



## TAXING AGRICULTURAL INCOME

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### ABSTRACT

*This paper is about taxation on Agricultural income in India and what are all the challenges in taxing agricultural income. It also critically analyses the arguments in respect of taxing the agricultural income. Agricultural income has remained exempted under Section 10(1) of Income Tax Act, 1961. Many Committees on tax reforms have proposed taxation of agricultural income. But States, on their part, have highlighted serious problems in the assessment of agricultural incomes such as widely dispersed potential assesseees, fluctuations in production due to uncertain weather conditions, and lack of accounting practices in the agricultural sector. The near absence of direct taxation of the agricultural sector is partly due to the preponderance of big landlords and other vested interests in State legislatures. Moreover, the exclusion of agricultural incomes from the income tax base provides opportunities for tax evasion by camouflaging taxable income and black money as gains from agriculture. Therefore, there is a need to relook the proposal for taxation on agricultural income.*

Keywords : Agriculture Income, Taxation, Exemption and Apportionment of Agriculture Income etc

### INTRODUCTION: -

Agriculture is the backbone of the Indian economy. Agriculture employs about 50% of the population contributing approximately 17% to the GDP of the country. Figures ascertained by the Food and Agriculture Organisation (FAO) indicate that agriculture still serves as a primary source of income for about 70% of the Indian rural households. According to Indian Constitution, agriculture and the taxation of agricultural incomes has been a state subject.

The Agricultural income has remained exempted under Section 10(1) of Income Tax Act, 1961. This has led to rich farmers and landlords taking the benefit of immunity from the tax net. As the focus of government is on black money, looking at agriculture for enhanced tax collection appears a logically corollary. Several committees also recommend the taxation of agricultural income.

But the recommendation of the committees is not implemented because this issue is politically sensitive with several vested interests involved. Also, the issue of taxing agricultural income is not something new. It has been a remained issue of debate in India whether agricultural income should be taxed or not.

### MEANING OF AGRICULTURAL INCOME: -

Agricultural income refers to the income earned or revenue generated from sources essentially premised on agricultural activities. These sources of income include farming land, buildings on or identified with agricultural land as well as commercial produce from a horticultural land.

### DEFINITION OF AGRICULTURAL INCOME: -

As per section 2(1A) of Income Tax Act, 1961,

Agricultural income generally means:

- (a) Any rent or revenue derived from land which is situated in India and is used for agricultural purposes.
- (b) Any income derived from such land by agriculture operations including processing of agricultural produce so as to render it fit for the market or sale of such produce.
- (c) Any income attributable to a farm house subject to satisfaction of following conditions: -
  - i. The building is on or in the immediate vicinity of the agricultural land;
  - ii. It is occupied by the cultivator or receiver of rent or revenue;
  - iii. It is used as a dwelling house or store house or out-house; and
  - iv. The land is assessed to land revenue in India or it is not situated within the specified area.

Explanation: - Any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income.

In addition, the term agriculture does not extend to the breeding and rearing of livestock, dairy farming or poultry farming. According to the Central Statistical organization of the Government of India, the agriculture sector comprises agriculture proper, livestock and livestock products and operation of irrigation system.

Out of these activities only agriculture proper and that too the growing of field crops, fruit, nuts, seeds and vegetables (without any subsequent processing) would not be taxable, being under the accepted legal definition of agriculture for tax purposes. The other agricultural activities would be

taxable under the Central Income-Tax as non-agricultural income.

#### **LANDMARK CASES RELATED TO AGRICULTURAL INCOME: -**

In the following cases, Court interpreted the definition of agricultural income.

#### **CIT -vs- RAJA BENOY KUMAR SAHAS ROY(1957) 32 ITR 466**

Supreme court held that basic operation must be performed before any income can be called as agricultural income. Activities like dairy farming, poultry farming, butter making, etc., are not considered to be agricultural activities. Also, income derived from sale of plants grown directly in pots would not be treated as agricultural income.

#### **CIT -vs- SOUNDARYA NURSERY (2000) 241 ITR 530**

Madras High Court held that income from the nursery is agricultural income.

#### **EXEMPTION OF AGRICULTURAL INCOME FROM INCOME TAX: -**

Section 10 of Income Tax Act, 1961 deals with exempted income or income which do not form part of total income. Section 10(1) of Income Tax Act, 1961 states that agricultural income derived in India is exempted from tax subject to the conditions mentioned in Section 2(1A) of Income Tax Act, 1961.

#### **TREATMENT OF AGRICULTURAL INCOME: -**

##### **Partial integration of agricultural income with non - agricultural income: -**

In the above discussion, we have seen that agricultural income is exempt from tax. However, a method has been laid down to levy tax on agricultural income in an indirect way. This concept is called partial integration of agricultural income with non-agricultural income. It is applicable only to individuals, HUF, AOP, BOIs and artificial juridical persons. Two conditions which need to be satisfied for partial integration. They are: -

1. The net agricultural income should exceed Rs.5,000 p.a. and
2. The Non-agricultural income of the taxpayer exceeds the maximum amount non-chargeable to tax. i.e., Non-agricultural income is:

- i. Greater than Rs. 2,50,000 for individuals below 60 years of age and all other applicable persons
- ii. Greater than Rs. 3,00,000 for individuals between 60 – 80 years of age
- iii. Greater than Rs. 5,00,000 for individuals above 80 years of age

In such a case, calculation of Income tax is done in the following manner. To calculate the total tax payable, there are four steps as follows:

Step 1: – Add net agricultural income with non-agricultural income and calculate tax on the aggregate income.

Step 2: – Add net agricultural income with maximum exemption limit available to the assessee tax and calculate tax on the aggregate income.

Step 3: – Deduct the amount of income tax computed in step 2 from tax computed in step 1. The amount so computed is the actual tax payable.

Step 4: -Add surcharge and health and educational cess.

#### **APPORTIONMENT OF INCOME: -**

Rule 7, 7A, 7B and 8 of Income Tax Rules, 1962 provide the basis for apportionment of income between agricultural income and business income.

Rule 7 – Income from growing and manufacturing of any product:- Under this rule, income which is partially agricultural income and partially income chargeable under the head “profits and gains of business” then in determining chargeable income, the government will determine the market value of agricultural produce which is raised by the assessee or rent received by him and which has been utilised as a raw material in a business then only that amount shall be deducted and no further deduction shall be made.

**Table - Apportionment of income between agricultural income and business income: -**

Rule	Apportionment of income in certain cases	Agricultural income	Business Income
Rule 7A	Income from the sale of the rubber products derived from the rubber plants grown by the seller in India.	65%	45%
Rule 7B	Income from sale of coffee		

	- grown and cured by the seller in India	75%	25%
	- grown, cured roasted and grounded by the seller in India	60%	40%
Rule 8	Income from the sale of tea grown and manufactured by the seller in India	60%	40%

#### **CENTER -VS- STATE FOR THE TAXATION OF AGRICULTURAL INCOME: -**

Under the Indian Constitution, the power of the Centre to tax income is restricted to the income that arises from sources other than agriculture. The State Government has the exclusive power to tax agricultural income under the Seventh Schedule of the Indian Constitution. Not all the State governments have used their power to collect agricultural income tax. Only six states are levying this tax and that too on a limited base such as income from plantation crops like rubber, coffee and tea, though at one time eleven States levied this tax.

The agricultural income tax is levied on income from tea plantations by West Bengal, Tripura and Assam while Karnataka and Tamil Nadu levies it on income derived from growing a range of crops like tea, coffee, cardamom etc. Kerala on the other hand has an exempted list of seventeen crops on which this tax is not levied, with income from the rest being taxed. The tax collected from agricultural income has been less than half of a percent of the tax revenue collected by each of the states.

Despite the constitutional limitations, the Centre has repeatedly tried to tax agriculture indirectly. Since 1973 on the recommendation of the Raj Committee, the Central Government has been using a system of partial integration of the tax bases by taking the agricultural income of a person into account for determining the rates of income tax to be applied to his/her non-agricultural income. The Indian Constitution has given the Central Government the power to define as to what constitutes agricultural income. The Centre under its ordinary legislative power can amend the definition of agricultural income and define the boundaries of the States taxing powers, while remaining within the bounds of the Constitution. What constitutes agriculture is important because it determines the fiscal boundary between the Centre and the State.

#### **COMMITTEES REPORT ON TAXING AGRICULTURAL INCOME: -**

The following committees recommended the taxation on agricultural income to prevent black money and to reduce tax evasion from time to time,

1. K N Raj Committee (1972)
2. Tax Reforms Committee (1991)
3. Kelkar Committee (Task Force on Direct Tax) (2002)
4. White Paper on Black Money (May 2012)

5. Tax Administration Reform Commission (TARC – November, 2014)
6. CAG REPORT (2019)

#### **CHALLENGES IN LEVYING THE TAX ON AGRICULTURAL INCOME: -**

##### **Legal Issue: -**

The agricultural tax is a state subject. The state is empowered to levy tax on agriculture under Entry 46 of List II of Seventh Schedule of the Constitution of India. So, if agriculture has to be taxed, it would be done by the States as our Constitution would not permit the Centre to do so.

##### **Other Challenges: -**

1. Taxing the agricultural income is a politically sensitive issue. There will be lot of opposition to this move. So, many states may have been reluctant to tax agriculture incomes as they do not wish to lose vote bank of farmers. Moreover, India's state legislatures have typically been populated by land owners who have been blocking efforts to impose a tax on themselves.
2. The main issue is deciding what is to be taxed, whether the value of output or the net income earned by farmers?
3. Another major problem is to identify the eligible individuals for taxation because many of them own small pieces of land or are landless laborers. The latest data on tax collections reveals that of the 42 million-odd people in the organized sector around 17 million are salaried and pay taxes and there are 56 million workers in the unorganized sector and around 18 million pay taxes. Particularly in the case of agriculture, there is around 120 million potential assesseees it will be difficult to identify them.
4. In India in particular, agriculture sector is harder to tax as it is based largely on cash transactions which are hard to track and trace. Cash transactions not routed through the banking system are difficult to verify and be used for assessment of agricultural incomes.
5. Accessing their income and filing income tax returns will be an uphill task for farmers.

**SUGGESTIONS: -**

1. Farmers with small land holding of less than 2-3 hectares should be exempted from income tax
2. Tax should be levied on big agricultural farmers and rich industrialist who owns farm lands.
3. Method should be devised to bring agricultural income beyond certain threshold limit under tax slab.
4. The procurement policy plus pricing policy and the public distribution system has to be factored in before there is any talk of bringing the sector in the income tax net.
5. The government will have to make the use of biometric impressions for all sale transactions in the mandi and data can be recorded and aggregated leading to subsequent taxation beyond the limit. Also, if National Agricultural Market attains a reasonable density, then tracking persons who evades with large transactions becomes easier.
6. A bold and dynamic approach is needed in India whereby all the political parties and all the Chief Ministers of India organize a conclave to debate and discuss the issues concerning taxation of agricultural income in India.
7. There must be a unified system of taxation across states. Agricultural income taxation must be integrated with non-agricultural income taxation
8. In the case of large farmers parameters for exemption can be decided for specific crops.

**CONCLUSION: -**

Thus, Government should levy tax on agricultural income without affecting the agricultural sector. There is no point in leaving rich farmers out of tax and taxing others. It is clear that the government is willing to treat agriculture on a par with other sectors. But there must be right balance between taxing agricultural income and avoiding disincentivising the agriculture sector. The present partial integration rule which taxing agricultural income to some extent indirect way is not at all sufficient. Imposing tax on agricultural income on a selective basis (i.e., especially levying tax on rich farmers) as stated by the committees is a most feasible one. Central Government can levy tax on agricultural income above a threshold limit by way of Constitutional amendment and amendment in Income Tax Act, 1961 and Income Tax Rules, 1962.

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