

## Should software units migrate from STPI to SEZ?

**D. Murali**

### Low-cost competition is emerging, says tax expert

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Software companies are in a dilemma whether they should locate new units within an STPI or an SEZ. Thus opined Mr Kiran Karnik, President, Nasscom, recently, when asked if the Special Economic Zone (SEZ) scheme did not address some issues that the Indian IT industry faces.

"SEZs had the potential to lead us to such solutions but now, they are not being looked at in that way at all," he said, pointing out how the scheme created more problems than it solved.

Companies in the IT industry currently enjoy tax benefits within the Software Technology Parks of India scheme, which ends with 2009, explained Mr Karnik. And, SEZ promised the advantage of beneficial regime beyond that.

### I-T perspective

What are the advantages/disadvantages of STPI and SEZ from a tax angle?

"From an income-tax perspective, STPI units enjoy a 10-year complete tax exemption on export profits against a 15-year tax holiday for SEZ units (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 reserves)," says Mr Ajay Kumar, Executive Director, PricewaterhouseCoopers.

"For both, exemption is available only on profits earned through actual physical exports out of India and on-site services. Further, while the tax-holiday regime for STPI units is set to expire in 2009, the regime for SEZ units is open-ended." Additionally, SEZ units are also eligible for capital gains tax exemption on relocation from urban area to SEZ.

### Indirect taxes

How do STPI and SEZ units fare on the indirect-tax front? Both enjoy exemption from many indirect taxes in respect of procurements of capital goods and goods/services for operations, says Mr Kumar. "These include exemption from central excise, customs duty, CST (Central Sales Tax, as reimbursement to STPI units on inter-state purchases), service-tax (as refund/rebate of input tax to STPI units, subject to output services being exported out of India and covered under a taxable category)."

These apart, there can be benefits accorded under State legislations. SEZ units too get exemption from VAT (value-added tax) / LST (local sales tax), besides other State-level taxes and levies, he says.

Should companies think of shifting from SEZ to STPI and vice-versa? What are the pros and cons? "Unless locational flexibility becomes an important consideration, a shift from SEZ to STPI is highly unlikely for any business unit," says Mr Kumar. Why so? Because such a shift would not only result in loss of exemption from VAT, LST and other local levies, but also require unit-level customs bonding, and trigger a time-limit of six months for the unit to realise export proceeds (for availing tax holiday), he says.

### **Gains from shift**

In the absence of any 'business reconstruction' restrictions, if an STPI unit shifts into any SEZ, what are the consequences? "It may become entitled to an increased income-tax holiday, that is balance of 10 + 5 years, get exemption (as against reimbursement) from service-tax and CST, get entitled to exemption from VAT, LST and other local levies depending upon VAT legislation of the States.

Additionally, it can do netting-off of import and export payments, without prior Reserve Bank of India approval."

Should there be more sops to STPI units, as demanded by Nasscom? Mr Kumar said, "Considering the importance of IT/ITeS sectors for the continued growth of Indian economy, the STPI regime should extend the entire gamut of major direct and indirect tax benefits that the industry genuinely needs, and which are, in some way or the other, addressed in the SEZ scheme." However, he is of the view that any extension of income tax benefits should be done in an intelligent manner, based on incremental capacity creation. "Without similarity in tax regime, existing STPI units would shut shop only to re-invent themselves as SEZ units. Something that the SEZ scheme does not intend to promote."

### **Tax sops elsewhere**

"Almost all of India's main competitors offer comparable tax incentives for IT/ITeS sectors," says Mr Kumar. He reminds India has many advantages, such as "a vast pool of young English-speaking, technically-competent and cheap manpower, cost competitiveness (through low infrastructure costs and tax incentives) as well as capabilities to move up in the value chain".

Despite all these, going forward, India faces threats on account of rising costs, due to increasing infrastructure and manpower costs and diminishing tax incentives, cautions Mr Kumar.

"Don't forget that low-cost competitors are emerging," he adds, rather ominously.

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