Service tax exemption to save R1,500 crore for SEZs annually

The finance ministry's recent decision to give upfront service tax exemption for all SEZ developers and units would mean additional savings of R1,500 crore for these units annually, as they no longer have to wait for refunds.

The service tax incidence (the tax paid on input services) for SEZ developers and units is over R8,000 crore annually. Although the input service taxes are to be nullified in regard to these enclaves under the SEZ policy, the opaque refund system has practically led to some 20% of the claims getting indefinitely stuck with the authorities at any given time.

Although the gain would be of R1,500 crore only, the new move would improve liquidity of the SEZ developers and units even more substantially as they don't have to pay the tax in the first place and wait for refunds.

The problem of delayed/denied refunds has especially been in the case of IT SEZs. Large port SEZs, refineries and petrochemical manufacturing zones would be among the other beneficiaries, official sources said.

The revenue department on July 1 allowed upfront exemption of service tax, education cess and secondary and higher education cess to SEZ developers and units that have operations within such duty free enclaves as well as outside.

Prior to this, such units got refunds of only the tax they paid, subject to the ‘place of provision’ rules to ensure that tax-free services were availed only for export of goods and services and not for those sold in the domestic tariff area. Performance-based services such as repair of goods, storage and warehousing, cargo handling, technical testing and those related to property such as construction, maintenance and engineering services on which invoices cannot be faked, were the only areas enjoying upfront service tax exemption earlier. The new rules extend the benefit to those having operations inside and outside SEZs.

Fear of abuse

However, there is now a fear that the new rules might be subject to misuse. Field officers of the department suspect that without the place of provision rules to ensure services were consumed for exports, the SEZ unit may be used as a front for availing tax exemption for services actually used in operations outside SEZs.

“There may have been a genuine grievance of refunds getting delayed for some IT companies. But the upfront exemption is allowed across the board, which raises the possibility of abuse,” said a field officer, who asked not to be named. The tax administration now wants its investigating wings access to SEZ premises to check if invoices are genuine, something the commerce ministry had steadfastly denied for a long time to avoid what it believes is interference in export production. As per the Central Board of Excise and Customs (CBEC) notification, place of provision rules are no longer applicable to services to SEZ developers and units having operations outside the duty free zone.

Instead, the upfront tax exemption is available to all “authorized operations” of such units. Field officers of the department said even segregation of scrap is considered an authorised operation within SEZs to claim the tax benefit. CBEC also allowed Cenvat credit facility to all SEZ units and developers, which was so far restricted to manufacturing activities and input services. Officers suspect this could lead to false claim of credit using fake invoices.

“The exemption allowed across the board could open the floodgates of tax evasion by way of fake invoices in the absence of preventive checks,” said another official. Now, officials of the Directorate General of Central Excise Intelligence (DGCEI) cannot enter SEZ premises to verify invoices without permission from the Development Commissioner of an SEZ appointed by the commerce ministry.

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