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AGRICULTURE INCOME : OVERVIEW AND TAXABILITY*

ABSTRACT

India, being a diverse country have many source and ways to generate income. The government also requires an ample amount of revenue to function and govern properly. At present the government collect the large part of their revenue from imposing tax on commodities and services i.e., the indirect taxes. But rate of tax can increase exponentially sometimes on it, which can lead to inflation and social inequality, because of aggressive nature of tax. On the other hand, if we look into the tax on income or direct tax, these are progressive in nature. However, the Income Tax Act, 1961 specifically mentioned that Income from agriculture is described in Section 2(1A) and it is exempted from taxation. This implies that there is no tax on income gained from agricultural activities. The reason for the exemption from central taxation of cultivation earning is that the Constitution provides the State Legislature exclusive authority to make legislation concerning taxes on agricultural revenue. This exemption though benefits the rural agriculturalists with meagre income, but on the other way around many large-scale farmers and agriculture companies, exploit this clause and escape from paying taxes. Although they are earning the huge profit out of agriculture produce and machinery. which is not the intended outcome of the clause. This research paper throws light on the probable taxation of agricultural income and its impact on government revenue and other taxpayers.

Keywords: Agricultural Income, Agricultural Purpose, Tax on Income

1. INTRODUCTION

“Art 366(1) of Indian Constitution – Agricultural income implies agricultural income as described in the Indian income tax enactments.”¹ “Art 274 of Indian Constitution which prohibits any amendment which may vary with the expression of Agriculture Income as defined in the income tax act unless it is introduced or moved in either house of parliament on the recommendation of the president”². “Entry 82 of List – I enables parliament to levy tax on income tax other than agriculture income”³. However, parliament has power to levy tax on capital gain arising from transfer of agriculture land.

Entry no 14 of list no-II of the constitution of India lists down the authority to frame rule in reference to agriculture is in the hand of state. So only State legislature has authority to levy tax on cultivation revenue. (Parliament has no such power)

According to provision 10(1), revenue obtained through cultivated property shall not be constituted in Taxable revenue. Most significant issue here is what is agriculture income? usually we can say that it relates to income gained or income obtained from sources including agricultural land, houses on or identified with agricultural land and horticultural business products. Section 2(1A) of Income Tax Act also talks about Agriculture Income.

Meaning of agriculture income⁴

“Agriculture Income means -

- (a) Any rent or revenue obtained from land in India used for agricultural purpose;
- (b) Any revenue from such land by- (i) agriculture; or (ii) Performance of a cultivator or receiver of rent-in-kind of any process ordinarily employed them to render the produce raised or received, fit to be taken to market; or (iii) Sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him, in respect of which no process has been performed.

¹ INDIA CONST. art.366(1).coi_part_full.pdf, https://www.india.gov.in/sites/upload_files/npi/files/coi_part_full.pdf (last visited Feb 29, 2020).

² INDIA CONST. art.274. *Id.*

³ ARVIND P DATAR ; THE LAW AND PRACTICE OF INCOME TAX372;(Lexis Nexis 10th Edition.,2014)(1950)

⁴ Agricultural Income – Tax treatment / Taxability, , TAXGURU , <https://taxguru.in/income-tax/income-tax-treatment-taxability-of-agricultural-income.html> (last visited Mar 12, 2020).

- (c) Any income derived from any building owned and occupied by the receiver of the rent or revenue of any such land, or occupied by the cultivator or the receiver of rent-in-kind, where any process above-mentioned in 2(1A)(b) was carried on.

Provided that –

- (i) The building is in immediate vicinity of the land and such building is required as a dwelling house/state house by – receiver of rent or revenue, or the cultivator, or the receiver of rent in kind.
- (ii) The land is either assessed to land revenue in India or is subject to a local rate assessed and collected by officers of the Government as such or where the land is not so assessed to land revenue or subject to a local
- (iii) rate, it is not situated—
- (A) in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area committee, town committee or by any other name) or a cantonment board and which has a population of not less than ten thousand; or
- (B) in any area within the distance, measured aerially, —
- (I) not being more than two kilometres, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than ten thousand but not exceeding one lakh; or
- (II) not being more than six kilometres, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than one lakh but not exceeding ten lakhs; or
- (III) not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than ten lakh.

Explanation 1.—Earnings obtained from property shall not include and shall never be considered to have included any income resulting from the transfer of any property referred to in sub-clause (iii) of paragraph (14) of this section.

Explanation 2.— Income derived from any building or land referred to in sub-clause (c) arising from the use of such building or land for any purpose (including letting for residential purpose or for the purpose of any business or profession) other than agriculture falling under sub-clause (a) or sub-clause (b) shall not be agricultural income.

Explanation 3. — For the purpose of this section, Any income obtained from nursery-grown saplings or seedlings shall be considered as agricultural income”⁵.

I. CIT V. SOUNDARYA NURSERY⁶

Judgement – income derived from nursery is deemed cultivation revenue.

Explanation 4.— For the purpose of section 2(1A)(C)(ii), Population implies the population according to the last census released prior to the first day of the preceding year.

Key point– provision 2(1A) does not require land to be agricultural land. It may be commercial land but such Commercial land to be used for farming reasons.

Definition of “Land used for agricultural purposes”

II. “C.I.T. V. BENOY KUMAR SAHAS ROY”⁷.

The Apex Court noted that if the merged action of the farmers, i.e., cultivation involving a basic operations and subsequent operations is carried out and carried out with respect to any property, that land may be said to have been used for agricultural purposes and the income from it may be said to be agricultural income from the soil derived from agriculture.

Basic operations – it would include land cultivation and consequently land tilling, seed sowing, planting, and all such activities that directly on the soil require human skill and effort. Basic operation includes human skill and labour to prepare a property for agriculture.

Subsequent operations - The subsequent operations would include activities performed to grow and preserve the products, such as weeding, digging soil around the plants cultivated, etc., as well as those activities that would render the products suitable for market use, such as tending, pruning, cutting, harvesting, etc.

Key point - You must carry out basic operations for agricultural purposes. Where an individual performs only subsequent operations without carrying out basic operations, the land for agricultural purposes shall not be used.

Ownership of land is immaterial for this section.

For example –

⁵ *Id.*

⁶ 2000 241 ITR 530 Mad

⁷ (1957) 32 ITR 466 (SC)

(i) A gave his property to B for the purpose of agriculture for 5000 and B conduct basic operation and subsequent operation on the land and receive 10,000. A's and B's income here is agricultural income.

(ii) After carrying out basic operations, A gave his property to B for agriculture purposes for 5000. B only perform subsequent operations on the land and receive 10,000. Here A's earning will be cultivation revenue , but B's revenue will not be agricultural income.

III. **BACHA F. GUZDAR V. C.I.T.**⁸

Facts -

In this case, there were two companies. These two companies continued to grow and manufacture tea company. Mrs. Bacha F. Guzdar was a shareholder in these companies.

Under Rule 24 of the Indian Income Tax Rules,1922, revenue derived from the sale of tea grown and generated by the seller in the taxable areas is calculated as revenue derived from the company and 40% of that revenue is considered taxable revenue, revenues and gains.

As a consequence, 40% of the tea company's revenue was taxed as revenue from manufacturing, tea sales, and rest 60% of revenue was not taxable because of cultivation revenue.

Arguments -

The petitioner's claim that the dividend earned by the him in regard of the shares held by the petitioner in the above companies is in her hands 60 percent of the agricultural income and is therefore tax-free.

The revenue authority stated that the revenue from dividends is not agricultural income and therefore the entire revenue is taxable.

Judgement -

The Supreme Court ruled that meaning of agricultural income provided under the Income Tax Act refers to income obtained by direct connection with property used for agricultural reasons and does not extend it indirectly to instances where that income or portion of it shifts in the manner of dividend distribution or otherwise. A shareholder does not directly obtain profit from the property, although the business may participate in agricultural operations and is not entitled to the exemption. Dividends derive from shares, not from agricultural income.

⁸ AIR 1955 SC 74

The expression “**Ordinary employed process**” used in Section 2(1A) (b) means – customs which are ordinary prevails in such market.

For example – (i) converting paddy into rice is ordinary employed process. (ii) converting Sugarcane into sugar is not ordinary employed process.

In simple language, we can say that income from the sale of standing crop or raw produce after harvest without performing marketing process is income derived from agriculture. You can't change the character of the product for agriculture income. She-sun tree oil extraction is not agriculture income because tree oil extraction is a mechanical method.

The expression “rent or revenue derived from land” used in section 2(1A)(a) means- land should be an effective and intimidating source of revenue and not distant source.

Meaning of Rent and Revenue –

Rent – is cash, a share of plants, a service or anything else of value to be made regularly or on a given occasion by the tenant in account of land use. In simple language, we can say that it is a payment in money or in kind by one person to another in respect of the grant of a right to use land.

Revenue – are premium. Revenue is used in the broad sense of return, yield or income, and not in the sense of land revenue. For example - Gives agricultural land on a lease for six months is revenue.

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IV. CIT V. RAJA BAHADUR KAMAKSHYA NARAYAN SINGH⁹

Issue - Whether interest on lease arrears payable on property which is used for agricultural purposes is agricultural income or not? Whether it is exempted from income tax or not ?.

Judgement - It was ruled that, within the meaning of Section 2(1A) of the Income Tax Act, there was no property rent or income.

Intention plays a very important role in deciding that whether income is an agriculture income or not-

For example

Agricultural income is the production of sugar cane and the sale of sugar cane. But converting sugar cane into sugar is not income from agriculture, as this involves business intention.

Burden of Proof – the burden is on the assessee who claims exemption from tax to prove that the income in question is agriculture income¹⁰.

⁹ AIR 1949 Privy Council 1

¹⁰ See ‘Burden of proof’ under s 1 ante.

Meaning of market

V. “Thiru Arooram Sugar Ltd Vs. CIT

In this case, the sugar manufacturer Tiru Arooran sugar ltd. used to buy sugar cane from the crushing industry. They have their own sugarcane fields and they utilise such cultivation of sugarcane for themselves. Because the earnings from the sale of sugar included both agricultural and non-agricultural operations. No tax on agricultural revenue is leviable under the income tax act, but tax is leviable on non-agricultural profits. The issue with the calculation of such income emerged in this case.

Section 10(1) states that income from agriculture is exempt from income tax levies. In this case, the income scenario was partly agricultural and partly commercial, in accordance with Rule 7 of income tax Rules 1962, which states that where such circumstances arise, the market value of any agricultural product raised or obtained by the assessee as a lease or rent-in-kind shall be determined by that portion of the income taxable. Under Rule 7(2), the market value shall be determined or considered to be (a) agricultural production normally or after any ordinary method sold on the market has been applied. (b) where agricultural produce is not ordinarily or after application of any process sold in market. the following aggregate (i) expenses of cultivation.(ii) land revenue or rent paid.(iii) such amount as the assessment officer finds reasonable amount of profit. And question arose that what is “market”?

Market in context of Rule 7 does not mean an open market where buyers and sellers get together for the purpose of sale and purchase of goods. It means that market does not have to be one open place of business where buyer and seller congregate¹¹.

2. Partly Agricultural and Partly Non-agricultural Income

Partially Agricultural Income (Rule 7)

If income is partially agricultural income and partially under the head “PGBP”, then, in determining that part which is chargeable to income tax the market value of the agricultural produce which has been raised by the assessee and which has been utilised as a raw material in such business shall be made in respect of any expenditure, by the assessee, as a cultivator.

¹¹ (1997) 142 CTR SC 9

Rules 7, 7A, 7B and 8 of the Income Tax Rules 1962 set out the technique of separating the two revenues. In such instances of composite revenue, these laws deal with calculating agricultural earnings and non-agricultural earnings.

Corp	Rule	Agriculture Income	Business Income
Growing and Manufacture of Tea	8	60%	40%
Rubber manufacturing business	7A	65%	35%
Coffee grown and cured by seller	7B(1)	75%	25%
Coffee grown, cured, roasted and grounded by the seller in India with or without mixing chicory or other flavouring ingredients	7B(2)	60%	40%

“Law commission on Agricultural Income

Law commission of India, under the chairmanship of P.B.Gajendragadkar, in his 49th report on the suggestion for inclusion of agriculture income as a whole to determine the rate of tax under the income tax act,1961. This applies on individual, HUF, Association of persons, Body of individual.

The suggestion was given in relation to the need to eliminate multiple shortcomings of the current scheme, namely

- (1) The inequality that currently arises from the reality that agricultural income tax rates differ from state to state, so that people with some revenue has to pay distinct tax rates depending on the source of revenue.
- (2) Evasion of income tax by assesses, showing their non-agriculture income as agricultural income and thus avoiding the tax they pay on non-agricultural income.

In general, the commission’s aim was to provide parliament with the reason for calculating the rate of income tax on non- agricultural income and to include agricultural income in its total income. Once the rate is set, it will only apply to non-agricultural income.

The commission endorsed their suggestions by pointing out the history that the income was taxable under four schedules during 1860.

- (1) Income from landed property, which also included income from agricultural land and from house property.
- (2) Income from professions and traders.
- (3) Income from securities countries and dividends included.
- (4) Incomes from salaries and pensions.

But since 1886, agricultural income has been excluded from income tax. So, taxation of agricultural income prior to 1886 was to include:-

- (a) Taxation of agricultural land.
- (b) Taxation of agricultural produce.
- (c) Taxation of income from agricultural land”¹².

“Kelkar Committee report on agriculture income

Kelkar committee panel has promoted the idea of levying of agriculture income tax. It can be observed that non- agriculturist’s agriculture revenue has increasingly been used as a tax shield for laundering money, leading in annual leakage to the tune of Rs. 1000 crore. Under Art 252¹³ of Indian constitution, authorises centre that it can pass a resolution to tax agricultural revenue. All the taxes gathered by the centre could be allocated to states and net of collection costs will also be allocated to states. Such tax payers will be prescribed a district income tax return form. This is probably to assist mobilise extra revenue by states without affecting 95% of real farmers, who would not fall into net income tax anyway when the exemption threshold becomes RS. 1 lakh per year.

Tax on agriculture income is welcome and it makes no sense to oppose farm tax as this move would plug the loophole of the current scheme where agricultural revenue is used as a conduit for tax avoidant”¹⁴.

“Partial Integrated Agriculture income

Although agriculture income is exempted from tax, but if an individual has both agricultural and non- agricultural earning , due to notion of partial integration, the individual has to pay more tax on non-agriculture income.

¹² The Proposal Inclusion Of Agricultural Income In The Total Income, Report49.pdf, <http://lawcommissionofindia.nic.in/1-50/Report49.pdf> (last visited Mar 12, 2020).

¹³ coi_part_full.pdf, *supra* note 1.

¹⁴ Chapter 5 analysis of Vijay Kelkar committee report.pdf, <https://shodhganga.inflibnet.ac.in/bitstream/10603/53204/9/chapter%205%20analysis%20of%20kelkar%20committee%20report.pdf> (last visited Mar 12, 2020).

So, if an individual earns both cultivation and non-cultivation earning, then the taxable income is calculated according to the technique of partial integration. This scheme is intended for those assesses who enjoy the benefit of slab and they are having the agricultural income greater than Rs. 5000 and non-cultivation earning greater than Rs. 2.5 lakhs.

Now the following steps are followed to calculate taxable income in such case:-

Step 1- calculate total income (Agriculture income +non-agriculture income)

Step 2 – Now calculate tax on total income.

Step 3 – Calculate agriculture income + maximum exemption limit.

Step 4 – Calculate tax on such income (step 3)

Step 5 – Calculate difference in tax that is step 2 – step 4.

Step 6 – Reduce Refund (if any)

Step 7 – Add education cess @3%

Step 8- Calculate tax +cess”¹⁵.

Let’s discuss the method of calculating tax liability when income includes agriculture income and non- agriculture income through an example-

Income tax slab – 1) upto 2.5 lakhs – exempted . 2) 2.5 lakhs – 5 lakhs – 5%. 3) 5 – 10 lakhs – 20%. 4) more 10 lakhs – 30%.

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Agriculture Income – 100000.

Business income – 800000

Step 1 - add agriculture income + non agriculture income and deduction exempted income and find out tax liability.

$800000+100000 = 900000.$

$9 \text{ lakhs} - 2.5 \text{ lakhs} = 6.5 \text{ lakhs}$

$5\% \text{ of } 2.5 \text{ lakhs} = 12,500$

$20\% \text{ of } 4 \text{ lakhs} = 80 \text{ thousands.}$

$80 \text{ thousand} + 12,500 = 92,500.$

Step 2 – add agriculture income with max. threshold limit.

$1 \text{ lakh} + 2.5 \text{ lakhs} = 3.5 \text{ lakhs.}$

¹⁵ Tax on Agricultural Income, , INDIA FILINGS - LEARNING CENTRE (2016), <https://www.indiafilings.com/learn/tax-agricultural-income/> (last visited Mar 12, 2020).

5% of 1 lakh =5000.

Step 3 – deduction step 1 – step 2

92,500 – 5000 = 87,500.(have to pay)

3. Why agriculture income is not taxable in India?

When we address why agricultural income in India is not taxable? The first response came to mind from many people is for the advantage of farmers alone, but it is not entirely true. If farm income is taxable, it would affect not only farmers but us as well. Because the real issue begins after food prices have risen. In India, there are many poor individuals who are unable to afford food at present rates. These are the individuals who are unemployed, uneducated, and who have no means of sustaining their lives. Food prices need to be controlled for them. Another reason not to levy tax on cultivation revenue is that if Govt imposes tax on it than nobody likes to produce crops because healthy plants depend on many variables, such as rain, tilling, weeding, sowing, etc., there is always a 50-50 percent possibility of good income in this field. If no one is interested in cultivating it impacts a nation as a whole because it will not meet the fundamental necessity of public that is food.

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4. CONCLUSION

Income from agriculture is described in Section 2(1A) and it is exempted from taxation. This implies that there is no tax on income gained from agricultural activities. The reason for the exemption from central taxation of cultivation earning is that the Constitution provides the State Legislature exclusive authority to make legislation concerning taxes on agricultural revenue. Income from agriculture is described in Section 2(1A) and it is exempted in the Indian Income Tax Act.

In my opinion, farm income should be taxable up to a certain point because many persons misuse this advantage of farmers like politicians covers their black money into white money by investing or buying farmland. Many people evade taxation by showing their non-agriculture income as agriculture income. As during the period of 1860, an agriculture income was included in the income tax. but after 1886, it was exempted from income tax. Various committees have suggested including agriculture income as taxable. The government has implemented such suggestion given by the committee's report. The method of partial integrated

agriculture income technique is used to determine the amount taxable as an income tax, when income includes agriculture income and non- agriculture income.

So, agriculture income is exempted from income tax to encourage the farmers or cultivators to produce more with less burden. It must be utilised properly by them without misusing such exemption to convert their non agriculture income into agriculture income.

