

A successful economic zone not just a special one

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Special economic zones (SEZs) as they are known have been the subject of debate across various economic quarters around the world. Essentially, a SEZ is a subset within the territorial boundaries of a state with entitlements to certain benefits, with the objective to fulfil microeconomic and macroeconomic objectives of a state.

India was the first country in Asia to recognize the effectiveness of the export processing zone (EPZ) model in promoting exports, setting up its first EPZ in Kandla in 1965. Its special economic zones policy was announced much later, in 2000, as a part of its export-import policy.

SEZ legislation

The SEZ policy sought to address myriad issues relating to multiple regulatory approvals, absence of world-class infrastructure and unstable fiscal regime. The Special Economic Zones Act was passed by the parliament in 2005.

Some of the salient features of the SEZ Act are exemption from customs duty; exemption from excise duty on import/domestic procurement of goods for development, operation and maintenance of SEZs and units in a SEZ; and exemption from capital gains tax on the transfer of an undertaking from an urban area to a SEZ.

Rationale

The rationale behind such a mechanism is to promote investment to facilitate exports and growth. The administrative setup is a three-tier structure comprising: (i) a board of approval, (ii) a unit approval committee, and (iii) a development commissioner.

India has made great efforts to

replicate the successful Chinese model of SEZ yet there are certain areas where India falls short. The Chinese experience shows that the size of a SEZ does matter. Compared to China's SEZs, India's have been much smaller in size and largely have been unaided by world-class supporting infrastructure.

Legal challenges

With a surge in the number of SEZs in India the legal challenges posed have also risen significantly. In the case of *Essar Steel v Union of India*, which pertained to the levy of export duty on the supply of goods from the domestic tariff area (DTA) to a SEZ, the petitioner contended that a SEZ is within the custom barriers of the country and there is no export when goods are transferred from the DTA to a SEZ. The counter-argument by the Revenue Department before Gujarat High Court was that since SEZs are deemed to be outside the territories of India export duty should be levied on the supply of goods from the DTA to a SEZ.

Rejecting the contention of the Revenue Department, the court held that export is said to be made only when the goods are taken outside the territorial waters of India. The court further held that this is based on section 53 of the SEZ Act, which provides that a SEZ is deemed to be a territory outside the customs territory only for the purpose of undertaking authorized operations. The term "customs territory" cannot be equated to the territory of India and as per the General Agreement on Tariffs and Trade, to which India is a signatory, a country can have more than one customs territory. The Revenue Department's interpretation would essentially mean that SEZs would not be subject to any

laws at all and the SEZ Act would be rendered redundant since it is stated to extend to whole of India.

Subsequently the matter went before the Supreme Court, which upheld the decision of Gujarat High Court.

In the case of *Torrent Energy Ltd v Dakshin Gujrat Vij Company*, India's Appellate Tribunal for Electricity held that a notification issued under section 49(1) of the SEZ Act conferred the status of a deemed distribution licensee as envisaged under section 14 of the Indian Electricity Act on the developer of a SEZ and that the developer would not be required to apply for a distribution license under the Electricity Act.

Social issues

Apart from the legal issues, SEZs have also been plagued by social issues. SEZs are often seen as a means for companies to grab fertile land and with hardly any positive commitment that units would function effectively after tax holidays. More often than not, the units in a SEZ seek an extension of tax holidays.

In recent years, SEZs have mushroomed in India with the number currently around 500. However, there are also instances where developers have applied for de-notifying their SEZ.

Although, SEZs are yet to live up to the expectations, they have shown promise in this regard. Both the direct and indirect employment and other benefits have been far-reaching. However, there is a long way to go before we can call the SEZ experiment in India a success story.

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