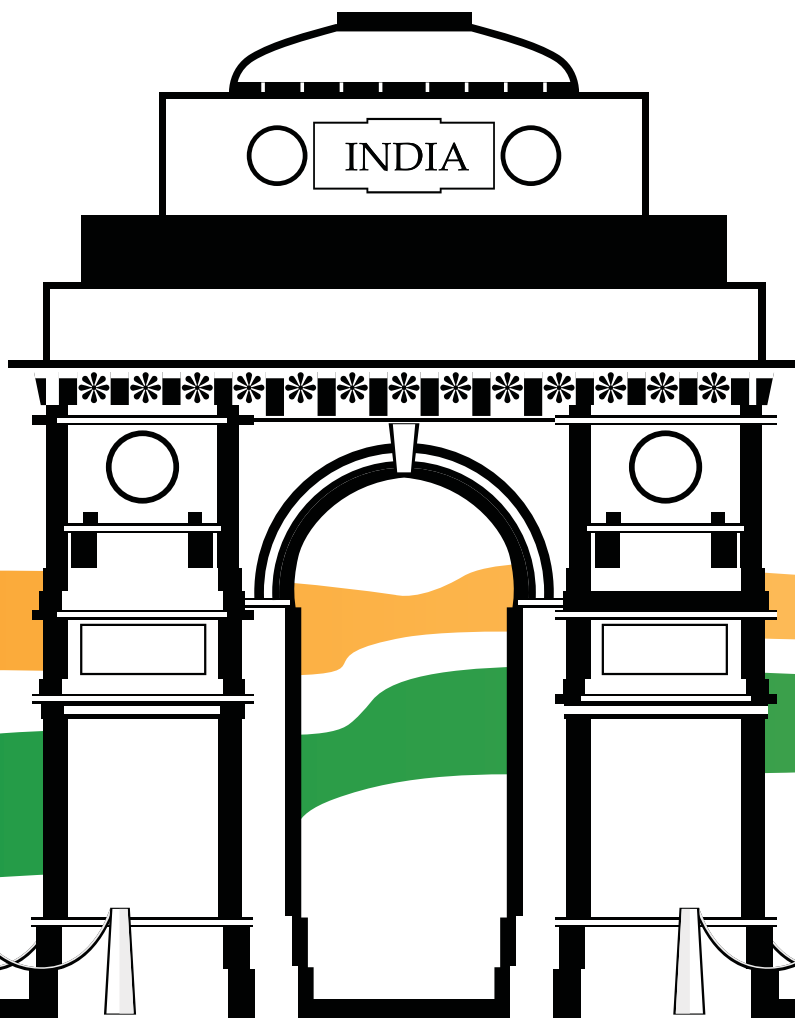


The Lure of

SEZ





With increasing number of investors and managers looking seriously at investing in India, we look closer at the generous tax benefits available in Special Economic Zones (SEZ) throughout the country, contingent on sector and operating dates.

By Dezan Shira & Associates

Part of India's favourable investment environment lies in the numerous Special Economic Zones (SEZ) scattered throughout the country. In an attempt to draw in more foreign investment, the government has a number of industry specific incentives which potentially exempt companies completely from taxes for up to five years. These incentives are subject to specific conditions, depending on date of establishment and location of operations.

An SEZ can be established by a private company (e.g. individual, NRI, domestic company, or foreign company), state government or a combination of both. For SEZ developers, or units of SEZs, to acquire any foreign direct investment (FDI) they must be in compliance with related policies and procedures.

The following are common SEZ policies and procedures:

- Where the developer has leasehold rights, leases should be for a minimum of 20 years
- The types of units specified for an SEZ (e.g. manufacturing, service, trade, or warehouse)

must comply with approved minimum area coverage requirements

- Minimum land areas for adjacent or vacant space bordering an SEZ is determined by the type of units in the SEZ. The adjacent area should not include any public access roads

FDI is progressively being acknowledged as an imperative aspect of economic growth in developing countries. Besides financial capital, FDI facilitates the transfer of technology, organisational and managerial practices and skills, as well as entrance to international markets. More and more countries are pushing for policies to generate constructive and enabling environments to attract FDI. In addition to lowering the barriers to FDI, India is aggressively liberalising its FDI regime.

INDUSTRY SPECIFIC INCENTIVES

Manufacturing And Production

A manufacturing/production entity qualifies for a 30% tax exemption on profits for 10 years (beginning in the first year of production) if:

- Established before March 31, 1995
- Established in underdeveloped state/union territory (or technologically underdeveloped district)
- Parallel remuneration is presented to small-scale industrial activities that began manufacturing or production on cold storage plants before March 30, 2000

Manufacturing entities may also qualify for additional tax exemptions if:

- Established before March 2000
- Located in underdeveloped states, as specified by the Eighth Schedule of the Constitution
- Category A or B: 100% tax exemption on income for first five years, 30% for next five years

Power Generation/Allocation

An enterprise established for power generation or power allocation is entitled to a 100% tax exemption on profits for first five years and 30% for the next five years if:

- Established before March 31, 2003

An enterprise established for oil production, anywhere in India, is exempt from taxes on profits for the first seven years if:

- Established before Oct. 1, 1998



Infrastructure

An enterprise which develops, maintains and operates new infrastructure services is entitled to a 100% tax exemption on profits for the first five years of operations and 30% for the following five years if:

- Established on or after April 1, 1995
- Examples of applicable infrastructure services include work related to roads, highways, bridges, airports, ports, rail systems, irrigation, sanitation and water supply and any other similar public facility notified in the Official Gazette

The exemption is available for any 10 successive years of the first 12 years of the development, maintenance and operation of infrastructure. The limit for claiming the exemption increases if the highway project timeline increases from 10 to 20 consecutive years.

Telecommunications

A telecommunications-related enterprise is entitled to a 100% tax exemption for the first five years and 30% for the following five years on profits if:

- Established before March 31, 2000
- Applicable enterprises are engaged in providing basic or cellular telecommunications services (including radio paging, domestic satellite or network services and electronic data interchange services)

Science And Industrial R&D

A scientific and industrial R&D-related enterprise is entitled to a 100% tax exemption on profits for its first five years if:

- Established before April 1, 1999

INCENTIVES

The highest tax benefit (not a tax break) is provided to companies that are established in free trade zones (FTZs) for the first 10 years of operations.

These FTZs include:

- The Kandla Free Trade Zone (KAFTZ) (Gujarat)
- Santa Cruz Electronics Export Processing Zone (SEEPZ) (Mumbai)
- Madras Export Processing Zone (MEPZ) (Tamil Nadu)
- Cochin Export Processing Zone (CEPZ) (Kerala)
- Noida Export Processing Zone (NEPZ) (Uttar Pradesh)
- Falta Export Processing Zone (FEPZ) (West Bengal)

Official, newly established 100% export-oriented industrial activities and units in electronic hardware and software technology parks are permitted to a similar tax break.

Hotel or Travel Agency

A hotel or travel agency company (Indian company or a non-corporate resident) can enjoy a 50% tax break on income resulting from services provided to foreign tourists, plus any portion of the leftover income that is transferred to a reserve account from the profit and loss account. Profit must be reported in convertible foreign exchange.

Construction

For construction ventures (including construction of buildings, roads, dams, bridges, assemblage or installation of machinery or plants, and construction executed outside



In an attempt to draw in more foreign investment, the government has a number of industry specific incentives which potentially exempt companies completely from taxes for up to five years.



Besides financial capital, FDI facilitates the transfer of technology, organisational and managerial practices and skills, as well as entrance to international market



of India) a 50% tax freedom is available on profits. The tax freedom should be allocated to a Foreign Project Reserve Account and utilised for the purpose of business within the next five years and not used for distribution (i.e. dividends or profits).

Housing

For housing projects, a similar tax exception advantage as those available for construction ventures is accessible on profits supported by a global currency and aided by the World Bank. The total of tax immunity should be transferred to a Housing Projects Reserve Account and utilised within five years.

Other incentives

For the export of manufactured goods or computer software, an

occupant tax payer can claim deduction from profits on the basis of the fraction of export turnover to total income. The profits must be received in convertible foreign exchange.

Dividends, interest or long-term capital gains of an infrastructure capital fund or infrastructure capital company, earned from investments made on or after June 1, 1998 in any venture engaged in developing, maintaining and constructing any infrastructure facility, and which has been permitted by the central government, is not liable for tax.

Dividends paid by domestic entities to their shareholders are excused from tax. However, the domestic corporation would have to pay a "tax on circulated profits" computed at 10% of total dividends distributed by the company.

INCENTIVES FOR SEZ DEVELOPERS AND UNITS

Special Economic Zone developers are awarded a number of additional

tax benefits in India, deductible from profits and gains from the export of goods and services, including:

- 100% income tax exemption for first five years
- 50% income tax exemption for five following years

For businesses that relocate to Special Economic Zones, the following benefits are provided:

- Capital gains tax exemption on relocation to SEZ (Section 54GA) for new units
- No TDS by overseas banking units (OBUs) on interest on deposits and loans from non-residents or aliens
- No MAT (Minimum Alternate Tax)
- Transferee developer enjoys 100% income tax exemption for the balance period of 10 assessment years. **BF**



Dezan Shira & Associates is a specialised foreign direct investment practice, providing business advisory, tax, accounting, payroll and due diligence service to multinationals investing in China, Hong Kong, India, and Vietnam. Established in 1992, the firm is a leading regional practice in Asia with nineteen offices in four jurisdictions, employing over 170 business advisory and tax professionals. To contact Dezan Shira & Associates please email info@dezshira.com or visit www.dezshira.com.