L&S UPDATE
An e-update to clients from Lakshmikumaran & Sridharan

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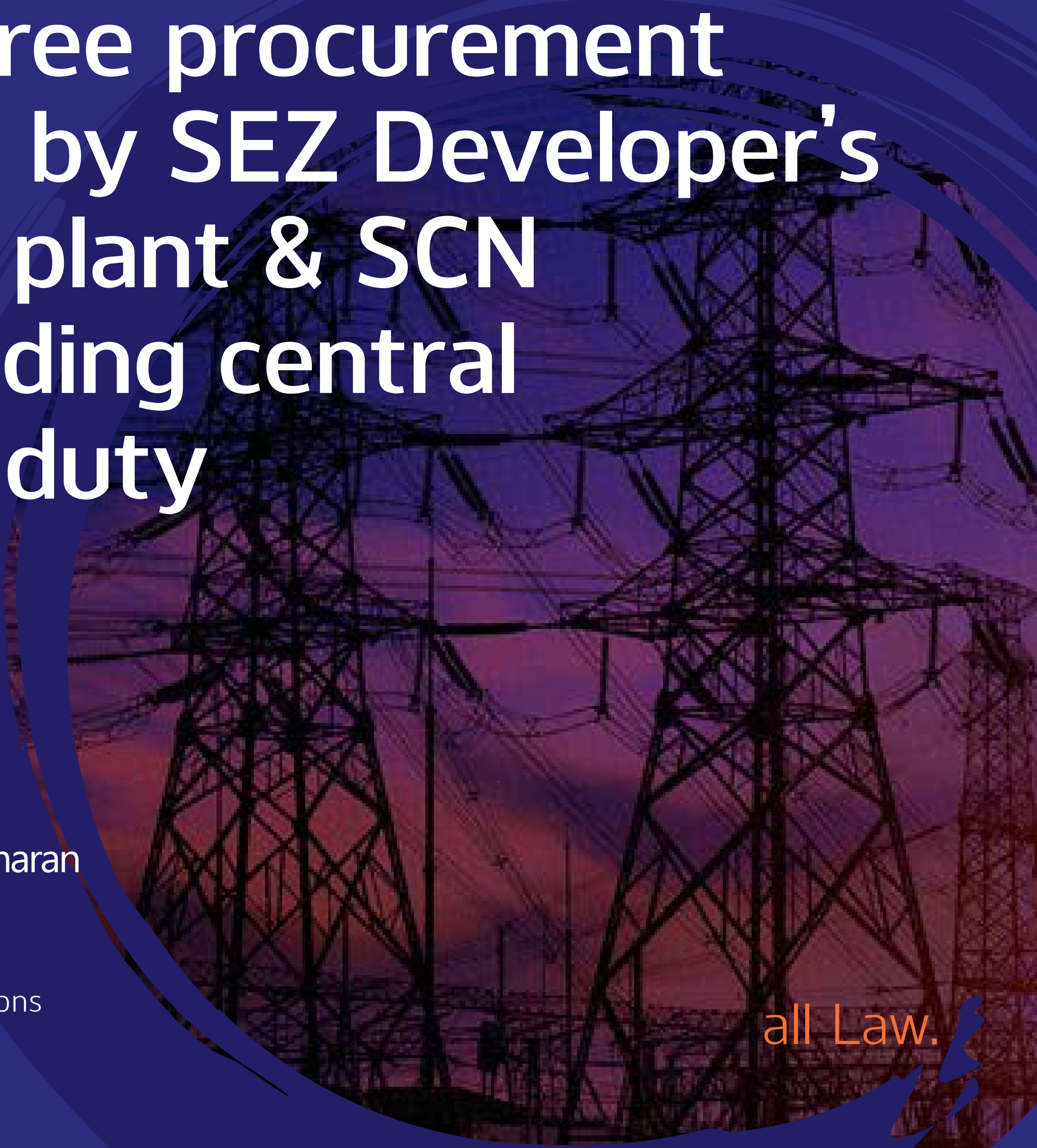
SPECIAL ECONOMIC ZONES

Madras HC quashes Guidelines denying duty-free procurement of fuel by SEZ Developer's power plant & SCN demanding central excise duty



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ISSUE

Can an IT / ITES Special Economic Zone (**"SEZ"**) Co-Developer procure inputs for operation and maintenance of a power plant during the period from April 6, 2015 till February 15, 2016?

FACTUAL BACKGROUND

- The Petitioner undertook generation of electricity from their power plant located in the processing area of an SEZ and supplied the same to the units within the zone.
- They procured High Speed Diesel Oil (**"HSD"**) from a manufacturer-refinery located in the Domestic Tariff Area without payment of central excise duty. Such benefit of duty-free procurement (**"fiscal benefit"**) was available only to power plants located in the 'processing area'. To regulate this benefit, periodical Power Guidelines were issued by the Ministry of Commerce and Industries in 2009 and 2012.
- The Power Guidelines dated April 6, 2015 were issued in supersession of the previous Guidelines wherein the 'processing area' in which the power plants were located were demarcated as a 'non-processing area'. Consequently, the Petitioner became ineligible to the fiscal benefit for operation and maintenance of the power plant.
- The Petitioner continued to procure HSD duty-free till October 2015. Thereafter, they started procuring the goods on payment of excise duty, under protest, till February 15, 2016. The fiscal benefits were restored thereafter, w.e.f. February 16, 2016, through the 2016 Power Guidelines.
- A Show Cause Notice (**"SCN"**) was issued by the Development Commissioner under the provisions of the *Special Economic Zones Act, 2005* (**"SEZ Act"**), proposing to recover the excise duty exemption availed by the Petitioner on such HSD.
- Writ Petitions were filed before the Madras High Court challenging the validity of the 2015 Power Guidelines on the ground that it takes away fiscal benefits conferred under Section 26 of the SEZ Act.
- The SCN issued by the Development Commissioner was also challenged as being without jurisdiction.

FINDINGS OF THE COURT ON VALIDITY OF 2015 POWER GUIDELINES

- As per Section 6 of the SEZ Act, the area where goods are 'manufactured' must necessarily be demarcated as a 'processing area'. The term 'manufacture', as defined under Section 2(r), is wide enough to include generation of power also. Thus, the area in which the power plant of the Petitioner is located is to be treated as a processing area of the SEZ. Consequently, the fiscal benefits available to power plants located in processing area will be available to the Petitioner also.
- The fiscal benefit was available to the Petitioners under the 2012 Power Guidelines. The fiscal benefit was restored under the 2016 Power Guidelines, which replaced the 2015 Power Guidelines w.e.f. February 16, 2016. This shows that it is the consistent policy of the Government to allow the fiscal benefits. Therefore, the 2015 Power Guidelines denying such benefit are not sustainable.
- Section 26(1)(c) of the SEZ Act entitles the Petitioner to procure goods from a Domestic Tariff Area (**"DTA"**) supplier for carrying out authorised operations subject to the limitations prescribed under Rule 30 of the SEZ Rules, 2006. A combined reading of the provisions shows that a DTA supplier is entitled to clear the goods without payment of duty/claim rebate of duty paid by it.
- Section 26(1)(c) enables an SEZ Developer/Unit to procure goods duty-free from a DTA manufacturer. However, excise duty is payable only by the manufacturer and not the buyer. There is no reverse charge mechanism under *Central Excise Act, 1944*. Thus, provisions of the SEZ Act should not be interpreted in direct contradiction to the provisions of the *Central Excise Act, 1944* by demanding excise duty from the SEZ Developer / unit.

FINDINGS OF THE COURT ON VALIDITY OF SCN

- The Development Commissioner cannot issue a notice for recovery of excise duty since he is not a 'Central Excise Officer' under the *Central Excise Act, 1944*. Therefore, the SCN issued by the Development Commissioner is without jurisdiction.
- The entire demand is also revenue-neutral, since the central excise duty paid by the DTA supplier would have been available as rebate.

RATIO DECIDENDI

- The 2015 Power Guidelines denying the benefit of duty-free procurement of HSD by an SEZ for use in authorised operation of power generation was quashed.
- The SCN issued by the Development Commissioner, proposing to demand central excise duty on HSD procured by the Petitioner is without jurisdiction and stands quashed.

IMPLICATIONS AND COMMENTS

- Relying on the 2015 Power Guidelines, SCNs have been issued in respect of goods procured by SEZ Developers, proposing to recover excise duty exemption benefit claimed by them under the SEZ Act. This decision has come as a relief to such assessees.
- This case can also be used to quash all SCNs issued by the Development Commissioners for recovery of the excise duty since they have been held to not have jurisdiction.
- Paragraph 1(iv) of the 2016 Power Guidelines restricts the exemption benefit to average monthly power supplied to SEZ Units by the Developer. This decision may be useful in cases where the above restriction is challenged.

[*DLF Utilities Ltd.* v. *Union of India* – W.P. Nos. 25837 and 25838 of 2016 and W.M.P. Nos. 22135 and 22136 of 2016, decided on May 19, 2020, Madras High Court]

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