**Semester: IV (UG)**

**Subject: Taxation I**

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**Lecture Note # 3**

**Agricultural Income**

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**3.1. Introduction:** Section 10(1) specifically exempts agricultural income from tax. The reason for exempting agricultural income from income-tax is that under the Constitution, Parliament has no power to impose tax on agricultural income. Agriculture is a State subject , therefore, only the State Govt. can impose tax on agriculture. However, where the agricultural income is more that Rs. 5,000 and non-agricultural income is more than the amount, which is not taxable, the agricultural income shall be aggregated with the non-agricultural income in order to determine the rate of tax that would apply on the non-agricultural income.

**3.2. Definition of agricultural income**: Under Section 2(1A), agricultural income means the following:

a. **Agricultural rent or revenue [Section 2(1A)(a)]:**  In order to constitute agricultural income the following conditions should be satisfied:

* **The rent or revenue should be derived from land**
* **The land should be situated in India**
* **The land should be used for any agricultural purpose**

b. **Income from agricultural produce and from marketing process *[Section 2(1A)***

***(b)]* :** Agricultural income may also be resulting in any income derived from land situated in India by :

* agriculture ; or
* the performance of any process employed by a cultivator or the receiver of rent-in-kind to render the produce raised by him fit to be taken to market ; or
* the sale of the produce raised or received by a cultivator or the receiver of rent-in-kind in respect of which no process [other than the one mentioned in (b) above] has been performed.

**c. Income from farm buildings *[Section 2(1A)(c)]* :**

Any income from farm buildings which satisfies the following conditions shall be agricultural income\_:

(a) the building is on or in the immediate vicinity of the agricultural land ;

(b) it is owned or occupied by the receiver of rent or revenue of any such land or occupied by the cultivator or the receiver of rent-in-kind of any and with respect to which, or the produce of which, any process mentioned in para 2.2 above is carried on ;

(c) the receiver of rent or revenue, or the cultivator, or the receiver of rent-in-kind should, by reason of his connection with land, require it as a dwelling house or as a store house or other out-building.

In addition to the above three conditions, any one of the following conditions should also be satisfied :

(i) the land should either be assessed to land revenue in India or subject to a local rate assessed and collected by the officers of the Government as such, or

(ii) where the land is not so assessed to land revenue in India or subjected to a local rate,

(a) it should not be situated in any area which is comprised within the jurisdiction of a municipality or a cantonment board having a population of not less than ten thousand, or

(b) it should not be situated in any area within such distance, not being more than eight kilometres from the local limits of such municipality or cantonment board, as the Central Government may by notification in the Official Gazette specify.

With effect from the assessment year 2001-2002, *Explanation* 2 to *Section 2(1A)* has made it clear that, if the building or land referred to in para 2.3 above, is used for any purpose other than agriculture (e.g., letting out for residential or business purposes), the income shall not be agricultural income.

**3.3. Partly agricultural income :**

When agricultural crops are subjected to manufacturing processes and the manufactured product is sold, the resulting profit is neither purely an agricultural income nor purely a business income; they are partly agricultural income. Examples of such partly agricultural incomes are : tea, tobacco, sugar cane, rubber, coffee, etc,. Since agricultural

income is totally exempt from tax, for the purpose of charging to income tax, the non-agricultural component should be separated from the agricultural component.

**3.4. Rules for separation between agricultural and non-agricultural incomes**: Rules 7, 7A, 7B and 8 of the Income-tax Rules, 1962, provide the basis on which such separations are to be made.

**Rule 7** provides that in the case of partly agricultural income, in determining the part which is chargeable to income-tax, 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 used as raw materials in the business is deductible from the business profits as representing agricultural income.

**Under Rule 7A**, in the case of income derived from the sale of centrifuged latex or cenex manufactured from rubber plants grown by the seller in India, 35% of such income shall be treated as business income liable to tax and the balance 65% shall be treated as agricultural income.

**Under** **Rule 7B**, in the case of income derived from the sale of coffee grown and cured by the seller in India, 25% of such income shall be treated as business income which is liable to tax ; the balance 75% of the income shall be regarded as agricultural income, which is exempt from tax. However, in the case of sale of coffee grown, roasted and grounded by the seller in India, with or without mixing chicory or other flavouring ingredients, 60% of such income shall be treated as agricultural income and balance 40% shall be treated as business income, which is taxable.

**Rule 8** applies only where the assessee himself grows tea leaves and\_manufactures tea in India. In such cases, 60% of the income from such combined operations is to be treated as agricultural income and the remaining 40% is to be treated as business income, which is taxable.

**3.5. Examples of agricultural incomes:**

1. Income from use of land for grazing of cattle required for agricultural pursuit.
2. Profit on sale of crops after harvest, made by cultivator or receiver of rent-in-kind.
3. Compensation received from insurance company for damage caused to the crops by hailstorm or flood.
4. Salary, interest on capital, share of profits, etc., received by a partner of a firm having agricultural income.
5. Income from running a dairy which is purely incidental to agriculture.
6. Income from growing flowers and creepers.
7. Income from saplings and seedlings grown in nursery .

**3.6. Instances of non-agricultural income** :

1. In the following cases, incomes derived by the assessee shall not be treated as agricultural income
2. Income from sale of trees, flowers and fruits growing spontaneously in for
3. Profits arising from purchase and sale of standing crops.
4. Remuneration received by a manager as a percentage of profit from a firm having agricultural income.
5. Dividends paid by a company from its agricultural incomes
6. Income from fisheries.
7. Royalty income from mines.
8. Poultry farming.
9. Annuity received for transfer of agricultural land.
10. Interest on arrears of rent payable in respect of agricultural land.
11. Interest received by a money lender in the form of crops.

**Exercises :**

1. State with reasons briefly whether the following items are agricultural income as per Income-tax Rules :

(a) Dividends received by a shareholder from a company engaged fully in agricultural activities ;

(b) Profits from sale of agricultural products from a land situated at Khulna (Bangladesh) ;

(c) Income from growing flowers and creepers ;

(d) Salary received by an acting partner from a firm the entire income of which comes from agricultural operations ;

(e) Profit from sale of agricultural land in a village in India ;

(f) Rent received by way of letting a land for grazing of cattle required for agricultural operations **[ CU B.Com. (H) 2002]**

**Answers:**

1. Non- agricultural income
2. Non-agricultural income
3. Agricultural income
4. Agricultural income
5. Non-agricultural income
6. Agricultural income