# Special Economic Zones

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India was one of the first in Asia to recognize the effectiveness of the Export Processing Zone (EPZ) model in promoting exports, with Asia's first EPZ set up in Kandla in 1965. With a view to overcome the shortcomings experienced on account of the multiplicity of controls and clearances; absence of world-class infrastructure, and an unstable fiscal regime and with a view to attract larger foreign investments in India, the Special Economic Zones (SEZs) Policy was announced in April 2000.

**In news:** Evaluation of Special Economic Zones
**Placing it in syllabus:** Economy
**Dimensions**

- Treatment in domestic territory and for purpose of taxation
- MAT and AMT
- Success and failures
- Current status of SEZs in India

## Content:

### What are SEZs?

- Special Economic Zone (SEZ) is a **specifically delineated duty-free enclave** and shall be **deemed to be foreign territory** for the **purposes of trade operations and duties** and tariffs.
- In order words, SEZ is a **geographical region that has economic laws different** from a country's typical economic laws.
- SEZs **have access to duty-free imports of manufacturing inputs** because technically they are **considered to be outside of the country's domestic tariff area**.

- Business units that set up establishments in an SEZ would be entitled for a package of incentives and a simplified operating environment.
- Besides, **no license is required for imports,** including second hand machineries.
- The Special Economic Zone (SEZ) policy in India first came into inception on April 1, 2000.
- The **prime objective was to enhance foreign investment and provide an internationally competitive and hassle free environment for exports**.
- The idea was to promote exports from the country and realising the need that a level playing field must be made available to the domestic enterprises and manufacturers to be competitive globally.

***The incentives and facilities offered to the units in SEZs for attracting investments into the SEZs, including foreign investment include:-***

- **Duty free import/domestic procurement of goods** for development, operation and maintenance of SEZ units
- **100% Income Tax exemption on export income for SEZ units** under Section 10AA of the Income Tax Act for first 5 years, 50% for next 5 years thereafter and 50% of the ploughed back export profit for next 5 years. (Sunset Clause for Units will become effective from 01.04.2020)
- **Exemption from Central Sales Tax, Exemption from Service Tax and Exemption from State sales tax**. These have now subsumed into GST and supplies to SEZs are zero rated under IGST Act, 2017.
- Other levies as imposed by the respective State Governments.
- Single window clearance for Central and State level approvals.

***The major incentives and facilities available to SEZ developers include:-***

- **Exemption from customs/excise duties** for development of SEZs for authorized operations approved by the BOA.
- **Income Tax exemption on income derived from the business of development of the SEZ** in a block of 10 years in 15 years under Section 80-IAB of the Income Tax Act. (Sunset Clause for Developers has become effective from 01.04.2017)
- Exemption from Central Sales Tax (CST).
- Exemption from Service Tax (Section 7, 26 and Second Schedule of the SEZ Act).

## The Special Economic Zones Act, 2005

- After extensive consultations, the SEZ Act, 2005, supported by SEZ Rules, came into effect on 10th February, 2006.
- It provides for drastic simplification of procedures and for single window clearance on matters relating to central as well as state governments.
- The SEZ Act 2005 envisages a key role for the State Governments in Export Promotion and creation of related infrastructure.
- A Single Window SEZ approval mechanism has been provided through a 19 member inter-ministerial SEZ Board of Approval (BoA).
- The applications duly recommended by the respective State Governments/UT Administration are considered by this BoA periodically.
- All decisions of the Board of approvals are with consensus.
- The SEZ Rules provide for different minimum land requirements for different classes of SEZs.
- Every SEZ is divided into a processing area where alone the SEZ units would come up and the non-processing area where the supporting infrastructure is to be created.

***The main objectives of the SEZ Act are:***

- generation of additional economic activity
- promotion of exports of goods and services
- promotion of investment from domestic and foreign sources
- creation of employment opportunities
- development of infrastructure facilities

## MAT and AMT

- The Government has introduced various profit linked deductions and incentives in order to encourage investment in various industries.
- Taxpayers who are eligible to claim such deductions/incentives would become zero tax companies or may end up paying marginal tax though they are capable of paying normal tax.
- The Government also needs regular/consistent inflow of tax which is one of its major revenues to fund various expenses for the welfare of the country.
- Hence, ensuring not to completely disrupt the intention of introducing such incentives/deductions by taking it away indirectly and also to ensure levy of tax on such zero tax/marginal tax companies, concept of Minimum Tax was introduced.
- This was initially introduced for companies in the name of 'Minimum Alternate Tax (MAT)' to collect minimum tax to be paid by companies who are claiming profit linked deductions in such financial years (FYs) wherein normal tax payable is lower than MAT.

### Minimum Alternative Tax (MAT)

- The **Minimum Alternative Tax (MAT)** is **imposed on book profit** of **companies** who record nil or negligible profit to pay the usual corporate income tax.
- The provisions of MAT are applicable to a corporate taxpayer only.

- Under the original scheme, businesses in SEZs were exempted from the minimum alternate tax (MAT) on book profits and developers were exempted from payment of the dividend distribution tax (DDT).
- From 2011-12, MAT exemptions for SEZ units and developers were withdrawn and DDT exemptions for developers were terminated.
- Now, SEZ units should pay the Minimum Alternative Tax (MAT). Currently MAT is levied at 18.5% on the book profit of firms, with the effective rate over 21%, factoring in surcharges and cess.
- Exemption from Dividend Distribution Tax (DDT) under Section 115O of the Income Tax Act was also withdrawn from 1.6.2011)

***Alternate Minimum Tax (AMT)***

- The provisions relating to AMT are applicable to **non-corporate taxpayers** in a modified pattern in the form of Alternate Minimum Tax, i.e., AMT.
- AMT applies to a person (and not a company)
- AMT is a minimum tax that is a leviable alternative to normal tax.
- Current Rate of AMT is 18.5% (plus applicable surcharge and cess).
- AMT is a tax levied on 'adjusted total income' in a FY wherein tax on normal income is lower than AMT on Adjusted total income.

## Success and Failures of SEZ:

***Following are some of the success stories of SEZ:***

- Nokia Special Economic Zone (Telecom Equipment SEZ)
- Mahindra City SEZ (Apparel and fashion accessories; IT/Hardware; Auto-ancillary)
- Apache SEZ Development India Private Limited (Footwear SEZ)

- Reliance Jamnagar Infrastructure Limited (Multi-product SEZ)

***Reasons for failure of SEZ in India:***

- The unpredictability of the tax regime in India
  - predictability in taxation policies is essential for making the environment conducive for investment, whether foreign or domestic.
  - The withdrawal of direct tax benefits has been a setback for the SEZ programme and has affected its future prospects

- Effect of FTAs
  - India has signed a number of free trade agreements (FTAs), with countries such as Sri Lanka, Japan and the Association of Southeast Asian Nations (Asean), under which import duties have been slashed to zero for several product lines.
  - This impacts local sales of SEZ units, which are taxed at higher rates.

- Lack of complementary infrastructure
  - A major reason for the success of SEZs in China was the creation of complementary infrastructure, power, roads and ports; these are lacking in India.
  - Location, infrastructure, logistics and professional zone management are four key factors determining success of SEZs.
  - The SEZs have to be connected with ports and airports with world-class roads and rail; ports and airports, too, have to be world-class, with Customs authorities adopting international best practices in trade facilitation.
  - This is not the case at present.

- Improper Site Selection
  - Failure of local Indian politicians to select SEZ

sites that offer maximum development potential is seen as another reason
- Site selection for SEZs has been guided by self-serving agendas rather than considerations of growth and development.
- Local politicians often influence bureaucrats at state-owned industrial development corporations to secure land for personal gains.
- As such, sites for SEZs are selected based on real estate speculation rather than the economic potential of a region.

SEZs have taken a severe beating due to disruptions caused by the pandemic. Export from SEZ units fell by more than 50 per cent while more than a third of the orders placed have been cancelled in April 2020 due to the pandemic, as per an internal survey carried out by the EPCES.

SEZs have attracted investments worth ₹5,32,631 crore so far and have provided direct employment to over 21 lakh. Exports from SEZs increased from ₹22,840 crore in 2005-06 to ₹7,01,179 crore in 2018-19

## Current status of SEZs in India:

- There were 7 Central Government Special Economic Zones (SEZs) and 12 State/Private Sector SEZs prior to the enactment of the SEZs Act, 2005.
- In addition to that 416 proposals for setting up of SEZs in the country have been accorded formal approvals.
- Presently, 351 SEZs are notified, out of which 232 SEZs are operational.

**Mould your thought:** What are Special Economic Zones? Evaluate the performance of SEZ in India?

***Approach to the answer:***

- Introduction
- Define SEZs
- Discuss the objectives of SEZ
- Mention successes of SEZs
- Discuss the reasons for failures of SEZs in India
- Conclusion