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Direct Taxation and Economic Growth

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I. INTRODUCTION

A well-structured taxation system prevails in India. Taxes here are the largest source of revenue for the government.² This money is deployed for various purposes and projects for the development of the nation. Taxes are levied by the Central and State Governments along with local authorities such as municipal corporations.

Taxes are categorised under two heads - direct and indirect. Direct tax is a tax levied on corporate entities and individuals which is payable directly to the government and is not transferrable. Examples are gift tax, income tax, wealth tax. Indirect tax, on the other hand is not directly paid by the assessed. It is levied on goods and service and is paid by the intermediaries who is usually the seller of those goods and services to the government.³

Direct taxation is one of the significant sources of government revenue.⁴ Further it also has a direct effect on the disposable income of individuals, if the rate of direct taxation is enhanced by the Government, people commence saving for investment purposes. This individual behaviour hampers the progress of the economy, this is especially true for luxury commodities. This diminishes the manufacture of luxury commodities in the economy and as a consequence also detrimentally affects the Gross Domestic Product and the standards of living in the country.

However, proper deductions being allowed based on investments, it can result in the capital formation in the country. Thus, the following are the advantages of direct taxation on the economic growth- better capital formation, increase in planned expenditure of government, decrease in inflation rate due to lesser availability of disposable income to persons, timely availability of revenue to the Government.⁵

In this research project I have narrowed down the topic of direct taxation to direct taxation of agricultural income and its impact on economic growth of the country. I have tried to point towards the loopholes of the Indian taxation system, wherein agricultural income is left

¹ Author is a Student at Symbiosis Law School Noida, India.

² (Saha, 2019)

³ (S.P.Goyal, 2019)

⁴ (Pandey, 2017)

⁵ (Hicks, 1956)

untaxed. I have tried to cover up about how the economic growth and the GDP of the country would be influenced had the Direct Tax Code- 2008 not missed out taxing agricultural income. The paper discussed how the scenario pertaining to the field of agriculture has changed and how it is no more just a means a livelihood of small farmers but a competition between body corporates and hence should be taxed.

II. RESEARCH QUESTIONS

Whether agricultural income must be included within the ambit of taxable income keeping in mind the burden on the Government to generate superfluous revenues without the generation of too many distortions?

Majority of the income from agriculture in India remains non-taxable. As of 2009-10 such income accounted for 12% of the total gross domestic product, still its contribution to tax is only limited to the value added tax paid on certain products and agricultural income tax on certain plantation crops like coffee. A significant question arising from this situation is that if agricultural income was also treated as being equal to the income from other sectors, i.e. if it was also subject to tax how much additional revenue could be mobilised into the economy? Estimates have shown that it could have created a revenue of approximately Rs. 50,000 Crore for 2007-08 which would account for 1.2% of the total GDP.

Besides revenue being a factor, another issue is that the exemption of agricultural income from being taxed encourages people to under report their income from taxable sources as well. Hence the malpractice of disguising the taxable income under the garb of agricultural income to avoid tax liability is prevalent.

This brings back the discussion that has for long been debated in our country, whether agriculture income must be rendered taxable? The changed organisation and structure of agricultural practices has led to the reignition of this debate. In recent times the face of the concept of agricultural sector has undergone a drastic change and now it is not describable as small farmers struggling to deal with the food security challenge in the nation.⁶ Now, participants in the sector are for commercialisation and competition. The increasing use of machinery in this sector has resulted on changes in the pattern of livelihood. For instance- The number of tractors used for agricultural purposes per 100 square km has risen from 50 in the 1980s to about 200 in 2008. Similarly, in 2008, the total cropped area has been augmented from 185 to 195 million hectares since 1990-91, but interestingly the share of food grains over the

⁶ (Krishna, 1972)

cropped area has remained stagnant at 125 million hectares. This indicates that the area dedicated towards cultivation of non-food grain crops has increased. This would comprise of the fibre-yielding crops and a large variety of horticultural crops and floricultural crops. The returns on non food grain crops are more as compared to those of food grains.⁷ This shows that agriculture is no more the growth of only food grain for self-consumption and for the market rather it has become diversified into a large variety of commercial crops cultivated for commercialisation for the purpose of earning huge profits.

The radical growth of corporate bodies e.g. companies engaged in the agricultural sector is noteworthy. The resultant income from the sale of agricultural products is an enormous amount ranging over Rs. 31313 Crore for 50 companies in 2009-10. The companies involved in such profits earning are not confined to sale of agricultural produce rather they specialise in a diverse range of finished products. Hence the income reported as agricultural income is from the sale of both the agricultural produce and the sale of such non-agricultural products for which the agricultural products have been put to use. For example-A corporate producing cotton and then utilizing it for the production of fabric for sale, may not report the same as income from cotton. The presence of corporate body in then sector depicts that the concept of agriculture has undergone massive change and it is no more true that it implies a small farmer growing crops for his sustenance alone.⁸

A modern concept which brings the corporate houses closer to the agricultural sector is the concept of contract farming. There are two aspects to this concept, the first being that these corporate houses provide technical advisory assistance to these farmers to help them yield quality crop. The second one being that they protect these farmers from the uncertain market fluctuations in the price of the crop either by predetermined prices at which the company will procure the crop or by aiding in the marketing of the product. Small farmers seem to be much benefitted by this practice. Certain initiatives taken up by body corporates have helped the farmers in improving their returns from their cultivated crop. For instance, the PepsiCo initiative in potato cultivation has successfully protected farmers from the effects of a steep fall in potato prices in the market.⁹ Such initiatives show that there have been improvements in the returns that the farmers get after cultivation either by technical inputs chipped in by the corporate houses or by their initiatives to stabilise the price of the crop in the market.

⁷Sushil Kumar et al (2001), "Higher Yields and Profits from New Crop Rotations Permitting Integration of Mediculture with Agriculture in the Indo-Gangetic Plains", *Current Science*, 80 (4), pp 563-66. Surabhi Mittal (2007), "Can Horticulture Be a Success Story for India?", ICRIER Working Paper No. 197

⁸ (Raj, 1973)

⁹<http://www.livemint.com/2010/03/25213353 /Problems-of-plenty-for-West>

A dispute that has arisen in the recent times is that of the treatment of sale of saplings and plants by a nursery.¹⁰ Earlier the tribunals were of the opinion that nursery and pot cultivation shall not be regarded as agricultural activity per se. Any type of cultivation shall only be regarded as being agriculture when it involves both the primary as well as secondary operations in the course of the operations being carried out. Primary operations include basic or the initial steps in agriculture such as tilling of the land. It is only when it is assessed that a person has been performing primary operations that we will come to check if he is also carrying out secondary operations.¹¹ Performing secondary operations alone as in the case of maintenance of a nursery shall not be sufficient for standing the test of being an agricultural activity. The nature of operations involved in the keeping of a nursery are not the cultivation of soil in their true sense. Although there may be utilisation of the earth for rearing plants, the soil is not actually used since cultivation of plants for the purposes of a nursery is usually in earthen pots placed on a concrete structure. Hence it must not be regarded as agriculture and income from them must be subject to taxation.

But by the Finance Act 2008, the definition of agricultural income was enlarged by adding an explanation to it stating that income generated from the selling of plants grown in a nursery shall be regarded as agricultural income. Thus, it is no longer material whether or not basic operations have been carried out and the such income shall receive the benefit of the exemption from tax liability.

Repercussions of changes made by the Direct Taxes Code 2010

The changes brought in by Direct Tax Code have had an effect of widening the scope of the definition of agriculture and agricultural income.

The current definition comprises of three parts, the first being rent from agricultural land, the second being income derived from agriculture on such land and the last being income from farmhouses. The second component has been proposed to be altered by the DTC. The current definition confines that the agricultural produce can be subject only to those additional processes that are so required to be ordinarily employed by the cultivator to render it saleable in the market. It is stipulated that no other processes not essential for rendering it fit for sale must be applied on them. However, the language used in DTC says "any profits and gains derived from cultivation of agricultural land".¹² This definition is wide enough to include all income which is derived from cultivation of land. The restriction that those processes which

¹⁰ (Jugal Kishore Arora vs Deputy Commissioner of Income-Tax , 2004)

¹¹ (C.I.T v. Raja Binoy Kumar Sahas , 1957)

¹² (Jain, 2012)

are not essential for making the produce saleable does not exist and hence the definition of agricultural income has become invariably large.

Also, with respect to farmhouses the current definition stipulates that it be located within the immediate vicinity of the agricultural land, must be used as dwelling house/store house and must be assessed to land revenue. If not assessed to land revenue it must be located outside urban area. By an explanation inserted into the Finance Act 2008 it was added the income from farmhouse for purpose other than agriculture was not regarded as agricultural income. The changed definition as proposed lacks the land revenue stipulation and also the condition that if not assessed by land revenue the farmhouse be located outside urban area. The explanation clause is also absent in it. The implication will be that income derived from the use of farm house whether located in the urban area or the rural area, whether used for agricultural processes or any other processes will be regarded as agricultural income.

The Code also exempts from tax the income earned from cultivation and sale of saplings and plants grown in a nursery.¹³

Hence what is observed is that the scope of agriculture has been increased rather than being narrowed down by the DTC.

How can we most effectively utilise the current taxation legislation and regulations framed thereunder to make sure that the exemption limit of agricultural income from taxation is kept as minimal as possible?

Within the present dispensation of tax powers, the right to tax agricultural income lies with the state governments. However, it is well recognised that while most of the state governments can benefit from the additional revenue this could provide, it may be politically unacceptable for any political to attempt such a measure unilaterally. State-level reforms would, therefore, need either a consensus to jointly implement the tax on some common agreed norms, or even to enter into a tax rental arrangement with the union government. If this is considered a significant enough source of revenue, it might even be worthwhile for the finance commission to assess the potential and find some means of incentivising the introduction of such a tax. This route clearly worked for the adoption of Fiscal Responsibility Acts by the state governments. Here it may be mentioned that while the state governments do seek to safeguard their autonomy, the right to choose not to levy a tax should be accompanied by the responsibility to bear the cost of the resultant short fall in revenue as well.¹⁴

¹³ (Shivani, 2018)

¹⁴ (RAO, 2012)

In the absence of the above, it may be a difficult proposition for the centre to bring all such people under the tax net. To tax such income, therefore, one has to explore the possibilities of taxing at least a part of agricultural income within the present parameters. It is in this context that the definition of "agricultural income" under the Income Tax Act can be used to at least bring a part of the income from agriculture to tax by restricting the ambit of agricultural income to only some crops or processes. In the past, attempts have been made to restrict the income from farmhouses. Such legislations have also withstood judicial scrutiny. Therefore, the DTC provided an ideal opportunity to attempt an exercise in that direction. Unfortunately, no attempt has been made. The discussion paper released at the time of the introduction of the DTC is completely silent in regard to this vital aspect of taxation. Obviously, no suggestions have also been received in this regard. To begin with, income from cash crops and similar produces can be taken out of agricultural income by stipulating that the processes involved therein would not constitute agricultural income. Of course, for this purpose, a thorough study has to be made to properly identify the processes and describe the same. The income of multinationals from growing and selling hybrid seeds has been held to be non-agricultural by some courts. It is necessary to actually spell this out in the form of an explanation rather than leave the litigation to fester. The Direct Tax Code by using a different language, seems to bring such income also under "agricultural income". Wherever there is a significant value addition after the produce is brought out from the soil, it can be kept out. On the contrary, the DTC seems to omit any reference to the "process" itself. Similarly, there is absolutely no reason why income from farmhouses, particularly those in the vicinity of urban areas should not be taxed. The DTC, in fact, is quite regressive in this regard in that instead of restricting the scope, it seems to have enhanced the same.

III. CONCLUSION

A bold and dynamic approach is needed in India whereby all the political parties and all the Chief Ministers of India must organize a conclave to debate and discuss the issues concerning taxation of agricultural income in India. The discussion should be held primarily with reference to the national outlook and not personal gain or otherwise to a political party. If this type of debate or discussion takes place in the country, then surely the policy makers may be able to come to the conclusion that after decades of exemption of agricultural income now is the time that agricultural income be put to tax like any other normal income of the tax payer.¹⁵

The prudent path to take would be to amend the definition of 'agricultural income' under the

¹⁵ (Prakash, 2013)

tax laws, and impose an appropriate monetary threshold after careful deliberation and study. Income that is not covered by this revised definition can then be subject to income tax.¹⁶ This would ensure that only the high-income farmers come under the purview of taxation, and the interest of small scale and mid-scale farmers is protected. Another alternative is for the parliament to formulate a model law to for the states to adopt, with a reasonable threshold and slab rates, much like income tax, to tax agricultural income.

¹⁶ (Rajaraman, 1995)

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