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Report of the Comptroller and Auditor General of India

भारतीय लेखा एवं लेखा परीक्षा विभाग ✦ INDIAN AUDIT AND ACCOUNTS DEPARTMENT

Performance of Special Economic Zones (SEZs)

Union Government
Department of Revenue - Indirect Taxes - Customs
No. 21 of 2014

Report of the Comptroller and Auditor General of India

For the year 2012-13

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PREFACE

This Report for the year ended March 2013 has been prepared for submission to the President under Article 151 of the Constitution of India.

This Report of Comptroller and Auditor General of India contains the results of performance audit of 'Performance of Special Economic Zones (SEZs)' during April 2013 to January 2014.

The instances mentioned in this Report are those, which came to notice in the course of test audit for the period 2006-07 to 2012-13 as well as those which came to notice in earlier years, but could not be reported in the previous Audit Reports; matters relating to the period subsequent to 2012-13 have also been included, wherever necessary.

The audit has been conducted in conformity with the Auditing Standards issued by the Comptroller and Auditor General of India.

Audit wishes to acknowledge the cooperation received from Ministry of Commerce and Industry (DoC and DGFT), Department of Revenue (CBEC and CBDT) at each stage of the audit process.

EXECUTIVE SUMMARY

Background

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. Though a number of deficiencies in administering indirect taxes were brought out in the Report No. 6 of 2008 of the C&AG of India, besides several audit findings in the subsequent years, on inadmissible concessions given to SEZs; a comprehensive performance assessment of SEZs was impending. Considering the magnitude of exemptions[1] availed by SEZs, it was imperative to assess their performance vis-a-vis the duty forgone.

The objective of this performance audit was to assess the adequacy of regulatory framework, policy implementation, operational issues and internal controls of SEZs. An attempt was also made to study the social and economic benefits of SEZs in India.

[1] *₹ 1.76 lakh crore, according to 83rd Report of Parliamentary Standing Committee on Commerce on Functioning of SEZs, June 2007.*

Our audit conducted between November 2013 and January 2014 involved review of records maintained by a functionaries (BoA[2], DC, SEZ Authorities, SEZ units), located throughout the country, under the Ministry of Commerce and Industry (DoC, DGFT), and units under the Department of Customs, Central Excise & Income Tax. We had also obtained information from various Ministries/Departments/PSUs of State Governments/Public sector Banks. Stakeholder's feedback were obtained from Development Commissioners, Developers, SEZ units, Exporters, Trade and Industry associations through questionnaires administered for this purpose.

Audit observed that there was a requirement of multiplicity of approvals for SEZs with just 38.78 percent of them becoming operational after their notification. 52 per cent of the land allotted remained idle even though the approval dated back to 2006. There was a decline in the activity in the manufacturing sector in the SEZs. Land acquired for public purposes were subsequently diverted (up to 100% in some cases) after de-notification. Seventeen States were not on board in implementing the SEZ Act with matching State level legislations, which rendered the single window system not very effective. Developers and units holders were almost left un-monitored, in the absence of an internal audit set-up. This posed a huge risk for the revenue administration.

(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 ₹ 3793 crore was provided under ASIDE scheme during the 11th Five Year Plan (2007-12). ₹ 2050 crore was spent in the 10th Plan period and ₹ 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.

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[2] *Board of Approval is a 19 member body in the MoC&I responsible for scrutiny and approval of applications received throughout the country for establishing 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, we 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[3], 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 ₹ 6309.53 crore of loan through mortgaging SEZ lands. Out of which, three developers/units had utilized the loan amount (₹ 2211.48 crore i. e 35 per cent of ₹ 6309.53 crore) for the purposes other than the development of SEZ, as there was no economic activity in the SEZs concerned.

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[3] *Andhra Pradesh, Gujarat, Karnataka, Maharashtra, Odisha and West Bengal*

(iv) Tax Administration

SEZs in India had availed tax concessions to the tune of ₹ 83104.76 crore (IT-₹ 55158; Indirect taxes-₹ 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 ₹ 1,150.06 crore (Income tax ₹ 4.39; Indirect Taxes ₹ 1,145.67 crore) and systemic weaknesses in Direct and Indirect tax administration to the tune of ₹ 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 ₹ 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.

Recommendations

1. *The 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.*

   (Paragraph 2.5)

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.*

   (Paragraph 3.1)

3. *MOC&I may consider prescribing time limits for each stage of the SEZ life cycle for benchmarking purposes.*

   (Paragraph 3.3)

4. *MOC&I may consider introducing a suitable mechanism to monitor non-operational SEZ units.*

   (Paragraph 3.12)

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.*

   (Paragraph 4.5)

6. *DoR may like to visit the Income Tax Act, 1961 and Wealth Tax 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 which does not define the terms 'profits of the business', 'total turnover of the business', thereby assessees 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*

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

(Paragraph 5.5)

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.*

(Paragraph 5.11)

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.*

(Paragraph 5.17)

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.*

(Paragraph 6.4)

Performance of Special Economic Zones (SEZs)

Performance of Special Economic Zones

Chapter I: Introduction

1.1 Background

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. Depending on their geographical location, Free trade zones around the world are called by different names. In the United States, they are called as *foreign-trade zones* while those in developing countries producing specifically for export are typically called *export processing zones*. They are also called *special economic zones* in China and India, *industrial free zones* or *export free zones* in Ireland, *Qualifying Industrial Zones* (QIZs) in Jordan and Egypt, *free zones* in the United Arab Emirates, and *duty free export processing zones* in the Republic of Korea.

India's tryst with trade zones started with its first Export processing Zone (EPZ) launched in 1965 at Kandla, Gujarat. The geographical areas thus notified were declared to be outside the normal customs territory of India. The 'Special Economic Zones' (SEZ) policy announced in April 2000 was intended to make the SEZs as growth engines that can boost manufacturing, augment exports and generate employment. SEZ is a specifically delineated duty free enclave and is a deemed foreign territory for the purpose of trade operations, duties and tariffs. Accordingly, goods and services from domestic tariff area (DTA) to SEZ are to be treated as exports and goods coming from SEZ into DTA are to be treated as imports. SEZs functioned from 1 November 2000 to 9 February 2006 under the provisions of the 'Foreign Trade Policy' (FTP) and fiscal incentives were made effective through the provisions of the relevant direct and Indirect tax statutes.

Though DoC has an outcome budget for SEZs, however, no outcome analysis of the scheme was done by the Department.

1.2 Objectives of the policy

The SEZ Act, 2005, supported by the SEZ Rules, came into effect from 10 February 2006, providing for simplification of procedures and for single window clearance on matters relating to Central as well as State Governments. The main objectives of the SEZ Act/policy are (i) Generation of additional economic activity, (ii) Promotion of exports of goods and services, (iii) Promotion of investment from domestic and foreign sources, (iv) Creation of employment opportunities and (v) Development of infrastructure facilities.

It was anticipated that the new law would trigger a large flow of foreign direct investment as well as domestic investment in infrastructure and productive capacity leading to creation of new employment opportunities.

1.3 Fiscal incentives and facilities offered to SEZs

Under the provisions of SEZ Act, several tax incentives and other facilities are offered to the SEZ Developers and units. They are discussed below.

Direct Tax Benefits:

I. 100 per cent income tax exemption for Entrepreneurs on export income of SEZ units under section 10AA of the Income Tax Act for first five years, 50 per cent for next five years thereafter and 50 per cent of the ploughed back export profit for next five years,

II. Income Tax exemption for Developers on income derived from the business of development of the SEZ in a block of 10 years in 15 years under Section 80-IAB of the Income Tax Act.

III. Exemption from Minimum Alternate Tax (MAT) under section 115JB of the Income Tax Act (withdrawn from 1st April 2012),

IV. Exemption from Dividend Distribution Tax (DDT) under section 115-0 of the Income Tax Act (withdrawn from 1st June 2011),

Indirect Tax Benefits:

I. Duty free import/domestic procurement of goods for development, operation and maintenance of SEZ units,

II. Exemption from Service Tax (Section 7, 26 and Second Schedule of the SEZ Act),

III. Exemption from Central Sales Tax,

Other Benefits:

I. External commercial borrowing by SEZ units upto US $ 500 million in a year without any maturity restriction through recognized banking channels,

II. Single window clearance for central and state level approvals, and

III. Exemption from state VAT tax, stamp duty and other levies as extended by the respective State Governments.

1.4 Approval process and administration of SEZs

The developer[1] is required to submit the proposal for establishment of an SEZ to the concerned State Government. The State Government has to forward that proposal, with its recommendation, within 45 days from the date of receipt thereof, to the Board of Approval (Department of Commerce, Ministry of Commerce and Industry). The applicant also has the option to submit the proposal directly to the Board of Approval. A Single Window approval mechanism has been provided through a 19 member inter-ministerial Board of Approval (BoA), headed by the Secretary, Department of Commerce. The applications, duly recommended by the respective State Governments/UT Administrations, are considered by the BoA, periodically. All the decisions of this Board are arrived at with consensus. The Approval Committee at the Zone level deals with approval of units in the SEZs and other related issues. At the grass root level, each Zone is headed by a Development Commissioner, who is ex-officio chairperson of the Approval Committee. Various stages involved in approval process and functioning of SEZs is illustrated in Figure 1.

To regulate the usage of SEZ area by the developers, the Central Government has notified the list of operations which can be authorized by the SEZ Board of Approval. Moreover, the Board will assess the size requirement of infrastructural facilities like housing, commercial space, recreational amenities, etc., based on the employment generation potential of the SEZ, and allow development in a phased manner, depending upon the progress in allotment/occupancy of units in the processing area.

All the imports/exports operations of the SEZ units are on self-certification basis. The units in the zones are required to be Net foreign exchange (NFE) compliant, which is calculated cumulatively for a period of five years from the commencement of production. These units have to execute a Bond-cum-legal undertaking with regard to imported/procured duty free goods and achievement of positive NFE.

An SEZ unit could opt out (de-bonding) of the SEZ scheme with the approval of the UAC and on payment of the applicable customs/excise duties on the imported and indigenous capital goods, raw materials etc. and finished goods in stock. In case of Developers, De-notification is to be approved by BoA at MOC&I.

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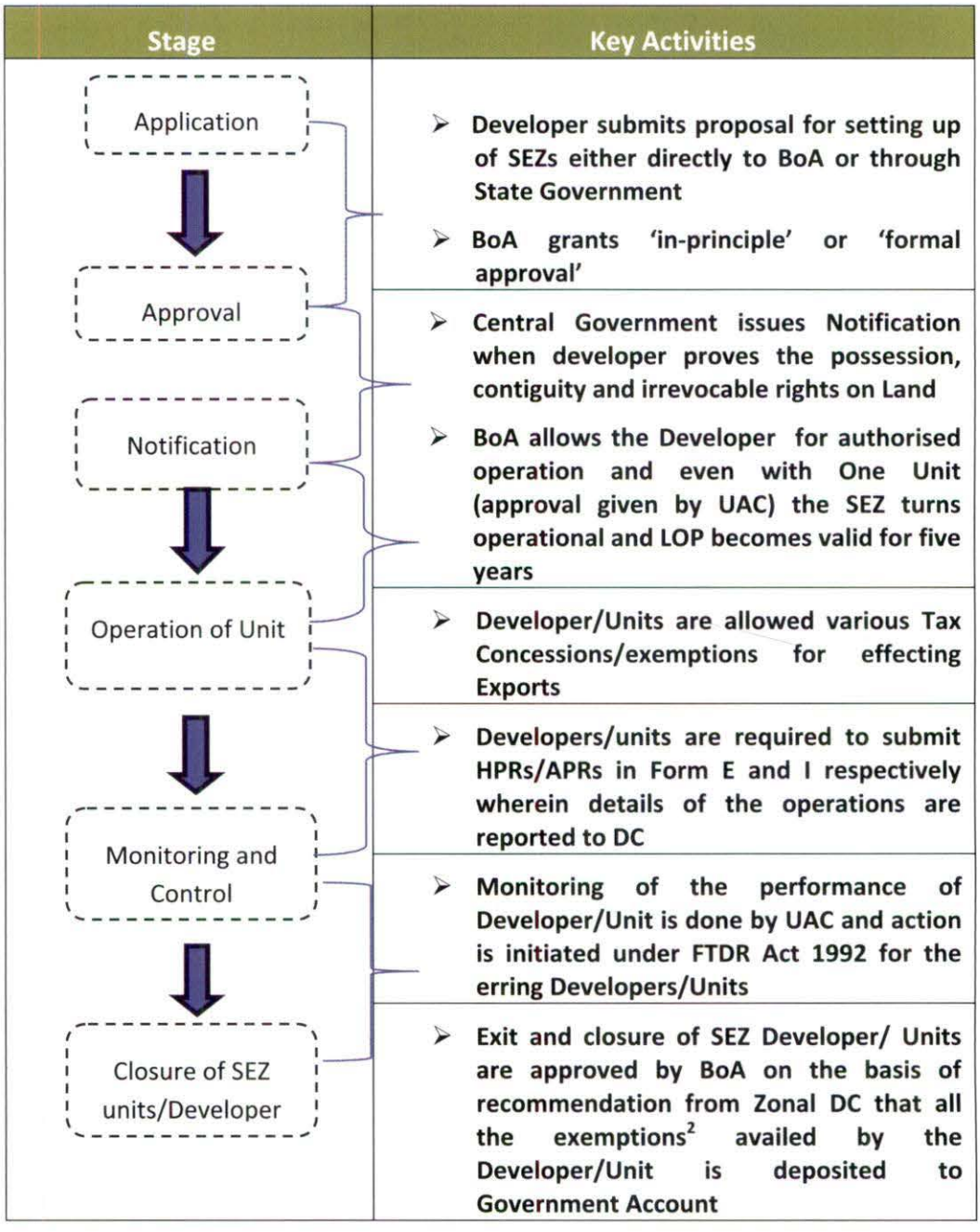
[1] *Developer means a person who, or, a State Government which, has been granted by the Central Government a letter of Approval (section 2(g) of SEZ Act, 2005)*

1.5 Life cycle of Special Economic Zones (SEZs)

Figure 1

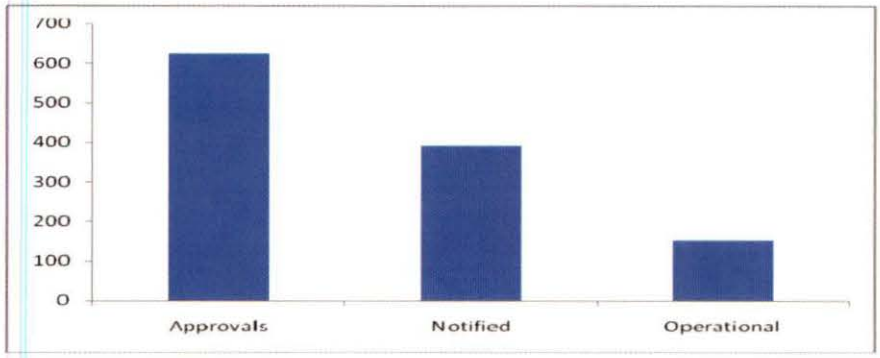


[2] In de-notification application (Form C6), the Development Commissioner has to certify that an amount equivalent to tax/duty exemption availed has been deposited to the Government Account.

1.6 SEZs in India-State wise Distribution

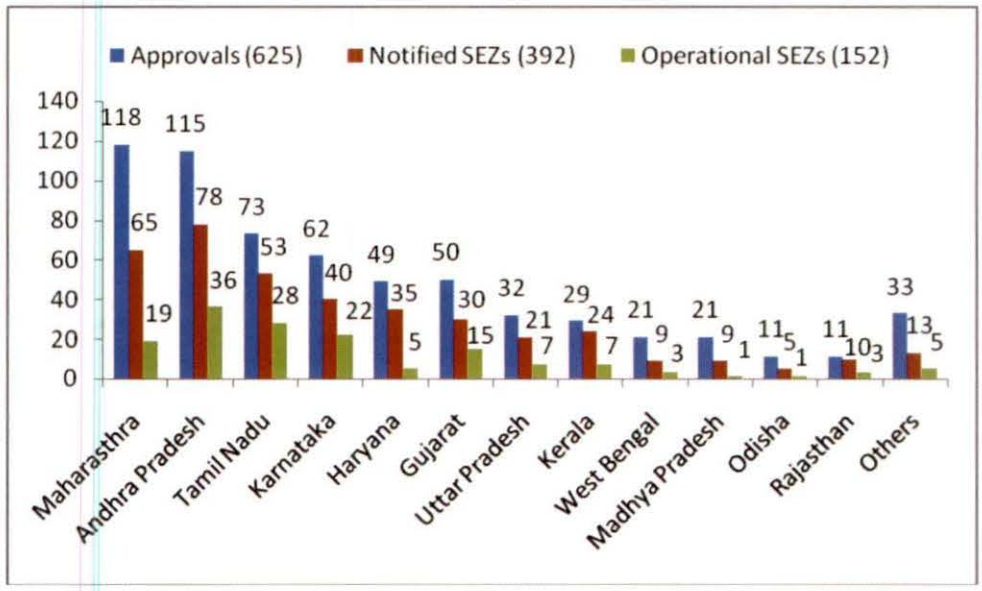
As per the data available on the website (www.sezindia.nic.in) of MOC&I, 625 SEZs were approved upto March 2014, out of these 392 units were notified and 152 were operational as depicted in Figure 2 below.

Figure 2: SEZs in India



State-wise distribution of the SEZs according to the stage of approval/operation is shown in Figure 3 below.

Figure 3: Distribution of SEZs in India



The number of operational SEZs in India is reported as 173 on the website of MOC&I. This includes 19 SEZs which existed prior to the enactment of the SEZ Act. Further, as per our verification, 2 SEZs in Andhra Pradesh (M/s APIIC Sarpavaram, Kakinada and M/s Maytas, Gopanpally) have been wrongly reported as operational units. Hence, pan India 152 SEZs have become operational subsequent to the enactment of the SEZ Act.

Andhra Pradesh has the highest number (36) of operational SEZs in the country followed by Tamil Nadu (28), Karnataka (22), Maharashtra (19) and

Gujarat (15). These states account for 78.95 per cent of the operational SEZs in the country. However, the percentage of Operational SEZs when compared with the total approvals in India works out to 24.32 per cent and it is only 38.77 per cent of the notified SEZs.

The state wise performance of operational SEZs and notified SEZs indicate that 5[3] states account for over 79 per cent of all operational zones in the country.

DoC may like to examine that most of the SEZs are situated in the States which are industrialised and connected with sea ports. Other States (17 States) seemed to have lost out on SEZ based employment, income and investment.

1.7 Why we chose this topic

At a time when the Government faces hard choices in order to reduce the fiscal deficit and use available resources wisely, no expenditure or subsidy, indirect or direct cash transfer or tax revenues forgone, should escape careful examination of audit. It is imperative to ensure that the same set of controls that are applicable to expenditure are exercised in the case of tax expenditure too.

Several inadequacies on account of concessions given from Indirect Taxes angle were brought out in a Report of the Comptroller and Auditor General of India in 2008, myriad paragraphs on the concessions given to SEZs (Appendix 1). However, there has been no report to study all the aspects of the creation and functioning of SEZs. Thus, a review of the performance of SEZs, post enactment of the SEZ Act, was warranted in order to analyse the efficacy of the scheme under the new regime (SEZ Act) including private SEZs and to highlight the systemic and other issues, if any, so as to meet the intended objective of the scheme and harness maximum benefit by fostering exports, investments and employment.

1.8 Audit Objectives

While the primary aim of this audit was to assess the contributions of SEZs, and to evaluate the actual potential, economic and social costs and benefits of SEZs in the country, our work was guided by the following audit objectives set during our planning process.

[3] Andhra Pradesh, Tamilnadu, Karnataka, Maharashtra and Gujarat.

To verify whether:

a) There exists adequate statutory provisions/rules, regulations, instructions/ notifications with regard to approval, creation, functioning and monitoring of SEZs;

b) SEZ/Units were approved and allowed to avail concessions under Central and State Taxation laws in accordance with the provisions;

c) SEZ/Units were able to fulfil the intended socio-economic objectives spelt out in the SEZ Policy/SEZ Act/SEZ Rules/Letters seeking approvals; and

d) Adequate and effective internal controls exist to safeguard the best interests of the Government.

1.9 Audit Scope and Methodology of Audit

Through a letter addressed to the Secretary/Commerce, Government of India, we had intimated the overall purpose of the stated audit with a request to extend necessary co-operation to our audit teams and produce the requisitioned records/information. Given the scope of the Performance Audit, an Entry Conference with Additional Secretary, MOC&I, Members, CBDT/CBEC was held on 22nd November 2013.

Considering that the subject selected cut across various functional wings of audit to review an array of issues, our field audit conducted between April 2013 and January 2014 involved review of the minutes of the BoA at MOC&I which is responsible for according in principle/formal approvals[4] of the Developer's proposals. Followed by this, we had reviewed a representative sample of the notified, operational and exited SEZs in the States of Andhra Pradesh, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Odisha, Punjab, Rajasthan, Tamilnadu, Uttar Pradesh, West Bengal and union territory of Chandigarh for the period 2006-07 to 2012-13 at the offices of the jurisdictional Zonal Development Commissioners[5] (to review the functioning and monitoring of the SEZs), concerned Commissionerates of Income Tax (for verifying the manner in which the assessee's returns were scrutinized) and the Commissionerates of Customs and Central Excise (to review the manner in which the indirect tax exemptions were allowed).

[4] *This classification is based upon the stage of approval of the SEZs. In the case of in-principle approval, the developer gets approval considering the plan of the SEZs projects. Formal approval, on the other hand, is the final approval for SEZs projects from the BoA.*

[5] *Jurisdictional details of sampled states under Zonal DC's: DC KSEZ: Gujarat; DC VSEZ: Andhra Pradesh; DC FSEZ: West Bengal and Odisha ; DC CSEZ: Karnataka and Kerala; DC SEEPZ : Maharashtra; DC MEPSEZ: Tamilnadu; DC NSEZ: Punjab, Haryana, Rajasthan, Uttar Pradesh, Madhya Pradesh and Union territory of Chandigarh.*

Further, information was also obtained from State Pollution Control Boards and Industrial Development Authorities to verify the process of Environment Impact Assessment (EIA) and award of other environmental clearances to the SEZ Developers/Units along with issues related to land allotments.

In order to analyze the quantum of IT exemptions availed by the SEZ assessees, we had obtained data for both Companies and Individuals from DG IT (Systems), CBDT. Some assessees being multi-locational were filing their returns in other states. With the help of our counterparts in other States, we could cross-verify the data and the deficiencies in assessment of those returns are also included in the Report.

Apart from this, all the Central and State Government SEZs and private SEZs (19 SEZs) which were operational before the enactment of SEZ Act 2005 were also selected. Further, information/records of various State Government departments/entities were also called for/examined for a 360 degree review of the process of approval and operations of SEZs.

In order to seek responses from various stakeholders of the system and in line with a request made by the MOC&I during the entry conference, we had administered a questionnaire on certain key areas of functioning of SEZs to the concerned DCs/Developers/Unit holders. The results are discussed in this report.

Information was also obtained through a questionnaire survey from Trade and Industry Association – PHD Chamber of Commerce and Industry - PHDCCI, Export Association - Federation of Indian Export Organisation-FIEO).

With a view to verify whether the Developers/Units had raised any loans through mortgaging government leased lands, we addressed various nationalized banks to furnish this information to which few responses were received.

The draft report was issued to DoR, DoC, CBEC and CBDT on 17 April 2014. Exit conference was held on 29 April 2014.

1.10 Audit Sample

Considering the volume of cases under different categories (in principle approval/formal approval/operational/non-operational) of SEZs, we had selected a representative sample of 187 Developers and 574 Units spread over 13 States (Andhra Pradesh, Gujarat, Haryana, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Odisha, Punjab, Rajasthan, Tamilnadu, Uttar Pradesh and West Bengal) and union territory of Chandigarh which constitutes 31 per cent of total developers and 21 per cent of total units in the country for

assessing the entire spectrum of their functioning. Number of cases selected for the period of audit which ranges between nine percentage and 100 per cent for examining land related issues and the manner in which Indirect Tax exemptions were allowed. In case of Direct Taxes, not all the cases selected for Indirect Taxes evaluation could be selected since in many cases the IT returns did not come for scrutiny and as per the extant practice, Audit steps in only after a return was scrutinized by the Assessing Officer. Therefore, a different sample was chosen for DT cases, where scrutiny returns of 598 assessees were selected in audit.

List of files not produced to audit by MOC&I is enclosed (Appendix 2).

1.11 Audit Criteria

We bench marked our findings against the following sources of Audit criteria:

I. Customs Act, 1962
II. Export of Services rules, 2005
III. Foreign Trade Policy (2004-09 and 2009-14) along with Handbook of Procedures with Appendices
IV. Income Tax Act, 1961
V. Instructions of the Ministry of Environment and Forests issued from time to time in safeguarding the environment and conditions attached in giving clearances
VI. Indian Stamp Act, 1899
VII. Land Acquisition Act, 1894 as amended from time to time
VIII. RBI Master Circulars on EXIM policies
IX. Recommendations of the Public Accounts Committee meeting dated 23rd August 2012
X. Recommendation of Parliamentary Standing Committee on Commerce, 83rd Report on functioning of SEZs.
XI. Recommendation of EGoM Meeting on SEZs
XII. SEZ Act, 2005
XIII. SEZ Rules, 2006
XIV. Service Tax rules, 1994
XV. Wealth Tax Act, 1957
XVI. National database on growth, trade, infrastructure, employment and investment

Chapter II: Performance of SEZs and socio-economic impact

2.1 Performance of SEZs

Though the objective of the SEZ and the fact sheet on (provided by DoC March 2014 -Appendix 3) its performance claimed large scale employment generation, investment, exports and economic growth, however, the trends of the national databases (Appendix 4) on economic growth of the country, trade, infrastructure, investment, employment etc do not indicate any impact of the functioning of the SEZs.

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 ₹ 3793 crore was provided under ASIDE scheme during the 11th Five Year Plan (2007-12). ₹ 2050 crore was spent in the 10th Plan period and ₹ 3046 crore (upto 1 Jan 2013) was spent during the 11th Five Year Plan under the scheme. However, the same has not been reflected in the outlay or domestic investment of SEZs.

DoC, in the Exit meeting (29 April 2014) stated that ASIDE only funds Government SEZs and is meant for development of infrastructure. No funds were allotted to private SEZs. Further, it was mentioned that the SEZ Act being only 7 to 8 years old contributed to the growth in the exports of the country and very few schemes are as good as SEZ and therefore, the scheme needs to be viewed in this perspective. Joint Secretary, DoC, emphasized that the Indian SEZs can not be compared with SEZs in China due to the fundamental differences.

DGFT further added that SEZ scheme was introduced in April 2000 with a view to provide an internationally competitive environment for exports, and for continuity and stability of the scheme, SEZ Act was enacted in 2005. The scheme has shown a tremendous growth in infrastructure investment, employment and exports. Export has touched ₹ 4,25,000 crore in 2014 vis-à-vis ₹ 22,000 crore in 2005; similarly, investment was ₹ 2,84,000 crore in 2014 in comparison to ₹ 4000 crore in 2005. At present 185 SEZs are operational, out of which only seven SEZs are Central government SEZs, clearly indicating the substantial contribution by the private SEZs.

The compounded annual growth rate shows decline in agriculture and manufacturing activity and stagnancy in service activity in the last seven years. Simultaneously, there was a decline in the number of operating and exporting STP units in the last five years almost to the extent of 45 per cent.

The following parameters indicated economic activity:

- GDP by economic activity
- Factor income by economic activity
- Gross State domestic product
- Industrial production

The following parameters indicated employments:

- Labour force and labour force participation rate
- Estimates of unemployment

The following parameters indicated investment:

- Gross capital formation
- Net capital stock
- Foreign investment inflows

The following parameters indicated Trade:

- Foreign Trade
- Terms of Foreign Trade

An average 15 per cent of exports were sold in DTA and it was observed that gradually the sales not counting for positive NFE has overtaken the value of DTA sales counting for positive NFE.

Though most of the investment and employment has been in the SEZs notified under the Act, in the private sector, the macroeconomic indicators did not show a change in the trend growth, indicating diversion of capital and labour from DTA, STP to SEZs.

2.2 Socio-economic impact

The three important objectives of the SEZ Act, 2005, are to generate employment opportunities, encourage investment (both private and foreign) and increase India's share in global exports. In this section, we review whether SEZ Developer/Units in the selected states and SEZs have been able to make a social and economic contribution as envisaged in their project proposals.

MOC&I measured its performance based on the employment recorded from year to year by various operating SEZs. According to the Fact sheet on SEZs, employment, investment and exports registered a growth of 4692 per cent, 1679 per cent and 1276 per cent respectively between 2006 and 2012. However, this does not reflect the complete picture of the performance of the SEZs in the country. To illustrate, 17 SEZs[6] contribute to 14.16 per cent of employment, 40.49 per cent of investment and 51.10 per cent of exports in the country and at the same time the macro indicators show no variation in the trend growth for the last 7-8 years, as reported in the above paragraph.

[6] *Out of these two SEZs were already in existence prior to the enactment of SEZ Act, 2005.*

Therefore, a different approach was adopted, whereby a comparison of the projections made by the Developers/Unit holders in their applications as accepted by BoA/UAC was made with the actuals as reflected in their APRs from time to time.

Using these results, the performance of SEZs in India in terms of achievement of the social objectives of the scheme viz., employment generated, and the economic objectives of the scheme viz., Investments, NFE status and Exports have been projected.

Social Impact

2.2.1 Employment

As per section 5 of SEZ Act, one of the objectives of SEZ Act was generation of Employment i.e both direct employment for skilled and unskilled labour.

We compared the statistics of employment provided by the developers from the QPRs/HPR/APRs submitted by the Developers/Units to the concerned DCs as a part of their monitoring mechanism with the projections made by them in Form-A submitted by them while applying for the SEZs. This comparison was restricted to only those developers where shortfall was noticed (as on March 2013) even after five years of their notification.

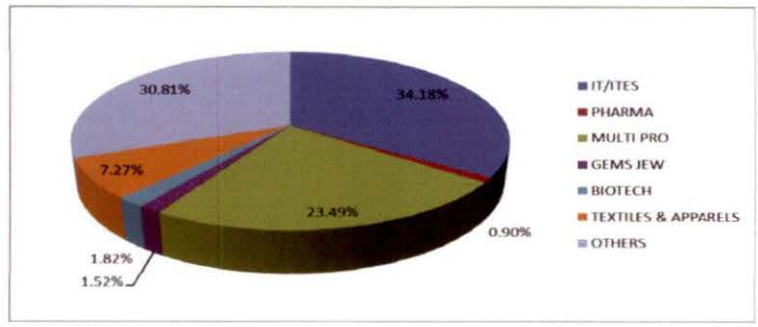
It was noticed that in the selected 117 Developers/Unit in 12 States the actual employment (2,84,785) vis-à-vis the projections (39,17,677) made by the Developers/Units had fallen short by nearly 93 per cent (absolute number being 36,32,892). State-wise contribution to this shortfall is indicated below:

States	No. of Developers/ Units	Employment (Number of people)			Shortfall (%)
		Projected	Actual	Difference	
Andhra Pradesh	33	16,78,945	1,13,780	15,65,165	93.22
Maharashtra	19	5,06,242	34,999	4,71,243	93.08
Tamilnadu	5	50,647	10,470	40,177	79.32
Kerala	4	8,551	1,545	7,006	81.93
Karnataka	10	2,08,875	44,483	1,64,392	78.70
Odisha	2	5,200	1,688	3,512	67.54
Gujarat	12	12,47,077	42,650	12,04,427	96.58
Rajasthan	2	40,000	8000	32000	80.00
West Bengal	8	1,58,550	22,742	1,35,808	85.65
Uttar Pradesh	11	4,617	1,082	3,535	76.56
Chandigarh	5	7,578	2580	4,998	65.95
Madhya Pradesh	6	1395	766	629	45.09
Total	**117**	**39,17,677**	**2,84,785**	**36,32,892**	**92.73**

Five states viz Andhra Pradesh, West Bengal, Karnataka, Maharashtra and Gujarat constitute 90 per cent of the total shortfall of the employment.

Further, the shortfall was significant in IT Sector SEZs followed by Multi product sector as depicted in the figure-4 below:

Figure 4: Sector-wise shortfall in employment



Thus, there are wide gaps in the employment projected by the developers and that provided in all the categories of the industries. It is clear from the above data that the pattern of employment generation is also not uniform across sectors and states. The other interesting fact is that there is a concentration of SEZs close to urban agglomerations resulting in employment generation in the districts that are already industrialized with higher levels of literacy. Thus, SEZs to be 'a new avenue of employment generation' as claimed by the MOC&I could not come true.

The following two cases typify the severe shortfall noted in Andhra Pradesh (Box-1).

Box-1: Breach of condition of MOU to generate employment

The Government of Andhra Pradesh allotted 80.93 hectares Land to M/s Hyderabad Gems SEZ in June 2007 vide MOU with the condition to generate employment for 15000 people within five years of allotment of land which was relaxed to 10000 people vide revised GO (February 2010). However, as of March 2013, the total employment generated was only 3835 i.e. 38.35 per cent of the commitment.

Similarly, M/s Wipro Gopanapally was allotted 40.46 hectares in October 2005 and they were required to generate employment for 10000 people. However, as of March 2013, the total employment generated was only a meagre 356 (3.6 per cent).

However, no action was initiated against the developers for violation of condition in the absence of any enabling provisions.

2.2.2 Rehabilitation, resettlement and employment

Government of Andhra Pradesh vide its G.O. Ms. No. 68 dated 8th April 2005 issued the Rehabilitation and Resettlement (R&R) Policy for the persons affected due to compulsory acquisition of land. Chapter VI of the policy stipulates the R&R benefits for the Project Affected Families (PAF) which

includes free house sites, grant for house construction/subsistence allowances, etc.

APIIC acquired 9287.70 acres of land (6922.29 acres of Patta land and 2365.41 acres of Government/assigned land) during 2007-08 in Atchyutapuram, Rambilli mandals of Visakhapatnam district for development of integrated SEZ. The rehabilitation payout was proposed at Dibbapalem and Veduruvada villages for the Project Displaced Families (PDF) and the cost of rehabilitation package was worked out at ₹ 106.21 crore. 5079 families were affected in 29 villages (15 villages in Atchyutapuram mandal and 14 villages in Rambilli mandal). It was observed that only 1487 families could be shifted to Dibbapalem till date. Further, out of 4300 plots developed for the major married sons of the affected people, only 3880 could be allotted. In Vedurvada too, no plots had been allotted till date.

The difference between the value of acquisition and value of allotment in a few SEZs is as follows:

Name of the SEZ	Area of Land Acquired (acre)	Period of acquisition	Acquisition rate (₹ lakh/ acre)	Year of Allotment for SEZ purpose	Allotment Rate/ lease premium (₹ lakh/acre)	Difference per/acre (max of acquisition minus min of allotment)
Pharma SEZ Jedcherla	250	2005-06	0.55 to 1.80	2007 to 2010	7 to 35	5.20
APSEZ Vizag	5449	2001-08	2.95	2007 to 2013	30 to 52	27.05
Sricity SEZ	3796	2007-11	2.5 to 3.5	2009 to 2013	12 to 14	8.50
Total	9495					

The "Eighty-Third Report on the Functioning of Special Economic Zones", presented in the Rajya Sabha by the Parliamentary Standing Committee on Commerce (in June 2007), sought to address many of these issues through its new draft Resettlement and Rehabilitation (R&R) Bill, 2007. However, there is no policy for skill development for employment of the PDF/PAFs which has led to providing of employment to very few individuals. An isolated best practice is highlighted in Box-2.

Box-2: Best Practice- Skill impartation initiative to PDF/PAF by the Vizag district administration

District administration, Visakhapatnam registered "The Visakha Skill Development Society" to impart skill development training to the unemployed members from PDF/PAFs for facilitating employment. Upto period of audit (August 2013) training was imparted to 24 candidates, of whom 19 candidates were employed in SEZ Units.

Economic Impact

2.3 Shortfall in Investments

SEZs were intended to attract a foreign multinational enterprise which was supposed to have a catalytic effect. The foreign capital was to be attracted by means of leveraging incentives and to use foreign technology and management skills to augment exports. While applying for permission to establish an SEZ, the Developer indicates the quantum of investment proposed to be made in the SEZ. It was noted that during the period of audit the actual investment (₹ 80176.25 crore) vis-à-vis the projections (₹ 194662.52 crore) in 79 Developers/Units in 11 selected States was 58.81 per cent lesser than the projected amount. This includes shortfall in FDI to the tune of ₹ 2468.53 crore (66.83 per cent).

A comparison of state wise shortfall in investment made in respect of 79 Developers/Units drawn based on their projections made while applying and the actual investments received as depicted in the APRs/QPRs submitted by them to the Government is indicated below:

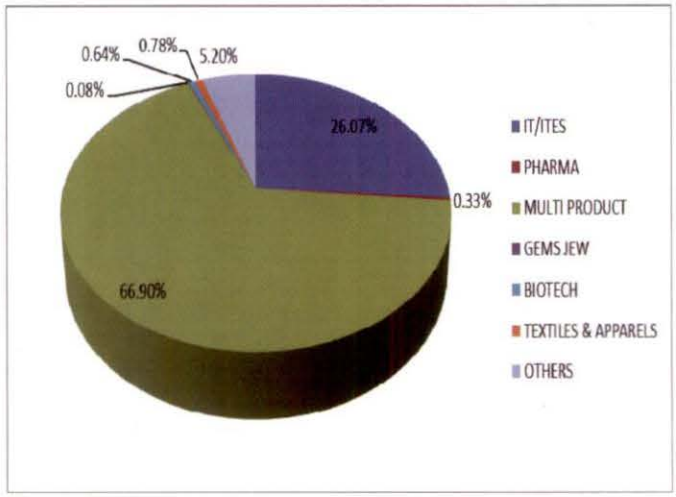
State	No. of Developers /units	Investment (₹ in crore)			Shortfall (%)
		Projected	Actual	Difference	
Andhra Pradesh	28	45897.41	11511.59	34385.82	74.92
Maharashtra	11	15433.86	4264.59	11169.27	72.36
Tamilnadu	4	1913.18	1369.50	543.68	28.41
Kerala	2	352.72	120.96	231.76	65.70
Karnataka	5	2700.34	1157.51	1542.83	57.13
Odisha	2	192.20	61.93	130.27	67.78
Gujarat	14	118962	58661.80	60300.20	50.68
Rajasthan	1	25.90	19.69	6.21	23.98
West Bengal	2	2773.88	874.57	1899.31	68.46
Uttar Pradesh	9	6146.03	1997.11	4148.92	67.51
Chandigarh	1	265.00	137.00	128.00	48.30
Total	79	194662.52	80176.25	114486.27	58.81

Five states (Andhra Pradesh, Uttar Pradesh, Karnataka, Maharashtra and Gujarat) contributed to 57 per cent of the total shortfall of the investment. In case of Madhya Pradesh, no short fall of investment was noticed.

One important concern is that despite the SEZ Act advocating investment to promote exports in the manufacturing and services sectors, the main contributor to the development of SEZs in India has been the IT/ITES sector. Investment in SEZs is primarily concentrated in IT and IT-enabled services, leaving behind the manufacturing sector. There was a large scale shift from the STPI units (45 per cent) to SEZs in the last five years. Therefore, multi product sector registered 67 per cent shortfall in investment in the selected

zones located in various states during the period of audit. This was followed by 26 per cent shortfall in IT Sector as depicted in the figure 5.

Figure 5: Sector-wise shortfall in Investment



2.4 Exports

The establishment of SEZs was envisaged as an important strategic tool to expedite the growth of international trade which manifests itself in the form of increased exports as units set up in an SEZ have to produce goods and services mostly for exports. Hence, the increased level of exports has been critical to the success of SEZs.

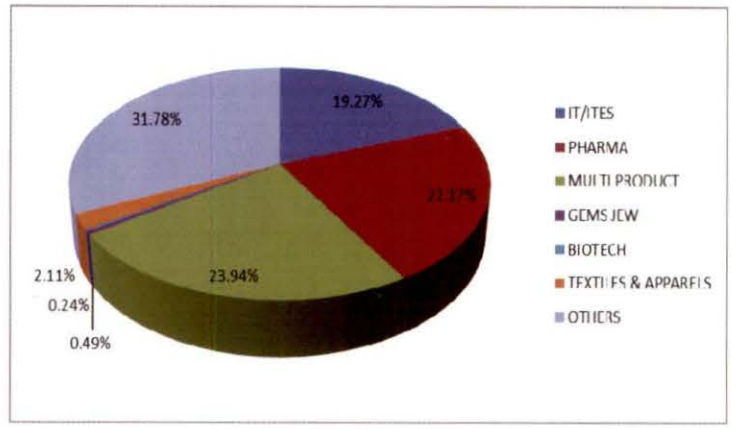
It was noted that the actual Exports (₹ 1,00,579.70 crore) vis-à-vis the projections (₹ 3,95,547.43 crore) in 84 Developers/Units in 9 selected States was 74.57 per cent lesser than the projected amount during the period of audit. State-wise details are indicated below:

State	No. of Developers /units	Exports (₹ in crore)			Shortfall (%)
		Projected	Actual	Difference	
Andhra Pradesh	18	1,84,592.72	11,415.50	1,73,177.22	93.81
Maharashtra	18	55,135.78	13,865.56	41,270.22	74.85
Tamilnadu	5	1,22,670.89	64,526.40	58,144.49	47.39
Kerala	12	2,468.76	5,76.73	1,892.03	76.64
Odisha	2	4161	618.64	3542.36	85.13
Rajasthan	2	11000	2251.09	8748.91	79.54
Uttar Pradesh	12	6,984.15	3,202.33	3,781.82	54.15
Chandigarh	9	5,648.34	3,041.11	2,607.19	46.16
Madhya Pradesh	6	2885.83	1082.34	1803.49	62.49
Total	84	395547.43	100579.70	294967.73	74.57

Four states viz., Andhra Pradesh, Tamilnadu, Maharashtra and Rajasthan constitute 72.61 per cent of the total shortfall of Exports.

The shortfall is significant in multi product sector SEZs (23.94 per cent) and this was followed by pharmaceutical sector SEZs (22.17 per cent) as depicted in the figure-6 below:

Figure 6: Sector-wise shortfall in Exports



2.5 Foreign Exchange Earning

Net Foreign Exchange is to be calculated cumulatively for a period of five years from the date of commencement of production (Rule 53). Export orientation is one of the key expectations from SEZs, but the only requirement imposed on them in this regard is to have positive net foreign exchange balance which applies only to industrial units in the zone, not for the SEZ as a whole. An average 15 per cent of exports has been sold in DTA and gradually sale, not counting for positive NFE, has overtaken the value of DTA sales counting for positive NFE. NFE is monitored through APRs of the Units and a report on this is sent to MOC&I periodically. It was noted that there was shortfall in respect of 74 operational SEZ Units which completed five years in the following 10 States.

Name of the state	No. of SEZ units	NFE (₹ in crore)			Shortfall (%)
		Projected	Actual	Difference	
Andhra Pradesh	5	413.66	85.46	328.22	79.34
Maharashtra	9	1302.52	800.18	502.34	38.56
Tamilnadu	13	32069.18	4841.50	27227.67	84.90
Kerala	8	495.54	257.68	237.86	48.00
Karnataka	3	3721.09	1228.58	2492.51	66.98
Rajasthan	5	109.42	68.16	41.26	37.71
West Bengal	6	240.27	46.27	194	80.83
Uttar Pradesh	13	3657.42	(-)321.50	3978.92	108.79
Chandigarh	8	4741.72	2144.74	2596.98	54.77
Madhya Pradesh	4	1784.05	795.18	988.87	55.43
Total	74	48534.87	9946.26	38588.61	79.50

Five states viz., UP, Tamilnadu, Karnataka, Maharashtra and Chandigarh constitute 97.87 per cent of the total shortfall of Net Foreign Exchange.

Though projections are not binding, however, they do serve as benchmarks for assessing a unit's success/failure. No records were produced to show that current operations were being pegged with the intended scale of operations and, consequently no attempts were on record regarding corrective action initiated to understand the possible reasons for the shortfall so as to realise the full potential of SEZs. Absence of any monitoring or study in order to redress possible reasons for the shortfalls makes the "projected figures" redundant.

However, there are some units that had surpassed their expectations. Two such cases in Andhra Pradesh are given in Box-3:

Box-3: Splendid performance

M/s.Wipro Ltd. Manikonda and M/s. CMC Ltd., Gachibowli both IT/ITES SEZs notified in 2006 at Hyderabad deals with software development. They have exceeded their projections made for five years with that of actual as on 2012-13 on all counts i.e, Exports, Employment and Investment as detailed below:

There was an increase in the projections made by M/s Wipro Manikonda on account of Exports, Investment and Employment by 415 per cent, 15.18 per cent and 21.32 per cent.

Similarly, in the case of M/s CMC Gachibowli, the projections made on account of Exports, Investment and Employment increased by 742 per cent, 47.72 per cent and 10.48 per cent respectively.

Thus, despite the good performance of SEZs being claimed by MOC&I noted in a few major SEZs, severe shortfalls were observed in audit in their performance on account of the social and economic parameters when compared to their envisaged performance in the selected states. The results of the above analysis also revealed that the real benefits from SEZs are yet to accrue commensurate to the investment.

DOC in their reply (June 2014) stated that in a short span of about eight years since SEZs Act and Rules were notified in February, 2006, formal approvals have been granted for setting up of 566 SEZs out of which 388 have been notified and the total exports, employment and investment in 2013-14 have increased by 124, 155 and 100 percent respectively, since 2009-10.

The reply is silent about prescribing performance indicators in line with objectives and functions of SEZ scheme to measure the actual performance of the scheme.

Recommendation: *The 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.*

Chapter III: Growth of SEZs

Audit observed that there was a requirement of multiplicity of approvals for SEZs with 38.78 percent of them becoming operational after their notification. 52 per cent of the land allotted remained idle even though the approvals dated back to 2006. There was a decline in the activity in the manufacturing sector in the SEZs. Land acquired for public purposes were subsequently diverted (up to 100% in some cases) after de-notification. Seventeen States were not on board in implementing the SEZ Act with matching State level legislations, which rendered the single window system not very effective. Developers and unit holders were almost left un-monitored, in the absence of an internal audit set-up. This posed a huge risk for revenue administration.

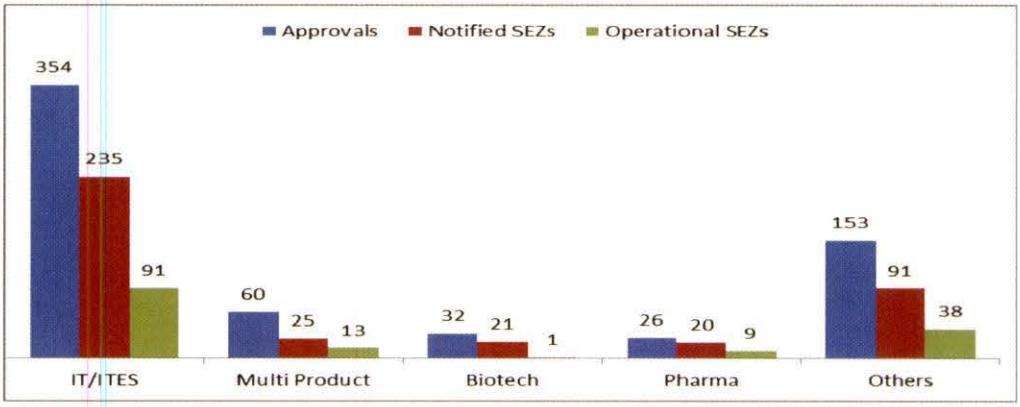
3.1 Growth pattern of SEZs-Regional and Sectoral Imbalances

While one of the significant objectives of establishing an SEZ was to achieve a balanced growth across all the regions of the country, it was noted that out of the 392 notified SEZs in India, 301 (77 per cent) are located in the infrastructural developed states (Andhra Pradesh -now bifurcated into Telangana and Andhra Pradesh -78; Maharashtra-65; Tamil Nadu-53; Karnataka-40, Haryana-35, and Gujarat-30) of the country. The numbers indicate certain locational preferences of SEZs in India. The spread of SEZs within the state is also in specific locations. To illustrate, in Andhra Pradesh, out of 36 operational SEZs, 20 are close to the vicinity of capital city Hyderabad. This scenario is similar in other States as well. This might have been because of the States could not be fully involved in the Scheme and 17 States have not even framed their respective SEZ Act/Policy.

A comparative analysis of the SEZ scheme across the globe in terms of their share of exports to the national exports may reveal necessary corrective measures to be taken by MOC&I as also recommended in the 83rd report of the Parliamentary Standing Committee.

Sector wise analysis of the SEZs revealed a pre-dominance of IT/ITES SEZs (56.64 per cent Approvals, 60 per cent 'notified' and 60 per cent 'operational'). Multiproduct SEZs which are more labour/capital intensive are very few (9.60 per cent Approvals, 6.37 per cent Notified and 8.55 per cent Operational), as depicted in the figure 7.

Figure 7: Category-wise distribution of SEZs in India



The large number of IT/ITES SEZs coincides with the expiry of the ten year Income-tax break period allowed to IT sector under Software Technogy Park Scheme which gave a fillip to the sector. Several units closed and shifted to SEZs to avail of the benefits offered in SEZ area.

DoC stated (April 2014) that SEZs suffer disadvantage because of the lack of the infrastructure status accorded by the banks to the developers. Regarding imbalance in growth in manufacturing sector and IT/ITES, it was also pointed out that manufacturing units are discouraged by not being allowed other fiscal benefits such as incentives given in Focus Product scheme and Focus Market scheme.

Further, in their reply (June 2014) DoC stated, that balanced regional and sectoral development has never been an objective of SEZ Act. However, States have been divided into different categories with regard to the land requirement for setting up of SEZs to ensure balanced regional development. The SEZ Rules, 2006 also provide for requirements of land for different sectors to have balanced sectoral developments.

Regarding developments of IT SEZ for abolition of Tax holidays in STPS, DoC stated that as per SEZ Act and Rules, IT SEZ can only be set up on the vacant lands and the use of second-hand capital goods from DTA has been made in line with the provisions of Section 10AA of the IT Act which allows only 20 per cent utilization of used plant and machinery. Development of IT/ITES SEZs required comparatively less time as the area to be developed is also small and the infrastructure required is less compared to multi-product SEZ. When the infrastructure is developed in other parts of India, industries will automatically spread. Moreover, it is for the concerned State Government to utilize the SEZ framework for development of various regions of the State. However, the Central Government has made special provisions for different

States regarding area requirement and built up area requirement in the SEZ Rules, 2006, especially for North-Eastern States.

Audit is of the opinion that the SEZ policy and procedures are not directed towards involving all the states and the unique advantageous points of certain regions and sectors.

Recommendation: *The SEZ policy and procedures need to be integrated with the Sectoral and State policies with the involvement of the unique advantageous points therein.*

3.2 Blocks in the single window clearance system

One possible reason for the skewed regional spread of SEZs, among others, could be the absence of an effective single window mechanism as envisaged in the SEZ policy for giving all the clearances to the SEZ projects by a single authority which could not be implemented successfully. It was observed that the single window mechanism is either absent or has not worked as per its intended objectives. In addition to the Central Regulatory Regime, only 11 states have framed their respective SEZ Act/Policy (Gujarat, Haryana, Tamil Nadu, Madhya Pradesh, Punjab, Jharkhand, Uttar Pradesh, Karnataka, Maharashtra, Kerala and West Bengal). The remaining 17 states could not enact the SEZ Act which led to a lack of coordination across departments at the Central and State Government level resulting in delay in according approvals and this was also stated by the Developers/units in their feedback.

Absence of Single Window Mechanism was observed even in the States (Tamilnadu, Kerala and Uttar Pradesh) which had their respective SEZ Act/Policy in place. One such case is discussed in Box-4.

Box-4: Lack of co-ordination leading to seven years of delay

M/s OSE Infrastructure Limited, Noida was granted Formal Approval (November 2006) by BoA for setting up of IT/ITES SEZ and was notified in May 2007. However, the SEZ could not start the construction even after 7 years due to non-clearance of FAR (Floor area ratio) by NOIDA Authority although necessary directions from the State Government was issued (June 2009). Meanwhile BoA accorded fourth extension to the approval up to November 2013.

Moreover, the investment of ₹ 343.22 crore as projected in their Project Report could not be made in the absence of clearance from NOIDA Authority.

A well framed State level SEZ Act or policy with an effective single window mechanism would provide a comprehensive regulatory framework for the development of SEZs in the state in consonance with the Central Act to provide fiscal incentives to SEZ Developers/ Units and provide a platform for

facilitating/resolving state level matters such as labour, pollution control authority, Municipal Corporation, etc. The above account calls for a review of the single window system in various States to unplug the loopholes. In a recent study (1 May 2014) report of the Department of Industrial Policy and Promotion (MOC&I) on improving the Business environment in India, Single Window Clearance has been one of the best practices for catalyzing the business environment in India.

DoC, stated (April 2014) that the SEZ scheme is a well devised scheme, with the Unit Approval Committees (UAC) at the State level and BoA at Central level acting as a single window mechanism. BoA is represented by members from different Ministry/Department, which finally gives clearances. However, DOC, in their reply (June 2014) stated that there is a need for review of single window system in various States to unplug the loopholes and it is for the State Governments to take the proper initiative on this issue. DoC further stated that in many States, single window system is yet to be implemented.

Audit is of the opinion that the envisaged single window system for speeding up the process of approvals has not rolled out as many States are not on board with their matching policies/Acts.

3.3 Notification of SEZ-absence of time limit

Section 4 (1) of SEZ Act 2005, stipulates the procedure for notification wherein the Developer who has been granted Letter of Approval submits the particulars of the identified land to the Central Government who in turn notifies the SEZ after satisfying that the requirements under sub-section (8) of Section 3 and other requirements as may be prescribed are fulfilled.

However, no time limit has been prescribed in SEZ Act or Rules within which the Developer needs to submit all the details required for notifying the SEZs. Absence of such provisions resulted in delays in issuing notifications. Consequently, only 392 SEZs could be notified in India as against 625 Formal Approvals granted. Analysis of approvals accorded vis-a-vis notifications between 2006 and July 2013 across the country indicated that pendency, year on year, ranged between 57 per cent and 95 per cent, necessitating a need for reviewing the time taken at various stages. Coupled with the fact that extensions for SEZ approvals are being given in a routine manner, relaxing the time limit only compounds the issue.

Review of six SEZs in Andhra Pradesh, Odisha and Uttar Pradesh indicated that SEZ could not be notified even after a lapse of 7 years in case of M/s

IDCO, Kalinga Nagar, Odisha or got delayed by 7 years in case of M/s Gopalpur SEZ, Odisha.

A case where one developer in Andhra Pradesh was accorded 14 approvals in 2008 but could not be notified till date is highlighted at Box 5.

Box-5: Fourteen approvals to one Developer, but none notified

In Andhra Pradesh, a Developer M/s Deccan Infrastructure and Land Holdings Ltd., a subsidiary of AP Housing Board was accorded 14 Formal Approvals to set up SEZs in different places of the State over 640.964 Hectares in 2008. The validity of LOP expired in 2011, which was extended up to July 2012. Even then the Developer could not fulfil the conditions stipulated for notification viz., legal possession, irrevocable land rights, contiguity of land, etc in any of the approvals. No action was taken either to review the case or cancel the approval.

DOC in their reply (June 2014) stated that the Developer shall, after the grant of LoA submit the exact particulars of the identified area to the Central Government and subsequently that Government may, after satisfying itself, notify the specifically identified area in the State as a SEZ. Completion of the formalities for notifying SEZ requires coordination with various authorities of the State Government, which takes time. Hence, it is difficult to prescribe a time limit for issue of notification after the formal approval is granted to the Developer. Moreover, the SEZ is not eligible for any duty benefits before issue of notification. Issue of notification is pre-requisite for getting SEZ benefits.

Audit is of the opinion that timelines may inter alia help in monitoring delays, if any.

Recommendation: *MOC&I may consider prescribing time limits for each stage of the SEZ life cycle for benchmarking purposes.*

3.4 Delays in approval

Board of Approval (BoA) is empowered to grant approval/reject/modify proposals for establishment of SEZs as per section 9 of SEZ Act 2005 read with Rule 5 of SEZ Rules 2006. A time limit has been prescribed in the Rules ibid on the part of all the concerned authorities, viz., Development Commissioner, State Government and Government of India ranging between 15 days to 6 months for processing at various stages. However, no such time limit has been prescribed for BoA to grant the approvals. We noted from the scrutiny of BoA Minutes and Agenda papers that in 5 instances in Maharashtra, Kerala and Tamilnadu, the proposals were deferred for six months to one year, ostensibly due to paucity of time even though the

applicants had secured the possession of land and explicit recommendations of the State Governments were in place. Consequently, setting up of these SEZs got delayed to that extent.

DOC in their reply (June 2014) stated that while delay in giving approvals is an exception and not the norm, it occurs sometimes due to unavoidable administrative reasons. Now the meetings of BoA are being convened regularly and such delays are not happening.

The reply of the department is not tenable as the reason cited for delay in granting of approvals was paucity of time which is evident from the agenda of 33rd BoA. Further, in the Agenda itself, the BoA clarified that the land was in possession of Developer in respect of M/s MM Tech Towers, M/s Emaar MGF Land Ltd. and M/s Yashprabha Enterprises. BoA also grants In-Principle approval on the basis of State Government recommendation and hence, In-Principle approval could have been granted in respect of M/s Yashprabha Enterprises and M/s Limitless Properties Ltd. who were recommended by the concerned State governments.

3.5 Non-consideration of State Government's Recommendation

As per section 3 (3) of The Special Economic Zones Act, 2005, any person, who intends to set up a Special Economic Zone, may, after identifying the area, at his option, make a proposal directly to the Board for the purpose of setting up the Special Economic Zone, provided that where such a proposal has been received directly from a person under sub-section, the Board may grant approval and after receipt of such approval, the person concerned shall obtain the concurrence of the State Government within the period, as may be prescribed.

We noted that in eight cases the developers had submitted proposal for setting up of SEZ directly to the Board and state government recommendation was received in the Department of Commerce (DoC) before considering the case in the meeting of BoA. However, the developers were granted formal approval by BoA without considering State government's recommendation for In-Principle approval/deferment.

Further, we also noted that in respect of M/s APIIC's proposal to set up a Biotech SEZ at Karakapatla village, Medak district, Andhra Pradesh in an area of 100 acres, the state government vide their letter no. 9289/INF/A2/2006 dated 01.07.2006 and 19.07.2006 had recommended the proposal for formal approval for an area of 75 acres. However, the BoA had granted formal approval for an area of 100 acres (40.47 hectares) without considering the

state government's recommendation to restrict the Bio-tech SEZ to the extent of 75 acres only.

DOC in their reply (June 2014), inviting attention to the provisions of SEZ Act and SEZ Rules stated that initially, the proposals for setting up of establishment of SEZs were considered and approved by the BoA even without the recommendation of State Government. Rules have been substituted vide GSR 501(E) dated 14.6.2010 which indicates "every proposal under sub-sections (2) to (4) of section 3 shall be made in Form 'A' and be submitted to the concerned Development Commissioner as specified in Annexure-III, who, within a period of fifteen days, shall forward it to the Board with his inspection report, State Government's recommendation and other details specified under Rule 7."

Cases indicated by the Audit pertain to the period well before 2010 and, therefore, such proposals were considered and approved by the Board in accordance with the then prevailing provisions of SEZ Act/Rules. However the observation of the audit is noted for further compliance.

Similar other cases may be reviewed and outcome intimated to audit.

3.6 Irregular extension of formal approvals

Rule 6 (2) (a) of the Special Economic Zones Rules, 2006 envisages that Developer or Co-developer as the case may be, shall submit the application for extension of validity of approval in Form C1 to the concerned Development Commissioner.

In respect of two developers i.e. M/s Peninsula Pharma research center and M/s Wipro Ltd. the dates of formal approval of which are 25.10.2006 and 25.06.2007 respectively, audit scrutiny revealed that application for extension of validity of formal approval had neither been made in Form C 1 prescribed for the purpose nor duly recommended by the concerned Development Commissioner.

It was further noticed that in case of M/s APIIC, Karakapatla village, Mulugu Mandal, Medak Distt, Andhra Pradesh (F. 2/317/2006-EPZ), formal approval was granted on 26 October 2006. Further extension upto 25 April 2014 was granted on 27 June 2013 except for the period 26 October 2010 to 25 October 2011.

Similarly, in the case of M/s Ansal IT City and Parks Ltd, Plot No. TZ-06, Tech Zone, Greater Noida, Uttar Pradesh (F-2/28/2006-SEZ), scrutiny of records revealed that formal approval was granted on 07.04.2006. The formal

approval was periodically extended till 11.06.2014 except for the intervening period 07.04.2012 to 11.06.2012 (66 days).

DoC in their reply stated (June 2014) that as per Rule 6(2)(a) of the SEZ Rules, the formal approval granted to the Developer is valid for a period of 3 years within which time at least one Unit should have commenced production for the SEZ to become operational from such a date of commencement of production. The Board may, on an application by the Developer, extend the validity period. The Developer shall submit the application in Form C1 to the concerned DC, who shall forward it to the Board with its recommendations. Form C1 has been introduced in the SEZ Rules w.e.f. 14.6.2010 and, therefore, the question of granting extension to formal approval without Form C1 does not arise.

Reply is not acceptable because case cited by audit in respect of M/s APIIC and M/s Ansal IT City and Parks Ltd extensions were granted after 14.6.2010.

3.7 Non furnishing of projected exports in Form A

We noted that in 16 cases the figures for projected exports from the project in the next five years in Form A at the time of submitting proposal for setting up of SEZs were not furnished by the Developer along with the application which is a mandatory requirement. However, BoA granted formal approvals and subsequently issued notification for setting up of SEZ. Since the Developers did not project the export figures in their application, their performance with respect to projected exports in these case could not be monitored all along.

DoC in their reply (June 2014) stated that Form A is scrutinized at the time of considering proposals for setting up of SEZs. The cases pointed out by the Audit are isolated cases and is not a standard practice. The projected exports figures serve as a guideline for measuring export performance vis-à-vis projected exports. The Zonal Development Commissioners periodically monitor the export performance of all SEZ Developers and Units. After the SEZ becomes operational and Units start production, the Units are granted LoPs for a block of 5 years. They are required to achieve positive Net Foreign Exchange (NFE) for a block of 5 years. Their performance is measured on this criteria and further extension of LoP is based on achievement of positive NFE. The defaulting Units are penalized as per the provisions of the SEZ Act/Rules.

The contention of DoC that the cases pointed out by the audit are isolated cases, is not acceptable because test check of records of 187 Developers revealed that 16 Developers have not submitted the Form A while applying for setting up of SEZ. Further, the issue raised by audit is not regarding

monitoring of the earning of foreign exchange by the developer/unit, rather it is non adherence of the codal provisions.

3.8 Extension of approvals despite failure to commence work

Formal and in-principle approval given to Developers for establishing SEZs is valid for three years and one year respectively as stipulated in Rule 6 (2) of SEZ rules 2006. Letters of approval awarded to SEZ Units are valid for one year within which the unit needs to commence production vide Rule 19(4). As per the earlier provision BoA can give approvals for extension of this time limit maximum up to two years after ascertaining the facts that the Developers/Units have taken sufficient steps towards operationalization of the project and further extension is based on justifiable reasons. However, restriction of two years was relaxed (June 2010) which led to extension of approval for 7 to 8 years, even though the developers had not commenced any investment, thereby defeating the very intent of the scheme. We noted in the case of 31 developers and 10 units in 9 states (Andhra Pradesh, Gujarat, Haryana, Karnataka, Maharashtra, Odisha, Tamilnadu, Uttar Pradesh and West Bengal) that extensions were given as a matter of routine despite nil/meagre investments in these projects.

Consequently, the projected investments, employment and exports could not be achieved in any of the projects. We believe that according extensions in a routine manner without linking it to the progress of the projects is fraught with the risk of Developers utilising the SEZ route to plan for alternative use of SEZ land or for raising loans against the government land[7], besides defeating the intended socio-economic benefits projected by the Developers.

The following illustration at Box-6, further highlights the issue being flagged where M/s Navi Mumbai SEZ in Maharashtra were granted routine extensions (6th year) even though the Developer had not complied with the conditions attached to the approval.

Box-6: Routine Extensions despite failure to meet the conditions set

M/s Navi Mumbai SEZ (NMSEZ) applied (February 2006) for setting up of Multiproduct SEZ over an area of 1250 hectares at Dronagiri, Maharashtra and stated in its application that the land is contiguous except for Public Roads and Railway Lines wherein Flyovers/underpasses would be made. BoA granted Formal approval (July 2007) subject to the conditions that the developer would establish contiguity by having dedicated security gates/Flyovers/underpasses and no tax benefit would be available for establishing contiguity. It was further stated that the work for establishing contiguity would be started only after obtaining approval from Railways and NHAI.

Meanwhile, MOE&F granted environmental clearance (August 2006) subject to the condition that the Developer ensures that the mangroves are fully conserved in the creek areas at the periphery of NMSEZ and as Dronagiri comes under CRZ notification, the Developer needs to comply with the Hon'ble Mumbai High Court order dated 6th October 2006 in Writ Petition No. 3246 of 2004.

Inspite of the Developer's failure to comply with any of the above condition, BoA notified the SEZ in the same year (November 2007) and had been granting extensions (beyond 6th year) in a routine manner. The Developer had procured (as of 31st March 2013) duty free goods valuing ₹ 37.82 crore with duty forgone of ₹ 4.9 crore. The expected socio-economic benefits projected by the Developer on account of Investment (₹ 2800 crore), Exports (₹ 10000 crore) and employment (75000) could not be achieved as the project had not taken off even six years after its notification.

DoC in their reply stated (June 2014) that Rule 19(4) of SEZ Rules, 2006 does prescribe a limit for extensions of LOA of a unit by the DC. Beyond the prescribed limit of extensions permissible under the para, BoA grants further extensions on a case to case basis, under proviso to rule 19(4).

Extensions of LoA in respect of Developers/Co-Developers are granted by BoA taking into consideration the merits of the case, factors like global recession, industry-specific cyclical problems etc.

The loss of revenue pointed out by the Audit is not an actual loss but a presumptive loss. Once the unit commences operations and exports within the extended period of LoA, there is no loss to the Government. In case the unit fails to commence operations and the LoA lapses, applicable duties and dues, if any, will be collected by the Government.

The reply of the department was not acceptable because in terms of proviso under Rule 19(4) extension for the maximum period of 3 years was subject to the condition that two-thirds of activities including construction, relating to the setting up of the Unit is complete and a chartered engineer's certificate to this effect is submitted by the entrepreneur. In the cases pointed out by audit, none of the conditions were met by the developers and the developers failed to commence operations as such the duty benefits availed by them need to be recovered.

3.9 Extension beyond 6th year in contravention of norms set

The Board of Approval in their meeting (September 2012) advised the Development Commissioners to recommend the requests for extension of formal approval beyond 5th year and onwards only after satisfying that the Developer had taken sufficient steps towards operationalization of the project and further extension is based on justifiable reasons. Board also observed that extensions may not be granted as a matter of routine unless some progress has been made on ground by the developers. The Board, therefore, after deliberations, extended the validity of the formal approval to the requests for extensions beyond fifth year for a period of one year and those beyond sixth year for a period of 6 months from the date of expiry of last extension.

However, we noted from the scrutiny of minutes of the subsequent BoA meetings that in 22 cases pertaining to Andhra Pradesh, Gujarat, Maharashtra, Karnataka, Odisha, Tamilnadu and West Bengal, extensions beyond 6th year were further granted for one year instead of for six months.

DoC in their reply stated (June 2014) that in the cases highlighted by the Audit, BoA has granted extensions beyond 6th year to 9 developers in Tamil

Nadu after taking into consideration factors like global recession, market conditions of a particular industry etc. based on which BoA, the highest deciding authority on SEZ issues, takes a decision on a case to case basis.

Reply is not acceptable because BoA does not have any power to override the provisions of SEZ Act/Rule.

3.10 SEZs operating without environmental clearance

Though the key objectives of SEZs are to boost exports and attract investments, if not properly planned, they can impact natural habitats and result in loss of necessary forest cover and bio-diversity.

As per sub-section (1) and clause (v) of sub-section (2) of section 3 of the Environment (Protection) Act, 1986, read with clause (d) of sub-rule (3) of rule 5 of the Environment (Protection) Rules, 1986, the construction of new projects or activities or the expansion or modernization of existing projects or activities listed in the Schedule to Notification entailing capacity addition with change in process and or technology shall be undertaken in any part of India only after the prior environmental clearance from the Central Government or as the case may be, by the State Level Environment Impact Assessment Authority (SIEAA), duly constituted by the Central Government under sub-section (3) of section 3 of the said Act, in accordance with the procedure specified in the Notification.

It was noted that 10 out of 36 operational developers in Andhra Pradesh and 2 out of 11 selected operational developers in Maharashtra have not obtained Environmental Clearances as per the information available on the website of the MoEF[8] and the data given by SIEAA as detailed below:

Sl. No	Name of Developer	Date of Notification	Date of Operation	Nature of project or activity as per the schedule to notification dated 14/09/2006
1	Anrak Aluminum Ltd Makavanipalem, Vizag	5.52009	NA	Alumina 3(a)
2	APACHE SEZ Development India Pvt. Ltd.; Footwear; Tada, Nellore Dist.	8.8.2006	27.12.11	Leather Complexes 7(c)
3	APIIC Ltd.; Formulation; Jedcharla, Mahaboobnagar	13.6.2007	NA	Formulations 5(f)
4	Divi's Laboratories Limited; Pharma Chippada, Vizag	16.5.2006	12.12.06	Formulations 5(f)
5	Dr. Reddy's Laboratories Ltd.; Pharma; Ranastalam, Srikakulamj	11.11.2009	NA	Formulations 5(f)
6	Hetero Infrastructure; Pharma; Nakkapalli, Vizag	11.01.2007	01.04.11	Formulations 5(f)
7	APIIC, Building Product, Prakasam	08.09.2009	13.08.10	7(c)

[8] Ministry of Environment and Forest

Sl. No	Name of Developer	Date of Notification	Date of Operation	Nature of project or activity as per the schedule to notification dated 14/09/2006
8	APIIC, IT/ITES; Hill No.3, Madhurawada, Vizag	28.12.2006	03.02.08	7(c)
9	APIIC, IT / ITES; Hill No.2, Madhurawada, Vizag	11.04.2007	25.11.09	7(c)
10	LandT; IT / ITES; Hi-Tech City, Keesarapalli, Gannavaram	15.01.2007	01.04.10	7(c)
11	Wockhardt Infrastructure Development Limited	17.04.2007	31.05.2012	SEZs (7 (c))
12	Quadron Business Park Ltd SEZ, Pune (formerly known as DLF Akruti Infopark Ltd)	14.09.2007	12.11.2007	SEZs (7(c))

Carrying out operations without appropriate environmental clearances by the statutory authorities are a risk requiring a review of their activities vis-à-vis the norms on the subject.

DoC in their reply stated (June 2014) that in the case of M/s. Quadron Business Park Limited, one unit has obtained the Certificate of Environment Clearance and submitted to the Zonal DC Office. Second Unit has also obtained clearance from Pollution Control Board. They have been asked to obtain the Environment Clearance Certificate without further delay. However, observations have been noted for compliance and the matter is being examined for further necessary action.

DoC may intimate the final outcome to audit.

3.11 Environmental Impact and CRZ clearance in the case of M/s Adani Ports and Special Economic Zone Ltd.

The Hon'ble Supreme Court of India[9] ordered that forests, tanks, ponds, etc., which are nature's bounty, maintain delicate ecological balance and hence need to be protected for a proper and healthy environment. Further, the Central Government issued instructions in April 2006 banning construction activity within 500 yards from defence Notified land. SEZ Instruction No.65 dated 27 October 2010 also prescribes restriction on use of irrigated and double crop land for setting up of SEZs.

The Ministry of Environment and Forests had banned a number of ecologically destructive activities along the coast vide CRZ-91 dated 19th February 1991 (amended as CRZ-2011). Moreover, the guidelines on development of SEZs issued through, Department of Commerce, SEZ Division, instruction no. 65 dated 27 October 2010 stipulate that as far as possible SEZs shall be self-contained with respect to basic facilities and requirements. The

[9] Civil Appeal No.4787/2001(SLP No.13695/2000) dt.25/7/2001

developer of the SEZs shall make a development plan, keeping in view the site analysis and assessment of physical and natural resources. Further, the developer of the SEZs would strive to address environmental aspects as prescribed by law, planned green areas, ground water recharging areas and disaster mitigation aspects.

We observed at DC, Adani Ports & Special Economic Zone Ltd. (formerly Mundra Ports and Special Economic Zone Ltd.)(AP&SEZ), Mundra office that, as per the decision in 59th meeting of BoA dated 30 August 2013, it was granted In-Principle approval to establish their new multiproduct SEZ on 1856 hectares land at Mundra, of which 1840 hectares land was actually a reserved forest land allotted to the AP&SEZ in 2009 by Government (vide GOI, Ministry of Environment and Forest, New Delhi's letter no.F.No.8-2/1999-FC(Pt) dated 30 September 2009 and as per Govt. of Gujarat, Forest and Environment Department's Memorandum No.FCA-1009(10-14)SF-18-K dated 17 November 2009). Remaining land of 16 hectares was de-notified from the existing SEZ with an intention to club it with 1840 hectares land for fulfilment of conditions of 'contiguity of land' for new SEZ. Thus, BoA considered in-principle approval to establish new SEZ on reserved forest land.

Further, as per information provided by Specified officer, DC office-Mundra, AP&SEZ, Mundra did not get environmental clearance for setting up SEZ. For information on details of CRZ clearance by AP&SEZ, it was replied that the developer did not provide information regarding CRZ clearance to DC office.

However, as per the information (SCN dated 30 September 2013 and report on environmental issue) available in the website of Ministry of Environment and Forests (MoEF) it was observed that:

- MoEF granted environment and CRZ clearance to AP&SEZ on 12 January 2009 for the development of port facilities at Mundra. However, on the basis of representations from the Machhi Mar Adhikar Sangarsh Sangthan, MoEF conducted (6-7 December 2010) site verification and found certain violations related to construction of air port, township, hospitals and destruction of mangroves. Ministry issued directions on 23 February 2011 to project authorities not to undertake any reclamation activity and not to initiate any new construction activity in new CRZ area.
- PIL 12 of 2011 was also filed by Kheti Vikas Sewa Trust in the Hon'ble High Court of Gujarat alleging destruction of mangroves by the project authorities.

- On account of serious violations, MoEF constituted (September 2012) a committee to examine the issue and committee submitted (18 April 2013) report which revealed the violations such as massive ecological changes with adverse impacts, construction of airship/aerodrome without EC, unauthorized construction resulting in blocking of creeks, rampant destruction of mangroves etc.
- Committee also recommended remedial measures to safeguard environment and issued SCN to AP&SEZ on 30 September 2013.

It was noticed that, even though SEZ area was within Coastal Region Zone and SEZ was functioning since 2006, department failed to ascertain the non compliance of the environmental guidelines/CRZ guidelines up to December 2010. This issue came to the notice of the department only after receiving representations from the fishermen community in December 2010. Non-monitoring of environmental compliance by the department from 2005-06 to 2010-11 led to a negative impact on various aspects of environment as reported by MoEF.

DoC in their reply stated (June 2014) that although, the Environmental Clearance has not been granted by MoEF to the SEZ, however, the Expert Appraisal Committee of MoEF has recommended the project for environmental and CRZ clearance. The matter is being examined for further necessary action.

DoC may intimate the final outcome to audit.

3.12 Absence of mechanism to monitor non-operational Units

Rule 54 of SEZ Rules read with Annexure I of the rules stipulate monitoring the performance of units which have completed at least one year of operations from the date of commencement of production. However, there is no provision to monitor the units that have not commenced their operations. Consequently, their actions remain generally out of the day-to-day monitoring by the DC/UAC. Few such cases where the fifth year of extension is in progress but the Units were yet to start their operations despite importing duty free goods are shown below:

Developer/Unit	Location/State	Value of goods imported and amount of duty forgone (₹ in crore)	Year of Import
M/s XL Energy	FAB City, Hyderabad, Andhra Pradesh	153/37.94	2008 and 2009
M/s iGate Global Solutions	MIDC Pune, Maharashtra	14.15/ 1.75	
M/s Hangers Plus	Mahindra World City, Tamilnadu	1.5/0.37	

The above account calls for a review of the monitoring system in place to provide for a system of periodic monitoring of non-operational units as there was none as per the system in place. Further, non-operational units are also fraught with the risk of leased land being mortgaged by the Developers to raise capital for the purposes other than SEZ use as commented at paragraph 4.10 of this report.

DoC in their reply stated (June 2014) that with a view to strengthen monitoring system, SEZ Online System has been introduced. UAC in the zones also monitors the performance of SEZ Units and the Formal Approval granted to the Units is valid for one year and in case the Unit does not implement the project, it has to approach for further extension with justification. In case, the performance of the SEZ is not satisfactory, extension is not granted.

Reply is not acceptable because cases highlighted by audit indicates that there were weaknesses in monitoring the performance of SEZ units.

Recommendation: *MOC&I may consider introducing a suitable mechanism to monitor non-operational SEZ units.*

Chapter IV: Land allotment and utilisation

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, we 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[10], 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.

Land and its development are State subjects, but acquisition of land is on the Concurrent List. As per SEZ Act 2005, land for establishment of SEZs needs to be contiguous and the developer is required to have irrevocable rights over the Land. Lands are being allotted by the State Government directly or through Land banks/Agencies on the basis of proposals made by the Developers. Land is acquired vide section 4 read with Section 6 of Land Acquisition Act 1894. It is a known fact that land acquisition for SEZs has given rise to widespread protest in various parts of the country. Large tracts of land were being acquired across the country for this purpose. The acquisition of land from the public by the government is proving to be a major transfer of wealth from the rural populace to the corporate world. Questions have already been raised on account of loss of revenue on tax holidays and the effect on agriculture production. An Expert Group Report[11] released by the Planning Commission had called into question the benefits of SEZs.

Monitoring of acquisition/de-notification of land needs to be done by MOC&I as acquisition is in the name of the SEZs which is a Central Scheme and involves invoking of Land Acquisition Act which is again a Central Act.

Under this section, we reviewed the land allotment and land utilisation related issues.

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[10] *Andhra Pradesh, Gujarat, Karnataka, Maharashtra, Odisha and West Bengal*

[11] *"Development Challenges in Extremist Affected Areas".*
Online at http:// planningcommission.nic.in/reports/publications/rep_dce.pdf.

4.1 Ownership of land

In the present set up, a developer can acquire the land by direct purchase for establishing a SEZ. In cases where State Government acquires the land under *"public purpose"* or the land is in the ownership and possession of the State Government or a State Government Undertaking like APIIC in Andhra Pradesh, KIADB in Karnataka etc, the State Government may either transfer the Land on *ownership or lease* basis to the developer, depending on the terms and conditions under which the land is acquired, and on the policies and procedures adopted in the particular State. The developer, however, as per the extant rules (Rule 11(9) of SEZ Rule) cannot sell the land within a SEZ and the land in the processing and non-processing area can be allotted only on lease basis, as per the SEZ Act.

We noted that the transfers of the Government land to the developers were mostly taking place on transfer of ownership basis. Technically, for a developer/unit-holder, access to land for operating his business should be the key concern rather than having the ownership of the land transferred in his name. In the backdrop of developers not commencing their investments for years together, transfer of ownership of land is saddled with the risk of developers using it for furtherance of their economic interests based on the government land, and or diversion after getting it de-notified, which is not in the interest of the State. Instances pointed out in Paragraph 4.5 of this report, further substantiates the observation made in audit.

It appears that the ownership of land acquired by the State Government for a SEZ is transferred to the Developer. It could be considered by MOC&I to lease out the land to the developer/unit-holder on a long-term basis, with the provisions of extension duly built into the lease deed. This may help in controlling the misuse and diversion of SEZ land through de-notification.

DoC in their reply explaining the provision of Rule 7 of the SEZ rules stated (June 2014) that for notification of the SEZ, the developer should have legal possession and irrevocable rights to develop the said area as SEZ and that it is free from all encumbrances and for the developer having leasehold rights, the lease shall be for a period not less than 20 years. Therefore, the SEZ Rules does not insist that the developer should be the owner of the land. It is for the State Government to decide whether the land is to be provided on a freehold or leasehold basis.

Land being a State subject, BoA on SEZs only considers those proposals, which have been duly recommended by the State Government. Further, pursuant to the decision of Empowered Group of Ministers (EGoM) the State

Governments have been informed on 15th June 2007 that the Board of Approval 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.

Government of India has already issued Instruction No. 29 dated 18.08.2009 to all Chief Secretaries that State Governments should not undertake any compulsory acquisition of land for setting up of the SEZs, and BoA will not approve any SEZs where the State Governments have carried out or proposed to carry out compulsory acquisition of land for such SEZs after 5th April, 2007. Moreover, the notification of SEZs and its de-notification is done only after the "NOC" from the State Government.

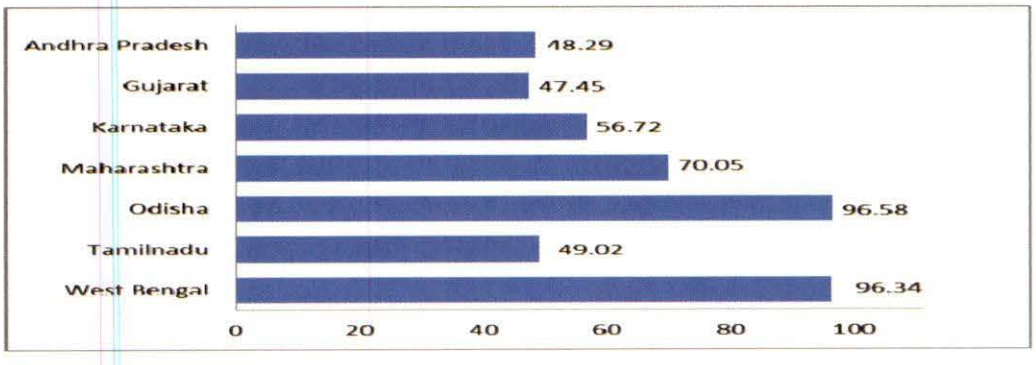
Reply of DoC does not address the issue of misuse and diversion of land after de-notification of SEZ. Department may elucidate the mechanism that they have to prevent such misuse or diversion of land by developers.

4.2 Land allotment to SEZs

Since the enactment of SEZ Act 2005, 576 formal approvals of SEZs covering 60374.76 hectares was granted in the country, out of which 392 SEZs covering 45635.63 hectares have been notified till date (March 2014).

We observed that out of 392 notified zones, only 152 have become operational (28488.49 hectares). The land allotted to the remaining 424 SEZs (31886.27 hectares) was not put to use (52.81 per cent of total approved SEZs) even though the approvals and notifications in 54 cases date back to 2006. We also observed that out of the total 392 notified SEZs, in 30 SEZs (1858.17 hectares) in Andhra Pradesh, Maharashtra, Odisha and Gujarat, the Developers had not commenced investments in the projects and the land had been lying idle in their custody for 2 to 7 years. Details of extent of area not put to use in the major States are indicated below:

Figure 7: SEZs Land lying idle (%) in various States



A case where second formal approval was given even though the applicant failed to put to use the first one is highlighted in the Box-7.

Box-7: Second approval given despite failure to put to use the first one

M/s Kakinada SEZ (KSEZ) Andhra Pradesh was granted 'formal approval' for setting up of another multi-product SEZ adjacent to the already approved SEZ in Kakinada on 1013.60 hectares of land in February 2012 even though the first SEZ admeasuring 1035.66 hectares (In-principle approval was given in 2002) was not put to use in 12

DoC, stated (April 2014) that Central Government does not allot any land for SEZs, only State Governments at times acquire land through their Industrial Infrastructure Corporations. In most of the occasions land is acquired by the private developers. On the recommendation of State Government, DoC, after verification of title and contiguity of the land, accorded approval for SEZ.

DoC in their reply stated (June 2014) that though SEZ Act is a Central Act, land is either acquired by the developer themselves or it is allotted/its acquisition is facilitated by the State Govt. Before de-notification of any SEZ, clearance from the State Govt. is always sought. Thus, in the matter of land, in our federal system, intervention of a Central Ministry may not be appropriate. This issue needs to be looked into by the respective State Governments.

Audit is of the opinion that even after a lapse of 2 to 7 years after notification, Developers could not implement the project on lands acquired by invoking Land Acquisition Act under Public interest clause. Further, considering that agricultural land was acquired in many cases and persistence of the trend of acquiring vast tracts of land without any economic activity would be a matter of social concern in future, necessitating a caution in allocating agricultural land.

4.3 Allotment of restricted land

The Supreme Court of India in Civil Appeal No. 4787/ 2001 (SLP No. 13695/2000) ordered (25th July 2001) that forests, tanks, ponds, etc., which are nature's bounty, maintain delicate ecological balance and hence need to be protected for a proper and healthy environment. Further, the Central Government issued instructions in April 2006 banning construction activity within 500 Yards from Defence Notified Land. SEZ Instruction of October 2010 prescribes restriction on use of irrigated and double crop land for setting up of SEZs.

We observed that 9 SEZs were allotted land which was restricted under various statutes (Defence, Forest, Irrigated land) in Andhra Pradesh,

Maharashtra and West Bengal involving 2949.61 hectares of restricted land as detailed below:

Nature of land	Name of the SEZ	State	Are of Land (ha)		% of restricted land notified as SEZ
			Notified as SEZ	under 'restricted' category	
Defence Land	M/s Hyderabad Gems	Andhra Pradesh	80.93	29.54	*36.5*
Forest Land	M/s Indutech		101.21	101.21	*100*
	M/s Stargaze		101.21	101.21	*100*
	M/s Brahmani		101.21	101.21	*100*
	M/s JT Holdings		28.34	28.34	*100*
	M/s Adityapur Industrial Area	West Bengal	36.42	21.93	*60.19*
Irrigated Land	M/s Sricity	Andhra Pradesh	1538.12	1538.12	*100*
	M/s Kakinada SEZ		2049.26	1018.02	*49.67*
Green Zone	M/s Geetanjali Gems Ltd	Maharashtra	10.03	10.03	*100*
Total			4046.73	2949.61	*72.88*

Land identified for SEZs in case of M/s Sricity and M/s Kakinada SEZ in the state of Andhra Pradesh comes under Telugu Ganga and Pithapuram Irrigation Projects respectively. In respect of Kakinada SEZ, Government of Andhra Pradesh in December 2009 accorded permission to delete the land coming within the SEZ, from the Ayacut of the Pithapuram branch canal.

DoC in their reply stated (June 2014) that 'land' is a State subject. State Governments have been advised that first priority should be for acquisition of waste and barren land, and only if necessary, then single crop agricultural land could be acquired for the SEZs. Cases quoted by the Audit are isolated cases and State Governments are to look into such matters before recommending cases to the Ministry for formal approval of SEZs.

Reply of the department is not acceptable. It appears that DoC absolved itself from the responsibility of monitoring and proper implementation of the scheme.

4.4 Under-utilisation of land in processing area

Analysis of extent of land put to use in the selected operational SEZs revealed that the processing area[12] earmarked for SEZs could not be optimally used for the intended purpose in 18 SEZs involving an area of 4185.19 Ha in eight states. They could use only 16.29 per cent of the land in the processing area as against the norm of 50 per cent. Though many of them were notified in 2006/2007 (except Adani Ports in Gujarat) the percentage of utilisation is abysmal as detailed overleaf:

[12] *Processing area is an area of SEZ which is meant for manufacturing, services and infrastructure for units. Minimum area to be set apart for this purpose is minimum of 50% of the total SEZ area.*

Name of the Developer	Processing area under-utilised (%) (Area in ha)	Sector /Industry
	Andhra Pradesh	
FAB city	91.16 (296.26)	Semi Conductors
AP SEZ	83.89 (1573.78)	Multi Product
Sricity	93.56 (719.48)	Multi Product
Brandix	88.31(234.03)	Apparel
	Chandigarh	
M/s Ranbaxy Laboratories Ltd	87.10 (27.00)	Pharmaceuticals
	Gujarat[13]	
Adani Ports SEZ	87.11 (5639.09)	Multi Product
	Maharastra	
Wokhardt Infrastructure	89.78 (58.52)	Pharmaceuticals
	Odisha	
IDCO SEZ Chandaka Industrial Estate	30.70 (21.24)	Information Technology
	Rajasthan	
Boranada SEZ	52.88 (23.38)	Handicrafts
	Karnataka	
Infosys Ltd., SEZ (Mysore)	60 (13.22)	Information Technology
Quest SEZ	91.29 (97.07)	Engineering Products
KIADB Food processing SEZ	73.56 (52.99)	Food Processors
KIADB Pharmaceutical SEZ	78.22 (63.97)	Pharmaceuticals
KIADB SEZ, Hassan	55.47 (92.54)	Textiles
	Tamilnadu	
J Matadee Free Trade Zone P Ltd.	90.48 (76.71)	FTWZ
Flextronics Technologies India P ltd	56.57 (46.95)	Electronic Hardware
New Chennai Township Private Limited	89.75 (54.48)	Multi Services
New Chennai Township Private Limited	82.12 (51.84)	Light Engineering
Average (%)/ (Area involved)	85.78 (9142.54)	
Total	83.71 (3503.45)	

Even though the above listed 17 SEZ were notified between April 2006 to August 2008, 3503.69 ha (83.71 per cent) of processing area was not utilised out of the 4185.19 ha of land earmarked for processing. In case of Adani Ports, out of the notified (May 2009) area of 6472.86 ha only 833.77 ha was utilised leaving 5639.09 ha (87.11 per cent) unutilised so far.

In two instances, unauthorised allotment of Units were observed in the sector specific SEZ (food) developed by KIADB in Karnataka where the units (M/s Hassan Bio Mass Power company Pvt Ltd and M/s Yakima Filers Private Ltd) were occupying the SEZ area without necessary approvals. Even the activity of the Units were not related to the sector specific SEZ.

[13] *Notified in 2009. Area of land unutilised arrived by subtracting from notified area as processing area was not furnished to Audit.*

Further, 74 LoAs were cancelled in Jaipur SEZ-II and Boranada SEZ in Rajasthan. However, the Land admeasuring 32.72 acres of land could not be returned to the Developer as the units have made lease agreement for 99 years and resultantly occupied the land. Thus, the Units were not willing to vacate the land even after their LoAs were cancelled. The lease period should be co-terminus with the validity period of LoA (five years).

DoC in their reply (June 2014) while accepting the audit observation stated that the provision already exists in the SEZ Rules regarding termination of lease agreement in case of expiry or cancellation of LoA. Further, in order to utilise the vacant land available in SEZs, an exercise was undertaken to identify vacant spaces in the processing area of the notified SEZs and detailed information relating to vacant spaces in SEZs has been provided to National Manufacturing Competitive Council, FICCI, CII, ASSOCHAM, Ministry of MSME, Department of Industrial Policy and Promotion etc. for wider circulation so as to help in populating the SEZs.

DoC further stated that it is a fact that sometimes land of SEZs may remain vacant due to non-setting up of Unit, but investment in SEZs depends on many factors like change of Government policies, market conditions etc. And the decision to set up units (which occupy the processing area) depends on a host of factors like global recession, industry specific reasons, local factors etc. DoC makes efforts to extend facilitation to the entrepreneurs for setting up of Units.

Reply was not acceptable to audit because respective DC, SEZ failed to get the land vacated from the unit, though their LoAs were cancelled.

4.5 Diversion of SEZ land

(a) Section 6 of the Land Acquisition Act 1894 bestows rights on State governments to acquire land under 'public purpose'.

The Government of Andhra Pradesh in June 1996, issued orders to keep the interest of small and marginal farmers in mind while acquiring the land. In Andhra Pradesh, Andhra Pradesh Industrial Infrastructure Corporation Ltd. (APIIC), a Government undertaking, provides industrial infrastructure and develops industrial townships. APIIC requested the revenue authorities to acquire land under Land Acquisition Act for the establishment of SEZs and the same was stated in the Draft notification and draft declaration issued in this regard.

We observed in respect of four SEZs tabulated below, out of the allotted land of 11328.12 hectares, only 6241.03 hectares of land was actually notified (55.09 per cent) for SEZs purpose. The allotted land was acquired by using the

government machinery under the "public purpose" clause of Land Acquisition Act for establishment of SEZs by private developers. The remaining 5087.12 hectares was allotted to other private DTA clients or kept with the developer. Thus, 44.91 per cent of the total land of 11328.15 hectares was not utilised for the intended SEZ purpose.

We also noted that out of the notified land, 1667.66 ha of land was subsequently de-notified by the developers reducing the overall non-utilisation for intended purpose to 59.62 per cent.

Name of the SEZs State	Area of land (ha)					Land acquired for SEZs but not used for SEZs (%)
	Requested by Developer	Acquired and handed over to Developer	Notified as SEZ	De-notified	Non-SEZ land with Developer	
Andhra Pradesh						
APIIC Atchyutapuram	3760.20	3760.20	2206.03	905.21	2459.38	65.40
Sricity, Chitoor	5442.50	3158.70	1538.12	449.54	2070.12	65.53
Kakinada SEZ (KSPL)	3995.54	3849.55	2049.26	-	1800.29	46.76
Gujarat						
Reliance SEZ, SURSEZ	559.70	559.70	447.62	312.91	424.99	75.93
Total	13757.94	11328.15	6241.03	1667.66	6754.78	59.62

A case of diversion of land for private industries is also highlighted in Box 8 below.

Box 8: Diversion of land for private industries

In M/s Sricity SEZ, Andhra Pradesh declared in its application that the land acquired and allotted by the Corporation shall be utilized for developing multi-product SEZ only. The Developer requested (February 2006) for 5442.5 ha of land for establishment of SEZ out of which 3158.70 ha was handed (May 2006 to December 2011) to Developer. The land was acquired @ ₹ 2.5 lakh per acre for dry land and ₹ 3.0 lakh per acre for wet land. The Developer notified only 1538.12 ha of land (September 2007 to April 2010) and further de-notified 449.54 ha of land (October 2010 and November 2011). Thus land involving 2070.12 ha of land of the total allotted land was not used for the intended purpose. It was also noted that the de-notified land was allotted to private DTA industries viz., Alstom, Pepsico, Cadbury, MMD, Unicharm, Colgate, ZTT, IFMR, Kellogg's, S&J Turney Contractors, Tecpro, Sripower, RMC/WMM, Danjeli, Ayurvet, TII, Godavari Udyog, Thaikikuwa. However, the price at which the land was allotted to DTA Units was not produced to audit.

Similarly in Essar Steel Hazira Ltd. and Reliance Industries Ltd, Jamnagar SEZs in Gujarat the de-notified area of 247.522 ha and 708.13 ha respectively were allotted to DTA units.

It was further observed that EGoM (Empowered Group of Ministers) in their meeting (April 2007) emphasized the need for restricting the use of land acquisition act for acquiring land for private SEZs and issued guidelines that the Land Acquisition Act would no longer be used for making land transfers to private SEZs. The guidelines were circulated to all the DCs by Commerce Secretary in June 2007. Further, MOC&I reiterated the same in its Instruction No.29 dated 18th August 2009. However, in respect of Sricity SEZ, land was acquired by APIIC in phases invoking the Land Acquisition Act and handed over from May 2007 to December 2011, in contravention of the instructions issued by EGoM and MOC&I.

A case of EOU allowed under SEZ is highlighted in Box-9 below:

Box-9: EOU allowed under SEZ

In West Bengal under FALTA SEZ M/s SenPet (India) Ltd was allotted plot No. 51 to 56 at Sector-II of FEPZ for setting-up of an EPZ Unit. In 2003, the Unit opted for exit from the SEZ scheme by way of conversion into a 100% Export Oriented Unit (EOU) and the same was allowed by the Ministry.

We noted that though the Unit was permitted to convert into an EOU, the developer was not asked to *physically move out of the SEZ* but was allowed to continue utilising the same premises. Further no orders for de-notification of the land being occupied by the Unit were produced to audit and the Unit continues to carry out their activities as a 100% EOU from the same premises.

(b) In the Development Plan Gurgaon-Manesar-2021, provision of SEZ was made wherein non-polluting industrial units associated with high technology and high precision were to be set up.

Though the Final Development Plan-2021 was operative, Development Plan-2025 was notified on 24 May 2011, in which an area of 4570 hectares was earmarked for SEZ. Apart from earmarking land for SEZ in development plan, SEZs like DLF SEZ, Unitech SEZ, Orient Craft SEZ, Metro Valley SEZ etc. were also notified by Government of India. Instead of establishing industrial units in SEZ, the Development Plan 2025 was superseded by Development Plan 2031 notified on 15 November 2012. In the Development Plan 2031, 4570 hectares of land earmarked for SEZ land which included 1458.03 acres of land acquired from farmers for development of SEZ was converted into residential/commercial use on the plea that there were no more takers for SEZs.

It was observed in the audit that, SEZ sectors were converted into residential as well as Industrial sectors. With the conversion of the Zoning Plan, the implementation of SEZ was adversely affected. In fact, Reliance Haryana SEZ

Limited (RHSL) requested (January 2012) the State Government that the suggestion of the State Government to de-freeze the area presently earmarked for development of SEZ had come at a time when the RHSL had made substantial investment in the project. The RHSL further stated that in case the State Government decides to de-freeze the area, RHSL would not be able to complete even the development of first phase of 2500 acres of SEZ, let alone expansion to 12500 acres of SEZ. With the de-notifying of this area, the SEZ conceived by RHSL in which State Government was also a major stake holder was abandoned by RHSL as discussed in paragraph above.

In addition, following policies incentivized the developers to utilize the land for other purposes:

- The State Government removed the limit of the maximum height of the buildings in case of Group Housing Colonies and Commercial Colonies for which the licences were issued by Town and Country Planning Department (TCPD). After this notification, developers were allowed to construct any number of storeys. Resultantly, developers engaged in Real Estate were benefitted.
- Section 5 of Haryana Ceiling on Land Holding Act, 1972 was amended by promulgating 'The Haryana Ceiling on Land Holdings (Amendment) Ordinance 2011' (Haryana Ordinance No.4 of 2011). With this amendment individuals and private companies were allowed to buy unlimited chunks of land for non-agriculture purposes. Subsequently, a notification was issued and the Act was deemed to have been modified retrospectively with effect from 30th January, 1975. Notification with retrospective effect was apparently to benefit the persons who owned land in excess of the permissible limit prescribed in the land ceiling Act. With this amendment, developers who had got SEZs de-notified were able to hold this land for purposes other than SEZ also.
- In July 2013, a policy for conversion of de-notified SEZs into cyber park/cyber city was formulated. Up to 10, 4 and 2 per cent of the area was allowed for the purposes of group housing, commercial and recreational component respectively on payment of applicable charges. Since with the promulgation of this policy, the developers were permitted to use de-notified SEZ land for Group Housing and recreational purposes also, the objective of SEZ policy was defeated.

DoC in their reply (June 2014) stated that based on the decision of the EGoM, DoC had issued instructions (15.6.2006) to all State Governments stating that

"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."

Since land is a State subject, State Governments are free to frame any law/rule on the subject. MOC&I may not have right to give directions or guidelines to frame any such rules.

Nevertheless, necessary steps have already been taken by the Ministry by issuing Instruction on 18.08.2009 and clarification on 13.09.2013.

The land is de-notified on payment of concessions/benefits availed as per the relevant provisions of SEZ law, and the same is put to industrial use for setting up new projects in DTA, as per the land use policy of Government of Gujarat.

Specific replies to the observations highlighted by audit have not been responded by the DoC.

Recommendation: *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.*

4.6 Development of SEZs without approval of NCRPB

In order to ensure balanced and harmonized development of the region, 'National Capital Region Planning Board' (NCRPB) was set up by GOI in March 1985 under 'the National Capital Region Planning Board Act -1985'. All the five SEZs operationalised in Haryana fall in NCR.

As per Section 17 of NCRPB Act, each participating State has to prepare a Sub-Regional Plan for the area falling within that State. In terms of Section 19 of the Act, each participating State has to refer such Plan to the Board and finalize the Sub-Regional Plan after ensuring that it is in conformity with the Regional Plan of NCRPB.

Regional Plan 2021 for National Capital region was notified by NCRPB on 17 September 2005. It was mandatory for the State to prepare a Sub Regional Plan in conformity with the Regional Plan. The Sub Regional Plan has not been got approved by Haryana even after nine years of preparation of Regional Plan by NCRPB.

In the CWP 19050 of 2012, the Punjab and Haryana High Court observed (23 January 2014) that development works of areas falling in NCR were being executed without approval of Sub Regional Plan by NCRPB.

The State Government had stated in Hon'ble Punjab and Haryana High Court that it would put on hold the grant of fresh licenses, change of land use and further acquisition till the Sub Regional Plan is approved by NCRPB.

As a result of non-preparation of Sub Regional Plan, further licensing of de-notified SEZs has been put on hold.

DoC in their reply (June 2014) stated that in a Single Window mechanism, Industry Department of the State Government is the nodal Department which is required to obtain all the necessary clearances/ approvals from all the concerned agencies including NCRPB before sending its no objection certificate to the DoC. Once NOC from the Industry Department is received, it is presumed that all the necessary approvals are in place. All SEZs are approved on the recommendation of the State Govt.

Reply of the department and cases highlighted by audit indicates that there was no mechanism with BoA to cross verify the NOC issued by Industry Department.

4.7 SEZ approved on a plot of land meant primarily for hospital and training institution.

BoA, MOC&I approves the establishment of SEZ vide procedure established under Section 3 of SEZ Rules, 2006. Rule 5 specifies the area requirement for establishment of different SEZs. Rule 7 further mentions the details to be furnished by Developers for issue of notification for declaration of area as a SEZ.

Proposal for setting up of a SEZ is to be made in Form A of the SEZ Rules, 2006, which requires the applicant to certify possession and contiguity of the land which needs to be free from all encumbrances.

Test check of records of operational SEZs revealed that M/s DLF Limited got approval (October 2006) under Section 3 of SEZ Rules, 2006 for setting up of IT/ITES SEZ on a 37 acre land against a minimum requirement of 25 acre. This land was purchased from M/s East India Hotels Limited (EIHL) through two conveyance deeds for 29.82 acre and 7.19 acre comprising 81.1% and 18.9% of the land parcel respectively. There was a clause in the conveyance deed of the larger land parcel (29.82 acre) that the purchaser should utilise the land for the permitted public purpose, i.e. construction of 300 bedded hospital and an institute of hotel management.

BoA, MOC&I approved setting up of IT/ITES SEZ on a land primarily earmarked for hospital and a hotel management institute without scrutiny of the land use in the conveyance deed, in violation of the Rule 3 and 7 of the

SEZ Rules. BoA also did not observe any short comings during its periodical review through the respective DC SEZ.

This 29.82 acre land parcel also suffered from a disputed land release order by the State Government of Haryana. The High Court of Punjab and Haryana in a related civil writ petition held (3 February 2011) that the whole transactions of land release was a result of fraudulent exercise of power and permission granted to the Company to sell the land and execution of sale deed was illegal. The State Government was directed to initiate the proceedings for acquisition of land and to put to use for the permitted public purpose.

M/s DLF however, filed a Special Leave Petition (SLP) challenging the High Court order in the Hon'ble Supreme Court of India and the Apex Court had stayed the operation of the impugned judgment till further orders.

MOC&I in their reply (June 2014) to the audit observation stated that since the matter was sub judice, there were no comments to offer.

Audit maintains that BoA, MOC&I approved a SEZ without carrying out the due diligence of verifying the title and usage of the land proposed by the developer nor did it point out the lacunae while monitoring the progress of the SEZ.

4.8 De-notification of lands

For SEZ purposes substantial tracts of land are required by the developer and such land is generally acquired through government machinery under the "public purpose" clause of Land Acquisition Act for establishment of SEZs. After being notified as SEZs, few developers subsequently opt for de-notification from the SEZ scheme. Though Rule 11(9) of SEZ Rules 2006 restricts the developer from selling any land within the SEZs, there is no restriction/condition on usage of such de-notified land. This encourages the developers to de-notify SEZ land and either keep it in their possession or sell it in the absence of any restrictive policy. In fact Haryana had incentivised this process (as indicated in box 10 below).

Box No.10- One time relaxation for changing land use pattern by Haryana Government

Haryana Government vide their policy decision dated 9th July 2013 accorded one time relaxation for changing Land Use pattern for already de-notified SEZs or SEZs which would be de-notified within subsequent six months. There were 49 Approvals (46 formal and 3 In-principle), 35 Notified and 5 Operational SEZs in the State. In 2013, BoA had accorded approval for five de-notifications and withdrawal of one Formal Approval.

According to the system in place, a developer who is not interested in continuing with the scheme has an option to apply for identification of part or full area of land by applying for the same to the DC with an undertaking that he would pay back the concessions availed till then which mostly would be in the form of reimbursement of concessions availed on account of various exemption/concessions given by Central and State Governments. Based on the recommendation of the State, the extent of land is de-notified 'in principle' which is formally declared through another (formal) notification. Besides this, there are no other conditions attached to it.

It is a common understanding that consequent on notification of a project, the land rates in and around the project site appreciates either immediately or in due course, as the project progresses, depending on the nature of the project. As already stated, most of the SEZs in the country are IT based and they are concentrated in the urban agglomeration, and therefore appreciation of these lands is inevitable. In this milieu, owing to lack of a deterrent provision in the Act to discourage de-notifications, developers resort to de-notification of the entire SEZ or a part of the of land allotted to them for SEZs, and in many cases they are diverted for commercial purposes. We noted that out of 230 notified SEZs in Andhra Pradesh, Maharashtra, Karnataka, West Bengal, Gujarat and Odisha, 52 were de-notified involving 5402.22 ha of land out of 39245.56 ha of land notified during the period of audit. Out of 52, 100 per cent of the notified land was de-notified in respect of 35 developers, putting a question mark over the logic that had gone into deciding the area of land acquired and subsequent application for de-notification. The following table illustrates state-wise de-notification details which indicate that out of 230 notified SEZs, 52 SEZs were de-notified (23 per cent) either partially or in full involving 5402 ha of land.

State	Number of Notified SEZs	Area (ha) notified	Number of SEZs de-notified (partial/full)		Area (ha) de-notified	*% of Area (SEZs) de-notified*
			Partial	Full		
Andhra Pradesh	78	13291.40	12	7	2102.08	15.81 (24.35)
Maharashtra	66	9280.76	0	19	1856.21	20 (28.78)
Karnataka	40	2416.81	3	1	61.95	2.56 (10)
Gujarat	32	13432.19	2	4	1209.51	9.00 (18.75)
Odisha	5	635.70	0	2	152.35	23.97 (40)
West Bengal	9	188.70	0	2	20.12	10.66 (22.22)
Total	230	39245.56	17	35	5402.22	13.76 (22.61)

The above position indicates that though Andhra Pradesh has the distinction of having the highest number of Notified SEZs (78) in the country, the state also has a record number of 19 de-notifications i.e., partial and full.

Even though SEZ land cannot be sold by the Developers, after de-notification and in the absence of restrictive provision in the Act, the land which was acquired by using government machinery for establishment of SEZ, can be used/ sold by the developers for other commercial purposes. To illustrate, in Sri City SEZ in Andhra Pradesh, 228.61 hectares out of the total de-notified land of 449.54 ha was allotted to 18 customers and the details regarding the allotment were not on record.

Considering the huge extent of land that had been de-notified with no economic activity for several years, the big question that remains to be answered is whether this land would be returned to the original owners from whom it was purchased invoking 'public purpose' clause.

DoC in their reply (June 2014) stated that it is for the State Government to prescribe conditions on use of land to allow exit from the SEZ Scheme while de-notifying the SEZ. However, in order to prevent any possible misuse of de-notified parcels of land by the developers, DoC has issued guidelines on 13th September 2013 with regard to de-notification of land, that:

I. All such proposals must have an unambiguous 'NOC' from State Government concerned.

II. State governments may also ensure that such de-notified parcels would be utilized towards creation of infrastructure which would sub-serve the objective of the SEZ as originally envisaged.

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

Audit is of the opinion that, according extensions to developers routinely without appropriate measures and consequent de-notification and diversion of land is defeating the objective of the SEZ scheme.

4.9 Approval of SEZ without required land use permission

Section 3 (2) of SEZ Act, 2005 inter alia lays down that any person intending to set up a SEZ would make a proposal to the State Government concerned for the purpose of setting up of SEZ. Sub Section 3 (3) further enjoins that in case such a proposal is submitted to the Board (GOI) directly by the person, the Board may grant approval subject to the condition that the person concerned shall obtain concurrence of the State Government within the period of six months prescribed in the Rule 4 of SEZ Rules 2006 from the date of such approval.

On the basis of proposal submitted by M/s. DLF Cyber City, MOC&I granted In-principal approval (January, 2006) to M/s DLF for setting up of SEZ for

IT/ITES sector in Sector 24 and 25 A, Gurgaon. As per Rule 5 (2) (b), minimum area requirement for setting up SEZ exclusively for IT/ITES was 10 hectares with a minimum built up processing area of one lakh square meters. The DLF Cyber City SEZ for IT/ITES was notified by GOI (April 2007) on an area of 10.73 hectares and subsequently with slight modifications (March 2010) for an area of 10.30 hectares. The SEZ had become operational with effect from 05 November 2007.

Audit observed that the area identified by the developer included 1.21 hectares of land falling under Residential Zone on which the developer had been granted license by the Town and Country Planning Department (TCPD) for development of a residential colony. This fact was known to the State Government as well as MOC&I, therefore could not be considered for fulfilment of minimum area requirement (10 acre) for setting up of IT/ITES SEZ. This area was neither got de-licensed from the TCPD nor the TCPD converted the Residential Zone to Industrial Zone till May 2014.

In the absence of clearance by TCPD on change of land use of 1.21 hectare, the inclusion of the land for IT/ITES SEZ was not in order.

MOC&I in their reply (June 2014) stated that as per Rule 3 of the SEZ Rules, every proposal for setting up of SEZ shall be submitted to the concerned DC, who shall forward it to the Board with its inspection report, State Government's recommendation and other details specified under Rule 7. So far as the case of M/s. DLF Cyber City is concerned, it is submitted that the notified area is 10.30 Ha. As far as change of land use for Residential Zone is concerned, the matter pertains to the State Government. SEZ was approved based on recommendation of State Government.

MOC&I may review their reply in the context of the fact that land use of 1.21 hectares has not been changed by Department of Town and Country Planning, Haryana till May 2014. Thus the approval was granted by MOC&I on a piece of land for setting up of IT/ITES SEZ in violation of Rule 5 of the SEZ Rules requiring a minimum area of 10 hectares land.

4.10 Loans raised on SEZ Land used for non-SEZ purposes

As per sub rule (9) to Rule 11 of the SEZ Rules, 2006, a developer shall not sell the land in a Special Economic Zone. As per sub rule (6), a developer holding land on lease basis shall assign lease hold rights to the entrepreneur holding valid letter of approval. However, there is no restriction under the SEZ Act, 2005 on mortgage of leasehold land with banks or other financial institutions for raising loans. There are also no clear provisions or instructions as to how banks would realise the loan amount in the case of default by the borrowing

developer as the leased land belongs to government and further SEZ land cannot be sold.

In response to our requests made to various banks for furnishing the details of SEZ land mortgaged by Developers/Units in various States, we had received 10 responses, according to which 11 Developers/Units in Andhra Pradesh, Karnataka, Maharashtra and West Bengal had raised loans of ₹ 6,309.53 crore against mortgage of lease hold government land.

Further, we also noted that 3 out of 11 developers/units had raised loans amounting to ₹ 2,211.48 crore (35 per cent of ₹ 6,309.53 crore) against the notified SEZ lands which are not put to use as detailed below.

Developer/Unit	Extent of land mortgaged (ha.)	Amount of loan ₹in crore)	Details of Collateral/SEZ land mortgaged
M/s Quest SEZ Development Pvt Ltd., Karnataka	40.47	21.48	Cosmos Bank-₹ 9.18 cr mortgaged/registered mortgaged land and building measuring 66000 Sq.ft. Axis Bank – ₹ 12.30 cr mortgaged/registered mortgaged land and building measuring 47,902 Sq.ft. and 25,156 sq.ft. respectively
RMZ Eco World Infrastructure, Karnataka	5.651	1135.00	Entire SEZ Land Mortgaged
M/s New Found Properties Ltd, Maharashtra	21.26	1055.00	Entire SEZ land mortgaged
Total		2211.48	

Therefore, in the absence of specific provisions with regard to mortgage of SEZ lands this has encouraged the developers/units to raise loans against the SEZ lands for the purposes other than the development of SEZ.

DoC stated (April 2014) stated that raising of loans from financial institutions by mortgaging leased SEZ lands is the concern of the financial institution and DoC has no jurisdiction over it. However, DoC in their reply (June 2014), while not accepting audit suggestion to have specific provision in SEZ Act/Rules to restrict utilization of loans raised by mortgaging SEZ land only for purposes of development of SEZ, stated that SEZ Act/Rules does not restrict the Developer from mortgaging the lease hold rights in favour of the banks/financial institution and the bank has the right to proceed under Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, subject to grant of LoA/LoP to the successful bidder by the BoA.

Further, in all Central Govt. SEZs, while issuing NOC for mortgage, it is categorically mentioned that land is not a subject matter of mortgage.

Reply of the department does not address the issue raised by audit as to how banks would realise the loan amount in the case of default by the borrowing developer as the leased land belongs to government and that the SEZ land could not be sold.

4.11 Non fulfilment of leasing conditions by developer

In Andhra Pradesh, M/s Brandix Apparel was granted LOP in August 2006 for development, operation and maintenance of Textiles SEZ at Atchutapuram mandal, Visakhapatnam District over an area of 404.70 hectares. Land was allotted by M/s APIIC at the rate of 1 Rupee/Acre per annum wherein the lease rental was fixed up to 5 years from the date of GoAP 'Commitment Fulfilment Date'[14], subject to the condition that the SPV/users generate employment for 60,000 persons within 5 years from GoAP commitment fulfilment date. Further, in the event of failure of SPV/users to generate the agreed employment within the stipulated period, it shall pay lease rentals equivalent to the then prevailing lease rentals in the vicinity of the land as determined by an independent Chartered Accountant, which shall be in proportion to the extent of employment not created by the SPV viz., if employment for only 30,000 persons is achieved, the enhanced lease rentals will be charged only to the extent of 50 per cent of the land leased i.e., on 500 acres or else the lessee/SPV at its option, shall surrender this portion of the land.

We noted that as of March 2013, only eight units had started their operations providing employment to 11737 people (19.6 per cent). Further, GoAP had not fixed and communicated the 'Commitment Fulfilment Date' for the developer, in the absence of which action could not be initiated to surrender the land or to quantify the obligation on part of the developer in discharging the Lease rental obligation arising from the breach of agreement.

As the employment generated was much below the commitment, the enhanced lease rentals as per the clause 4 (a) ibid should have been charged to the extent of 80.44 per cent of the land leased i.e., on 804.40 acres at the rate of approximately ₹ 35 lakh per acre (comparable rate at which APIIC has allotted land to SEZ Units in the same mandal viz., APSEZ, Atchyutapuram) which works out to ₹ 281.54 crore, or else the developer should have surrendered this 80 per cent portion of the land after June 2011 i.e on the lapse of the five year period.

[14] Date on which complete state support as envisaged is fulfilled and communicated in writing by GoAP.

DoC in their reply (June 2014) stated that due to economic slowdown and imposition of MAT, DDT, uncertainty over implementation of DTC has adversely affected investments in the SEZ which has resulted in under utilisation of processing area.

As far as Brandix SEZ is concerned, the matter is between the Developer, APIIC and Government of Andhra Pradesh.

DoC may intimate the final outcome to audit.

Chapter V: Tax administration

SEZs in India had availed tax concessions to the tune of ₹ 83,104.76 crore (IT-₹ 55,158; Indirect taxes-₹ 27,946.76 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 ₹ 1,150.06 crore (Income tax ₹ 4.39; Indirect Taxes ₹ 1,145.67 crore) and systemic weaknesses in Indirect and Direct tax administration to the tune of ₹ 27,130.98 crore.

The withdrawal of exemption from MAT/DDT was considered by business as an important measure affecting the promotion of SEZs in the country

SEZs avail various concessions/exemptions of Central as well as State taxes. Annual Statement of Revenue forgone under Central Tax System presented along with the Union budget by the Ministry of Finance quantifies the tax expenditure/ revenue forgone under various schemes. The tax expenditure on SEZs for the period from 2006 to 2013 works out to ₹ 83104.76 crore on account of Direct Taxes and Customs. However, this Statement of Revenue Forgone does not include revenue forgone on account of Central Excise and Service Tax in relation to SEZs. Further, concessions under State statutes viz., Stamp Duty, VAT, CST, etc could not be quantified in the absence of any monitoring mechanism. Therefore, these estimates do not give a true picture of the revenue forgone. However, the Ministry of Finance, in a study, pegged the loss at ₹ 1,75,487 crore from tax holidays granted to SEZs between 2004 and 2010. The revenue forgone by CBEC and CBDT during the year FY 08 to FY12 was tabulated below:

Amount ₹ in crore

	Scheme	FY08	FY09	FY10	FY11	FY12
Customs	SEZ	1803.95	2324.29	3987.06	8630.16	4559.87
	DEPB (SEZ)	29.29	4.52	19.51	20.15	4.52
	Dbk (SEZ)	14.84	4.45	12.28	17.85	2.55
	Total SEZ	1848.04	2333.41	4080.85	8668.16	4566.94
	Other Schemes	66331.15	58839.82	48587.54	62360.32	64111.45
	On Commodities	85414	164579	181344	159103	202015
Direct Taxes	SEZ	3000	3313	5515	6637	12667

Under this section we have discussed category of tax wise deficiencies noted in the manner in which these concession were allowed to SEZ Developers/Units.

Direct Taxes

5.1 No time limit for realisation of exports proceeds

The intent of enactment of sections 10A/10B/10BA/10AA in the Income Tax Act, 1961 is to encourage exports which in turn would infuse the economy with foreign currency remittances.

Timely 'foreign currency remittances' into India is the underlying intent spelt out in section 10A, section 10B and section 10BA. However, no such provision was made in section 10AA, thereby the objective of timely remittance of 'foreign currency' into India gets defeated.

Further, the RBI vide its circular No. 91 dated 01 April 2003 and master circular 09/2009-10 dated 01 July 2009 decided to remove the stipulation of twelve months or extended period thereof for realization of export proceeds from SEZs. Accordingly, there was no provision for any time limit for realization of exports made by Units in SEZ. Further, in the case of Units who are into the business of Gems and Jewellery, they are allowed to receive the export payments in the form of precious metals (Gold/Silver/Platinum) equivalent to value of jewellery exported on the condition that the sale contract provides for the same and the approximate value of the precious metal is indicated in the relevant Forms.

With due regard to the slump in the economy and attendant constraints the entities face, lack of a provision to monitor the economic output of the units at specified periodical intervals (although it may be acting as an incentive) is not in line with the spirit of the Scheme.

We observed in a few illustrative cases viz., M/s Suzlon Wind International Limited, CIT-III, Bangalore, Karnataka and M/s S.E. Blades Limited, CIT-III, Bangalore, Karnataka for AYs 2009-10 that the export proceeds amounting to ₹ 1,579.50 crore and₹ 347.71 crore respectively were not received to the end of 31 March 2009. Similarly, in the case of M/s Tata Consultancy Limited, a Co-developer-cum-Unit (IDCO SEZ), Odisha for the year AY 2011-12 revealed that export proceeds of ₹ 10.44 crore for the period January 2009 to March 2012 was outstanding for more than 3 years.

DoR in their reply (25 April 2014), while accepting the discrepancy in section 10A/10B etc and section 10 AA, stated that the section 10 AA was inserted in the Income Tax Act through the SEZ Act 2005 by MOC&I and the realisation of forex in twelve month was earlier mandated by RBI but this condition was removed by RBI in 2009; however, the reason for the removal of this condition was not elucidated by DoR.

Further, in their reply stated (June 2014) that RBI has issued instruction in June 2013 to realize the proceeds within twelve months.

Reply is not acceptable to audit because as per RBI circular dated 11/06/2013, the time limit for repatriation of foreign exchange by SEZ Units is twelve months. This circular is issued for regulation of foreign exchange as per Foreign Exchange Management Act 1999 read with Foreign Exchange

Management (Export of Goods and Services) Regulations 2000, and which has no relevance to the Income-Tax Act 1961. Therefore, there is no specific provision in the Income-Tax Act 1961 for timely remittance of export proceeds for claiming deduction u/s 10AA.

5.2 Absence of clarity in the Income Tax Act, 1961

The following issues in the Income Tax Act, 1961 require clarity.

Section 10A/10AA/10B/10BA of the Income Tax does not define the terms *'profits of the business'*, *'total turnover of the business'*, thereby assessees get an opportunity to tweak their 'profits of the business' and 'total turnover of the business' according to their suitability which facilitates incorrect claim of deductions.

Assessees compute 'Profits of the businesses' either under normal provisions or adjusted book profits u/s 115 JB, whichever is beneficial to them. Similarly, although the expenses like freight, telecommunication charges or insurance, and foreign exchange expenses for rendering services outside India shall be excluded from 'Export turnover', the same expenses were also being excluded from the 'Total turnover of the business'.

DoR in their reply (April 2014) stated that the deduction under 10A/10B of the Income Tax Act is with reference to the profits and gains derived from the export of articles or things. Under section 10AA, the deduction is also available on profits and gains derived from the services. Sub-section (7) of section 10 AA provides that the profits and gains derived from the export of articles or things or services shall be the amounts which bears to the profits of the business of the unit, the same proportion as the turnover in respect of such articles or things or services bears to the total turnover of the business carried on by the unit.

The 'profit of the business' for the purposes of deduction under section 10AA has to be computed in accordance with the provisions of part D of Chapter IV of Income Tax Act dealing with the head 'profits and gains of business or profession'. For the purposes of deduction under section 10AA, the term 'export turnover' has been given a specific meaning. The other terms such as 'total turnover' in the absence of a definition in the Act will have dictionary meaning. Therefore, the profit of the business for the purposes of deduction under section 10AA has to be computed in accordance of chapter IV D and such profits are not the book profits on which MAT liability is determined.

Audit is of the opinion that though sub-section (7) of section 10AA(7) defines the amount of deduction to be calculated in proportion to the ratio between export turnover and total turnover and profits of the business or profession

of the undertaking to be calculated as per part D of Chapter-IV, however, what should 'profits of the business or profession' of the undertaking constitute for the purposes of deduction u/s 10AA is not defined clearly, whether 'other incomes' and incomes which are not having nexus with exports shall also qualify for deduction under section 10AA. Similarly, 'total turnover of the undertaking' is also not defined.

DoC in their reply (June 2014) stated that already MAT and DDT have been imposed. Other reduction of tax benefits will make the SEZ units unviable.

CBDT in their reply (June 2014) stated that the term 'profits of the business' as referred in section 10AA(7) implies profits as computed in accordance with the provisions of the Part D of Chapter-IV of the Income-tax Act. It was also replied that it is not open to Unit to interpret the expression 'profits of the business' to mean book profits as mentioned in the observations of the Audit.

Export Turnover shall have the meaning assigned to it in Explanation 1 of section 10AA. However, in the absence of any definition, 'total turnover' shall have its dictionary meaning.

Reply is not acceptable to audit because sub-section (7) of section 10AA defines the amount of deduction to be calculated in proportion to the ratio between export turnover and total turnover. Such profits of the business or profession to be calculated as Part D of Chapter-IV.

However, it did not define clearly what should 'profits of the business or profession' of the undertaking constitute for the purposes of deduction u/s 10AA, whether 'other incomes' or 'incomes' which are not having nexus with exports shall also qualify for deduction.

Adoption of dictionary meaning for the term 'total turnover of the undertaking' (not defined in the Act) is a clear loophole in the Act, and encourages assessees' to quantify deduction more beneficially. However, the exact reason for not defining the terms 'profits of the undertaking' and 'total turnover of the undertaking' was not elucidated in its reply.

5.3 Need for review of taxing mechanism in view of re-introduction of DDT

Any amount declared, distributed or paid on or after 01 June 2011 by domestic companies within SEZ by way of dividend attracts dividend distribution tax (DDT) vide proviso below sub-section (6) of section 115-O of Income Tax Act 1961. Further, provisions relative to payment of MAT were reintroduced for units operation within SEZs AY 2012-13. When SEZ Act was promulgated, sub-section 6 of 115JB and sub-section 6 of 115O was

introduced in the IT Act totally exempting the developers/units within SEZs from payment of MAT and DDT. However, re-introducing these taxes during AY 2012-13 and 01 June 2011 for a scheme aimed at incentivizing exports from these Zones, dampens its relative attractiveness vis-à-vis DTA operations. Further, it signals an unstable fiscal regime to the investors in these Zones, further impacting forex inflow and thus being counterproductive in the long run.

DoR in the Exit meeting stated (29 April 2014) that MAT/DDT are nothing but advance tax to be adjusted in subsequent year, in other words it only affects the cash flow of the developer/unit. This was introduced to avoid cases where the developer/units took the Income Tax benefit and opted out of the scheme after some time.

DGEP further added that new IT/ITES units were operating in SEZs and due to imposition of MAT/DDT, the input price of goods manufactured in SEZs increased in comparison to goods manufactured in non-SEZ units.

DoC in their reply (June 2014) stated that DoC has requested Ministry of Finance to withdraw DDT, but the same has not been agreed so far.

CBDT in their reply (June 2014) stated that MAT is based on the principle that every person participating in the economy must contribute to the exchequer. It also quoted the Supreme Court judgement in Lakshmi Devi's case wherein the Hon'ble court held that all decisions in the "economic and social spheres are essentially adhoc and experimental. Since the economic matters are extremely complicated, this inevitably entails special treatment for special situations. The State must, therefore, be left with wide latitude in devising ways and means of fiscal or regulatory measures, and the courts should not unless compelled by the statute or by the Constitution, encroach into this field or invalidate such law."

Audit appreciates the point regarding contribution to the exchequer and also that the state has full powers of dealing with economic matters. However, the audit point is raised vis-à-vis the impact that reintroduction of MAT & DDT has had on the overall economic sentiment vis a vis the SEZ scheme. Audit point is also echoed by the stakeholders of the SEZ viz., the Developers and Units, details of which are outlined in paragraph 6.4.

5.4 Failure to invoke provisions of Wealth Tax

As per section 2(ea) of Wealth Tax Act 1957 - asset, *inter alia*, includes any unused land held by the assessee for industrial purposes for a period of 2 years or as stock-in-trade for a period of 10 years from date of its acquisition

is not treated as asset. We noted that SEZ developers were in possession of large tracts of land, and in certain cases the chunk of land is kept idle for a longer duration than the period permissible under the provisions of section 2(ea). It was observed that, selection of assessment for scrutiny basically covers assessees who are actively conducting business operations. However, lands which are not allotted to any Units for various reasons are not monitored for the purposes of invoking the provisions of Wealth Tax Act. The details of such cases are illustrated below:

Name of the State	No. of SEZs involved	Area notified (Hectares)	Earliest date of Notification
Andhra Pradesh	22	1408.13	12/2006
Gujarat	13	925.92	09/2007
Karnataka	6	378.334	08/2006
Maharastra	88	8987.90	04/2007
Rajasthan	2	61.943	09/2003
Tamilnadu	23	1239.861	04/2007
West Bengal	13	953.629	08/2007
Total	167	13955.717	

DoC in their reply stated (June 2014) that land in SEZs is to be viewed in a special context as its use is dependent upon the units coming into SEZ, and the entry and exit of the units in SEZ is dependent on factors such as market conditions, the Govt. policies etc. The observation of Audit may not be relevant, if BoA after considering the proposal extends formal approval depending upon merits of each case.

However, CBDT in their reply (June 2014) stated that the matter is under consideration of CBDT. Necessary instructions have been issued to the field authorities to determine the unused land lying in each SEZ vis-a-vis the time period for which the same is lying idle. Field officers have been directed to closely monitor and wherever required invoke provisions of wealth Tax Act of urban land falling in SEZs that escapes the exemptions provided in definition of urban land as contained in para (b) of the explanation 1 contained in Section 2 (ea) of the Wealth Tax Act 1957.

DoC may intimate the final outcome to audit.

5.5 Changes in the Direct tax incentives

In the investment linked regime, specified businesses will experience accelerated depreciation which in other words means the new regime would favour capital intensive industries. In a scenario where multi-product SEZs constitutes only 4 per cent of the total sectors, this move would trigger establishment of more capital intensive (multi-product) industries. This would facilitate more employment to unskilled people. However, the other side of this change would impact the sectors where 'employed intensive

industries' including IT sectors which is not capital intensive and lesser requirement of capital. This may be in direct contradiction with the SEZ's objective of generating employment.

Further, with MAT and DDT being reintroduced, the tax paid by DTA units is less than the tax paid by SEZ units as illustrated below:

The tax payable by the company, if its operations are carried out in a domestic tariff area and in a SEZ would be as under:

	DTA	SEZ	
AY 2012-13	**32.445 per cent** {30% + 5% (SC) + 35 (SHEC)}	MAT 20.008 per cent (18.5% + 5% SC + 3% S.H.E.C)	DDT 16.995 per cent 15% + 10% + 3% S.H.E.C
		Effective Tax : 37.003 per cent	

The above scenario may partially answer the question regarding reasons for many units seeking extensions, resizing, and de-notification of the proposed projects. Though it may not fully typify the scenario as there could be other valid reasons, the following chart shows an increase in the number of de-notifications after re-introduction of MAT and DDT:

	2009	2010	2011	2012	2013
Partial de-notification	1	3	5	7	5
Full de-notification	4	7	10	6	4

This sentiment was also echoed in the responses given by the developers/units in response to a question of survey questionnaire for developers/units on the reason for their exit from the scheme.

Comparison of duty structure and taxes in SEZ and DTA in engineering industry

Comparison of duty structure and taxes in SEZ and DTA	
Engineering industry SEZ	**Engineering industry DTA**
Nil custom duty on capital	Customs duty 7.5 % on capital goods(zero if unit exports 6 times duty forgone)
Nil CVD on capital goods	CVD 12% on capital goods+ 3% cess+ 3% edu cess + 4% addl duty (zero if unit exports 6 times duty forgone) Note- CVD+ cess + edu cess+ SAD are eligible for cenvat credit
CST - NIL	CST - 2%
CST - 2%	VAT 14.5% (excavators) - this can be adjusted against VAT on inputs
Excise duty -Nil	Excise duty payable at 12% (now 10% till June 2014)
Service tax - Nil for services rendered or received	Service tax 10.5% payable for services rendered or received
No income tax for first 5 yrs (MAT 18.5% payable)	Income tax payable from first year
50% income tax for 2nd 5 years ie 16.5% but mat applicable at 18.5%	Income tax payable in all years

50 % income tax in 3rd 5 yrs ie 16.5% but mat applicable at 18.5%	Income tax payable in all years
No duty on raw material imports (duty+CVD+SAD)	Duty payable but advance license for imports can be taken with 20 % value addition
Sales to DTA with duty+CVD+SAD subject to +NFE	Exports to SEZ get duty drawback
No chapter 3 benefits	Chapter 3 benefits applicable
Duty drawback on exports - Nil	Drawback allowed as per product category
Eg- if a company in SEZ exports for ₹ 100 - net realisation is 100. If profit is 10% then tax savings is (33%*-18.5%= 14.5%) of ₹ 10= ₹ 1.45, therefore effective realisation = ₹ 100 + ₹ 1.45 = ₹ 101.45 In case of DTA unit, exports for ₹ 100 with 50% import content for which custom duty is 7.5 %= ₹ 3.75. The unit also gets drawback 4 %= ₹ 4 and Chapter 3of FTP benefit of ₹ 4. Further the unit pays additional tax compared to SEZ unit =14.5% =₹ 1.45 (as the unit is not saving any tax as in the case of SEZ unit above) . Therefore, the effective realisation is ₹ (100-3.75+4+4-1.45) =₹ 102.80. Hence working in DTA is beneficial. * 30% (tax) + 10% (SC)	

DoC in their reply (June 2014) while accepting that the introduction of MAT and DDT has affected the SEZ scheme adversely and there has been an increase in the number of de-notifications after introduction of MAT and DDT on SEZs stated that the decision to de-notify a SEZ may depend on a host of factors like global recession, industry specific reasons, local factors etc.

Recommendation: *DoR may like to visit the Income Tax Act, 1961 and Wealth Tax 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 which does not define the terms 'profits of the business', 'total turnover of the business', thereby assessees 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*

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

Direct Tax: Compliance issues

Income Tax Act provides deductions to the assessees operation in the SEZs subject to certain conditions. Compliance issues related to non-adherence of

such conditions involved deficiencies in Tax administration to the tune of ₹ 12.08 crore as detailed below:

Information Technology Sector

5.6 Excess claim of deduction

In the case law, DCIT Baroda vs. Rameshbhai C. Prajapati ITAT Ahmedabad C Bench it was held that disallowance of expenditure u/s 40(a)(ia) shall not qualify for any deduction. Further, disallowance of employees contribution to provident fund/superannuation fund etc., u/s 36(1)(va) is to be computed under the head income from other sources[15] which shall not qualify for any deduction.

In the case of M/s Xavient Software Solutions (India) Pvt. Ltd, CIT Noida - Uttar Pradesh AY 2009-10, it was seen that deduction u/s 10AA to the tune of ₹ 27,62,799 was allowed without Auditor's Report in Form 56F which is mandatory u/s 10AA(8) read with section 10A(5) and hence deduction need to be disallowed. The short demand worked out to ₹ 8,56,072.

5.7 Incorrect computation of loss

As per section 80A(2) the aggregate amount of deduction shall not, in any case, exceed the gross total income of the assessee.

In the case of M/s Ernst & Young Pvt. Ltd., CIT-III Kolkata, West Bengal for AY 2010-2011 deduction was allowed u/s 10A and 10AA at ₹ 63,76,99,495 against total taxable income of ₹ 55,86,57,869 which resulted in incorrect determination of loss of₹ 7,90,41,626. The potential tax effect worked out to ₹ 1,68,46,696.

Pharmaceutical Sector

5.8 Excess claim of deduction

In the case of M/s Biocon Research Ltd., CIT-I Bangalore, Karnataka for AY 2010-11 we noted that a non-refundable amount of ₹ 38,44,00,000 was received from M/s Mylan Gmbh, Switzerland for undertaking research and development activities on which deduction u/s 10AA was claimed to the tune of ₹ 15,46,72,345 without Auditor's Report in Form 56F which is mandatory u/s 10AA(8) read with section 10A(5). However, Assessing Officer estimated income at ₹ 7,68,80,000 (20 per cent of agreement amount of ₹ 38,44,00,000) and allowed deduction to that extent u/s 10AA.

[15] *section 2(24)(x) read with section 56(2)(ic)*

We noted that, the amount of ₹ 38,44,00,000 received by the assessee was not on account of export of any articles or things or provide any services but for the purpose of 'initial execution for M/s Mylan and Biocon Collaboration' and, therefore, would not qualify for deduction. Hence, incorrect allowance of deduction of ₹ 7,68,80,000 need to be brought to tax. The tax effect worked out to ₹ 2.61 crore. It was replied (January 2104) that the issue would be examined.

Foliage and Handicrafts Sector

5.9 Failure to examine inter-unit transfer of stocks and Non-restriction of deduction to computed profits

In the case of M/s Vaachi International Pvt. Ltd., CIT-III Kolkata, West Bengal for AYs 2010-2011 and 2011-2012, inter-unit stock transfer from non-SEZ Unit to SEZ Unit of ₹ 1,76,29,081 and ₹ 2,42,05,506 respectively was not examined [sub-section (9) of section 10AA read with sub-section (8) of section 80IA] while completing regular assessmentu/s 143(3). Further, deduction of ₹ 84,73,452 was not restricted to the amount of profit available of ₹ 80,67,795 which resulted in incorrect determination of loss of ₹ 4,05,657 with a consequential potential tax effect of ₹ 1,25,348.

Other

5.10 Non-submission of Auditor's Report

As per section 10AA(8) read with section 10A(5) deduction shall not be admissible unless the assessee furnishes the Auditor's Report in Form 56F.

In the case of M/s Parampara Builders (P) Limited, CIT Moradabad, Uttar Pradesh for AY 2010-11 that, the assessee company claimed deduction u/s 10AA to the tune of ₹ 34925 without Auditor's Report in Form 56F.

Indirect Taxes

SEZ Act provides exemption of duties of customs, central excise and service tax for operations within SEZs subject to certain conditions. Compliance issues related to non adherence of such conditions that involve deficiency tax administration to the tune of ₹ 28,268.96 crore are discussed below.

5.11 Absence of mechanism for accounting of Service tax exemption

Rule 12(1) of SEZ Rules stipulates that the Developer may import or procure goods and services from the DTA, without payment of duty, taxes and cess for the authorized operations, subject to the provisions contained in Sub-rule (2) to (8). Duty free procurement of services was inserted from June 2010.

Sub rule 5 states that the Developer shall execute a Bond-Cum-Legal Undertaking (BLUT) in Form-D, jointly with the Development Commissioner and Specified Officer, with regard to proper accounting and utilization of goods for authorised operations within a period of one year or such period, as may be extended by the specified officer.

We observed that even though duty free services were being allowed to Developers, there was no mechanism in place to capture the duty forgone on account of Service Tax availed by the Developers. Monitoring is done without this vital information even though the eligibility for availing exemption viz., list of authorised services and Form A-1 is given by DC/specified officer only. Consequently, Service Tax exemptions availed by the Developers cannot be considered while calculating the total indirect tax exemptions availed by the Developers. Further, duty free procurement of services by the developer was inserted under Rule 12 wherein requirement of Bond cum Legal Undertaking (BLUT) was also stipulated. Hence, duty free service components should also factor in while quantifying the value of BLUT to monitor the total duty forgone.

In this milieu, our analysis of ST exemption availed by the Developers obtained through concerned DCs indicated that 46 Developers/Co-developers in Andhra Pradesh, Gujarat, Maharashtra, Tamilnadu, Kerala and Odisha had availed ST exemption to the tune of ₹ 1,559.43 crore as on March 2013, but the same could not be verified, monitored and accounted for by the DC while calculating the Indirect Tax Benefits extended as there was no mechanism in place to facilitate this. The interest of Government would have been protected even if the exemption was quantified and covered by Bond-cum-Legal Undertaking (BLUT).

We believe that this is a serious risk which facilitates revenue leakage which unfortunately was not being monitored either at the level of DC or the jurisdictional Commissionerates. This loophole assumes significance as de-notification request of Developer is approved by BoA based on the recommendations of DCs wherein the details of recovery of total exemptions availed by the developer is given. In the absence of a mechanism for accounting of Service Tax exemptions, the computation of the total dues to be recovered by the DC is flawed, facilitating undue benefit to the Developers. Two such cases are highlighted in Box-11.

Box-11: De-notification allowed without recovering Service Tax due

BoA approved de-notification relying on the certificate furnished by the DC without taking cognizance of Service Tax Exemption of ₹ 33.01 lakh availed by two Developers/units in Tamilnadu (M/s Aspocomp Electronics and Estra IT Park).

BoA in their meeting held in August 2009, approved de-notification in M/s Maytas, Gundlapochampally, Andhra Pradesh subject to payment of ST exemption of ₹ 31.46 lakh which was not paid till date (August 2013).

Box-11 (Contd..): De-notification allowed without recovering Service Tax due

The cited instances occurred as the Department did not have a system of monitoring and accounting the exemption allowed on account of Service Tax.

DoC in their reply (June 2014) stated that this aspect has already been taken care of and as per notification dated 01 July 2013 issued by DoR, the mechanism for monitoring of availment of Service Tax has been incorporated and developers/units are required to submit quarterly report to the jurisdictional ST Authority.

The conditions of the BLUT in para 2 provides for refund of service tax exemption availed by the developer.

Reply is not acceptable as all the duty free benefits availed by the Developers were being monitored by Specified Officers (Customs) through BLUT and hence the value of duty free service availed by the Developers should also be monitored through BLUT. Further, the issue raised in the audit observation was availment of ST exemption by Developers/units and accounting thereof by DC for calculating the Indirect Tax benefits availed by Developers/units and covered under BLUT. DoC's reply is silent about the mechanism that they have with ST Commissionerates to safeguard the revenue in such cases.

Recommendation: *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.*

5.12 Incorrect exemption of service tax

Export of Services Rules, 2005 introduced exemption of service tax on export of taxable services subject to two conditions i.e such service is provided from India and used outside India and the payment for such service provided outside India is received by the service provider in convertible foreign exchange.

In Andhra Pradesh, M/s Satyam BPO Ltd., an SEZ Unit in Satyam Computer Services Ltd. IT/ITES SEZ, Madhapur, Hyderabad were engaged in providing information technology software services (ITSS) and other related services to various clients in India as well as abroad which also included services provided to its parent company M/s Tech Mahindra and M/s Satyam Computers Ltd. The assessee paid Service Tax on services rendered in DTA and claimed exemption for other services under Export of Service Rules 2005. However, we noted from the scrutiny of the services claimed to have been exported that a few services were rendered to its parent companies which

were billed to the locations in India and the money received was in Indian currency which is in contravention to the rules stated supra.

As per the Annual Performance Report for the year 2011-12, the Unit has done deemed exports worth ₹ 43.81 crore to its parent companies and claimed exemption under Export of Service Rules 2005 which was incorrect and hence Service Tax is leviable @ 10.3 per cent which works out to ₹ 4.51 crore which needs to be recovered along with interest.

We also noted that the assessee was paying Service tax on similar transactions (Deemed Exports) from July 2012 onwards, which corroborates the audit observation. However, the assessee had not paid any Service Tax for the prior period in question.

Similarly, in Karnataka, in the case of M/s Syngene International Ltd.(Unit I to VI) in Biocon SEZ, services amounting to ₹ 47.94 crore claimed to be exported were actually rendered to its group companies billed in India and money was also received in Indian currency. Service tax liability of ₹ 5.13 crore on the services rendered needs to be recovered along with Interest.

DoC in their reply (June 2014) stated that Satyam Services rendered services within SEZ and whole amount realized in FE. The only issue was to verify whether double IT exemption was taken. Even though M/s. Satyam BPO did not receive foreign currency directly for the services rendered by them to overseas clients, the transaction should be treated as export of service by M/s. Satyam BPO. The money for the services rendered by M/s. Satyam BPO was received in foreign currency by M/s. Satyam, who in turn paid them in Indian currency. Commissioner (Appeals) and CESTAT have upheld this contention and as it stand now, such transactions have to be treated as export of services. They have started paying Service Tax after the enactment of the "Place of Provision of Services Rules, 2012".

CESTAT vide order No. 1382 to 1386/2008 dated 4.11.2008, allowed the Unit to obtain refund for the Service Tax paid on the services provided to the client located abroad.

Reply is not tenable as the basic condition of receiving proceeds in foreign currency for treating a service to be exported is not satisfied by M/s Satyam BPO. The unit was rendering service to its parent company (Satyam and Tech Mahindra) in India and classifying it in the APRs as deemed exports which is not envisaged in the Export of Service Rules 2005 and hence the benefit of exemption cannot be granted. Further, possibility of double claim under export of service by both Satyam BPO and its parent company cannot be ruled out.

5.13 Failure to pay Service Tax under Reverse charge Mechanism

Rule 2(1) (d)(iv) of Service Tax Rules, 1994 specifies that the service receiver as the Person liable for paying service tax in relation to any taxable service provided or to be provided by any person from a country other than India and received by any person in India under section 66A of Finance Act 1994. Benefit of exemption of Service Tax under section 66A for SEZ Units has been introduced from March 2011 and no such exemption was in effect for the prior period.

We noted 33 instances of incorrect availment, *ab-initio,* of exemption of Service tax in Andhra Pradesh, Karnataka, Madhya Pradesh and Tamilnadu amounting to ₹ 287.52 crore under 66A for the period prior to March 2011 which need to be recovered along with interest.

Further, for the subsequent period the units were required to get approval of the services as specified services for availing *ab-initio* exemption of service tax liability under reverse charge mechanism u/s 66A.

We noted in 23 cases involving incorrect exemption of ₹ 128.28 crore in Andhra Pradesh, Tamilnadu, Karnataka and Rajasthan, which did not comply with the conditions stipulated for claiming *ab-initio* exemptions which needs to be recovered along with interest.

DoC in their reply (June 2014) stated that audit tried to point out that Service Tax exemption was not available for services availed by SEZ units from abroad for the period March, 2009 to February, 2011. Services provided by Indian suppliers is covered under section 66 of Service Tax Act and services provided by supplier from abroad are covered under section 66(A) of Service Tax Act.

By virtue of notification dated 03.03.2009, the Government introduced exemption from Service Tax for the services used by SEZ Unit / Developer by way of refund which hitherto was unconditionally exempted. In other words, before 03.03.2009, Service Providers were not required to pay Service Tax for the services rendered by them to a SEZ Unit / Developer. The above modus operandi of granting exemption by way of refund was limited to Service Tax paid under Section 66 of the Finance Act. Thus, Service Tax payable under Reverse Charge Mechanism in terms of Section 66A of Finance Act, 1994 continues to be unconditionally exempted.

Notification dated 20.05.2009 was issued amending the notification dated 03.03.2009 to exclude exemption by way of refund in respect of such services which are wholly consumed within SEZ. Thus, in respect of services which are consumed within SEZ again become unconditionally exempted.

In view of the above statutory provisions, the issue raised by audit that RIL SEZ Unit was liable for Service Tax in respect of Service Providers located outside India in terms of Section 66A for the period from March, 2009 to February, 2011 is not legally tenable.

The reply is not acceptable to audit as SEZs are deemed to be foreign territory under SEZ Act, but not under Finance Act 1994 and hence liable for levy of service tax unless specifically exempted. Benefit of exemption of service tax under 66A was allowed from March 2011 vide notification No.17/2011 and hence, exemption benefit is to be allowed for the subsequent period provided the conditions stipulated in the notification was adhered to. Further, benefit of exemption is given at DC level by issuing Form A1 and also declaring the nature of specified services. Hence, in our opinion the action for non-compliance needs to be initiated by DC only.

5.14 Non-payment of Service Tax

In terms of notification dated 3 March 2009, taxable services specified in Clause (105) of Section 65 of the Finance Act, 1994, chargeable to service tax under Section 66 of the said Act, received by a Unit located in a Special Economic Zone or Developer of SEZ for authorized operation, are exempt from the whole of service tax, education cess and secondary and higher education cess leviable thereon. It therefore follows that such an exemption is not available if the Developer/unit is engaged in operations not connected with the Zone.

In terms of Section 65(30a) of the Finance Act, 1994, construction of residential buildings, townships, row-house complex, etc. would attract service tax with effect from 16 June 2005. We noted in the following two instances Service Tax due from the concerned units was not recovered.

(a) M/s. New Chennai Township Private Limited, Cheyyur, a SEZ developer, owners of land measuring 612 acres, had obtained approval from the BoA (January 2008) for promoting two SEZs viz. Light Engineering Sector (312 acres) and Multi-Sector service (300 acres). Further scrutiny revealed that though nine units who had obtained approval for manufacturing and service activities in the said Zones commenced operations only during 2011-12, the Developer had started constructing residential apartments in each Sector in the Non-Processing Area and received advances from prospective customers, as early as in 2007-08 onwards. In the two phases of construction completed, 580 residential apartments were leased out to individuals unconnected with the authorised operations of the Zone.

Despite carrying out activities not connected with the authorised operations of the Zone, the Developer did not discharge the service tax obligation to the tune of ₹ 16.42 crore, computed on the total income from operations amounting to ₹ 150.76 crore received from the prospective buyers during the period from 2007-08 to 2012-13 towards construction of these residential buildings.

(b) Taxable services of transportation of goods by vessel are liable to Service Tax with effect from 1 September 2009 subject to exemption granted to transportation of specified goods listed out in the Table annexed to the Notification No.25/2012 – ST dated 20 June 2012. Further, Notification No.26/2012-ST dated 20 June 2012 permitted abatement of 50 *per cent* of the gross amount charged for determining the value of taxable service of transport of goods in a vessel from one part to another part in India.

M/s. Larsen and Toubro Limited, Modular Fabrication Facility, Kattupalli, an SEZ unit in Tamilnadu had transported their finished product viz., "Process-cum-living quarters platform" meant for Deendayal Field Development Project of M/s. Gujarat State Petroleum Corporation Limited, Kakinada Coast, Andhra Pradesh by Barge-Posh Giant-I with Tug-Martime Mesra during 2012-13 for a value of ₹ 184.27 crore and incurred transportation charges of ₹ 37.27 crore. Inasmuch as the goods were not covered in the Notification first cited *supra*, the unit is liable to pay Service Tax amounting to ₹ 2.30 crore (@12.36 per cent of 50 per cent of ₹ 37.27 crore), calculated on the abated value of the goods, which is recoverable along with applicable interest.

(c) In term of sub-rule 3 of rule 27of SEZ Rules, Import of duty-free material shall not be permitted for operational and maintenance activity in the non-processing area. It, therefore, follows that exemption from duties/taxes is not admissible for such activity.

Further, as per clause (90a) of section 65 of the Finance Act, 1994 "renting of immovable property" includes renting, letting, leasing, licensing or other similar arrangement of immovable property for use in the course of furtherance of business or commerce. Explanation 2, thereunder, provides "renting of immovable property" also includes allowing or permitting the use of space in an immovable property, irrespective of the transfer of possession or control of the said immovable property. The activity of renting of immovable properties for commercial use is liable to Service Tax with effect from 1 June 2007 under the service of "Renting of Immovable Property".

M/s. L&T Shipbuilding Limited, Kattupalli, awarded 'Operation and Maintenance of the container port terminal' at Kattupalli Village, to a Contractor viz. M/s International Container Terminal Service (India) Private Limited on receipt of Contract Licence Fee of ₹. 85.45 crore during the year 2011-12. However, the unit did not discharge its service tax liability amounting to ₹ 10.20 crore despite the fact that receipt of operation and maintenance charges was not exempt from Service tax in terms of rules cited above.

DoC in their reply (June 2014) stated that in case of specific demand, SCN will be issued for recovery of the Service Tax wrongly availed. Further, in the case of M/s New Chennai Township Pvt Ltd, Cheyyur, during the period 2007-08 to 2012-13 amounting to ₹ 16.42 crore, action has been initiated against the Developer and the case of M/s L&T Shipbuilding Ltd. regarding payment of Service Tax amounting to ₹ 2.30 crore along with interest is being referred to Service Tax Department.

DoC may intimate the final outcome to audit.

5.15 Insufficient Bond - Cum Legal Undertaking

Rule 22 of SEZ Rules, 2006, stipulates that the value of the Bond Cum Legal Undertaking (BLUT) shall be equal to the amount of effective duties leviable on import or procurement from the Domestic tariff Area (DTA) of the projected requirement of capital goods, raw materials, etc for three months as applicable. Where the value of BLUT executed falls short on account of requirement of additional goods, the unit or the Developer shall submit additional BLUT.

We noted in 13 cases in Andhra Pradesh, Karnataka, Maharashtra and Uttar Pradesh where the value of BLUTs executed had fallen short by ₹ 1037.71 crore and additional BLUT was not submitted. A case of executing BLUT 8 years after notification noted in Jaipur is highlighted in Box-12.

Box-12: Execution of BLUT eight years after notification

In Rajasthan the developer (RIICO) had not entered BLUT for eight years in respect of two SEZs (Jaipur SEZ I and II). The SEZs were notified in July 2003 and February 2004 and the Developer executed the BLUT jointly for ₹ 10 lakh in May 2012 i.e, after 8 years of notification.

DoC in their reply (June 2014) stated that in case of any shortfall in BLUT amount with respect to import/local procurement, the SEZ entities are advised to execute additional BLUT.

DoC may intimate the final outcome to audit.

5.16 Physical exports vis-a-vis turnover

The guiding principles of SEZs, *inter alia*, include promotion of exports of Goods and Services. Expressing their concern over fall in physical exports, the Public Accounts Committee (PAC) in its 62nd report in the year 2012-13 emphasised the need for having Physical exports and hence recommended that at least 51 per cent of the production of goods and services by a unit in a SEZ be physically exported out of India.

We noted in 34 cases in Andhra Pradesh, Maharashtra, Karnataka, Tamilnadu, Kerala, Gujarat, Uttar Pradesh and West Bengal that the SEZ units could undertake physical exports ranging from zero to 46.91 per cent only of their turnover thereby defeating the basic objective of the scheme of earning foreign exchange from overseas by the units by resorting to deemed exports/ DTA sales but not effecting actual physical exports to foreign countries. A typical case is highlighted at Box-13 below:

Box-13: Unit became NFE compliant without physical Export

M/s Gupta-Zhongchen Electrotech Ltd. in Falta SEZ in West Bengal was allowed de-bonding even though the unit had never cleared any finished goods. The Unit became NFE compliant by clearing all its goods (Raw Materials and Capital goods) to other units in FSEZ itself.

DoC in their reply (June 2014) stated that though the SEZs are primarily viewed as elements of the Government's exports promotion strategy but that is not entirely correct as evident from the above objectives of SEZ scheme.

The unit may sell their goods in DTA against the payment in foreign exchange from the EEFC account or foreign currency received from overseas for calculation of NFE. The goods purchased by the DTA buyer may also be helpful to save foreign currency because, if they could not purchase the same from SEZ, they may have to import the same from overseas which will impact the foreign exchange reserves of the country. Deemed exports refer to import substitution, which has the effect of saving outflow of foreign exchange.

Achieving 51 per cent physical exports is not mandated under the SEZ Act or SEZ Rules. Therefore, the Units cannot be faulted for not achieving 51 per cent physical exports. Imposition of 51 per cent physical exports would affect certain units which have already made investments in the SEZ with the idea of achieving NFE Earnings taking into account their deemed exports also, which is permitted under the present policy for calculation of NFEE under Rule 53 of SEZ Rules.

The reply of the department is not tenable as PAC's 62nd report recommended at least 51 per cent of the production of goods and services by a unit and not for the State put together, need to be physically exported. Further, no foreign exchange, as contemplated in the SEZ scheme, is earned in the case of deemed exports.

5.17 Level playing field between SEZs, EOU and DTA units

EOUs get duty free imported/indigenously procured raw materials and subject to certain conditions are even allowed to sell their finished goods into Domestic Tariff Area (DTA) after paying the applicable Basic Customs Duty (BCD) and Countervailing Duty (CVD) as if the final products were imported. However, in cases where both the BCD and the CVD were 'nil', the EOU would not pay any duty on clearance of the final products in DTA. A unit in the DTA producing/clearing same final product would also clear these goods at 'nil' rate of duty, but would have suffered duty on inputs used in the manufacture of these products. This had put the DTA units under a comparative disadvantage. To remove this anomaly, the EOUs were required to pay back the duty forgone on inputs utilised for manufacture of such goods cleared into DTA at 'nil' rate of duty with effect from 1st September 2004.

However, such protection to units in DTA was not provided under the SEZ policy/Act. SEZ units can sell their goods, including by-products, and services in DTA on payment of applicable duty including at 'nil' rate with no requirement to pay back the duty forgone on such inputs used. Proportionate duty forgone on inputs utilized in the manufacture of finished goods cleared at nil rate in DTA works out to ₹ 84.19 crore in 20 SEZ units in Andhra Pradesh, Maharashtra, Gujarat, Uttar Pradesh and West Bengal which could not be recovered in the absence of enabling provisions. Additionally, this policy had put SEZ units at a distinctly advantageous position compared with similar units in the DTA or even other EOUs.

A similar case of inverted duty structure was observed in three Units in Aspen SEZ, Coimbatore, Tamilnadu who were granted LOA in 2007 for manufacture of parts of Wind Mills. The SEZ units were encouraged to clear more into DTA in view of the lesser rate of customs duty on Wind Mill parts which ranged between 5.30 and 7 *per cent* in terms of exemption Notification No. 21/2002 – Cus dated 01 March 2002 whereas the rate of duty payable but for the exemption on the inputs utilized in the manufacture of finished goods ranged between 14 and 21 *per cent*. However, in the absence of enabling provisions, the proportionate duty concession amounting to ₹ 155.00 crore availed by

these three units on the raw materials consumed in the manufacture of finished products sold in DTA could not be recovered which would have otherwise discouraged such DTA sales.

DoC in their reply (June 2014) stated that the Units under SEZs operate under the different tax regime compared to EOUs. SEZ units have to pay full duties while clearing the goods into DTA whereas EOUs have concessional duties. The SEZ and EOUs operate under different legal framework and have prescribed entitlements and obligations.

Reply of the department is not acceptable to audit as in the case of final goods cleared in the DTA with nil rate of duties, by SEZ, EOU and DTA units, the EOUs are required to pay back the duty benefits availed while importing the raw material, similarly DTA units also bears the duty liability on the imported inputs, SEZ units while clearing the goods in DTA need not pay any duty benefits availed on the inputs, thus putting both EOU and SEZ in a dis-advantageous position.

Recommendation: *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.*

5.18 Absence of provisions to consider positive NFE criteria while permitting exit of SEZ unit under EPCG Scheme

EOUs are permitted to exit from the Scheme under the prevailing EPCG scheme under paragraph 6.18(d) of FTP, *subject to achievement of positive NFE criteria.* However, no such restriction is prescribed for SEZs under Rule 74 of SEZ rules which allow units with negative NFE or even non-operational Units to opt for exit.

We noted that M/s. Hazira Plate Ltd., an SEZ unit in Essar SEZ, Gujarat with cumulative Negative NFE of ₹ 285.49 crore (as on 2009-10) had applied for exit of SEZ unit (September 2009) under Rule 74 and intended to clear its capital goods under EPCG scheme. Meanwhile, the unit was issued SCN (February 2010) which was adjudicated by DC, KASEZ wherein the proceedings for negative NFE was dropped and the unit was allowed to exit under EPCG scheme (February 2010) involving duty forgone of ₹ 414.77 crore on total value of plant of ₹ 1,880 crore. Thus, in the absence of restrictive provisions as existed for EOUs scheme, SEZ units are allowed to exit even with negative NFE.

It was further observed in M/s Essar Steel Ltd. in KASEZ, Gujarat that permission to exit under EPCG scheme was allowed (September 2010) to the

unit even though the unit could not implement its project, LOP for which was given in 2006.

DoC in their reply (June 2014) stated that EOU scheme is governed by FTP and HBP, whereas SEZs are governed by the provisions of SEZ Act, 2005 and rules framed there under. As per the provisions of Section 51 of the SEZ Act, 2005, the provisions of the Act shall have overriding effect over the provisions of other Acts as such comparing the provisions made out in respect of exit of EOU under FTP and HBP vis-à-vis exit of SEZ units may not be appropriate.

Reply is not acceptable because similar provisions for exit by EOU under EPCG scheme are available subject to achievement of positive NFE by EOU whereas the same provisions are not provided for SEZs.

Audit is of the opinion that Department may consider allowing SEZ units under EPCG scheme to exit only after achieving positive NFE.

5.19 Insurance on the amount of duty forgone

As per GOI, MOF, Dept. of Revenue Circular no 99/95 dated 20 September 1995 read with section 65 of the Customs Act 1962, hundred percent EOUs are required to take a comprehensive Insurance Policy, at least for the value equal to customs duty not levied at the time of import.

We noted that in the absence of similar provisions in SEZ Act/Rules, no insurance policy has been obtained in favour of the government, for the amount of duty forgone, putting its interest at risk, although working of SEZ is quite similar to EOUs.

DoC in their reply (June 2014) stated that in terms of provision of Rule 22 of SEZ Rules, 2006, every unit is required to execute a BLUT with regard to its obligations regarding proper utilization and accountal of goods including capital goods, spares, raw material, components and consumables including fuels, imported or procured duty free. The value of the said Bond cum LUT shall be equal to the amount of effective duty leviable on imports or procurements from the DTA of the projected requirement of capital goods, raw materials, spares, consumables, intermediates, components, parts, packing material for their manufacture as applicable and hence there does not appear any need for insuring goods in the name of SEZ authority/customs authority because the BLUT executed by the unit before the Development Commissioner is nothing but surety given by the SEZ unit to pay back the applicable duty for the goods imported or procured from the DTA, goods under authorized operations, goods under movement for export /import,

sub-contracting etc. Moreover, taking insurance is a business decision of the Unit.

In audit's opinion the Government's interest is at risk therefore an appropriate provision in the Act for obtaining Insurance policy for the duty forgone in line with EOUs, may be considered.

5.20 Failure to meet export obligation

Rule 43 of SEZ Rules 2006 permits subcontracting by SEZ Unit for exports on behalf of the DTA exporter subject to the condition that all the Raw Materials including semi-finished goods and consumables including fuel shall be supplied by the DTA Exporter. Further, finished goods need to be exported directly by the SEZ Unit on behalf of the DTA exporter. However, exports can be made either by the SEZ Unit or EOUs when sub-contracting on behalf of EOUs is undertaken. "Export" as defined in section 2(m) of SEZ Act 2005 means taking Goods/service out of India from a SEZ, supplies from DTA to a SEZ Unit/Developer and supplies from one SEZ Unit to other SEZ unit and does not include Deemed Exports.

In Andhra Pradesh, M/s Hetero Labs (Unit-I) an SEZ unit in APIIC Jedcherla took sub-contracting permission from DC and Specified Officer for manufacture of Zidolam-N amounting to ₹ 149.24 crore. The entire quantum of subcontracted materials was sent to Hetero Unit-III (EOU Unit) and from there, the material was cleared as physical exports as well as deemed exports. Deemed exports of material sub-contracted by the SEZ Unit through an EOU is not in order as the said materials are required to be physically exported under the SEZ Rules. A total of Zidolam-N amounting to ₹ 106.86 crore was cleared under Deemed Exports by the EOU and hence, the above transaction cannot be treated as exports under SEZ Act.

DoC in their reply (June 2014) stated that SEZ Unit may, in terms of Rule 43(b) of SEZ rules, on the basis of annual permission from the Specified Officer, undertake sub-contracting for export on behalf of a DTA exporter, subject to condition that finished goods shall be exported directly by the Unit on behalf of the DTA exporter provided that in case of sub-contracting on behalf of an EOU or EHTP unit or STPI unit or Bio-technology Park unit, the finished goods may be exported either from the Unit or from the EOU or EHTP unit or STPI unit or Bio-technology Park unit. Accordingly the decision was taken.

Rule 43(b) provides for Sub-contracting for Domestic Tariff Area unit for export – A Unit may, on the basis of annual permission from the Specified Officer, undertake sub-contracting for export on behalf of a Domestic Tariff Area exporter, subject to following condition that finished goods shall be

exported directly by the Unit on behalf of the Domestic Tariff Area exporter provided that in case of sub-contracting on behalf of an Export Oriented Unit or an Electronic Hardware Technology Park unit or a Software Technology Park unit or Bio-technology Park unit, the finished goods may be exported either from the Unit or from the Export Oriented Unit or Electronic Hardware Technology Park unit or Software Technology Park unit or Bio-technology Park unit.

The reply is not acceptable to audit as proviso to Rule 43(b) of SEZ Rule specifically prescribes that the finished goods manufactured on sub-contracting basis are to be mandatorily exported either from the Unit or from the EOU. Further, the 'condition of export' is referred to in SEZ Rules which does not include deemed exports.

5.21 Irregular grant of permission to clear non-SEZ goods as unutilized SEZ goods resulting in short levy of duty

The goods imported by any SEZ units, if remained unutilized, may be allowed to be sold in DTA under the provisions of Rule 34 of SEZ Rule 2006 on payment of applicable duties. Rule 25 of SEZ Rule 2006, states where an entrepreneur or Developer does not utilize the goods or services on which exemptions, drawbacks, cess and concessions have been availed for the authorized operations or unable to duly account for the same, the entrepreneur or the Developer, as the case may be, shall refund an amount equal to the benefits of exemptions, drawback, cess and concessions availed.

M/s. Coastal Energy Systems, an SEZ unit in Falta SEZ, West Bengal imported 5065 MT of "Palm Fatty acid" worth ₹ 17.87 crore (average rate @ ₹ 35280/PMT) during April 2008 to August 2008 with total duty exemption involving ₹ 5.67 crore. However, the unit did not bring the goods into SEZ premises and stored it in warehouse tank at port and after expiry of six to eight months the unit requested the DC, FSEZ (February 2009) to allow these raw materials to be cleared as unutilized raw materials of SEZ units. The DC, FSEZ permitted the said goods to be cleared in DTA. Subsequently, the unit brought the goods into the FSEZ and cleared 5003 MT in DTA in several phases in 2009 at an abnormally low declared value (@₹ 13750/PMT) compared to imported price (i.e. almost one third of import value) and the duty was also assessed on the declared price without taking into consideration the import price of the goods at the time of importation.

As the goods were not even brought in to the SEZ unit, the said goods, as per Section 2(o) of SEZ Act 2005, was not to be considered as imported goods of the SEZ unit and the same should not have been allowed to be cleared in DTA

with status of SEZ goods attracting the relevant provisions of SEZ Act 2005 and SEZ Rule 2006. Moreover, even if the unit was allowed to clear the said goods as unutilized SEZ goods the unit was supposed to pay the duty equal to the duty exemption of ₹ 5.50 crore availed at the time of its import in SEZ instead of duty paid at the time of its clearance (i.e. ₹ 2.08 crore) in terms of the provisions of Rule 25 of SEZ Rule 2006. Non-observance of the provision of the SEZ Rules, as discussed above, resulted in short levy of duty to the extent of ₹ 3.42 crore.

DoC in their reply (June 2014) stated that once permission for sale of the unutilised goods into the DTA was granted under Rule 34, it had got overriding effect over Rule 25.

The fact remains that Rule 25 and Rule 34 are contradictory as both the rules provide for clearance of unutilised goods into the DTA. However, provision of Rule 34 may be a route for misuse of the SEZ scheme by way of selling the imported goods to the sister units in DTA at much lower value paying less duty.

5.22 Customs duty on electrical energy supplied by SEZ to DTA unit

As per section 60(1) of Finance Act 2010 w.e.f 26 June 2009 electrical energy supplied by SEZ to DTA and non-processing zone of SEZ will attract 16 per cent BCD. The rate was revised downwards wef 06 June 2010 wherein rate for power projects below 1000 MW using imported coal as fuel was reduced to ₹ 40 per 1000kwh. The rate was further reduced to NIL rate of BCD w.e.f 18 April 2012. As per customs notification No 45/2005 dated 16 May 2005 the exemption in respect of special additional duty under subsection(5) of Section 3 of Customs Tariff Act 1975 is not available for the goods sold in DTA from SEZ when the goods are exempted from the payment of sales tax or VAT.

As per SEZ instruction 67 dated 28 October 2010 for implementation of customs notification No. 91/2010 dated 06 June 2010 it was decided that operation of Rule 47(3) of SEZ Rules 2006 which is regarding sale of power from SEZ to DTA would be kept in abeyance w.e.f 06 September 2010. SEZ instruction 75 dated 07 February 2011 was also issued modifying instruction 67 that Rule 47(3) of SEZ Rules is kept in abeyance w.e.f 06 June 2010. Further, no instructions have been issued.

The duty leviable for the DTA sale of power from SEZ to DTA in M/s Himatsinghka Linens an SEZ unit in KIADB-Textile Zone, Bangalore for the period upto 5/9/2010 worked out to ₹ 1.34 crore and duty not levied due to

Rule 47(3) of SEZ Rules 2006 being kept in abeyance for the period 06 June 2010 to March 2013 amounted to ₹ 1.56 crore.

Similarly, in Gujarat M/s Adani Ports' Co-developer paid duty of ₹ 13.50 crore (under Rule 47) for power sold to DTA upto 5 September 2010 as against ₹ 46.62 crore (@16 per cent) and thus differential duty of ₹ 33.12 crore could not be recovered. Further, the Developer moved Hon'ble High Court and got interim relief and has paid the duty under protest. The Developer was asked to take BG on the differential duty but the Developer did not take BG stating that it amounted to payment of double duty.

DoC in their reply (June 2014) stated that due to ambiguity/ inconsistency in Rule 47 (3) of SEZ Rules, 2006 which provides for surplus power generated in a Special Economic Zone's Developer's Power Plant in the SEZ or Unit's captive power plant or diesel generating set may be transferred to DTA on payment of duty on consumables and raw materials used for generation of power subject to specified conditions, the rule has been kept in abeyance and at present the Customs duty is being recovered only in accordance with Section 30 of the SEZ Act, 2005. Regarding Bank Guarantee, the matter is under examination for further necessary action.

Reply of the department is not acceptable to audit as the rule was kept in abeyance w.e.f 6 June 2010 and the ambiguity/ inconsistency could not be settled even after four years. In absence of a rule, the risk of revenue loss could not be ruled out.

5.23 Incorrect permission to exit under Zero duty EPCG Authorization

As per Rule 74 of SEZ Rules, DC may permit a unit to exit from SEZ on payment of duty on capital goods under the prevailing EPCG (Export Promotion Capital Goods) scheme under the FTP subject to the unit satisfying the eligibility criteria under that scheme.

M/s. Essar Steel Ltd. Kasez, Gujarat applied (9 September 2009) for exit from SEZ. The unit was granted In-Principle exit order (17 September 2009) and final exit order on 28 September 2010. It was noticed that Unit initially opted to exit under 3 per cent EPCG scheme and was already issued three EPCG authorizations (2009) out of which the first one was partly utilized by the unit.

Initially at the time of application of exit under EPCG, finished products of the unit were not eligible for zero duty EPCG scheme. However, in new FTP announced on 23 August 2010 the same was made eligible for zero duty EPCG scheme. Though the unit was already issued three EPCG authorizations under 3 per cent scheme, unit requested DC on 25 August 2010 to

recommend issuance of fresh zero duty EPCG authorizations and surrender of earlier authorizations. Unit surrendered all the existing three EPCG authorizations to RA on 25 August 2010 and the unit was issued fresh zero duty EPCG authorization with CIF value of ₹ 8,344.98 crore and duty saved value of ₹ 1,994.03 crore. It was noticed that fresh EPCG authorization was applied on the pretext of a change in the name of the company. The name of the Company was changed as per permission dated 19 August 2010 by DC, KASEZ. This resulted in permitting the SEZ unit to exercise option two times instead of once and consequent grant of undue benefit to the extent of ₹ 257.86 crore.

It was also noticed that out of the total value of ₹ 8344.98 crore considered for zero duty, EPCG authorization includes ₹ 403.36 crore worth of goods (procured during 1.7.2010 to 22.8.2010) which was not certified by valuer (M/s. Mecon Ltd., a GOI enterprise).

On this being pointed out, it was replied (December 2013) by RA, Surat that department had considered the positive NFE criteria before allowing exit and option was exercised for once as zero duty authorisation for final exit.

A case in respect of Tamilnadu is highlighted in Box No.14 where assessment could not be done in the absence of enabling provisions.

Box 14: No time frame set for assessing the duty on de-notification

MOC&I approved (March 2013) de-notification of a portion of land measuring 25.07 hectares in M/s. Flextronics Technologies India Private Limited, a Developer in Tamilnadu wherein the Developer had utilised duty free concessions. However, no assessment could be made by the department till date (March 2014) to quantify the duty liability on such duty free benefits availed on de-notified land. The developer engaged a chartered engineer and arrived at the value of duty/tax liability as ₹ 4.83 crore which could not be recovered till date as the department failed to make the assessment even after a lapse of almost one year.

DoC in their reply (June 2014), in respect of M/s Essar Steel Ltd., stated that whenever there is saving of duty on an EPCG authorization there is correspondingly an export obligation fixed which is equivalent to certain times of duty saved. So if the unit saves more amount of duty, more liability in the form of export obligation is fixed. Further, this is not a case of exercising option two times to exit the SEZ scheme. The unit was allowed once to exit under EPCG scheme, the unit surrendered its first EPCG authorization obtained under 3 per cent EPCG scheme and obtained a fresh EPCG authorization when zero duty EPCG scheme became available and in respect of M/s Flextronics Technologies, developer, DoC stated that the

developer was not granted exit to operate under EPCG Scheme. The developer was granted approval for partial de-notification of SEZ by BoA subject to clearance from State Government and payment of applicable duties. The SEZ is not yet partially de-notified, and a conditional NOC received from State Government are being processed/examined. Further report in this regard will be sent shortly.

Reply in respect of M/s Essar Steel Ltd. is not acceptable as unit had exercised option two times as three authorisations were already issued to the unit of which one was also partly utilised and again on surrendering existing authorisation zero duty EPCG authorisation were issued which was more beneficial to the unit. Goods procured during July 2010 to August 2010 remained unvalued though the same was required to be valued as done for the prior period. Final outcome in respect of M/s Flextronics Technologies may be intimated to audit.

5.24 Examination of goods at premises other than at the Factory Gate

In terms of sub-Rule 11 of Rule 27 of SEZ Rules, 2006, examination of any import or export of goods or those procured from DTA shall be carried out at the SEZ gate or if the same is not possible, in an area, so notified by the Specified Officer for this purpose and no examination shall be carried out in the premises of the Unit.

We noted in respect of J Matadee SEZ and State Industrial Promotion Corporation of Tamil Nadu (SIPCOT), Sriperumbudur SEZ that the Authorized Officers (AO) posted in the SEZ were not carrying out these functions at the respective SEZ Gates but from other SEZ Units. Since the AOs were functioning far away from the SEZ Gate, there was no control at the SEZ gate resulting in lack of proper monitoring of duty free movement of goods at the Gate.

An instance of fraud had occurred in the M/s Dell India Private Limited, an SEZ Unit in SIPCOT SEZ involving misappropriation of 1794 laptops aggregating to ₹ 5.50 crore out of which ₹ 30 lakh in cash and 565 laptops were recovered and sold by the unit subsequently. However, the cost of the balance laptops (numbering 1229) amounting to ₹ 3.70 crore net of recovery of ₹ 30 lakh was written off from stock as per Note 47 to the Financial Statements.

Incidentally, AO of SIPCOT SEZ was functioning from this unit only. However, it could not be confirmed whether the AOs were informed of the fraud that had taken place in the unit. Consequently, the duty forgone amount of ₹ 0.44 crore calculated at 12 *per cent* of the written off value of goods

amounting to ₹ 3.70 crore could not be realised. Proper monitoring of clearances of goods and control over the movement of goods at the SEZ gate could have been avoided such fraudulent removals.

DoC in their reply (June 2014) stated that entire FALTA Zone is covered by boundary wall having 2 gates which are manned by Security Officer. Without Gate Pass as issued by authorised Officer nothing can be taken out from the Zone.

Regarding the case of M/s Dell India Pvt. Ltd., it was stated that the misappropriation was identified to have been committed by an employee of the company. It may be stated that the misappropriation was the criminal act committed the individual and it may not be appropriate to hold the company responsible for the misappropriation. Further, Rule 75 of the SEZ Rules does not mandate examination of every consignment. Regarding functioning of the AOs of the SEZ in the premises of M/s. Dell India Private Ltd., DoC stated that SIPCOT, the developer of the building had not provided proper building in the SEZ for functioning of the Customs officers and the environment surrounding the building was unsafe for the officers to function and discharge their duties. Since 80 per cent of the workload of the SEZ relates to M/s. Dell India Pvt. Ltd., and the Unit volunteered to provide accommodation, the Customs officers are functioning in the unit's premises. However, SIPCOT has been asked to provide suitable space for the Customs officials at the entry point in order to incoming/outgoing goods.

Audit is of the opinion that the provisions of sub-Rule 11 of Rule 27 of SEZ Rules, 2006, was not followed in these cases DoC may take necessary action for proper monitoring of duty free movement of goods at the Gate.

5.25 Inclusion of DTA Sales in foreign currency terms for the purpose of trading activity

In terms of explanation under Rule 76 of the SEZ Rules, 2006, trading shall mean import for the purposes of re-export, whereas instructions to the contrary were issued by MOC&I vide Instruction No. 49 dated 12 March 2010 allowing trading of goods from DTA to SEZ or from SEZ to DTA in foreign currency terms.

M/s Unblock India Private Limited, a SEZ unit in J Matadee Free Trade and Warehousing Zone (FTWZ) imported granites worth ₹ 8.58 crore involving duty forgone of ₹ 1.26 crore and traded the goods to 100 *per cent* EOUs for ₹ 7.08 crore in foreign currency during the period 2012-13.

Since the EOU Scheme administered under the FTP, 2009-14 provides for sale of manufactured goods in DTA upto 50 *per cent* of the FOB value of products

exported, on concessional rate of duty, there is every possibility of the traded goods being sold in DTA on payment of concessional rate of duty after carrying out the process of manufacture.

Thus, the instructions cited above encourage the SEZ units to trade the goods in DTA which was against the provisions of the SEZ Rules. The duty concession of ₹ 1.26 crore, therefore, allowed in respect of the trading unit was not in order.

DoC in their reply (June 2014) stated that SEZ Rule 76 should be read with the definition of Section 2(z) of SEZ Act where it is categorically envisaged that it should be against earning foreign exchange only. As per Rule 76 of SEZ Rules, 2006, the expression "trading" for the purpose of second schedule of the Act, shall mean import for the purpose of re-export. Hence, this condition is only for the purpose of income tax exemption. Otherwise, trading from DTA to SEZ and from SEZ to DTA is allowed. Further, EOUs are not supposed to clear goods as it is, in the DTA. They are supposed to clear only those goods which are manufactured by them. In case of raw materials remaining unutilized, they have to follow the prescribed procedure which includes approval from Customs/Excise authorities.

Reply is not acceptable to audit as the issue raised here is issue of Instruction No. 49 dated dated 12 March 2010 allowing trading of goods from DTA to SEZ or from SEZ to DTA in foreign currency terms in contrary to the SEZ Rules.

5.26 Utilization of goods and services for unauthorized operations[16]

In terms of sub-rule 9 and 10 of Rule 11, the Developer shall not sell the land in a SEZ and vacant land in the non-processing area shall be leased for social purposes such as residential and business complexes, to a co-developer approved by the Board who, in turn, may lease the completed infrastructure along with the vacant land appurtenant thereto for such purposes. Further, the Developer or Co-Developer shall strive to provide adequate housing facilities not only for the management and office staff but also for the workers of the SEZs/Units. The SEZ Rules further provided that any such infrastructure created in addition or in excess thereof shall not be eligible for any exemptions, concessions and drawback.

In terms of Rule 25 of SEZ Rules 2006, where an entrepreneur or Developer does not utilize the goods or services for the authorized operations shall

[16] A Para has been included vide 4.9.11 (Chapter IV) of Report No. 1 of 2013-Tamilnadu- Revenue Sector on sale of Residential Flats in SEZ Area wherein we have quantified ` 8.68 crore as registration charges. However, here we are quantifying other Direct/Indirect taxes benefits wrongly availed by the Developers.

refund an amount equal to the benefits of exemptions, drawback, cess and concessions availed without prejudice to any other action under different Acts.

a) Three co-developers[17] in Mahindra World City SEZ, Chengalpattu, Tamilnadu obtained LoA between April 2006 and April 2008 for carrying out authorized operations in the non-processing area for construction of residential houses after availing duty concessions / exemptions on the imported / procured inputs and Capital Goods.

We noted that the residential buildings constructed on such leased lands, by the co-developers, were sold to individuals unconnected with the authorized operations of the Zone, by camouflaging 'Sale Deeds' as 'Perpetual Lease' agreements with a lease term of 99 years on receipt of valuable consideration. This activity of the co-developers was in violation of SEZ Rules cited *supra* and hence ineligible for the benefit of duty concession on the imported/procured inputs and capital goods to the extent of ₹ 7.83 crore which is required to be recovered.

In addition, Sales Tax/VAT concessions amounting to ₹ 7.09 crore and service tax to the tune of ₹ 8.27 crore was recoverable along with applicable interest from the developer.

(b) Similarly, another developer (New Chennai Township Pvt. Ltd.) in Cheyyur, Tamilnadu obtained two formal approvals on 23 May 2007, one for setting up of SEZ for engineering sector and another for multi-services SEZ. The developer was permitted to construct 7500 residential apartments in the non-processing areas of each SEZ.

We noted that the developer had proposed to construct 4620 and 2068 apartments in the non-processing area of both the SEZs, out of which 300 and 280 apartments respectively had been completed. The developer entered into lease deeds for a perpetual lease term of 99 years, against payment of one time lump-sum premium, with the lessees who are not connected with the authorised operations of the zone which is in violation of the provisions prescribed in Rule 11.

Further, scrutiny of the pamphlets/brochures of residential apartments distributed by the Developer revealed that the number of dwelling units constructed is far in excess of the actual employment generated (approx. 500) by the nine SEZ Units situated in the Zone which clearly indicates that

[17] Mahindra Integrated Township Limited, Mahindra Residential Developers Limited and Mahindra Lifespace Developers Limited (Mahindra Gesco)

the apartments were constructed mainly for selling it to outsiders on commercial profit, in violation of SEZ Rules.

In view of the above, the operations carried out by the Developer were unauthorized and hence ineligible for the benefit of duty concession on the imported/procured inputs and capital goods availed to the extent of ₹ 9.55 crore which is recoverable along with applicable interest.

In addition, Sales Tax/VAT concessions availed to the extent of ₹ 9.53 crore and service tax amounting to ₹ 3.03 crore for their services rendered is also recoverable along with applicable interest.

DoC in their reply (June 2014) stated that action has been initiated to issue demand, SCN for recovery of duty wrongly availed. Further, action has been initiated under FTD&R Act, 1992 against the three co-developers of Mahindra World City SEZ and New Chennai Township Ltd. regarding illegal allotment of Residential Units to persons not connected with the SEZ.

DoC may intimate the final outcome to audit.

5.27 Failure to recover cost recovery charges

The Department of Personnel and Training vide their O.M. No.6/8/2009- Estt. Pay II dated 17.6.2010 read with SEZ Guidelines dated 16th September 2010 stated that the cost recovery of all expenses towards pay and allowances of staff sanctioned and posted in the notified SEZs are to be collected from the developers.

We noted that an amount of ₹ 4.63 crore was outstanding in respect of 59 Developers as on June 2013 in Andhra Pradesh, Maharashtra, Karnataka, Kerala, Odisha, Gujarat and West Bengal.

Further, the issue of custodianship of imported/export cargo within the International Container Transhipment Terminal (ICTT) at Vallardapam, SEZ and payment of cost recovery charges for the officers posted at ICTT remains un-resolved.

Audit is of the opinion that approvals for activities in the non-processing area are not commensurate with the operations in the processing area to prevent SEZ units becoming real estate business establishments.

DoC in their reply (June 2014) stated that regarding posting of officials in the private SEZs on additional charge basis, it is informed that in order to examine the development (specially construction) of the proposals as submitted by the private SEZ, the officials are posted in addition to their existing duties. Raising of demand to any Developer appears feasible when

at least one unit of the Developer becomes operational and recruitment of officers on deputation basis as per existing norms is done on regular basis. As the example cited by the Audit the Project of respective Developer has not been materialized and the SEZ was not operational the raising of demand towards cost recovery charges does not arise. However, proportionate cost recovery as suggested by Audit will be followed on operational SEZs.

Action for recovery has already been initiated by the respective zones. The actual recovery of amount in accordance with the dues will be intimated shortly.

DoC may intimate the final outcome to audit.

5.28 Outstanding lease rentals, water charges and maintenance charges

Section 34(1) and (2) of SEZ Act 2005 stipulates that SEZ Authority can undertake measures as it thinks fit for the development, operation and management of the Special Economic Zone for which it is constituted. The Authority shall be responsible for development of infrastructure and can levy user or service charges or fees or rent for the use of properties belonging to the Authority.

We noted from the records of the concerned SEZ Authorities in Andhra Pradesh, Gujarat, Madhya Pradesh, Maharashtra, Rajasthan, West Bengal and Uttar Pradesh that a sum of₹ 49.33 crore remained pending as of June 2013 on account of various services rendered by the Authority to the unit holders viz., lease rentals, service charges, maintenance charges, etc.

DoC in their reply (June 2014) stated that lease rentals, services charges, maintenance charges are monitored/recovered regularly except the cases which are sub judice or are registered under BIFR. All out efforts are made to recover the dues including by issuing Recovery Certificates to the concerned Collector/District Magistrate.

DoC may intimate the final outcome to audit.

5.29 Exemption on payment of Stamp duty-failure to recover dues

The Indian Stamp Act, 1899 as amended through Section 57 of the SEZ Act 2005 stipulates that no duty shall be chargeable in respect of any instrument executed by or on behalf of or in favour of the Developer or Unit or in connection with the carrying out of purposes of the Special Economic Zone.

Instructions of MOC&I issued in July 2009 stipulates that when a SEZ is not commissioned within the time indicated by the MOC&I in the approval, or if the SEZ notification is cancelled, the State Governments will be entitled to

withdraw the concession of stamp duty and recover the same from the developer.

We observed in eight cases in Andhra Pradesh, Gujarat, Uttar Pradesh and Odisha that the stamp duty exemption availed while registering the lease deed was not recovered on de-notification thereby resulting in a loss of ₹ 8.56 crore to the concerned states. In case of M/s Vivo-biotech and M/s Maytas Ventures, the Government of Andhra Pradesh issued NOC without quantifying the exemption availed on stamp duty.

DoC in respect of Welspun Anjar SEZ stated (June 2014) that the developer had purchased land directly without availing the benefit of stamp duty concession and after notification of SEZ entered into an agreement with the units for leasing of land. It is the case of stamp duty on the said lease. The Audit has pointed out while completing formalities for exiting, the developer had not refunded the said stamp duty. This Administration had received NOC from Industrial Commissioner, Gandhinagar which encloses a NOC about stamp duty paid back issued by Addl. Supdt., Stamp Duty & Valuation Deptt. The audit objection has since been referred to the State Govt. for appropriate reply.

As far as de-notification of M/s. IVR Prime is concerned, though LOA has expired, however the SEZ has not yet been de-notified. Stamp duty shall be recovered prior to de-notification of SEZ. Wherever a SEZ is de-notified, all duties are recovered including stamp duty.

In respect of Sri City SEZ, DoC stated that as per Govt. of A.P., State Support Agreement dated 25.06.2008, 'GoAP has agreed to the formation of a SEZ and DTA both collectively referred to as the "Project". It also states under the Definition & Interpretation the word "Land" as more fully defined as SEZ and an accompanying DTA, all comprising "Special Investment Region". That was the reason based on the request of the developer of Sri City SEZ (Multi Product) had been recommended to BoA for de-notification without insisting on payment of Stamp Duty to GoAP. The intention would have been that the land will ultimately be utilized/allotted to the Industrial Units in DTA thereby the purpose for which land was allotted to the developer will be served.

DoC may furnish replies on other cases to audit.

Chapter VI: Monitoring, evaluation and control

The DCs, Developers and Units have largely stated in their response to our survey that, monitoring was adequate. However, based on the evidence gathered by audit, we conclude that this is the weakest link in the whole scheme of SEZs. Developers and unit holders were almost left un-monitored, in the absence of an internal audit set-up. This posed a huge risk for revenue administration. The inadequacies in the performance appraisal system of SEZs, compounded by lack of Internal Audit, facilitated developers to misrepresent facts to the tune of ₹ 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.

SEZ online system is a Database Management system and a life line for working of SEZs. DoC does not have any IS Strategic plan for the 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 i.e 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 application needs to be mandatorily with the Government. Accordingly, separate and specific SLAs are required to be reviewed and aligned.

6.1 Monitoring and Evaluation

Considering the wide array of exemptions and concession extended to Developers/Units under various Central and State statutes, existence of a robust monitoring and evaluation mechanism will ensure that the SEZs function as intended.

Internal Audit arrangements

Though the Act was introduced several years ago, and considerable concessions are extended to the developers, there is no structured internal audit mechanism in the MOC&I to assist in oversight of the functioning of

SEZs. Absence of a structured internal audit arrangement is fraught with the risk of undetected misrepresentation of facts by developers which cannot be left to the jurisdictional Commissionerates dealing with Direct and Indirect Taxes administration.

In response to a query in this regard, DC, SEEPZ, Maharashtra while agreeing with the audit view stated (January 2014) that creation of an internal audit arrangement would supplement the existing monitoring mechanism but opined that this needs to be decided by MOC&I as it was a policy matter.

Audit is of the opinion that the department may institutionalize a system of internal audit of the establishments under MOC&I dealing with SEZs and SEZs/units.

System of Monitoring and evaluation

Annual monitoring on the functioning and performance of the units in the SEZs is carried out by the Unit Approval Committee (UAC). The performance of the units/Developers is being monitored annually through the Annual Performance Reports (APRs) in case of Units and Half-yearly/Quarterly returns in case of Developers. Based on such review, the DCs inform/suggest to the Department of Commerce, corrective measures to enable the defaulting units to fulfill their obligations as per SEZ Act/Rules. For any violation, the DC is empowered to initiate action under the Foreign Trade (Development and Regulation) Act, 1992, which includes issue of show cause notice (SCN), levy of penalty, cancellation of the Letter of Permission (LOP), etc. The applicable customs duty forgone on such violations is to be recovered by the revenue department.

6.1.1 Inadequate Monitoring Mechanism

The primary objective of SEZ Scheme as per the SEZ Policy is to serve as growth engines to promote Exports, Investment and to generate Employment. Section 3 of SEZ Act read with Rule 3 of SEZ Rules prescribes the procedure for establishing SEZs wherein the Developer has the option of directly applying to Board or through the State Government. Various details like project report, exports projections, investments, projected employment are required to be submitted in the application, based on which the approval is granted.

As approvals are granted based on these commitments/projections, monitoring of the SEZs should logically be pegged to these parameters. We noted that performance of Developers/Units is monitored by UAC at the zonal DC Level and not at BoA Level. Further, the details of projections made by Developers are not available at DC level. Monitoring is based on Form E

(QPRs/HPRs) submitted by Developer as per Rule 12(7) read with 22(4) and 15 of SEZ Rules wherein no columns are prescribed for projected figures of Exports, Investment and Employment. Hence, monitoring of actual performance vis-à-vis projected figures promised by the developer in Form A is not being done at all. Consequently, the Ministry will not be able to measure the pace of performance against the expected deliverables at any given point of time. Further, it was observed that no time limit was prescribed for submitting the HPRs/QPRs by Developers.

State-wise deficiencies in monitoring and evaluation are tabulated below:

State	Name of the SEZ	Deficiencies in monitoring
Rajasthan	RIICO	Failure to file HPRs/QPRs, a mandatory requirement
Tamilnadu	J Matadee FTWZ	Failure to file Chartered Engineer's Certificate on utilisation of Duty Free Goods, a mandatory requirement
Gujarat	Diamond and Gems SEZ (Sur SEZ)	Failure to file HPRs/QPRs, a mandatory requirement
	M/s Adani Port & SEZ Ltd.	Diversion of duty free goods from SEZ to non SEZ areas was not reported in the HPRs. Developer paid duties amounting to ₹ 19.39 crore along with interest of ₹ 2.39 crore. Short payment of ₹ 84.06 lakh on VAT/CST and education cess of ₹ 5.01 lakh on indigenously procured cement was made. Further interest was paid on customs but not on VAT/CST. However, these issues were not monitored.

6.1.2 Review of Annual Performance Reports (APRs)

Rule 22(3) of SEZ Rules, 2006, stipulates that SEZ units shall submit Annual Performance Reports in Form I, to the Development Commissioner. Rule 54 read with annexure I states that the annual review of performance of unit and compliance with the conditions of approval shall be done by the Unit Approval Committee on the basis of APRs which needs to be certified by an independent Chartered Accountant and submitted before the end of the first quarter of the following financial year. Monitoring of performance is done by UAC based on APRs and the Units with Negative NFE for 1st and 2nd year are to be kept on watch list. SCN needs to be issued at the end of 3rd year and penal action is to be initiated at the end of 5th year.

Our observations arising out of the review of the state wise APRs are tabulated below:

Nature of irregularity	% of States selected	States involved	Remarks
Failure to file APRs	28.57	Andhra Pradesh, Rajasthan, Gujarat and Tamilnadu	178 units involving 261 cases
Delay in submission of APRs	78.57	Andhra Pradesh, Rajasthan, Gujarat, Maharashtra, Karnataka, Tamilnadu, Kerala, West Bengal, Uttar Pradesh, Madhya Pradesh and Chandigarh	Delay ranged from 1 to 72 months in 1318 cases
Submission of revised APRs	7.14	Chandigarh	Though there was no provision in the extant rules, in 11 cases involving 3 units APRs were revised which were

Nature of irregularity	% of States selected	States involved	Remarks
			accepted by the DC
Uncertified APRs	21.42	Andhra Pradesh, Rajasthan and Gujarat	14 Units involving 17 cases
Non/Short reporting of DTA sales in APRs	28.57	Andhra Pradesh, Maharashtra, West Bengal and Karnataka	₹ 98.50 crore of DTA sales Non/short reported in APRs by 23 units in 26 cases
Failure to initiate against Units with negative NFE	14.28	Gujarat	No action against M/s Terram Geosynthetics in Mundra SEZ Gujarat even though the unit had a negative NFE of ₹ 98.35 lakh at the end of five years. Even SCN was not issued.
		Karnataka	No SCN was issued in M/s Quest Global in Karnataka for having negative NFE of ₹ 88.81 lakh at the end of three years.

In response, DC, VSEZ while accepting the audit observation stated (September 2013) that appropriate action would be initiated against the erring units.

6.1.3 No provision for monitoring duty free indigenous procurement

Rule 22 (3) of SEZ Rules stipulates submission of Annual Performance Report (APR) in the Form prescribed wherein the NFE calculation is to be reported and monitoring of the Units is to be done by UAC Committee based on the APRs submitted by the Units. Further, PAC in its 62nd report has emphasised the need for accounting of duty free supplies of indigenously procured goods while monitoring the performance of the units.

We noted from a scrutiny of APRs that complete transactions/ working of the units were not being captured in the APRs and information involving foreign exchange alone needs to be reported thereby leaving out transactions viz. duty free supplies of indigenous procurement of raw materials, capital goods, building materials, etc, since the format prescribed does not provide for capturing these particulars. Scrutiny of 121 Units located in Andhra Pradesh, Madhya Pradesh, Maharashtra, Tamilnadu, Kerala, Karnataka, Rajasthan and West Bengal indicated that the units made DTA purchase of material worth ₹ 89,792.01 crore involving duty exemption of ₹ 10,576.41 crore which was not accounted for in the APRs of the respective units. Consequently, the same could not be monitored by the UAC as there was no enabling provision in the SEZ Acts/Rules in this regard.

In case of M/s Charisma Jewellery Pvt. Ltd, SEEPZ SEZ, Mumbai, the Unit made procurements from offshore banking unit amounting to ₹ 4.68 crore and did not report it in their APRs by treating it as indigenous procurement. Since procurement from offshore banking unit is a case of inter unit transfer,

the same should have been considered as import for the purpose of calculating NFE which was overstated by ₹ 4.68 crore.

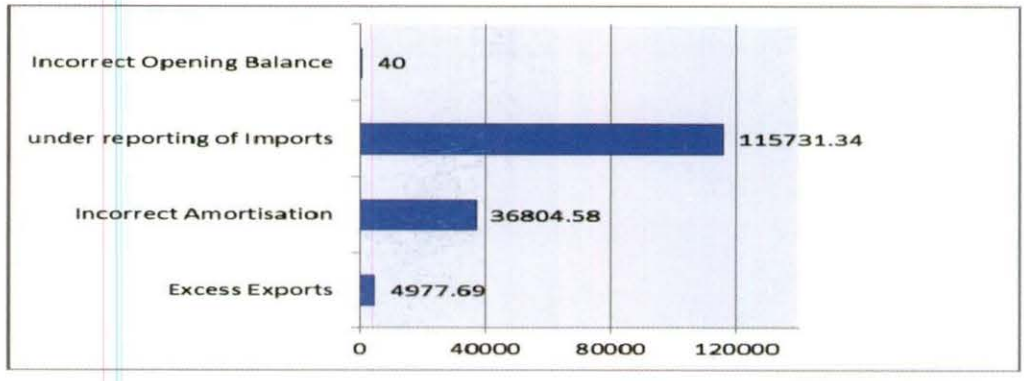
Department replied (September 2013) that APRs were devised to capture all transactions that impinge upon NFE calculation.

The reply is not tenable as the fact remains that APRs are the sole mechanism for monitoring of the Units. In the absence of provision to capture all financial data of the SEZs, comprehensive monitoring could not be done.

6.1.4 Verification of data in APRs

As per the Rule 54 of SEZ Rules 2006, every unit in a SEZ has to maintain proper accounts, and submit APR in prescribed format (Form I) to the DC duly certified by a Chartered Accountant. This data is important as it serves as the basis for verifying whether the units have indeed achieved the required positive NFE and also as a monitoring mechanism to ensure that the units are functioning as intended under the applicable policy and rules. However, the SEZ scheme relies mainly on self-certification and does not require the APRs to be supported by other statutory documents like annual accounts, customs records, income tax (IT) returns, bank realisation certificates (BRC) etc. This facilitated few units to provide incorrect /inconsistent data in their APRs. The NFEs derived on the basis of this inconsistent data cannot be relied upon.

Results of our correlation of data furnished by the units in their annual performance reports with data available in the annual accounts, customs records, IT returns, etc., indicated that 21 units located in Andhra Pradesh, Gujarat, Kerala, West Bengal and Uttar Pradesh had reported excess NFE to the tune of ₹ 1150.06 crore. This modus operandi was through under/non reporting of imports, exports prior to commencement of production, incorrect amortization of Capital Goods, etc., which led to excess reporting of NFE in the APRs as depicted below:



Further, as per Rule 22 (3) of SEZ Rules, the Units are required to provide details of outstanding Export proceeds in their APRs. We observed that the

information on unrealised exports proceeds was not furnished in any of the APRs submitted. Cross-verification with Annual Accounts and outstanding Bank Reconciliation Statements revealed unrealised exports to the tune of ₹ 5,386.19 crore to be realised in respect of 110 Units located in Andhra Pradesh, Gujarat, Rajasthan, Kerala, West Bengal, Tamilnadu, and Uttar Pradesh.

Incidentally, all these APRs were duly certified by Chartered Accountant for the veracity of facts and figures reported in it.

As monitoring of Units is based solely on the information contained in the APRs, hence due diligence is expected both from Units in reporting of facts and figures and Chartered Accountants in certifying the same.

A typical case of failure in monitoring excess reporting of NFE/Exports is discussed in Box 15.

Box-15: Failure in monitoring excess NFE/Exports

In case of Solar Semiconductors an SEZ Unit in FAB City Hyderabad wherein imports were under reported by ₹ 1129.30 crore is resulting in excess reporting of NFE by ₹ 1129.30 crore. Further, there were outstanding export proceeds to be realised to the tune of ₹ 48.34 crore which was not reported in APR and the same was not monitored and action taken.

In the case of M/s Euro Trousers, an SEZ unit in KASEZ, Gujarat, department did not take action even though the CA had given adverse remarks in the APR of 2009-10 and 2010-11 that the unit was a branch office of its foreign entity and had major forex transactions. However, the details of outstanding export proceeds were not produced to audit.

MOC&I vide its Instruction (41 dated 13th November 2009) stated that the Units claiming negative NFE on account of foreign exchange fluctuation need to submit a certificate from the authorised bank to the UAC. A unit in SURSEZ, Gujarat (M/s. Raj International) reported negative NFE of ₹ 13.43 lakh and ₹ 1.33 crore in their APR for the year 2010-11 and 2011-12 respectively. The reason attributed for negative NFE was due to Foreign Exchange fluctuation. However, no certificate was adduced in this regard from the authorised bank in contravention to the instruction issued by MOC&I.

Finally, the widespread loopholes noted in the manner in which APRs are filed by the Developers/Units raise doubts regarding the completeness, authenticity and reliability of the information used for managing the database maintained by the Ministry of Commerce for various purposes. This

also calls for a review of the entire monitoring structure to plug the deficiencies pointed out which will not only streamline the system but also plug the revenue leakages taking place in the existing set up.

Audit is of the opinion that for effective monitoring of unrealised export proceeds, APRs need to be captured accordingly.

In reply to paragraphs 6.1 to 6.1.4, DoC stated (11 June 2014) that the findings of Audit have been noted and shared with all Zonal Development Commissioners for compliance. The findings of Audit will be taken into account while reviewing the SEZ policy.

DoC may intimate the outcome of the review of the SEZ policy to audit.

6.2 SEZ Online

As a part of the e-Governance initiative, Ministry of Commerce (MOC) entered into an agreement with NSDL Database Management Limited (NDML) in Sep-2009 for establishing and managing a nationwide integrated solution for administration of Special Economic Zones (SEZ) of India along with Infosys. SEZ Online is a total integrated solution which facilitates speedy processing of various transactions that SEZ Developers, Co-Developers, Units, EOUs and Deemed Exporter have with SEZ administration.

The layered architecture of the application was aimed at future extensibility, scalability and maintainability of the application. The application is accessed by MoC, DCs and Users (Developers/Units) using their respective modules meant for this purpose.

The envisaged benefits of the system are as under:

- Online clearance of imports and exports and consequent reduction in Operational Cost and Turnaround Time
- Reduction in Compliance Cost
- Faster Clearance including applications
- Improvement in efficiency and transparency in Service to End Users
- Availability of Repository of all transactions / interactions with DC's Office
- System to act as a Dashboard and MIS for MOC and DCs

We requested MOC&I for an online access (view facility only) of the system, but the same was not provided. The following audit findings are made based on the results of analysis of electronic data and other paper version of the documents provided by the Ministry.

a) DoC does not have any IS Strategic plan for Database Management System of the SEZs in the country because the entire project, its maintenance and the strategic management control have been outsourced to NSDL. Thus, such 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.

b) Approval/consent of an important stakeholder in DoR was also not taken with regard to the revenue administration function of the system.

c) It was also observed that there was no HR (Human Resources) management policy for recruitment, capacity building, skill upgradation of manpower required to strategically manage and monitor a critical revenue sensitive system.

d) Audit is of the opinion that in an IS organisation a critical application like SEZ Online with massive revenue implication requires a regular audit of the database, OS, infrastructure, application hardware for:

I. IT security audit
II. Malware analysis
III. Source code review
IV. Application configuration review
V. ICT infrastructure configuration review
VI. Application-OS-hardware-network performance reviews
VII. Vulnerability assessment and penetration testing (VAPT)
VIII. Analysis of system generated logs for application change management
IX. Web application security (WAS) assessment
X. Validation of the patches deployed and protocol functionality
XI. Analysis of SLA (Service Level Agreement) indicators and the tools to monitor and calculate the SLA indicators
XII. Review of technology deployed to ensure continuity of IT system
XIII. IT Act Compliance
XIV. National Cyber Security Policy compliance

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 application needs to be mandatorily with the Government. Accordingly, SLAs may be reviewed and aligned.

e) Not all users are onboard : As per Rule 78 (E-filing) of Chapter VIII, Miscellaneous, of "The Special Economic Zones Rules, 2006" (as amended up

to 31.08.2010), every developer and unit shall file applications and returns electronically on the Special Economic Zone online system, within a period of one month of the system being commissioned. However, as per the e-update of SEZ Online system (October 2012) as many as 170 SEZs out of 392 are registered with SEZ Online and only 119 of them had commenced transacting.

f) General Controls:

i) **Access privileges not restricted ideally:** The roles and privileges for customs/DC officials should be based on 'Need-to Know' basis. In the event of change in the incumbency, if any, the roles and privileges should be updated by Admin at the DC level. However, it was observed in Hyderabad that even after transfers, assessment and other files of the previous incumbent were being shown as pending with the Official concerned.

ii) **Conflict in the duties performed:** Owing to manpower shortage, there was an overlap in the roles performed by the Specified officers and the Authorized Officers. This is fraught with the risk of conflict in duties performed. In view of this, there should be appropriate compensating controls to address this residual risk.

iii) **Need to restrict roles and privileges to functional area:** Roles and privileges need to be restricted to functional area of operation. It was seen that users can access the system from any place. AOs sitting in one place can do assessment of all the SEZs.

g) Deficiencies in System Designing: Notwithstanding the fact that the system was initiated over two years ago, many business rules are yet to be integrated into the system. Consequently, they were being performed manually or were being maintained as standalone systems as discussed below:

i) According to the system in place invoices are based on international commercial terms (INCOTERMS) which are a series of pre-defined commercial terms published by the International Chamber of Commerce (ICC) that are widely used in international commercial transactions or procurement processes. We noted that during assessment the Customs officials were entering the type of Invoice (as system captures only CIF/FOB/CI/CF Invoice types) manually based on which duty assessment is done in case of Imports or DTA Sales. Assessment of duty was being done based on Customs and Central Excise Tariff. However, this was not integrated into the system and assessment was being done manually.

ii) Anti-Dumping Duty (ADD) is levied under sub-section (5) of section 9A of the Customs Tariff Act, 1975 to protect the domestic industry. We noted that although data required for levying such duty has already been captured in the System (viz., country of origin, price, etc.), ADD was being calculated manually wherever applicable.

iii) One of the objectives of the system was to have electronic database on the performance of the SEZ units and the duty/ tax exemptions that was provided to the SEZ units. However, we noted that there was no provision in the system to capture the Service Tax exemptions availed by the Units/Developers. The interest of the Government could have been at least saved had the value of exemption availed on service Tax been entered in the BLUT (Bond cum Legal Undertaking).

iv) We noted that there was no facility for e-payment of duty in respect of DTA sales as available in ICEGATE. SEZ online system was not linked to ICEGATE or Bank portals. For instance, SEZ units, located in Sriperumbudur or Chengalpattu, situated at the outskirts of Chennai (i.e. more than 35 Kms.) have to make duty payments through DD/Cheque at Air Cargo Customs, Meenambakkam, Chennai due to lack of e-payment facility. Similarly, due to lack of linkage with ICEGATE the movement of goods to and from the SEZ could not be watched through the Customs Houses located all over India. The Import General Manifest /Export General Manifest details are captured manually and fed into the SEZ online module which, if linked to the ICEGATE, could be gathered automatically without manual intervention.

v) No reconciliation of accounts could be carried out by the PAO with the Banks as far as the revenue earned from SEZ is concerned.

vi) One of the objectives of the system was to serve as a data repository for SEZs. However, there was no provision to store the data prior to 2010 and hence Ministry has to depend on the manual system to give information putting a question mark on the completeness and reliability of the database in use.

vii) Processes like approval of SEZ, its notification, extension of approval if any, investment, employment, land, de-bonding, calculation of duty to be paid on such de-bonding etc. were yet to be made functional and integrated into the system.

viii) One of the vital MIS tool (reports) was not made functional. In the Export Module, no provision was made to capture data pertaining to Onsite locations.

h) Service Level Agreement: The Service level Agreement between DOC and NDML needs to be reviewed in view of the following:

i) Although the ownership of database lies with DOC, strategic management control of the vital data is left with the private vendors. How the risk associated with this has been mitigated is not known.

ii) No time schedule was given for the functionalities (SEZ A1 to A27 in Administrative Module, C1 to C6 in customs module) to be developed. Since signing of SLA (September 2009), most of the functionalities could not be developed viz., interface with ICEGATE, MIS reports, etc.

iii) No provision was made for reviewing the application with regard to the adequacy of business processes covered and the correctness of business rules mapping. Similarly, no provision was made to review the SLA except for pricing of the fees to be charged by NDML.

iv) Assessment Functionality with provision of Duty Payment through payment gateway was not mentioned in the SLA even though online payment option for all the charges of MDML is available in SEZ Online system.

v) Clause 5.5 of the SLA promises to switch over to a Disaster Recovery Site in shortest possible time in the event of disaster in the primary test. However, no specified time limit, description of Back up site (Hot/Warm/Cold) is agreed upon.

vi) Clause 5.7 specifies that NDML will obtain ISO 27001 certification for SEZ Online System with distinct policies for data management and Security. Whether the certification was acquired is not known.

vii) Clause 6 deals with ownership of hardware, software and data. It is seen that software is not to be transferred to DOC even after the termination of the agreement.

viii) Clause 8.1 promises operational uptime of 97 per cent. However, no performance metrics or measurement tools (throughput/response time/downtime) are agreed upon and further nothing is mentioned about non-fulfilling of the promised operational uptime.

ix) Clause 8.2 stipulates maintaining of single shift telephonic support desk. Although the system is online, it still has the archaic telephonic support desk. A proper support desk handling Incident and Problem management in line with ITIL Framework and features like escalating the critical problems to the apex authorities needs to be put in place. Response times also need to be agreed upon.

x) It has been observed that NDML is charging ₹ 200 for each transaction in SEZ online system apart from one time registration of ₹ 50,000 and annual maintenance charges of ₹ 20,000 per year whereas the transaction cost for the similar data was ₹ 66 in the ICES.

xi) SLA needs to be reviewed in view of newer concepts like Application Performance Management which provides a means for measuring and analyzing an application's quality of service as experienced by the end-user. With this perspective, an end-to-end view of performance can be obtained across all components including application, desktop, network and server on a per user, per application, per transaction, or per business process basis.

i) **Data Analysis:** the year-wise data received from DOC in respect of Imports, Exports and DTA Sales/Purchases were analyzed and the findings are given below:

Imports:

S/No.	Financial Year	Total Number of Cases	Duty forgone (₹ in crore)	No. of instances of Null/Zero values of Duty forgone
1	2010-2011 (12/10 to 3/11)	212534	3106.23	6325
2	2011-2012	543050	9937.80	11736
3	2012-2013	684041	16909.12	6346

- Blanks or gaps were observed in row no.128344 in 2010-2011 and row no.564386 and 190099 in 2012-13.
- Zero/Null IGM in 36630 cases out of 212534(2010-2011).
- 7663 cases in 2010-11 where country of origin and port of shipment are different. Individual cases need to be checked to see whether Anti-Dumping duty is levied wherever, applicable.
- 160 cases of imports of wastes and scraps in 2010-2011 (Rule 18(4)(a) restricts recycling of plastic wastes and scraps).
- 139 cases in 20101-11 where Invoice No. was zero/dots (lack of Input validation Controls).
- 36581 cases in 2010-2011 where the nature of transaction was given as "Others" and items like Diamonds, Labels were imported without having any duty forgone.
- Invoice Type: FOB (103998 cases in 2010-11 but details of insurance and freight was not given in few cases); CF (7746 in 2010-11 but insurance not given in few cases) and CI (11840 in 2010-11 but freight details not given in some cases). When invoice is in FOB/CI/CF actual

incidence of freight and insurance is to be loaded or in the absence of details Freight at the rate of 20 per cent and Insurance at the rate of 1.125 per cent is to be added to the FOB value to arrive at the CIF Value. This aspect needs to be checked.

DTA Purchases:

S/No.	Financial Year	Total Number of Cases	Duty Forgone (₹ in crore)	No. of instances of Null/Zero values of Duty forgone
1	2010-2011 (12/10 to 3/11)	21433	4.86	18113
2	2011-2012	139218	107.83	103206
3	2012-2013	266206	2658.94	116038

- Duty forgone amount stated above cannot be relied upon with such huge number of null/zero value cases (18113 in 2010-11, 103206 in 2011-12 and 116038 in 2012-13).
- Blank entries observed at row no.146395, 146396 and 240538 in the year 2012-13 for the same party.
- Lack of Input Validation control in Invoice date field where dates of 2001 and 2005 are also allowed to be entered (Data entry error as other details are for 2011 but invoice date is given as 2001).
- Instances of purchase of Waste/Scrap from DTA.
- Duty Forgone on supplies on Consignment/Free of cost basis not captured.
- Duty Forgone is not captured in some cases where nature of transaction is "others" (1329 records in 2010-11).

DTA Sales

S/No.	Financial Year	Total Number of Cases	Duty forgone (₹ in crore)	No. of instances of Null/Zero values of duty forgone
1	2010-2011 (12/10 to 3/11)	47342	423.13	6116
2	2011-2012	143144	980.22	17624
3	2012-2013	211094	2278.65	23799

- Blank entries at row no. 35053 in 2010-11, 75502, 42750 and 41442 in 2011-12 and 59344, 59363 and 60135 in 2012-13 (in 2011-12 same party M/s Gupta Associates).
- Zero Duty Clearances (6116 in 10-11, 17624 in 11-12 and 23799 in 12-13) needs to be analyzed further and item details and classification

need to be cross checked. Certain items like Insulin, Solar modules, Contraceptives are exempted. A unit in the DTA producing/clearing same final product would also clear these goods at 'nil' rate of duty, but would have suffered duty on inputs used in the manufacture of these products. This puts the DTA units under a comparative disadvantage .

- Duty forgone is given as nil in some cases where Nature of Transaction is "Free of Cost" (220 cases) and "Consignment" (5711 cases) with item details like diamond, capital goods, plastic hangers etc.

Exports:

S/No.	Financial Year	Total Number of Cases	Exports (₹ in crore)	No. of instances of Null/Zero values of Duty forgone
1	2010-2011 (12/10 to 3/11)	248538	45113.54	112
2	2011-2012	486749	100759.69	244
3	2012-2013	583488	151208.02	83

- Exports through SEZs for the year 2012-13 as per SEZ online data was ₹ 151208 crore whereas the exports for the same period was given as ₹ 476159 crore (MOC&I Annual report and BoA Minutes).
- 169 entries in 2012-13 with export value blank/dot/zero.
- 2824 entries in 2012-13 are shown to be exported to India.
- 11415 entries in 2012-13 were exported in Indian Rupees.
- 7 entries with Negative FOB value in 2010-2011 (inadequate input validation control).

DoC in their reply (June 2014) stated that SEZ Online System is still under implementation and on Live Testing Stage and the audit observation will be taken into consideration by the DoC, in consultation with the DoR.

Final outcome may be intimated to audit.

j) Production of Records: The following documents were not produced to audit:

I. Details of fees charged by NDML as per SLA was not provided to audit.

II. SLA between NDML and M/s Infosys (vendor) was not produced to audit.

III. Details of vulnerability assessment and penetration testing along with application security assessment are stated to have been produced;

however, only copy of code review certificate dated 10th December 2013 was produced to audit.

DoC in their reply (June 2014) stated that the available records were produced and other records shall also be made available in due course of time.

Reply is not acceptable to audit because no reason for non availability of records with the auditee was furnished to audit. These records could have been produced to audit during the period between issue of the draft report (27 April 2014) and furnishing of DoC's reply (14 June 2014) to the draft report.

To sum up, the system could not be utilized optimally even after two years of the system going live (October 2011) with much functionality to be rolled out completely. This calls for a review of the progress made and the service level agreements with NSDL so as to expedite the system development in all respects in a time bound manner to realize the full potential of the objectives with which the system was embarked upon.

DoC in their reply (June 2014) stated that the Advice/Comments of Audit shall be duly taken into consideration before the portal is independently functional after the ICEGATE integration is done. The Department will ensure the streamlining of all the shortcomings of SEZ Online System noticed by the DoC, DoR or any other participating Ministry /Department before the system is in place on standalone basis.

As no targets were suggested by DoC for integration of the portal with ICEGATE, it is suggested that a specific time line may be drawn up for completion of the project.

6.3 Other Compliance Issues

Various other compliance issues (17 issues) amounting to ₹ 17.96 crore noted in various states are indicated in Appendix 5:

DoC in their reply (June 2014) stated that the matter is being examined for further necessary action and shared with all Zonal Development Commissioners for compliance.

DoC may intimate the final outcome to audit.

6.4 Stakeholders' feedback

As a part of our review and based on a need expressed by MOC& I during the Entry Meeting (22 October 2013), it was felt necessary to have direct inputs from the principal players in the SEZ scheme viz., Developers, Units within

SEZs and the Development Commissioners to elicit their feedback on various issues concerning functioning of SEZs in the country.

With the intended objective, we selected a sample of 91 Developers, 532 Units and 9 Development Commissioners spread over 11 States/UT[18] out of the audit sample for our survey by issuance of questionnaires containing questions on various aspects relating to formal/in-principle approvals, notification, and subsequent business activities carried out by the Units in the Special Economic Zone. In response, 39 Developers (43 per cent of 91 developers), 173 Units (33 per cent of 532 units) and 9 Development Commissioners have responded to our Survey Questionnaire.

In response to our survey questionnaire (Appendix 6), it has been observed that majority of the Developers/units expressed satisfaction in obtaining approvals from BoA/UAC, sanction of claims/concession, and process of de-notification and exit from SEZ, including grievances redressal. However, the redressal mechanism for grievances is not efficient. A fixed time frame is required for getting approval from BoA, submission of documents and setting up of single window clearance mechanism in each State. SEZ units also felt that operating in DTA has become more beneficial as compared to operating in SEZs after withdrawal of exemption for MAT and DDT for the SEZs. Signing of more Free Trade Agreements by India enabled Indian exporters outside the SEZs to import duty free inputs which acted as a disincentive for exporters operating within SEZs. Export benefits to the SEZ units have considerably reduced vis-a-vis DTA units. Global recession and end of tax holiday were attributed to be the main causes for shortfall between projections and actual. This was followed by other reasons such as, too many restrictions, lack of infrastructural facilities and cumbersome land acquisition processes. SEZs opted for de-notification mainly because of infrastructure facilities and growth in domestic market, poor global market, excessive restrictions, end of tax holiday and introduction of MAT.

The experience of Development Commissioners in respect of issues flagged to BoA, addressing the issues related to Developers/Units by members of UAC and adequacy of information furnished by Developers/Units in APR/QPR for effective performance of Units are satisfactory. About 12 per cent DCs agreed that Single Window Clearance mechanism is not very effective. 56 per cent of the DCs expressed that concession/exemption granted to SEZs are

[18] *Andhra Pradesh, Chandigarh, Delhi, Gujarat, Haryana, Karnataka, Maharashtra, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal*

sufficient, whereas, 12 per cent disagreed with them. Frequent changes in fiscal policy, lack of interest, contiguity norms and non-recognition of SEZ as public utility etc were felt to be the reasons for bottlenecks in functioning of SEZs.

The details of the sample and responses received are given in Appendix 6.

FIEO and PHDCCI expressed the views of the exporters and industry where acquisition of farmland for establishing SEZs was considered a very important issue. The other issue is related to the concentration of SEZs in the districts that are relatively more industrialized or situated in sea connected States, which creates regional imbalances and income inequality. Moreover, different land requirement criterion for setting up a SEZ in different sectors also creates concentration of SEZ in specific sectors. This is evident from the fact that 60 per cent of the SEZs in India are comprised of IT based products and services sector and it is considered that SEZs in India has become an attractive area for information technology firms to avail tax incentives by shifting to the zones from domestic tariff areas.

With regard to the overall functioning of the SEZs, getting permission from the custom authorities for procuring/exporting materials/services and getting sanction of claims viz. rebate, CST etc. were considered to be the major difficulties. Non existence of single window clearance system widely and lack of clarity in certain procedures viz. exit from the SEZ results in operational inefficiency for a SEZ. The major change which is observed is change in SEZ developers/units pessimistic attitude towards the SEZ concept in India. This is on account of enhancing several export incentives for the exporters operating within DTA which finally acted as a disincentive for the exporters operating within SEZ. PHD Chamber believes that operating in DTA area has become more beneficial as compared to operating within SEZs.

The essence of the stakeholders response is given in the box below.

Box-16

- Single Window Clearance has not integrated all the clearances and therefore it was not serving the intended purpose. Absence of state level Acts adds to this problem.
- Minimum Alternative Tax (MAT) and Dividend Distribution Tax (DDT) seem to be acting as impediments in the growth story of SEZs which was evident from the magnitude of de-notifications.
- IT/ITES Sectors have an edge over other sectors due to availability of skilled manpower and plug and play facilities.
- It is now beneficial to work out side SEZs, in the DTA, for greater fiscal benefits.

Recommendation: *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.

7. Conclusion

Audit observed that MOC&I has not prescribed any measurable performance indicators in line with its objectives and functions, for the real socio-economic benefits for citizens and the State. The SEZ policy and procedures were not directed towards involving all the states. There were no time limits for each stage of the SEZ life cycle for bench marking.

The system of according extensions without appropriate corrective measures or deterrent action, led to de-notification and diversion of the land for commercial purposes which necessitates review of the system being followed.

The Statement on revenue loss on account of various tax sops to SEZs presented along with Budget every year is not comprehensive as it does not consider concessions given on account of Central Excise and Service Tax. Income tax Act, 1961 does not provide for timely remittance of foreign currency; there was also no mechanism for capturing, accounting and monitoring of ST forgone, either by Development Commissioners or the jurisdictional ST Commissionerates. There is no provision to recover duty forgone on inputs utilised for manufacture of finished products on clearances of such exempted goods in DTA as it is done in EOUs. The tax administration's (direct taxes and indirect taxes) failure to process many cases of undue tax claims amounting to ₹ 1654 crore questions the robustness of the tax scrutiny process in place. Further, concessions under State statutes viz., Stamp Duty, VAT, CST, etc could not be quantified in the absence of any monitoring mechanism.

The modest achievements of SEZs in the country are a contribution from a few SEZs operating in a few developed States. Many of these SEZs were established in the EPZ regime between 1965 and 2005. Many SEZs in the country remained at approval/notification stage which is reflected by the fact that per cent of operational to notified zones is only 38.78 per cent. Considering the significant shortfalls in achievement of the intended socio-economic objectives by all the sectors of SEZs, there is an urgent need for the Government to review the factors hindering the growth of non-operational and under-performing zones.

Monitoring and internal audit needs urgent attention in the whole scheme of SEZs. Strategic control of the SEZ online database management system has been outsourced to a private operator NSDL. In the absence of an effective internal audit set-up, Development Commissioners, Developers and unit

holders are loosely monitored. This posed a huge risk for revenue administration as well as the growth impetus of the nation.

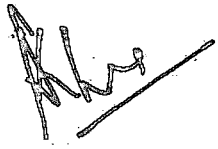
DoC agreed with the audit conclusions and admitted (June 2014) that Government of India introduced the SEZ Act, 2005 to make SEZs an engine for economic growth, supported by a quality infrastructure and complimented by an attractive fiscal package, at the Centre and the State levels. SEZs have tremendous growth potential, however, number of bottlenecks which have come in the way of SEZ growth need to be addressed, such as; adverse impact on development of SEZs due to imposition of MAT and DDT; non applicability of export promotional benefits of FTP to SEZs. There were difficulties in acquiring land for establishing contiguity in the SEZ for setting up large SEZs consequent upon the enactment of the LARR Act, 2013. Multiple permissions from State/Central Authorities for master plan and environmental clearance at various levels due to non-delegation of powers to DCs and UACs also hindered the growth of SEZs.

Audit is of the opinion that there is a need to relook at the policy framework and its implementation for better outcome.

New Delhi
Dated : 28 July 2014

(Nilotpal Goswami)
Principal Director (Customs)

Countersigned



New Delhi
Dated : 30 July 2014

(Shashi Kant Sharma)
Comptroller and Auditor General of India

Appendices

Appendix 1

Audit Report No.	Paragraph No.	Topics
CA 20 of 2009-10	15.1. 2, 15.1.3	Incorrect availing of exemption
	15.1.5	Irregular DTA Sale
No. 14 of 2009-10 (CA)	2.1.1, 2.1.2 and 2.1.3	Short/Non-levy of education cess on DTA clearance
	2.1.5	Incorrect reimbursement of Central Sales Tax
	2.1.7 and 2.1.9	Non-achievement of net foreign exchange earning/non-fulfilment of export obligation
	2.1.11	Irregular DTA Sale
	2.1.15	Incorrect grant of exemption
24 of 2010-11 (CA)	4.2.1	Adoption of incorrect assessable value
	4.2.3	Incorrect reimbursement of CST
31 of 2011-12 (CA)	2.1.1	Export proceeds realization
	2.1.3 and 2.1.4	Incorrect reimbursement of CST
	2.1.6	Ineligible DTA Sale
	2.1.9	Anti-dumping duty not collected on DTA sale
14 of 2013 (CA)	2.35 to 2.39	Incorrect exemption allowed against DFIA licence
	2.41 to 2.44	Excess DTA clearances of the export product.
	2.45 to 2.47	Excess DTA clearance of export produce

Appendix 2

List of files not produced to audit

Sl. No.	Name of the SEZ Unit/Developer/co-developer
1	Kandla SEZ
2	Adani Port and SEZ limited (formerly MPSEZ)
3	Diamond and Gems Development Corporation (SURSEZ)
4	Jubilant Infrastructure Ltd.
5	Essar Hazira Ltd.
6	MIDC
7	SEEPZ-SEZ
8	Hari Fertilizers Ltd
9	DLF Commercial
10	State Industrial Development Corporation Uttaranchal Ltd
11	Moser Baer India Ltd Greater Noida
12	Aachiya Softech Noida/IT/ITES
13	Arshiya Northern FTWZ, Khurja
14	Moradabad SEZ/Handicrafts
15	NOIDA SEZ, Noida/multi-Product
16	Electronics Technologies Sriperumbudur
17	Synerfra Engineering construction Ltd, Coimbatore
18	Mahindra Worldcity, Chengalpattu
19	MEPZ, Chennai
20	Global Village SEZ
21	Infosys Mysore SEZ
22	Infosys Mangalore SEZ
23	Suzlon SEZ
24	Infosys, Bangalore
25	Jubliant Infrastructure Ltd
26	Bagamane Builders
27	KIADB Shimoga
28	M/s Poornimadevi Tech. Park Pvt Ltd, Karnataka (Incomplete File)
29	M/s Gokaldas Images Infrastructure Pvt Ltd (Incomplete File)
30	Rajiv Gandhi Chandigarh Technology Park Phase-I, Chandigarh
31	Ranbaxy Laboratories Ltd. Mohali
32	Gurgaon Infospace Ltd. Gurgaon
33	AKVN Indore/Indore SEZ
34	M/s Parsvanath SEZ Ltd, Village Lasudia Parmar, Indore
35	FALTA Special Economic Zone
36	Manikanchan Special Economic Zone
37	Wipro Special Economic Zone
38	Bengal Shapoorji Infrastructure Development Pvt. Ltd.
39	Enfield Energy Ltd
40	FAB City SPV India Ltd
41	L & T Hi-Tech City
42	SRI City/Satyavedu Reserve Infracity Pvt. Ltd.
43	Wipro Ltd/Gipannapalli
44	DLF Commercial
45	GMR Hyderabad International Airport Ltd
46	Kakinada Sea Portal Ltd
47	M/s Poppalaguda Village Ranga Reddy District, Hyderabad (AP), huda (Incomplete file)

Appendix 3

No. of Operational SEZ

	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14 (as on 31-12-2013)
Number of formal approval accorded*	453	577	578	585	589	577	572
Number of notified SEZs (as on date)*	207	325	353	381	389	389	390
Number of In-Principle approvals accorded*	136	146	149	42	48	49	45
Unit approved in SEZs*	-	2263	2850	3290	3400	3589	3861
Operational SEZs (as on date)*	-	87	111	133	153	170	181
Land for SEZs	SEZ notified before SEZ Act, 2005	Notified under SEZ Act		Formally approved SEZs		Total Area	
	2900.34 Ha	44,914.28 Ha		14,750.40 Ha		62,565 Ha	

INVESTMENT

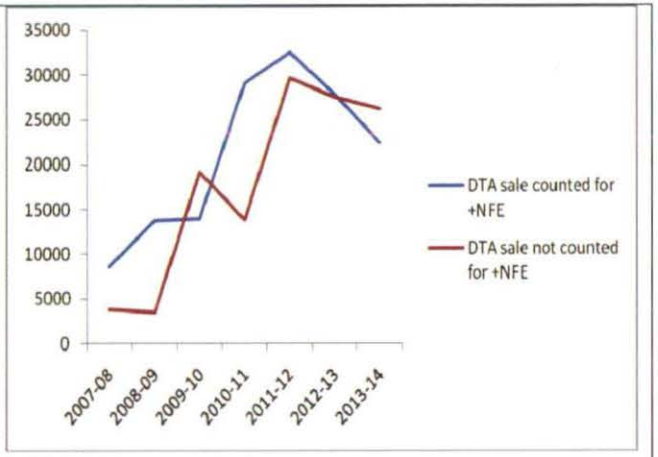
	Investment (as on February 2006) (₹ In crore)	2007-08		2008-09		2009-10		2010-11		2011-12		2012-13		2013-14 (as on 31.12.2013)	
		Incremental Investment	Total Investment	Incremental Investment	Total Investment	Incremental Investment	Total Investment	Incremental Investment	Total Investment	Incremental Investment	Total Investment	Incremental Investment	Total Investment	Incremental Investment	Total Investment
Central Govt. SEZs	2,279.20	₹ 1.620.29 cr.	₹ 3,899.49 cr.	₹ 2,591.88 cr.	₹ 4,871.08 cr.	₹ 4,707.75 cr.	₹ 6,986.95 cr.	₹ 8,173.39 cr.	₹ 10,452.59 cr.	₹ 9,207.21 cr.	₹ 11,486.41 cr.	₹ 9,640.52 cr.	₹ 11,919.72 cr.	₹ 10,619.46 cr.	₹ 12,898.66 cr.
State/Pvt. SEZ set up before 2006	1.756.31.	₹ 2,204.13 cr.	₹ 3,960.44 cr.	₹ 3,777.67 cr.	₹ 5,533.98 cr.	₹ 5,250.6 cr.	₹ 7,006.91 cr.	₹ 5,960 cr.	₹ 7,716.31 cr.	₹ 5,881.30 cr.	₹ 7,637.61 cr.	₹ 6,993.42 cr.	₹ 8,749.73 cr.	₹ 8,453.63 cr.	₹ 10,209.94 cr.
SEZ notified under the Act	0.	₹ 69,349.573 cr.	₹ 69,349.57 cr.	₹ 98,498 cr.	₹ 98,498 cr.	₹ 1,34,494.76 cr.	₹ 1,34,494.76 cr.	₹ 1,84,640.64 cr.	₹ 1,84,640.64 cr.	₹ 1,82,750.74 cr.	₹ 1,82,750.74 cr.	₹ 2,16,047.20 cr.	₹ 2,16,047.20 cr.	₹ 2,65,368.38 cr.	₹ 2,65,368.38 cr.
Total	4,035.51.	₹ 73,173.993 cr.	₹ 77,209.50 cr.	₹ 1,04,867.48 cr.	₹ 1,08,903 cr.	₹ 1,44,453.11 cr.	₹ 1,48,488.62 cr.	₹ 1,98,774.03 cr.	₹ 2,02,809.54 cr.	₹ 1,97,839.25 cr.	₹ 2,01,874.76 cr.	₹ 2,32,681.14 cr.	₹ 2,36,716.65 cr.	₹ 2,84,441.47 cr.	₹ 2,88,476.98 cr.

EMPLOYMENT

	Employment (as on February 2006)	2007-08		2008-09		2009-10		2010-11		2011-12		2012-13		2013-14 (as on 31.12.2013)	
		Incremental Employment	Total Employment	Incremental Employment	Total Employment	Incremental Employment	Total Imployment	Incremental Employment	Total Employment	Incremental Employment	Total Employment	Incremental Employment	Total Employment	Incremental Employment	Total Employment
Central Govt. SEZs	1,22,236 Persons	71,238 Persons	1,93,474 Persons	74,686 Persons	1,96,922 Persons	71,592 Persons	1,93,828 Persons	88,198 Persons	2,10,434 Persons	91,617 Persons	2,13,853 Persons	97,160 Persons	2,19,396 Persons	96,306 Persons	2,18,542 Persons
State/Pvt. SEZ set up before 2006	12,468 Persons	32,300 Persons	44,768 Persons	43,422 Persons	55,890 Persons	45,723 Persons	58,191 Persons	53,563 Persons	66,031 Persons	66,547 Persons	79,015 Persons	77,469 Persons	89,937 Persons	65,496 Persons	77,964 Persons
SEZ notified under the Act	0 Persons	97,993 Persons	97,993 Persons	1,34,627 Persons	1,34,627 Persons	2,51,592 Persons	2,51,592 Persons	4,00,143 Persons	4,00,143 Persons	5,52,048 Persons	5,52,048 Persons	7,65,571 Persons	7,65,571 Persons	9,43,339	9,43,339 Persons
Total	1,34,704 Persons	2,01,531 Persons	3,36,235 Persons	2,52,735 Persons	3,87,439 Persons	3,68,907 Persons	5,03,611 Persons	5,41,904 Persons	6,76,608 Persons	7,10,212 Persons	8,44,916 Persons	9,40,200 Persons	10,74,904 Persons	11,05,141 Persons	12,39,845 Persons

EXPORTS

Exports in 2007-08	₹ 66,638 Crore (Growth of 93% over 2006-07)
DTA sale (counted for + ve NFE)	₹ 8,560.86 Crore **DTA as % Exports: 19%**
DTA sale (Not counted for + ve NFE)	₹ 3,842.615 Crore
Exports in 2008-09	₹ 99,688.87 Crore (Growth of 50% over 2007-08)
DTA sale (counted for + ve NFE)	₹ 13,708.67 Crore **DTA as % Exports: 17%**
DTA sale (Not counted for + ve NFE)	₹ 3,472.556 Crore
Exports in 2009-10	₹ 2,20,711.39 Crore (Growth of 121% over 2008-09)
DTA sale (counted for + ve NFE)	₹ 13,937.04 Crore **DTA as % Exports: 15%**
DTA sale (Not counted for + ve NFE)	₹ 19,200.92 Crore
Exports in 2010-11	₹ 3,15,867.85 Crore (Growth of 43.11% over 2009-10)
DTA sale (counted for + ve NFE)	₹ 29,093.02 Crore **DTA as % Exports: 14%**
DTA sale (Not counted for + ve NFE)	₹ 13,881.20 Crore
Exports in 2011-12	₹ 3,64,477.73 Crore (Growth of 15.39% over 2010-11)
DTA sale (counted for + ve NFE)	₹ 32,472.70 Crore **DTA as % Exports: 17%**
DTA sale (Not counted for + ve NFE)	₹ 29,664.83 Crore
Exports in 2012-13	₹ 4,76,159 crore (Growth of 31% over 2011-12)
DTA sale (counted for + ve NFE)	₹ 27,884.80 Crore **DTA as % Exports: 12%**
DTA sale (Not counted for + ve NFE)	₹ 27,545.46 Crore
Exports in 2013-14 (As on 31.12.2013)	₹ 3,77,283.22 Crore (Growth of 7% over the exports of the corresponding period of FY 2012-13)
DTA sale (counted for + ve NFE)	₹ 22,440.24 Crore **DTA as % Exports: 13%**
DTA sale (Not counted for + ve NFE)	₹ 26,217.02 Crore



Average DTA sale as a percentage of Exports: 15%

*Source: DoC
** Calculated on cumulative basis.
Note: The Data includes FTWZ SEZs.

Appendix 4

1. Economic Activity

A. GDP by Economic Activity (Constant Prices)

	Agriculture, for & Fishing		Industry		Services	
	₹ Crore	% to GDP	₹ Crore	% to GDP	₹ Crore	% to GDP
Series with bases Year 2004 - 05						
1950-51	145052	51.9	45277	16.2	82591	29.5
1960-61	195482	47.6	82413	20.1	123872	30.2
1970-71	245699	41.7	139321	23.6	196158	33.3
1980-81	285015	35.7	204861	25.7	300614	37.6
1990-91	397971	29.5	372360	27.6	573465	42.5
2000-01	522755	22.3	640043	27.3	1007138	48.2
2010-11	709103	14.5	1358726	27.8	2818125	57.7
2004-05	565426	19.0	829783	27.9	1576255	53.0
2005-06	594487	18.3	910413	28.0	1748173	53.7
2006-07	619190	17.4	1021204	28.7	1923970	54.0
2007-08	655080	16.8	1119995	28.7	2121561	54.4
2008-09	655689	15.8	1169736	28.1	2333251	56.1
2009-10	662509	14.7	1267936	28.1	2577192	57.2
2010-11QE	709103	14.5	1358726	27.8	2818125	57.7
2011-12 RE	728667	14.0	1404659	27.0	3069189	59.0

Notes: (i) Industry includes mining and quarrying manufacturing, electricity and construction.
(ii) Services include trade, hotels and communication, financing, insurance, real estate and business service and community, social & personal Services.
RE: Revised Estimates
QE: Quick Estimates

Source: Central Statistics Office.

B. Factor Income by Economic Activity: Current Prices

	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Agriculture, etc.						
CE	82903	95520	109340	126389	141183	164149
OS/MI	444387	500167	565998	655562	724417	849360
CFC	38136	42085	47646	54567	63343	75788
GDP	565426	637772	722984	836518	928943	1089297
Industry						
CE	314127	350530	399245	476939	581170	629208
OS/MI	355132	419028	530365	606363	626719	695050
CFC	160524	184314	213587	246974	282555	329611
GDP	829783	953872	1140197	1330276	1490444	1653869
Services						
CE	515504	55856	613315	689364	865431	1073831
OS/MI	939521	1102077	1318368	1542247	1779876	2065957
CFC	121230	137314	157378	183017	217392	250275
GDP	1576255	1797977	2089061	2414628	2862699	3390063

CE – Compensation of Employees;
OS – Operating surplus;
MI – Mixed income;
CFC – Consumption of fixed capital;

C. Gross State Domestic Product

State	2004-05		Constant (2004-05) Prices 2011-12		Current Prices 2011-12	
	GSDP ₹ (Crore)	Per Capita (₹)	GSDP ₹ (Crore)	Per Capita (₹)	GSDP (Crore)	Per Capita (₹)
All India	2971464	27056	5202514	42790	8232652	67713
Andhra Pradesh	224713	28265	407611	47849	675798	79331
Arunachal Pradesh	3488	30355	5899	4227	9397	66980
Assam	53398	18993	80465	26133	115408	37481
Bihar	76574	8637	151866	15417	252694	25653
Chhattisgarh	47862	21463	87723	34401	135536	53151
Goa	12636	88424	23151	128688	44460	247137
Gujarat	203373	37803	NA	NA	NA	NA
Haryana	95319	41978	179482	69875	308943	120277
Himachal Pradesh	24077	37001	24032	60907	63331	91770
Jammu & Kashmir	27005	25198	40970	34702	63589	53860
Jharkhan	59766	20850	91421	28815	130505	41134
Karnataka	166306	30059	291661	48789	326693	54649
Kerala	119264	36278	208468	60063	315387	90869
Madhya Pradesh	112927	17449	202971	27850	135536	18597
Maharashtra	413826	40347	805031	72885	1248453	109929
Manipur	5131	20775	7632	27032	10188	36085
Meghalaya	6526	26887	11215	42497	15895	60231
Mizoram	2682	27564	NA	NA	NA	NA
Nagaland	5204	21919	9357	46903	12134	60823
Odisha	76579	19980	137585	32584	226236	53579
Punjab	96694	37173	156483	52918	248301	83968
Rajasthan	127745	21056	215454	312468	368320	53794
Sikkim	1739	30730	5148	83568	8400	136358
Tamil Nadu	219234	34034	416549	61531	639025	94394
Tripura	8904	26586	15463	42469	19731	54191
Uttar Pradesh	258653	14490	420017	20708	687836	33912
Uttarakhand	24821	27536	60898	60734	95201	94945
West Bengal	208857	24893	333583	37070	541586	60185
Union Territories						
A & N Islands	1813	45029	3684	73095	5026	99722
Chandigarh	8404	82887	15959	106322	23368	155683
Delhi	100325	65205	213429	125984	313934	185310
Puducherry	5754	55218	11448	90734	13724	108773

D. Industrial Production

Index of Industrial Production (Base 2004-05=100):

Year	Index of Industrial Production	Mining & Quarrying	Manufacturing	Electricity
Weight Indices	100.0	14.2	75.5	10.3
2005-06	108.6	102.3	110.3	105.2
2006-07	122.6	107.5	126.8	112.8
2007-08	141.7	112.5	150.1	120.0
2008-09	145.2	115.4	153.8	123.3
2009-10	152.9	124.5	161.3	130.8
2010-11	165.5	131.0	175.7	138.0
2011-12	170.2	128.4	180.8	149.3
Growth Rates (Year-on-Year)				
2005-06	8.6	2.3	10.3	5.2
2006-07	12.9	5.1	15.0	7.2
2007-08	15.6	4.7	18.4	6.4
2008-09	2.5	2.6	2.5	2.8
2009-10	5.3	7.9	4.9	6.1
2010-11	8.2	5.2	8.9	5.5
2011-12	2.8	2.0	2.9	8.2

Note: IIP with new base 2004-05=100 introduced with effect from June 10.2011.
Source : Central Statistics Office.

E. Industrial Production: Use –Based Classification

Year	Basic Industries	Capital Goods Industries	Intermediate Goods Industries	Consumer Goods Industries
Weight	**45.7**	**8.8**	**15.7**	**29.8**
Indices				
2005-06	106.1	118.1	106.6	110.7
2006-07	115.6	145.6	118.8	128.6
2007-08	125.9	216.2	127.5	151.2
2008-09	128.1	240.6	127.6	152.6
2009-10	134.1	243	135.3	164.3
2010-11	142.2	278.9	145.3	178.3
2011-12	150.0	267.5	143.9	186.1
Growth Rates (year-on-year)				
2005-06	6.1	18.1	6.6	10.7
2006-07	8.9	23.3	11.4	16.2
2007-08	8.9	48.5	7.3	17.6
2008-09	1.7	11.3	0.1	0.9
2009-10	4.8	1.0	6	7.7
2010-11	6.0	14.8	7.4	8.5
2011-12	5.5	(4.1)	(1.0)	4.4

Source : Central Statistics Office.

F. Electronic Goods Production					(₹ Crore)
year	Consumer Electronics	Commercial Broadcasting & Equipments	Computers, Industrial & Strategic Electronics	Components	Total Electronic Production
Production					
2000-01	11950	4500	9150	5500	31100
2004-05	16800	4800	20100	8800	50500
2005-06	18000	7000	22800	8800	56600
2006-07	20000	9500	27700	8800	66000
2007-08	22600	18700	33480	9630	84410
2008-09	25550	26600	33070	12040	97260
2009-10	29000	31000	37110	13610	110720
2010-11	32000	35400	39670	21800	128870
2011-12	34300	40500	43700	24800	143300
Growth Rates (year-on-year)					
2005-06	7.1	45.8	13.4	0.0	12.1
2006-07	11.1	35.7	21.5	0.0	16.6
2007-08	13.0	96.8	20.9	9.4	27.9
2008-09	13.1	42.2	-1.2	25.0	15.2
2009-10	13.5	16.5	12.2	13.0	13.8
2010-11	10.3	14.2	6.9	60.2	16.4
2011-12	7.2	14.4	10.2	13.8	11.2

Source: Department of Information Technology.

2. Employment

A. Labour Force and Labour Force Participation Rate (LFPR)

Usual Status (PS+SS)						
	Labour Force (In millions)			Labour Force Participation Rate (%)		
	Rural	Urban	Total	Rural	Urban	Total
Total						
1972-73	199.6	40.6	240.2	43.9	34.5	42.0
1977-78	228.1	53.5	281.6	54.8	37.5	44.0
1983	247.2	63.2	310.4	45.2	36.2	43.0
1987-88	260.1	74.3	334.4	44.3	35.6	42.1
1993-94	293.0	85.7	378.7	44.9	36.3	42.7
1999-2000	305.2	100.7	405.9	42.3	35.4	40.4
2004-05	348.7	120.3	469.0	44.6	38.2	43.0
2009-10	341.9	126.9	468.8	41.4	36.2	40.0
Male						
1972-73	128.7	32.9	161.6	55.1	52.1	54.5
1977-78	144.5	41.4	185.9	56.5	54.3	56.0
1983	155.9	50.2	206.1	55.5	54.0	55.1
1987-88	165.0	58.5	223.5	54.9	53.4	54.5
1993-94	189.3	67.3	256.6	56.1	54.3	55.6
1999-2000	200.2	80.7	280.8	54.0	54.2	54.1
2004-05	222.5	93.9	316.4	55.5	57.0	55.9
2009-10	235.7	102.7	338.4	55.6	55.9	55.7
Female						
1972-73	70.9	7.7	78.6	32.1	14.2	28.6
1977-78	83.6	12.1	95.7	34.5	18.3	31.0
1983	91.3	13.0	104.3	34.2	15.9	29.9
1987-88	95.1	15.8	110.9	33.1	16.2	28.8
1993-94	104.7	18.4	123.1	33.0	16.5	28.7
1999-2000	105.0	20.0	125.1	30.2	14.7	25.8
2004-05	126.2	26.4	152.6	33.3	17.8	29.4
2009-10	106.2	24.2	130.4	26.5	14.6	23.3

Note: Usual Status = Principal Status + Subsidiary Status

Data relate to usual status of individuals.

Labour force covers those involved in gainful activity regularly, those involved in gainful activity occasionally and those unemployed.

Labour force participation rate represents size of labour force as per cent of population.

Source: National sample Survey Organization (NSSO), various reports.

B. Estimates of Unemployment

	Usual Status (PS+SS)					
	Labour Force (In millions)			Labour Force Participation Rate (%)		
	Rural	Urban	Total	Rural	Urban	Total
			Total			
1972-73	1.8	2.1	3.9	0.9	5.2	1.6
1977-78	6.6	4.3	10.9	2.9	8.0	3.9
1983	4.1	3.6	7.7	1.7	5.7	2.5
1987-88	7.6	4.8	12.4	2.9	6.5	3.7
1993-94	4.7	4.8	7.5	1.6	5.6	2.5
1999-2000	4.2	3.8	8.0	1.4	3.8	2.0
2004-05	5.9	5.4	11.3	1.7	4.5	2.3
2009-10	5.5	4.3	9.8	1.6	3.4	2.0
			Male			
1972-73	1.5	1.6	3.1	1.2	4.8	1.9
1977-78	3.1	2.6	5.7	2.2	6.5	3.1
1983	3.2	2.9	6.1	2.1	5.9	3.0
1987-88	4.5	3.5	8.0	2.8	6.1	3.6
1993-94	3.7	3.6	7.3	2.0	5.4	2.8
1999-2000	3.2	2.9	6.1	2.1	4.8	2.2
2004-05	3.6	3.6	7.2	1.6	3.8	2.2
2009-10	3.8	2.9	6.7	1.6	2.8	2.0
			Female			
1972-73	0.3	0.5	0.8	0.5	6.0	1.0
1977-78	3.5	1.7	5.2	5.5	17.8	5.4
1983	0.9	0.7	1.6	1.4	6.9	1.5
1987-88	3.1	1.3	4.4	3.5	8.5	4.0
1993-94	1.0	1.2	2.2	1.4	8.3	1.8
1999-2000	1.0	0.9	1.9	1.5	1.7	1.5
2004-05	2.3	1.8	5.1	1.8	6.9	2.6
2009-10	1.7	1.4	3.1	1.6	5.7	2.3

Note : Unemployment rate is the number of unemployed as percentage of labour force. PS : Principal Status, SS: Subsidiary Status.

Source: National Sample Survey Organisation (NSSO), various reports.

3. Investment

A. Gross Capital Formation (Unadjusted) at Current Prices

Year	GCF (₹ Crore)	Rate (% to GDP)	Agriculture (₹ Crore)	Manufacturing Registered (₹Crore)	Services
1950-51	1133	10.89	221	242	157
1960-61	2618	14.59	325	836	421
1970-71	7297	15.32	1154	1968	1385
1980-81	27003	18.05	4074	4544	6276
1990-91	146018	24.91	17112	33948	29901
2000-01	510354	23.53	48391	104490	70974
2004-05	1011178	31.19	69148	245984	140563
2005-06	1224682	33.16	81886	352958	179966
2006-07	1490876	34.71	91902	408585	206972
2007-08	1843208	36.96	113199	583237	249193
2008-09	1927890	34.24	148574	441919	285756
2009-10	2216069	34.32	168378	606435	306078
2010-11	2586353	33.70	196435	685507	335139

Notes: (i) Share is percentage to total GCF (ii) Services includes mining & quarrying, electricity, gas & water supply, railways and transport by other means.
Source: Central Statistics Office.

B. Net Capital Stock (Series with Base year 2004-05)

End March	Net Capital Stock (₹Crore)	Average capital output Ratio (ACOR)**	Incremental Capital Output Ratio (ICOR)	
		Net Capital Stock to Output	NDCF to output*	NFCF to output***
At 2004-05 Prices				
2001	7271744	3.37	4.76	4.29
2002	7705843	3.39	3.52	3.72
2003	8113468	3.44	5.11	4.76
2004	8609784	3.36	2.79	2.43
2005	9325629	3.38	4.52	3.71
2006	10162674	3.36	3.54	2.92
2007	11158662	3.35	3.68	3.06
2008	12323856	3.38	4.23	3.45
2009	13514747	3.50	4.99	4.46
2010	14700599	3.54	4.43	3.50
At Current Prices				
2001	6101181	3.27	2.6	2.3
2002	6703508	3.30	2.2	2.3
2003	7220873	3.33	2.5	2.3
2004	8027105	3.24	1.9	1.6
2005	9325629	3.27	2.5	2.0
2006	10529765	3.28	2.4	2.0
2007	12256314	3.22	2.2	1.8
2008	14338731	3.25	2.5	2.1
2009	16958893	3.30	2.1	1.9
2010	19402011	3.35	2.5	2.0

Notes : *Average of beginning and year-end capital stock as ratio of the year's NDP at factor cost.
**ACOR data for 2001 pertains to 2001-02 and so on.
***Based on increase in NDP at Factor Cost.
Source : Central Statistics Office.

C. Foreign Investment Inflows (Incl: Advance)

	Foreign Direct Investment		Portfolio Investment	
	(₹)Crore	US $ mn	(₹)Crore	US $ mn
1990-91	174	97	11	6
2000-01	18406	4029	12609	2760
2001-02	29235	6130	9639	2021
2002-03	24367	5035	4738	979
2003-04	19860	4322	52279	11377
2004-05	27188	6051	41854	9315
2005-06	39674	8961	55307	12492
2006-07	103367	22826	31713	7003
2007-08	140180	34835	109741	27271
2008-09	100100	22372	-65000	-14030
2009-10	86000	17966	154000	32396
2010-11	42900	9360	139400	30293
2011-12	103200	22061	-27700	17170

Source : RBI Bulletin.

4. Trade

A. Foreign Trade

(US $ million)

	DGCI&S Data					RBI BoP Data	
Year	Exports	Growth (%)	Imports	Growth (%)	Trade Balance	Exports	Imports
1950-51	1016		1292		(276)	1355	1366
1960-61	1346	2.9	2353	6.1	(1007)	1326	2324
1970-71	2031	4.2	2162	(0.1)	(131)	1876	2416
1980-81	8485	15.4	15867	22.1	(7382)	8429	16284
1990-91	18145	7.9	24073	4.3	(5927)	18477	27915
2000-01	44560	9.4	50537	7.7	(5976)	45452	57912
2010-11	251136	18.9	369769	22.0	(118633)	250468	381061
2004-05	83536	30.8	111517	42.7	(27982)	85206	118908
2005-06	103091	23.4	149166	33.8	(46075)	105152	157056
2006-07	126414	22.6	185735	24.5	(59321)	128888	190670
2007-08	162904	28.9	251439	35.4	(88535)	166162	257629
2008-09	185295	13.7	303696	20.8	(118401)	189001	308521
2009-10	178751	(3.5)	288373	(5.0)	(109622)	182235	300609
2010-11	251136	40.5	369769	28.2	(118633)	250468	381061
2011-12	304624	21.3	489417	32.4	(1847940	309774	499533

Note: Growth for decades from 1950-51 to 2010-11 is CAGR that from 2000-01 onwards is the annual growth rate.
Source: Directorate General of Commercial Intelligence and Statistics (DGCI&S), Calcutta, RBI for BoP data.

B. Index Numbers and Terms of Foreign Trade							
	Unit Value Index		Quantum Index		Terms of Trade		
Year	Exports	Imports	Exports	Imports	Gross	Net	Income
Base: 1999-2000 =100							
2000-01	102	109	125	99	79	94	118
2001-02	103	112	126	103	82	92	116
2002-03	106	128	150	109	73	83	125
2003-04	114	132	161	128	80	86	138
2004-05	131	157	179	150	84	83	149
2005-06	139	179	206	174	84	78	161
2006-07	158	206	227	191	84	77	175
2007-08	166	210	245	218	89	79	194
2008-09	194	239	267	262	98	81	216
2009-10	196	215	264	288	109	91	240
2010-11	223	243	304	311	85	113	279

Note: Index of foreign trade of country is instrument which indicate the temporal fluctuations in export/import in terms of volume and unit price. It may be defined as a measure of average change in a group of related variables over two different situations.

1. Gross terms of trade are the ratio of overall import quantum index to similar export index.
2. Net Terms of Trade is the ratio of overall export unit value index to similar import index.
3. Income Terms of Trade = (NTTXQEI)/100

Source: Economic Survey, Handbook of Statistics on Indian economy.

Appendix 5
Other compliance issues

S. No	Issue	State(s)	No. of unit/SEZ/Cases	Amount (₹ in lakh)	Statutes	Remarks
1	DTA sales made prior to the commencement of Production	Andhra Pradesh	1Unit	246	-	Commercial production of the unit in April 2010; however, DTA sales shown from 2006 onwards
2	Lease deed not entered	Andhra Pradesh, Odisha and Gujarat	65Units	0	Rule 18 (2) (ii) of SEZ Rules 2006	Developer needs to enter into lease agreement which needs to be registered and furnished to the DC concerned within six months from the issuance of the LOA
3	Non registration of Lease deeds	Andhra Pradesh, Maharashtra, and Gujarat	373 Units	0		
4	Non fulfilment of Minimum Built up Area	Andhra Pradesh, Maharashtra, Gujarat, West Bengal and Uttar Pradesh	10 SEZ	0	Rule 5(7) read with 5(2)(b) of SEZ Rules 2006	IT/ITES SEZs needs to construct minimum Built up area of 1 lakh Square metres within a period of 10 years from the date of notification of the SEZ in which at least 50 % of such area is to be constructed within 5 years
5	Non utilization of material procured for authorised operation	Uttar Pradesh	1 SEZ	25.18	Rule 37 of SEZ Rules 2006	Goods admitted in SEZ shall be utilized within a period of one year
6	Non-levy of duty on failure to bring back goods removed for job-work/sub-contracting within the stipulated period	West Bengal and Karnataka	5 Unit	40	Rule 41(1) of SEZ Rules 2006	Sub-contracting is permitted with prior permission of the Specified Officer (SO) provided the finished goods are required to be brought back to the Unit within 120 days
7	Incorrect extension of benefit of Job-work	West Bengal	1Unit	13.04	Rule 42(2) of SEZ Rules 2006	SEZ Units are permitted to export finished goods directly from the sub-contractor's premises provided it is a direct export and identity of the goods exported is established with the goods sent on sub-contract.
8	Non-recovery of duty on goods removed for re-warehousing (Inter-Unit transfer), but not re-warehoused	West Bengal	69 Consignments	65.38	Rule 46 (12) and (13) of SEZ Rules	Transfer of goods from one SEZ Unit to other SEZ/EOU/EHTP is allowed provided the Unit submits re-warehousing certificate within forty-five days, failing which applicable duty is to be demanded from the receiving unit

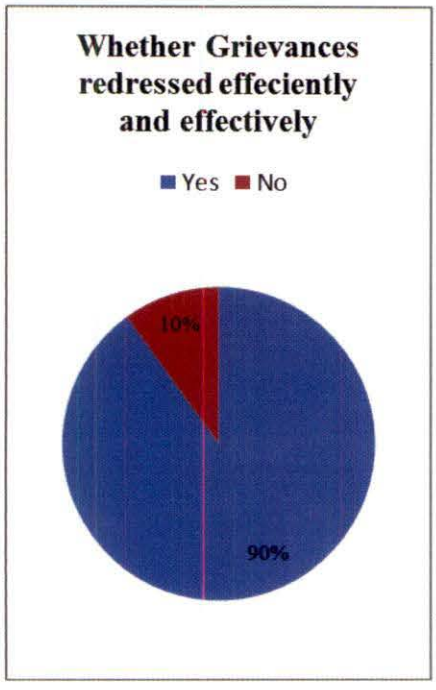
9	Non-levy of Antidumping Duty	West Bengal	1 Unit	5.37	Customs Notification No.05/2009	Anti-Dumping Duty on mulberry raw silk (not thrown) 2A grade and below when imported from the People's Republic of China
10	Incorrect determination of assessable value	West Bengal and Tamil nadu	5241 consignments and 1 Unit	115.09	Rule 47(4) of SEZ rules r.w. Rule 10(2) of customs valuation Rules 2007	Non adoption of 1% landing charges in arriving at assessable value for calculation of Duty liability for clearances made to DTA and non inclusion of pattern cost collected in the AV
11	Export of goods not covered in LOP	Rajasthan	4 Units	17.36	Rule 34 r.w 19(2) of SEZ Rules	Units manufactured goods which were not covered in the LOP
12	Refund of Cenvat Credit for supplies made to SEZs	Gujarat	3 units	39.64	Rule 5 of Cenvat Credit Rules 2004	Supplies made to SEZs are not exports out of India and hence refund of Cenvat credit is not allowed.
13	Short Payment of Duty on Debonding	Gujarat, Rajasthan, West Bengal and Tamilnadu	11	319.01	Rule 74 of SEZ Rules	Short/non Payment of Duties on de-bonding
14	Short Payment of Entry Tax and VAT on de-bonding	Gujarat, Madhya Pradesh and Tamilnadu	6 units	451.46	Rule 74 (1)	Entry Tax and VAT short paid
15	Non maintenance of Separate set of accounts for SEZ Units	Tamilnadu	3 units	0	Rule 19(7) of SEZ Rules	Combined annual accounts produced to audits
16	Irregular payment of DEPB and Duty Drawback on supplies made to SEZs	Tamilnadu	1 Developer	458.62	Section 2 (18) of the Customs Act, 1962 read with. Drawback rules	DEPB and Duty Drawback on supplies made to SEZs
17	Improper maintenance of files	MOC&I (Director SEZ - DOC)	-	0	Deficiencies noticed in maintenance of files Important documents i.e., State Government Recommendations, Environmental Clearance etc., were not available in the files Documents found in torn condition Noting portion not been placed in the files Files not page number	

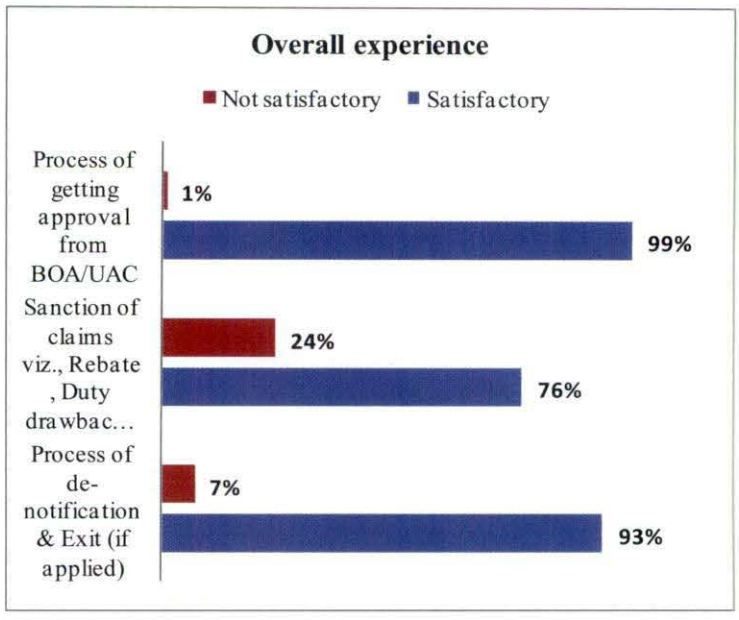
Appendix 6

Responses by Developers/Units and DCs are presented below;

A. Developers/Units

1. Overall experience





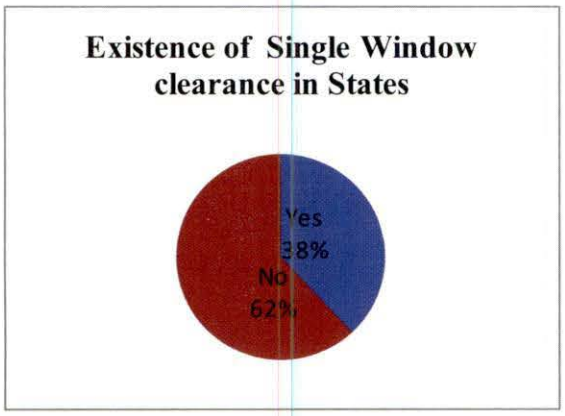
Timelines between 15 days to 6 months were prescribed to authorities, viz., Development Commissioner, State Government and Government of India for processing at various stages. However, no such time limit has been prescribed for BoA to grant the approvals. Nevertheless, majority of the stakeholders expressed satisfaction in obtaining approvals from BoA/UAC, sanction of claims/concession, and process of de-notification and exit from SEZ, including grievances redressal.

Audit observed that the redressal mechanism for grievances is not efficient. A fixed time period may be prescribed for getting approval from BoA, submission of documents and setting up of single window clearance mechanism in each State.

2. Single window clearance mechanism

SEZ Act provides for creation of Single window clearance mechanism. However, sixty two per cent of Developers/Units stated that there was no single window clearance facility.

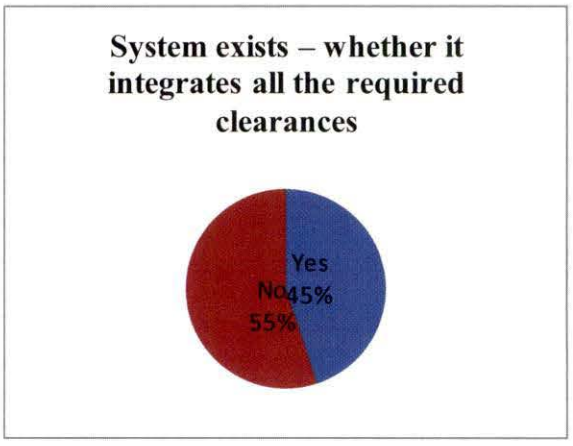
Only 11 states have framed their respective SEZ Act/Policy (Gujarat, Haryana, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, Punjab, Tamil Nadu, Uttar Pradesh and West Bengal). Rest of the 17 states could not enact SEZ Act which led to lack of coordination across departments at the Central and State Government level resulting in delay in according necessary approvals (Paragraph 3.2).



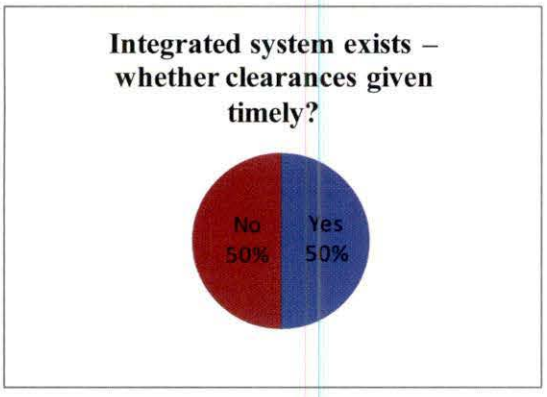
Though 38 per cent have expressed the existence of single window mechanism, majority (55 per cent) have stated about non integration of required clearances.

Equal per cent of Developers/Units have expressed about delivery of timely clearances through single window mechanism.

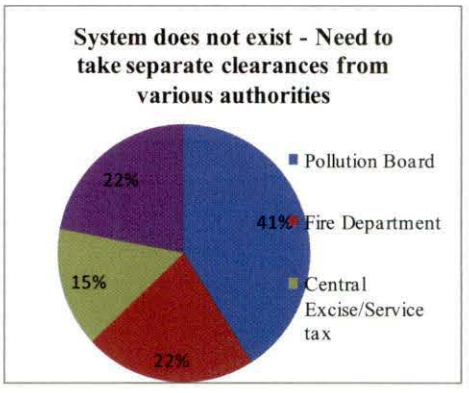
Non-existence of single window clearance facility entailed 62 per cent of Developers/Units to seek various clearances, for developing and setting up of SEZ/Units, from authorities' viz., Pollution Control Board, Fire Department, Central Excise/Service Tax and others.



This defeated the purpose of providing the intended facilities of various clearances in a single counter, and proved to be a major bottleneck in development of SEZ and establishment of Units. To conclude, the reason for ineffective single window mechanism is either its absence or has not worked as per its intended objectives.

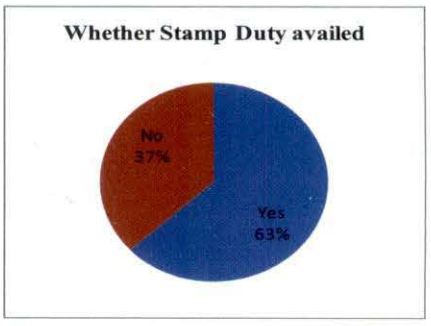


DoC may intimate the average time taken by the respective authorities to give clearances /sanction for electricity, water supply, effluent disposal, environment clearances, land related matters, licence, NOC from local authorities, police station, poison licence, licence related to prohibition and excise etc

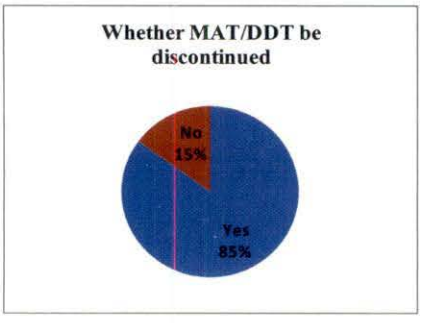


3. Stamp Duty, MAT and DDT

The Indian Stamp Act, 1899 as amended through Section 57 of the SEZ Act 2005 stipulates that no duty shall be chargeable in respect of any instrument executed by or on behalf of or in favour of the Developer or Unit or in connection with the carrying out of purposes of the Special Economic Zone



Around 63 per cent of Developers/Units availed Stamp duty exemption.



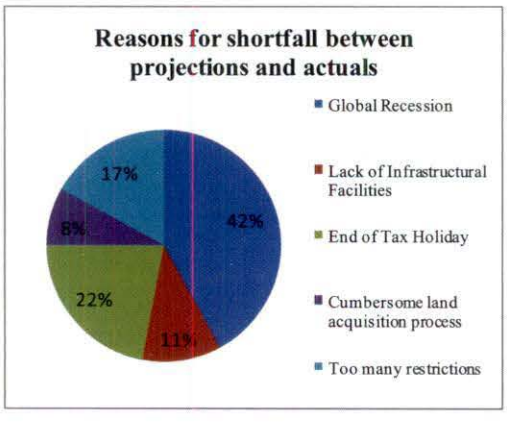
However, on de-notification the stamp duty exemption availed while registering the lease deed need to be recovered. We observed in 8 cases Andhra Pradesh, Gujarat, Odisha and Uttar Pradesh that on de-notification the stamp duty exemption of ₹ 8.56 crore was not recovered.

Eighty five per cent of Developers/Units opined for discontinuance of MAT/DDT. It is pertinent to refer here that 85 per cent of the respondents felt that introduction of MAT/DDT was one of the main reasons for de-notification and exit from the SEZ which is followed by global recession (42 per cent).

Audit observed that SEZ units felt that operating in DTA has become more beneficial as compared to operating in SEZs after withdrawal of exemption for MAT and DDT for the SEZs. Signing of more Free Trade Agreements by India enabled Indian exporters outside the SEZs to import duty free inputs which acted as a disincentive for exporters operating within SEZs. Export benefits to the SEZ units have considerably reduced vis-a-vis DTA units.

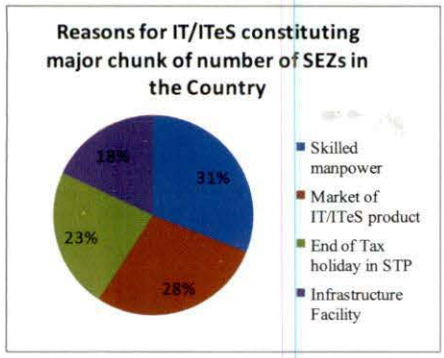
4. Why there are shortfalls?

Global recession and End of tax holiday were attributed to be the main causes for shortfall between projections and actual. This was followed by the reasons like too many restrictions, lack of infrastructural facilities and cumbersome land acquisition processes were negated the projections.



5. Why IT/ITES rules the roost?

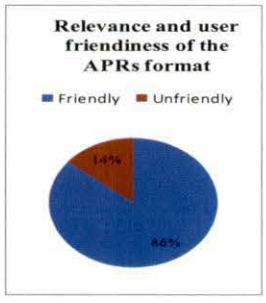
Availability of skilled manpower, better market for IT/ITES products/services, end of tax holiday in STPI to avail incentives provided in SEZ were attributed to be the reasons for establishment of too many IT/ITES units in SEZ.

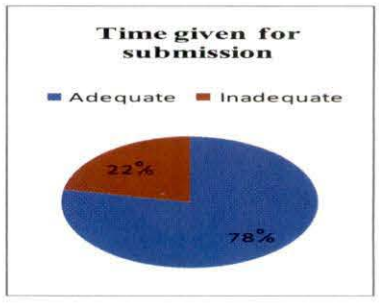


Some respondents also attributed the reasons to availability of infrastructural facilities and lesser requirement of area.

6. Adequacy of monitoring and control - APRs

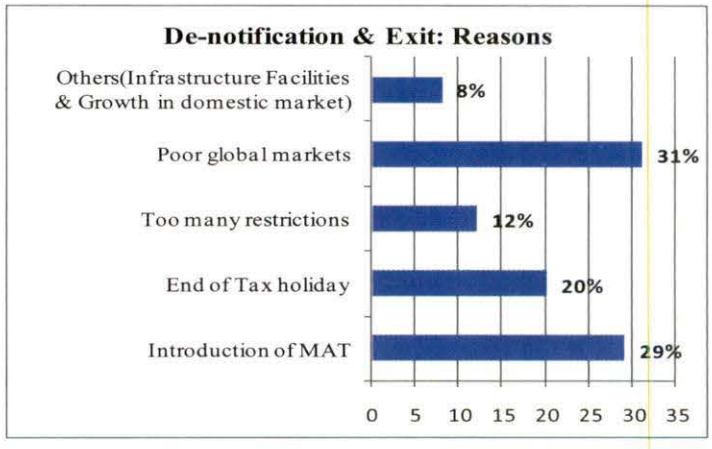
Performance of Units / Developers is monitored annually through Annual Performance Reports (APRs) in case of Units and Half-yearly/Quarterly returns in case of Developers. Majority of the respondents opined that the two key aspects of monitoring and control – Relevance and user friendliness and time given for submission were adequate. However, the reported findings at paragraphs 6.1.1 and 6.1.2 illustrates that the APRs do not provide for capturing all vital information such as uncertified APR's, non/short reporting of DTA sales in APRs, No action initiated against Units with negative NFE and there were serious delays (1–72 months) in their submission.





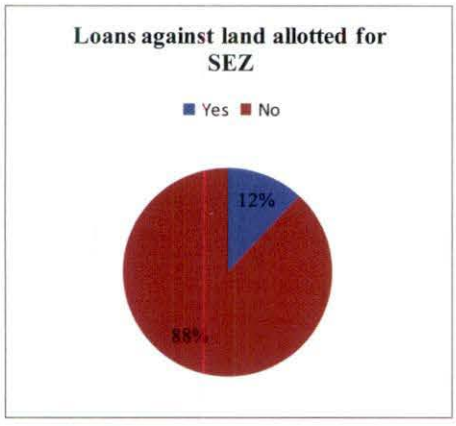
7. Why do they want to exit?

A developer, who is not interested in continuing with scheme, has an option to exit by de-notifying with an undertaking to pay back the concessions availed.



As already reported at paragraph 4.9 out of 230 notified SEZs in Andhra Pradesh, Gujarat, Karnataka, Maharashtra, Odisha and West Bengal 52 zones were de-notified mainly because infrastructure facilities and growth in domestic market, poor global market, excessive restrictions, end of tax holiday and introduction of MAT.

8. Raising loans against SEZs land

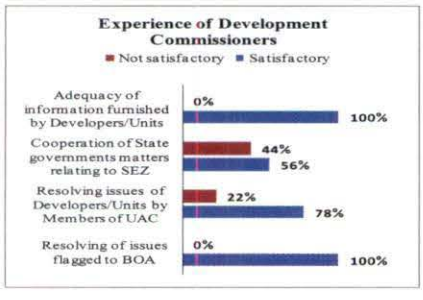


Rule 11(9) read with Rule 11(6) of SEZ Rules, 2006, a developer shall not sell the land in a Special Economic Zone, and shall assign lease hold rights to the entrepreneur holding valid letter of approval.

Twelve per cent of Developers accepted that loans were raised mortgaging the notified SEZ lands. Though the magnitude is limited, as pointed at paragraph 4.10 in absence of a system to monitor this aspect, this is fraught with the risk of capital raised not being ploughed back into SEZ and the land meant for SEZs may remain idle without any economic activity. This holds good for government transferred lands.

B. Development Commissioners

9. Overall experience



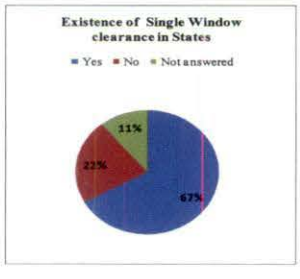
The experience of Development Commissioners in respect of issues flagged to BoA, addressing of issues relating to Developers/Units by members of UAC and adequacy of information furnished by Developers/Units in the returns (APRs/QPRs) for an effective performance of Units are satisfactory.

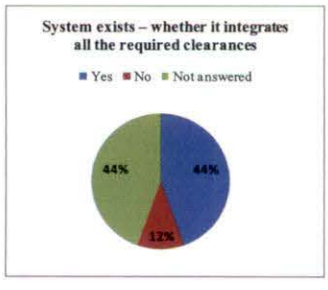
However, with regard to co-operation of State Governments in matters relating to SEZ was trifle low.

10. Single window clearance

Sixty seven per cent of DCs accepted the existence of single window clearance at State level. However, 22 per cent expressed non-existence of single window clearance mechanism. Eleven per cent did not answer.

It is pertinent to mention that in response to this question, 62 percent of the developers/units replied in negative. Forty four per cent of DCs accepted that the single window clearance mechanism integrates all the required clearance from various authorities to Developers/Units. However, 12 per cent disagreed. Forty four per cent did not answer.



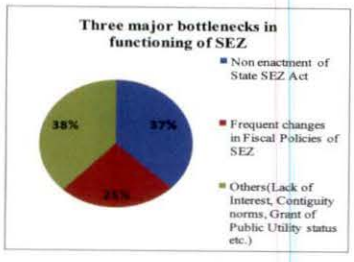


11. Concessions/exemptions

Fifty six per cent of the DCs opined that the concessions/exemptions granted to SEZs are sufficient, which is a shade above the disagreement expressed by 12 per cent.

12. Bottlenecks in functioning of SEZ

Thirty seven per cent of DCs stated there were no state level SEZ Acts and in 25 per cent frequent changes in fiscal policies of SEZ were attributed to be the major bottle necks in functioning of SEZ apart from other reasons viz., lack of interest, contiguity norms, non-recognition of SEZ as public utility etc.



Glossary

Glossary

APR	Annual Performance Report
AY	Assessment Year
BCD	Basic Customs Duty
BIFR	Board of Industrial and Financial Reconstruction
BLUT	Bond-cum-Legal Undertaking
BOA	Board of Approval
BRC	Bank Realisation Certificate
CA	Chartered Accountant
CBDT	Central Board of Direct Taxes
CBEC	Central Board of Excise and Customs
CESTAT	Customs Excise and Service Tax Appellate Tribunal
CIF	Cost, Insurance and Freight
CII	Confederation of Indian Industry
CIT	Commissioner of Income Tax
CRZ	Coastal Region Zone
CSEZ	Cochin Special Economic Zone
CST	Central Sales Tax
CVD	Countervailing Duty
DC	Development Commissioner
DDT	Dividend Distribution Tax
DG	Directorate General
DGEP	Director General of Export Promotion
DGFT	Director General of Foreign Trade
DoC	Department of Commerce
DOR	Department of Revenue
DT	Direct Taxes
DTA	Domestic Tariff Area
EAC	Expert Appraisal Committee
EC	Executive Committee
EEFC	Exchange Earner's Foreign Currency
EGoM	Empowered Group of Ministers
EHTP	Electronic Hardware Technology Park
EIA	Environment Impact Assessment
EOU	Export Oriented Unit
EPCG	Export Promotion Capital Goods
EPZ	Export Process Zone
FE	Foreign Exchange
FEMA	Foreign Exchange Management Act
FICCI	Federation of India Chamber of Commerce and Industry
FIEO	Federation of Indian Export Organisation
FMS	Focus Market Scheme
FOB/CI/CF	Free on Board/Costal Insurance/Costal Freight
FPS	Focus Product Scheme
FSEZ	Falta Special Economic Zone
FTDR	Foreign Trade Development & Regulation Act
FTP	Foreign Trade Policy
FTWZ	Free Trade and Warehousing Zone
FY	Financial Year
GDP	Gross Domestic Product

GOI	Government of India
HBP	Hand Book of Procedure
HPR/APR	Half Yearly Progress Report/Annual Progress Report
HUDA	Haryana Urban Development Authority
ICC	International Chamber of Commerce
ICEGATE	Indian Customs Electronic Commerce Gateway
ICES	Indian Customs Electronic Data Interchange System
ICTT	International Container Transhipment Terminal
ISO	International Organization for Standardization
IT	Income Tax
IT/ITES	Information Technology/Information technology enabled services
ITSS	Information Technology Software Services
KSEZ	Kandla Special Economic Zone
LOA	Letter of Approval
LOP	Letter of Permission
LARR Act	Land Acquisition & Rehabilitation & Resettlement Act
MAT	Minimum Alternate Tax
MEPSEZ	Madras Export Processing Special Economic Zone
MIS	Management Information System
MOC&I	Ministry of Commerce and Industry
MoEF	Ministry of Environment and Forest
MOF	Ministry of Finance
MOU	Memorandum of Undertaking
NCR	Non Capital Region
NCRPB	National Capital Region Planning Board
NFE	Ne Foreign Exchange
NFEE	Net Foreign Exchange Earnings
NSDL	National Securities Depository Limited
PAC	Public Accounts Committee
PAF	Project Affected Families
PDF	Project Displaced Families
PHDCCI	PHD Chamber of Commerce and Industry
PIL	Public Interest Litigation
QIZs	Qualifying Industrial Zones
QPR	Quarterly Performance Report
R&R	Rehabilitation and Resettlement
RBI	Reserve Bank of India
SARFAESI Act	Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act
SCN	Show Cause Notice
SEEPZ	Santacruz Electronic Export Processing Zone
SEZ	Special Economic Zones
SIEAA	Stat Level Environment Impact Assessment Authority
SLA	Service Level Agreements
SLP	Special Leave Petition
ST	Service Tax
STP	Software Technology Park
STPI	Software Technology Park of India
TCPD	Town and Country Planning Department
UAC	Unit Approval Committee
VSEZ	Vishakhapatnam Special Economic Zone