

**PERFORMANCE OF SPECIAL
ECONOMIC ZONES (SEZ)**

MINISTRY OF COMMERCE AND INDUSTRY

**PUBLIC ACCOUNTS COMMITTEE
(2017-18)**

NINETIETH REPORT

SIXTEENTH LOK SABHA



**LOK SABHA SECRETARIAT
NEW DELHI**

PAC No.2124

NINETIETH REPORT

PUBLIC ACCOUNTS COMMITTEE
(2017-18)

(SIXTEENTH LOK SABHA)

**PERFORMANCE OF SPECIAL
ECONOMIC ZONES (SEZ)**

MINISTRY OF COMMERCE AND INDUSTRY



Presented to Lok Sabha on:

28/03/2018

Laid in Rajya Sabha on:

28/03/2018.

**LOK SABHA SECRETARIAT
NEW DELHI**

March 2018/ Phalguna 1939 (Saka)

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- * I. Minutes of the Seventh Sitting of Sub-Committee IV of PAC (2017-18) held on 31.08.2017.
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- * III. Minutes of the Twenty First Sitting of PAC (2017-18) held on 15.03.2018.

* Not appended to the Report.

COMPOSITION OF PUBLIC ACCOUNTS COMMITTEE (2017-18)

Shri Mallikarjun Kharge - Chairperson

M E M B E R S

L O K S A B H A

2. Shri Sudip Bandyopadhyay
3. Shri Subhash Chandra Baheria
4. Shri Prem Singh Chandumajra
5. Shri Nishikant Dubey
6. Shri Gajanan Chandrakant Kirtikar
7. Shri Bhartruhari Mahtab
8. Smt. Riti Pathak
9. Vacant*
10. Shri Abhishek Singh
11. Prof. Ram Shanker
12. Dr. Kirit Somaiya
13. Shri Anurag Singh Thakur
14. Shri Shivkumar C. Udasi
15. Dr. P. Venugopal

R A J Y A S A B H A

16. Shri Naresh Agrawal
17. Shri Satyavrat Chaturvedi
18. Shri Bhubaneswar Kalita
19. Shri Mohd. Ali Khan†
20. Shri Sukhendu Sekhar Roy‡
21. Shri Ajay Sancheti
22. Shri Bhupender Yadav

SECRETARIAT

- | | | | |
|----|----------------------------------|---|----------------------|
| 1. | Shri A.K. Singh | - | Additional Secretary |
| 2. | Shri T. Jayakumar | - | Director |
| 3. | Shri Paolientlal Haokip | - | Deputy Secretary |
| 4. | Shri Shankarnath Sharma Laimayum | - | Executive Assistant |

* Shri Neiphiu Rih Ceased to be a Member of Committee consequent upon acceptance of his resignation from Lok Sabha w.e.f. 22 February, 2018.

† Elected w.e.f. 29 December, 2017 in lieu of vacancy caused due to retirement of Shri Shantaram Naik.

‡ ceased to be a Member of Committee consequent upon his retirement from Rajya Sabha on 18 August, 2017 and re-elected w.e.f. 29 December, 2017.

Sub-Committee – IV (Civil Ministries and Non-compliance of timely submission of Action Taken Notes) (2017-18)

- Convenor : 1. Shri Bhartruhari Mahtab
Alternate Convenor : 2. Shri Gajanan Chandrakant Kirtikar
Members : 3. Shri Nishikant Dubey
4. Dr. P. Venugopal
5. Shri Ajay Sancheti
6. Shri Shivkumar C. Udasi
7. Shri Mohd. Ali Khan

INTRODUCTION

I, the Chairperson, Public Accounts Committee (2017-18), having been authorised by the Committee, do present this Ninetieth Report (Sixteenth Lok Sabha) on 'Performance of Special Economic Zones (SEZ)' based on C&AG Report No. 21 of 2014, relating to the Ministry of Commerce and Industry.

2. The Report of the Comptroller and Auditor General of India was laid on the Table of the House on 28th November, 2014.

3. The Public Accounts Committee (2017-18) took up the subject for detailed examination and report. The Sub-Committee-IV was constituted under the Convenorship of Shri Bhartruhari Mahtab, MP (LS) and Member of PAC that took evidence of the representatives of the Ministry of Commerce and Industry on the subject at their sitting held on 31st August, 2017. Accordingly, a draft Report was prepared and finalized by the Sub-Committee and placed before the Public Accounts Committee (2017-18) for their consideration.

4. The Committee considered and adopted this draft Report at their sitting held on 15th March, 2018. Minutes of the sittings are appended to the Report.

5. For facility of reference and convenience, the Observations/Recommendations of the Committee have been printed in bold and form Part II of the Report.

6. The Committee would like to express their thanks to the representatives of the Ministry of Commerce and Industry for tendering evidence before them and furnishing information in connection with the examination of the subject.

7. The Committee place on record their appreciation of the assistance rendered to them in the matter by the office of the Comptroller and Auditor General of India.

NEW DELHI;

27 March, 2018

6 Chaitra, 1939-40 (Saka)

MALLIKARJUN KHARGE

Chairperson,

Public Accounts Committee

PART - I
REPORT

**PERFORMANCE OF SPECIAL ECONOMIC ZONES (SEZs) (MINISTRY OF
COMMERCE AND INDUSTRY)**

Introductory

This Report of the PAC, prepared by Sub-Committee IV of PAC (2017-18) on "Civil Ministries and Non-Compliance in timely submission of Action Taken Notes" is based on the report No. 21 of 2014 of Comptroller and Auditor General of India containing the results of performance audit of 'Performance of Special Economic Zones (SEZs)' during April 2013 to January 2014. The Audit Report relates to instances which came to their notice in the course of test audit for the period 2006-07 to 2012-13 as well as those of earlier years, not reported in the previous Audit Reports.

2. A Special Economic Zone is a geographical region within a Nation-State in which a distinct legal frame work provides for more liberal economic policies and governance arrangements than prevail in the country at large. The geographical areas thus notified under the SEZ Act, were declared to be outside the normal customs territory of India. To establish a new regulatory framework, Government of India announced a comprehensive SEZ policy in April 2000 as a part of the EXIM Policy, which was followed by a dedicated SEZs Act in February 2006. This Act aimed to promote economic growth and development in the form of greater economic activity, promotion of exports, investments and creation of employment and infrastructure. The objectives were to be achieved through incentivizing the SEZ activities in the form of income tax holidays, various exemptions from several indirect taxes and other benefits. For success of this Act, DoC, DoR, CBEC, CBDT, State Governments, Banks etc were required to act in tandem. Post enactment of the Act, the country had witnessed several protests resisting land acquisition initiatives for SEZs, pointing towards a need for their social evaluation in addition to the defined objectives. Considering the magnitude of exemptions availed by SEZs, it was imperative to assess their performance vis-a-vis the duty forgone. The objective of Audit's performance audit was to assess

the adequacy of regulatory framework, policy implementation, operational issues and internal controls of SEZs. The Report of C&AG also made an attempt to study the social and economic benefits of SEZs in India.

3. Before delving into specific issues, the following are the broad observations by Audit in their report that the Committee are concerned about, resulting in their closer examination and compilation of this Report.

(i) Performance of SEZs and socio economic impact

Though the objective of the SEZ is employment generation, investment, exports and economic growth, however, the trends of the national databases on economic growth of the country, trade, infrastructure, investment, employment etc do not indicate any significant impact of the functioning of the SEZs on the economic growth. Outcome budget of Department of Commerce indicated that the capital outlay of SEZs for development of the infrastructure is funded under Assistance to States for Developing Export Infrastructure and Allied Activities (ASIDE) Scheme from 1 April 2002. An outlay of Rs. 3793 crore was provided under ASIDE scheme during the 11th Five Year Plan (2007-12) Rs. 2050 crore was spent in the 10th Plan period and Rs. 3046 crore (upto 1 Jan 2013) was spent during the 11th Five Year Plan under the scheme. However, the same has not been included to indicate the outlay or domestic investment of SEZs.

Generation of employment opportunities, encouraging investment (both private and foreign) and increasing India's share in global exports are the three important objectives of the SEZ Act. Performance of sampled SEZs (152) in the country indicated certain non performance in employment (ranging from 65.95% to 96.58%), investment (ranging from 23.98% to 74.92 %), and export (ranging from 46.16 to 93.81%). The achievements of SEZs in the country are contributed by a few SEZs located in some developed States, which were mostly established prior to enactment of the SEZ Act.

(ii) Growth pattern of SEZs

Among all the States of India, Andhra Pradesh boasted of operating maximum number (36) of SEZs in the country followed by Tamil Nadu, Karnataka, and Maharashtra. Over a period of time, the growth curve of SEZs had indicated preference for urban agglomeration by industry, undermining the objective of promoting balanced regional development. Another significant trend in the SEZ growth has been the preponderance of IT/ITES industry. 56.64 per cent of the country's SEZs cater to IT/ITES sector and only 9.6 per cent were catering to the multi product manufacturing sector.

(iii) Land allotment and utilization

Land appeared to be the most crucial and attractive component of the scheme. Out of 45635.63 ha of land notified in the country for SEZ purposes, operations commenced in only 28488.49 ha (62.42 %) of land. In addition, Audit noted a trend wherein developers approached the government for allotment/purchase of vast areas of land in the name of SEZ. However, only a fraction of the land so acquired was notified for SEZ and later de-notification was also resorted to within a few years to benefit from price appreciation. In terms of area of land, out of 39245.56 ha of land notified in the six States, 5402.22 ha (14%) of land was de-notified and diverted for commercial purposes in several cases. Many tracts of these lands were acquired invoking the 'public purpose' clause. Thus land acquired was not serving the objectives of the SEZ Act. In four States (Andhra Pradesh, Karnataka, Maharashtra and West Bengal), 11 developers/units had raised Rs. 6309.53 crore of loan through mortgaging SEZ lands. Out of which, three developers/units had utilized the loan amount (Rs. 2211.48 crore i. e 35 per cent of Rs. 6309.53 crore) for the purposes other than the development of SEZ, as there was no economic activity in the SEZs concerned.

(iv) Tax Administration

SEZs in India had availed tax concessions to the tune of Rs. 83104.76 crore (IT-Rs. 55158; Indirect taxes-Rs. 27946.76 crore) between 2006-07 and 2012-13. Our review of the tax assessments indicated several instances of extending in-eligible exemptions/deductions to the tune of Rs. 1,150.06 crore (Income tax Rs. 4.39; Indirect Taxes Rs. 1,145.67 crore) and systemic weaknesses in Direct and Indirect tax administration to the tune of Rs. 27,130.98 crore.

(v) Monitoring and Control

A feedback response of Developers, Units within SEZs, the Development Commissioners, Exporters, Trade and Industry, was elicited on various issues concerning functioning of SEZs in the country. These responses mainly point towards, among others, a need for revamping single window clearance system efficient tax administration and review of the decision to introduce DDT and MAT. The DCs, Developers and Units have largely stated in their feedback that, monitoring was adequate. However, audit is of the opinion that monitoring framework requires strengthening. The inadequacies in the performance appraisal system of SEZs, compounded by lack of Internal Audit, facilitated developers to misrepresent facts to the tune of Rs. 1150.06 crore which remained undetected as there was no mechanism to cross verify the data given in the periodical reports with the original records. Further, there was no system to monitor the exemptions given on account of Service Tax, Stamp Duty etc. Consequently, a reliable estimate of the magnitude of the total tax concessions provided could not be made. DoC does not have any IS Strategic plan for Database Management System of the SEZs in the country because the entire database management system project, its maintenance and the strategic management control have been outsourced to NSDL. Thus, a critical IS system is not internally monitored nor has any committee been formed to adequately monitor the system as required in a typical IS organisation. Approval of an important stakeholder in DoR was also not taken with regard to the revenue

administration function of the system. In view of the complete outsourcing of the project and its maintenance activities, the strategic control of Service Level Agreements review, source code review and performance audit of the IT infrastructure and the application needs to be mandatorily with the Government. Accordingly, separate and specific SLAs are required to be reviewed and correspondingly aligned.

Audit scrutiny revealed the requirement of multiplicity of approvals for SEZs with just 38.78 per cent becoming operational after their notification; idling of 52 per cent of the land allotted; decline in the activity in the manufacturing sector; diversion of land acquired for public purposes after de-notification; ineffective single window system as there is no matching State level legislation in seventeen States of the SEZ Act; non-monitoring of the SEZ developers and unit holders; absence of internal audit set up; extending ineligible exemptions/deductions in tax assessments and systemic weakness in direct and indirect tax administration, etc.

5. The recommendations by Audit are also reproduced below for reference.

1. The Ministry of Commerce and Industry (MOC&I) may prescribe measurable performance indicators in line with the objectives and functions of the SEZs so that the real socio-economic benefits accrue for citizens and the States.
2. The SEZ policy and procedures need to be integrated with the Sectoral and State policies with the involvement of the unique advantageous points therein.
3. MOC&I may consider prescribing time limits for each stage of the SEZ life cycle for benchmarking purposes.
4. MOC&I may consider introducing a suitable mechanism to monitor non-operational SEZ units.
5. MOC&I may review the SEZ policy and procedures regarding developers seeking vast tracts of land from the government in the name of SEZs and putting only a fraction of it for notification as SEZ.
6. DoR may like to visit the Income Tax Act, 1961 and Wealth Tax Act, 1957 in view of the: I. Need for timely remittance of foreign currency remittances which

was not provided for under section 10AA as in the case of Sections 10A, 10B, and Section 10BA;

II. Section 10A/10AA/10B/10BA of the Income Tax Act which does not define the terms 'profits of the business', 'total turnover of the business', thereby assesseees get an opportunity to tweak their 'profits of the business' and 'total turnover of the business' according to their suitability which is resulting in incorrect claim of exemptions;

III. Misuse of Section 2(ea) of Wealth Tax Act 1957 where asset, inter alia, includes Land held by the assessee as stock-in-trade for a period of 10 years from date of acquisition; and Report No. 21 of 2014 (Performance Audit)

IV. Impact of levy of DDT and MAT in SEZs vis-a-vis DTA units based on an empirical study.

7. MOC&I may review the arrangements in place for Service Tax administration as there was no mechanism for capturing, accounting, and monitoring of ST forgone by DC or the jurisdictional ST Commissionerates.

8. MOC&I may consider recovering duty forgone on inputs utilised for manufacture of finished products, on clearance of such exempted goods in DTA, as is done in the case of EOUs.

9. In addition to specific monitoring measures, internal audit needs to be conducted and internal controls both in the manual and online system need to be strengthened while retaining the strategic control of the SEZs database management system with MOC&I.

II. PERFORMANCE OF SEZs AND SOCIO-ECONOMIC IMPACT

6. Asked for comments the Ministry has to offer on the findings of Audit relating to failure of SEZs to achieve objectives, the Ministry in reply wrote;

"The Audit has pointed out that the three important objectives of SEZ Act, 2005 are to generate employment opportunities, encourage investment and increase India's share in global exports. The Audit in its findings pointed that same were not achieved.

In this regard it is to be mentioned that the average time for development of SEZ takes about five to six years. Therefore immediately for five to six years after the SEZ Act coming into force in 2005, no significant growth was registered due to high gestation period. However, the comparative data on employment, investment and export in respect of SEZs from the year 2009-10 to 2016-17, shows that there has been a significant increase in these parameters."

Financial Year	Exports (Rs. Crore)	Employment (Persons)	Investment (Rs. Crore)
2009-2010	220711	503611	148489
2010-2011	315868	676608	202810
2011-2012	364478	844916	201875
2012-2013	476159	1074904	236717
2013-2014	494077	1283309	296663
2014-2015	463770	1442316	338794
2015-2016	467337	1591381	376494
2016-2017	523637	1731641	423189

7. On the reasons as to why the outlay of Rs.3793 crores during 2007-12 (10th plan) and Rs.3036 crores up to 1st January, 2013 (11th plan) provided under Assistance to States for Developing Export Infrastructure and Allied Activities (ASIDE) Scheme have not been included to indicate the outlay or domestic investment of SEZs, the Ministry in reply wrote;

"It is true that funds for infrastructure were allotted to Government SEZs under ASIDE Scheme. The point is well taken that the investment in SEZs on the basis of funds provided under ASIDE Scheme should have been taken into account to indicate outlay or domestic investment. Development Commissioners have been asked to indicate this in future."

8. As to why there is non-performance in employment ranging from 65.95% to 96.58%, investment ranging from 23.98% to 74.92% and export ranging from 46.16% to 93.81% respectively thus defeating the objectives of the SEZ Act, they replied;

"As may be seen from comparative data as given above, there has been a significant growth in the areas on employment, investment and exports from SEZs. However, the individual projections of the developers while seeking approval of the Board of Approval for getting a letter of approval for setting up an SEZ may not have been achieved due to reasons such as market forces, global and domestic demand, change of business plans etc. The SEZ rules also provide a period of 10 years for construction of minimum built up area from the date of notification of the SEZ."

9. Asked to explain why the achievements of SEZs in the country are contributed by only a few SEZs located in developed States and mostly established prior to the enactment of the SEZs Act. The Ministry replied;

"It may be appreciated that while setting upon an SEZ by the developer various necessary aspects like availability of contiguous and vacant land, availability of managerial, skilled, semi-skilled, non-skilled workforce, distance from nearest sea-port, air-port, rail and road head in the vicinity of the proposed SEZ are taken into consideration to attract the prospective entrepreneurs and provide them World Class Infrastructure with ease of connectivity to facilitate their hassle-free operations from said SEZ. As a result, location of SEZs plays a vital role in its successful take-off and fulfilling the purpose of SEZ regime."

10. Explaining the below par performance of SEZ units in the country, the representative of the Ministry during evidence stated;

"Sir, first you had talked about the fact that the growth of the SEZs is not as much as we could anticipate or perhaps hope. Let me say for the record and the presentation also brought out; the employment has continued to grow and the investment has also continued to grow. Nevertheless, the policy of the Government of India is an evolving policy. We had created a certain tax regime for this SEZ unit. Subsequently, we introduced MAT, we brought in DDT, so it became a less attractive investment for many of the manufacturing units.

The second aspect is that over the last three years we have seen the slow down in the world demand and these are the units that are dedicated to exports largely. So, they have been affected to some extent. Nevertheless, some of the industries have grown and some of them have not. So, this is the position. None of our industries, within our country also, can be immuned to the economy around them and the world around them. Some of these are beyond our control.

The competitiveness, while it is affected by domestic factors, it is also affected by global commodity prices, the currency fluctuations, so there is a large number of factors which do influence the competitiveness of our exports. We have to keep addressing them and the policy keeps adapting to deal with that.”

(III) GROWTH PATTERN OF SEZs

11. Asked as to why the growth curve of SEZs had indicated preference for urban agglomeration by industry undermining the objective of promoting balanced regional development, the Ministry in reply wrote;

“The growth trajectory of SEZs inter alia depends upon crucial factors like availability of contiguous and vacant land, availability of funds by financial institutions for the development of SEZ, easy connectivity with sea-port, airport, rail, road and availability of skilled, non-skilled and managerial staff in the vicinity of proposed SEZs etc. for its smooth functioning & successful take-off. Further it may be appreciated that in Indian scenario all these requirements for SEZs are fulfilled by urban areas. As SEZs are private investment driven most of the developers prefer urban areas. However, to encourage setting up of SEZs in all the areas, different limits of minimum area requirement of land were provided in the SEZ Rules.”

12. Explaining as to why 56.64% of the country’s SEZs cater to IT/ITES sector and only 9.6% are catering only to the multi-product manufacturing sector, the Ministry replied;

“In the field of IT/ITES sector India has proved its mettle and has been successfully registering robust and unwavering growth trajectory year on year. Therefore the same was reflected in SEZs also.

Further as compared to IT/ITES Sector, contribution of multi-product manufacturing sector has not been up to the expectation because of various factors which mainly entails competition with major World Economies like that of China which provides manufactured products at a highly Internationally Competitive price/rates as compared to India's ones particularly due to their scale of operations and their more pro- active labour laws.”

(IV) LAND ALLOTMENT AND UTILIZATION

13. Explaining as to why operations commenced only in 28488.49 hectares (62.42%) of land out of the total hectares 45635.63 ha of land notified, in the country for SEZ purposes, the Ministry replied;

“It needs to be stated at the outset that SEZs in India are primarily private investment driven. Commencement of operation of notified SEZs takes place when first unit setup in the zone starts its commercial activities. To reach to this point, the SEZ developer has to comply with various statutory requirements beginning from land possession to its notification, development of infrastructure within the prescribed time frame or as may be extended, compliance with the building bye-laws, attracting the prospective entrepreneurs for setting up units in their SEZs, providing the units the quality infrastructure competitively at reasonable rates/price. Besides, market conditions in the International Business also play a key role in the success of a SEZ and its timely take-off/utilization of land. Due to the reasons enumerated above, some of SEZs may not be able to take-off timely and successfully, and thus unable to utilize the notified land. However, the department is looking into ways and means to ensure that the unutilized area is utilized optimally. Also the withdrawal of MAT and DDT to Units as well as developers could have caused the entrepreneurs not to come forward to set up units in the SEZs leading to land remaining unutilized.”

14. On whether there is any mechanism within the Ministry for containing developers approaching the Government for allotment/purchase of vast areas of land in the name of SEZ wherein only a fraction of land so acquired is notified for SEZ and later de-notified to benefit from price appreciation and action, if any, taken against such fraudulent developers who fleece the exchequer, the Ministry replied;

“Since land is a State subject and the State Government has to give its NOC for allowing an SEZ to be developed in that State, the Central Government has no role to play under the federal structure of the Constitution of India in containing the developers from approaching the State Government for land and permission/NOC for setting up SEZs. However, the Department of Commerce has already taken effective and clear-cut steps to contain any possible misuse of SEZ policies viz as per letter dated 18.08.2009 addressed to all Chief Secretaries of States, the States Governments would not undertake any compulsory acquisition of

land for setting up of the SEZs. Board of Approval (BoA) will not approve any SEZs where the State Governments have carried out or propose to carry out compulsory acquisition of land for such SEZs after 5th April 2007.

The DOC vide its Letter No. D.12/45/2009-SEZ dated 13.09.2013 has advised all state governments the following points while recommending for consideration of de-notification of notified SEZ land :-

(i) All such proposals must have an unambiguous 'No Objection Certificate' from State Government concerned.

(ii) State governments may also ensure that such de-notified parcels would be utilised toward creation of infrastructure which would sub-serve the objective of the SEZ as originally envisaged

(iii) Such land parcels after de-notification will conform to Land Use Guidelines/master plans of the respective State Governments.

Further there is no loss to the exchequer due to the de-notification of an SEZ.

In fact the developer who proposes to de-notify an SEZ is required to pay back all fiscal benefits taken from the State Government and the Central Government before de-notification is allowed."

15. Explaining the instances pointed out by Audit of land acquired for SEZs being put to other uses, the representative of the Ministry during evidence stated;

"There was the concern about what is the land allocation guidelines which you have just mentioned, Sir, let me make it very clear the special economic zone is not merely a Central Government imposition, it is a partnership with the State Government. Yes, land is entirely within their domain. We cannot interfere. Even under the Constitution, we cannot. So, it is not a question of absolving ourselves of the responsibility. We have set certain priorities. Even when a SEZ is to be de-notified, we take the inputs of the State Government. We also tell them that when it is de-notified and you have recommended, please, see that it is used for the purpose for which it was intended as far as possible. So, if it is an industrial area then it should be used industrially. If it was meant for some housing project, they may do like that. The onus is certainly on the State

Government that is because under the Constitutional arrangements that is the responsibility of the State.”

16. Replying to concerns raised by the Committee about the misuse of the clause ‘public purpose’ under which land for SEZs are acquired by State Governments/developers and later on utilized for other purposes, the representative of the Ministry during evidence stated;

“In some cases, the State Governments have done. Those are a limited number of cases. The vast majority of the SEZs are privately owned. In the scheme of things, from us to say that a businessmen who has invested in a piece of land today he sees a certain framework of financial benefit to him, he decides to go for SEZ. Tomorrow, that framework changes, is it right and appropriate for us to not permit him to de-notify that SEZ? To the extent possible, we would ask the State Government to ensure that it is used for the purpose originally intended. We have issued detailed guidelines in 2013. We will give a copy of that.....

...Sir, I just wanted to add, this is a communication of 2007. It says, the Board of Approval will not approve any SEZ where the State Governments have carried out or propose to carry out compulsory acquisition of land. So, the point only is that for almost a decade, we have been saying the same thing; do not acquire; there should be no compulsory acquisition; we will not approve an SEZ like this. So, we are consistent in the policy. We have framed guidelines to the extent. Nevertheless, I very much understand the anguish that is being expressed by the Members. We would be happy to be advised in what further manner we could take it up with the State Governments because we are certainly conscious. We have been doing for the last one decade always making the same point; there should be no land acquisition and certainly no compulsory land acquisition.”

17. The Committee note that 11 developers/units in four States (Andhra Pradesh, Karnataka, Maharashtra and West Bengal) raised Rs.6309.53 crore loan through mortgaging SEZ land. And these being only test checked cases, the Committee wanted to know whether the Ministry have undertaken any inquiry to find out the total number of such economic offenders, the Ministry replied;

“There is no provision in the SEZ Act or Rules specifying that SEZ land cannot be mortgaged. However, there is a provision in Rule 11(9) of the Rules that SEZ Land cannot be sold. Audit has tried to say that when the

land cannot be sold how it can be mortgaged. In respect of SEZ units in the Central Govt. SEZ, Department of Commerce had issued instructions vide letter No. A.2/3/2010-SEZ dated 31/03/2010 permitting units to mortgage the lease hold rights to financial institutions/banks. In this regard it is for the lending bank to decide whether a particular asset can be mortgaged or not. In fact this matter was taken up by the Department of Commerce with the Department of Financial Services. In response a reply (copy enclosed) has been received from the Indian Banking Association stating that the SEZ act and Rules do not prohibit creation of Charge / security interest over the SEZ Land. Marketability of such SEZ Land in the event of enforcement is challenging. Even when there is restriction on alienation, lender do get security interest created in their favour and similar challenges are faced in the case of agricultural land / project assets under various concessions. Mortgage of SEZ land is based on a credit decision, and that even an unsecured lending is permissible if deemed fit. It has been pointed out that in the case of SEZ land transferee of such land should be acceptable to the Board of approval. Even where permission for creation of security has been granted by the concerned authorities there are terms which says that such permission of SEZ land is granted subject to extent SEZ Laws and SEZ Law shall prevail over other laws in case of enforcement of security interest by lenders. However, comments of the Department of Financial Services are awaited.”

18. Asked whether the loan amount of Rs 2211.48 crores which have been utilized by three developers/units for purposes other than the development of SEZ been recovered and reasons therefore, the Ministry replied;

“As already mentioned in reply to the previous question, the mortgaging of land is between the developer/Unit and the lending bank and monitoring of the utilization can be done by the lending bank. There is no role of the Department of Commerce. Any recovery due to default by the borrower can be undertaken by the lending bank. Therefore, the question of money coming back to the Department of Commerce does not arise.”

19. Replying to queries regarding irregular extensions being granted with gaps between dates of expiry and grant of extension, the representative of the Ministry stated;

“Sir, it happens sometimes that a developer makes an application for extension after expiry of the validity period. Or, sometimes, the application is made just before the expiry and the request comes up before the Board of Approval. In this case, once the Board of Approval has given the extension up to a particular period, then there is no gap in

between. That is what the Board of Approval decided at that point of time. In the meeting held on 13th March, 2012, the Board of Approval had granted the approval up to 6th April, 2013. So, once the extension is given up to 6th April, 2013, then there is no gap in between.”

(V) TAX ADMINISTRATION

20. Explaining the reasons for extending in-eligible exemptions/deductions to the tune of Rs. 1,150.06 crores (income tax Rs. 4.39 crore and indirect taxes Rs. 1145.67 crore) and systemic weakness in Direct and Indirect tax administration to the tune of Rs. 27,130.98 crores, the Ministry replied;

“The matter pertains to the Department of Revenue. However, the Department of Commerce will take up concerns of the Audit and the Subcommittee on the issue with the Department of Revenue for effective tax administration in SEZs and the measures that can be taken by the Department of Commerce in this regard.”

21. Further elaborating on the tax administration in SEZs, the representative of the Ministry during evidence stated;

“Sir, if I may clarify, the tax regime is as stated in the policy. On the date a unit becomes approved, its tax calculation begins from that day when it starts the business and that process is certainly monitored by our Development Commissioners and their team. We have a team from the Customs also because if any item has to go outside the boundary, you have to pay the customs duty. The Customs Officer watches the tax regime that he is not taking more than he is entitled to just like for a unit that is located in the DTA the income tax officer makes sure that he pays his tax in accordance with the rules applicable to him. So, any unit that is located within SEZ will pay income tax or whatever tax is due according to the regime available to him. So, it is the same rule of law. The exemptions that are available will be available as per the location of the unit. The regime is exactly the same and my Development Commissioners know the date on which a unit has started operating and they are monitoring it.”

(VI) MONITORING AND CONTROL

22. On whether the Ministry is revamping a single window clearance system, tax administration and review of the decision to introduce DDT and MAT within a

time frame as being pointed out by the stake holders in their feedback responses regarding the functioning of SEZs in the country? If not, why, the Ministry replied;

"Though efforts to strengthen the single window clearance system have been made by way of taking up the issues with the respective State Governments from time to time, however, in cases where State Governments authorities have to examine applications under the prescribed rules and regulations of the State Government, single window facility from State Government is required. Central Government has already provided single window in the form of Board of Approval (BoA) at Central level and Unit Approval Committee at SEZ level.

In order to revive the lost charm of SEZs amongst the entrepreneurs, need for removal of MAT & DDT is strongly felt as being expressed by the stakeholders. Despite the matter having been taken up with the Ministry of Finance at the highest level of Government, the Ministry of Finance has not agreed to the same. However, this Department continues to project this issue before the Ministry of Finance for a resolution."

23. Explaining the reason as to why the Ministry failed to strengthen the monitoring frame work leading to inadequacies in the performance appraisal system of SEZs, lack of internal audit thus facilitating developers to misrepresent facts to the tune of Rs.1150.06 crore which remained undetected, the Ministry replied;

"To strengthen the monitoring framework and put in place the performance appraisal system, steps like implementation of SEZ online system across all SEZs in the Country and deployment of dedicated CA firms, have been taken.

Furthermore, Department of Commerce vide notification dt.05.08.2016, has inserted a new rule i.e. Rule 79 in the SEZ Rules,2006, whereby, All the authorized operations under Special Economic Zones Act, 2005 and transactions relating thereto in Special Economic Zones and Units in the Special Economic Zones shall be audited by the Customs officers from a panel drawn by the Jurisdictional Development Commissioner in consultation with the Jurisdictional Chief Commissioner of Customs and Central Excise."

24. Explaining the reason as to why there was no system to monitor the exemptions given to SEZs on account of service tax, stamp duty etc, the Ministry replied;

"Matters pertaining to Service Tax & Stamp Duty are handled by two different Government Authorities i.e. Central Excise (Govt. of India) & Stamp Duty (State Govt.) respectively. Therefore, SEZ authorities of Department of Commerce are not empowered to maintain/monitor such records of Service Tax/ Stamp Duty."

25. Explaining the reasons as to why DOC does not have any strategic plan for Database Management System of the SEZs in the country to adequately monitor the systems online, the Ministry replied;

"DOC has engaged NSDL for Database Management System. All SEZ activities are now being carried out online. Full integration with the icegate system of Directorate of systems of the CBEC is also being actively pursued to integrate all the import and export activities of SEZs with Indian Customs EDI System."

PART II

OBSERVATIONS AND RECOMMENDATIONS

1. Performance of SEZs

The Committee note that there are elements of gestation period related delays during the initial years of SEZ regime. They also note steady rise in the performance from 2009-2010, i.e. five years after notification of SEZs. However, the Committee find the absence of defined performance indicators vis-à-vis investments and revenues forgone. The Committee, therefore, concur with Audit's recommendation for the Ministry to prescribe measurable performance indicators. They would also like to agree with Audit's recommendation and desire that such performance parameters should be reflective of the revenue forgone as well as the investments that goes into the SEZs and must justify not only the economic, but the social and ecological costs of setting up SEZs.

2. Non-uniform performance

The Committee note that the achievements of SEZs in the country are due to good performance of few SEZs located in developed States and mostly established prior to the enactment of the SEZs Act. They opined that the Export Promotion Zones (EPZs) prior SEZ's Act had performed better than the SEZs which have become tax evading zones without proportionate benefits to the economy. The Ministry on the issue submitted that the location of an SEZ plays a vital role in its successful take-off depending on factors like availability of contiguous and vacant land, availability of managerial, skilled, semi-skilled, non-skilled workforce, distance from nearest sea-port, air-port, rail and road head in the vicinity of the proposed SEZ, etc. The Committee could not comprehend as to why the Ministry, while being aware of such important factors for the success of

SEZ, still went ahead with most of the SEZs which are under-performing for want of one or more of these factors and desire the Ministry to explain in the rationale for setting up such SEZs which are performing under par.

3. Sectoral imbalance

The Committee note the poor performance of multi-product manufacturing Sector SEZs, with 9.6% only catering to multi-product manufacture, while IT/ITES Sector contributed 56.64%. The Committee also observe the disadvantages faced by multi-product manufacturing SEZs, such as stiff competition from major world economics like China which provide manufactured products at a highly competitive price/rate, lack of required scale and labour laws of the country. They desire the Ministry to explore effecting suitable amendments in labour laws that are seen to have negative impact/bearings on the labour supply in the country, especially for multi-product manufacturing sector SEZs.

4. SEZ land utilization review

The Committee note that there are numerous instances of developers seeking vast tracts of land from the government in the name of SEZs and putting only a fraction of it for notification as SEZ, and earning a lot of money by mortgaging large percentage of the land acquired for "public purpose". The Committee while concurring with recommendation on the matter, further desire that actual land requirements by developers should be ascertained to the extent possible and necessary amendments effected in the SEZ laws to effectively curb mortgaging and utilization for other purposes of land notified or acquired for SEZs. The Committee note that DoC vide its letter dated 13th September, 2013 advised all State Governments, *inter-alia*, to ensure that the Developer who propose to denotify SEZ land is required to pay back all fiscal benefits taken from the Central and State Governments before denotification is allowed. The Committee, therefore, desire to be apprised of the total fiscal benefit

obtained by the central Government till date on this account within three months of presentation of this reports.

5. Mortgage of SEZ Land

The Committee note 11 developers/units in AP, Karnataka, Maharashtra and West Bengal had raised ₹ 6309.53 crore as loans by mortgaging SEZ land. They also note that SEZ Act or Rules do not specify that SEZ land cannot be mortgaged, and that the Ministry of Commerce had in 2010 permitted units to mortgage the lease hold rights to financial institutions/banks. They further noted that three developers/units had raised a loan amount of ₹ 2211.48 crore and utilized the same for purposes other than development of SEZ. The Committee desired to be apprised by the Department of Financial Services the total amount of loans raised from Financial institutions/banks by developers/units of SEZ through mortgage of SEZ land lease hold rights, and the amount of such loans which have gone bad. The Committee recommend that the Department of Commerce and Financial Services review the SEZ Act to specify that SEZ land lease hold rights cannot be mortgaged to curb the possibility of huge loans going bad which ultimately would affect the public exchequer.

6. Tax Administration of SEZs

The Committee note lacunae in the Income Tax and Wealth Tax Acts pointed out by Audit. While endorsing the recommendations by Audit, they desire the Department of Revenue, in consultation with the Department of Commerce, to make incessant efforts as to remove the existing lacunae in the Income and Wealth Tax Acts so that short realization of dues from developer entities are effectively checked and recoveries made at the earliest. The Committee opined that the introduction Minimum Alternate Tax (MAT) and Dividend Deduction Tax (DDT) with retrospective effect has made the tax policy regressive. The Committee further desire the Ministry of Finance to seriously reconsider the removal of Minimum Alternate Tax

(MAT) and Dividend Distribution Tax (DDT) which have to make SEZs more alternative for entrepreneurs and developers.

7. Internal Audit and records management

The Committee note weaknesses in internal audit and controls leading to undetected misrepresentation of facts by developers to the tune of Rs. 1150.06 crore, and while endorsing Audit's recommendations, desire that a fixed timeline should be laid out to strengthen internal Audit of SEZs and to achieve full integration of SEZ tax administration with ICEGATE system of CBEC. Further, they recommend the Ministry of Commerce to work out a mechanism in consultation with Department of Central Excise and State Governments to streamline management of records of exemptions, stamp duty and Service tax for SEZs.

8. Miscellaneous matters

The Committee are aware that the Ministry have settled most of the paragraphs with Audit. On matters specifically not dealt with in this report, the Committee desire that the issues should be settled to the satisfaction of Audit. However, the Committee note that a number of Audit observations have been treated as settled with the Ministry's undertaking for future compliance by way of amendments/incorporations in the new Foreign Trade Policy, Income Tax laws, SEZ laws, etc. The Committee desire that the Ministry submit a list of such changes to be affected with draft amendments in law and policy to this Committee within six months of presentation of this report.

NEW DELHI;

27 March, 2018

6 Chaitra, 1940 (Saka)

MALLIKARJUN KHARGE

Chairperson,

Public Accounts Committee

