



Exemption of Agricultural Income From Taxation Under Income Tax Act- How Far Justified?

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The definition of agricultural income is very broad as it includes not only agricultural produce but also various other things defined under Section 2(1A) of the Income Tax Act, 1961. This section defines agricultural income as follows: -

- **Rent or income from agricultural land in India**
Any rent or income from agricultural land is agricultural income. Rent or income earned is treated as agricultural income only if land is the direct and actual source and not a secondary or indirect source.
- **Any income derived from any agricultural activity in the country including processing of agricultural produce to make it marketable and sale of such products.**
Income earned is treated as agricultural if a process is carried out to manufacture a product, which is marketable and this process has not changed its original nature.
- **Income attributable to farm must satisfy certain conditions under Section 2(1A).**
As per law, it is the duty of the Government officer to assess property tax. In circumstances where the amount of tax cannot be determined or where local tax rates are not applicable, the country must not be under the jurisdiction of a municipality or state council with a population of more than 10,000 (according to the most recent census conducted before the date of first publication in the year preceding the sale of the land), or must not be:

1. more than 2kms. from the local limits of any municipality or cantonment board and which has a population of more than 10,000 but not exceeding 1,00,000; or not being more than 6kms. from the local limits of any municipality or cantonment board and which has a population of more than 1,00,000 but not exceeding 10,00,000; or
 2. not being more than 8kms. from the local limits of any municipality or cantonment board and which has a population of more than 10,00,000.
- **Use of land for agricultural activities: Agricultural activities are the efforts undertaken to ensure that crops germinate on the land.**
The scope of agricultural income includes income from agricultural activities including the steps taken to prepare products for sale in the market. Rent or income from agricultural land and income earned by farmers or recipients from the sale of products are exempt from tax only if agricultural activities are carried out on the land.
 - **Cultivation of land is mandatory:**
For the exemption to be possible, the land must be used exclusively for agricultural purposes. The scope and extent of agriculture is sufficiently broad and includes cereals, fruits, tea, coffee, plantations etc.
 - **Ownership of land is not mandatory:**
For rent and income to be treated as agricultural income, the taxpayer must have an interest in the land,

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either as owner or mortgagee. However, in agriculture, the tenant need not necessarily be the owner of the land. That is, a tenant or subtenant who cultivates land for agricultural purposes is exempt from tax.¹

Examples Of Agricultural Income

- Income from sale of replanted trees.
- Rent received for agricultural land.
- Income from growing flowers and creepers.
- Share of profit of a partner from a firm engaged in agricultural operations.
- Interest on capital received by a partner from a firm engaged in agricultural operations.
- Income derived from sale of seeds.

What Is Not Included In Agricultural Income?

Certain agricultural related activities and income derived therefrom are not agricultural income.

- If a farmer sells processed products without carrying out agricultural or processing activities, this income is classified as business income.
- If a farmer follows strict procedures to increase the saleable value of the product, the income derived therefrom is not considered agricultural.
Example: If a farmer processes mangoes grown on his farm into jam, the income from the sale of the mangoes is taxed as business income.
- Animal husbandry on agricultural land (this includes dairy cattle, fishing and poultry farming) is not an agricultural activity.
- If trees are grown on agricultural land for the sole purpose of later selling them as timber, this is not treated as agricultural income since the agricultural process is not completed throughout the business.
- Those earning income through agricultural trade must pay normal tax on it.
- Under certain conditions, agricultural income from exports may be exempt from income tax.²

¹Sunita Mishra, What is Agriculture Income, Prop Tiger (Oct. 14, 2018, 12:35 PM) <https://www.proptiger.com/guide/post/what-is-agriculture-income>.

²Agricultural Income and its tax treatment, India Filings (Oct. 14, 2018, 1:00 PM) <https://www.indiafilings.com/learn/agricultural-income-tax-treatment/>.

Noteworthy

If a taxpayer also earns non-agricultural income, in this case both incomes are added together to calculate tax and the corresponding benefit is granted.

However, it should be noted that tax is calculated only if the taxpayer's non-agricultural income exceeds the basic allowance.

How Is Agricultural Income Taxed?

In India, there is no tax on income from agriculture. Hence, a person whose sole source of income is agriculture is not required to file an income tax return. However, if he has income other than agricultural income like salary, land rent, business income etc, he is required to file a tax return.

The steps for taxation for taxpayers having agricultural and other income are as follows:

Step 1 – Agricultural income is added to the taxpayer's other income and considered as assessable income. In this way, the total amount of income is calculated.

Step 2 – Tax on this total income is calculated as per graduated tax rates.

Step 3 – Agriculture income is added to the taxpayer's basic allowance. Tax on this income is calculated again.

Step 4 – The difference between the above two taxes is the actual tax liability of the taxpayer. Education cess and surcharge are added to this amount. The entire tax payable shall be paid by the taxpayer.³

Section 54B of the Income Tax Act, 1961

Section 54B of the Income Tax Act, 1961 provides tax relief to a taxpayer who sells his land and uses the proceeds of such sale for generating other agricultural income.

To claim the benefit under this section, the following conditions must be fulfilled: -

1. The benefit can be claimed only by an individual or a HUF.
2. The agricultural land must have been used by the individual or his family for at least two years from the date of sale of the land. Also, in case of a HUF, the land must have been used by its members.
3. In addition, the taxpayer must purchase another agricultural land within two years from the date of sale of the previous property. In case of expropriation, the period for acquiring the new agricultural land is calculated from the date of receipt of the compensation.⁴

³Mitra, How is Agriculture Income Taxed, My IT Return (Oct. 15, 2018, 5:00 PM) <https://help.myitreturn.com/hc/en-us/articles/219454808-How-is-Agricultural-income-taxed->.

⁴What is Agriculture Income, CoverFox (Oct. 15, 2018, 5:30 PM) <https://www.coverfox.com/personal-finance/tax/agricultural-income/>.

Why Agricultural Income Should Not Be Taxed

According to the 2010-11 Agricultural Census, more than 95% of farms in India are less than 4 hectares (10 acres), and therefore 4,444 farmers are exempt from paying agricultural taxes. Also, there are not many farmers in this income bracket who earn more than Rs 500,000 per year. Such exemptions not only ensure that income remains tax-free, but also ensure that farmers work wholeheartedly to improve the productivity of their produce and use the best possible inputs for farming. This exemption also allows farmers to carry forward losses and depreciation of assets from year to year. India is an agrarian economy where agriculture is considered the backbone of the country, so taxing such a primary activity is considered to be crippling to the economy.⁵

Why Agricultural Income Should Be Taxed

According to Benoy, a member of Niti Aayog, it is a well-known fact that India has the lowest tax base with only 6% of the working population, so agricultural programs should be taxed. It places an unnecessary burden on an already overburdened public sector. Further, the Aayog is of the view that there should be no artificial distinction between urban and rural areas. If farmers exceed the tax allowance, then the urban income tax rate should be the same as in rural areas. Many politicians and economists supported Vivek Debroy's vote as there are many wealthy farmers and there are valid reasons to tax them. According to Debroy, to restore the lost balance in the agriculture sector, a proper tax policy should be developed to differentiate between poor and rich farmers. According to our Constitution, the central government cannot levy taxes on agricultural income. The power to tax agricultural income lies with the states. However, with income derived from agricultural activities being low and meagre, with 90% of farmers owning less than 2 hectares of land, the prospects of taxing agricultural income are extremely low. Currently, only a few states such as Kerala and Tamil Nadu impose taxes on the plantation sector.⁶

⁵Gudipati Kumar, NITI Aayog proposes tax on agriculture income: Pros & Cons, The Hans India (Oct. 15, 2018, 7:00 PM) <http://www.thehansindia.com/posts/index/Young-Hans/2017-06-26/NITI-Aayog-proposes-tax-on-agriculture-income-pros-cons/308806>.

⁶Yogesh Singh, Taxing Agriculture Income in India, Jagran Josh (Oct. 15, 2018, 8:00 PM) <https://www.jagranjosh.com/current-affairs/taxing-agricultural-income-in-india-1494410251-1>.

As per various reports by the RBI, around 66% of the households are located in rural India. As these are not covered under the tax system, the situation becomes a bit complicated and the economy becomes disorganized. Taxation of agricultural income is urgently needed because today, many farmers and agribusinesses are diverting funds to the agriculture sector to avoid the tax axe, thereby undermining the tax system. Large agricultural corporations are benefiting from these tax exemptions. Companies like Kaveri Seeds and multinational corporation Monsanto India are availing the multi-million-dollar tax exemptions and making profits worth millions of dollars. This is because agribusinesses cultivating the crop are placed in the same tax bracket as individual farmers. Thus, the tax system will contribute to the development and replenishment of the almost depleted agricultural sector. Imposing tax up to a certain threshold will help the government tax the rich farmers and subsidize the poor farmers.⁷

Imposing a tax on agricultural income would bring many benefits by providing true and reliable information on farmers' financial status and income potential. Such verifiable information would help distinguish between good and productive farmers and unscrupulous or unproductive farmers, thereby saving poor farmers from nepotism in availing bank loans and also protecting them from the mercy of private creditors. Imposing a tax would also help banks weed out strategic defaulters who seek to weaken and exploit the country's law enforcement standards.

This taxation would also prove beneficial for farmers as it would help them to obtain loans based on their documented financial status. Moreover, including agriculture in the fiscal dimension would also improve the country's GDP and fiscal deficit, which in turn would help the government to spend more funds on social programs.⁸

Challenges In Taxing Agricultural Income

Taxing agricultural income is a very challenging task as the entire process involves many issues. Most importantly, the issue is highly political and therefore will automatically bring negative points to anyone who tries to introduce it.

⁷Taking the rich farmers- Current Status of Farm taxes, Pros and Cons, GK Today (Oct. 16, 2018, 3:15 PM) <https://www.gktoday.in/gk/taxing-the-rich-farmers-current-status-of-farm-taxes-pros-and-cons/>.

⁸Tojo Jose, Why agriculture income is to be taxed? , Indian Economy (Oct. 16, 2018, 3:00 PM)

<https://www.indianeconomy.net/splclassroom/why-agricultural-income-is-to-be-taxed/>.

Secondly, the tax is considered a gamble with the lives of around 600 million people and no political party would dare to play with it. Moreover, a large proportion of Indian farmers are socially and economically backward and most of them own only small tracts of land. Hence, imposing a tax on such income will only bring more misery to farmers instead of development of the economy and the country. Imposing an agricultural tax on an agricultural economy is a really tough task to set the tax rate and the value of the farmer's production or net profit and even considering the fact that this tax will be introduced in one way or another, consumers will have to bear the burden as they will have to pay more than what is required. But that is not the only problem. If we take a closer look at the implementation of this taxation perspective, we can see that imposing taxes on agriculture is a very difficult task since agricultural production depends on various external factors such as weather and the availability of high-quality raw materials. From a legal point of view, it can be said that the authority to impose taxes on agriculture lies solely with the state governments, and any discussion on changing this authority would lead to political turmoil, thereby making the entire task almost impossible.⁹

Another important point to consider is what exactly should be taxed? Should the production value or net profit be taxed? While the value of production is easy to measure and track, it is difficult to determine the net profit from a crop, since a lot of money is spent on growing the crop and for the equipment owners, it also requires the

calculation of depreciation. It can be very time-consuming to determine whether it is possible. Also, surplus agricultural products that do not make it to the market end up being stored in various warehouses, making it difficult to assess the true value of the produce.¹⁰

Conclusion

It is clear that the government is ready to work towards bringing agricultural income up to the level of other activities. However, the government needs to keep in mind the structural problems facing agriculture. To maintain a balanced economy, the central government should ideally share taxes with the states to ensure that they do not overtax agricultural income. Furthermore, the government should work with the states to develop a uniform tax system to ensure transparency and efficiency. There are a large number of wealthy farmers and agribusinesses who similarly enjoy tax exemptions, so the government should work hard to establish a uniform tax base for these groups. The introduction of a strict tax regime would also help in tracking down those who evade large transactions. It is crucial that the government deals with this sensitive issue in a sensible manner. While it is at the discretion of the government whether to tax agricultural income or not, it needs to tread with extreme caution as even a small miscalculation could have a devastating impact on the economy. Hence, if policymakers decide to go ahead with the long-pending tax and budgetary reforms in the agriculture sector, they are expected to proceed with caution.

⁹Issues with Taxing agriculture income, IAS Parliament (Oct.16, 2018, 4:00 PM) <http://www.iasparliament.com/current-affairs/daily-news/issues-with-taxing-agriculture-income>.

¹⁰Madan Sabnavis, We should tax Agriculture. But how?, Business Line (Oct. 16, 2008, 4:15 PM) <https://www.thehindubusinessline.com/opinion/we-should-tax-agriculture-but-how/article9677312.ece>.