

A walk-through of the SEZ models in India

August 2021



India recognised the effectiveness of Export Processing Zone (EPZ) model in promoting exports, with Asia's first EPZ set up in Kandla in 1965. To overcome the shortcomings arising out of multiple controls and clearances and with a view to attract larger foreign investments, an independent Act, the Special Economic Zones Act, was introduced in 2006.

While the income tax holiday available to units in a SEZ (special economic zone) had a sunset clause of 31 March 2020 and the overall regulatory regime i.e., the Companies Act, the Foreign Exchange Management Act (FEMA), stamp duty, state laws, etc., for SEZ units have increasingly got rigid over the years, media reports indicate that India is set to revamp the SEZ framework to house a wider range of businesses and allow easy exits to lure foreign investment and promote exports.

India is also set to strengthen regulations related to Free Trade Warehousing Zones (FTWZ). FTWZ is intended to create trade-related infrastructure to facilitate the import and export of

Objectives of the SEZ regime



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

goods and services with the freedom to carry out trade transactions in free currency. There is also an increasing attention to promote India as a destination for international financial service centers (IFSC).

The SEZ route not only provides impetus to the government's Make in India scheme, it also provides an effective alternative to curb the misuse of free trade agreements (FTA). The route plays a pivotal role in making India a robust international financial service location. It is essential to consider the role of direct tax and transfer pricing when considering setting up FTWZ and IFSC units.

SEZ at a glance

India is predicted to become one of the leading economies of the world, with some of its initiatives, such as **Make in India**, which aim to transform India into a global market. SEZs, across India, have expanded enormously; key data pertaining to the same is as follows*:

5000+
units in
operation

2.36
million+
employees

INR
6,174
billion+
investment

INR
7,595
billion+
exports per year

Key milestones for setting up SEZ/IFSC/FTWZ



Identify appropriate location and agree with the developer for lease of land/building



Make a proposal for setting up the unit before the Unit Approval Committee (UAC)



The UAC may approve (with or without modifications) or reject the proposal



The BoA, after hearing the applicant's stance, renders its final decision

In case of acceptance, the Development Commissioner (DC) will issue a Letter of Approval (LOA) to the applicant

In case of rejection, appeal will be made to the Board of Approval (BoA)

Post the receipt of the Letter of Approval, applicant to enter into definitive lease and carry out post-approval formalities

Key features of the SEZ scheme

Requirement of a positive Net Foreign Exchange (NFE)

01

All earnings of units in IT (Information technology)/ITES (Information Technology Enabled Services) must, necessarily, be in foreign exchange only

Manufacturing is defined separately under SEZ rules

03

02

Work from home allowed during the COVID-19 pandemic with certain conditions

05

06

IFSC units are governed by SEZ laws and are read with rules framed by the Central Government

04

Tax exemptions allowed to the extent attributable to authorised operations

07

Subcontracting by SEZ allowed, subject to permissions and conditions

Endorsement of invoices for procurement of goods and services required

08

Duty free import of goods for authorised operations

09

Exemption from GST on import of services for authorised operations

10

Domestic procurement of goods and services for authorised operations are zero rated under GST

11

All notified SEZs deemed as multi-sector SEZs*

12

* MOC Notification No. GSR-940(A) dated 17 December 2019



Manufacturing and trading of goods through SEZ

- With a 58% IT/ITES sector participation in the SEZ scheme, the operating model of SEZ has been leveraged well by the service sector. However, the situation is completely opposite for the manufacturing and trading sector, wherein there has been a significant lag in adoption of the SEZ operating model.
- SEZ policy, being primarily focused and contingent on export performance, in order to qualify for tax incentives, has not been compliant with the WTO (World Trade Organisation) norms.
- Far reaching impact of amendments in the SEZ framework are:
 - All SEZs are deemed as multi-sector SEZ, which facilitates the unit of one sector to harmoniously co-exist with another. This offers flexibility to the units to diversify operations.
 - With an aim to promote development and ease of operations and to reduce time and cost of moving cargo of SEZs located on the vast coastal lines of the country, trusts are now allowed to set up a SEZ. This facilitates SEZs to be owned by listed or private infrastructure, or real estate investment trusts.
 - Logistic loopholes, which have plagued the industry for so long, have been addressed by establishing important linkages of market, nearby ports, domestic/international airports and the source for procuring raw materials with the SEZs.

Key challenges



Sub-contracting from domestic tariff area (DTA) for domestic market is restricted

Restrictions and complexities in undertaking domestic and international business from the same unit

Existence of multiple regulatory stakeholders

Alignment of SEZ scheme with GST law

Customs duty and other import restrictions

Revamp of the SEZ policy in India

To evaluate the existing policy frameworks, the Ministry of Commerce constituted a committee headed by Baba Kalyani, Chairman and Managing Director, Bharat Forge Limited, in June 2018. The objective of the committee was to study the existing SEZ and prepare a policy framework that would make SEZ policy more compliant with WTO norms and help develop a highly competitive manufacturing and service base. Major recommendations of the Baba Kalyani Committee include:

Changing the SEZ philosophy from being export-oriented to following a broad-based Employment and Economic Growth approach (Employment and Economic Enclaves-3Es).

Extending the sunset clause beyond 2020 and retaining the taxation benefits withdrawn earlier

Utilising multi-services SEZ and IFSC for all inbound and outbound investments

Granting similar features of Gujarat International Finance Tec-City (GIFT) to SEZs

SEZ: Emerging trends

IFSC

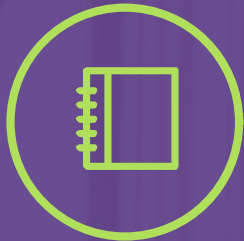
- The central government is empowered under the SEZ Act, 2005, for granting approval for setting up an IFSC
- The objective is to promote India as a preferred destination for financial services (both onshore and offshore)
- IFSC provides world class eco-system which provides facilities and regulations comparable to other leading IFSC's in the world
- IFSC provides opportunity to domestic players like Banks, Insurance companies, Fund Managers, etc. to tap off-shore market by allowing them to transact across the border
- Gujarat International Finance Tec-City (GIFT), India's first International Financial Services Centre (IFSC), has been set-up with an objective to enable Indian entities to compete on an equal footing with offshore financial centers and to provide facilities and regulations comparable to other leading IFSCs in the world
- IFSC enjoys fiscal benefits in the areas of direct tax, indirect tax and local taxes

FTWZ

- FTWZ is a specially demarcated area where warehousing, trading and other related activities are carried out
- FTWZs are allowed to:
 - hold goods on account of foreign suppliers for dispatch as per the owner's instructions
 - trade with or without labelling, packing or re-packing without any processing
 - refrigeration for the purpose of storage
 - assembly of completely knocked down or semi knocked down kits
 - resell or re-invoice, or re-export the imported goods
- FTWZ units enjoy indirect tax benefits for non-DTA sales
- FTWZ would be a key link in logistic and global supply chains, servicing both India and the globe
- Minimum area of 50 hectares* is required to establish a FTWZ. 50% of the FTWZ should be demarcated for processing area

*25 hectares for hill states, Goa and UT's (NN - G.S.R. 940(E) dated 17 December 2019)

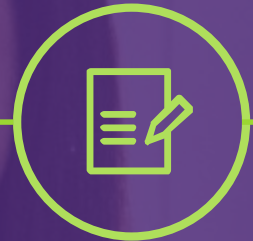
Key compliance requirements



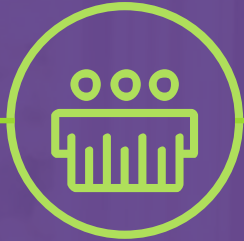
Monthly Performance Report (MPR)



Service Export Reporting Form (SERF)



LOA renewal/extension/BLUT



Work from home/job-work/DTA sale



Software Export Declaration (SOFTEX)



Endorsement of purchase invoices for goods and services



Assessment of BOE



Annual Performance Report (APR)

How Grant Thornton can help

At Grant Thornton, we provide a range of services that enable clients to successfully implement their SEZ/FTWZ/IFSC plans.

Setting up of SEZ/FTWZ/IFSC unit

Phase I

High level study on setting up of SEZ unit

Assistance in making an informed decision on setting up a new unit or transitioning to a SEZ/FTWZ/IFSC unit from other schemes such as STPI etc.

Phase II

Assistance in setting up SEZ unit

Assistance in preparation and finalisation of proposal (Form-F), along with projected financials
Representation before the SEZ authorities and obtaining LOA

Phase III

Execution of Bond-cum-Legal Undertaking (BLUT)

Assistance in preparation of application for BLUT with appropriate supporting documents
Representation before the SEZ authorities

Phase IV

Transitional support

Assistance in phase-wise shifting of goods to SEZ unit
Mapping tax implications and compliance proposed/ planned transactions to be undertaken by the SEZ unit

SEZ advisory services

Compliances and advisory

- Assistance in preparation and filing of periodic returns such as MPR, SERF, SOFTEX, and APR
- Advisory services for the routine functioning of the unit covering SEZ, Customs, GST and FEMA laws
- On-call advisory

SEZ health check

- Identifying risk areas and possible mitigation strategies by undertaking diagnostic reviews from an SEZ perspective
- Review of key documentation and tax positions adopted
- Review to ascertain and mitigate issues, if any, prone to litigation

Litigation support

- Support during audit, investigation, search and seizure, including representation and response to initial queries
- Draft replies to the demand notices, appeals and cross-objections for filing before various appellate authorities
- End to end support for handling all the litigations pending at various levels

Representational support

- Specialised SEZ representational support services to SEZ developers/ units with the objective of minimising future legal and financial risk.
- Drafting detailed representation covering all factual and legal aspects of the matter
- Representation before UAC/ BOA or Ministerial committee

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