

Income tax treatment / Taxability of Agricultural Income

Agricultural Income :Agriculture income is exempt under the Indian Income Tax Act. This means that income earned from agricultural operations is not taxed. The reason for exemption of agriculture income from Central Taxation is that the Constitution gives exclusive power to make laws with respect to taxes on agricultural income to the State Legislature. However while computing tax on non-agricultural income agricultural income is also taken into consideration.

What does the term Agricultural Income mean?

As per Income Tax Act income earned from any of the under given three sources meant Agricultural Income;

(i) **Any rent received from land which is used for agricultural purpose:** Assessee do not have to pay tax on rent or revenue from agricultural land. Such land should, of course, be assessed to land revenue in the country or be subject to a local rate. Further, there must be a direct link between the agricultural land and the receipt of income by way of rent or other revenue (for instance, a landlord could receive revenue from a tenant).

(ii) Any income derived from such land by agricultural operations including processing of agricultural produce, raised or received as rent in kind so as to render it fit for the market, or sale of such produce.

(iii) **Income attributable to a farm house** subject to the condition that building is situated on or in the immediate vicinity of the land and is used as a dwelling house, store house etc. Income from such farm houses is considered agricultural income. The definition of 'farm houses' covers buildings owned and occupied by both cultivators of agricultural land and assessee who receive rent or revenue from agricultural land. The sole purpose of such farmhouses should be for use as dwellings for the cultivators or use as store houses. Normally, the annual value of a building is taxable as 'income from house property'. However, in the case of a farm house, the annual value would be deemed agricultural income and would, thus, be exempt from tax.

(iv) Income earned from carrying nursery operations is also considered as agricultural income and hence exempt from income tax.

In order to consider an income as agricultural income certain points have to be kept in mind:

(i) There must be a land.

(ii) **The land is being used for agricultural operations:-** Agricultural operation means that efforts have been induced for the crop to sprout out of the land. The ambit of agricultural income also covers income from agricultural operations, which includes processing of agricultural produce to make it fit for sale. Like the people who receive passive agricultural income in the

form of rent or revenue, the people who actually carry out agricultural operations are also eligible for tax-free agricultural income.

(iii) **Land cultivation is must:-** Some measure of cultivation is necessary for land to have been used for agricultural purposes. The ambit of agriculture covers all land produce like grain, fruits, tea, coffee, spices, commercial crops, plantations, groves, and grasslands. However, the breeding of livestock, aqua culture, dairy farming, and poultry farming on agricultural land cannot be construed as agricultural operations.

(iv) If any rent is being received from the land then in order to assess that rental income as agricultural income there must be agricultural activities on the land.

(v) In order to assess income of farm house as agricultural income the farm house building must be situated on the land itself only and is used as a store house/dwelling house.

(vi) **Ownership is not essential.** In the case of rent or revenue, it is essential that the Assessee have an interest in the land (as an owner or mortgagee) to be eligible for tax-free income. However, in the case of agricultural operations it isn't necessary that the person conducting the operations be the owner of the land. He could be just a tenant or a sub-tenant. In other words, all tillers of land are agriculturists and enjoy exemption from tax. In some cases, further processes may be necessary to make a marketable commodity out of agricultural produce. The sales proceeds in such cases are considered agricultural income even though the producer's final objective is to sell his products.

Certain income which is treated as Agriculture Income;

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

Certain income which is not treated as Agricultural Income;

- (a) Income from poultry farming.
- (b) Income from bee hiving.
- (c) Income from sale of spontaneously grown trees.

- (d) Income from dairy farming.
- (e) Purchase of standing crop.
- (f) Dividend paid by a company out of its agriculture income.
- (g) Income of salt produced by flooding the land with sea water.
- (h) Royalty income from mines.
- (i) Income from butter and cheese making.
- (j) Receipts from TV serial shooting in farm house is not agriculture income.

(k) Income from Plantation companies:- Many plantation companies have launched schemes that offer tax-free agricultural income. These schemes are of various types: while some give investors leasehold rights to the land, some give rights to trees a certain level above the ground, even as others offer rent. If the scheme gives rise to ownership or leasehold interest in the land, then the income is considered to be rent or revenue in the hands of the investor. **In the absence of ownership or leasehold rights, income from plantation companies is either considered interest or non-agricultural income chargeable to tax.**

Certain points to be remembered:

- (a) Agricultural income is considered for rate purpose while computing tax of Individual/HUF/AOP/BOI/Artificial Judicial Person.
- (b) Losses from agricultural operations could be carried forward and set off with agricultural income of next eight assessment years.
- (c) Agriculture income is computed same as business income.

Exceptions: – If a person just sells processed produce without actually carrying out any agricultural or processing operations, the income would not be regarded as agricultural income. Likewise, in cases where the produce is subjected to substantial processing that changes the very character of the product (for instance, canning of fruits), the entire operations cannot be regarded as agricultural operations. The profit from the sale of such processed products would have to be apportioned between agricultural income and business income. Further, the income from trees that have been cut and sold as timber is not considered agricultural income since there is no active involvement in operations like cultivation and soil treatment.

Tax on Sale of agricultural land:- Before 1970, profit on the sale or transfer of all agricultural land was considered rent or revenue derived from the land. Such profit was, therefore, tax-exempt as agricultural income. There were several favorable judgments of various High Courts on the issue. However, via a retrospective amendment that took effect from April 1, 1970 LAND qualifies to be agricultural land if it is not situated 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 does not have a population of 10,000 or more according to the last preceding census which has been published before the 1st day of the previous year in which the sale of land takes place, and it is not situated less than eight kilometers from the local limits of any municipality or a cantonment board.

If, by the test above, the land is agricultural land, it will not form part of the definition of a capital asset and so there will be no capital gains on the sale of such land.

Agricultural land not forming part of the above will be a capital asset and sale of which will attract capital gains tax subject to Section 54B, which is explained below.

Section 54B – Capital gain on transfer of land used for agricultural purposes not to be charged in certain cases.

The agricultural land should have been used for agricultural purposes.

It must have been used either by the assessee or his parents in the two years immediately preceding the date on which the transfer of land took place.

The assessee should have purchased another land, which is being used for agricultural purposes, within a period of two years from the date of sale.

The whole amount of capital gain must be utilised in the purchase of the new agricultural land. If not, the difference between the amount of capital gain and the new asset will be chargeable as capital gains and the tax will be computed accordingly.

The new asset purchased should not be sold within a period of three years.

If sold, the cost of the new asset will be reduced by the amount of capital gain for the purpose of computing capital gains tax.

Where the amount of capital gain is not utilised by the assessee for the purchase of the new asset before the due date of furnishing his return of income, he may deposit it in the Capital Gains Account Scheme (CGAS) of any specified bank.

The return of income of the assessee should be accompanied by the proof of such deposit.

In such a case, the cost of the new asset shall be deemed to be the amount already utilised by the assessee for the purchase of the new asset together with the amount deposited in the CGAS.

If the deposited amount is not utilised for the purchase of the new asset within the specified period, then the unutilised amount shall be charged in the year in which the period of two years from the date of sale of the original asset expires.

Tax after including agricultural income in total income:- Although agricultural income is fully exempt from tax, the Finance Act, 1973, introduced a scheme whereby agricultural income is included with non-agricultural income in the case of non-corporate assesseees who are liable to pay tax at specified slab rates. The process of computation is as follows:

(a) Income tax is first calculated on the net agricultural income plus the assessee's total income from non-agricultural sources.

(b) Income tax is then calculated on the basic exemption slab increased by the assessee's net agricultural income.

(c) The difference between (a) and (b) is the amount of tax payable by the assessee.

This process of computation is, however, followed only if the assessee's non-agricultural income is in excess of the basic exemption slab.

Clearly, despite agricultural income being tax-exempt, assesseees have to be extra careful while dealing with such income. They must make sure that they aggregate agricultural income with their total income to avoid interest payments and possible penalties for concealment of income. Assesseees must also maintain credible records to provide the tax authorities with proof of ownership of agricultural land and evidence of having earned agricultural income.

Income from Film Shooting on Agricultural land is not Agricultural Income:- Supreme Court of India in the case of CIT v Raja Benoy Kumar Sahas Roy (32 ITR 466) laid down the following three propositions to decide as to what constitutes agricultural income – (a) some basic operation, prior to germination, involving expenditure of human skill and labour on the land itself and not merely on the growths from the land, is essential to constitute agriculture. Illustrative instances of such basic operations are tilling of the land, sowing or disseminating of seeds, and planting; (b) subsequent operations, i.e., operations performed after the produce sprouts from the land, e.g. weeding, digging the soil around the growth, removal of undesirable undergrowths, tending, pruning, cutting, felling and preservation of the plants from insects, pests and other animals by themselves would not constitute agriculture. However, in cases where the subsequent operations are combined with basic operations, the subsequent operations would also constitute part of the integrated activity of agriculture; (c) activities not involving any basic operation on the land would not constitute agriculture merely because they have relation to or connection with the land. This point was considered by the Madras High Court in B. Nagi Reddi v CIT ((2002) 125 Taxman 20). In this case, the assessee had shown certain income from film-shooting in his premises, which was known as Vijaya Gardens, and he used to recover charges for the same. The assessee claimed that those charges amounted to agricultural income as the said premises were used for agricultural activities also. The assessing authority, however, treated it as business income. The assessee, therefore, filed three separate appeals before the Tribunal.

The Tribunal held against the assessee on the basis of the earlier orders passed that the income earned by the assessee by way of film-shooting charges did not amount to agricultural income. On a reference, the High Court observed that the assessee used to grow agricultural produces like paddy and derived income from fruit-yielding trees, etc. He earned income from rice, vegetables,

fruits, etc., and, incidentally, he had also permitted film-producers to shoot their films in the said garden on payment of hire charges. It was the case of the assessee that had it not been for the vegetation, there would not have been any occasion for the producers to shoot films in the garden and, it was because of that, that the income earned from those shooting charges amounted to agricultural income. The High Court considered whether the income earned by the assessee by permitting film producers to shoot their films in his garden could amount to agricultural income within the meaning of section 2(1-A) of the Income-tax Act, 1961.

The Court referred to the aforesaid decision of the Supreme Court in the case of Raja Benoy Kumar Sahas Roy in which it was emphasized that certain basic operations should be carried out alongwith subsequent operations. The Supreme Court observed that if the integrated activity of the agriculturist, viz., agriculture, which includes the basic operations and the subsequent operations, is undertaken and performed in regard to any land, that land can be said to have been used for agricultural purposes and the income derived therefrom can be said to be agricultural income derived from the land by agriculture. In the very same judgment, the Supreme Court also considered the other activities in relation to the land or having connection with the land including breeding and rearing of live-stock, dairy-farming, butter and cheese-making, poultry-farming, etc.

The Supreme Court observed and considered that this extension was based on the dictionary meanings of the term and the definitions of “agriculture” in Whartons Law Lexicon. The Supreme Court then went on to hold that the mere fact that an activity has some connection with or is in some way dependent on land is not sufficient to bring it within the scope of the term “agriculture”.

Applying the aforesaid principles, the Madras High Court held in Nagi Reddi’s case that income earned by the assessee by way of shooting-hire charges by permitting film producers to shoot their films in his garden was not agricultural income. The shooting of films is an activity which has no nexus whatsoever with agricultural operations, or with the land, except that the shooting is done on land which may be or has been agricultural land yielding some agricultural income. The nexus, as claimed by the assessee, was non-existent, far-fetched and illusory. To conclude, there is enough scope for taxing income from activities which are non-agricultural in nature. In fact, it is well known that agriculturists themselves do not have taxable income, taking into account the fact that when it is divided amongst family members who are involved in agricultural operations, each one of them would have income within the exemption limit. However, there are hundreds of thousands of middlemen like wholesalers, retailers, distributors, etc. who earn substantial income from trading in agricultural produce as well as fruits, flowers, etc. Such income or profits are fully taxable under the present law and, therefore, if concerted efforts are made by the Tax Department to recover tax from them, the need for widening the tax base to rope in agriculturists and farmers, would be eliminated.

TAX SAVING TIP

Form a company or a partnership firm for the purpose carrying on your agricultural operations and nothing else. As indirect effect of agricultural income is not applicable in a company or a firm. The complete amount would become exempt from taxation.

TAX TABULATOR

Although agricultural income is not taxable, it must be included with non-agricultural income in the case of non-corporate assesseees who pay tax at prescribed slab rates. Resultantly, the rate of tax on non-agricultural income is higher for such assesseees. Take the case of Tushar Singh, who earned an agricultural income of Rs 1,50,000 and non-agricultural income of Rs 2 lakh during the year ended March 31, 2009. Singh's tax liability is to be calculated as follows:

(a) Agricultural income (Rs 1,50,000) plus non-agricultural income (Rs 2 lakh) = Rs 3.5 lakh.

(b) Income tax on Rs 3.5 lakh = Rs 25,000

(c) Tax on agricultural income of Rs 1,50,000 plus basic exemption of Rs 1.50,000 = Rs 15,000.

(d) Tax payable = (b) – (c) = Rs 10,000/-

Singh would have ended up paying Rs 5,000 in taxes on a non-agricultural income of Rs 2 lakh if it wasn't for the provision governing inclusion of agricultural income for rate purposes. Following the inclusion clause, he pays an additional tax of Rs 5,000 on non-agricultural income.

FAQ

Q. Do Interest on arrears of rent qualify as Agricultural Income and will this be exempt from tax?

Sometimes, a tenant could slip up on rent or revenue payments (either in cash or kind) and have to pay arrears. If the landlord charges interest on such arrears, the income would not be considered agricultural income, but would be deemed income by way of interest and would, hence, be chargeable to tax. While 'rent' presupposes periodical and pre-determined payment (either in cash or kind), 'revenue' implies a sharing arrangement that depends on the actual agricultural produce. In either case, ownership of agricultural land or interest in such land is essential. Which means, the owners of agricultural land, tenants who are given a sub-lease, and people who are mortgagees of agricultural land, all enjoy tax-free agricultural income.

Q. if agricultural produce is processed to make it marketable at a place other than the agriculture land then amount charged for such processing will be agriculture income or not ?

A. Any processing done on Agricultural produce to make it marketable is a part of agricultural operations and such amount recovered will be treated as agricultural income only. Say for example trashing of wheat, mustard, etc is part of agricultural operations only and the amount recovered will be treated as agricultural income only no matter processing takes place on the land itself or some other place.

But in certain cases like in the case of tea, coffee, sugarcane where a major processing is being done then some part of the processed produce (tea, coffee & sugar) is taxed as non-agricultural income and rest is exempt as agricultural income.

Q. What if agriculture operation is carried on urban land?

A. No Matter whether the land is urban or rural agricultural land. If agricultural operations are carried out on land the income derived from sale of such agricultural produce shall be treated as agricultural income and will be exempt from tax.

Q. If any industrial organisation grow crops and sale half of the goods as raw material in market and remaining further processed and sold as finish goods what will be the tax treatment?

A. Agricultural income is exempt from income tax. no matter agricultural operations are done by an industrial organisation or an individual. If any industrial organisation grow crops and sale half of the goods as raw material in market and remaining further processed and sold as finish goods the income earned on first half of produce which is sold in market as raw material is totally exempt from tax.

The second half of the produce which is further processed in this case scheme of presumptive taxation is applicable. Rule 7,7A,7B & 8 of Income tax rules deals with such type of income. Rule 7A deals with Income from manufacture of rubber, 7B deals with Income from manufacture of coffee and Rule 8 deals with Income from manufacture of tea. . Rule 7 deals generally wich says that in cases in which income is partially agriculture and partially from business the market value of the agricultural produce which has been raised by the assessee or received by him as rent in kind and which has been utilised as a raw material shall be deducted from the sale receipts and will be treated as agriculture income. Remaining will be treated as non agricultural income.

Q. in my agriculture farm I am operating 5 cow in Pune, Maharashtra. this is not by product, only product of milk. So is this income is agriculture income or taxable income? (This milk is sold to dairy product plant in nearest co-op society).

A. dairy farming is not an agricultural income.

Q. why rent on land treated as agricultural income? what difference is there if the land is in specified area?

A. Rent received from agricultural land used from agricultural purpose is treated as agricultural income. This is the law.

Q. I HAVE business income of Rs 1,95,000 and agricultural income of Rs 2,95,000. These figures relate to the assessment year 2009-10. How will my tax liability be computed?

A. Agricultural income is exempt under Section 10(1) of the Act so long as the income is derived from agricultural land situated in India. This income is, however, included merely for rate purposes and rebate is allowed on the same in accordance with the Finance Act. No Tax is payable if total Income of an individual do not exceed 1,50,000/- . The inclusion of agricultural income for rate purposes is only required where the total income exceeds Rs 1,50,000.

PARTICULARS	RUPEES
Business Income	1,95,000/-
Agricultural Income	2,95,000
Income Including Agricultural Income	4,90,000
Tax on 4,90,000/-	53,000/-
Less: Rebate on Agricultural Income	
(Tax on 2,95,000+ 1,50,000 being basic Exemption)	44,000/-
Net Tax Payable	9,000/-
Add: Education Cess 3%	270/-
Total tax Payable	9,270/-