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PRESS RELEASE

Text of the D.O. letter dt.24.8.2014 addressed by **Selvi J Jayalalithaa**, Hon'ble Chief Minister of Tamil Nadu to **Shri Narendra Modi**, Hon'ble Prime Minister of India, New Delhi is reproduced below:-

"I understand that the Government of India has referred an additional term of reference to the Fourteenth Finance Commission, regarding making recommendations on the resources that would be available to the successor or reorganized States on the reorganization of the State of Andhra Pradesh in accordance with the Andhra Pradesh Reorganization Act, 2014. The Act promises a number of fiscal and economic benefits to the successor States in Section 93 read with the Thirteenth Schedule and in Section 94. As a neighbouring State, we do not begrudge the benefits that are sought to be conferred on the successor States of Andhra Pradesh and Telangana for their development. However, sub-section (1) of Section 94 which states as follows, is of particular concern to us in Tamil Nadu:

"94. (1) The Central Government shall take appropriate fiscal measures, including offer of tax incentives, to the successor States, to promote industrialisation and economic growth in both the States."

This provision promises tax concessions to the two States to promote industrialization and economic growth. The nature and type of concessions have not been indicated in the Act and the matter appears to have been left to the discretion of the Government of India. I understand that there are demands from certain quarters that area based tax concessions should be provided to Andhra Pradesh and Telangana. Hence, it would be appropriate to intervene at this stage and express some of the apprehensions and reservations that Tamil Nadu has as a neighbouring State.

As you are aware, the general direction of taxation reforms in India has been towards rationalization and simplification of various exemptions. A conscious attempt has been consistently made at harmonizing indirect tax rates amongst States and to eliminate harmful tax competition. This led to the introduction of the Value Added Tax regime which substituted the earlier Sales Tax regime at the State level. The Centre, over the last two decades, has also attempted to reduce and eliminate various exemptions. A major aberration in this regard was the introduction of area based

exemptions from income tax and central excise for new industrial units located in certain parts of Himachal Pradesh and Uttaranchal in 2003.

I recall that there was a spirited debate on this issue in the meeting of the National Development Council held in June, 2005, and I had also written to the then Prime Minister seeking withdrawal of such exemptions in August 2005. In the NDC meeting, almost all the Chief Ministers had even then favoured the scrapping of such exemptions as they significantly distorted the investment decisions of companies and corporate houses, thereby drastically affecting the investment climate in their own States. Independent analysis has also acknowledged that the area-based exemption scheme was not calibrated properly and did not take into account the possibility of flight of capital and relocation of units from other States in the country. Any extension of such area based concessions to Andhra Pradesh or Telengana would cause a huge flight of capital and relocation of industries, in particular from neighbouring States. It would also make the neighbouring States totally uncompetitive. In fact, such concessions to new industries would render existing industries, both in neighbouring States and even in the States where such concessions are granted, completely uncompetitive. These are grave risks which cannot be ignored.

Such area based exemptions are also fiscally very expensive. The Statement of Revenue Foregone presented to Parliament in July, 2014, along with the Union Budget for 2014-15 indicates that the total revenue foregone through such area based tax concessions during 2013-14 was Rs.9267.5 crores in direct taxes and almost Rs.18,000 crores in excise duty. These are revenues which could have been shared with the States. If a similar concession is extended to the successor States of Andhra Pradesh or Telengana, the fiscal impact would be substantially greater, given the much larger size of the States and the fact that these States have a fairly well developed infrastructural base.

It must also be pointed out that when a bifurcation of three States took place in 2000, neither Jharkhand and Chattisgarh, two of the newly created States nor the residual States of Bihar, Madhya Pradesh and Uttar Pradesh received any such fiscal incentive. In the case of Uttarakhand, then Uttaranchal, the comparison could have been with Himachal Pradesh, another hill state with issues of difficult terrain and remoteness, which was already categorized as a special category state on par with the North Eastern States, Jammu and Kashmir and Sikkim. A similar categorisation cannot be made in the case of either Andhra Pradesh or Telengana.

A very limited, time bound exemption may be justified to enable an area to recover from a natural disaster. An area based exemption was granted for a limited period of 3 years for the Kutch area of

Gujarat in 2001 soon after the devastating earthquake that struck the area. However, when I made a similar request on 6th June, 2005, for a limited excise duty holiday for the areas affected by the catastrophic tsunami in Tamil Nadu in December 2004, no such concession was provided by the then UPA Government even when adequate justification existed.

The Andhra Pradesh State Re-organization Act, 2014, already contains a substantial and significant economic package. Hence, I strongly urge you to adopt a cautious approach to the complex issue of providing area based tax concessions in the name of encouraging economic development in these two States. Such exemptions run counter to one of the basic thrusts of economic reforms — a rational tax policy that is neutral, encourages a common market in the country, rewards competitive efficiency, and exploits comparative advantage. Any shift of investments from States with a strong infrastructure and trained manpower to other States motivated by tax reliefs alone would undo the two decade long work of rationalisation of tax structures.

Despite having put in place sunset clauses on area based exemptions during their two terms in office, the previous UPA Government, on grounds of sheer short term political expediency, offered this vaguely worded promise of taking appropriate fiscal measures including distortionary tax incentives. This reflects the moral bankruptcy of the previous UPA Government.

Your Government must exercise the greatest care in approaching this issue. Nothing should be done which would distort economic incentives or a level playing field and render States like Tamil Nadu uncompetitive vis a vis their neighbours. It would be highly ill-advised to offer across the board area based tax concessions.

I am confident that you would definitely consider all aspects of this issue and ensure that the interests of neighbouring States like Tamil Nadu are fully protected while taking a final decision.”

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