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Make in India: Investors may have SEZ option beyond 2020

PHASING OUT of the exemptions is a necessary condition for cutting the corporate tax. Over the last 5 years, the government has lowered corporate taxes for 99% of the companies paying taxes but the large companies with revenue over ₹250 crore continue to pay 30% tax and applicable surcharges.

"Any policy decision on extending the sunset clause would also have to consider the revenue implications," the official said. Direct tax collection in FY19 fell short by nearly ₹70,000 crore, though it was primarily due to the deficit in personal income tax. Corporate tax needs to grow over 13% to meet the budget estimate for the current fiscal, a tall order given it grew by less than 8% in FY19.

"Reinstating the fiscal benefits would definitely boost non-resident investments in the manufacturing sector, providing a booster shot to the flagship Make in India campaign, especially at a time when it's been reported that as many as 200 US companies are looking to shift manufacturing bases out of China," Rakesh Nangia, managing partner, Nangia Advisors (Andersen Global) said.

The SEZ Act was introduced in 2005 along with tax exemptions through Section 10AA of the Income Tax Act. The provision offered deduction of entire export-related profit for the first five years. For the next five years, 50% of the export profit was deductible. However, in 2011, minimum alternate tax (MAT) and dividend distribution tax (DDT) were introduced for SEZ developers.

Introduction of MAT ensured that even if SEZ companies paid an effective tax of 20% (MAT is levied at 18.5% of book profit) as the exemptions would drag down the normal corporate tax liability below the MAT value. Similarly, DDT meant that firms declaring dividends have to pay 15% tax on the amount.

Before the MAT and DDT were imposed in 2011-12, growth in exports from SEZs was as high as 121% (2009-10) and 43% (2010-11), far exceeding the increase in the country's overall goods exports for these years. The taxes then hit the SEZ exports; although SEZs have started to improve their performances, the growth in exports from these duty-free zones are still way below the level before the taxes were imposed.

These changes took some of the sheen from SEZ prospects which was evident in falling investments and exports from such units. Industry and even Commerce ministry has since demanded withdrawal of these taxes before subsequent budgets. There are over 420 SEZs in the country with over 60% of them engaged in IT/ITES sector.