CONTENTS

Foreign Trade Policy - Focus on exports

Foreign Trade Policy
- Focus on exports

☞ INTRODUCTION

The trade policy of India has undergone a structural change in the liberalization era which began in 1991. The inward-looking, protectionist stance towards the economy (resulting in a dismal share of trade in the world economy) has been replaced by a regulatory openness which is bullish on business. The Government has adopted a multi-pronged approach to increase India's foreign trade. As a part of this initiative, the Government announced the Foreign Trade Policy, 2004-2009 ("**FTP**")[1], which replaced the existing Export-Import trade policy. The objectives of the FTP are, principally, to increase India's outward trade i.e. exports and to generate large scale employment. In the three years of its working, Indian exports have doubled and India's share of world trade has grown from 0.76% in 2004-05 to 1% in 2006-07.[2]

To facilitate large scale exports and attract capital to the sector, multifarious incentives are provided to export-enclaves termed as Export Oriented Unit ("**EOU**"), Electronic Hardware Technology Park ("**EHTP**"), Software Technology Park ("**STP**") and Bio Technology Park ("**BTP**") by framing the EOU/EHTP/STP/BTP Schemes (also collectively referred to as "**Schemes**", for the sake of convenience).[3] This newsletter seeks to give an overview of the policy pertaining to these specialized export-oriented entities.

[1] Under Section 5 of the Foreign Trade (Development & Regulation) Act, 1992. The FTP is updated annually with an amendment termed as the Annual Supplement. The Annual Supplement 2007-2008 focuses on boosting exports in the agriculture and high technology sectors.

[2] Highlights of the Annual Supplement 2007-2008 dated April 19, 2007.

[3] These Schemes are covered by Chapter 6 of the FTP.

1. Features of export entities

The units under these Schemes are required to realize Net Foreign Exchange ("**NFE**")[4] earnings by exporting 100% of their merchandise goods and services.[5] They are provided tariff, non-tariff and policy support to make them internationally competitive. 100% Foreign Direct Investment (**"FDI"**) under the automatic route is allowed in the EOU/EHTP/STP/BTPs.[6]

The benefits offered to these units are similar to those offered to Special Economic Zones ("**SEZs**").[7] However, the units under the Schemes score an edge over the SEZs because they offer more flexibility in terms of geographical location, and have low threshold requirements of land and investment. A unit can have an investment of below INR 10 million (approx. US $ 243,902)[8] and have no specified minimum size in terms of area. Even within an existing unit under these Schemes, a separate unit can be established thus making a considerable saving in overall costs.[9]

[4] NFE earnings are calculated cumulatively in blocks of five years, starting from commencement of production.

[5] Units can sell 50% (10 % in the case of gems & jewellery EOUs) of Free-on-Board value of their goods to the Domestic Tariff Area (*defined below in para 4*), subject to payment of concessional duty.

[6] Clause 6.12(g)

[7] SEZs were previously covered under the FTP itself but now are governed by the Special Economic Zones Act, 2005..

[8] 1 US $ = INR 41.

[9] Elcoteq, a Finnish mobile manufacturer has opened a unit under the EHTP Scheme. It has rented space in the pre-existing telecom industry park, an EHTP, near Bangalore, to operate its facility.

The EOU Scheme, introduced in 1981, has been updated under the FTP and continues to be at the helm of the country's export promotion Schemes. The industries covered by this Scheme are very diverse and range from horticulture, textile and leather to gems & jewellery.

The EOUs are under the administrative control of the Development Commissioner ("**DC**"), appointed by the Ministry of Commerce.[10]

The EHTP Scheme is devised for encouraging exports of electronic hardware items including hard disk drives, computers, television, etc. The Ministry of Communications & Information Technology ("**MCIT**") administers these Parks.

The STP Scheme focuses on the development and export of computer software and IT- enabled services. BPOs can also avail the benefits under this Scheme. Software Technology Parks are also administered by the MCIT.

The BTP Scheme has its focus on R&D in the biotech field, bio-informatics and pharmaceuticals and is administered by the Department of Bio-Technology, Ministry of Science & Technology.

2. Formation Procedure

2.1 EOU

In order to establish an EOU unit, an applicant must submit the application to the concerned DC. For a unit involved in manufacturing (without the requirement of an industrial license), the approval time-frame is 15 days. The criteria for approval include consideration of diverse factors such as residence proof, income-tax returns, experience, and marketing tie-ups of the applicant.

2.2 STP/EHTP

An application must be submitted to the Designated Officer ("**DO**") appointed in that behalf. It is essential that the application is approved by the Department of Information Technology, MCIT or by the Director (Software Technology Parks of India).

2.3 BTP

Application for setting up a BTP needs to be submitted to the Department of Bio-Technology and upon approval, is recommended to the Directorate General of Foreign Trade for notification.

Once the relevant regulatory authority approves the application, a Letter of Permission /Letter of Intent is issued by the concerned DC/DO.[11] An approved unit is required to execute a legal undertaking with the DC/DO concerned.

Existing EOUs can be converted to EHTP/STP/BTPs and vice-versa. Units in Domestic Tariff Area ("**DTA**") can also be converted into EOU/EHTP/STP/BTP units. Single window clearance for approvals is offered to all prospective units applying under these Schemes.

3. Benefits offered

The FTP has tried to facilitate the export & import trade by offering multifarious sops to the industry in order to attract FDI, make exports more competitive and reduce the tax component from the eventual price of the products and services. Some of the tax benefits offered to the units are enumerated below

- No customs duty on all types of capital goods, raw material, consumables meant for production.
- Reimbursement of Central Sales Tax ("**CST**") on goods manufactured in India.[12]
- Exemption on payment of Central Excise Duty on goods procured from the DTA on goods manufactured in India.
- Reimbursement of CENVAT Credit on service tax paid.[13]

---

[10] In all there are seven Development Commissioners, based at Mumbai, Ghandhidham, Chennai, Cochin, Vizag, NOIDA and Calcutta.

[11] The Letter of Permission/Letter of Intent is construed as an authorization for all purposes, as per Clause 6.3.7 of Handbook of Procedure V.1 to the FTP.

[12] Clause 6.11(c)(i) stipulates that interest on delay in refund of the CST would be paid, as notified.

[13] CENVAT stands for Central Value Added Tax covered by Cenvat Credit Rules, 2004. Under this provision a manufacturer

- Reimbursement of duty paid on fuels procured from domestic oil companies.

- Income-tax exemption, till 31st March, 2010, under Sections 10A & 10B of the Income Tax Act, 1961, respectively applicable to EHTP/STPs and EOU/BTPs.[14]

Service tax exemption/remission on services rendered in India is permitted. The Annual Supplement 2007-08 has proposed service tax exemption for services rendered abroad and charged on exports from India.[15] India has a leadership position in offering services to the world. The present initiative, by effectively reducing the cost component of services, would make India even more competitive in the sector.

Some of the non-tax benefits offered under these Schemes include the retention of 100% of the export earnings in Exchange Earners Foreign Currency account; exemption from furnishing a bank guarantee at the time of import or for job work in DTA; repatriation of 100% of benefits and manufacturing of small scale industry items.[16] Sub-contracting of work to other units is permitted as is re-exports, inter-unit transfer and temporary removal of goods for display purposes.

In addition, different states in India have concessional policies in providing land and infrastructure facilities to prospective units under these Schemes. In some states exemption on stamp duty and registration charges for the acquisition of land for the project is offered as an incentive at the time of grant of approval to the units.[17]

4. Interface with the DTA

The FTP defines DTA as the area within India that is outside SEZs and EOU/EHTP/STP/BTPs.[18] These units are deemed as foreign territory for the purpose of trade. The units operating under the Schemes are free to import from the DTA all types of goods without paying any duty as also to sell their merchandise goods to the DTA, subject to payment of concessional duty. The supplies from the DTA to the units are treated as 'deemed exports' in which the payment is received either in Indian Rupees or in foreign currency.[19] In specified cases, even the supply of goods by the units to the DTA can be counted for the purpose of calculating NFE. For instance, when the supply has been against foreign exchange remittances from overseas, supplies to other units, etc.[20]

5. Criticism

The FTP is predominantly oriented in favour of boosting exports in the white-collared services sector.[21] There has been little focus to develop the exports of labour intensive low-scale manufactured goods. India has a huge resource of cheap labour which can be utilized, as in China, to develop the outbound trade of manufactured goods. To realize the potential in manufacturing, the issue of infrastructure up-gradation demands urgent attention as lack of reliable and adequate power; outdated ports, airports and roads act as a detriment to prospective investment in the export manufacturing sector. The custom clearances, which are meant to be expeditious, face delays in practice. Labour laws too require overhaul in the face of market reality and must have flexibility in terms of retrenchment policies. All these factors have kept investment at bay in the manufacturing units.

The FTP is silent on the extension of income-tax holiday given to the units till 2010, which has created unnecessary uncertainty for the investors. Reimbursement of local tax paid by the units for goods procured from the DTA should be provided as an added incentive.

or producer of final product or a provider of taxable service is allowed credit on duty paid on input goods and input services.

[14] On-site development of software by a unit in STP would be eligible for tax exemption under Section 80HHE of the Income Tax Act, 1961.

[15] The proposal is yet to be notified by the Ministry of Finance.

[16] Small scale industry means undertakings where the investment in fixed assets - in plant and machinery does not exceed Rs 10 million.

[17] For example Tamil Nadu & Jharkhand offer 50% exemption on such charges to IT units under the STP Scheme.

[18] Clause 9.2.1

[19] Clause 8.1

[20] Clause 6.9

[21] Clause 3.6.4 envisages the Served from India Scheme, to accelerate the growth of export of services.

☞ CONCLUSION

Despite the slow implementation, the trade regime has an openness which is investor friendly. All the economic indicators point to a robust long-term growth in the export sector. However, FDI inflow has been largely limited to units engaged in the export of services, particularly software services. To ensure large-scale, inclusive development in India, it is imperative that the Government focuses on developing the manufacturing base as well.

(Manish Bhardwaj)

Contact Lawyers

Priti Suri
p.suri@psalegal.com
Mobile +(91) 98100-92842

Manish Bhardwaj
m.bhardwaj@psalegal.com
Mobile +(91) 98999-00737

Contact Details

PSA
Legal Counsellors
E-601, Gauri Sadan
5, Hailey Road
New Delhi - 110 001
India

Tel: +(91 11) 4350-0500
Fax: + (91 11) 4350-0502