AGRICULTURAL INCOME

⌘ Definition of Agricultural Income [Section 2 (1A)]

"Agricultural income" means :

Section 2 (1A) (a) :

Any ***rent*** or ***revenue*** derived from land which is situated in India and is used for agricultural purposes.

Section 2 (1A) (b) :

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

Section 2 (1A) (c) :

Income attributable to a farm house subject to the conditions that :

- the building is situated on or, in the immediate vicinity of the land and is used as a dwelling house, store house or other outbuilding and the land is assessed to land revenue or a local rate or,
- the building is situated on or in the immediate vicinity of land, which (though not assessed to land revenue or local rate) is situated outside the ***urban areas***.

Note :

(a) ***"Rent"*** is payment, in money or in kind, by one person to another in respect of grant of right to use land.

(b) ***"Revenue"*** covers all income from agricultural land other than rent. For example, fees extracted for the grant of a renewal of a lease is a "revenue" derived from land.

(c) ***"Urban area"*** means any area situated within the territorial jurisdiction of a municipality or cantonment board having a population of ten thousand or more or any area situated within eight kilometers from the local limits of such municipality or cantonment board.

(d) ***Any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income [Explanation 3 to Section 2 (1A)] [Applicable from A.Y. 2009-10] [Details on Page 5].***

⌘ CIT Vs. Raja Benoy Kumar Sahas Roy (Supreme Court, 1957)

Since the expressions "agriculture" and "agricultural purposes" have not been defined in the Income-tax Act, 1961, there were divergent views of the Indian courts on this issue which have been afterwards settled by the Supreme Court in this case. After exhaustively discussing the various cases dealing with the aforesaid different aspects, Bhagwati, J. laid down the following principles to serve as a guide in the determination of the scope of the terms "agriculture" and "agricultural purposes" :

1. **Basic operations :**

   Prior to germination, some basic operation is essential to constitute agriculture. The basic operation would involve expenditure of human skill and labour upon the land itself and not merely on the growths from the land. Some illustrative instances of such operations are tilling of land, sowing of the seeds, planting and similar operations on the land.

2. **Subsequent operations :**

   Beside the basic operations, there are certain subsequent operations, which are performed after the produce sprouts from the land. Illustrative instances of subsequent operations are weeding, digging the soil around the growth, removal of undesirable undergrowths and all operations which foster the growth and preserve the same not only from insects and pests but also from depreciation from outside, tending, pruning, cutting, harvesting and rendering the produce fit for the market. Mere performance of these subsequent operations on the products of the land (where such products have not been raised on the land by the performance of the basic operations described above) would not be enough to characterize them as agricultural operations. Where, however, the subsequent operations are performed in conjunction with and in a continuation of the basic operations, the subsequent operations would also constitute part of the integrated activity of the agriculture.

3. **Agriculture not merely includes food and grains** :

   Agriculture does not merely imply raising of food and grains for the consumption of men and animals; it includes all products from the performance of basic as well as subsequent operation on land. These products, for instance, may be grain or vegetable or fruits including grass or pasture for consumption of beasts or articles of luxury such as betel, coffee, tea, spices, tobacco, etc., or commercial crops like cotton, jute, hemp, indigo, etc. and would also include forest products such as timber, Sal and piyasal trees, tendu leaves, horra nuts, etc.

4. **Mere connection with land not sufficient** :

   The mere fact that an activity has some connection with or is in someway dependent on land is not sufficient to bring it within the scope of the term “agriculture”. For instance, breeding and rearing a livestock, dairy farming, cheese and butter making and poultry farming would not by themselves be agricultural purposes.

⌘ CIT Vs. R. Venkataswamy Naidu (Supreme Court)

Onus of proving that an income is agricultural income is on the assessee.

⌘ Scheme of partial integration

Constitution gives exclusive power to make laws with respect to taxes on agricultural income to the State Legislature. Since income tax is a tax levied by the Central Government, it is not empowered to tax agricultural income. Therefore Section 10 (1) of the Income-tax Act, 1961 exempts agricultural income from income tax. But on the recommendation of the ***Committee on Taxation of Agricultural Wealth and Income***, headed by Dr. K. N. Raj, the Finance Act, 1973 introduced the ***Scheme of partial integration*** of non-agricultural income with agricultural income for determination of tax liability of the assessee from A.Y. 1974-75 and onwards.

The scheme of partial integration is applicable to an assessee being an individual or a HUF or an AOP/BOI or an artificial juridical person subject to the fulfillment of ***both*** of the following conditions :

(a) Agricultural income during the P.Y. exceeds Rs. 5,000.

(b) Non-agricultural income during the P.Y. exceeds the ***maximum amount not chargeable to tax.***

Illustration :

Income structure of a male individual below the age of 65 years

Agricultural income	Non-agricultural income	Scheme of partial integration
6,000	1,59,000	Not applicable
4,000	1,61,000	Not applicable
6,000	1,61,000	Applicable
5,000	1,61,000	Not applicable
5,000	1,60,000	Not applicable

If scheme of partial integration is applicable tax liability will be determined as follows :

COMPUTATION OF TAX LIABILITY

	Rs.
Total Income / Net Income / Taxable Income	-----------
Total income subject to special tax rate	-----------
Total income ***(including agricultural income)*** subject to normal tax rates	-----------
Tax on Total income subject to special tax rate	-----------
Tax on Total income ***(including agricultural income)*** subject to normal tax rates	-----------
	-----------
Less : Income Tax on agricultural income plus maximum amount not chargeable to tax at normal rates	-----------
Income Tax	-----------
Add : EC @ 2 %	-----------

Add : SHEC @ 1 %	-----------

Add : Interest / Penalty	-----------

Less : Prepaid taxes (i.e. Advance Tax, TDS, etc.)	-----------
Tax Payable / Refund	-----------

⌘ Income which is partially agricultural and partially from business

Income-tax Rule	Nature of income	Amount of agricultural income	Amount of business income
8	Income from sale of tea ***grown*** and ***manufactured*** by the assessee in India.	60%	40%
7A	Income derived from sale of centrifuged latex or cenex or latex based crepes or brown crepes or technically specified block rubbers manufactured or processed from field latex or coagulum obtained from rubber plants grown by the seller in India.	65%	35%
7B	Income derived from the sale of coffee ***grown*** and ***cured*** by the seller in India	75%	25%
7B (1A)	Income derived from the sale of coffee ***grown***, ***cured***, ***roasted*** and ***grounded*** by the seller in India, with or without mixing chicory or other flavouring ingredients.	60%	40%
7	Income from growing and manufacturing of any product other than tea, rubber and coffee (See Note on next page)		

Note : Income from growing and manufacturing of any product other than tea, rubber and coffee :

An assessee may have composite business income which is partially agricultural and partially non-agricultural, for example, where XYZ Ltd. grows sugarcane and further processes its produce to sell them as sugar. In this case the company has composite income i.e. income from agriculture as well as income from business. The composite income has to be disintegrated and :

- for computing **business income** the ***market value of any agricultural produce*** (i.e. sugarcane) raised by the assessee (or received by him as rent-in-kind) and utilized as raw material in his business is deducted. No further deduction is permissible in respect of any expenditure incurred by the assessee ***as a cultivator***.
- for computing **agricultural income** the ***market value of total agricultural produce*** will be the total ***agricultural receipt*** on account of sugarcane. From such ***agricultural receipt***, expenses such as cultivation expenses etc. incurred in connection with such receipt will be deducted and balance will be agricultural income which will be exempt.

Illustration 1 :

X Ltd. Grows sugarcane to manufacture sugar. The data for the financial year 2010-11 is as follows :

	Rs.
Cost of cultivation of sugarcane	6,00,000
Market value of sugarcane when transferred to factory	10,00,000
Other manufacturing cost	6,00,000
Sales of sugar	25,00,000
Salary of managing director who looks after all the operations of the company	3,00,000

Determine the income of the company.

Solution :

Profits & Gains of Business or Profession :

Sale of sugar		25,00,000
Less : Market value of sugarcane when transferred to factory	10,00,000	
Other manufacturing cost	6,00,000	
Salary of managing director	3,00,000	19,00,000
Profits & Gains of Business or Profession		6,00,000

Agricultural Income :

Market value of sugarcane when transferred to factory	10,00,000
Less : Cost of cultivation of sugarcane	6,00,000
Agricultural Income (Exempt)	4,00,000

Illustration No. 2 :

For the assessment year 2011-12, net agricultural income of an assessee is Rs. 86,000 and non-agricultural income (before claiming deduction under Chapter VI-A) is Rs. 5,05,000. The taxpayer contributes Rs. 40,000 towards public provident fund. Find out the tax liability if the assessee is :

(a) X, a businessman (below age of 65 years),

(b) X & Sons, a HUF,

(c) XYZ & Co., a firm,

(d) X Ltd., an Indian company.

Solution :

Computation of tax liability in case of X and X & Sons

	X	X & Sons
Total Income / Net Income / Taxable Income (after deduction u/s 80C)	4,65,000	4,65,000
Total income subject to special tax rate	Nil	Nil
Total income ***(including agricultural income)*** subject to normal rates	5,51,000	5,51,000
Tax on Total income subject to special tax rate	Nil	Nil
Tax on Total income ***(including agricultural income)*** subject to normal rates	44,200	44,200
	44,200	44,200
Less : Income Tax on agricultural income plus Rs. 1,60,000 at normal rates	8,600	8,600
Income Tax	35,600	35,600
Add : EC @ 2 %	712	712
	36,312	36,312
Add : SHEC @ 1 %	356	356
Tax Payable (Rounded-off)	36,670	36,670

Computation of tax liability in case of XYZ & Co & X Ltd.

	XYZ & Co.	X Ltd.
Total Income / Net Income / Taxable Income	**5,05,000	**5,05,000
Total income subject to special tax rate	Nil	Nil
Total income subject to normal rates	5,05,000	5,05,000
Tax on Total income subject to special tax rate	Nil	Nil
Tax on Total income subject to normal rates (@ 30%)	1,51,500	1,51,500
Income Tax	1,51,500	1,51,500
Add : EC @ 2 %	3,030	3,030
	1,54,530	1,54,530
Add : SHEC @ 1 %	1,515	1,515
Tax Payable (Rounded-off)	1,56,050	1,56,050

**Deduction under Section 80C not available.

EXPLANATION TO SECTION 2(1A)

"Any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income"

Judicial Controversy

There was a judicial controversy whether or not income from nursery operations would qualify as agricultural income within the definition given under Section 2(1A).

In case of ***Soundarya Nursery (Madras, 2000) and Sudisha Farm Nursery (Delhi, 2004)***, it was held that unless an assessee carries out the basic operations upon the land, i.e., tilling of land, sowing of the seeds, planting etc., requiring the expenditure of human skill and labour upon the land, it cannot be said that the income earned by the assessee is agricultural income. Further, subsequent operations would also be agricultural operations if taken in conjunction with basic operations.

However, subsequent operations by themselves cannot be considered as agricultural operations. Hence, if any income is earned by carrying out the subsequent operations without carrying out the basic operation, then such income will not be considered as agricultural income. The nature of product is irrelevant.

In other words, in the cases mentioned above it was pointed out that the income from all nurseries cannot be considered as agricultural income. It would depend on the facts of each case. If the nursery is maintained by carrying out the basic operations, then income from such nursery would be agricultural income. If, however, the nursery is maintained independently without resorting to basic operations on the land, then income from such nursery would not be "agricultural income" within the definition given under section 2(1A).

Same view was taken earlier in 1957 by the Supreme Court in case of ***CIT Vs. Raja Benoy Kumar Sahas Roy***.

The Amendment made by Finance Act, 2008

With a view to giving finality to the issue, Section 2(1A) has been amended with effect from assessment year 2009-10 so as to provide that any income derived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income. Accordingly, irrespective of whether the basic operations have been carried out on land, such income will be treated as agricultural income, thus qualifying for exemption under Section 10(1).