CHAPTER 4

REVIEW OF SPECIAL ECONOMIC ZONE ACT 2005

4.1 Tax benefits to Special Economic Zones

4.1.1 Goods and Services supplied to Special Economic Zones are tax-free

- **Exemption from Taxes, Duties or Cess**

Any goods or services exported out of, or imported into, or procured from the Domestic Tariff Area by

i. a unit in a special economic zone, or

ii. a developer,

shall, subject to such term, conditions and limitations, as may be prescribed, be exempt from the payment of taxes, duties or cess under all enactments specified in the first schedule. [Section 7 of SEZ Act, 2005]

- **Exemptions, drawbacks and concessions to every developer and entrepreneur**

Every developer and the entrepreneur shall be entitled to the following exemptions, drawbacks and concessions namely:

a. **Exemption from any duty of customs, under the customs act 1962**, (52 of 1962) or the customs tariff act, 1975 (51 of 1975) or any other law for the time being in force, on goods exported from, or services provided, from a special economic zone or from a unit, to any place outside India;
b. **Exemption from any duty of excise, under the central excise act, 1944** (1 of 1944) or the central excise tariff act, 1985 (5 of 1986) or any other law for the time being in force, on goods brought from domestic tariff area to a special economic zone or unit, to carry on the authorized operations by the developer or entrepreneur;

c. **Drawback or such other benefits** as may be admissible from time to time on goods brought or services provided from the domestic tariff area into a special economic zone or unit or services provided in a special economic zone or a unit by the service providers located outside India to carry on the authorized operations by the developer or entrepreneur;

d. **Exemption from service tax under chapter v of the finance act, 1994** (32 of 1994) on taxable services provided to a developer or unit to carry on the authorized operations in a special economic zone;

e. **Exemption from securities transaction tax** leviable under section 98 of the finance (no.2) act, 2004 (23 of 2004) in case the taxable securities transactions are entered into by a non-resident through the international finance services centre;

f. **Exemption from the levy of taxes on the sale or purchase of goods other than newspapers under the central sales tax act, 1956** (74 of 1956) if such goods are meant to carry on the authorized operations by the developer or entrepreneur. [Section 26 (1) of SEZ Act, 2005]
The central government may prescribe the manner in which, and the terms and conditions subject to which, the exemptions, concessions, drawback or other benefits shall be granted to the developer or entrepreneur.

[Section 26(2) of SEZ Act, 2005]

**Terms and Conditions for availing exemptions, drawbacks and concessions:**

(1) Grant of exemption, drawbacks and concession to the entrepreneur or developer shall be subject to the following conditions, namely:

(i) the unit shall execute a Bond-cum-legal Undertaking in from H, with regards to its obligations regarding proper utilization and accounting of goods, including capital goods, spares, raw materials, components and consumables including fuels, imported or procured duty free and regarding achievement of positive net foreign exchange earning;

(ii) the developer and co-developer shall execute the Bond-cum-legal Undertaking in from D with regard to their obligations regarding proper utilization and accounting of goods, including goods procured or imported by a contractor duly authorized by the developer or co-developer as the case may be;

(iii) the Bond-cum-legal Undertaking shall be jointly accepted by Development Commissioner and by the specified officer;

provided that the Bond-cum-legal Undertaking executed by the unit or the developer including co-developer shall cover one or more of the following activities, namely;
(a) the movement of goods between port of import or export and the special economic zone

(b) the authorized operations, as applicable to unit or developer;

(c) temporary removal of goods or goods manufactured in unit for the purposes of repairs or testing or calibration or display or processing or sub-contracting of production process or production or other temporary removals into Domestic Tariff Area without payment of duty;

(d) Re-import of exported goods.

(iv) the procedure for execution of Bond-cum-legal undertaking shall be as under;

(a) the Bond-cum-legal Undertaking, where the entrepreneur or developer is a company shall be executed by the managing director of the company or the director(s) or any person who has or have been duly authorized for this purpose by a resolution of the Board of Directors of the company and shall be affixed with the common seal of the company; where the entrepreneur is a partnership firm, Bond-cum-legal Undertaking shall be executed by all the partners or authorized partner(s); where the entrepreneur is a Hindu Undivided Family, the Bond-cum-legal Undertaking shall be executed by the Karta; and where the entrepreneur is a proprietorship concern, the Bond-cum-legal Undertaking shall be executed by the proprietor;

(b) the value of the Bond-cum-legal Undertaking shall be equal to the amount of effective duties leviable on import or procurement from the Domestic Tariff Area of the projected requirement of capital goods, raw materials, spares,
consumables, intermediates, components, parts, packing materials for three months as applicable but which will not be levied on account of admission of such goods into the Unit or the amount of effective duties leviable on import or procurement from Domestic Tariff Area of the projected requirements of goods for the authorized operation by the developer but will not be levied on account of admission of such goods into the Special Economic Zone;

(c) where the value of Bond-cum-Legal Undertaking executed falls short on account of requirement of additional goods, the Unit or the Developer shall submit additional Bond-cum-Legal Undertaking;

(d) there shall be no debit and credit, the Bond-cum-Legal Undertaking amount shall be monitored quarterly or yearly on the basis of Quarterly Progress Report or Annual Progress Report submitted by the Developer or Unit, as the case may be, and in case of any shortfall in the Bond-cum-Legal Undertaking amount, a fresh or additional Bond-cum-Legal Undertaking shall be furnished;

(e) the original of Bond-cum-Legal Undertaking shall be maintained by the office of Development Commissioner and certified copies shall be given to the Specified Officer and Unit or Developer;

(f) the value of the Bond-cum-Legal Undertaking in respect of gems and jewellery units shall be calculated on rates as notified by the Central Government, from time to time;

(g) duly completed Bond-cum-legal undertaking executed by the Unit or Developer, in accordance with the rules above, as the case may be, shall be
deemed to have been accepted, if no communication is received within seven working days from the date of its submission.

(2) Every Unit and Developer shall maintain proper accounts, financial year wise, and such accounts which should clearly indicate in value terms the goods imported or procured from Domestic Tariff Area, consumption or utilization of goods, production of goods, including by-products, waste or scrap or remnants, disposal of goods manufactured or produced, by way of exports, sales or supplies in the domestic tariff area or transfer to Special Economic Zone or Export Oriented Unit or Electronic Hardware Technology Park or Software Technology Park Units or Biotechnology Park Unit, as the case may be, and balance in stock:

Provided that Unit and Developer shall maintain such records for a period of seven years from the end of relevant financial year:

Provided further that the Unit engaged in both trading and manufacturing activities shall maintain separate records for trading and manufacturing activities.

(3) The Unit shall submit Annual Performance Reports in the Form I, to the Development Commissioner and the Development Commissioner shall place the same before the Approval Committee for consideration.

(4) The Developer shall submit Quarterly Report on import and procurement of goods from the Domestic Tariff Area, utilization of the same and the stock in hand, in Form E to the Development Commissioner and the Specified Officer and the Development Commissioner shall place the same before the Approval Committee.
VAT on supplies to SEZs stays

The empowered committee has said value added tax on supplies to SEZs and EOU will stay and asked taxpayers to claim credit on VAT instead of demanding over right withdrawal of the levy. Exporter had earlier demanded that VAT on these supplies be withdrawn as their money is blocked even though credit is paid on the tax. "We are against giving exemptions since its leads to tax evasion." If exemption is given directly, it would not be known whether a product is consumed with in the country or exported, he said. However, taxing the product and then reimbursing it does not lead to such confusion, he added. As exports or first taxed and then reimbursed, supplies to SEZs and EOU are also taxed first and then credit is given. 

4.1.2 Export Benefits to Supplier from DTA

SEZ Rules 2006 states that supplies from the Domestic Tariff Area to a Unit or Developer for their authorized operations shall be eligible for export benefits as admissible under the Foreign Trade Policy.

4.1.3 Procedure for drawback and Duty Entitlement Pass Book

SEZ Rules 2006 states that (1) The procedure for grant of drawback claims and Duty Entitlement Pass Book(DEPB) credit to a Developer or Unit shall be as under:

(a) **Drawback Claims:** The triplicate copy of the assessed Bill of Export shall be treated as the drawback claim and processed in the Customs section of the

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1 Ramesh Chandra, Secretary, Empowered Committee "The Economic Times" October 12, 2005, Page 7
Special Economic Zone and the Specified Officer shall be the disbursing authority for the said claims:

Provided that the Specified Officer shall follow the Customs and Central Excise, Duties Drawback Rules 1995, circulars and instructions made in this regard to sanction of duty drawback claims and the interest on delayed payments.

(b) Duty Entitlement Pass Book Credit: the Domestic Tariff Area Supplier or the Unit may make an application for grant of Duty Entitlement Pass Book credit for supplies from Domestic Tariff Area to a Unit or Developer or Developer in the format prescribed under the Foreign Trade Policy.

(2) A Unit or Developer shall file application for Duty Entitlement Pass Book claim with the Development Commissioner concerned or the Domestic Tariff Area supplier may claim the same from the concerned Licensing Authority of the Office of the Directorate General of Foreign Trade or the Development Commissioner concerned.

4.1.4 Exemption from Central Sales Tax On Supplies from Domestic Tariff Area:

Dealers in India supplying goods to unit in SEZ are exempt from central sales tax act. The unit in SEZ is required to furnish declaration in prescribed from I to Indian manufacturer.

The registered dealer in SEZ can obtain goods from selling registered dealer outside the zone without payment of central sales tax.
The SEZ unit can obtain goods or purpose of manufacture, trading, production, processing, assembling, repairing, reconditioning, reengineering, packaging or for use as or packing material or packing accessories.

The developer of SEZ can obtain goods for development, setting up, operation and maintenance of the zone.

The registered dealer in SEZ (developer of SEZ or SEZ unit as the case may be) should have been authorized to establish such unit in SEZ by authority specified by central government. [Section 8(6) of CST Act]

The goods that the developer of SEZ or unit in SEZ can obtain without CST shall be specified in the sales tax registration certificate of SEZ unit. [Section 8(7) of CST Act]

Thus, existing SEZ units and SEZ developers should get their sales tax registration certificate amend to include all the articles, which they intend to procure.

The purchasing dealer has to submit a declaration in prescribed from 'I'. Consequential amendment is made by inserting section 13(1)(aa) of CST Act, to authorize central government to make rules to provide form and manner of furnishing declaration u/s 8(8) of CST Act. SEZ unit or SEZ developer will supply 'I' form signed by himself. The original 'I' form should be submitted to the assessing authority. Hence, copy marked 'duplicate' may not be held as
acceptable. In such a case, supplies to unit in SEZ or the developer of SEZ will not be liable to CST.

4.1.5 Exemption under Income Tax Act 1961

The provisions of the Income Tax Act 1961 (43 of 1961), as in force for the time being, shall apply to, or in relation to, the developer or entrepreneur for carrying on the authorized operations in a SEZ or unit of SEZ subject to the modification specified in the second schedule.

*Exemption u/s 10(15)(viii) on Interest Income*

Any income by way of interest received by a non-resident or a person who is not-ordinarily resident, in India on a deposit made on or after April 1, 2005, in an Offshore Banking Unit referred to clause (ii) of section 2 of the Special Economic Zone Act 2005.

*Exemption u/s 10(34) on Dividend Income*

Any dividend income referred to in section 115-O shall not be included in the total income of the assessee, being a developer or entrepreneur.

*Exemption u/s 10A on profits of undertaking in any SEZ*

Sub section 1A of the said section contained that an undertaking which begins to manufacture or produce articles or things or computer software during the previous year relevant to any assessment year commencing on or after April 1, 2003 but before April 1, 2005 in any special economic zone, is eligible for hundred percent deduction for a period of five years and fifty percent for the next
two years followed by fifty percent of profits credited to a reserve account to be utilized for the purpose of the business, for the next three years.

No deduction u/s 10A shall be allowed to any undertaking, which begins to manufacture or produce articles or things or computer software after March 31, 2005, in any special economic zone.

**Exemption u/s 10AA on profits of new units established in SEZ**

In computing the total income of an assessee, being an entrepreneur referred in SEZ Act 2005, from his unit, who begins to manufacture or produce articles or things or provide any services during the previous year relevant to any assessment year commencing on or after the first day of April, 2005, a deduction of—

i. hundred percent of profits and gains derived from the export, of such articles or things or from services for a period of five consecutive assessment years beginning with the assessment year relevant to the previous year in which the units begins to manufacture or produce such articles or things or provide services, as the case may be, and fifty percent of such profits and gains for further five assessment years and thereafter;

ii. for the next five consecutive assessment years, so much of the amount not exceeding fifty percent of the profit as is debited to the profit and loss account of the previous year in respect of which deduction is to be allowed and credited to a Special Economic Zone Re-investment Reserve Account and utilized for the purposes of the business of assessee.
iii. the amount credited to the Special Economic Zone Re-investment Reserve Account is to be utilized (a) for the purpose of acquiring machinery or plant which is first put to use before the expiry of a period of three years following the previous year in which the reserve was credited, and (b) until the acquisition of the machinery or plant as aforesaid, for the purposes of the business of the undertaking, other than for distribution by way of dividends or profits for the remittance outside India.

iv. the particulars, as prescribed by CBDT in this behalf, have been furnished by the assessee in respect of the machinery or plant along with the return of income for the assessment year relevant to the previous year in which such plant or machinery was first put to use.

v. Where any amount credited to Special Economic Zone Re-investment reserve account, it has been used for any purpose other than those referred to clause (iii) or it has been utilized before the expiry of the period specified in clause (iii)(a).

the amount not so utilized shall be deemed to be the profit
(a) in the year in which the amount was so utilized; or
(b) in the year immediately following the period of three years and shall be charged to tax accordingly.

Where in computing the total income of the unit for any assessment year, its profits and gains had not been included by application of provision of section 10 (7B), the unit shall be entitled to deduction for the unexpired period of 10
consecutive assessment years and thereafter it shall be eligible for deduction from income under this section.

A unit, which already availed, before the commencement of the Special Economic Zone Act 2005, the deduction u/s 10A for ten consecutive assessment years, such unit shall not be eligible for deduction from income under this section.

Where a unit initially located in any free trade zone or export processing zone is subsequently located in a special economic zone by reason of conversion of such zone into a SEZ, the period of ten consecutive assessment years shall be reckoned from the assessment year relevant to the previous year in which the unit began to manufacture, or produce or process such articles or things or services in such free trade zone or export processing zone.

Tax holiday not for migrating to another SEZ

Companies seeking to extend tax holidays available by migrating from an existing export processing zone to a new special economic zone may be in for some rude shock. The government may insert a new clause in the Income tax act 1961 which would effectively state that tax holiday can not be extended by company or a unit by migrating it self. The Income tax department is concerned about the possibility of the misuse of the SEZ Act by units, simply changing their names to obtain tax concessions for fresh term of 10 years. The incentive to misuse the SEZ Act has risen after the government put incentive sections like 80HHC on the last track for closure. In other cases, a company may setup a unit
in a SEZ and gradually shift out operations from an existing tax free zone to the new zone.

**SEZ benefits for STPs**

The Prime Minister Office has said that the government should consider extending tax benefits to software technology park (STP) units at par with special economic zones. A proposal to this extent has been routed to the finance ministry through the group of empowered ministers on special economic zones. If the plan is accepted, STP units would get full income tax holiday for five years, 50% exemption for the next five years; and tax exemption of ploughed back profits for another five years. Instead of phasing out income tax sops available to STP units by 2009-10, the proposal would make these concessions available to new units for 15 years. If this suggestion is implemented, would benefits nearly 4200 units under STP scheme. These STP units account for export of nearly Rs.1,00,000 crore and their share in the country's export is estimated at 41%.

Extension of income tax benefits to STP units beyond 2009-10 would require amendment to section 10A and 10B. Since STP units have already enjoyed benefits of income tax exemption, there was a view that SEZ benefits should not flow to them they might otherwise migrate to SEZs.²

² The Economic Times, May 30, 2006, Page 9

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**Exemption of Capital Gains on transfer of assets in cases of shifting of Industrial undertaking from urban area to any Special Economic Zone u/s 54G**- Where the capital gain arises from the transfer of a capital asset, being
machinery or plant or building or land or any rights in building or land used for the purposes of the business of an industrial undertaking situate in an urban area, effected in the course of, or in consequence of the shifting of such industrial undertaking to any special economic zone, whether developed in any urban area or any other area and the assessee has within a period of one year before or three year after the date on which the transfer took place-

(a) purchased machinery or plant for the purposes of business of the industrial undertaking in the SEZ to which the said undertaking is shifted;
(b) acquire building or land or constructed building for the purposes of his business in the SEZ;
(c) shifted the original asset and transferred the establishment of such undertaking to the SEZ; and
(d) incurred expenses on such other purposes as may be specified in a scheme framed by the central government for the purposes of this section,

then, instead of the capital gain being charged to Income tax as income of the previous year in which the transfer took place, it shall, subject to the provisions of sub-section (2), be dealt with in accordance with the following provisions of this section, that is to say,-

i. if the amount of capital gain is greater than the cost and expenses incurred in relation to all or any of the purposes mentioned in clause (a) to (d) i.e. cost of new asset, the difference between the amount of the capital gain and the cost of new asset shall be charged under
section 45 as the income of the previous year and for the purpose of computing in respect of the new asset any capital gain arising from its transfer within a period of three years of its being purchased, acquired, constructed or transferred, as the case may be, the cost shall be nil; or

ii. if the amount of the capital gain is equal to, or less than, the cost of the new asset, the capital gain shall not be charged u/s 45, and for the purpose of computing in respect of the new asset, any capital gain arising from its transfer within period of three years of its being purchased, acquired, constructed or transferred, as the case may be, the cost shall be reduced by the amount of the capital gain.

Exemption u/s 10B on profits of a newly established hundred percent Export oriented undertakings

Any profits and gains derived by a hundred percent Exported-oriented undertaking is allowed as deduction in the total income of the undertaking for any ten consecutive assessment years beginning with the assessment year relevant to the previous year in which the undertaking begins to manufacture or produce articles or things or computer software. However, no deduction under this section shall be allowed to an assessee who does not furnish a return of his income on or before the due date specified u/s 139(1).
Deduction in respect of profits and gains of an undertaking or enterprise engaged in development of SEZ u/s 80IA

An undertaking which develops and operates or maintains and operates an Industrial park or Special Economic Zone during April 1, 1997 and March 31, 2005, 100% of profits is deductible for 10 years commencing from initial assessment year which means the assessment year specified by the assessee at his option to be the initial year not falling beyond the fifteenth assessment year starting from the previous year in which the undertaking begins operating or developing the special economic zone.

Deduction in respect of profits and gains by an undertaking or enterprise engaged in development of SEZ u/s 80IAB

Where the gross total income of an assessee, being a developer, includes any profits and gains derived by an undertaking or an enterprise from any business of developing a SEZ, notified on or after April 1, 2005 under SEZ Act 2005, there shall, in accordance with and subject to the provisions of this section, be allowed, in computing the total income of the assessee, a deduction of an amount equal to 100% of the profits and gains derived from such business for ten consecutive assessment years.

The deduction, at the option of the assessee, be claimed by him for any ten consecutive assessment years out of fifteen years beginning from the year in which a SEZ has been notified by the central government.
Where in computing the total income of any undertaking, being a developer, for any assessment year, its profits and gains had not been included by application of section 80IA, the undertaking being the developer shall be entitled to deduction under this section only for the unexpired period of ten consecutive assessment years and there after it shall be eligible for deduction from income under this section.

Where an undertaking, being a developer who develops a SEZ on or after April 1, 2005 and transfers the operation and maintenance of such SEZ to another developer, this deduction shall be allowed to such transferee developer for the remaining period in the ten consecutive assessment years as if the operation and maintenance were not so transferred to the transferee developer.

**Deductions in respect of certain incomes of Offshore Banking Units and International Financial Services Centre u/s 80LA**

Where the gross total income of an assessee,-

i. being a scheduled bank, or, any bank incorporated by or under the laws of a country outside India; and having an offshore banking unit in a SEZ; or

ii. being a unit of an International Finance Services Centre, includes any income, there shall be allowed, in accordance with and subject to the provisions of this section, a deduction from such income, of an amount equal to-

(a) 100% or such income for five consecutive assessment years beginning with the assessment year relevant to the previous year in which the
permission, u/s 23(1)(a) of the Banking Regulation Act, 1949 or permission or registration under the Securities and Exchange Board of India Act, 1972 or any other relevant law was obtained, and thereafter;

(b) 50% of such income for five consecutive assessment years.

The term income means

i. from an Offshore Banking Unit in a SEZ; or

ii. from the business referred u/s 6(1) of the Banking Regulation Act 1949 with an undertaking located in a SEZ or any other undertaking which develops, develops and operates, or develops, operates and maintains a SEZ; or

iii. from any unit of the International Finance Services Centre from its business for which it has been approved for setting up in such a centre in a SEZ.

Relaxation for application of section 115JB

The provisions of this section shall not apply to the income accrued or arising on or after April 1, 2005 from any business carried on, or services rendered, by an entrepreneur or a developer, in a unit or SEZ, as the case may be.

Relief from dividend tax u/s 115-O(6)

No tax on distributed profits shall be chargeable in respect of the total income of an undertaking or enterprise engaged in developing or developing and operating or developing, operating and maintaining a SEZ for any assessment year on any amount declared, distributed or paid by such developer or enterprise, by way of
dividends on or after April 1, 2005 out of its current income either in the hands of the developer or enterprise or the person receiving such dividend not falling u/s 10(23G).

Relief from TDS u/s 197A (1D)

The Offshore Banking Unit shall make no deduction of tax from the interest paid-

(a) on deposit made on or after April 1, 2005, by a non-resident or a person not ordinarily resident in India; or

(b) on borrowing, on or after April 1, 2005, from non-resident or a person not ordinarily resident in India.

4.1.5 Relaxations to SEZ under FEMA

Foreign Direct Investment (FDI)

5 FDI up to 100% is allowed through to automatic route for all manufacturing activities in special economic zones, except for the following activities:

(a) arms and ammunition, explosives and allied items of defence equipments, defence aircraft and warships;

(b) atomic substances;

(c) narcotics and psychotropic substances and hazardous chemicals;

(d) distillation and brewing of alcoholic drinks; and

(e) Cigarettes/ cigars and manufactured tobacco substitutes.

6 SEZ unit may issue equity shares against capital goods supplied by non-residents. Committee consisting of Development Commissioner and Custom Officials should verify valuation. Details in Form- FCGPR should be
submitted to the regional office of RBI. However, 100% FDI in trading activity will not be permitted.

7 SEZ units may manufacture articles reserved for small scale industry if foreign equity exceeds 24% for which no license is required.

**No time limit for receipt of export proceeds**

Generally, export proceeds should be received in India within 6 months (12 months in case of status holders). However, in case of SEZ units exporting goods or software, the time limit for receipt of full export value of goods or software do not apply.

**Supply to EOU/SEZ units in foreign exchange**

The SEZ unit may supply to EOU/SEZ unit and may obtain payment in foreign exchange. The units may also sale to DTA in foreign exchange if concerned authorities permit.

**Branch office in SEZ by a person resident outside India**

Any branch office may be established in SEZ to undertake manufacturing and service activities, without permission of RBI in those sectors where 100% FDI is permitted. Such unit shall function on stand alone basis, however, it should not carry on business of SEZ.
Payment of SEZ by DTA unit in foreign exchange

A SEZ/EOU/STP/EHTP/BTP may supply goods to any unit of Domestic Tariff Area. In such a case, the DTA unit can pay for the goods in foreign exchange, for which foreign exchange can be released by the authorized dealers.

Foreign Currency Account

Every unit located in Special Economic Zone may open/ hold and maintain a foreign currency account with authorized dealer in India. All foreign exchange funds received by SEZ are credited in this account. However, foreign exchange purchased in India against Rupees can not be credited in this account without permission of RBI. The accounted funds may be used for any bonafide trade transactions with person resident in India or otherwise i.e. NRI. The money in this account is exempt from all restrictions except that gifts and donations exceeding $5,000 per remitter or donor per annum. The dispatch of export documents by a SEZ unit directly to consignee outside India need not be routed through authorized dealer. However, remittance should be obtained and GR/SDF form should be submitted to authorize dealer within 21 days. Provisions in respect of EEFC account are not applicable to units in SEZ.

Netting off by SEZ units

Where a SEZ unit may have transactions of import and also export with the same foreign customer, the exporter may 'net off' export receivables against import payments. The transactions should be between same two properties and there should be proper documentation.
Job work abroad and export of goods

A SEZ unit may undertake job work abroad and export goods from that country itself. The exporter has to make satisfactory arrangement for realization of full export proceeds subject to GR procedure.

Foreign Exchange derivative contracts

A SEZ unit may enter into contract in commodity exchange or market outside India to hedge the price risk in the commodity on export/import, without prior approval of RBI. It should be on 'stand alone' basis i.e. if SEZ unit is completely isolated from financial contracts with its parent or subsidiary outside the SEZ, as far as import/export transactions are concerned.

External Commercial Borrowing by SEZ

A SEZ unit may raise external commercial borrowings even if maturity period is less than three years on 'stand alone' basis, i.e. they should be isolated from financial contracts with their subsidiaries or parent company in the mainland or within SEZs. There would be annual cap of $ 500 million for unit in SEZ. This will be treated as external debt of India. The SEZ unit shall raise external commercial borrowings for its own requirements and borrowed funds shall not be transferred to its sister concern or any other unit in domestic tariff area.

Technical Collaboration Agreement

Foreign Technological Agreements are permitted in any industry to promote technological dynamism in Indian industry. The prescribed limit for royalty is:
- Lump-sum payment up to $2 million plus 5% royalty on domestic sales and 8% on export sales. However, total royalty paid, including lump-sum payment, should not exceed 8% of sales over a period of ten years from date of agreement or seven years from commencement of production. The royalty percentage should be calculated on sale price net of excise duty and taxes as per standard conditions prescribed. The payment of royalty is subject to TDS.

- Royalty up to 2% for exports and 1% for domestic sale is allowed on use of trademark and brand names without any technology transfer. The royalty should be calculated on net sales \( \text{Gross sales} - (\text{dealers' commission} + \text{transport costs} + \text{insurance} + \text{taxes and duties} + \text{other charges} + \text{cost of raw materials, parts, components imported from the foreign licensor or its subsidiary/ affiliated company}) \).

- Lump-sum fee up to $2,000,000 plus franchising and marketing/ publicity support up to 3% of gross room sales for hotel and tourism industry. If the foreign investor puts in at least 25% of the equity, management fees up to 10% of the foreign exchange earnings is permitted. This will include payment for marketing and publicity support.

In above cases, RBI will grant automatic approval within two weeks of submission of application in form FT to concerned regional offices of RBI.

In case of composite proposals for foreign investment and technology transfer, application should be made to central office of RBI in form FC.
If foreign technology agreement does not meet the aforesaid parameters, approval will be granted to each case on merits, for which application should be submitted to approval board.

Government expects that the foreign collaboration agreement should contain the following terms and conditions:

- exports to all countries should be permitted;
- agreement should provide for training of Indian personnel and sharing of research and development facilities;
- collaboration agreement should be subject to Indian laws;
- There should be no condition for payment of minimum royalty.

**SEZ rush likely to hit indirect tax reforms**

The Special Economic Zone mania could dampen the indirect tax reforms. Faced with the prospect of potentially huge revenue losses due to plethora of SEZs, developing across the country, the finance ministry may re-draw its indirect tax rationalization plans. The ambitious plans to migrate to comprehensive goods and service tax by 2010 could come under scanner. The plans to share service tax revenue with states under the compensation package for value added tax will also become difficult to implement. This would mean bad news for the corporate sector, as they have been damouring for a simplified and reduced indirect tax platform to make their goods and services competitive in the international market.

The empowered committee of state ministers will be meeting finance ministry officials to work out a list of services that will be taxed only by the states.
The growth rate in excise taxes has been showing over the decrease over the past five years. This has been compensated to a large extent by a robust growth in the service tax corpus. For instance, while excise duty was expected to touch Rs.1,21,533 crore as per the budget estimates for 2005-06, it managed only Rs.1,12,000 crore. The estimates for 2006-07 is only Rs.1,19,000 crore. If a large number of industries migrate to SEZs, the range of tax exemptions would hit the growth in excise duty even more. A recent study by NIPFP has also suggested that instead of encouraging of new units, the tax exemption regime for SEZs is promoting even existing companies to switch operations. The expending number of SEZs could also distort land, capital and labour costs. It would also encourage industries located in Domestic Tariff Areas to migrate to SEZs. The finance ministry may therefore have to do a rethink on its plans to reduce the level of excise duties from the median level of 16% for alleging it with the GST rate. The earlier assumption was to make up the loss through higher direct tax receipts, which would mean removing exemptions and tax incentives3.

4.1.6 Relaxations to SEZ by State Government

The Special Economic Zones Rule 6(5) clears that before recommending and proposal for setting up of a SEZ, the state government shall endeavour that the following are made available in the state to the proposed SEZs and developer, namely:

(a) exemption form the state and local taxes, levies and duties, including stamp duty, and taxes levied by local bodies on goods required for

3 The Economic Times, June 26, 2006, Page 7
authorized operations by a unit or developer, and the goods sold by a unit in the Domestic Tariff Area except the goods procured from Domestic Tariff Area and sold as it is;
(b) exemption from electricity duty or taxes on sale of self generated or purchased electric power for use in the processing area of a SEZ;
(c) allow generation, transmission and distribution of power within a SEZ subject to the provisions of the Electricity Act, 2003;
(d) providing water, electricity and such other services, as may be required by the developer be provided or caused to be provided;
(e) delegation of power to the Development Commissioner under the Industrial Disputes Act, 1947 and other related Acts in relation to the units;
(f) delegation of power to the Development Commissioner under the Industrial Disputes Act, 1947 in relation to the workmen employed by the developer;
(g) delegation of the SEZ as a public utility service under the Industrial Disputes Act, 1947;
(h) Provide single point clearance system to the developer and unit under the State Acts and rules.

The State government shall, while recommending the proposal for setting up of SEZ to the board indicate whether the proposed area falls under reserved or ecologically fragile area as may be specified by the concerned authority.
4.2 Area Requirement of Special Economic Zones Section 3(8)(a)

The minimum area of land and other terms and conditions subject to which the board shall approve, modify or reject any proposal received by it. Different minimum area of land and other terms and conditions may be prescribed by the central government for a class or classes of Special Economic Zones.

(a) Multi-Product Special Economic Zone shall have a contiguous area of one thousand hectares or more.

Services Provider Special Economic Zone may have a contiguous area of one hundred hectares or more.

Special Economic Zone which is proposed to be set up in Assam, Meghalaya, Nagaland, Arunachal Pradesh, Mizoram, Manipur, Tripura, Himachal Pradesh, Uttarakhand, Sikkim, Jammu and Kashmir, Goa or in a union territory, the area shall be two hundred hectares or more.

At least 50% of the area shall be earmarked for developing processing area.

The fulfillment of the requirement of the contiguous area shall be considered and decided by the board on a case-to-case basis on merits.

(b) A Special Economic Zone for a specific sector or in a port or airport, shall have a contiguous area of one hundred hectares or more.

A Special Economic Zone is proposed to set up exclusively for electronics hardware and software, including information technology enabled services, the area shall be ten hectares or more with a minimum built up processing area of one lakh square metres.
A Special Economic Zone is proposed to be set up exclusively for biotechnology, non-conventional energy, including solar energy equipments/cell, or gem and jewellery sectors, the area shall be ten hectares or more.

A Special Economic Zone for a specific sector is proposed to be set up in Assam, Meghalaya, Nagaland, Arunachal Pradesh, Mizoram, Manipur, Tripura, Himachal Pradesh, Uttarakhand, Sikkim, Jammu and Kashmir, Goa or in a union territory, the area shall be fifty hectares or more for the Special Economic Zones.

At least fifty percent of the area shall be earmarked for developing processing area.

(c) Special Economic Zone for free trade and warehousing shall have an Area of forty hectares or more with a built up area of not less than one lakh squire metres.

A free trade and warehousing zones may also be set up as part of a Special Economic Zone for multi-products.

A Special Economic Zone for a specific sector, free trade and warehousing zone may be permitted with no minimum area requirement but subject to the condition that the maximum area of such free trade and warehousing zone shall not exceed twenty percent of the processing area.

**Area limit for SEZs to deter profiteers**

The government is likely to standardize the minimum area threshold level for SEZs to weed out small non-serious players who have tagged alone to take
advantage of the huge tax waivers. And it is not just about serious investors- the
government is also looking at creating balanced approach in the development of
SEZs by limiting the maximum number of SEZs that can be sustained in a
particular region or state given the infrastructure, demand and accessibility. State
government has already begun rejecting some proposals based on these
considerations.

The government rethinks on these minimum area stipulations could for stance
have an impact on the IT SEZs, which were among those, that could be setup
even on a 10-hectare area. The proposal for introducing standardizes norms,
which would have to come in the form of amendment, could disqualify some of
the current applicants. The move is likely to come as a dampner to the real
estate industry, which has been making a beeline for the SEZs thanks to the
huge arbitrage.

Approvals have been granted from 10 acres to 1000 acres. It is argued that
special allowances for smaller SEZs were given only for specific cases like
exclusively for electronic, hardware or IT enabled services or in the northeastern
area. It is being argued that quality infrastructure can be built only where there is
a scope for scale No scale of infrastructural development can the achieved on a
10 acre land. The scheme was conceived with an objective of creating state of
the art facilities. Although there is no confirmation, industry sources have it that
the government may introduce the minimum threshold level to form the current
position, around 25 hectares. This is to discourage bits and pieces real estate
players in the market. Also in the offing is coming out with stricter guidelines for development of each SEZ and gives each SEZ a scale. This would necessitate that there were few SEZs in a state and ensure that overcrowding does not make each of them unviable.

The commerce and Industry ministry has strongly defended the package of incentives provided for investment in special economic zones. The revenue department, which is now opposing smaller special economic zones for IT sector, had approved several projects, which are much smaller. The ministry has come to the rescue of India INC’s SEZ dreams and a point-by-point rebuttal of revenue department’s allegations would be provided to the group of ministers on SEZs in case the committee is reconstituted. The move has come to a major relief to Indian industry since than various SEZ projects are in the pipeline in this includes top corporates of India. The revenue department had notified clearance for SEZ at various places where the area covered was just 16 acres or slightly more. Now the revenue department wants that the minimum size of IT SEZ should be 61.75 acres (25 hectares) and the floor level for sector specific SEZs should be 247 acres (100 hectares). The revenue department had also notified a gem and jewellery SEZ with an area of just 5 acres. The current stand of the department is, therefore, seen as a contradiction of the earlier position of revenue department officials. Such flip-flop in policy would only discourage India INC’s investment plans. The final words on the issue of area of SEZs would be known only after the group of ministers on SEZs is reconstituted.

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4 The Economic Times April 21, 2006, Page 11
The finance ministry has been insisting in the meeting of group of ministers that minimum area specified for sector specific SEZs - like those proposed by the IT sector and the gems and jewellery industry - should be increased by 25 hectares as compared to 10 hectares prescribed under SEZ rules.

The commerce and industry ministry intention is that increase in the minimum area stipulation would cause hardship to promoters of SEZs, which have already been approved by the government. Developers of these SEZs would have already taken steps to implement the project on the basis of government approval and they could face financial loses. This makes it clear that retrospective changes in the minimum area stipulation would be harmful to the industry while the option of prospective changes is open for discussion.

The commerce and industry ministry argued that an increase in the minimum area requirement would have an impact on proposals that had been approved for setting up the SEZs before the rules came into force. It would also impinge on many of the proposals considered by the board of approval. It has also been pointed out that the SEZ rules have tried to streamline clearances by prescribing minimum area for various categories. The earlier rules did not have any stipulation.

The IT SEZ charade

The group of ministers is debating squire footing and classification of cities to determine the entry norms of IT SEZs. On the other hand an IT SEZ is really a

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5 The Economic Times, May 5, 2006, Page 9
real estate charade. On one hand we have a powerful real estate lobby pushing IT SEZ and Nasscom, pushing the cause for the smaller IT companies while the government does a flip-flop every month. Is this going to undermine the competitive advantage of a large number of IT companies? How big are the stakes from a real estate point of view? In simple terms, the SEZ policy essentially exempts the developers of the SEZ from taxes. It also exempts the occupier of the property from taxes on exports. Both the developer and occupier enjoy the tax break for over 15 years starting from 100% exemption and progressively going down in block of 5 years. To elaborate, the developer has tax-exempt profits on development of the IT park and there after the rental income he receives from the occupier for 15 years! The large slurp that you hear is the chorus from real estate developers and real estate investors! Now let us quantify the value of this tax break from a real estate point of view to answer the first question that we raised. To compute the value of tax break we are relying on publicly available data from the leading IT companies like Infosys, TCS, simply because the data is reliable and these companies operate with exceptional corporate governance. Here is the methodology. On a general assumption, that an employee occupies an average 100 sq. feet, we can workout the profits before tax per square fit (PSF) generated by these companies. Hence the PBT PSF per annum for each of these companies is as under: Infosys: Rs.5,167 and TCS: Rs.4,893Let us say the average profit before tax is Rs.5,000 per square fit per annum.
Since the SEZ policy exempts taxes simply because the company operates from a SEZ building versus a non-SEZ building, the tax break works out to Rs.1,690 per squire fit per annum or Rs.140 PSF per month i.e. 33.6% corporate tax including surcharge on the average PBT of Rs.5,000 per squire fit. This tax break is not available from a building right outside the SEZ compound. If one compares the average IT park rental in the country of around Rs.35 PSF per month, against the above tax break of Rs.140 PSF per month, no sensible company would have a desire to operate from a non-SEZ property. In other words, even if a company pays Rs.100 per squire fit in an SEZ building, it would still be more profitable than another paying Rs.35 from a non-SEZ building. Nothing can be more ridiculous.

Since large IT companies like Infosys get the SEZ status for their campus they will not be affected. Commercial interest will ensure that other SEZ developers will prefer the big IT companies and MNCs as tenant. It is the smaller companies who will pay the price since they will be denied the present STP policy benefits and would also be on the last priority of SEZ developers to rent out space.

Where is the real estate charade in this?

Well, development profits of residential and other commercial space are also exempt from tax in an SEZ! So in a 50 acre SEZ, the 'non processing area', which is 60% of the space for other uses, is also tax-free! That's why every dude who has a piece of land wants to setup an SEZ! And here is the twist in the tale. The government is now thinking of limiting the number of SEZ i.e. those who stood first in the queue! This will further skew the supply, result in profiteering by
the few who get the SEZ approval and adversely affect a large number of IT companies. Since the government has accepted the tax write off, the simpler solution, is to extend the STP so far as IT parks are concerned and keep a level-playing field between the big boys and the smaller companies. As for investors, they would of course not pass up a gift horse and focus on investing in IT SEZs! But then, the real estate industry has had few favourable policy initiatives and for long has been used to shabby treatment from the government and monetary policy despite being a key driver for economic growth⁶.

The opposition parties in the centre submitted a memorandum to president of India on the issue of SEZ, branding it a 'real estate scandal with the aim to rob farmers of their fertile land, it has nothing to do with export promotion and foreign capital in flow. Even on theoretical basis, SEZ Act is a heavy burden on our economy⁷.

**SEZ processing area limited to 50% of the land size**

The government of India has decided to allow 50% of total area to special economic zones to be used for non-export activities such as schools, hospitals, banks, housing and entertainment. The board of approvals, which clears SEZ applications, has been authorized to allow this concession in case of multi product SEZs. The IT sector has also been provided a major relief by scrapping the minimum employment criteria stipulated earlier by the prime minister office.

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⁷ Sharad Yadav, The Economic Times, September 26, 2006, Page 3
Minimum generation of 10,000 jobs was recommended by PMO in the case of IT SEZs coming up in mega cities. While reduction of ‘processing area’ or export production facilities to 25% of multi product SEZs will benefits big players like Reliance, scrapping of the employment criteria for IT SEZs will provide relief to leading companies like Infosys and Wipro. The board of approval has been informed that it could clear minimum processing area of 50% for multi product SEZs. The lower processing area threshold, however, is to be allowed only case-to-case basis. The board has been told that the reasons for allowing lower processing area are too recorded in writing. The flexibility will allow SEZ developers like Reliance, DLF and Unitech to go in for large scale plans for developing airports, cargo handling facilities and other support infrastructure for export activities. All the same time, they would get more land area for developing schools, entertainment facilities, hotels and housing facilities for SEZ employees. However, there is some apprehension that an SEZ developer may misuse the land and turn it into a real estate project, hence the government may come out with a working model on how SEZ developers can use the non processing area within the SEZ for setting up social infrastructure.

**Land acquisition by States for SEZs**

The compulsory acquisition of land for SEZs by States under the Land Acquisition Act would not be allowed, leaving it to the developers to directly purchase land from farmers. States would be empowered to reduce the size of SEZs below the 5,000-hectare limit set by the Centre.
Use of barren land for SEZs

Land acquired for SEZs should primarily be waste or barren land. Agricultural land may be acquired only if necessary to meet the necessary minimum area requirements. Only single crop agricultural land should be acquired for the SEZs, if perforce a portion of double cropped agricultural land has to be acquired, the same should not exceed 10% of the total land required for the SEZ.

Rehabilitation of SEZ project affected families

The Rural Development Ministry has come up with a draft National Policy for Resettlement & Rehabilitation (NPRR) of project affected families, 2006, to replace the NPRR, 2003. It is mandatory to make it effective, unlike the existing policy, which is not binding. Any developer planning to undertake a project which involves physical displacement of 400 or more families in plain areas or 200 or more families in tribal or hilly areas will have to prepare a Social Impact Assessment (SIA) report in the proforma to be prescribed simultaneously with the Environmental Impact Assessment (EIA) report and submit it to the agency prescribed. At least one member of a displaced family would have to be employed in the project. This would be in addition to the compensation paid to the farmers.8

Displaced May land stake in SEZ projects

"Corporate may have to provide equity stake to SEZ projects to the local population displaced due to land acquisition. Compensation for such people will

8 The Economic Times, October 4, 2006, Page 1
have to be minimum agricultural wages for 750 days. If land is acquired by a company, not by State Government, the promoters also have to give a stake to the displaced people equal to 20% of the total compensation." These proposals are being discussed for inclusion in the revised rehabilitation and resettlement policy (R&R policy), which is likely to be considered by the cabinet. A new policy has been proposed to improve the compensation component for families displaced by any project. This has also become important in the wake of stiff resistance to projects, especially SEZs, acquiring large chunks of agricultural land. The land acquiring agency, whether a corporate entity or a government agency, would have to try to compensate the displaced family or individual by providing adequate land for farming and bear the entire cost of relocation. If the displaced family has lost jobs, they would have to offer employment to one member of a nuclear family subject to availability. If the company concerned is unable to offer agricultural land in lieu of the land acquired by it, minimum agricultural wage for 750 days has to be paid in addition to normal compensation for the acquired land. In addition, shares at par worth 20% of the wage would be offered to displace families if land is bought by a company rather than being acquired by State Government. However, States would have freedom to offer a better package promised in their own R&R, Policy. In order to make the rehabilitation process more equitable, landless workers would get first preference for work involving construction of the industrial facilities or SEZs. The land acquiring entity would also provide grant of Rs.10,000 per hectare for land development if the displaced family is provided waste land.
Socio-economic impact of SEZ on people

Land acquired by SEZ displaced the farmers and other villagers. Displacement usually shatters social-economic, cultural and physical linkage of the people. These upheavals and disintegrations of firmly settled communities will indeed create problems of resettlement and readjustment. It wants all the concerned to recognize and acknowledge the right of information of local population as majority of the villagers, including the panchayat members, are unaware about the nature and character of the proposed project. Displacement is not restricted only to the inhabitants with their own agricultural land in the villages but extends equally to the dependents on the system. All these equally affected and get deprived directly or indirectly of their means livelihood. The relief and rehabilitation plan should include these groups of people. Since many of project affected people may not have dealt with big cash amount, the villagers should be given appropriate ‘Money Management Training and their money should be invested to give permanent and reliable return’9.

4.3 Other Facilities

4.3.1 Facility of Single Window Clearance

It is expected that all permissions and approvals required to set up and run a unit both by Central government and State government shall be given at one place under ‘Single Window Clearance Scheme.’ The approvals will be granted by ‘Board of Approval’ and procedure for establishment of unit is given in SEZ Rules, 2006:

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9 Study report of ‘Tata Institute of Social Sciences’ Published in The Economic Times, Page 8, June 6, 2007
Proposal for approval of Unit –

(1) A consolidated application seeking permission for setting up of a Unit and other clearances, including those indicated below, shall be made to the Development Commissioner, in Form F, in five copies, with a copy to the Developer:-

(a) Setting up of unit in a Special Economic Zone;
(b) Annual permission for sub-contracting;
(c) Allotment of Importer-Exporter Code number;
(d) Allotment of land/industrial sheds in the Special Economic Zone;
(e) Water connection;
(f) Registration-cum-Membership Certificate;
(g) Small Scale Industries Registration;
(h) Registration with Central Pollution Control Board;
(i) Power connection;
(j) Building approval plan;
(k) Sales tax registration;
(l) Approval from inspectorate of factories;
(m) Pollution control clearance, wherever required;
(n) Any other approval as may be required from the State Government.

(2) The Development Commissioner shall get the proposal scrutinised and get it placed before the Approval Committee for its consideration.
(3) The proposals received under clauses (c) and (e) of section 9(2) shall be placed before the Board by the Development Commissioner for its consideration.

Consideration of proposals for setting up of Unit in a Special Economic Zone -

(1) The Approval Committee may approve or approve with modification or reject a proposal placed before it under sub-rule (2) of rule 17, within fifteen days of its receipt:

Provided that where the approval is to be granted by the Board in terms of sub-rule (3) of rule 17, the Board shall approve or approve with modification or reject such proposal with in forty-five days of its receipt:

Provided further that the Approval Committee or the Board, as the case may be, shall record the reasons, in writing, where it approves a proposal with modifications or where it rejects a proposal and Development Commissioner by order shall communicate such reasons to the person making the proposal.

(2) The Approval Committee shall approve the proposal if it fulfills the following requirements, namely: -

(i) the proposal meets with the positive net foreign exchange earning requirement as provided in rule 53;

(ii) availability of space and other infrastructure support applied for, is confirmed by the Developer in writing, by way of a provisional offer of space;
Provided that the Developer shall enter into a lease agreement and give possession of the space in the Special Economic Zone to the entrepreneur only after the issuance of Letter of Approval by the Development Commissioner:

Provided further that a copy of the registered lease deed shall be furnished to the Development Commissioner concerned within six months from the issuance of the Letter of Approval;

(iii) the applicant undertakes to fulfill the environmental and pollution control norms, as may be applicable;

(iv) the applicant submits proof of residence, namely, passport or ration card or driving license or voter identity card or any other proof of the proprietor or the partners of partnership firms or Directors of the Company, as the case may be, to the satisfaction of Development Commissioner;

(v) the applicant submits the Income tax returns, along with annexure, of the Proprietor or Partners, or in the case of a company, audited balance sheet for the last three years.

(3) the proposal shall also fulfill the following sector specific requirements, namely:-

(a) export of high-grade iron ore that is sixty-four per cent. Fe and above, except iron ore of Goa origin and Redi origin, which would be subject to approval of Board;
(b) no sub-contracting or job work of polyester yarn shall be permitted in Domestic Tariff Area or in Export Oriented Unit or Units in other Special Economic Zone:

Provided that this restriction shall not apply to the Units which intend to send the fabric, made by them out of polyester or texturised yarn, for subcontracting but the third party exports shall not be permitted:

(4) No proposal shall be considered for:-
(a) recycling of plastic scrap or waste:
Provided that extension of Letter of Approval for the Board shall decide an existing Unit;
(b) enhancement of the approved import quantum of plastic waste and scrap beyond the average annual import quantum of the unit since its commencement of operation to the existing Units;
(c) reprocessing of garments or used clothing or secondary textiles materials and other recyclable textile materials into clipping or rags or industrial wipers or shoddy wool or yarn or blankets or shawls:
Provided that extension of Letter of Approval for an existing Unit shall be decided by the Board;
(d) import of other used goods for recycling,
Provided that extension of Letter of Approval for an existing Unit shall be decided by the Board;
Provided further that reconditioning, repair and reengineering may be permitted subject to the condition that exports shall have one to one correlation with imports and all the reconditioned or repaired or re-engineered products and scrap or remnants or waste shall be exported and none of these goods shall be allowed to be sold in the Domestic Tariff Area or destroyed;

(e) Export of Special Chemicals, Organisms, Materials, Equipment and Technologies unless it fulfils the conditions indicated in the Import Trade Control (Harmonized System) Classifications of export and import items;

(f) if there is any instance of violation of law or public policy by the promoters, having a bearing on the merits of the proposal.

(5) The Units in Free Trade and Warehousing Zones or units in Free Trade and Warehousing Zone set up in other Special Economic Zone, shall be allowed to hold the goods on account of the foreign supplier for dispatches as per the owner's instructions and shall be allowed for trading with or without labeling, packing or repacking without any processing:

Provided that refrigeration for the purpose of storage and assembly of Completely Knocked Down or Semi Knocked Down kits shall also be allowed by the Free Trade and Warehousing units undertaking the said activities:

Provided further that these Units may also re-sell or re-invoice or re-export the goods imported by them:
Provided also that all transactions by a Unit in Free Trade and Warehousing Zone shall only be in convertible foreign currency;

(6) Units may also be setup for providing services or manufacturing services to Overseas Entities subject to following conditions, namely:-

(a) Capital goods, raw materials including consumables sub-assemblies, components, semi-finished goods shall be supplied by the Overseas Entity free of cost;

(b) Capital goods for setting up such facilities may also be supplied on loan or lease basis, provided the notional value of such capital goods shall be taken into account for calculation of Net Foreign Exchange Earnings under rule 53.

(c) finished goods shall be exported out of the country or transferred to the Customs Bonded Warehouse to be maintained by the overseas entity; Provided that any supplies of finished goods shall be as per the instructions of the Overseas entity.

(d) the Unit shall receive the consideration for its manufacturing services in convertible foreign exchange directly from the said overseas entity;

(e) in case the said manufacturing facility is used by the Unit for carrying out production on its own account, separate accounts shall be maintained for the manufacturing and service activity.

Explanation: - “Overseas Entity” means a non-resident or a person of foreign origin and includes a company not incorporated in India.
Letter of Approval to a Unit-

(1) On approval of a proposal under rule 18 and 19, Development Commissioner shall issue a Letter of Approval in Form G, for setting up of the Unit:

(2) The Letter of Approval shall specify the items of manufacture or particulars of service activity, including trading or warehousing, projected annual export and Net Foreign Exchange Earning for the first five years of operations, limitations, if any on Domestic Tariff Area sale of finished goods, by-products and rejects and other terms and conditions, if any, stipulated by the Board or Approval Committee:

Provided that the Approval Committee may also approve proposal for broad banding, diversification, enhancement of capacity of production, change in the items of manufacture or service activity, if it meets the requirements of rule 18.

Provided further that the Approval Committee may also approve change of the entrepreneur of an approved unit, if the incoming entrepreneur undertakes to take over the assets and liabilities of the existing Unit.

(3) An entrepreneur holding Letter of Approval issued under sub-rule (1) shall only be entitled to set up a Unit in processing area of the Special Economic Zone or Free Trade and Warehousing Zone, as the case may be:

Provided that a proposal for setting up of a Unit in a Special Economic Zone or Free Trade Warehousing Zone shall be entertained only after the processing
area of the Special Economic Zone or Free Trade Warehousing Zone has been
demarcated under rule 11.

(4) The Letter of Approval shall be valid for one year within which period the Unit
shall commence production or service or trading or Free Trade and Warehousing
activity and the Unit shall intimate date of commencement of production or
activity to Development Commissioner:

Provided that upon a request by the entrepreneur, further extension may be
granted by the Development Commissioner for valid reasons to be recorded in
writing for a further period not exceeding two years:

Provided further that the Development Commissioner may grant further
extension of one year subject to the condition that two-thirds of activities
including construction, relating to the setting up of the Unit is complete and a
chartered engineer's certificate to this effect is submitted by the entrepreneur.

(5) If the Unit has not commenced production or service activity within the validity
period or the extended validity period under sub-rule (4), the Letter of Approval
shall be deemed to have been lapsed with effect from the date on which its
validity expired.

(6) The Letter of Approval shall be valid for five years from the date of
Commencement of production or service activity and it shall be construed as a
license for all purposes related to authorized operations, and, after the
completion of five years from the date of commencement of production, the
Development Commissioner may, at the request of the Unit, extend validity of the Letter of Approval for a further period of five years, at a time.

(7) If an enterprise is operating both as a Domestic Tariff Area unit as well as a Special Economic Zone Unit, it shall have two distinct identities with separate books of accounts, but it shall not be necessary for the Special Economic Zone unit to be a separate legal entity:

Provided that foreign companies can also set up manufacturing units as their branch operations in the Special Economic Zones in accordance with the provisions of Foreign Exchange Management (Foreign exchange derivatives contracts) Regulations, 2000.

IT must create jobs to get SEZ status
In a significant policy intervention that could settle the ongoing dispute over IT sector SEZs, prime minister has said that employment generation would be a key eligibility criterion for approving new IT SEZs. The move provides a new twist to the tussle between the commerce and industry and the finance ministries over the minimum area requirement for IT sector SEZs. The combination of employment generation and minimum built area was recommended by planning commission and endorsed by PMO. It includes creation of at least 10,000 jobs and minimum built up area of 1 million sq.ft. for setting IT SEZs in mega cities, generation of 5,000 jobs and built up area 5,00,000 sq.ft. in medium cities and 2,500 jobs plus minimum built up area of 2,50,000 sq. ft. in smaller towns. Essentially, all new IT SEZs would have to create their minimum quota of jobs
before they start enjoying tax benefits available under the SEZ package. According to study commissioned by the department of information technology, it is also beneficial for existing Software Technology Parks and Electronic Hardware Technology Parks. As of now, IT sector SEZs need to have at least 10 hectares of land. The finance ministry has been demanding that this minimum area criterion should be increased to 25 hectares along with one lakh sq. meters of built up area.\textsuperscript{10}

**Administrative Control of Special Economic Zones**- Every Special Economic Zone shall be under the administrative control of a Development Commissioner appointed under sub-section (1) of section 11.

**Offshore Banking Unit**-

(1) The application for setting up and operation of Offshore Banking Unit in Special Economic Zone shall be made to the Reserve Bank of India in the Form VI prescribed under Banking Regulation (Companies) Rules, 1949 under section 23 of the Banking Regulation Act, 1949.

(2) The terms and conditions subject to which an Offshore Banking Unit may be set up and operated in a Special Economic Zone shall be as specified in the Notification number FEMA 71/2002-RB dated 7\textsuperscript{th} September, 2002 by the Reserve Bank of India, as amended from time to time.

\textsuperscript{10} The Economic Times, May 10, 2006, Page 11
4.3.2 Facility of Single Agency System

Central Government can appoint any officer to carry out survey or inspection for securing compliance with provisions of various central Act. (Section 20 of SEZ Act 2005)

**Special agency to deal with criminal offences and civil disputes**

It is proposed to deal with notified criminal offences in SEZ by a single enforcement officer or agency u/s 21 of SEZ Act 2005. Special Courts are proposed to be set up to try all suits of civil nature in SEZ and to try notified offences in SEZ. (Section 23 of SEZ Act 2005)

These sections have not brought into force. However, Section 42(1) of SEZ Act 2005 provides that any dispute of civil nature arising between entrepreneurs of units or developer and entrepreneur of SEZ shall be compulsorily referred to arbitration. Arbitrator will be appointed by Central Government. [Section 42(3) of SEZ Act 2005] These provisions will not apply if a dispute is referred to designated court proposed to be set up u/s 23 of the SEZ Act, 2005.

4.4 Special Economic Zones and Labour Laws

**4.4.1 Special Economic Zones** will have to comply with labour laws. However, State Government can declare units with the SEZ as public utility. It can also delegate powers of Labour Commissioner to another officer exclusively for SEZ or even to Development Commissioner of SEZ, so that resolution of disputes can be expedited. Five States-Rajasthan, Gujrat, MP, West Bengal and UP have
enacted SEZ legislations and legislations of Karnataka and Maharashtra are pending for approval of President\textsuperscript{11}.

Indian labour laws, which provide good working conditions and reasonable wages and security, are acceptable to all. However, the laws are over protective to labour. This increases indiscipline and reduces productivity to such an extent that Indian goods become uncompetitive.

Central government may exempt SEZ unit or modify applicability of various Central Acts by issuing notification u/s 49 of SEZ Act 2005. However, no such relaxation or modification is permissible in case of laws relating to Trade Union, industrial or labour disputes, labour welfare, provident fund, workmen’s compensation, pension and maternity benefits. Section 50 of SEZ Act, 2005 states that State Government may delegate powers to Development Commissioner in relation to developer or entrepreneur.

**Trade Unions up in arms against proposal for SEZ freedom**

Prime minister’s efforts to remove rigidities in the labour market have hit the trade union roadblock. A proposal to give permanent public utility status to Special Economic Zones faced stiff opposition from the trade unions with its leaders seeing it as a move to curb rights to workers. Consensus eluded a tripartite meeting of government, trade unions and employers over changes to industrial dispute act. The roadmap for bringing about labour market flexibility is facing hurdles from trade unions, cutting across party affiliations. The trade unions

\textsuperscript{11} Financial Express May1, 2004, 167ELT A67
opposed the commerce ministry's proposal to grant permanent public utility service to SEZs, export processing and export oriented units seeing it as a way of diluting labour laws. They suspect that the government was moving towards a hire and fire regime by proposing amendment to the act to allow firms with up to 300 workers to retrench employees or close operations without government prior approval. The trade unions are of the view that raising a figure from 100 to 300 for layoffs, closures and retrenchments in units would result in employers increasing the non-permanent workforce, which does not fall into the purview of labour laws. Reaffirming their opposition to this, the trade unions wanted to know from the government why it was exploring changes only in the Industrial dispute act. The government's argument has been that this amendment would lead to higher investment employment opportunities attracting more foreign companies to invest in India. According to the trade unions, up to 85% of the workers will now fall under this category, and these workers will be barred from knocking the doors of the labour department. The government has argued that economic reforms, particularly of industrial and trade policies have accentuated a demand for amending the Industrial dispute act 'to reorient towards securing greater industrial harmony and enhancing production and productivity, creating an environment to stimulate growth, attracting both foreign and domestic investment, while ensuring the dignity of labour and a fair deal to the workmen as the common minimum programme of the government.'

12 The Economic Times June 25, 2006 Page 7
4.4.2 Relaxation for payment of Managerial Remuneration under Companies Act, 1956

Restrictions in respect of Managerial remuneration have been relaxed in case of companies in SEZ. The remuneration can be up to Rs. 20 lakhs per month without approval of central government. The relaxation is applicable if (a) the Company has not raised any money by public issue of shares or debentures in India.

(c) The company has not made any default in India in repayment of any of its debt, including public deposits, or debentures or interest payable thereon for a continuous period of 30 days in any financial year. There are no restrictions on appointment of a non-resident as managing director or working director. He should have a proper employment visa from Indian Mission abroad and should furnish details of company, principal employer and terms of appointment along with visa application.

SEZ doors shut for trading units

The government has slammed the brakes on trading units seeking to enter the numerous special economic zones coming up across the country. While the development commissioners of SEZs have been asked not to clear applications from trading units, senior officials of the finance ministry are in consultation with their counterparts in the commerce and industry to debar trading units from availing income tax exemption available under section 10A and 10AA of the
income tax act. Each SEZ has a development commissioner who is responsible for all clearances.

The ban follows apprehensions that merchant exporters would relocate to SEZs to avail the tax holiday available to SEZ units. The finance ministry feels that revenue loss would be substantial if exporters procure goods from local market and then export it from SEZs, availing all tax benefits without actually setting up any new manufacturing capacity. "There was an apprehension that purely trading units in the domestic tariff area or local market may seek to relocate to a SEZ for tax avoidance. In view of the concerns of revenue loss due to such activity being allowed in the SEZs, the board decided to instruct development commissioners not to allow trading units to be set up in the SEZ until the issue was fully examined and guidelines were issued on the subject." The ban on trading units will not cover companies carrying out imports purely for exports from SEZs. Neither would the decision have an impact on the free trade warehousing zones proposed by the government. A large portion of India's exports is handled by merchant exporters who procured goods manufactured by smaller units and export them after branding. In some cases, even branding is not involved as these firms book orders and get goods manufactured by small units. This is typical in the case of sectors like textiles, handicrafts and gift items. Since the government wants to provide a thrust manufacturing and infrastructure through SEZs, the mood is against trading companies finding a place in these zones. Under the SEZ act, units located in these zones are eligible for full tax holiday for
the first five years, 50% tax exemption for the next five and the benefit on ploughed back profits for another five years.\textsuperscript{13}

**Relocation to SEZs gets burdensome**

Units planning to relocate to special economic zones to the advantage of tax sops are in for some disappointment. The commerce ministry has introduced amendments in the SEZ Rules to check diversion of exports and production activity to SEZs. The amendment seeks to introduce conditions to qualify for the tax benefits. As per the amended rules, companies operating in SEZs will have to make fresh investments on plant and machinery. Those that plant to install used plant or machinery will run the risk of being disqualified.

The other amendment relates to the definition of trading activities. Only those companies that import goods to re-export can claim an income tax rebate on trading activities. Trading by companies that source products from domestic tariff areas (any local market outside the SEZ) for export will not qualify for the tax benefits.\textsuperscript{14}

**SEZ on pause mode**

The government's reported decision to put a cap on the numbers of special economic zones is welcome, given that the recently notified rules for SEZs have met with opposition from within the government. The pause will allow the Government to debate the contours of incentives for SEZs, and even the very

\textsuperscript{13} The Economic Times, July 3, 2006 Page 9

\textsuperscript{14} The Economic Times, August 22, 2006, Page 1
need of such islands, to encourage export-oriented investments. Ever since the new SEZ rules came into force early this year, there has been a deluge of announcements. Many of these look suspiciously like land grab attempts seeking to make the most of generous incentives and the ongoing real estate boom. The various tax concessions have only made the appeal irresistible. Economic theory, too, is dismissive of the relative merit of tax incentives in attracting investments. Indeed our own experience—the 15 functioning SEZs have attracted private investments of only about Rs.2,200 crores and their share in export is dismal—highlights the failure of SEZs to yield the desired results. Investment located in SEZs is distortionary or sub-optimal as they give undue weightage to fiscal incentives, to the exclusion of other relevant parameters such as location or the availability of labour. All this learning is lost on the latest policy, which showers numerous direct and indirect tax incentives on net forex earners in SEZs. The question is, with Indian export finding their feet in global markets do they need such props. The justification of SEZs rests primarily on China's outstanding success with such zones. What is overlooked is that tax benefits in China's SEZs were available only to foreign investments, not exports. With tariffs coming down fast, it is not only the exporters, but even local industry that needs access to good infrastructure, cheap capital, deliverance from red-tape and more friendly labour laws. So, limited tax benefits could be made available, if it all, only to SEZ developer. For, if the SEZs come anywhere close to delivering what they promise the units located there would in any case get an enormous competitive edge.
IRDA rules out liberal FDI norms for insurance in SEZs

Insurance regulator IrDA ruled out any special provisions, including increased FDI limits, for Special Economic Zones, "SEZs are very small clusters and there is no need to treat them separately. The country had good service providers and the world's major players were also already present. We have already recommended 49% FDI. We can not have a separate insurance company."  

Minimum Investment criteria for SEZs

The board of approval (BOA) for SEZ has fixed minimum investment and net worth criteria for promoter companies. The BOA also drew up lists of authorized operations for SEZs, which would qualify for exemptions and concessions.

Minimum Investment and Authorized Operations criteria

<table>
<thead>
<tr>
<th>Types of SEZ</th>
<th>Minimum Investment (Rs. in crore)</th>
<th>Net worth (Rs. in crore)</th>
<th>Authorised Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multi-product SEZs</td>
<td>1,000</td>
<td>250</td>
<td>25,000 houses, 250 rooms Hotel, 100 beds hospital And schools</td>
</tr>
<tr>
<td>Sector specific SEZs</td>
<td>250</td>
<td>50</td>
<td>7,500 houses, 100 rooms hotel, 25 beds hospital and schools</td>
</tr>
<tr>
<td>(IT, Bio-tech and Gems &amp; Jewellery etc)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

To qualify for developing a multi-product SEZ, the net worth of the applicant has to be at least Rs.250 crore and the minimum investment in the project Rs. 1,000

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crore. For sector specific SEZ, the applicant's net worth has to be a minimum of Rs.50 crore while the minimum investment criteria is Rs.250 crore.

For applying for IT SEZs, the net worth of the applicant has to be Rs.100 crore. The list of authorized operations for IT, bio-tech and gems & jewellery SEZ include roads, housing apartments, convention centre, cafeterias & restaurant, air conditioning, telecom & other communication facilities, electrical, gas & PNG distribution network and recreational facilities. Sector specific SEZs will be allowed to have additional operations including hotels, schools and educational & technical institutes. It will be allowed to have 7,500 houses, hotels with a total of 100 rooms, a 25 bed hospital and schools and other educational institutions over 25,000 square meters. Multi-product SEZs will also be allowed to have ports, airports and golf courses. It will be allowed 25,000 houses, a 250 rooms hotels and a hospital with 100 beds. Developers will not get tax concessions for any construction beyond the specifications. They will also not be allowed to defy the master plan which clearly lays down what percentage of the zone should be demarcated for various facilities\(^{17}\).

**State’s approval stamp must accompany SEZ application**

The centre has decided not to clear proposals till a recommendation certificate accompanies it from the state government where the project is located. State governments are also authorized to facilitate purchase of not more than 10% of the land in special cases to help the developer in striking contiguity.

\(^{17}\) G.K. Pillai, Commerce Special Secretary, Economic Times, September 22, 2006, Page 9
The Board of Approvals has now listed some 36-infrastructure services in the non processing area which alone will be allowed in the SEZs. As it is, there is a ceiling of 75% (50% of the land size recommended by eGoM in its meeting held on April 5, 2007) in the area share which can be devoted to services. The approve infrastructure activities range from the normal transport, communication to power, medical, entertainment and hospitality sector. However, hotels and schools will not be allowed in IT and Gem and jewellery parks. Golf courses are only for multi-product zones, the single product zones and IT parks must make do with play ground and gymnasiums. Cargo complexes, airports, seaports, banks are only for multi-product SEZs.

**Tax sops for petro SEZ being reworked**

The tax sops for the proposed petroleum, petrochemical and specialty chemical investment hubs are being reworked by the government, to ensure that they do not become another drain on the fiscal like the SEZs. The revenue department, therefore, has recommended amendments to the tax treatment of companies in the specialty hubs. The department has taken a position that no additional tax and favoured treatment should be doled out, which exceed the benefits for the special economic zone projects.