

Recast SEZ Policy with recipe from ARC and CAG

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THE controversy over misuse of tax benefits by special economic zones (SEZs) and SEZ units is acquiring new dimension in the light of concern voiced by various institutions.

Official data, including the one available with the SEZ proponent-cum-patron Commerce Department shows irregularities by SEZ units. It is thus ridiculous to see Commerce and Industry Minister Kamal Nath claiming in Parliament that SEZs are working well and there is no plan to amend SEZ Act.

There were hardly any takers for Mr Nath's claim from the Left and Opposition benches in Rajya Sabha on 12 March. Reports indicate even few Congress MPs joined the opposition in raising issues relating to misuse of SEZ policy for development of real estate including cinema halls and amusement parks.

Rajya Sabha Chairman Hamid Ansari thus decided to allow a special discussion on SEZs. The expected debate is bound to generate fireworks especially in the light of reports and recommendations from Administrative Reforms Commission (ARC) and Comptroller and Auditor General (CAG). ARC has called for reconsideration of the highly liberal tax holidays provided to these entities.

In its seventh report submitted to Prime Minister on 17 March, ARC has proposed re-examination of the existing ratio between processing and non-processing areas to ensure the maximum percentage of land in a SEZ territory is used for productive purposes.

The report titled 'Capacity Building for Conflict Resolution' has proposed setting up of SEZ with larger minimum area on non-farming land in backward areas to serve as nuclei of economic growth.

Earlier this month, Comptroller and Auditor General (CAG) proposed a slew of initiatives to plug loopholes in SEZ policy and regulations that has encouraged SEZ to falter in compliance.

CAG has pointed that the policy does not prescribe any percentage of foreign exchange that should be earned by an SEZ unit through actual physical export. Neither it provides any ceiling on deemed exports to units in domestic tariff area (DTA).

Cashing on this basic flaw in the policy, 22 SEZ units achieved mandatory positive net foreign exchange (NFE) mainly through such domestic sales. Of their total export of Rs 7149.23 crore in 2006-07, as much as 72% was derived from sales to DTA units.

CAG says that the deemed exports resulted in customs duty forego of Rs 1043.29 crore on duty-free imports by these units. It has thus recommended that the Commerce Department "may consider restricting reckoning of deemed exports by an appropriate scale for the purpose of calculating NFE."

The report has also pointed out the case of Nokia India, clearing mobile phones from Chennai SEZ for sale in DTA at nil rate of import duty during 2005-06 and 2006-07. These total sales aggregated to Rs 4855.69 crore on which import duty of Rs 681.38 crore was foregone on components used in their manufacture.

As put by CAG, "The Government may consider introducing a provision to collect the duty foregone on inputs used by SEZ units in manufacturing final products cleared at 'nil' rate into the DTA to provide a level playing field for the indigenous industry."

A SEZ or an export-oriented unit (EOU) can market its products in DTA by paying basic customs duty (BCD) and countervailing duty (CVD) as if they were imported from abroad.

Assuming there is zero import duty on a product and zero excise duty on the indigenously manufactured product, then both SEZ and DTA units can clear the output from their respective premises at nil rate of duty.

In such as a situation, a DTA unit is loser because it pays duty on imported components whereas SEZ pays nil duty on such imports. As Cenvat credit is not available to DTA units in such situation, they find themselves at disadvantage against SEZ units.

SEZ units have been given so much freedom that they have to merely self-certify their performance. They are not required to furnish statutory documents such as customs records and bank realization certificates along with routine quarterly and annual performance reports (QPRs/APRs) submitted to Development Commission of respective SEZ.

CAG realized that this laxity “facilitated a few units to provide incorrect/inconsistent data in their APRs/QPRs. The NFEs derived on the basis of this inconsistent data cannot be relied upon.

It cited the case of Crysind Electronics, which operates from Cochin SEZ. The unit showed export of Rs 81.01 crore and import of Rs 79.13 crore in its APRs during five years ending 2005-06. Scrutiny by CAG revealed that the unit had exported products worth only Rs 55.62 crore and imported inputs worth Rs 77.25 crore, resulting in deficit of Rs 21.73 crore in NFE.

CAG said that the proportional import duty foregone in this case was thus recoverable apart from the need to initiate penal action under the Foreign Trade (Development and Regulation) Act.

NFE for a SEZ unit is reckoned for five years by deducting CIF value of imported inputs and other foreign exchange payments towards know-how fee, royalty, etc from FOB value of exports.

As many as 24 units have failed to achieve positive NFE from which import duty of Rs 106.71 crore along with interest of Rs 46.17 crore is recoverable.

Citing a few other instances of revenue leakages and forego, CAG said: “the review has revealed system as well as compliance weaknesses relating to policy and procedures governing the management and functioning of SEZ units in ensuring that these functioned as intended.”

What CAG has unearthed is only a part of the rot that is built-in SEZ framework. The Department of Commerce and Department of Revenue are privy to much more damning information on SEZs. Both should be asked to pool all cases of irregularities and deficiencies in a white paper on SEZ. This should form the base paper for discussion in Parliament and outside on the urgency to amend SEZ policy.

The least the Government should do is to take the fizz out of realty balloon called SEZs. It should do this by reducing non-processing area to nil in mini and small SEZs. Only SEZs spread over 5000 hectares or more area in backward areas should be allowed to set up hotels, service apartments, international schools, clubs, gymnasium and other recreational facilities.

The Government should also ban setting up of SEZs in metropolitan and big cities or on their outskirts to minimize urban chaos.

The Government ought to consider having single, uniform fiscal benefits policy for all exporters across the entire country for the sake of simplicity, preventing growth of regional disparities and for reducing burgeoning expenditure on governance. It must stop acting as Santa Claus, distributing different tax benefits to different categories of exporters under the garb policy-induced tax preferences.

Simultaneously, the Centre should advise States to refrain from acting as middle-men by acquiring land for SEZs. They should instead act as facilitators and arrange transparent auction of non-government land for SEZ or any other commercial activity to help rural people get the most competitive market prices for their assets.

Having arranged lucrative commercial deals for rural land-owning class, the authorities should dispense with the practice of imposing any obligation on land buyers towards the land sellers.