Q10

There is a clear acknowledgement that Special Economic Zones (SEZs) are a tool of industrial development, manufacturing and exports. Recognising this potential, the whole instrumentality of SEZs require augmentation. Discuss the issue plaguing the success of SEZs with respect to taxation, governing laws and administration.

UPSC Civil Services Mains 2015 · GS III · 12 marks · Indian Economy

Indian Economy and issues relating to planning, mobilization of resources, growth, development and employment.

Core demand of the question

- State the SEZ purpose under the SEZ Act 2005
- **Discuss tax issues:** holiday, MAT, DDT and uncertainty
- Discuss governing laws and administration that block manufacturing success

Revision summary

The SEZ Act 2005 promised duty-free, well-served export enclaves for manufacturing.

MAT on SEZ units and developers from 2011-12 and DDT on developers cut the original tax bargain.

Uncertain direct-tax reform talk further discouraged long-gestation factories.

State land, labour and local laws, plus the 2013 land acquisition regime, still bind most zones.

Administration remains multi-agency; many SEZs are IT-heavy or vacant rather than new manufacturing.

Introduction

Special Economic Zones were meant to be duty-free enclaves for **export manufacturing**, with world-class infrastructure and simpler rules. The **SEZ Act, 2005** and Rules, 2006 created that instrument. In practice many zones filled with **IT-ITES** and vacant land, not new factories. Taxation surprises, overlapping laws and heavy administration are the core sores that now need augmentation.

Body

Tax issues

- Units enjoyed a **phased income-tax holiday** (100 per cent then 50 per cent) on export profit under the SEZ code, which was the original bargain for locating inside the fence.
- **Minimum Alternate Tax** was levied on SEZ developers and units from **financial year 2011-12**, which cut the effective holiday and angered investors who had sunk capital on the old promise.

- **Dividend Distribution Tax** on SEZ developers from around **2011** further reduced the post-tax return.
- Talk of a **Direct Taxes Code** and periodic Budget tinkering created **policy uncertainty**; export units cannot plan a ten-year plant if the tax deal moves in year three.
- **Indirect tax** and duty-drawback interaction with the domestic tariff area (DTA) sales cap, and later GST design, add another layer of friction for firms that must sell some output inland.
- Instability of incentives pushed developers toward **real estate and IT parks** rather than long-gestation manufacturing.

Governing laws

- An SEZ still faces **State labour, environment, land and local-body** laws; the single-window claim is incomplete.
- **Land acquisition** after the 2013 Act made large contiguous manufacturing zones harder and costlier; several notified SEZs never became operational.
- **WTO** subsidy and export-contingent incentive concerns, plus free-trade-agreement rules of origin, limit how aggressive India can be on tax holidays.
- **Dual control: SEZ Act versus Customs, FEMA, company law and State industrial lock-in** produces conflicting circulars.

Administration

- The **Development Commissioner** and Board of Approval process is still paper-heavy for expansions, DTA access and service approvals.
- Coordination with State governments on water, power and road **outside the fence** is weak, so the zone is an island.
- Many SEZs are **too small or too IT-heavy**; they relocate existing exporters instead of creating new manufacturing.
- Augmentation needs a **stable tax covenant**, true single window, plug-and-play infrastructure, and a manufacturing-and-export test rather than vacant notified land.

Flow diagram

SEZ Act 2005 -> Export manufacturing aim

Export manufacturing aim -> Tax holiday then MAT DDT

Export manufacturing aim -> Land labour State laws

Export manufacturing aim -> DC and multi agency delay

Tax holiday then MAT DDT -> Weak manufacturing outcome

Land labour State laws -> Weak manufacturing outcome

DC and multi agency delay -> Weak manufacturing outcome

Conclusion

SEZs can still be a tool for manufacturing and exports, but MAT, DDT and shifting tax promises broke investor trust. Overlapping State and Union laws and slow Development Commissioner administration did the rest. Augmentation means a stable fiscal deal, real single window, and zones that actually make goods, not only park IT firms on cheap land.

Facts & figures

SEZ Act 2005

Union law creating special economic zones as deemed foreign territory for authorised operations, with a Development Commissioner.

MAT on SEZs

Minimum Alternate Tax extended to SEZ developers and units from financial year 2011-12, reducing the effective income-tax holiday.

DDT on developers

Dividend Distribution Tax applied to SEZ developers around 2011, another cut in the original incentive pack.

Land Acquisition Act 2013

Raised consent, social-impact and compensation requirements, which slowed large contiguous manufacturing SEZs.

DTA

Domestic Tariff Area: sales from the SEZ into the rest of India are capped and taxed, which complicates mixed-market plants.