

Strategy of Tax Exemption

The exemption for payment of excise duty provided by the Central Government to new industries established in the hill states has lapsed on March 31st. Jammu & Kashmir, Himachal, Uttarakhand and Sikkim are demanding that the exemption must be extended by at least another 3 years. Indeed a large number of industries have been established in these states in the last few years. But the objective to take the industries to the hills, it appears, has not been attained.

The cost of production is higher in the hills due to problems of transport and geographical terrain. The higher cost is sought to be compensated by a reduction in taxes. Problem is that the cost of production in the hills is higher perpetually while the tax exemptions are granted only for a few years. Industrialization of the hills, therefore, will be truly attained only if the exemptions too are given perpetually. Providing exemption for a short time will lead to the establishment of industries also for a short time only. Industries will flee back to the plains upon exhaustion of the exemption. More than 120 pharmaceutical units were established in Baddi in Himachal by 2006 to avail of the tax exemption. Then the rate of excise duty payable by units in the plains was reduced. Immediately large number of factories closed shop in Baddi and migrated back to their home base. P A Francis writes on Pharmabiz.com website: "After the reduction of excise duty to 8 per cent for the pharmaceutical sector in 2008, a large number of units started returning to the states from where they had migrated. Many more are set to return to Karnataka, Tamil Nadu and Andhra Pradesh. Businesses in the hill states are thus down by 50 per cent since last year."

The experience of Goa points in the same direction. The tax exemption given to that state came to an end in 2004. This was not followed by establishment of industries in the long run. The Goa Chamber of Commerce and Industry in a representation to the government has said, that "in 2001, the Central Government announced income tax and excise exemption for the Northern and North Eastern hilly states such as Himachal Pradesh. As a result many good investments which should have normally come to Goa, have gone to these hilly States. Existing industries in Goa have cancelled their expansion plans and instead have set up new units in these hill States, shifting production to these States. Along with principal companies, ancillaries have also shifted to these States."

Factories are not being established in the true hill areas anyway. These are being established almost exclusively in the plain areas of hill states like Kashipur in Uttarakhand and Baddi in Himachal. The main objective of taking industrialization to backward areas in the hills has, therefore, been defeated.

Tax exemptions are not justified from a national perspective either. The revenue foregone from industries in the hill states has to be made up by collecting higher taxes from industries in the plains. If industries in Jammu & Kashmir pay Rs 1,000 crore less, then industries in Punjab and Haryana have to pay Rs 1,000 crore more. "These exemptions encourage a lot of artificial activity in these regions-like (creating a) simple packaging industry for goods produced in some

other state. There have also been complaints of already functional industries migrating to these areas without any substantial increase in the total industrial production."

How to secure economic development of the hills states then? The solution is to treat the difficult geographical terrain of the hills as an asset rather than a liability. Switzerland shows the way of harnessing the beauty of the hills for economic growth. Tourism, herbal gardens, software parks, call centers, universities and hospitals can be established in the hills. The engineers will write better software and patients will be cured soon in the pristine natural surroundings of the hills. □□□