CHAPTER –VIII
CHAPTER VIII

SUMMARY OF FINDINGS, SUGGESTIONS AND CONCLUSION

INTRODUCTION AND DESIGN OF THE STUDY

In India, the rates of tax continued to be high. Apart from this, tax laws are admittedly complicated. Therefore, it is only logical that taxpayers generally plan their affairs so as to attract the least incidence of tax. However, practices of avoidance are worldwide phenomenon and there is always a continuing battle in this regard between the taxpayer and tax collector. The perceptions of both are different. The taxpayer spares no efforts in maximizing his profits and attracting the least incidence. The tax collector, on the other hand, tries to maximize revenue within the framework of law.

Three common practices of reducing the tax burden are:

(a) *Tax evasion*, by deliberately suppressing the income or by inflating the expenditure and resorting to various types of deliberate manipulations.

(b) *Tax avoidance*, by adjusting the affairs in such a manner within the four corners of the taxation laws and by taking advantage of loopholes therein to attract the least incidence.

(c) *Tax planning* - Tax planning can neither be equated to tax evasion nor to tax avoidance. With reference to a company, it is the scientific planning of the company’s operations in such a way so as to attract
minimum liability to tax or postponement of the tax liability for subsequent period by availing of various incentives, deductions, allowances, rebates and relief provided for in the context of socio economic development. Tax planning may be legitimately provided within the framework of law; colourable devices cannot be part of tax planning.

Objectives of tax planning:

1. Reduction of tax liability
2. Minimization of litigation
3. Productive investment
4. Healthy growth of economy
5. Economic stability

Areas of tax planning:

(i) Location Aspects: There are many factors affecting the location of a business. Tax deduction for location may also be taken into account while deciding the location of the business.

(ii) Type of activity: The problem of choosing the right product mix or business would be the other important area where tax planning may be helpful. A company producing some products after purchasing the raw material from an outside agency, might plan to produce the raw
material inside its factory instead, or in other cases, a company might plan to produce the final product and may not just stop by producing the required raw material for producing the final product. The business may be trading or manufacturing business or a combination of both.

Tax Concessions:

A company running a manufacturing business or established in a backward area will be eligible for the tax concessions like deduction from taxable income, tax holiday benefit, and lower tax rates. A list of such incentives is:

I INCENTIVES FOR INVESTMENT RELATING TO BUSINESS OR PROFESSION:

1. Deduction of expenditure on scientific research
2. Amortization of cost of patent rights and copyrights
3. Expenditure on eligible projects or schemes
4. Allowance for rural development
5. Tea development account benefit
6. Amortization of preliminary expenses
7. Deduction for expenditure for prospecting, etc., for certain minerals
8. Carry-forward and set-off of accumulated business loss and carry forward of unabsorbed depreciation in certain cases of amalgamation.
II INCENTIVES FOR TAX HOLIDAY OR DEDUCTIONS FROM GROSS PROFITS

1. Deduction in respect of profits and gains from newly established industrial undertakings or hotel business in backward areas

2. Deduction in respect of profits and gains from newly established industrial undertakings

3. Deduction in respect of profits and gains from newly established small-scale industrial undertakings in certain areas

4. Deduction in respect of profits and gains from projects outside India

5. Deduction in respect of profits and gains from housing projects in certain cases

6. Deduction in respect of profits of export business

7. Deduction in respect of earnings in convertible foreign exchange

8. Deduction in respect of profits from export of computer software

9. Deduction in respect of profits and gains from business of collecting and processing of biodegradable waste

10. Deduction in respect of employment of new workmen.

STATEMENT OF THE PROBLEM:

India is a vast country having geographical, political and cultural diversities. The basic objective of giving concessions to backward areas for starting industries is to have an equitable growth of industries in all areas of the country. In the present study, the problem that is being examined is 'Whether the deductions
allowed under the Income-tax Act for establishing business enterprises in backward areas has a significant effect on increasing the growth of industries in backward areas'.

In India, the rate of tax has been high. Though the successive Governments have reduced the rate of tax, there is still demand from the business enterprises for securing various deductions under the Income-tax Act especially for the Industries. The fact is that the direct tax laws are more complicated and cumbersome. The most recent version of Income-tax Act consists of 298 Sections, 115 Rules and 14 Schedules. Over and above, the Government periodically issues several notifications and circulars all of which complicate the already existing complex system. The legal interpretations further contribute to the complexity. These are made still more complex by the plethora of case laws. This has lead to unending tussle between the taxpayer and tax collector. In the present thesis, an in-depth study of the deductions given to the business enterprises for establishing the industries in backward areas with a special reference to the state of Tamilnadu is made.
OBJECTIVES:

The present study has been set out with the following objectives:-

(i) To make an in-depth study of deductions available for business enterprises established in backward areas.

(ii) To test the hypothesis that the deductions given under the Income-tax Act has significant effect on increasing the growth of industries in backward areas.

(iii) To study the growth of industries with reference to the number of factories, number of employees, invested capital, fixed capital and the emoluments disbursed.

(iv) To analyze the growth of industries with a special reference to the state of Tamilnadu.

(v) To study the judicial decisions and the audit report of the Comptroller and Auditor General of India with reference to backward area deductions.

(vi) To offer concrete suggestions for improving industrialization of backward areas.
SCOPE OF THE STUDY:
The study is confined to the deductions available under the Income-tax Act for establishing the industrial undertakings in backward areas. The factors taken for the study of industrial growth are the number of factories, number of employees, invested capital, fixed capital and the emoluments disbursed.

The study has not been extended to town or village level or district level as the object of the study is only to find out whether achieving the equitable distribution of industries in all regions have been met by introducing backward area deductions. Hence, the study has been confined to State/Union territory level.

HYPOTHESIS:
The general impression is that the deductions allowed under the Income-tax Act for establishing industries in backward areas, plays a significant role in achieving the industrial growth in the backward areas. To test this, the following hypothesis was formulated:

"THE DEDUCTIONS ALLOWED UNDER THE INCOME-TAX ACT TO THE BUSINESS ENTERPRISES FOR ESTABLISHING INDUSTRIAL UNDERTAKINGS IN BACKWARD AREAS HAS SIGNIFICANT EFFECT ON ACHIEVING THE GROWTH OF INDUSTRIES IN BACKWARD AREAS."
Government of India has been providing with the business enterprises the deductions under the Income-tax Act for establishing industries in backward areas. The Government desired to simplify the Income-tax Act, by reducing the rate of tax and attempting to withdraw the deductions available under the Income-tax Act. However, as the Government’s efforts to withdraw the deductions available for establishing industries in backward areas are met with little success, the deductions continue in one form or other. The present study would provide an insight into as to whether the objective of allowing the deductions for establishing industries in backward areas has been achieved or not.

METHODOLOGY – SOURCES OF DATA:

The findings of the study with regard to the significant effect of the backward area deductions available under the Income-tax Act in establishing industries in these areas is studied by analysis of published data of the Central Statistical Organisation of the Government of India in “Annual Survey of Industries”.

The study has depended on secondary data. The sources of secondary data are:

- Data published by the Central Government and State Governments
- Finance Acts of the Government of India
- Circulars issued by the Central Board of Direct Taxes
- Notifications issued by the Central Board of Direct Taxes
- Judgments pronounced by High Courts and the Supreme Court
- Comptroller and Auditor General of India's report on direct taxes

STATISTICAL TOOLS:

In this study, the statistical tools of time series, five years moving average, correlations co-efficient and co-efficient of determination have been applied for the analysis of data.

LIMITATIONS OF THE STUDY:

1. An important drawback relates to the incidence of non-reporting by factories. As has been admitted by Annual Survey of Industries (ASI) itself, until 1994-95, no adjustments were made for the non-responding factories in the reported data. Instead, separate data on the number of employees and fixed capital were only presented in the ASI publications to facilitate an assessment of the magnitude of non-response. As from the year 1995-96, on the other hand, the contributions on non-responding units (excluding the non-existing units) were estimated by the Central Statistical Organization (CSO) and included with the totals. While using ASI results, the CSO made necessary adjustments to overcome the problem of non-response.
2. Another related drawback was of non-existing factories. It was found that in spite of regular updating of the ASI frame, quite a number of small sized factories selected for the survey were found to be non-existing and were termed as deleted factories, for which the field staff filled blank cards. The ASI staff did not delete the name of any factory from its frame until the registration authorities deregister it. Thus, quite a few non-existing factories observed in one round of the survey continue in the frame for subsequent surveys also until the registration authorities delete them. Until 1982-83 and thereafter, the contribution of non-existing units was taken as zero, but the total number of factories included such factories. However, as from 1982-83 and thereafter, the deleted factories were not taken into consideration for purposes of tabulation and for any analysis in the ASI reports.
II FINDINGS

The major findings of the present study are given below:-

Industrial enterprises in India, which have been established in backward areas, receive income-tax incentives in the form of certain percentages of profits and gains derived from the manufacturing or production of article or thing. The backward areas are identified based on the factors:

1. Lack of industrial development
2. Lack of infrastructure facility

The deduction in respect of profits and gains from the newly established undertakings in backward areas was inserted by the Direct Taxes (Amendment) 1974 under the section 80HH with retrospective effect from 1.1.1970. The backward areas (districts) eligible for the deduction under 80HH was determined in the year 1974 with retrospective effect from 1.1.1970 and incorporated in the Eighth Schedule.

The backward areas (districts) mentioned in the Eighth Schedule have been re-organized. The new backward areas (districts) eligible for the deduction under section 80HH were identified with retrospective effect from 1.4.1983 in December 1986. The revised list of backward areas (districts) was notified. In this list of backward areas certain blocks/taluks, where investment exceeded Rs. 30 Crores as on 31.3.1983 were excluded. This section was omitted after 31.3.1990.
From 1.4.1990 to 31.3.1993, there was no special deduction for establishing industries in backward areas. After three years, (i.e., from 1.4.1993) a new section 80IA was introduced which allowed deduction in respect of profits and gains from newly established industrial undertaking in backward areas. The backward areas (States/union territories) were incorporated in the new Eighth Schedule. The practice of identifying the backward districts as eligible for this deduction was discontinued and only the States/union territories were identified as units eligible for declaration as backward areas.

Again the concept of identifying the backward districts as units eligible for deduction for establishing the industries in backward areas was introduced. In October 1997, guidelines for specifying the industrially backward districts were issued. Based on the guidelines, the new set of districts in Category A and Category B were notified as backward areas (districts) with retrospective from 1.10.94. The States/union territories mentioned in the new Eighth Schedule were also enjoying the status of backward areas. This section was replaced after 31.3.1999.

The objective of allowing deductions for establishing new industrial undertakings in backward areas is to encourage entrepreneur to establish industries. Establishing industries in backward areas will economically improve the backward area and the regions around it. The entrepreneur is discouraged by the absence of raw materials, transport facility, skilled manpower, supply of
power, water, telecommunication facilities and proximity to the markets. The deduction is allowed for compensating the entrepreneurs for undergoing these disadvantages.

The industrial activity is different from simple trading activity. The break-even point of an industrial undertaking will be reached only in the third or fourth year of operation. As seen above, the deduction is allowed for ten years. The quantum of deduction is 20% of the profits and gains of the industrial undertakings. Hence, the deduction is effectively available to the entrepreneur only for 6 or 7 years. It may be observed that section 80HH was introduced with retrospective effect. Even though the deduction was not an inducement for establishing the industrial undertakings in backward areas during the period 1.1.1970 to 31.3.74, these industries were allowed deduction under section 80HH from 1.4.1974 onwards. The retrospective applicability of the deduction has not served the objective. The policy of allowing deduction only to the industrial undertakings and not for the services sector is faulty. The encouragement of the services sector in backward areas also served the same objective of improving the backward areas.

The deduction allowed for establishing industrial undertakings in backward areas was withdrawn from 1.4.1990. Again, it was re-introduced from 1.4.1993 onwards taking a State or Union territory as one unit for determining the backwardness. The withdrawal of deduction, re-introduction and the policy of
changing the backward area from district wise to State/Union territory wise and again district wise/ State/ Union territory wise or do not show any reason. In addition to the States/Union territories mentioned in the new Eighth Schedule, Category A and Category B backward districts were notified in October 1997 with retrospective effect of 1.10.94. The retrospective effect given shows political compulsion rather than objectivity. The withdrawal of the deduction for establishing the industrial undertakings in backward areas and the re-introduction of the same in the year 1993 confirm the above view.

Inexplicably the industrial undertakings established by the co-operative societies enjoy the deduction for a longer period than the other types of entrepreneurs. This is inconsistency with the object of providing deduction. This is further proved by the fact that companies enjoyed higher quantum of deduction than the other types of entrepreneurs after the period of 100% deduction. There is no objectivity in giving preference to the co-operative while allowing the period of deduction and giving preference to the companies while allowing the quantum of deduction. When the object is to encourage establishment of undertakings in backward areas, the bias shown against the other types of entrepreneurs, i.e., Individual, Hindu undivided family, Partnership firm and Association of persons has no rationale at all.
The industrial growth in the States/Union territories of Arunachal Pradesh, Assam, Goa, Himachal Pradesh, Jammu and Kashmir, Manipur, Megalaya, Mizoram, Nagaland, Sikkim, Tripura, Andaman and Nicobar Islands, Dadra and Nagar Haveli, Daman and Diu, Lakshadweep and Pondicherry was studied in Chapter III. These States are termed as classification I States. The salient points deduced from the study are presented below:

**INDUSTRIAL GROWTH DURING THE PERIOD 1970-71 TO 1982-83**

- The share of backward States in the number of factories was reduced to 2.97% of the total number of factories in the year 1982-83. Their share was 3.33% in the year 1970-71.

- The share of backward States in the number of employees increased to 2.96% of the total number of persons employed in factories in the year 1982-83. Its share in the year 1970-71 was 2.82%.

- The share of backward States in the invested capital increased to 2.65% of the total investments in factories in the year 1982-83. This was 2.51% for the year 1974-75 (This is the first year for which data are available).

- The share of backward States in the fixed capital fell to 2.79% of the total fixed capital of the factories in the year 1982-83. The share of backward States was 3.03% in the year 1974-75 (As fixed capital forms part of invested capital, the data were compared with the same year as invested capital).

- The share of backward States in the emoluments disbursed decreased to 1.82% of the total emoluments disbursed by the factories in the year 1982-83 and for the year 1970-71, it was 1.99%.

**Conclusion:**

For a period of twelve years, the change in the growth of industries in backward areas is insignificant. The availability of deduction for establishing industries in the backward areas has not changed the investment pattern in favour of the backward States.
INDUSTRIAL GROWTH DURING THE PERIOD 1983-84 TO 1989-90

- The share of backward areas came down has decreased to 2.95% of the total number of factories in the year 1989-90. The share of backward areas was 3.20% for the year 1983-84.

- The share of backward areas in the number of employees increased to 3.19% of the total number of employees in the year 1989-90. The share of the backward areas was 3.02% for the year 1983-84.

- The share of backward areas in invested capital rose to 2.52% of the total invested capital for the year 1989-90. The share of backward areas was 2.42% in the year 1983-84.

- The share of backward areas in fixed capital fell to 2.64% of the total fixed capital for the year 1989-90. The share of backward areas was 2.65% in the year 1983-84.

- The share of backward areas in emoluments increased to 2.11% of the total emoluments for the year 1989-90. The share of backward areas was 1.90% in the year 1983-84.

Conclusion:

For a period of seven years, the change in the growth of industries in backward areas is insignificant. The availability of deduction for establishing industries in the backward areas has not changed the investment pattern in favour of the backward States.
INDUSTRIAL GROWTH DURING THE PERIOD 1990-91 TO 1997-98

- The share of backward areas increased to 3.74% of the total number of factories in the year 1997-98. The share of backward areas was 2.84% for the year 1990-91.
- The share of backward areas in the number of employees rose to 4.02% of the total number of employees in the year 1997-98. The share of the backward areas was 3.06% for the year 1990-91.
- The share of backward areas in invested capital increased to 3.19% of the total invested capital for the year 1997-98. The share of backward areas was 2.31% in the year 1990-91.
- The share of backward areas in fixed capital rose to 3.71% of the total fixed capital for the year 1997-98. The share of backward areas was 2.38% in the year 1990-91.
- The share of backward areas in emoluments increased to 3.32% of the total emoluments for the year 1997-98. The share of backward areas was 2.08% in the year 1990-91.

Conclusion:
For the period of three years, i.e., from 1990-91 to 1992-93, no deduction was available for establishing industries in backward areas. The analysis of data reveals a consistent increase in industrial growth during this period. It shows that the availability of deduction has no significant effect on the growth of industries in backward area.
CLASSIFICATION OF BACKWARD STATES BASED ON CATEGORY A & B DISTRICTS

As discussed in chapter III of the present report, the States Bihar, Madhya Pradesh, Uttar Pradesh and Rajasthan have been classified as backward States based on the number of category A and Category B districts notified as backward vide notification dated 7.10.1997. These States are termed as classification II States. The salient points deduced from the study are presented below:

- The share in number of factories in the States Bihar, Madhya Pradesh, Uttar Pradesh and Rajasthan during the years 1970-71 to 1982-83 increased marginally over the years from 17.1% to 18.1%. In the year 1983-84 it was 18%, and in the year 1989-90 it was 18.5%. The increase is insignificant. In the years 1990-91, 1991-92 and 1992-93 it was 19.2%, 19.3% and 18.6% respectively. In the year 1993-94, it was 18.3% and was declining over the years and was 17.1% in the year 1997-98. Even though these states have enjoyed the backward area status for most of their districts, there has been no significant increase in their share in the number of factories during the period 1-1-1970 to 31-3-1998.
• The share in number of employees in the States Bihar, Madhya Pradesh, Uttar Pradesh and Rajasthan during the years 1970-71 to 1982-83 has increased over the years from 18.57% to 22%. In the year 1983-84, it was 21.33% and in the year 1989-90 it was 22.54%. In the years 1990-91, 1991-92 and 1992-93 it was 22.15%, 21.45% and 21.44% respectively. In the year 1993-94, it was 20.93% and was declining over the years and was 18.09% in the year 1997-98. Even though these states have enjoyed the backward area status for most of their districts, there has been no significant increase in their share in the number of employees for the period from 1-1-1970 to 31-3-1998.

• The share in invested capital in the States Bihar, Madhya Pradesh, Uttar Pradesh and Rajasthan during the years 1974-75 to 1982-83 has increased over the years from 24.8% to 31.2%. In the year 1983-84, it was 30.04%, and in the year 1989-90 it was 27.9%. There was decrease over the years. In the years 1990-91, 1991-92 and 1992-93 it was 26.4%, 26.1% and 26.7% respectively. In the year 1993-94, it was 24.8% and was increasing over the years and was 24.9% in the year 1997-98. Even though these states have enjoyed the backward area status for most of their districts, there
has been no significant increase in their share in the invested
capital for the period from 1-1-1970 to 31-3-1998.

• The share in fixed capital in the States Bihar, Madhya Pradesh,
Uttar Pradesh and Rajasthan during the years 1970-71 to 1982-83
increased over the years from 28.29% to 35.06%. In the year 1983-
84, it was 33.82% and in the year 1989-90 it was 29.23%. There
was decrease over the years. In the years 1990-91,1991-92 and
1992-93 it was 27.72%, 27.25% and 27.62% respectively. In the
year 1993-94, it was 25.55% and was declining over the years and
was 22.54% in the year 1997-98. Even though these states have
enjoyed the backward area status for most of their districts, there
has been no significant increase in their share in the fixed capital
for the period from 1-1-1970 to 31-3-1998.

• The share in total emoluments disbursed to the employees in the
States Bihar, Madhya Pradesh, Uttar Pradesh and Rajasthan
during the years 1970-71 to 1982-83 has increased over the years
from 18.27% to 21.90%. In the year 1983-84, it was 21.15% and in
the year 1989-90 it was 23.75%. In the years 1990-91,1991-92 and
1992-93 it was 23.17%, 20.64% and 23.27% respectively. In the
year 1993-94, it was 22.16% and was declining over the years and
was 20.42% in the year 1997-98. Even though these states have
enjoyed the backward area status for most of their districts, there has been no significant increase in their share in the emoluments disbursed to the employees for the period from 1-1-1970 to 31-3-1998.

Conclusion:
During the period 1970-71 to 1989-90, there is no significant growth of industries in the backward States. For the period of three years, i.e., from 1990-91 to 1992-93, no deduction was available for establishing industries in backward areas. For the backward districts the deduction was available from 1-10-1994. The analyses of research data show a consistent decrease in industrial growth during the period 1-4-90 to 31-3-1997. It shows that the availability of deductions has no significant effect on the growth of industries in backward area.
CO-EFFICIENT OF DETERMINATION OF CLASSIFICATION I STATES AND ALL INDIA (SHORT TERM)

- In terms of number of factories, the co-efficient of determination of classification I States and all India the relationship was better at the time when the backward area deduction was not a criterion / not available. This shows that the availability of backward area deductions under the Income-tax Act has not made any significant impact on number of factories established in backward areas.

- In terms of number of employees, the correlation co-efficient of classification I States and all India for the period 1970-71 to 1973-74 was negative which was not supportable by any logical reason. Hence, co-efficient of determination was not made for this period. However, the co-efficient of determination was better during the periods in which the backward area deductions available than it were when the backward area deductions were not available. Even during the period the backward area deductions were available, the co-efficient of determination was less than 60%.

- In terms of invested capital, no data was available for the period 1970-71 to 1973-74. For the periods 1974-75 to 1989-90, 1990-91 to 1992-93 and 1993-94 to 1997-98 the correlation co-efficient was negative for these periods, which was not supportable by any
logical reason. As co-efficient of determination was not made for these periods, no interpretation was made.

- In terms of fixed capital, the correlation co-efficient of classification I States and all India for the period 1970-71 to 1973-74 was negative which was not supportable by any logical reason. For the period from 1974-75 to 1989-90 and 1990-91 to 1992-93, there was no significant difference in the co-efficient of determination of classification I States and all India. Hence, it can be concluded that availability of backward area deductions has no significant effect on the fixed capital for these periods. However, during the period 1993-94 to 1997-98, the co-efficient of determination was remarkably high.

- In terms of emoluments, the co-efficient of determination of classification I States and all India was 99.40% and 7.78% when the backward area deduction was not a criterion / not available; it was 35.04% and 10.46% when the backward area deduction was available. Hence, it is concluded that the availability of backward area deductions has no significant effect on emoluments disbursed.
CO-EFFICIENT OF DETERMINATION OF CLASSIFICATION I & II STATES AND ALL INDIA (LONG TERM)

- In terms of number of factories, number of employees, invested capital, fixed capital and emoluments the co-efficient of determination of classification I & II States with all India was between 89% and 100% irrespective of the fact that backward area deduction was available during the particular period or not. Hence, it is concluded that the backward area deduction has no significant effect.
In terms of number of factories, the co-efficient of determination of classification II and all India was not better or rather lower during the period in which the backward area deduction was available. Hence, the backward area deductions have no significant effect on the number of factories.

In terms of number of employees, the co-efficient of determination of classification II and all India was less during the period in which the backward area deduction was available. Hence, the backward area deductions have no significant effect on the number of employees.

In terms of invested capital, no data were available for the period 1970-71 to 1973-74. For the period from 1974-75 to 1989-90, the co-efficient of correlation was negative which was not supportable by any logical reason. Hence, co-efficient of determination was not made for this period. As data were available only for the period from 1990-91 to 1997-98, no comparison could be made.

In terms of fixed capital, the co-efficient of determination of classification II and all India was not better or rather lower during the period in which the backward area deduction was available. Hence, the backward area deductions have no significant effect on the fixed capital.

In terms of emoluments, the co-efficient of determination of classification II States and All India was less during the period in which the backward area deduction was available. Hence, the backward area deductions have no significant effect on the emoluments.

Conclusion:
The above findings show that the availability of backward area deductions has no significant effect on the growth of industries in backward area when compared to their All India growth.
Number of factories:

- The share of Tamilnadu in number of factories was 10.6% in the year 1970-71. It fluctuated from 10.1% to 10.8% during the period 1971-72 to 1979-80.

- During the next decade, it started from 10.7% of total number of factories and rose to 12.3% during the year 1985-86 and settled at 12.8% in the year 1989-90. During this period, it fluctuated from 10.4% to 13.5%.

- During the period 1990-91 to 1997-98, the share in the number of factory was the highest; and during the year 1993-94 and 1994-95, it stood at 15.2%. In the year 1997-98, the share was 14.6%.

- Tamilnadu has shown a significant increase in terms of number of factories. During the period 1970-71 to 1997-98, Tamilnadu was one of the States whose share in number of factories has increased.
Number of employees:

- The share of Tamilnadu in number of employees was 10.9% in the year 1970-71. It fluctuated from 9.9% to 10.9% during the period 1971-72 to 1979-80.

- During the next decade, it started from 10.3% of total number of employees and rose to 11.6% during the year 1988-89, and settled at 11.5% in the year 1989-90. During this period, it fluctuated from 10.2% to 11.6%.

- During the period 1990-91 to 1997-98, the share in the number of employees was the highest; and during the period 1996-97 to 1997-98, it stood at 12.8%.

- Tamilnadu has shown a significant increase in its share of number of employees. During the period 1970-71 to 1997-98, Tamilnadu was one of the States whose share in number of employees has increased.
The share of Tamilnadu in invested capital was 8.3% in the year 1974-75. It fluctuated from 7.4% to 8.6% during the period 1971-72 to 1979-80.

During the next decade, it started from 8.1% of invested capital and rose to 9.2% during the year 1989-90. During this period, it fluctuated from 5.5% to 9.2%.

During the period 1990-91 to 1997-98, the share in the invested capital was the highest at 10.4% in the year 1993-94. In the year 1997-98, the share was 8.7%. Tamilnadu has shown a significant increase in the share of invested capital.

Of the years 1970-71 to 1997-98, data for the period 1970-71 to 1973-74 were not available. Hence, the reference years were taken as 1974-75 and 1997-98.
Fixed Capital

- The share of Tamilnadu in fixed capital was 10.5% in the year 1970-71. It fluctuated from 6.8% to 10.5% during the period 1971-72 to 1979-80.

- During the next decade, it started from 6.8% of fixed capital and rose to 9.6% during the year 1988-89 and settled at 8.8% in the year 1989-90. During this period, it fluctuated from 6.8% to 9.6%.

- During the period 1990-91 to 1997-98, the share in the fixed capital was highest at 10.0% in the year 1994-95. In the year 1997-98, the share was 8.3%.

- Tamilnadu has shown a decrease in the share of fixed capital.
Emoluments

- The share of Tamilnadu in emoluments was 9.5% in the year 1970-71. It fluctuated from 8.7% to 9.5% during the period 1971-72 to 1979-80.

- During the next decade, it started from 9.5% of total emoluments and rose to 10.3% during the year 1987-88 and settled at 10.2% in the year 1989-90.

- During this period, it fluctuated from 9.2% to 10.3%. During the period 1990-91 to 1997-98, the share in the emoluments was the highest at 11.3% in the year 1991-92. In the year 1997-98, the share was 11.1%.

- Tamilnadu has shown a significant increase in the share of emoluments. During the period 1970-71 to 1997-98, Tamilnadu is one of the States whose share in emoluments has increased.
Conclusion:

Except for a few districts, Tamilnadu was not eligible for the deductions available for industrial undertakings established in backward areas. There is no evidence to show that this has curtailed the growth of industries in Tamilnadu. On the contrary, there is an overall growth in terms of all the factors viz., number of factories, number of employees, invested capital and emoluments.

The distribution of employment even though increased during the period 1970-71 to 1997-98 but when compared to number of factories, it lowered by 1.8%. The invested capital and fixed capital were lowered by 5.9% and 6.3% when compared with proportionate number of factories. It was possible that Tamilnadu attracted less capital-intensive factories. The emoluments were lowered by 3.5% when compared with proportionate number of factories. It may be concluded that the factories were less capital intensive as well as disbursed lower amount of emoluments in Tamilnadu State.
CASE LAWS

A plethora of cases have arisen on the point of allowing deductions for establishing the industries in backward areas. The main points of contention are

- Meaning of phrase “the industrial undertaking”
- Whether income from construction of dam is eligible for deduction?
- Whether income from processing of prawn is eligible for deduction?
- Whether lease income received by leasing the entire industrial undertaking is eligible for deduction?
- Whether liquidated damages received from suppliers of raw materials are eligible for deduction?
- Whether profit on sale of scrap is eligible for deduction?
- Whether interest earned on bank deposit is eligible for deduction?
- Whether interest earned on delayed payments by customers is eligible for deduction?
- Whether income from MODVAT credit is eligible for deduction?
- Whether interest on deposit with electricity board made out of statutory obligation is eligible for deduction?
- Whether depreciation is to be taken into account for quantifying the profits eligible for deduction?

- Whether deduction is to be allowed after setting of losses of the eligible industrial undertaking?

- Whether deduction is to be allowed after or before allowing investment allowance?

- Whether the losses of earlier years of industrial undertaking are to be set off against the current year’s profits of the industrial undertaking for the purpose of determining eligible profits for the deduction?

- Whether the profits of hospital are eligible for deduction?

- Whether income from preparation of Indian made foreign liquor products from potable spirit is eligible for deduction?

Large number of cases are pending before the various judicial authorities. The long drawn out court procedures, the time and uncertainty involved have not served the objective for which the deduction is given. Thus, the very purpose of providing deduction has become a source of irritation.
AUDIT OBJECTION

The various errors pointed out by the Comptroller and Auditor General of India (CAG) in his report show that administratively also it is difficult to allow the deduction correctly because of the cumbersome conditions imposed for allowing the deduction. The frequent changes in the backward areas have also created confusion in the minds of the entrepreneurs.
RELATED STUDY

The Report of the Advisory Group on Tax Policy and Tax Administration for the TENTH PLAN submitted to the Government of India on May 22, 2001 states the following regarding the tax incentives given to the industries established in the backward areas:

While revenue loss on account of the backward area allowance is not readily available, estimate of such loss is about Rs.355 crores on account of this incentive in the selected backward states covered by the study. In reality, however, the amount of revenue loss could be somewhat higher as the estimate does not include the revenue foregone from industries in the backward districts of the non-backward states. Furthermore, to the extent some tax-exempt taxpayers may have abused these incentives, and much tax administration effort may have been spent on administering these incentives, the monitoring and investigating of income tax abuses by large tax paying income earners have been ignored. The effective revenue forgone may, thus, have been somewhat higher.

The tax incentives have also been subject to abuse. Instances of abuse have been indicated in depth in the Report of the Comptroller and Auditor-General of India- Direct Taxes (1998).
It is important to note that inspite of tax incentives, the development process in the backward areas has failed to take off. The Government having provided these incentives is lulled in to complacency. The need to create urgent infrastructural facilities in these areas is pushed to the background.

The experience in the case of other similar provisions like section 80IA is no different since the design of the incentive is similar and the revenue loss far greater in view of its wide coverage. It would not be feasible for the Government to undertake any meaningful reform of the direct tax structure if such incentives continue to exist on the statute.

Experience in many countries of the world shows that income tax incentives are a poor instrument of encouraging economic activity and that income tax incentives to remove the backwardness of a backward state/districts/areas are no exception. This is primarily because the bottlenecks to development in such areas tend to be so basic that no amount of tax incentives can compensate for those structural handicaps. Only a well-thought out strategy of public investment-developed on a case-by-case basis and geared towards removing specific obstacles inhibiting economic development of individual areas- can provide the solution. The economic case for the grant of tax incentives remains extremely weak while the case for a good public investment strategy is strong.
III SUGGESTIONS

1. The backward area deduction based on the quantum of the profit of industrial undertaking established in the backward area shall not continue.

2. For the existing industrial undertakings already availing of backward area, deduction shall continue up to the period of their eligibility.

3. The backward areas identified should be developed as special industrial zones after taking into account the availability of raw material, power, skilled labour, and transport, climate, access to banks and other institutions providing finance, the size of the consumer market, level of urbanization, the law and order situation, the government administrative machinery and so forth. The deficiencies in these factors should be suitably supplemented by improving them and not by way of income-tax incentives.

4. The trend of establishing less labour intensive industries in backward areas should be discontinued and labour intensive industries should be encouraged in these areas.

5. Capital-intensive industries should be encouraged only in the areas where the supply of labour is less.

6. Before developing any backward area as an industrial zone, an analysis should be made with regard to the additional cost involved in providing the necessary infrastructure and the net benefit both in terms of quantity and quality accruing to the nation and the particular area.
IV CONCLUSION

From the aforesaid findings of the study, it may be concluded that -

"THE DEDUCTIONS ALLOWED UNDER THE INCOME-TAX ACT TO THE BUSINESS ENTERPRISES FOR ESTABLISHING INDUSTRIAL UNDERTAKINGS IN BACKWARD AREAS HAS SIGNIFICANT EFFECT ON ACHIEVING THE GROWTH OF INDUSTRIES IN BACKWARD AREAS," IS NOT TRUE. It is apt to remark in this context that the present study has opened new vistas for doing research in the arenas of various import incentives given under the direct and indirect taxes for the purpose of promotion of exports, various incentives given for establishing small-scale industries in backward areas under the direct tax and so forth.