CHAPTER I
INTRODUCTION:
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.

3. An important problem found in the ASI frame itself was that a sizeable number of factories were not even registered under the Factories Act though they were qualified to do so.

4. No survey was conducted for the year 1972-73. This to a little extent affects the study.

5. The data regarding fixed capital for the years 1970-71, 1971-72, 1972-73 and 1973-74 are not available.
6. The data regarding fixed capital for the year 1979-80 are not correct and show an aberration. No adjustments have been made in the data in the present study.

CONCEPTS & DEFINITIONS

For the present study, the data published by the Central Statistical Organisation in Annual Survey of Industries (ASI) were made use of for studying the impact of providing deductions under the Income-tax Act for establishing new industrial undertaking in specified backward areas.

VARIOUS TERMS USED IN THE ASI

1. Number of factories:

The Annual Survey of India covers all factories registered under sections 2m (i) and 2m (ii) of the Factories Act 1948, i.e., employing 10 or more workers with the aid of power and those employing 20 or more workers without the aid of power, respectively, on any day of the preceding 12 months. The survey also covers bidi and cigar manufacturing establishments registered under the Bidi and Cigar Workers Act 1966, i.e., employing 10 or more workers and using power and 20 or more if not using power. All the electricity undertakings registered with the Central Electricity Authority are covered under Annual Survey of India irrespective of their employment size.
Certain services and activities like cold storage, water supply and repair of motor vehicles and of other consumer durables like watches are also covered under the survey, as they are incidental to manufacturing processes. Some other servicing industries like laundry services and job dyeing are also covered under the survey. Their data are not tabulated, as these industries do not fall under the scope of industrial sector as defined by the United Nations. Defence establishments, oil storage and distribution depots, restaurants, hotels, cafes and computer services, as also the technical training institutes, are excluded from the purview of the survey.

2. Workers:

Workers are defined to include all persons employed directly or through any agency whether for wages or not, and engaged in any manufacturing process or in cleaning any part of the machinery or premises used for manufacturing process or in any other kind of work incidental to or connected with the manufacturing process or subject of the manufacturing process. Labour engaged in the repair and maintenance or production of fixed assets for factories' own use or labour employed for generating electricity or producing coal, gas etc. are included. However, persons holding positions of supervision or management or employed in administrative office, store keeping section and welfare section, sales department as also those engaged in the purchase of raw-materials etc.
and in production of the fixed assets for the factory and watch and ward staff are excluded

3. Employees:

Employees include all workers as defined above and persons receiving wages and holding clerical or supervisory or managerial positions or engaged in administrative office, store keeping section and welfare section, sales department as also those engaged in purchase of raw-materials etc. or production of fixed assets for the factory and watch and ward staff.

4. Fixed Captial:

Fixed Capital represents the depreciated value of fixed assets owned by the factory as on the closing day of the accounting year. Fixed assets are those, which have a normal productive life of more than one year. Fixed capital covers all types of assets, new or used or own constructed, deployed for production, transportation, living or recreational facilities, hospitals, schools, etc. for factory personnel. It includes the fixed assets of the head office allocable to the factory and also the full value of assets taken on hire-purchase basis (whether fully paid or not) excluding interest element. It excludes intangible assets and assets solely used for post manufacturing activities such as sale, storage, distribution, etc.
5. Physical Working Capital:

Physical Working Capital includes all physical inventories owned, held or controlled by the factory as on the closing day of the accounting year such as the materials, fuels and lubricants, stores etc., that enter into products manufactured by the factory itself or supplied by the factory to others for processing. Physical Working Capital also includes the stock of materials, fuels, stores etc, purchased explicitly for re-sale, semi-finished goods and work in progress on account of others and goods made by the factory which are ready for a sale at the end of the accounting year. However, it does not include the stock of the materials, fuels, stores, etc. supplied by others to the factory for processing. Finished goods processed by others from raw-materials supplied by the factory and held by them are included and finished goods processed by the factory from raw-materials supplied by others are excluded.

6. Invested Capital:

Invested Capital is the total of fixed capital and physical working capital as defined above.

7. Wages:

Wages are defined to include all remuneration capable of being expressed in monetary terms and also payable more or less regularly in each pay
period to all employees as compensation for work done during the accounting year. It includes

(a) Direct wages and salary (i.e., basic wages/salaries, payment of overtime, dearness, compensatory, house rent and other allowances);

(b) Remuneration for the period not worked (i.e., basic wages, salaries and allowances payable for leave period, paid holiday, lay-off payments and compensation for unemployment, if not paid from sources other than employers);

(c) Bonus and ex-gratia payment paid both at regular and less frequent intervals (i.e., incentive bonuses, good attendance bonuses, productive bonuses, profit sharing bonuses, festival or year end bonuses etc.). It excludes lay-off payments, which are made from trust or other special funds set up explicitly for this purpose i.e., payments not made by the employer. It also excludes imputed value of benefits and other social security charges, direct expenditure on maternity benefits and crèches and other group benefits. Traveling and other expenditure incurred for business purposes and reimbursed by the employer are excluded. The wages are expressed in terms of gross value i.e., before deduction for fines, damages, taxes, provident fund, employee's state insurance contribution etc.
8. Total Emoluments:

Total Emoluments can be defined in the same way as wages as defined above, but paid to all employees plus imputed value of benefits in kind i.e. the net cost to the employer on those goods and services provided to employees free of charges or at markedly reduced cost which are clearly and primarily of benefits to the employees as consumers.

DEFINITIONS UNDER THE INCOME-TAX ACT

1. Assessee:

Assessee means a person by whom any tax or any other sum of money is payable under this Act, and includes-

(a) every person in respect of whom any proceedings under this Act has been taken for the assessment of his income or of the income of any other person in respect of which he is assessable, or of the loss sustained by him or such other person, or of the amount of refund due to him or to such other person;

(b) every person who is deemed to be an assessee under any provision of this Act;

(c) every person who is deemed to be an assessee in default under any provisions of this Act.
2. **Assessment year:**

   Assessment year means the period of twelve months commencing on the 1st day of April every year.

3. **Previous year:**

   Previous year means the financial year immediately preceding the assessment year.

4. **Assessing Officer:**

   Assessing Officer means the Assistant Commissioner or Deputy Commissioner or Assistant Director or Deputy Director or the Income-tax Officer who is vested with the relevant jurisdiction by virtue of directions or orders issued under sub-section (1) or sub-section (2) of section 120 or any other provisions of this Act, and the Joint Commissioner or Joint Director who is directed under clause (b) of sub-section (4) of that section to exercise or perform all or any of the powers and functions conferred on, assigned to, an Assessing Officer under this Act.

**POLITICAL DIVISION OF INDIA**

Indian union is divided into 28 States and 7 union territories. Each State/Union territory is divided into number of districts. Each district is divided into a number of taluks. Each taluk is divided into blocks. Each block consists of towns and villages.
STRENGTH OF DATA COLLECTED FROM THE ANNUAL SURVEY OF INDIA

Strength of the data in the annual survey of India are:

➢ The ASI constitutes a reasonably comprehensive set of data on the industrial sector in India. The data are supplied by a single and unified survey of production units and so there is reason to believe in the consistency of various components of its results. Though, for the sample sector, the numbers obviously represent an estimate, it is unlikely to affect the overall results significantly for two reasons. First of all, the size of the sample is large; this is so at any rate since 1985-86. Secondly, the contribution of the sample sector to the totality of activities in the factory sector as a whole is relatively small, though it comprises of a predominantly large number of factories.

➢ Apart from the number of factories, the ASI generates data on different components of fixed capital and capital generally employed, values of inputs and outputs, number of workers and employees and their remuneration and social security benefits, value added and its distribution and nominal values of capital formation. Thus, the ASI makes available data on all principal characteristics involved in the production process. In many respects these data are superior to those in alternative sources like the Reserve Bank of India’s company finance studies. The latter studies, for instance, are based on samples of companies and do not provide data on the number of units involved in company finances studies in respect of
these characteristics are derived series, whereas ASI does gather these data directly.

➢ The superiority of the ASI data stands out in two or more respects. First, the industrial data so generated are capable of being disaggregated state-wise, which is not the case with the company finance data. In the ASI data, the primary production units, namely, factories, are captured and their locations can be distributed state-wise. On the other hand, in the company finances data, the places of registrations of companies may be elsewhere.

ABBREVIATIONS USED

1. ITR – Income Tax Reporter
2. CTR – Current Tax Reporter
3. STC – Sales Tax Cases
4. TTJ – Tribunal Tax Journal
ARRANGEMENT OF CHAPTERS:

The report of the study is presented in eight chapters as detailed below:-

CHAPTER I: INTRODUCTION & DESIGN OF THE STUDY

This chapter presents the statement of the problem, scope and objectives of the study. The limitations of the study, concepts and definitions of the various terms used are also given.

CHAPTER II: DEDUCTIONS AVAILABLE UNDER INCOME-TAX ACT TO BUSINESS ENTERPRISES FOR ESTABLISHING INDUSTRIES IN BACKWARD AREAS

This chapter presents the provisions of the Income-tax Act, 1961 relevant to the study of the deductions available for establishing industries in backward area.

CHAPTER III: ANALYSIS OF GROWTH OF INDUSTRIES IN BACKWARD AREAS

This chapter deals with the in-depth study made, in the growth of the industries in backward areas in number of factories, employment generated, capital invested, fixed capital and emoluments of employees.
CHAPTER IV: ANALYSIS OF RESEARCH DATA WITH STATISTICAL TOOLS

This chapter interprets data by applying the statistical tools. The tools used are time series, moving average, co-efficient of correlation and co-efficient of determination.

CHAPTER V: GROWTH OF INDUSTRIES WITH A SPECIAL REFERENCE TO STATE OF TAMILNADU

This chapter deals with the in-depth study made, in the growth of the industries in Tamilnadu State in number of factories, employment generated, capital invested, fixed capital and emoluments of employees.

CHAPTER VI: ANALYSIS OF JUDICIAL INTERPRETATIONS

This chapter presents various judicial interpretations made in various High Courts and the Supreme Court with regard to backward area deductions under the Income-tax Act.

CHAPTER VII: ANALYSIS OF COMPTROLLER AND AUDITOR GENERAL OF INDIA’S REPORT

This chapter explains the audit objections raised by the Comptroller and Auditor General of India on backward area deductions allowed under the Income-tax Act.

CHAPTER VIII: SUMMARY OF FINDINGS, SUGGESTIONS AND CONCLUSION

This chapter deals with summary of findings, suggestions and conclusion of the thesis.