory Regime

NEED FOR STATE SEZ ACT/POLICY

In addition to the above Central Regulatory Regime most of the states have or are in the process of enacting their respective SEZ Act or Policy. The need of State SEZ Act or Policy is to address the following:

- To provide an omnibus regulatory framework for SEZ development in the state in consonance with the Central Act
- To provide for fiscal incentives to SEZ Developers and SEZ Units
- To provide a mechanism for single window clearance for SEZ Developer
- To provide a mechanism for resolving state level matters concerned with labor, pollution authority, municipal corporation etc.

STATUS OF STATE SEZ ACT/POLICIES

States where SEZ Act has been enacted and is in force

State	SEZ Policy
Haryana	Haryana SEZ Act, 2005
Gujarat	Gujarat SEZ Act, 200
West Bengal	West Bengal SEZ Act, 2003
Madhya Pradesh	The Indore SEZ (Special Provisions) Act, 2003

States where SEZ Policy has been enacted and is in force

State	SEZ Policy
Uttar Pradesh	Uttar Pradesh SEZ Policy, 2006
Chandigarh	SEZ Policy of Chandigarh, 2005
Maharashtra	Maharashtra Draft SEZ Act, 2003
Tamil Nadu	Tamil Nadu SEZ Policy, 2003
Andhra Pradesh	Andhra Pradesh SEZ Policy, 2004
Karnataka	Karnataka SEZ Policy, 2002
Orissa	Orissa SEZ Policy, 2003
Kerala	Kerala SEZ Policy, 2003
Jharkhand	Jharkhand SEZ Policy, 2003
Rajasthan	Rajasthan SEZ Policy
Punjab	Punjab SEZ Policy, 2005

SALIENT FEATURES OF SELECTED STATE SEZ ACTS/POLICIES

Gujarat

(Formal approvals – 39, Notified SEZs – 19)

- Gujarat SEZ Act, 2004 came into force prior to the enactment of central SEZ Act. Subsequently the Gujarat SEZ Rules came into force in 2005 and Gujarat SEZ Regulations in 2007.
- The Act provides for operation, maintenance, management and administration of SEZs in the State.
- Certain fiscal benefits are provided under the state act in the form of exemptions of stamp duty, sales tax, purchase tax, motor spirit tax, luxury tax, entertainment tax and other taxes and cess levied by the state and payable on sales and transactions within the processing area of SEZ.

Maharashtra

(Formal approvals – 89, Notified SEZs – 27)

- The Maharashtra SEZ policy was introduced in the year 2001 and it applies to all SEZs proposed to be set up in the state subject to the framework for SEZs determined by Government of India from time to time.
- A number of Incentives are provided by the state which includes:
  - 100 % exemption from Stamp Duty and Registration Fees
  - Permission for Captive Power Generation.
  - All 100% EOUs will be given status of "Public Utility Service" with Labor Laws relaxation

Tamil Nadu

(Formal approvals – 59, Notified SEZs – 40)

- In the context of Government of India guidelines for the establishment of SEZs, the Government of Tamil Nadu has adopted the Tamil Nadu SEZ policy in the year 2003 that will be applicable to all SEZs in the State of Tamil Nadu, subject to the framework for SEZs determined by the Government of India from time to time.
- The Policy offers Exemption from all local levies and taxes including stamp duty, sales tax, turnover tax, VAT, purchase tax, mandi tax, octroi, electricity cess and other taxes and cess levied by the state and payable on sales and transactions made between units and establishments within the SEZ.

Andhra Pradesh

(Formal approvals – 75, Notified SEZs – 54)

- With the background of Government of India guidelines for SEZs, the State has formulated its SEZ Policy in the year 2004 to provide a comprehensive framework for establishment, operations and sustainability of the Special Economic Zones.
- The basic features of the policy are single-window clearance for investors, simplified business working environment, exemptions from stamp duty, registration fee and other local taxes.

Karnataka

(Formal approvals – 42, Notified SEZs – 20)

- In order to boost investor's confidence in the SEZ scheme and to highlight the State Govt.'s stand on issues relating to state levies, generation and distribution of power, environmental clearances, etc. a State Level Policy for Special Economic Zone has been formulated in 2002.
- Developers of SEZs and industrial units and other establishments within the SEZs are exempted from all State and local taxes and levies, including Sales Tax, Purchase Tax, Entry Tax, Cess, etc, in respect of all transactions made between units/ establishments within the SEZs and in respect of the supply of goods and services from the Domestic Tariff Area to units/ establishments within the SEZ.
- Further, industrial units within the SEZ will be eligible for all other incentives and concessions as per general policies of the Government.

Haryana

(Formal approvals – 38, Notified SEZs – 18)

- The SEZ Act was enacted in Haryana on 23rd January 2006.
- Act to override all other state laws.
- Land use change – not required
- No license under Haryana Development and Regulation of Urban Areas Act
- Stamp duty - All transactions of immovable property or documents related thereto - within SEZ to be exempt
- All taxes, duties, cess and levies under any state act to be exempted:
  - Goods imported or exported from SEZ,
  - Intra SEZ transactions,
  - Goods sent to DTA for value addition
  - Services providing value addition to product within SEZ

West Bengal

(Formal approvals – 22, Notified SEZs – 6)

- The West Bengal SEZ Act, was enacted in 2003 to facilitate the development, operation, maintenance, administration and regulation of SEZs in the state.
- Exemptions have been provided under the Act for all local taxes, duties, fee, cess or any other levies payable under the State laws by the developer or units in the SEZs.

Key Issues and Concerns

RBI classification

RBI classification of SEZ as real estate for the purposes of prudential norms has adverse effect on the cost and availability of finance.

ECB Policy

SEZ is currently not included in the list of “infrastructure” / “real sector” for the purposes of raising ECBs. Therefore, developers cannot source funds internationally at much lower costs.

Export of services

In the absence of Export of Services Rules, certain sectors – though earning foreign exchange are currently not entitled to corporate tax benefits. (Education, Medical Tourism, Travel & Tourism, Training services etc.)

Import Duty on DTA sales

Since goods sold from SEZ to DTA are considered “import” by DTA, full import duty is levied on such sale. Instead of import duty, duty foregone should be levied to make SEZ units more competitive against the DTA. By levying full import duty on such sale, value addition done by unit in the SEZ is also charged to import duty.

Connectivity

Though the policy aims at creating world class infrastructure within SEZs, the need for connecting these islands of excellence with other ports, airports and other social infrastructure is not addressed.

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