SEZ Hotline

June 01, 2006

WHERE DO YOU WANT TO GO - STP OR SEZ?

The recently constituted empowered group of ministers ("**eGoM**") has suggested to the Finance Ministry that the existing tax exemption available to a unit set up in a Software Technology Park ("**STP**") should be extended beyond 2009, when it is scheduled to expire, to bring it on par with the tax benefits available to a unit set up in a Special Economic Zone ("**SEZ**"). This suggestion was made to eGOM by the Prime Ministers Office ("**PMO**"), whose earlier suggestion of scraping the minimum land requirement for an Information Technology SEZ ("**IT SEZ**") has been accepted and is being implemented now.

Currently under section 10A of the Income Tax Act, 1961 ("**ITA**"), an STP unit can avail of a 10 year tax holiday on export profits, while under section 10AA of the ITA, an SEZ unit (including an IT unit set up in SEZ) can avail of a 15 year tax holiday on export profits, which is 100 per cent for the first five years, 50 per cent for the next five years, and up to 50 per cent for further five years, subject to creation of a SEZ Re-investment Reserve account. Further, section 10AA states that STP units, which have availed of a complete tax exemption under section 10A, cannot avail of any SEZ tax benefits. It is pertinent to note that the exemption available to an SEZ unit is open-ended and has no sunset clause as in the case of an STP unit.

Apart from the direct tax benefits, both STP and SEZ units enjoy similar indirect tax benefits such as exemption from excise, Value Added Tax ("**VAT**") and local state level taxes. However, an STP unit provides more locational flexibility as opposed to an SEZ unit, which needs to be located in an identified area designated as SEZ. The call for the extension of the tax exemptions for an STP unit comes in the wake of the fear that STP units may migrate to an SEZ, post 2009, when the exemption available to STP units is scheduled to expire. However, there is ambiguity on whether STP units will be allowed to migrate to an SEZ, and the same has to be clarified foremost in order to assess the benefits of the current proposal.

It seems that the proposed extension of tax benefits would be available only to "new" STP units and thus such a move would provide IT companies an opportunity of two different avenues with similar tax benefits to set up IT units. Thus, the PMO's suggestion, if implemented by the Finance Ministry, would open up more opportunities for the IT companies to set up their operations.

However, certain ambiguities remain in this proposal. The status of granting the SEZ tax holiday to the existing STP units, which by 2009 would not have availed of the full 10 year tax exemption, is not clear. Also, their status *vis-à-vis* the proposed extension of SEZ tax benefits to STP units, which seem to be made available only to "new" units, remains uncertain.

It remains to be seen whether the Finance Ministry accepts the proposal of eGOM of extending such SEZ benefits to STP units.

- Nishchal Joshipura & Nithya Reddy

Source:
- *The Economic Times (dated May 30, 2006)*
- *The Hindu Business Line (dated May 29, 2006)*

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