

Income Tax on Agriculture



Agriculture plays a vital role in Indian economy. According to Income Tax Department data, 6.57 lakh individuals declared agricultural income over 20 times the GDP in 2011. Except for two short periods of nine years in all (1860-1865 and 1869-1873) agricultural incomes have been exempt from the general income tax. In 1925, the Indian Taxation Inquiry Committee observed that there is no historical or theoretical justification for the continued exemption from the income tax of incomes derived from agriculture. They found it justified to include agriculture income for rate purposes. It continues unchanged till date. Section 2(1A) of the Income Tax Act, defines "agriculture income". But some incomes are derived partly from agricultural and partly from non-agricultural operations. Also it is difficult to define agricultural operations. Hence a detailed analysis has been given to define taxability of such income under the Income Tax Act.

Introduction

From the inception of our republic under constitution, agriculture and taxation of agricultural income is a state subject. Accordingly Section 10(1) of the Income-tax Act, 1961 exempts agricultural income from taxation by the central government.



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Hence plain reading of this section indicates that all agricultural income is exempt. But to understand provisions related to taxability of agricultural income, it is necessary to understand meaning of "agricultural income". To define agricultural income in one sentence, it can be mentioned that "income derived from agricultural land by carrying out agricultural operations is agricultural income". But some incomes are derived partly from agricultural and partly from non-agricultural operations. Also it is difficult to define agricultural operations. Hence broad definition of "agricultural income" has been given under the Income Tax Act. Definition of "agricultural income" as section

2(1A) of the Income-tax Act, 1961 is “agricultural income” 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—
 - (i) Agriculture; or
 - (ii) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market; or
 - (iii) the 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 other than a process of the nature described in paragraph (ii) of this sub-clause;
- (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, of any land with respect to which, or the produce of which, any process mentioned in paragraphs (ii) and (iii) of sub-clause (b) is carried on;

Provided that —

- (i) the building is on or in the immediate vicinity of the land, and is a building which the receiver of the rent or revenue or the cultivator, or the receiver of rent-in-kind, by reason of his connection with the land, requires as a dwelling house, or as a store-house, or other out-building, and
- (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 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 lakh; 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.

Explanations:

1. Revenue derived from land shall not include and shall be deemed never to have included any income arising from the transfer of any land referred to in item (a) or item (b) of sub-clause (iii) of clause (14) of this section.
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.
3. For the purposes of this clause, any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income.
4. For the purposes of clause (ii) of the proviso to sub-clause (c), “population” means the population according to the last preceding census of which the relevant figures have been published before the first day of the previous year.”

The word “means” used in the beginning of the definition makes the definition restrictive. Hence

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from the analysis of this broad definition, it can be concluded that two conditions are important to determine taxability of agricultural income.

- (1) Source of income must be agricultural land ; and
- (2) Basic agricultural operations like tiling of the land, sowing of seeds, planting etc. must be carried out on land.

If any of the above conditions is not followed, such income is not considered as agricultural income. Detailed analysis of agricultural income is as under:

Income from Sale of Produce without Carrying Out Agricultural Operations

As per definition of agricultural income, income derived from land by agriculture is considered as agricultural income. Meaning of “agriculture” is not defined under Income-tax Act. The word “agriculture” comes from Latin word ager, means the soil and cultivation. “Agriculture” can be defined as the cultivation and/or production of crop plants. Agriculture includes basic operations and subsequent operations. Hence agricultural operations like tiling of the land, sowing of seeds, planting etc. should be carried out along with subsequent operations, if necessary to make the product marketable, only subsequent operations are not sufficient to consider the income as agricultural income. Hence income from sale of trees as timber and selling of canned fruits and vegetables are chargeable as business income. But if subsequent agricultural operations like trashing of wheat, mustard is carried out along with basic operations to make the produce marketable income from such sale will be considered as agricultural income even if such further operations are not carried out at agricultural land. In case of *Commissioner of Income Tax Vs. Gaurishankar Agrawal (1980), 131 ITR 27* it was decided that “*basic operations including subsequent operations form one integrated activity and if this integrated activity which constitutes agriculture is undertaken and performed in regard to any land, that land can be said to be used for agricultural purpose and the income derived there from can be said to be agricultural income*”. Here notable point is that only subsequent agricultural operations that are necessary to make the produce marketable should be carried out along with basic agricultural operations and after subsequent operations, the produce must retain its original

character. Only change that could be permitted in the produce is in relation to making it marketable. After such change it should not result into the production of different commodity. In case of *E Palaniappan Vs. ITO (2009) 121 TTJ 541*, ITO Chennai decided that “*there is no nexus between jaggery and agricultural operations. The nature of commodity is different after the application of the process. Conversion of sugarcane into jaggery is not a necessary process performed by the cultivator to render the sugarcane fit for being taken to the market. As such profit from sale of jaggery falls beyond the ken of agriculture income*”. Some judicial rulings are against this decision and considered profit from sale of jaggery as agricultural income. But it is always a matter of litigation. Similarly if the farmer sells the ginned cotton, difference between the selling prices of ginned cotton and unginced cotton is taxable as business income. Also even if such agricultural operations are carried out by industrial organizations, it is considered as agricultural income. In case of tea, coffee, rubber etc., some industrial operations are carried out to make the produce marketable. So income from sale of tea, coffee, rubber etc. has to be bifurcated between agricultural income and non agricultural income as per rule 7A, 7B (1), 7B (1A) and rule 8 of Income Tax Rules.

Basic operations including subsequent operations form one integrated activity and if this integrated activity which constitutes agriculture is undertaken and performed in regard to any land, that land can be said to be used for agricultural purpose and the income derived therefrom can be said to be agricultural income”

Moreover, income does not lose its characteristic as “agricultural income” merely because the person holding land is not an individual. Section 2(1A) does not specify that person declaring agriculture income should be individual only. Hence company, partnership firm can also claim exemption for agricultural income. But in such cases, the notable point is that agricultural operations must be actually carried out by such entity and mere supervision and guidance provided to undertake agriculture operations by outsourcing is not sufficient. In case of *P. H. I. Seeds (P.) Ltd. vs. DCIT (ITAT Delhi)*, it was decided that if agriculture operations are not carried out by employed labour of the company,

but it is carried out by farmer under an agreement and if no risk of agriculture produce is bear by the company, mere supervision and guidance provided to farmer cannot be termed as basic agricultural operations and, therefore, such income cannot be claimed as agricultural income. However, some judicial pronouncements are against this view.

Source of income is not agricultural land: One of the conditions for claiming income as agricultural income is that such income should be derived from agricultural land. The word “derived from” indicates direct linkage/immediate source of income and not an indirect source of income. Hence there should be a direct nexus between income and the land. One notable point is that ownership of such agriculture land is not relevant to determine source of income. If primary/immediate source of income is not agricultural land, such income will be chargeable to tax. Hence following income is not considered as agricultural income, as source of income is not agricultural land.

- (1) Income from shooting of TV serials or films in farm house,
- (2) Income from stone quarries, royalty income from mines etc.
- (3) Income from poultry farming, dairy farming, butter and cheese making.
- (4) Income from bee hiving.
- (5) Income from sale of spontaneously grown trees.
- (6) Dividend paid by a company out of its agriculture income.
- (7) Salary of farm manager.
- (8) Income from fisheries.
- (9) Income from brick making.
- (10) Income from supply of water for irrigation purpose.
- (11) Income from production of salt for sea water.
- (12) Income from preservation, storage and sale of potatoes and other vegetables.
- (13) Rent of agricultural land used for aquaculture/ fisheries.

Income from Farmhouse

As per definition of agriculture income, any income derived from any building owned and occupied by the assessee, receiving rent or revenue from the land, by carrying out agricultural operations is exempt.

Hence if agricultural land along with farmhouse is given on rent for agricultural purpose, such rental income is exempt. If such farmhouse is used by tenant as store-house for agricultural produce, such rental income is also exempt. But if only farmhouse is given on rent for residential purposes, such rental income will be taxable. Similarly if farmhouse is given on rent for commercial purpose e.g. to conduct social functions, such rental income will not be considered as agricultural income. Also the land on which farm house is situated must be “agricultural land”.

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Income from Nursery or Greenhouse

With the advancement of modern technology, many crops, fruits, vegetables and flowers are grown in greenhouses. In this technique, soil is removed from the land and is placed in different containers, such as pots, trays and stands etc. and subsequent agriculture operations are performed on them to yield the desired results of production. Here the notable point is that place of such subsequent agricultural operations is not relevant. If basic agricultural operations are carried out on land and subsequent operations are carried out in continuation of basic operations, income from such produce is considered as agricultural income. Hence sapling or seeding grown in nursery or greenhouse is considered as agricultural income. But if nursery is maintained independently without carrying out basic operations on land, income from nursery will not be considered as agricultural income. Hence if flower plants purchased from farm are sold in nursery, such income will not be considered as agricultural income. Similarly if basic foundation seeds generated out of cultivation are sold by the farmer, income from seed production is considered as agricultural income.

Income from Turnkey Project for Plantation

In turnkey project for plantation, farmer sows seeds and develops plants in nursery owned by

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him. After such plants reach a certain height and/or health, they are transplanted to the land belonging to other company/institution for further care. Hence ownership of such plants is transferred to the company/institution at this stage. Thereafter the company/institution cares for survival of such plants. Hence the project is divided in two stages. First stage is up to development of plants in nursery and second stage starts from transplantation of such plants. Even if basic operations are carried out at first stage, activity carried out at second stage is different and not continuous integrated operation. Second stage can be carried out by other agency also. This activity involves income derived from agricultural land as well as contract receipt. There is much dispute regarding taxability of income from such projects. In case of *Forest Development Corporation Vs. Additional Commissioner of Income Tax and Ors.* it is decided that at first stage, primary source of income is agriculture land and at second stage income is derived from service contract. Hence income received up to first stage should be considered as agricultural income and income received thereafter should be considered as business income.

Income from Sale of Livestock used for Dairy Farming

Livestock such as cow and buffalo is used for the business of sale of milk in dairy. Such activity is not considered as "agriculture". Generally in dairy farming, stock account of cattle purchased and sold is not maintained. Hence it is not possible to ascertain exact purchase price of particular cattle which was sold. But fixed stock of cattle capable of giving good yield of milk is maintained to ensure constant supply of milk to run a dairy business. Hence in dairy business, such cattle cannot be considered as stock in trade, but it provides source of income to the owner of such cattle. Actual stock in trade is milk. Animals used to generate milk constitute a plant from which stock of milk is derived. Hence purchase price and expense on such livestock is considered as capital expenditure. It cannot be claimed as revenue expenditure. Also if such animals used otherwise than as stock in trade are sold, died or becomes

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permanently useless, difference between actual cost of such animals and amount, if any realized in respect of carcasses or animals is allowed as deduction u/s. 36(1)(vi) of the Income Tax Act. Also sale proceeds of such livestock are considered as trading receipt.

Capital Gain on Sale of Agricultural Land

If the land falls within limits specified in section 2(14)(iii) of the Income-tax Act, 1961, sale of such agricultural land will not be considered as capital asset and no capital gain will be charged on sale of such land. Similarly if the agricultural land is given on lease, gain on such transaction will not be taxable. But if agricultural land is converted into non agricultural and sub-plots of such land are sold, surplus resulting from this transaction will be considered as capital gain. If such agricultural land is converted into stock in trade and sub-plots of such land are sold after conversion into non-agricultural land, then conversion of agricultural land into stock in trade is considered as deemed transfer and it will attract capital gain and at the time of sale of such land, surplus will be charged as business income. Here one notable point is that the character of the land as "agricultural land" should continue at the time of execution of sale deed. If land was agricultural land at the time of agreement to sale, but it was converted to non-agricultural land before execution of sale deed, it will be considered as capital asset for computation of capital gain on sale of such land. Also, water-logged land adjacent to agricultural land is treated as agricultural land. Further, in case of sale of agriculture land, intention of the purchaser cannot be determinative factor to treat the profit on sale of agricultural land as business income. Similarly earning of huge amount of profit from sale of agricultural land cannot be the ground to treat such income as business income. In case of compulsory acquisition of agricultural land, compensation received in respect of award or agreement which has been exempted from levy of Income tax vide Section 96 of RFCTLARR Act shall also not be taxable under the provisions of Income-tax Act.

Interest on Rent of Agricultural Land

In some cases interest is charged for arrears of rent of agricultural land. It is arrangement between landlord and tenant to pay sum in addition to fix periodical and pre-determined payment for rent of agricultural land. In such cases, interest is charged for delayed payment of rent. Hence for the interest portion, source of income is not "agricultural land". Hence interest portion of rent received is separated from rental income and it will be chargeable to tax.

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Interest Received on Crop Loan

In case of crop loan, provider of loan receives interest from borrower. Such interest is received as part of arrangement between loan provider and borrower to pay fix amount as interest. There is no nexus between such interest receipt and the agriculture land. Hence for such interest receipt, source of income is not "agriculture land". Hence such amount cannot be considered as agriculture income.

Compensation Received for Loss or Damage to Crop

Compensation received from insurance company for loss or damage of crop is considered as agricultural income. Hence if amount received from insurance company for damage done by hail storm to growing crop, that crop represents basic agricultural operations. Therefore, any sum which represents profits of basic agricultural operations must be considered to be income from agricultural operations. Also as decided in case of *Meela Satyanarayan vs. ITO, Suryapet on 30 August, 2017*, if compensation received for loss of trees with roots on laying down gas pipelines, such income is exempt from tax.

Applicability of Section 14A Read with Rule 8D to Agricultural Income

The exemption from income tax can be granted under section 10(1) of the Income-tax Act, 1961 to the agricultural income earned, if the agricultural activities are actually carried out on said land during the financial year as stipulated under section 2(1A) of the Act to enable earning to fall within exemption provided under section 10(1) of the Act. One of the purposes for exemption from income tax is to encourage cultivation or actual utilisation of land for agricultural purposes and hence if there is neither in its condition nor anything in the evidence to indicate the intention of its owners or possessors so as to connect with an agricultural purpose, the land

could not be "agriculture land". Hence even if record for ownership and cultivation of agricultural land is maintained, but if no record for proof of agricultural income is maintained, such income is taxable under the head "income from other sources." Moreover if any person has different source of income including agricultural income, Section 14A is also applicable. Section 14A of Income-tax Act directs to disallow expenditure in relation to earning exempt income and Rule 8D prescribes the method of disallowance of such expenditure. Hence if gross agricultural income is shown in financial statement, disallowance under section 14A will be made for expenses incurred. But if agricultural income returned is net of agricultural expenditure, no disallowance will be made under section 14A. But if such expenditure claimed is inadequate, addition will be made to total income.

Taxability of Cash Sale of Agricultural Produce

Section 269ST of the Income-tax Act, 1961 subject to certain exception, prohibits receipts of ₹ 2 Lakh or more otherwise than by account payee cheque/draft or by use of electronic clearing system through a bank account from a person in a day or in respect of a single transaction or in respect of transactions relating to an event or occasion from a person. CBDT has issued circular No.27/2017 dated 3 November, 2017 clarifying that any cash sale of an amount of ₹ 2 Lakh or more by a cultivator of agriculture produce is prohibited. Moreover PAN has to be quoted or Form 60 has to be furnished if cash sale transaction by a cultivator to trader is for more than ₹ 2 Lakh. Also cash purchase of agricultural produce is out of ambit of Section 40A(3) of the Act.

Income Tax on Agriculture in Other Countries

United States (U.S.) taxes agriculture income as income from other businesses of a comparable size, but allows farmers to choose from federal corporation tax or federal income tax provided they are bounded by their choice for five years. In Canada also, farmer's income from farm and forestry are taxed as business income although some tax advantages are given to farmers. In Germany, agriculture income is calculated according to four different methods: (1) book keeping, (2) keeping an inventory, (c) flat method and (4) income valuation by financial administration. Also farmers are obliged to keep records if they exceed a certain size. The U.K. also taxes agriculture income in the same way income from other businesses and farmers are obliged to maintain books of accounts for tax computation. Also other countries like Australia, Ireland, France treat agriculture income as other business income. ■