Pre-Budget issues that the SEZs are seized with

Source: The Hindu
July 4, 2009

Author: Mahesh Jaising, Partner

Though the Government has been proactive in carrying out the necessary amendments to the laws relating to both the setting up and operating SEZs (Special Economic Zones) in India, there are certain areas that require amendments/ clarifications for an effective implementation of the policy and for the SEZ scheme to deliver the desired results, says Mahesh Jaising, Partner, BMR Advisors.

SEZ has been in the news ever since the introduction of a separate law to govern SEZs in 2005. Currently, there are more than 500 approved SEZs in India in various stages of development.

Establishing a stabilised policy for SEZs in India for promoting exports, employment and creation of superior infrastructure has been the aim of the Government and the recommendation of the industry, observes Jaising, during a recent email interaction with Business Line.

Excerpts from the interview

On tax holiday

One of the significant issues facing the industry is the way the section providing an income-tax holiday (Section 10AA of the Income-tax Act, 1961) is worded. It mandates that SEZ export profits (i.e., entitled for the tax holiday) be computed proportionately with reference to the total turnover of the company and not with reference to the turnover of the SEZ unit.

This creates a discriminatory structure for companies having operations through both SEZ units and STP/ EOU/ DTA units as against a company operating exclusively through an SEZ unit. Earlier, the Government through a press release from the Finance Ministry had stated that the anomaly in Section 10AA will be corrected through necessary changes in the Act. However, no amendments have been carried out till date. There is an expectation that this issue would be addressed by the Budget.

On the indirect tax front

While several tax benefits have been accorded to developers as well as units in a SEZ, two specific issues that have arisen in recent times require to be suitably redressed. Ironically, both issues pertain to a scheme of exemption from payment of service tax on services supplied to a SEZ developer/ unit.

At present, an exemption from levy of service tax is available on taxable services provided in relation to the authorised operations in a SEZ, and received by a developer or units of a SEZ. While such an exemption is a welcome relief, the ground reality is that the benefit if any that accrues by virtue of the exemption is, at best, truncated.

Issue 1: Recently an upfront service tax exemption has been made available in respect of services received by SEZ developers/ units and consumed wholly within the SEZ. Further, an exemption by way of refund has been made available for taxable services provided to SEZ developers/ units and consumed partially or wholly outside the SEZ.

With neither the service tax law nor the SEZ enactment defining the meaning and scope of the term “consumed” or “consumption”, the door has been virtually thrown open for multiple interpretations and unwarranted litigation on whether a particular service has been “consumed” by the SEZ unit/ developer.

While such a determination many be possible in respect of some service categories, such as, services provided by an architect in relation to immovable property located within a SEZ, such a determination is fairly difficult for other services which are intangible in nature, e.g., telecommunication services, consultancy services, etc.

Additionally, it is worthwhile to note that the provisions of SEZ law provide a carte blanche exemption on services received and used by a SEZ unit/ developer for its authorised operations, and the provisions of the SEZ law technically have an overriding effect over all other laws.

Accordingly, all such services received by a SEZ unit/ developer which are for its authorised operations should be exempt from service tax, irrespective of the condition of consumption of such services within the SEZ. However, given the disconnect in the notifications issued, such an interpretation is not likely to be accepted at the ground level.

Issue 2: Independently, SEZ is considered a “foreign territory” and consequently any supplies made to it qualify as exports for the purposes of fiscal benefits and, on the basis thereof, enjoy certain privileges. For example, under the CENVAT credit scheme, supplies of goods to a SEZ unit are zero-rated and treated as deemed exports thereby entitling the manufacturer to avail credit of the duty inbuilt in the components etc. used in activity of manufacture.

However, the supply of services to a SEZ unit has merely been treated as exempted. Not being zero-rated or considered as exports under the CENVAT credit scheme, a service provider is not entitled to credit of tax inbuilt into input services used by him in providing output service supplies. Such a differential treatment to goods and services is unwarranted and begs reasoning.

On the SEZ investments

After the initial rush, new SEZ investments have dwindled. SEZs accounted for a little over seven per cent of the total investment outstanding as of March 2009 and their share has been falling steadily since the peak of 10 per cent as of December 2006.

Pursuant to representations made, it is hoped that these issues highlighted above would get addressed and suitably redressed in the forthcoming Union Budget.