

Remodeling of SEZ for wider adoption

August, 2020

Our point of view:

Recent changes in the SEZ law aim to provide a definite push to increase adoption of SEZ as a broad-based and viable operating model for manufacturing and trade businesses dealing with global trade in goods. These changes also aim to neutralize some of the adverse impact of the WTO ruling against India's export incentive schemes. The WTO dispute panel had rejected India's claim that it was exempted from the prohibition on export subsidies under the special and differential treatment provisions of the WTO's Agreement on Subsidies & Countervailing Measures (SCM).

Going forward, all SEZs are deemed to be multisectoral SEZs, trusts (port trust, real estate investment trust etc) are allowed to set up SEZs and minimum land requirement for setting up of SEZ has been eased (reduced from 500 hectare to 50 hectare). These changes were recommended by Baba Kalyani Committee set up in 2018 to recommend reforms in SEZ law. These changes will go a long way in making SEZs a viable operating model offering comprehensive business solution for goods and services sector alike.

In addition to changes in SEZ law, Government has also rolled out change in customs law to support manufacturing under customs bond as an effective duty deferral scheme for manufacturing of goods. Through the introduction of two distinct operating models i.e. manufacturing in SEZ unit and manufacturing under customs bond, the Government has provided a comprehensive framework for businesses to be able to drive working capital and customs duty cost efficiency in global value chain. However a detailed analysis should be undertaken in specific business context to compare the advantages of each option and take an informed business decision.

“ At a very high level SEZ units may work better for export led supply chain while manufacturing under customs bond would work better for domestic supply chain ”

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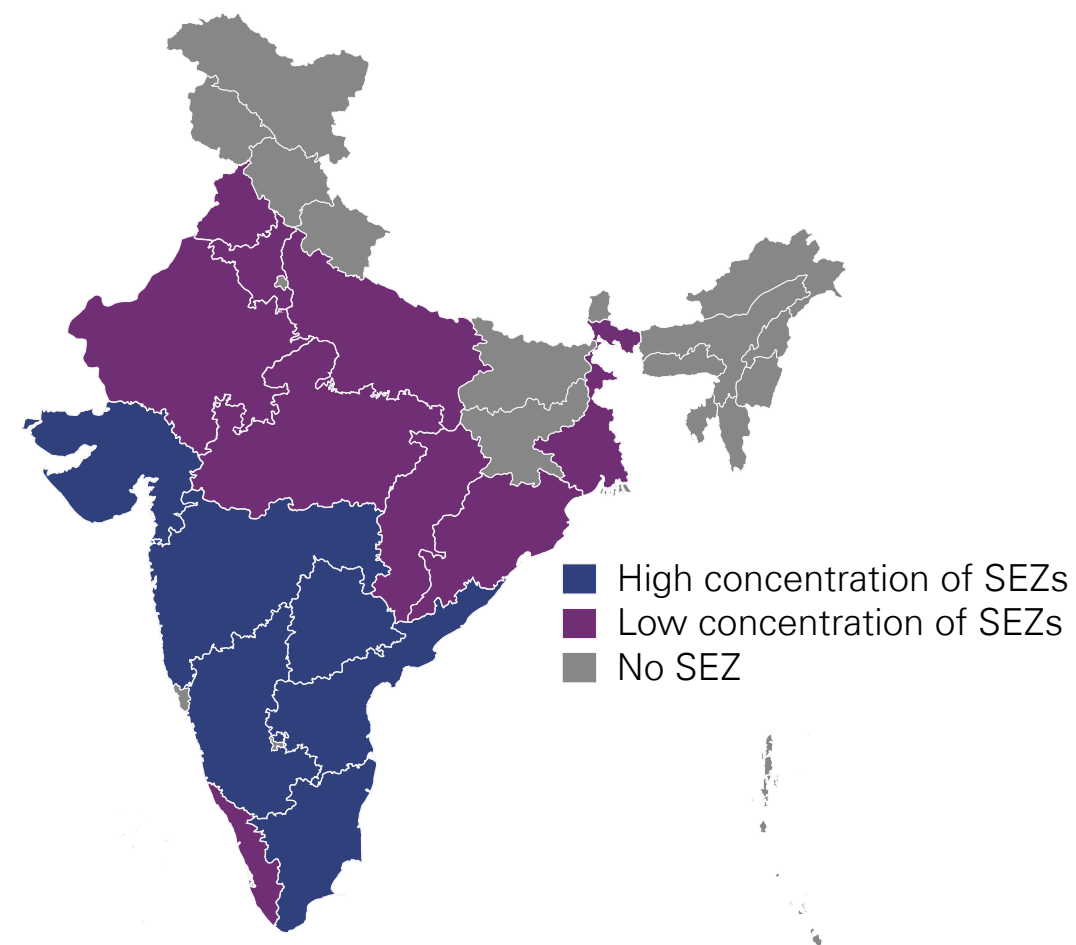


Manufacturing and trading of goods through SEZ

- **Success so far** - SEZ operating model has been leveraged well by service sector, with IT/ITeS sector participation in SEZ is around 58%. Manufacturing and trading businesses lagged behind in adoption of SEZ operating model
- **Compliance with WTO norms** - SEZ policy has not been found to be aligned to WTO norms as tax incentives were primarily contingent on export performance
- **Baba Kalyani Committee ('BKC')** was set up in 2018 to review the SEZ policy with an aim to:
 - Align it with WTO framework
 - Adopt SEZ as a means for overall economic growth and employment generation
- On the recommendations of the BKC, the government has **brought important changes** to the SEZ law
- Changes in SEZ law are expected to increase adoption of SEZ as mainstream operating model for manufacturing and trading of goods for global value chain
- SEZ units face the challenge in supplying the good for the domestic market in India as value addition in the SEZ attracts customs duty and other non tariff barriers
- Value addition in case of manufacturing under bond does not attract customs duty and import restrictions.

More changes are expected in SEZ law to make it more attractive for business

Current spread of SEZs in India



240 operational SEZs

USD 72 billion Investment

48,000 hect. land allocated

USD 80 billion export (2019-20)

Source: Approx. figures as on 31 December 2019 based on fact sheet and data available on SEZ official site

Journey so far



Key recent changes

Expansion in scope of SEZ

- Trusts allowed to set up SEZ
- All SEZs deemed as multi-sector SEZs
- Broad-banding allowed for IT/ ITeS SEZs

Operational relaxation

- Land lease allowed beyond 30 years
- Minimum land requirement reduced to 50 hectare
- Usage of common infrastructure relaxed

Paradigm shift (1/2)

Amendments in SEZ framework are likely to have far reaching impact in making SEZs a preferred operating model for businesses

All SEZs deemed as multi-sector SEZ

- Enables co-existence of SEZ units of one sector with any other sector
- **Offers immense flexibility to strategically add/ diversify operations**

'Trusts' allowed to set-up SEZ

- Likely to **promote development of port based SEZs on the coast line of India**, thereby significantly reducing the time and cost for cargo movement

Broad banding for IT/ ITeS SEZs

- Would help **achieve economies of scale, optimum utilization of infrastructure and competitive value chain** by clustering together similar/compatible businesses

Support funding for last mile connectivity

- Address logistical bottlenecks and **establish linkage of SEZs to market, sources of materials and port or airport**

Illustrative sectoral appeal:

- **Defense sector** - SEZ could allow duty free storage, maintenance of equipment for extended period of time. Enables temporary removal of equipment without payment of duty for field trials
- **Aerospace sector** – SEZ suitable for long term storage of high value spare parts and setting-up of MRO facility
- **Food and fashion industry** – SEZ will allow such time sensitive supply chains to be established closer to the markets

Key challenges:

- Value addition in SEZ attracts customs duty and import restrictions
- Restriction on sub-contracting from DTA for domestic market



**Source: Report dated 19 November 2018 of the Baba Kalyani Committee on SEZ*

Paradigm shift (2/2)

Key recommendations of the BKC*

1	Better funding opportunities through 'Infrastructure status'	2	Delinking of incentives from export performance - linking with value addition etc.	3	Remove condition to earn foreign exchange for services rendered to DTA units	4	Permit SEZ units to undertake sub-contracting for DTA units for domestic market
5	Existing tax and duty benefit to be retained, extension of sunset clause	6	Enable ease of doing business – simplification of approval/ exit process, modifications in authorized operations	7	Relaxation in restriction for usage of land in non processing areas	8	Identify sunrise service sectors and provide key growth enablers

Key messages from Baba Kalyani report

Use of Employment and Economic Enclaves (3Es) developmental framework for SEZs

SEZ not to be deemed as foreign territory

Potential to attract anchor investors which will enable development of ecosystem across the supply chain

Offer subsidized high quality utility services

Ability to have one unit serve both domestic and international market



**Source: Report dated 19 November 2018 of the Baba Kalyani Committee on SEZ*

Transformation opportunity



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