

EY Tax Alert

Department of Commerce issues clarification on newly inserted Rule 11B of SEZ Rules

Executive summary

This Tax Alert summarizes a recent instruction¹ issued by the SEZ Division, Department of Commerce, clarifying various concerns relating to Rule 11B of the Special Economic Zone (SEZ) Rules, 2006. The said rule provides for setting up of non-SEZ Information Technology (IT)/ IT Enabled Services (ITES) units in IT/ITES SEZs.

The key clarifications are:

- ▶ Demarcation of non-processing area (NPA) is permitted only after repayment of the tax benefits that were originally availed.
- ▶ Demarcation of NPA shall not be allowed if it results in decreasing the processing area to less than 50% of the total area or less than the area specified in rule 11B(7).
- ▶ Rule 49 would be applicable for clearance of plant and machinery pertaining to rule 11B(5)(i). For common social or commercial infrastructure covered under Rule 11B(5)(ii), benefits taken if any, will have to be repaid.
- ▶ No repayment of benefits is required where basements and other facilities are used exclusively by SEZ units, provided such demarcation is possible and permitted in terms of SEZ Rules, 2006.
- ▶ Common built-up infrastructure and amenities such as cafeteria, hubs, etc will attain dual usage status as provided under rule 11A(1) on repayment and surrender of tax benefits.
- ▶ The tax benefits already availed on goods & services used/ consumed for operation & maintenance of the SEZ are not required to be repaid.
- ▶ The tax benefits to be repaid includes customs duties, central excise duty, CGST, IGST and SGST and such other central levies and tax benefits availed by the developer.
- ▶ NPA units are not entitled for any right / privileges under SEZ law and would be subject to GST or any other law, as are applicable.

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¹ Instruction No. 115 dated 9 April 2024

Background

- ▶ Ministry of Commerce and Industry had inserted new Rule 11B² in the Special Economic Zone (SEZ) Rules, 2006 which allowed co-existence of SEZ units and non-SEZ Information Technology (IT) /IT enabled services (ITES) units in the same SEZ premises.
- ▶ Rule 11B of the SEZ Rules, 2006, laid down the process, conditions, compliances, etc. to allow conversion of processing area in IT and ITES SEZs into non-processing area (NPA). It became effective from 7 December 2023.
- ▶ Queries were received from stakeholders regarding the processes and compliances to be followed for setting up of non-SEZ units in IT/ITES SEZs.
- ▶ Accordingly, Instruction has been issued to clarify various issues relating to the implementation of aforesaid rule.

Instructions

- ▶ The demarcation of a NPA is permitted only after repayment of the tax benefits that were originally availed. Repayment will not be basis depreciated value or prevailing market value.
- ▶ The demarcated built up area shall be certified by the Chartered Engineer. However, no valuation would be needed as the tax benefit will be certified based on financial books.
- ▶ Demarcation of NPA shall not be allowed if it results in decreasing the processing area to less than 50% of the total area or less than the area specified in rule 11B(7).
- ▶ Rule 11B(9) provides that no tax benefits shall be available on operation and maintenance of common infrastructure and facilities of an SEZ.

The reference is to all common infrastructure of the entire SEZ and not just a partial floor/ area to be demarcated as NPA.

- ▶ The tax benefits on the construction of the building including basement should be taken into account for repayment of tax benefits attributable to the demarcated NPA.
- ▶ Rule 49 of the SEZ rules provides for removal of capital goods from SEZ unit on payment of duty at a depreciable value.

Depreciable value under rule 49 would be applicable for clearance of plant and machinery pertaining to the NPA calculated in proportion of the NPA to the total built-up area of the processing area as per 11B(5)(i).

For benefits attributable to common social or commercial infrastructure as per Rule 11B(5)(ii), all the benefits taken have to be repaid.

- ▶ SEZ units may opt out of SEZ under Rule 74 and complete built up floor is available for demarcation as NPA in terms of Rule 11B(3).
- ▶ Board of Approval (BOA) is empowered under Rule 11B to demarcate NPA.
- ▶ Ideally consent of the co-developers should be taken for demarcation of the NPA. However, BOA may relax this condition on merits of the case.
- ▶ No repayment of benefits is required where basements and other facilities are used exclusively by SEZ units, provided such demarcation is possible and permitted in terms of SEZ Rules, 2006.

Demarcation of vacant land in an SEZ is not permitted under rule 11B of the SEZ Rules, 2006.

- ▶ Common built-up infrastructure and amenities such as cafeteria, hubs, etc will attain dual usage status as provided under rule 11A(1) on repayment and surrender of tax benefits.
 - ▶ The tax benefits already availed on goods & services used/ consumed for operation & maintenance of the SEZ are not required to be repaid. Rule 11B(9) applies prospectively.
 - ▶ No benefits on operation & maintenance of common infrastructure and facilities shall be available if the same is used by units in NPA.
 - ▶ The demarcated area can only be used for IT/ITES business.
 - ▶ Rule 11B envisages demarcation of building in an SEZ, irrespective of location of such building in the SEZ Area.
 - ▶ Jurisdictional UAC shall specify the mechanism for access control as well as movement of common employees (Human resource, finance, legal etc.) based on specific requirements of the SEZ after considering the risk profile of each SEZ on a case-to-case basis.
- There will be no additional or specific requirements for scrutiny or verification of goods being procured by NPA units.
- ▶ Compliance requirements for NPA units will be at par with DTA units for administration of Central / State / local Government laws.
 - ▶ The tax benefits to be repaid includes customs duties, central excise duty, CGST, IGST and SGST and such other central levies and tax benefits availed by the developer.
 - ▶ NPA units are not entitled for any right / privileges under SEZ law and would be subject to GST or any other law, as are applicable.
 - ▶ NPA units are not SEZ units set up in processing area and are not envisaged to get benefits extended by the State Government under section 50 of the SEZ Act, 2005 or otherwise to SEZ units.

² Notification No. G.S.R. 881(E) dated 6 December 2023

Comments

- a. The Instruction addresses a lot of doubts arising out of demarcation of NPA in SEZ. It may facilitate ease of compliance for SEZ developers.
- b. While the Instruction clarifies that the benefits are required to be repaid in full, SEZ developers may represent to seek the repayment at depreciated value since the goods/ P&M have been used solely by the SEZ processing area till demarcation.
- c. It may be important to analyze the documents basis which tax benefits will be repaid and whether such tax can be claimed as input tax credit under GST basis the tax repayment documents.
- d. The requirement of obtaining separate GST registration by the developers for non-processing area as regular DTA registration and not SEZ will need to be evaluated.

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