# SEMICONDUCTOR POLICY

## Introduction

On March 21, 2007 government notified[1] the Special Incentive Package Scheme (**"the Scheme"**) and the Guidelines for the operation of the Scheme (**"the Guidelines"**) were notified on September 14, 2007[2] for the fab units and the eco-system units.

Fab unit means a semiconductor wafer fabrication[3] facility. It is engaged in the manufacture of semiconductor grade silicon wafers, chip design, assemble test mark and package.[4] Eco-system[5] unit mean units other than fab units which manufacture semiconductors, displays (including liquid crystal displays, organic light emitting diodes and plasma display panels), storage devices, solar cells, photvoltaics, and other micro and nano technology products. The incentives are also directed towards assembly and test of all the above stated products. The fab unit as well as the eco-system unit may have downstream and upstream investments in the vertical chain.

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[1] Notification number 3(1)/2007-IPWH (SIPS) dated March 21, 2007, issued by the Department of Information Technology, Ministry of Communications and Information Technology.

[2] Notification number 3(1)/2007-IPWH (SIPS) issued on September 14, 2007 by the Ministry of Communications and Information Technology.

[3] Website of Global Semiconductor Forum (http://www.semiconductor-technology.com/glossary/wafer-fabrication.html) defines Wafer Fabrication as a procedure composed of many repeated sequential processes to produce complete electrical or photonic circuits.

[4] Paragraph 2.1 of the Guidelines defines Fab Units.

[5] Paragraph 2.2 of the Guidelines defines Eco-systems.

The Scheme stipulates a cap on the number of fab and eco-system units which could be established in India. The maximum number of fab units can be 2 to 3 and the eco-system units can be 10.[6] As the technology in this sphere changes rapidly therefore, only the proposals involving state-of-the-art technology are allowed.[7] Therefore, old units and those units which are using second hand equipments are barred from availing the incentives.

This article deals with the incentives granted to the investors who invests in such units. It describes the eligibility of the investor who can avail the incentives, the period during which the incentives could be availed, the quantum and the types of incentives (i.e. equity and capital subsidy) proposed by the Scheme.

## 1. Net Present Value (NPV)

The incentives would be provided to a unit once the investment is above the threshold limit[8] of NPV. The Scheme gives the description of the relevant variables and expected NPV for the unit to achieve to qualify for the incentives. Black's Law Dictionary defines NPV as the present value of net cash flow from a project, discounted by the cost of the capital. NPV is used to assess the potential of the investment. The Scheme has defined the threshold limit of investments to avail the benefits of investment. In case of fab units the investment has to be INR 25,000 million (US$[9] 581 million) or above. In case of the eco-systems units the investments have to be INR 10,000 million (US$ 232 million)[10] or above. This threshold value is taken as the NPV of the investments made during the first 10 years of the project life. The discount rate has been fixed at 9%. This rate is used to determine the present value of a future investment. The base year for calculation of the threshold limit is the financial year[11] in which application is made.

## 2. Capital expenditure and duration of the Project

The incentives available to a unit are on the capital expenditure incurred by it. Capital expenditure has been defined as the total of capital expenditure of land, building, plant and machinery and technology including the R&D. However, if the cost of land exceeds 2% of the capital expenditure it shall not be considered for calculation.[12] Once the value of capital expenditure is determined the incentives are granted as a specified percentage of the capital expenditure.

[6] Paragraph 6 of the Scheme. The cap on the number of fab units would be either 2 or 3 and has not been clarified in the Scheme.
[7] Paragraph 2.3 of the Guidelines.
[8] Paragraph 2.7 of the Guidelines define the threshold limit of NPV as the minimum amount of investment calculated in NPV terms for eligibility of benefits under the Scheme.
[9] 1 US$= 43 INR.
[10] Paragraph 2.7(b) of the Guidelines.
[11] Paragraph 2.7(c) of the Guidelines define financial year as the year beginning on April 1 and ending on March 31 of the succeeding year.
[12] Paragraph 3.3 of the Scheme.

The incentives would be granted till a period of 10 years from the starting date of the project. The period of the project will exclude subsequent phases of the project.[13] Therefore, if a project is to be executed in multiple phases then the period would be calculated from the date when the project begins irrespective of the date when the next stage starts.

## 3. The Incentives

The Scheme provides two alternatives to the investors, which are either to establish their units in Special Economic Zone **("SEZ")** which are the SEZ units[14] or outside the SEZ i.e. the Non-SEZ units.[15] The incentives granted to a unit located in a SEZ can be about 20% of the capital expenditure; these incentives are over and above the incentives usually granted to any unit located in SEZs.[16] In case of units located outside the SEZ the incentive is 25% of the capital expenditure. The non-SEZ units would also get exemptions in countervailing duties.[17] The above incentives are to be provided by the central government only and incentives granted by the state government or any local body shall be over and above the incentives granted by the central government under the Scheme. The incentives granted to a unit could be in the form of capital subsidy or equity participation or combination of both.

The capital subsidy can be in the form of investment grant and interest subsidy. The incentives shall be provided on the annual basis depending on the value of the investments made in the year. The threshold limit of investment is the minimum amount of investment in terms of NPV for the benefits under the Scheme.[18] The incentives which can be interest-free loans, tax subsidies, and concessions can only be released in the year in which the NPV exceeds the threshold value.

## 4. Equity participation

The equity to be allotted to the government or any agency specified by the government should be at par value.[19] The equity participation of government in the project could be to a maximum of 26%. It is subject to the maximum cap of the investment Scheme i.e. it cannot breach the ceiling of the incentives fixed by the Scheme (20% capital expenditure in case of a SEZ unit and 25% in case of non-SEZ unit). The Scheme

[13] Paragraph 3.2 of the Scheme.
[14] Paragraph 2.7 of the Guidelines define SEZ Units.
[15] Paragraph 2.8 of the Guidelines define Non-SEZ Units.
[16] The incentives and concessions granted to a SEZ under the Special Economic Zones Act, 2005 includes tax concessions, concessions related to licenses like industrial license exempted if unit is engaged in the products reserved for small scale industries, import license etc.
[17] The notification states that the custom notification exempting countervailing duties for the non-SEZ units would be announced separately by the Ministry of Finance. As on October 11, 2007 the same has not been announced.
[18] Paragraph 2.7(a) of the Guidelines.
[19] Paragraph 3.4 of the Guidelines.

mandatorily stipulates that there should be an exit option for the government at a suitable point of time in the future after the project goes on stream. The Government's role is that facilitator of investments and it will exit the project once the project is on track and starts generating the revenue. This provision gives the investor the initial support and after the project is on track it ensures that there is no interference from the government

Financial closure of the project has been made a pre-requisite in case of availing the incentives in the form of equity. The financial closure of the project should be certified by a chartered accountant. The term financial closure has been defined as "A legally binding commitment of equity holders and debt financiers to provide or mobilize funding for the project. Such funding must account for a significant part of the project, which should not be less than 90% of the total project cost, securing the construction facility".[20]

The government would not contribute in the form of equity unless the promoters are able to arrange the required sum for the project. Furthermore, the amount of equity of the government should be in proportion to the amount of equity brought in by the promoters. Equity participation is to be held directly by the Central Government or through any agency specified by the Government. The investor is not allowed to dilute the stake of the government without its prior approval. The Scheme allows allotment of preferential shares or private placement to the Government or its agency.

The shareholder-cum-subscription agreement between the company and the promoter should have the affirmative rights for the Central Government or the investing agency. This is because the investor has to take the approval of the Central Government or the investing agency on certain issues. For instance in case of dilution of the equity shares of the Central Government or the investing agency prior approval is required; therefore, it is imperative that the shareholder-cum-subscription agreement should contain affirmative rights in respect of such situations.

## 5. Rules for applying

The application for applying for the Scheme should be made to the Appraisal Committee, Department of Information Technology, in 10 copies. The proposal should contain the data, surveys, projections (including financial flows for minimum of 10 years), business plan, phasing of expenditure and timelines for project implementation.[21]

The investor while applying for incentives other than equity contribution must ensure that the request is duly accompanied by the annual audit accounts adopted by the board of directors, a certificate from the auditors of the company in regard to the date wise

[20] The definition of Financial Closure is same as defined in the circular of Reserve Bank of India, (India's Central Bank) numbered C.17/01.02.00/2001-02 of Reserve Bank of India dated June 7, 2002.

[21] Paragraph 3.2 of the Guidelines stipulates the documents to be submitted with the application form. Same has been provided for in the application form appended to the Guidelines. The forms can be downloaded by the investor from the Ministry of Information Technology Website. ww.mit.gov.in/download/guidforsips.pdf

expenditure on the items eligible under the scheme.[22] The investment in land by the investor should be less than six months before the receipt of the application.

## Conclusion

The Scheme and Guidelines prescribe the incentives to fab and eco-system units which are capital intensive in nature and have to adapt to the rapidly changing technology. The policy provides incentives for units on capital expenditure which would provide the helping hands to the investors. The semiconductor industry in India is in a nascent phase and the incentives would give the investor the confidence to invest.

[22] Paragraph 3.7 of the Guidelines prescribes the details of application to be made when the proposal is for other incentives apart from equity option.