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SEZ

SUNSET CLAUSE

A 360° Perspective

A CUSHMAN & WAKEFIELD RESEARCH PUBLICATION

Setting the Context

Overview of the SEZ Landscape in the Country

The Indian SEZ Act, 2005 (the 'SEZ Act') heralded a new era in the country's economic progress, by introducing a systematic plan to put India on the global manufacturing and export map. The primary aim of the SEZ Act was to create a more welcoming private investment environment, specifically for the purpose of addressing India's trade imbalance by pushing outbound exports. This Act provided the necessary encouragement to industry, because it enabled the setting up of specially designated zones for export-oriented units, with single window clearance and tax incentives/concessions for the developers of such zones as well as units setting up their operations in SEZs.

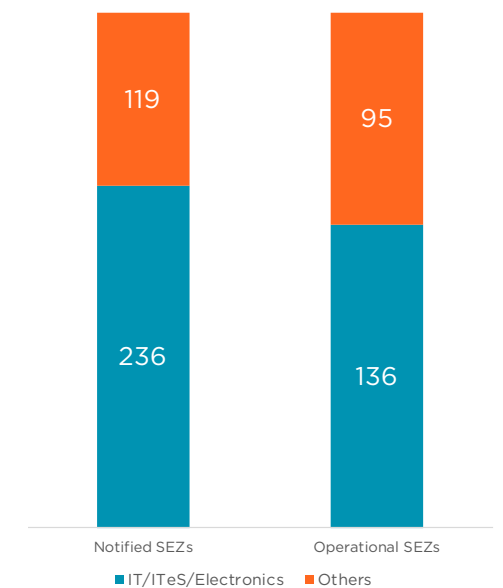
It has been an interesting journey for the SEZs set up under the SEZ Act, though the SEZ scheme and its subsequent evolutionary changes form the elements behind the relative lack of success that is often cited as a precursor to the debate centred around these tax-free enclaves. The SEZ Act and the evolution of the SEZs over a period of thirteen years, in the context of several regulatory changes, indicate how the policy flip-flops have never allowed the scheme to realize its true potential.

Since the enactment of the SEZ Act, over 20 lakh jobs have been created, with an incremental growth of 25.19% y-o-y. The share of SEZ exports in the total value of exports from India grew progressively until 2013, when it peaked at 29.1%, before stagnating at approximately the same levels. The share of SEZ exports was around 30% in 2018-19. Despite the rising share of SEZ exports in India's exports, on a y-o-y basis, growth in SEZs has remained sluggish, with the expected push to exports not being realised to its full potential.

It is no secret that software export driven SEZs (typically called IT/ITeS SEZs) have proven to be more successful than those in any other category. A few highlights below confirm the truth behind this statement:

IT SEZs have a majority share of exports from SEZs. The share from software exports, in 2017, stood at USD 36.9 bn, as against USD 78.07 bn of total SEZ exports. The highest quantum of share was achieved in 2018, with USD 43.2 bn of exports coming from software, compared to USD 85.64 bn of total SEZ exports.

Current Status of SEZs in India



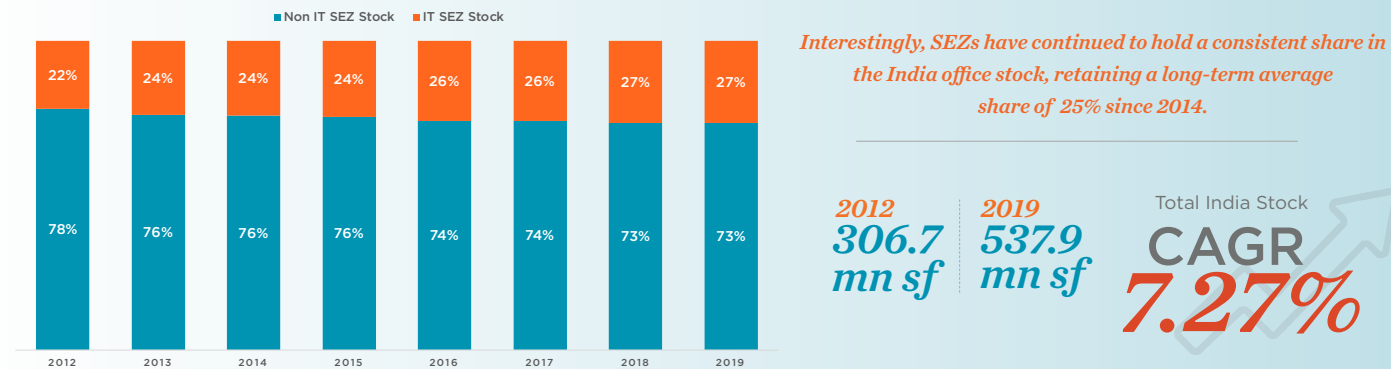
It is interesting to note that the share of software exports in the SEZ export performance metrics has a long-term average of 45%. This indicates the lopsided growth in the history of the SEZs, which is often used as a proxy for opening up a discussion on the relative failure of the scheme

Showcasing the Real Estate Performance of SEZs

Stock and Leasing Trends

We now take a look at the growth of speculative, privately developed IT SEZs over the years since the implementation of the SEZ Act, and their performance relative to the Indian office market, to establish a context for discussing of the impending sunset clause for the SEZs.

Total stock currently in operational IT SEZs is over 1/4th of the total Indian Real Estate stock (top seven cities)



64

operational
IT SEZs in
the country

IT SEZ stock across the top seven cities in the country

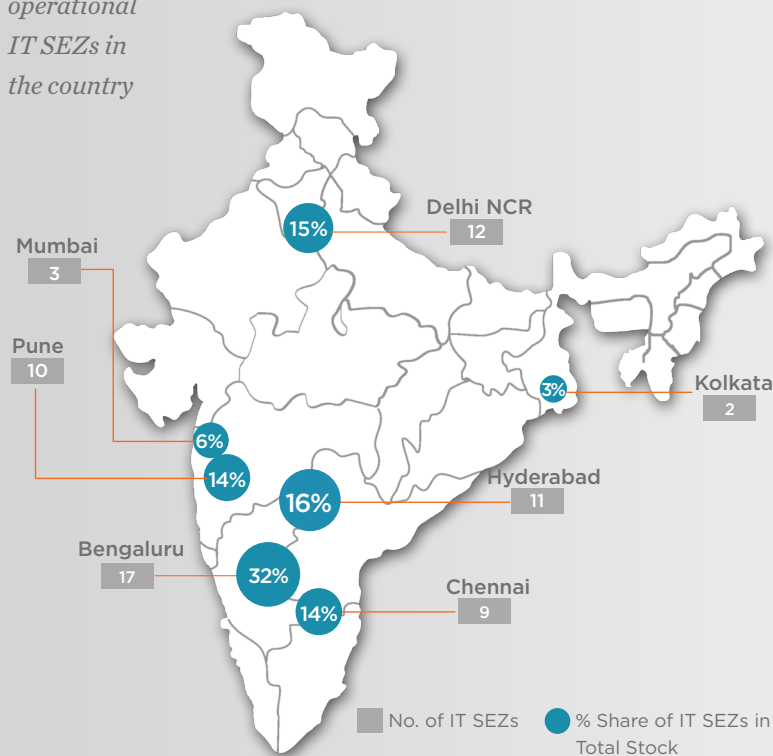
2007
7.6
mn sf

2019
143.2
mn sf

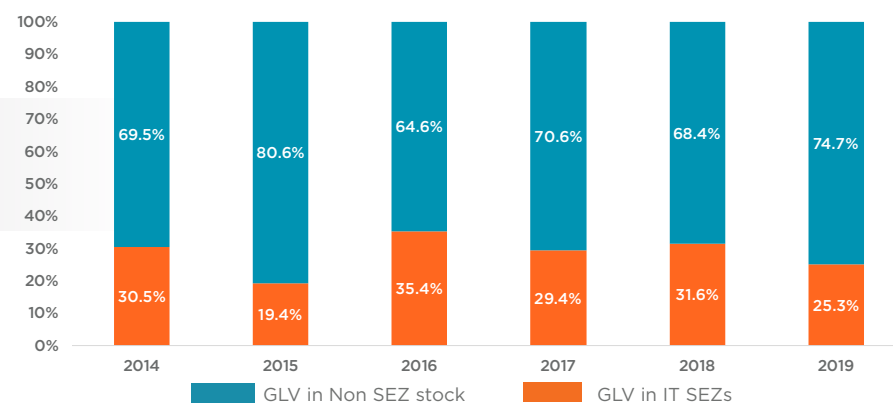
CAGR
27.7%

It is quite interesting to note that, while the well-known and established tech cities of India, viz., Bengaluru, Hyderabad, Chennai, and Pune have a healthy number of operational SEZs, Delhi-NCR, despite its diverse occupier base, is still second only to Bengaluru in terms of the number of operational SEZs.

The lack of large land parcels, barring the suburbs, and a largely financial occupier base, are some key reasons why Mumbai lags in terms of number of operational SEZs. Given the rental arbitrage, developers have found it more lucrative to undertake commercial developments, and the land size requirements have also limited the SEZ development in the city.



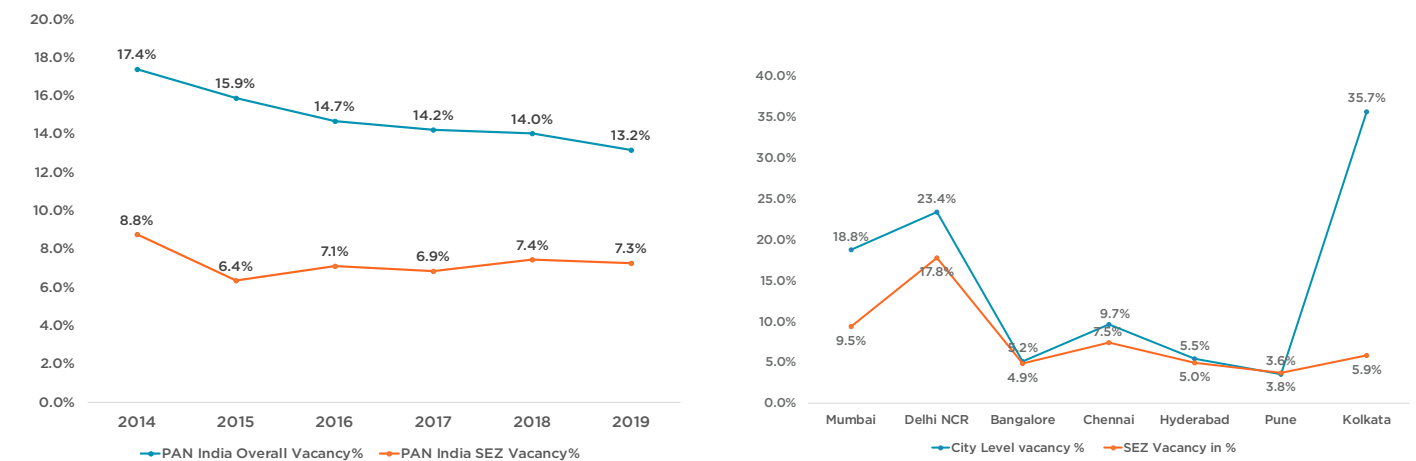
Gross Leasing Activity



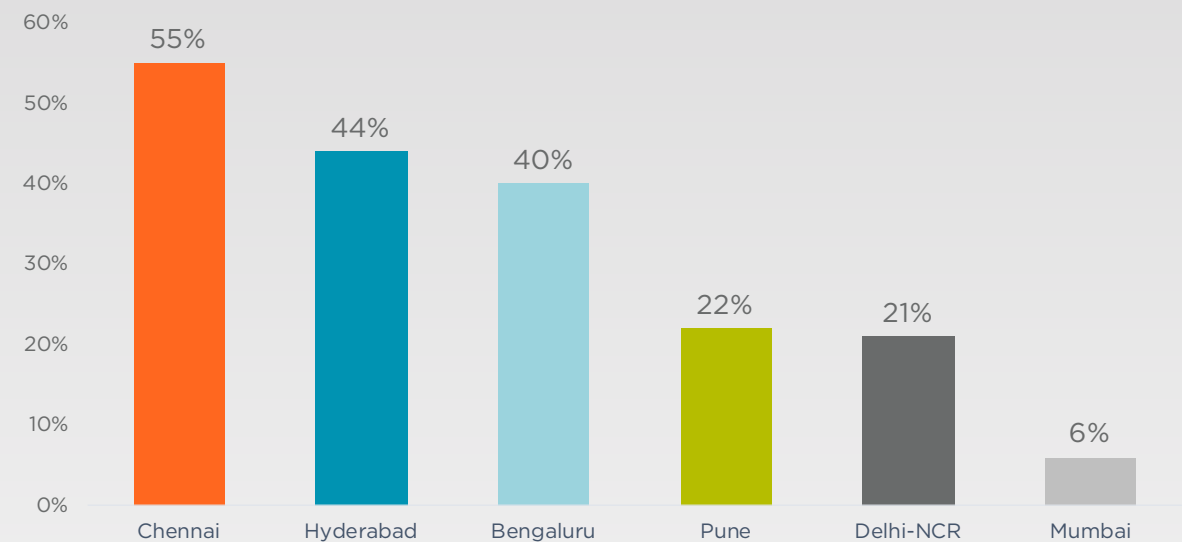
SEZs have also, on average, accounted for approximately a one-third share of the annual gross leasing volumes since 2014.

Vacancy Analysis and Upcoming SEZ Supply

It is even more interesting to note that the vacancy levels in the IT SEZs are currently lower by over 590 bps than the Indian vacancy level of 13.2% (considering the top seven cities). Following a deep dive at city level, across all of the major cities, the SEZs have lower vacancy rates, as compared to the city average. This shows that they have recorded healthy occupier demand, which in turn points to net job creation, and this is also visible in the rising share of SEZ software exports in the total SEZ export numbers



City Level Share of IT SEZs in Future Supply (2020-2022)



Going forward, the upcoming supply of SEZ projects remains quite healthy, which is indicative of a healthy demand scenario being anticipated by the developers of such projects. Significant investments have been made into these projects by global private equity players, with more investments being poured into future developments, which brings into focus the role of both developers and co-developers, as we approach the sunset clause.

Tech cities are likely to continue playing a significant role in the SEZ landscape, having a major share of the upcoming supply. Developers remain largely optimistic, with demand strengthening on the back of large-scale consolidations and the robust growth of captive centres over the last two to three years.

We have seen demand picking up in recent times, with the sunset clause approaching, and this makes a strong case for SEZs continuing to make a sizeable and significant contribution to Indian exports. It also suggests that SEZ occupiers, and those planning to expand into SEZs, have factored in the impact of the SEZ Sunset Clause and aligned their business plans with the impending timelines.

It is imperative that, beyond the clouds of doubt surrounding the sunset clause and its likely impact on the occupiers of IT SEZs, we seek to provide clarity across different scenarios and offer a short to medium-term outlook on SEZs. These answers should hopefully provide clarity to occupiers that have SEZ operations in their real estate portfolio as well as those exploring SEZ space options and what the aftermath of the sunset clause holds for them.

Impact Assessment of SEZ Sunset Clause

We look at the current taxation norms in SEZs (with an emphasis on IT SEZs) and the impact of the sunset clause on various scenarios for developers/ co-developers and occupiers that are in SEZs or looking at SEZs for the purpose of setting up new operations.

Stakeholder	Direct Tax Benefits	Indirect Tax Benefits
SEZ Unit Holder/ Occupier	Income tax deduction on profits and gains - For the period of the first five years - 100%; - For the next five years - 50%; and - For the last five years - 50% of the profits that have been credited to the SEZ Re-Investment Reserve Account and utilized for purpose of the business of the assessee in the manner as mentioned under the said section. The benefits mentioned above are available to all units that commence operations before 31 March 2020, subject to the satisfaction of the conditions specified therein. Units commencing operations after April 2020 are not eligible for these benefits.	Exemption from the payment of customs duties and/or GST. The SEZ unit is free to make supplies to a Domestic Tariff Area ('DTA') unit, based on a payment of IGST, where the payment is received in foreign exchange. SEZ units are eligible to claim Service Export from India Scheme ('SEIS') scrips as export incentives under the Foreign Trade Policy 2015-20, on the export of eligible services. The incentives are typically either 5% or 7% on the net foreign exchange that has been earned during a financial year. Please note that these benefits are only for exports of eligible services until 31 March 2020. Such benefits can be claimed after March 2020 only if an extension of benefits is notified by the Government.
SEZ Developer/ Co-Developer	A deduction of 100% of the profits and gains that have been derived from such business for any ten consecutive assessment years in any fifteen years, beginning from the year in which the SEZ was notified by the Central Government. For a co-developer, the deduction is available from the year in which the Co-developer received approval from the SEZ authorities. The deduction under this section shall not be available for development of SEZs beginning on or after 1 April 2017 ('sunset clause').	Exemption from the payment of customs duties and /or GST.

Post Sunset Clause Scenario in a Nutshell

Occupiers

New SEZ occupiers are eligible to receive both direct and indirect tax benefits, only if they commence operations before the end of March 2020. All new SEZ occupiers commencing operations beginning 1 April 2020 will not be eligible to receive direct tax benefits. However, the sunset clause will not impact their indirect taxes, and they will continue to receive benefits such as exemptions on GST and SEIS incentives (on eligible services), as long as they are operational.

Developers

The direct tax benefits are no longer available to SEZ developers and co-developers, but their indirect tax benefits continue uninterrupted. The sunset clause will not impact their indirect tax benefits in any form.

**A detailed illustration of the tax cost savings for an SEZ unit vis-à-vis a non-SEZ unit, from an indirect tax perspective, is provided in Annexure – A.*

1. Tax Issues Related to the Sunset Clause for Developers/Co-Developers

As mentioned above, the tax deduction is available to a SEZ developer from the year in which the SEZ is notified by the Central Government. For a co-developer, the deduction is available from the year in which the co-developer receives approval from the SEZ authorities. However, the deduction under the provisions of the Act is available to an SEZ developer only if the development of the SEZ commences on or before 1st April 2017.

However, there is ambiguity about what constitutes ‘commencement’, since, the term is not defined. There could be scenarios wherein a difficulty may arise in terms of determining whether a developer/ co-developer is eligible for a tax deduction. Some of the possible scenarios are highlighted below:

- *The developer commences the development of the SEZ before 1 April 2017, but the notification of the SEZ is obtained on or after 1 April 2017 – is the developer eligible for the tax deduction?*
- *The developer obtained the notification before 1 April 2017, but the development of the SEZ commences on or after 1 April 2017 - is the developer eligible for the tax deduction?*
- *The developer commences the development of the SEZ before 1 April 2017 and obtains notification before/on or after 1 April 2017. The co-developer obtains an approval on or after 1 April 2017 – is the co-developer eligible for the tax deduction?*

Relevant amendments/clarifications would need to be brought about in order to address the above issues.

In addition to the above, in certain cases developers/co-developers obtain phase-wise approvals for the development of the SEZ. Each approval would need to be reviewed on a case by case basis in order to understand the eligibility of the tax benefits for the SEZ developer/ co-developer.

2. Advantages to Occupiers Moving from DTA to SEZ Units

The major advantages of moving from a DTA to an SEZ unit is that the SEZ unit is eligible to claim tax benefits under the provision of section 10AA of the Income-tax Act, subject of course to there being a significant expansion of the unit in terms of the asset base, manpower, business, etc.

An SEZ unit commencing operations prior to 1 April 2020 would be eligible to claim the tax benefits for fifteen years (in the manner specified in paragraph 1 above). For example, if a unit commences operations in the financial year 2019-20, then such a unit shall be eligible for fifteen years of tax deductions, and the financial year 2019-20 shall be the first year for which the deduction is claimed under section 10AA of the Income-tax Act.

In a situation where capital goods and manpower are transferred from a DTA to an SEZ unit, the following aspects would need to be kept in mind, to ensure that the unit is eligible for the tax benefits:

- *There are no restrictions from an SEZ law perspective on the transfer of manpower and plants and machinery – Instruction No. 70 facilitates such a transfer, subject to certain compliance requirements*
- *From an income-tax perspective, the restrictive conditions relating to splitting up, or reconstruction of, a business that is already in existence and transfer to a new business, of machinery or plant previously used [i.e. the plant and machinery transferred should not exceed more than 20% of the total value of the plant and machinery of the unit] would need to be fulfilled.*
- *In addition to the above, from a manpower perspective, the Central Board of Direct Taxes has issued Circular No. 14 of 2014, which mandates the satisfaction of either of the following conditions in order to claim the tax benefit:*
 - (a) The transfer or deployment of manpower from the existing unit to the new unit, up to a limit of 50% of the total technical manpower actually engaged in the new unit, would not be construed as the splitting up or reconstruction of the existing business; and
 - (b) The net addition of the new technical manpower for all units of the assessee is at least equal to 50% of the total technical manpower of the new unit.

As is evident from the above, the eligibility of a tax holiday for a unit transitioning from a DTA to an SEZ unit is a fact-based exercise. However, the overarching principle is that, in order to be eligible for the tax holiday, there has to be a significant amount of business expansion. Where the operations are moved from a DTA to an SEZ in a phased manner, the SEZ unit would be eligible to claim tax benefits, if the SEZ unit has commenced operations on or before April 1, 2020 as long as the unit is not formed by splitting up or by reconstruction.

Having said the above, one would also note that the trend of existing companies carrying out operations from DTA/STP units and new companies looking to move to SEZs has gained a lot of traction as they look to set up units in an SEZ and commencing operations prior to the sunset date (1 April 2020), in order to be eligible to avail the direct tax benefits. Only the indirect tax benefits will be available to occupiers moving from a DTA to an SEZ unit after the sunset clause.

A few scenarios capturing the tax aspects of moving to an SEZ unit are provided below:

Stakeholder	Moving to an SEZ before 31 March 2020	Moving after 31 March 2020
An occupier that is not already present in an SEZ unit	All direct and indirect tax benefits are available.	Direct tax benefits will no longer be available but indirect tax benefits can be claimed.
An occupier that is already present in an SEZ but is looking to set up a new unit	All direct and indirect tax benefits are available for the new unit.	Direct tax benefits would no longer be available for the new units, but indirect tax benefits will still be available.
An occupier that is already present in an SEZ and is looking to expand/relocate	All of the benefits from the LOA date would continue, i.e. the benefits will be available for the unexpired period.	All of the benefits from the Letter of Approval (LOA) date would continue for the unexpired period, assuming that the unit is set up prior to 1 April 2020 and that the expansion takes place after 1 April 2020.

With the increase in exports and investments, based on publicly available data, the Commerce Ministry is in discussions with the stakeholders including the government, to consider a 5 year extension of tax benefits for units in SEZ by extending the sunset clause beyond March 31, 2020. Removing MAT on SEZs is also one of the proposals that is being put forth by the Commerce Ministry. One will have to wait and see if these proposals are implemented.



Recent developments in the tax code – Implications for SEZ occupiers

The Indian Government in recent weeks has announced several booster measures to revive the current slowdown in the Indian economy. A number of game-changing tax measures were announced by the Finance Minister on 20 September 2019, which were targeted at reducing corporate tax rates across the board, providing impetus to the “Make in India” initiative, and bolstering foreign investment. With these measures, India’s tax rates can be regarded as extremely competitive.

With this in mind, the Government has brought in the Taxation Laws (Amendment) Act, 2019. A snapshot of the concessional tax regimes has been provided below:

Scenario for occupiers	Tax regime as per recently announced Taxation Laws (Amendment) Act, 2019 [provisions of section 115BAA of the Act]	Implications
Domestic companies that are willing to open a new unit in SEZ before March 2020	Companies will have two options to choose from. Option 1: - Avail tax rate of 25.17% (22% plus a surcharge of 10% and cess of 4%) as against the existing highest bracket rate of 29.12% / 34.94% (25% or 30% plus surcharge and cess) - No other direct tax benefits under section 10AA of the Act will be available - Lapse of brought forward loss and unabsorbed depreciation attributable to the tax incentives claimed. - Minimum Alternate Tax (‘MAT’) credits to lapse. Option 2: - Continue with the tax rate of 29.12% / 34.94% (25% or 30% plus surcharge and cess) - Claim direct tax benefits under section 10AA - MAT is applicable at 17.16% (15% plus a surcharge of 10% and cess of 4%)	Companies should evaluate both options before setting up a new unit. The following aspects shall be evaluated in detail – - Impact of brought forward MAT credits; - A thorough review of business restructurings, business expansions, etc., to analyze the tax impacts under the old regime <i>vis-à-vis</i> the new regime before opting for one. - Impact of brought forward loss and unabsorbed depreciation attributable to the tax incentives claimed. It is pertinent to note that, once option 1 with a reduced tax rate is selected, reverting to option 2 is not possible. No amendments are made to indirect tax benefits; hence they would continue in the same manner as of today.

Please note the above analysis will have to be carried out in the following instances as well -

- Domestic companies that are already present in SEZ and are availing direct tax benefits
- Domestic companies that are already present in SEZ and are at the end of 15-year direct tax benefits window

Further, the Government has brought in concessional tax regimes for new manufacturing companies as well. Manufacturing companies incorporated after October 01, 2019 that are making fresh investments in manufacturing and commencing production by March 31, 2023 have an option to pay tax at a rate of 17.16% (including a surcharge and cess), without availing any incentives / exemptions, and subject to the satisfaction of the conditions specified therein. Further, MAT is not payable by such companies.



Key Learnings

● New country entrants and what should they do?

The possibility of setting up operations in an SEZ should definitely be explored. A detailed cost/ benefit analysis (not limited to taxes) should be undertaken in order to evaluate the benefits of setting up in an SEZ.

From a tax perspective, a new unit that is set up prior to 1 April 2020 will be entitled to the tax benefits under section 10AA of the Income-tax Act, 1961 for a period of fifteen years (in the manner specified in paragraph 1). For example, if a unit commenced operations in financial year 2019-20, then such a unit shall be eligible for fifteen years of tax deductions, and financial year 2019-20 shall be the first year for which deductions are claimed under section 10AA of the Income-tax Act, 1961.

Indirect tax benefits would also be available to the SEZ unit.

● Whether the tax benefits will still be available where to the occupier is at the end of the 15-year lease period

The direct tax benefits will no longer be available after the fifteen-year window, but the indirect tax exemptions will continue. However, if a new unit is set up by March 2020, then the direct tax benefits would start afresh (only for the newly started unit), subject of course to the fulfillment of any other restrictive conditions under section 10AA of the Income-tax Act, 1961.

● Whether the tax benefits will be available if temporary space is acquired before 1 April 2020 and actual space is subsequently acquired?

As long as a valid Letter of Approval is in place and the unit has commenced operations prior to 1 April 2020, the tax benefits ought to be available, subject of course to the fulfillment of any other restrictive conditions under section 10AA of the Income-tax Act, 1961. The appropriate details/documentation would need to be made available at the time of the application (including the letter of intent from the developer).

Indirect tax benefits would be available to the SEZ unit.

● Can a tenant occupy an SEZ building and not avail any benefits?

Yes, a tenant can occupy an SEZ building and not avail any benefits. However, it is pertinent to note that although an SEZ unit set up after April 1, 2020 will not be eligible to claim direct tax benefits, indirect tax benefits can still be availed. To reiterate, a detailed cost benefit analysis would have to be carried out to evaluate the benefits of carrying out operations from an SEZ unit.

● Whether movement of units from one SEZ to another SEZ is permissible?

Shifting of units from one SEZ to another is permissible under the SEZ Act, subject to obtaining specific approvals.

● Can domestic Business be conducted from SEZ location?

Domestic business can be conducted from an SEZ location, subject to the following conditions:

- From the SEZ law perspective, it is a requirement that the proceeds are realized in foreign exchange;
- A SEZ unit is required to achieve positive net foreign exchange, to be cumulatively calculated for a period of five years from the commencement of production;
- From a direct tax perspective, the tax holiday benefits would not be available, as providing services to Domestic Tariff Area(DTA) units would not qualify as exports under the provisions of the direct tax law;
- From an indirect tax perspective, when an SEZ supplies goods or services or both to a DTA, this will be considered as domestic clearance, where the clearance of goods would attract customs duties and the rendering of services would attract GST. However, customs and other import duties (including Integrated Goods and Services Tax (IGST)) will be payable by the person receiving these supplies in the DTA, while the GST on the supply of services has to be paid by the SEZ unit.

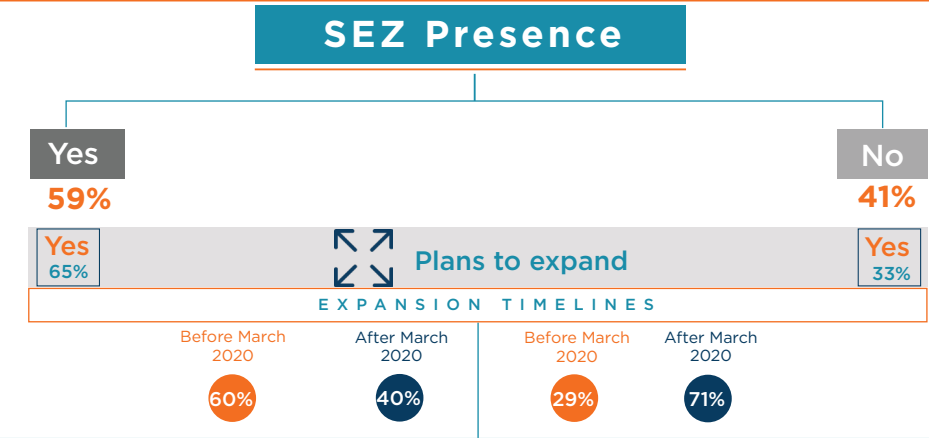
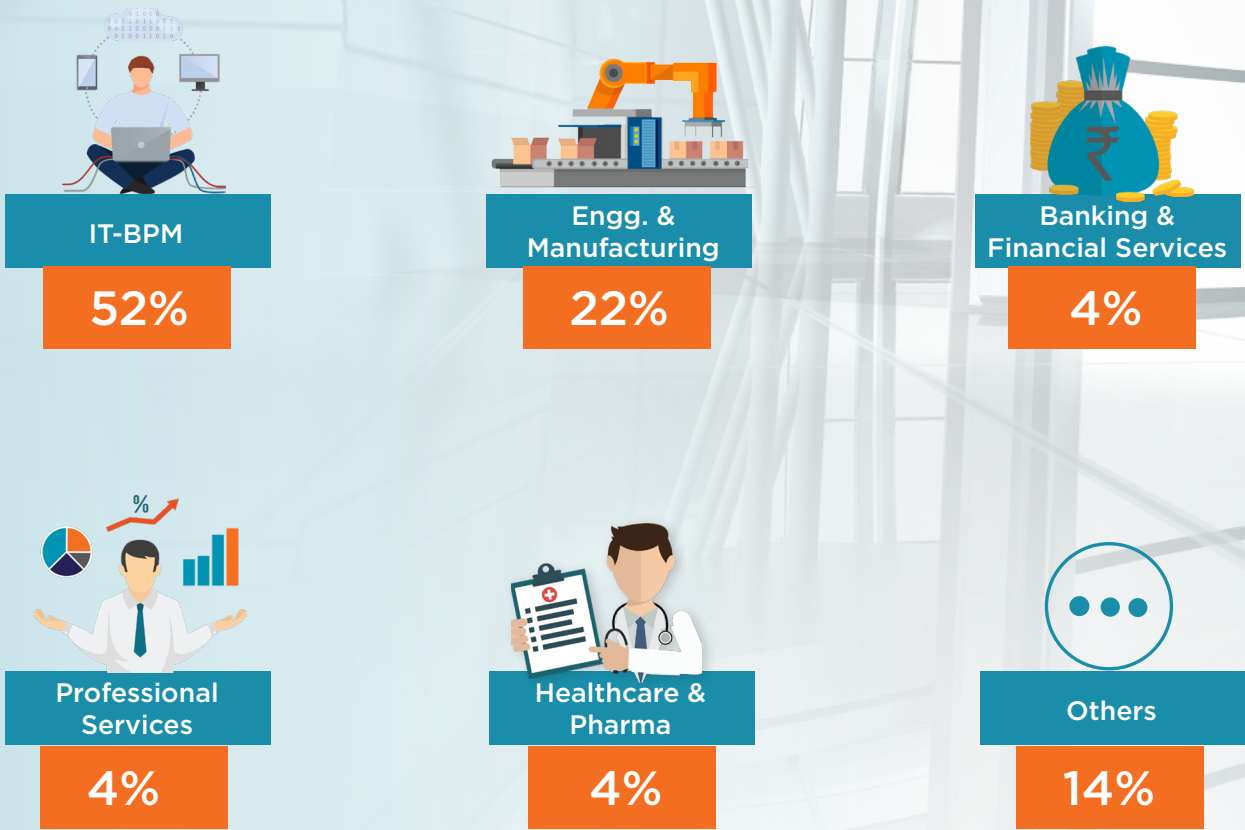
● Can investors still buy an SEZ space after the sunset clause?

Yes, the sunset clause will not change the existing process through which institutional investors buy SEZ space. However, investors will be mindful of the fact that the direct tax benefits will no longer be available to new unit holders commencing operations after the sunset clause, although the indirect tax benefits will still be available.

Occupier Perception Survey

We conducted an occupier survey to find out their views and probe more on their possible expansion and business strategies going forward. The respondents were all occupiers covering a wide range of business sectors although Technology (52%) and Engineering & Manufacturing (22%) comprised the majority. CRE leaders at all levels are well represented. The key outputs from the survey are outlined below.

Occupier Participation by Industry



Survey outcomes

- Nearly 2/3rds of the occupiers present in SEZs are willing to expand.
- The majority of them are willing to expand before March 2020.
- More than 1/3rd of them are willing to expand even beyond Q1 2020.

Inferences

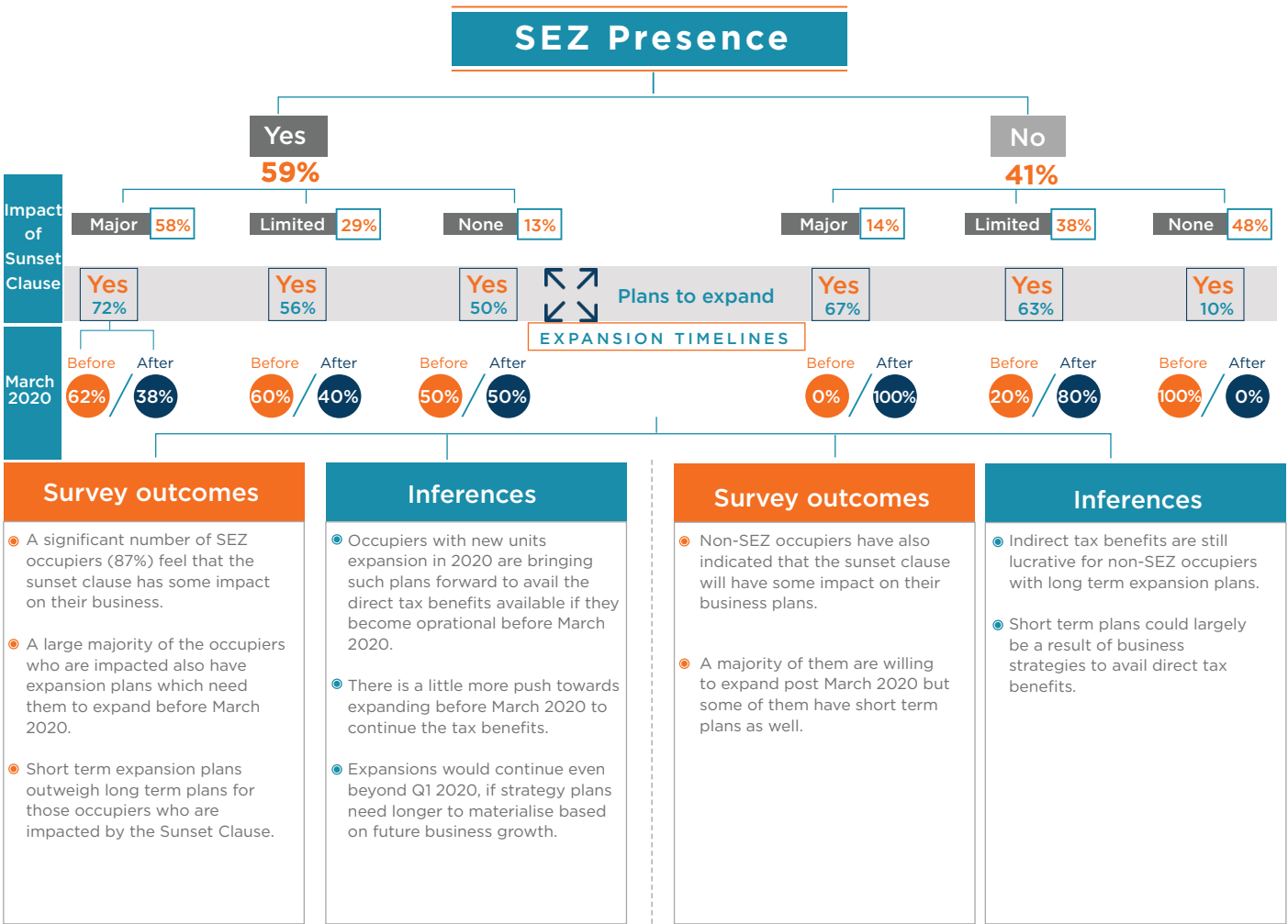
- The sunset clause is pushing the occupiers of SEZs to bring forward their growth plans in order to avail the tax benefits that will accrue upon expansion before the sunset clause.
- Occupiers are looking at short-term and long-term strategies in order to minimize the impact of the sunset clause.
- It is prudent for most of the companies operating from SEZs to expand before March 2020 in order to reduce their tax liability, if they have any short-term business plans.

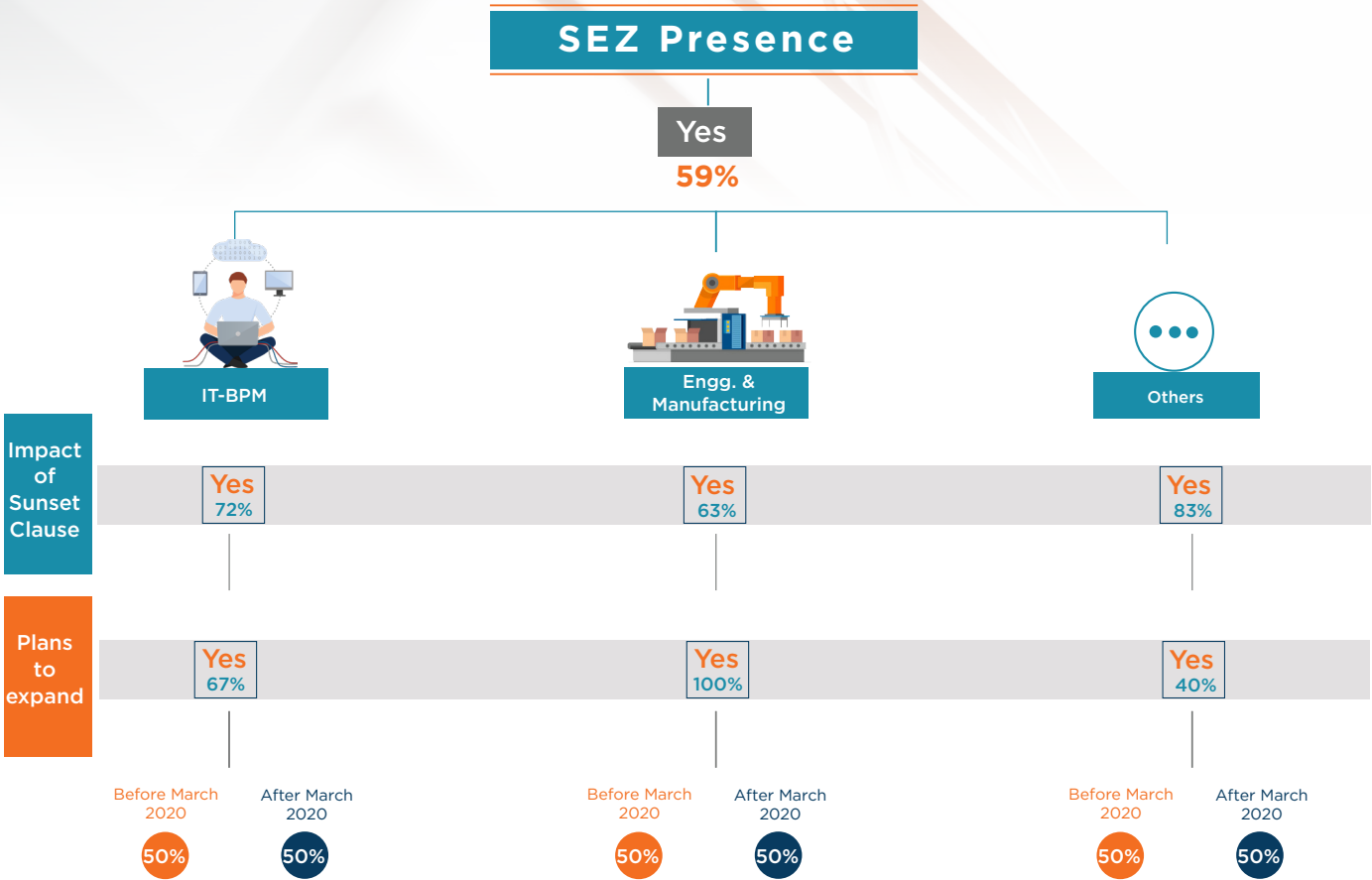
Survey outcomes

- Occupiers who are not present in SEZs are also considering SEZs for any planned future expansions, if they fulfil the SEZ criteria.
- A majority (71%) are looking to expand after March 2020, which indicates a careful and measured approach, while also suggesting that their expansion plans are likely to mature only after the sunset clause.

Inferences

- SEZ operations may seem overwhelming for non-SEZ occupiers, who may find it difficult to navigate and cope with the regulatory, administrative, and financial processes on a regular basis.
- However, the indirect tax benefits which will continue even beyond March 2020 will still be attractive to a new breed of occupiers with expansion/consolidation plans in the longer term.





Survey outcomes

- Occupiers from Tech, Engineering & Manufacturing sectors are the most represented in SEZ facilities. Hence the impact felt by the sunset clause is largely driven by such firms.
- An overwhelming majority of IT-BPM and Engineering & Manufacturing firms have expansion plans, which are equally split in terms of timelines being before and after the sunset clause.

Inferences

- SEZ occupiers irrespective of their business sector are impacted by the sunset clause and are looking at short-term and long-term strategies to ensure continuation of tax benefits to the maximum effect possible, in line with their growth plans.
- Technology sector, largely due to its vast presence in SEZs has a major impact. As such, tech occupiers are judicious about their expansion plans.

Thoughts for Developers:

- Although the direct tax benefits will no longer be available to developers after the sunset clause, they will continue to receive the indirect tax benefits as before. On the basis of our conversations with key developers that are active in SEZ development, the majority of them remain optimistic about the future of SEZs.

Currently, the corporate tax rates for domestic and foreign companies are **30%** and **40%**, respectively, in addition to health and education cess and a surcharge on the total amount of the payments (the tax rate in such a case would be **34.94%** for domestic companies and **43.68%** for foreign companies, considering the surcharge at its highest rates).

- The Central Government has recently cut the corporate tax for domestic companies with annual turnover up to INR 400 cr. to 25% from 30% earlier. The Government has also introduced a reduced corporate tax regime (refer paragraphs above) where the rates are now reduced to 22% (excluding surcharge and cess), with no taxes payable under MAT, subject to satisfaction of conditions specified therein.
- However, this reduced corporate tax regime is not available for a company, if the company continues to claim benefits under section 10AA of the Income-tax Act, 1961. Therefore, operating from SEZs may still be profitable for occupiers in the longer run. It is essential that a detailed comparative analysis be carried out on this front.

Ongoing space requirements clearly indicate that the demand for large-scale contiguous space remains robust across many cities, and SEZs are still a preferred choice when it comes to portfolio consolidation for larger occupiers. As is evident from the survey, several occupiers, irrespective of their presence, will be exploring SEZ options if they have any immediate space requirements.

- Our estimates indicate that there is 32 msf. of active demand for space across the country, with nearly 25% of that being geared towards SEZs, in keeping with the long-term average taking up of space. Of course, most of this stems from the major tech cities with a large-scale SEZ presence, such as Pune, Hyderabad, Bengaluru, and Chennai
- We expect that the demand for SEZs will remain healthy over the next 3 to 4 months, as occupiers expedite their business plans in order to take advantage of the direct tax benefits. Being a major occupier of SEZs across the country, the technology sector will drive the demand in the immediate term.

In several cases, developers are also expediting construction timelines in order to meet the Q1 2020 deadline, where possible. Those with projects being completed beyond March 2020 are still confident on demand over the longer term.



As identified by our survey, occupiers who already have an established footprint in SEZs are willing to continue, irrespective of the sunset clause. We believe that it is a minor regulatory change for them, and that it probably won't have a long-term impact on their business decisions. Given their popularity among occupiers, we expect SEZs to remain relevant even over the long term.

Outlook on Rents

So far, the sunset clause has not significantly impacted rental growth in any market and, looking at the supply-demand dynamics across the country, we do not see any impact on rentals resulting from the sunset clause. It is likely to be the low vacancy levels and an occupier rush that provides any push to rents. After all, market dynamics play a larger role in rental growth, with the developers likely to be unaffected by the sunset clause in any manner.

In Conclusion:

In our assessments and conversations with occupiers, most seem to have a fair idea of the sunset clause, and they are already exploring some of the possible scenarios that have been mentioned above. The majority of the occupiers, irrespective of their presence in SEZs, are considering SEZs as a viable option for expansion, relocation, or consolidation, in both their short- and long-term space strategies. Although it is important to note that the direct tax benefits will cease to exist from April 2020, occupiers should be aware of the indirect tax benefits that will continue, regardless of the sunset clause. These will be in addition to the incentives/exemptions that are provided by the respective state governments (where applicable), from time to time.

Those occupiers that are already in SEZs still have an option to expand or relocate after the sunset clause, using the letter of approval that was received before March 2020. However, the direct tax benefits will be available for the unexpired period. The direct tax benefits for developers have lapsed since April 2017, but the developers continue to receive indirect tax benefits, which are still substantial, in order to keep them going. The demand for SEZ space has remained healthy following the announcement of the sunset clause, as well.

With the increase in exports and investments, based on publicly available data, the Commerce Ministry is in discussions with the stakeholders including the government, to consider a 5 year extension of tax benefits for units in SEZ by extending the sunset clause beyond March 31, 2020. Removing MAT on SEZs is also one of the proposals that is being put forth by the Commerce Ministry. One will have to wait and see if these proposals are implemented in the forthcoming budget.

The recent changes wherein MAT has been reduced and minimum built-up area requirements in processing zone of SEZs have been halved makes for an interesting situation, with an inkling towards a more favourable treatment of the SEZ scheme. On the other hand with the recent WTO ruling, India wil need to tweak its SEZ policy from export oriented incentives towards an investment-driven incentive mechanism. The Baba Kalyani Report tasked with the SEZ scheme overhaul has recommended for similar treatment of SEZs where tax incentives are investment-linked and SEZs are treated as economic enclaves (3E framework). The report also pushes for extension of the sunset clause and also incentivising SEZ development by allowing greater flexibility in usage of the non-processing area along with recommendations for simplifying processes. A favourable take by the Commerce Ministry may bring about a formula that pushes for the revival of the SEZs in the country

Developers with upcoming projects beyond 2020 should not be deterred, as the impact of the sunset clause will be minimal on the occupiers. We could see a temporary moderation in the SEZ demand immediately following Q1 2020, as the occupiers evaluate the benefits that are available, but the long-term demand should remain constant. SEZs will still be lucrative for occupiers that are looking for some cost savings over the longer term.

Annexure – A

Particulars	SEZ Unit (Amounts in INR)	Non-SEZ Unit (Amounts in INR)	Remarks
Assessable value of the raw materials imported	100	100	
Custom duty on goods imported			
Basic customs duty	-	10 (100*10%)	
Social welfare surcharge		1 (10*10%)	
IGST		19.98 [(100+10+1)*18%]	
Total taxes payable on the import of goods	-	30.98 (10+1+19.98)	This amount is paid by the non-SEZ unit, and is available as credit that can either be utilized against the payment of IGST on exports or be claimed as a refund.
Assessable value of the goods exported	200	200	
IGST on exports	-	-	If a letter of undertaking is not executed, then the amount paid can be claimed as a refund by the non-SEZ unit.
Cost of acquiring the capital goods	100	100	
Tax/duty payable on the imports of capital goods			
Basic customs duty	-	10 (100*10%)	
Social welfare surcharge	-	1 (10*1%)	
IGST	-	19.98 [(100+10+1)*18%]	
Total tax on acquiring the capital goods	-	30.98 (10+1+19.98)	This will be available as an input tax credit by the non-SEZ unit.

As you would note, though the duties/taxes paid by non-SEZ units would be available as credits/refunds in future, however, there would be a huge cash outflow which would block the working capital for a significant time period. While in case of a SEZ unit, given that the duties/taxes are not payable, such a situation would not arise.

Please note that the above illustration is only indicative and the same would vary depending on the specific sector. The above illustration is independent of the benefits available from a direct tax perspective and export incentives (SEIS scrips).

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