

360° Workshop on Agricultural Income

INDEX

S.No.	Particulars	Page No.
1.0	Introduction	1
2.0	Constitutionality of Agricultural Income	1
3.0	Taxation of Agricultural Income	2
3.14.0	Sub-clause (a) – Rent or revenue	6
3.15.0	Sub-clause (b)	8
3.16.0	Sub-clause (c)	9
3.17.0	Composite Income	10
4.0	Exemption u/s. 10(1)	12
5.0	Capital Gains Exemption in respect of Agricultural land – u/s. 2(14)	13
5.13.0	Compulsory Acquisition	18
6.0	Exemption u/s. 10(37) and section 54B	18
7.0	Wealth-tax	21

CA. Ashish Goyal,

B.Com, ACA, ISA(ICA), LL.B.

E-mail: ashishgoyalg@yahoo.com

360° Workshop on Agricultural Income

- CA. Ashish Goyal,
B.Com, ACA, ISA(ICA), LL.B.
E-mail: ashishgoyalg@yahoo.com

1.0 Introduction

1.1 Agricultural income has been a major source of GDP in India. Although the percentage contribution of agricultural income to GDP is decreasing year after year, yet, in absolute terms the contribution of agricultural income to the economy is increasing.

1.2 Agricultural income has been a major tool for capital generation and we professionals have been suggesting investment in agricultural land and generation of agricultural income, as the income therefrom is tax free. Further, transfer of rural agricultural land is exempt from Capital Gains tax.

1.3 Kelkar Committee has suggested the Government to tax agricultural income. Kelkar committee pointed out that such exemption offered an escape route for tax evaders and that laundering of non-agricultural income as agricultural income is prevalent to a very large extent and that, this is “empirically verifiable”. In the absence of an equivalent tax burden in the States, it affects horizontal equity, because taxpayers similarly placed were facing dissimilar liability. With the Direct Tax Code in offing one wonders whether agricultural income would be brought to tax by Central Government. To tax it, the Constitution may be required to be amended, taxation of agricultural income seems to be quite unlikely in near future as to say it loosely, such an amendment would have a negative “political appeal”.

1.4 In this paper I have discussed in a question answer form, the relevant provisions of I-T Act.

2.0 Constitutionality of Agricultural Income

2.1 What is the Legislative position of agriculture and agriculture income?

As per entry 82 to the Central list in Schedule VII to the Constitution, the Central Government has been empowered to levy taxes on income except agricultural income. As per Article 366, ‘Agricultural income’ shall have the meaning ‘as defined for the purposes of the enactments relating to Indian Income-tax’.

The State Government has however the power to levy taxes on agricultural income.

2.2 What is the Constitutional validity of taxation of agricultural income/ operations?

(a) Including agricultural income for rate purposes has been held to be constitutionally valid. *Abdulla (KV) vs ITO (1980) 161 ITR 589 (Kar.)*

(b) By amendment made by Finance Act, 1989, sale of non-rural agricultural land was treated as capital gain and it was clarified that same is not agricultural income. However, rural agricultural land continued to be exempt from capital gains. Introduction of capital gains on agricultural lands by Finance Act, 1989,

w.r.e.f. 01.04.1970 was held constitutionally valid. Earlier to this amendment, assessee were disputing sale of agricultural land as agricultural income. The amendment is within legislative competence. Singhai Rakesh Kumar 227 ITR 81 (MP).

(c) Rule 8 which deals with apportionment of composite income in case of tea business was held to be Constitutionally valid. Tata Tea Co. vs State of West Bengal (1988) 173 ITR 18 (SC).

(c) By Finance Act, 2008, sale of seeds and saplings by nursery has been treated as agricultural income w.e.f. 01.04.2009. It is important to note Article 274(1) of the Constitution which states that “no bill or amendment...which varies the meaning of the expression ‘agricultural income’ as defined for the purposes of enactments relating to Indian Income-tax shall be introduced or moved in either houses of Parliament except on the recommendation of the President.” To be constitutionally valid, it may have to be seen that this amendment was brought after recommendation of President. The bill or explanatory notes/notes to clauses do not talk about it.

2.3 What is the importance of agriculture/ agricultural income under Income tax Act?

In Income-tax, agricultural income is important as: -

1. Such income forms part of total income for rate purposes.
2. Such income is a tax free source of capital generation.
3. In some cases where agricultural income generated is composite of agriculture and other activities, the provisions become important like tea, coffee etc.
4. Transfer of Rural Agricultural land is exempt /business income may arise thereon.
5. Exemption u/s. 10(37) and section 54B is also available on such transfer of agricultural land.
6. Ancillary activities relating to agriculture like
 - a. Krishi Upaj Mandi Simitis
 - b. Warehouses/ Cold Storages
 - c. Sale of agricultural equipments/ fertilizers/ pesticides
 - d. Co-operative banks for agricultural purposes etc.

may have special privilege under Income-tax.

7. Earning agricultural income may have bearing on assessment proceedings like selection of case for scrutiny.

In Wealth-tax Act, 1957 also, one needs to understand the status of an agricultural land, whether it is a part of “net-wealth” or not.

3.0 Taxation of Agricultural Income

3.1 What is agriculture? How can a land be said to be used for agricultural purposes?

In the celebrated decision of Supreme Court in CIT Vs Raja Benoy Kumar Sahas Roy (1957) 32 ITR 466 (SC) and Kameshwar Singh (Sir) 32 ITR 587 (SC) and CIT vs Jyotikana Chaowdhurani 32 ITR 705 (SC), the concept of agriculture was dealt in detail.

The primary sense in which the term “agriculture” should be understood, is its root meaning “ager” = field + “cultura” = cultivation; that is to say, field cultivation or cultivation of the ground, in the sense of tilling of the land, sowing of the seeds, planting and similar operations on the land.

Any type of agricultural income is exempt only in case where the land has been used for agricultural purposes. As per Supreme Court in aforesaid cases and subsequent cases, agriculture operations would be performed on land only when both primary and secondary operations are performed on land. Secondary operations are performed subsequent to when the crop sprouts from land.

- (a) Primary/basic operations includes tilling of land, sowing of seeds, planting etc.
- (b) Secondary operations includes weeding, digging the soil around the growth, removal of undesired growths, preservation of the crop from insects and pests and from depredation by cattle, tending, pruning, cutting etc.

The basic kind of operation required would depend upon the nature and kind of the crop intended to be raised.

However, there shall be direct association with the land. Without the operation on the land by way of interfering with the ground or the soil, there would be no agricultural operation within the meaning of the definition.

3.2 Whether the agriculture can be said to exist only if the produce is fit for human consumption?

The nature of produce obtained from agricultural operations is irrelevant. What is to be seen that the primary and secondary operations were performed on land.

Whether the produce was for human consumption or for animal or for any industry or for any other purpose would not make any difference.

Illustrative cases where agriculture operations were said to have been performed: -

1. Horticulture
2. Floriculture
3. Arboriculture
4. Sylviculture
5. Agriculture operations would not be dependent upon whether
 - a. food values are grown or
 - b. artistic or decorative produce is obtained or
 - c. trade or commercial value such as cotton, indigo, jute, rubber etc is grown
 - d. housing value such as bamboo, timber and Palmyra is grown
 - e. fuel value such as casuarinas is grown
 - f. Medicinal and health value such as cardamoms, areca nuts, betels etc are grown.
 - g. Trees are grown.

Thing which may be for human consumption do not be themselves become agricultural income. Eg : -

1. Poultry farming
2. Dairy farming
3. Fishing

In such activities no direct operations are conducted on land.

3.3 Whether where the produce is spontaneously grown, same would be agriculture?

Where the produce grows spontaneously, same cannot be regarded as agriculture as there were no operations performed on land. Grass growing spontaneously or forest produce are not agricultural income.

However, in CIT vs Ramakrishna Deo 35 ITR 312 (SC) the Supreme Court held that where the forest was 150 years old, although the trees may have grown spontaneously, however, substantial activities may have to be performed on such land by assessee for maintenance of such forest, therefore the income from sale of forest produce was agricultural income. With due respect to this decision, the Supreme Court failed to observe that no primary operations were performed in this case. Therefore the decision seems to be doubtful.

3.4 Whether cutting of forests and selling thereof is agricultural income?

Where the forest itself is cut and sold, the same is not agricultural income as no spontaneous operations have been performed. However, same may result in a capital receipt.

3.5 Where shall the land be situated?

In all cases covered u/s. 2(1A), for earning agricultural income, the land should be situated in India. CIT vs Carew and Co. Ltd. (1970) 120 ITR 540 (SC). Whether the land is situated in rural area or urban area is not a relevant factor. However, in respect to sub-clause (c) of section 2(1A), it would be relevant whether the land is assessed to land revenue or a local rate or not. Kindly refer discussion on sub-clause (c).

Non-residents can also earn income from agriculture, provided the land is situated in India.

3.6 Whether in case, assessee received income from leasing of agricultural land for grazing of cattle, whether it would be agricultural income?

Generally, farmers allow grazing of cattle on their agricultural land so as to protect their crop from wild grass and other spontaneous growths or to remove the surplus amount of crop left out. In such cases, the same constitutes agricultural income as the same is incidental to agricultural operations.

However, where letting of land is not incidental to agricultural operations, same does not constitute agricultural income. Like if only spontaneous grass was growing on land and to remove the same cattle was allowed to be grazed, same was not agricultural income. Maharaja Sir Pateshwari Prasad Singh 15 ITR 181 (Oudh); 135 ITR 527 (Mad.).

3.7 Whether income from nursery operations are agricultural income?

- (i) The amendment by Finance Act, 2008 covers income from seeds and saplings grown in nursery has been treated as agricultural income. The amendment does not cover other plantations in nursery like flowers, grass etc. Same is still debatable.
- (ii) In case primary and secondary operations are performed, same would be agricultural income. CIT vs Soundarya Nursery 241 ITR 530 (Mad.)
- (iii) In case pot cultivation is done, same would be agricultural income as long as basic operations are carried out in land. Further processing by pot cultivation does not lose the character of agricultural income. Sudisha Farm Nursery 81 TTJ 714 (Del.)

3.8 Whether primary and secondary operations are required to be performed by the same person?

Generally land shall be the direct or immediate or effective source of income. Where a person performs activity whereby land is not a direct or immediate or effective source of income, the income is not agricultural income in his hands. It is not every person in whose hands the produce of the land passes earns agricultural income.

- (a) In case assessee takes coconut plants on lease to extract coconut from them and sell them, same was not agricultural income.
- (b) Similarly where the assessee purchased rubber plantation, just to extract latex and thereby returned the trees, agricultural income was not earned by him.
- (c) Where assessee purchased standing crop and re-sold it subsequently after harvesting, which was also undertaken by the taxpayer as incidental to purchase of standing crops, when he had no interest in the land except mere licence to enter upon the land to gather produce, same was held to be non-agricultural.

Therefore, by above, it may be seen that generally primary and secondary activities should be performed by the same person.

However, where basic operations were performed by lessee and the lease expired in midst of accounting year and the lessee handed over the possession of the land and the lessor-performed subsequent operations, it was held to be agricultural income in hands of latter. A.S. Karachi 115 ITR 629 (Karn.)

3.9 Whether dividend paid out of agricultural income is also agricultural income?

The dividend income was held taxable, as dividend is received by a person different from company and shareholder receives dividend by virtue of his investment and not due to agricultural operations. Even in case of Tea company, 100% dividend was found taxable.

Bacha F Guzdar (Mrs.) 27 ITR 1 (SC); Tea Estate of India 103 ITR 785 (SC);

However, after introduction of section 115-O, it may be argued that Dividend Distribution Tax (DDT) cannot be levied as when normal tax cannot be levied on such income. Additional tax in the nature of DDT cannot be levied. Support may be taken from decision of Delhi Farming and Construction P Ltd. 260 ITR 561 (SC). In such cases also, on receipt of dividend the same would be exempt in hands of recipient.

3.10 Whether income of partner paid out of agricultural income is also agricultural income?

Conversely, partner's income of salary or interest on capital from agricultural income is held to be exempt as agricultural income. *CIT vs Chidambaram Pillai (RM) 106 ITR 292 (SC)*.

As held by Hyderabad ITAT, share in agricultural income from firm need not be added even for rate purposes.

3.11 In case of co-ownership/trust or any other obligation, if a managing agent/trustee is appointed, his salary in form of share of agricultural income/produce, would it constitute agricultural income?

In case of such managing agent/mutawalli etc. such amount constitutes agricultural income only if he has a beneficial interest over such income. However, if he receives such amount merely as an employee, trustee, manager etc. there is no agricultural income.

3.12 What happens in case money is lent and a mortgage is entered into where the mortgaged asset is agricultural land?

In case mortgaged property is free for use by mortgagee, income derived therefrom is his income.

Therefore where mortgagee earned income from mortgaged agricultural land, as rent or agricultural produce, same would be agricultural income. The income is agricultural income in the hands of mortgagee, even if the same goes to reduce the mortgaged debt, principal and interest.

Even in case if the mortgagee leases the asset, whether to mortgagor (owner) of land or to any other person, same is agricultural income in hands of mortgagee.

3.13 What is agricultural income?

The I-T Act defines the term "agricultural income" exhaustively u/s. 2(1A). A person can earn agricultural income in three manners, covered under sub-clause (a), (b) and (c) of section 2(1A) of the Income-tax Act, 1961. Each of these sub-clauses is discussed in following paragraphs.

3.14.0 Sub-clause (a) – Rent or Revenue

3.14.1 What is covered under sub-clause (a) as rent or revenue?

To be treated as agricultural income, following three conditions shall be fulfilled: -

- (a) The rent or revenue should be derived from land;
- (b) The land must be used for agricultural purposes; and
- (c) Land should be situated in India.

[Raza Buland Sugar Co. Ltd. 123 ITR 24, 28 (All.)]

Some important points to be considered in this respect are: -

- i. Derived from land: - It means “springing from land” or “arising from land”. Land should be immediate and effective source and not secondary or remote source. Income which is derived from agricultural income cannot be agricultural income for its immediate source is not land.

Income held not derived from land:

- Fees for renewal of leases
- Supply of water from an open tank in agricultural land
- Interest payable on rent in arrear. CIT vs Kamakhya Narayan Singh (1948) 16 ITR 325, 328 (PC).

- ii. Rent: -

- Rent is payment against right to use land. CIT vs Kamakhya Narayan Singh (1948) 16 ITR 325, 328 (PC). Giving land on rent is more popularly termed as koli or patta in our region.
- Rent may be in the nature of cash or in kind; both would be agricultural income. However, grant of land in lieu of service to be rendered by grantee is not agricultural income.
- Rent refers to a revenue receipt as against capital receipt. Thus salami paid by prospective lessees, if it is capital receipt is not agricultural income.
- Rent under Income-tax Act has not the same meaning as in Tenancy Acts.

- iii. Revenue: - The word ‘revenue’ in section 2(1A) is not used merely as a synonym for the word ‘rent’. It is used to cover every type of income which does not fall under the heading ‘rent’ or does not come under sub-clauses (b) or (c) provided such income is derived from land which is situated in India and is used for agricultural purposes.

- iv. The words ‘rent’ or ‘revenue’ is employed so as to prevent any discussion as to whether what the landlord realizes should be something in the nature of rent or whether it would include all other types of receipts (including receipts in the nature of tax) that the landlord may realize from the land.

Illustrative cases of what is covered under sub-clause (a)

- (i) Weighing charges recovered from tenants. Probyanand Stud Farm (1936) 4 ITR 114 (Lah.)
- (ii) Compensation from insurance company for the loss of crops due to hail storm. CIT Gupta (Tea) P Ltd. (1969) 74 ITR 337 (Cal.)
Camellia Tea Group P Ltd. 203 ITR 80 (Cal.)

Illustrative cases of what Is “not” covered under sub-clause (a)

- (i) Use of garden for film shooting.
- (ii) Sale of eucalyptus oil.
- (iii) Sale of seeds procured by research.

3.14.2 When an agricultural land is given on lease, but the lessee does not carry out agricultural operations but carries out non-agricultural operations, whether the lesser shall be entitled to claim lease as rent or revenue?

To give rise to agricultural income, it is not enough that the lands are leased for “Agricultural purposes”, if in fact, such agricultural operations are not undertaken. Beohar Sing Raghur Singh 16 ITR 433 (Nag.). It is the actual use of the land which is relevant.

Similarly where land was not given for performing agricultural operations however, agricultural income was generated, lease income in hands of lesser was agricultural income.

3.15.0 Sub-clause (b)

3.15.1 What is covered in sub-clause (b) of section 2(1A)?

Sub-clause (b) of section 2(1A) deals with income derived directly by the assessee first-hand by his own labour or hired labour. This income can be classified into following three categories: -

- a) Income derived by agriculture
- b) Income derived by performance of marketing process
- c) Income derived by sale of raw material.

Para b) above have been discussed below: -

- a) **Income derived by performance of marketing process:** - Many a times the crop as produced is not marketable. To make it marketable, it would be necessary in most cases to perform some processes. To summarise the decisions of Supreme Court and various High Courts, the income from performance of such processes are taken as a part of agricultural income only and only if: -
 - (i) The produce itself is not marketable
 - (ii) The process is ordinarily employed for making it marketable
 - (iii) The process involved is the first next process to make it marketable. For example, where cotton is extracted from trees, the process of converting cotton to cotton bales would be part of agriculture, whereas process of making textiles out of it would not be agricultural.
 - (iv) The product derived from such process is not a different marketable commodity then that of the actual produce. To put it differently, the produce must retain its original character. Like sugarcane is a different marketable commodity then sugar.

Such an income may accrue not only to cultivator who has grown the produce but also to a receiver of rent-in-kind.

Illustrative cases: -

- (i) Ginning of cotton was held to be taxable.
- (ii) Extracting oil from eucalyptus leaves is not marketing
- (iii) Threshing and winnowing of cereals is a process for marketability.
- (iv) Producing tendu leaves is agricultural activity but not making bidis.
- (v) Tobacco as such is salable, activities such as (a) redrying (b) stripping and (c) grading are not agricultural.
- (vi) Making sugar/ gur from sugarcane is not marketing activity.

- (vii) Purchasing paddy, hulling it and selling the resultant rice is not a process for marketability of paddy
- (viii) Raw coffee cannot be sold as such. It has to be dried and cured before it can be sold. Such a process is a part of marketing process.

3.15.2 What does word 'ordinarily employed to make it marketable' signify?

These words signify that the process shall not be essential to make the produce marketable, but may be of such nature as is 'ordinarily employed' by people of that region/locality to make the produce marketable. Paddy at some places is not marketable as such. But at other places is marketable as such. The process adopted in one locality may not necessarily be adopted by another locality. It is the process adopted in the relevant locality ordinarily that has to be taken into account.

3.16.0 Sub-clause (c) – Income from Farm Building

3.16.1 What is covered under sub-clause (c) of section 2(1A)?

Generally any income from building/house property is liable for tax and is not an agricultural income. However, it may be possible that building/house property is occupied as a necessary ingredient. Like farmer living in a part of the land, or a farm house is maintained, or store house is kept for produce or equipments.

This sub-clause deems income from buildings or house property as agricultural income on fulfilling the following circumstances: -

- (a) Requirements qua the PERSON
- (b) Requirements qua the BUILDING
- (c) Requirements qua the LAND

(a) Requirements qua the PERSON: -

- a. In case of landholder receiving rent or revenue: - The building shall be owned and occupied by him;
- b. In case of cultivator or landholder receiving rent-in-kind: - The building shall only be occupied by him. Owning the building is not required.

(b) Requirements qua the BUILDING: - Three conditions shall be satisfied: -

- a. Building shall be in immediate vicinity of the land
- b. It must be required as a dwelling house or as a store house or as an out-huse by the landholder or cultivator, and
- c. It should be so required by reason of the landholder's or cultivator's connection with the land.

If these conditions are satisfied, it is not open to the I-T department to enquire as to how much of the building is in fact necessary for such purposes.

(c) **Requirements qua the LAND:** - Land shall have the following qualities: -

- a. Land shall be situated in India
- b. It shall be used for agricultural purposes.
- c. Land shall either
 - i. Be assessed to land revenue or other local rate (like road cess, irrigation cess, education cess etc) ; or
 - ii. shall not be an 'urban land'.

3.17.0 Composite Income

3.17.1 What happens in case agricultural produce is used as raw material by assessee?

Where the agricultural produce has been used as a raw material in the business of assessee, as per Rule 7(1) of the IT Rules, 1962, the market value of the produce shall be treated as cost to the assessee and he shall be allowed deduction. The final product shall however be taxable.

Some examples are: -

1. Sugarcane plantation used in production of sugar.
2. Cotton plantation used in production of textiles.

It may however, be noted that the person earning the agriculture income and the person using it for business shall be same. Otherwise, this provision shall not be applicable.

3.17.2 What shall be market value in respect to such process?

The market value has been defined in rule 7(2) as: -

- (a) Where agricultural produce is ordinarily sold in the market in its raw state, or after application on it of any process ordinarily employed by a cultivator or received of rent-in-kind to render it fit to be taken to market, the value calculated according to the average price at which it has been so sold during the relevant previous year,
- (b) Where the agricultural produce is not ordinarily sold in the market in its raw state or after application to it of any process aforesaid the aggregate of: -
 - a. The expenses of cultivation;
 - b. The land revenue or rent paid for the area in which it was grown; and
 - c. Such amount as the AO finds, having regard to all the circumstance in each case, to represent a reasonable profit.

3.17.3 Whether where assessee did agriculture operations and stored his agricultural produce in cold storage, whether such income is exempt?

No judicial clarity is existing on the said issue. The Allahabad High Court has in *Avdehesh Kumar Jain (1989) 178 ITR 443 (All.)* held that in such cases, 50% income was held to be income from cold storage.

The matter went to Supreme Court and was set aside to Tribunal *Avadhesh Kumar Jain (1991) 187 ITR 217 (SC)*. The outcome of such decision is not available.

It is important to note that cold storage is not a manufacturing activity as held by Supreme Court in *Delhi Cold Storage P. Ltd. 191 ITR 656 (SC)*. By doing cold storage operations no new product no new marketable produce is made. Thus, the decision of Allahabad High Court in context of same is doubtful.

3.17.4 How income is computed in case of coffee/rubber/tea?

In case of these items the income is calculated as follows: -

	Taxable by Central Government (non-agricultural income)	Taxable by State Government (Agricultural I-T Act)
Tea	40%	60%
Coffee grown and cured	25%	75%
Coffee grown	40%	60%
Rubber	35%	65%

Some relevant issues in this regard are: -

1. In a very recent landmark decision of Supreme Court in *UOI vs Belgachi Tea Co. Ltd 11 ITJ 293 (SC)*, it was held that the income shall be treated as non-agricultural only when some operations are performed. Where tea leaves itself were sold, the entire income was agricultural income.
2. In case of rubber, where income relates only to extracting latex from rubber, same is non-agricultural.
3. Where the entire tea garden and its produce was destroyed by hail storm, and insurance claim was received, the entire income was said to be agricultural income. *Camella Tea Group Pvt LTd. 203 ITR 80 (Cal.)*
4. Where tea company received interest on advances made to sister concern, there was no need of apportionment of such interest income as the same was already taxable. *Sookerating Tea Co. 111 ITR 457 (Gau.)*

3.17.5 What are the special provisions for computing exempt income of Tea/Coffee/ Rubber producing organizations?

1. Tea/Coffee/Rubber producing organizations may also receive a subsidy from their respective Boards. In case such subsidy is received, same would be exempt u/s. 10(31). The exemption is blanket except in case of Tea, where exemption is available subject to Central Government notification.

2. Generally while computing the income of such organizations, an allowance/deduction shall be allowed in respect of replacing old plants. In case subsidy u/s. 10(31) is received, no such allowance shall be made.
3. As per section 43(3) plant inter-alia does not include “tea bushes”. While computing income of tea estates, tea bushes are not to be treated as plant. However, the question still remains whether coffee plants and rubber trees are plant u/s. 43(3) and are eligible for depreciation. In my view since they are tools of trade through which business is run and hence can be treated as plants.
4. U/s. 33AB, a special allowance is also given to such organization engaged in tea/coffee/ rubber production activities to the extent of 40% of their profits.

4.0 Exemption U/s. 10(1)

4.1 What is the exemption available u/s. 10(1)?

Section 2(1A) of the Income-tax Act, 1961 defines agricultural income. However, section 10(1) of the Income-tax Act, 1961 provides for exemption of agricultural income. Agricultural income is however, to be added for rate purposes.

4.2 How agricultural income is computed and added for rate purposes?

Rules for computation of ‘net agricultural income’ for its inclusion for rate purposes are set out in Part IV of the Schedule to each relevant Finance Act. They envisage the computation of income falling under sub-clause (a), (b) and (c) of section 2(1A) as if it were income chargeable under Other Sources, Business or House property respectively. While computing income under these sub-clauses, respective rule of the relevant head of income shall apply. Like while computing income u/s. 2(1A)(b) section 28 to 44D would be operative.

There is a provision for set-off of agricultural losses against agricultural income and any agricultural income-tax levied by a State Government would be deductible in the computation. If the result of the computation is a loss, it will be ignored and the agricultural income for the purposes of the rate schedule will be taken as nil. The net agricultural income thus computed is aggregated with the total income and tax by the assessee is difference of: -

- (a) Income-tax calculated on aggregate of such total income (including agricultural income)
- (b) The income-tax calculated on the amount of the net agricultural income increased by the amount of first slab of income on which tax is charged at nil rate, as if such increased amount were the assessee’s total income.

This computation is not applicable in following cases: -

- (a) The requirement of such computation does not arise in case of firm and company as the computation is only for rate purposes.

- (b) In case the agricultural income is not more than Rs. 5,000 during the year.
 (c) Where there is no income exceeding maximum exemption limit other than agricultural income.

4.3 Whether interest on borrowing for agricultural section is allowable expenditure while computing agricultural income?

No, as held in Addl CIT vs Challapalli Sugars Ltd. 116 ITR 255 (AP)

4.4 Can assessee claim any deduction u/s. 10A, 10B or section 80IA, 80IB etc on agricultural income?

No, since agricultural income is already exempt u/s. 10(1), no further deduction can be claimed.

4.5 During survey, excess stock of food grains was found. Assessee was an agriculturist and had no other source of income. Whether the excess stock of food grains represented undisclosed income?

Where the assessee has only one source and no other source, any undisclosed income would represent such source only. Thus the excess stock would represent the undisclosed agricultural income. Same cannot be added. Support may be taken from CIT vs Margret's Hope Tea Co. Ltd. 201 ITR 747 and Laxmichand Baijnath 35 ITR 416 (SC).

4.6 What records shall be maintained to prove agricultural income?

In case of exempt income it is the responsibility of the assessee to prove that the income is exempt. The relevant accounts for agriculture are required to be maintained. The land revenue records, like Khasra, Khatauni, Bhu-rin pustika etc. support the contention of the assessee. Further, mandi receipts justify the sales in case sales are made through Mandi-samiti. Where AO doubts that agricultural income cannot be deduced, he shall estimate such income u/s. 144. The importance of this arises as he would be treating the balance income as 'Undisclosed Income'.

1. It is important to note that while estimating, a reasonable basis shall be adopted looking to the crops grown, fertility, location, distance from market etc.
2. Further, the excess income computed may be treated as 'Undisclosed Income' only where the assessee has any other source of income. If the assessee has no other source of income or where other sources are defined sources like dividend etc., whatever excess income is earned would represent undisclosed excess agricultural income. Same cannot be added. Support may be taken from CIT vs Margret's Hope Tea Co. Ltd. 201 ITR 747 and Laxmichand Baijnath 35 ITR 416 (SC).

5.0 Capital Gains Exemption in respect of Agricultural land – U/s. 2(14)

5.1 What are the provisions in relation to capital gain of agricultural land?

U/s. 2(14)(iii) a rural agricultural land in India is exempt from capital gains. The following conditions shall therefore be fulfilled: -

1. There shall be an agricultural land
2. Such land shall be a rural land
3. Such land shall be in India.
4. Such transfer is made exempt only from the head “Capital Gains”. Where such transfer covered is under the head of “Profits and Gains of Business and Profession” same would be taxable.

5.2 When a land is said to be agricultural land?

What is ‘agricultural land’ has not been defined in the Constitution or the Income-tax Act. It, therefore must be given the meaning which it ordinarily bears in English language and as understood in common parlance.

Various tests are laid down by the courts for determining whether the land is an agricultural land or not. Totality of relevant facts must be taken into consideration while deciding if a land is agricultural. The tests evolved by the courts are more in the nature of guidelines. It is question of fact to be decided based on circumstances of each case.

Some of the tests are discussed below: -

1. Whether the land is assessed to land revenue as agricultural land. Although such a test is prima-facie test, but same is not conclusive.
2. Whether permission under Land Revenue Code was obtained for non-agricultural purpose? And if so, when and by whom and for what portion of land?
3. Actual usage of land for agricultural purposes at the time of transfer is a crucial test.
4. Usage for agricultural purposes shall be for a reasonable span of time prior to the relevant date. It must not be as a stop-gap activity.
5. Whether the income derived from the agricultural operations carried on in the land bore any rational proportion to the investment made in purchasing of land.
6. Whether the land, on the relevant date, has ceased to be put to agricultural use? If so, whether it was put to an alternative use? Whether such cesser and/ or alternative user was of a permanent or temporary nature?
7. Whether the owner meant or intended to use it for agricultural purposes?
8. Whether the land was situated in a developed area? Whether its physical characteristics, surrounding situation and use of the lands in the adjoining area were such as would indicate that the land was agricultural?
9. Whether the land itself was developed by plotting and providing roads and other facilities?
10. Whether there were any previous sales of portions of the land for non-agricultural purposes?
11. Whether permission was obtained because the sale or intended sale was in favour of a non-agriculturist? If so, whether the sale or intended sale was in favour of a non-agriculturist? If so, whether the sale or intended sale to such non-agriculturist was for non-agricultural or agricultural user? Such factor as been disputed vide Gordganbhai Kahandas Dalwadi 127 ITR 664 (Guj)
12. Whether the land was sold on yardage or acreage basis?
13. Whether, an agriculturist would purchase the land for agricultural purposes at the price which the land was sold and whether the owner would have even sold the land valuing it as a property

yielding agricultural produce on the basis of its yield. CIT vs Siddharth J. Desai 139 ITR 628 (Guj.)

14. Characteristics of adjoining land. If the surrounding lands are agricultural lands, the presumption would be in favour of holding that the land in question was also agricultural land.

Some irrelevant factors as decided by courts: -

1. Inflation or escalation of price of agricultural land would not change the basic character of the land.
2. Whether the land is capable of being used for agricultural purposes. CWT vs Officer in Charge (Court of Wards) 105 ITR 133 (SC).

Some of the relevant decisions are: -

1. Agricultural activities carried out as a stop-gap activity. Same is not eligible for exemption. CIT vs Geminie Pictures Circuit Pvt. Ltd. 220 ITR 43 (SC).
2. If the land had not been used for agricultural purposes in prior years, but has been used for such purposes at the time of sale, it could be agricultural land. Conversely, if it was used for agricultural purposes in prior years, but has not been used for such purposes at the time of sale, same would not be agricultural land.
3. Forest were purchased and assessee was converting them into agricultural land over a period of time. However, part of it could not be converted due to paucity of funds, and it was sold. Such land was agricultural land. ITO vs Thirumbadi Rubber Co. Ltd. 9 ITD 100 (Coch.)
4. Land was purchased for constructing house. However, agricultural operations were carried out. It was held that the fact that it was purchased for construction of house was irrelevant. Land was agricultural. Addl CIT vs Tarachand Jain 123 ITR 567 (Pat.).
5. Land purchased and building and road constructed on that. On remaining portion plantation was done. Land not assessed to land revenue. Assessee sold land at high price. Adjoining lands were residential buildings. Land was agricultural Land. Gemini Pictures Circuit P. Ltd. 130 ITR 686 (Mad.)

5.3 Where another person carried agricultural activities on assessee's land without the permission of assessee, whether it would be said to be agricultural land?

The same would be said to be agricultural land, as held by Calcutta High Court in CIT vs All India Tea & Trading Co 117 ITR 525 (Cal.)

5.4 Whether earning of agricultural income is necessary to show the land to be agricultural?

Under the 1922 Act, the land could have been said to be agricultural only if it yielded agricultural income. However, under the 1961 Act, there is no requirement that the land shall yield agricultural income.

Even if for situation beyond the control of assessee, no agricultural operations could be carried out during relevant year and no agricultural income is earned, the status as agricultural land would not cease. CIT vs All India Tea & Trading Co 117 ITR 525 (Cal.)

5.5 Where agricultural land comprises of other properties also, what portion of it would constitute agricultural land?

In such circumstances it would be relevant to see whether such other properties are necessary ingredients of and vitally connected with the assessee's properties for agricultural operations and constitute part of agricultural land.

In Tea Estates India Pvt. LTd. 59 ITR 428 (Cal.) it has been held that where water tanks and roads were located on the assessee's tea gardens, they formed part of the agricultural land. Water pipes and bridges were held not to be part of agricultural land. Also refer CIT vs Ananthan Pillai 94 ITR 122 (Ker.)

However, in Clen Leven Estates Ltd 92 ITR 391 (Ker.), building situated on agricultural land was held not to form part of agricultural land.

5.6 Burden of proving that the land is agricultural land or not lies on whom?

The burden of proof lies on assessee to prove that the a particular piece of land is agricultural and that the same is rural. However, once assessee produces cogent evidence to support him claim, the onus lies on department to establish that the claim of assessee is not correct.

5.7 What is a rural agricultural land?

A land which is not situated in following areas is rural agricultural land: -

- (a) In any area
 - which is comprised within the jurisdiction of a municipality or a cantonment board; and
 - which has population of not less than 10000 according to last preceding census of which the relevant figures have been published before first day of the previous year.
- (b) In any area
 - within such distance, not being more than 8 kms from aforesaid municipality or a cantonment board; and
 - the Central government having regard to urbanization of that area and other relevant considerations, specify in this behalf by notification in Official Gazette. [see Notification No. 9447 dt. 06.01.94 reported in 205 ITR St. 121 and Notification No. SO 1302 dt. 28.12.1999 reported in 248 ITR 258]

In case (a) both conditions are cumulative. Thus where the agricultural land is situated in municipality but the population is less than 10000, in my view the same would be rural agricultural land.

5.8 What is a 'municipality'?

Generally understood, 'municipality' means a legally incorporated or duly authorized association of inhabitants of a limited area for local governmental or other public purposes [BLACK's Law Dictionary]. The plain language employed in section 2(14), however, makes it clear that the intention of the Legislature is not to treat every local authority as a municipality; but, on the other hand, only those local

authorities which have all the trappings of a municipality as stated above, can be said to be municipalities. [CIT vs Murali Lodge 194 ITR 125 (Ker.)]

A panchayat cannot be treated as municipality.

5.9 Population of village in which assessee resides is 8000. Whereas population of the municipality is 12000. Whether the land is rural agricultural land or urban agricultural land?

The population of the municipality has to be taken into consideration. The land is not a rural agricultural land as situated in municipality having population not less than 10000. G.M. Omarkhan (1992) 196 ITR 269 (SC).

5.10 As on 01.04.2005 census of 1991 was available. On 10.04.2005 Census of 2001 were published. Whether for F.Y. 2005-06 Census of 1991 would be relevant or Census of 2001 would be relevant?

The Act uses the words “according to last preceding census of which the relevant figures have been published before first day of the previous year”. Thus the census should have been published prior to first day of the previous year. Census of 1991 would be relevant.

It is worthwhile to note that for wealth-tax, the census published prior to valuation date are relevant. Valuation date is 31st March each year. So in the present case, for F.Y. 2005-06, for wealth-tax valuation of 2001 would be relevant.

5.11 Can AO treat the income from sale of agricultural land as business income/ adventure in nature of trade?

Yes, however the ingredients of adventure in nature of trade shall be satisfied.

Where assessee inherited agricultural land and after converting it into non-agricultural land and dividing it into plots sold it, and also re-purchased some of the plots sold and resold them, it was held that it was capital gain and not business Income. CIT vs Premji Gopalbhai 113 ITR 785 (Guj.); CIT vs Dhananjay Rao Jadhav 7 ITJ 208 (MP)

Assessee did not convert agricultural land into non-agricultural purposes, and sold after dividing into plots. It was held that assessee was not engaged in business of buying and selling land. Same is not taxable as business income/adventure in nature of trade. CIT Vs Smt. Bilkishbai 7 ITJ 202 (MP);

In CIT vs Suresh Chand Goyal 209 CTR 410 (MP) assessee diverted land and even did development work including laying of road etc . It was held to be capital gain exempt from tax.

5.12 Can AO make a reference to DVO for determining the FMV of 01.04.1981?

There is no provision in the Act. Neither section 55A allows it nor the same is covered u/s. 142A and also section 50C does not allow it. AO cannot make such a reference.

5.13.0 Compulsory acquisition

5.13.1 What are provisions relating to compulsory acquisition ?

In case of compulsory acquisition of any capital asset: -

1. The compensation is taxable in the year of first receipt (whether such receipt was part receipt of full receipt)
2. Enhanced compensation shall be taxable in the year of its receipt. In such a case, the cost of acquisition shall be taken as NIL.
3. Where compensation/ enhanced compensation is reduced by court, the Capital Gain of that year in which such amount was taxed, shall be recomputed.
4. Interest on enhanced compensation is also taxable only when the matter attains finality. However, such interest is said to accrue on year to year basis and shall not be taxable in year of receipt, but shall be spread over all the years.

5.13.2 The agricultural land of assessee was compulsorily acquired, but he challenged the compulsory acquisition. He won the case, and the court held that compulsory acquisition was invalid. Assessee received compensation for wrongful acquisition of his agricultural land. Whether amount received was agricultural income?

The compensation in such cases is inseparably connected with agricultural land, and the assessee receives such in lieu of agricultural land which he would have otherwise received by cultivating the land. In my view such compensation is agricultural income. Support may be taken from CIT vs Gauri Shankar Agrawal 131 ITR 27 (All.)

6.0 Exemption u/s. 10(37) and section 54B

6.1 What is covered for exemption u/s. 10(37)?

Where the rural agricultural land is compulsorily acquired, the compensation received is treated as agricultural income. However, in case of acquisition of urban agricultural land, the assessee had to make investment u/s. 54B or other sections.

In order to provide an exemption in case of compulsory acquisition of urban agricultural land, section 10(37) had been inserted by Finance (No. 2) Act, 2004. The exemption is available if following conditions are satisfied: -

1. Exemption is available to Individual or HUF only.
2. The land is agricultural land
3. The land is not a rural agricultural land.
4. The land was used by assessee individual or HUF during two years immediately prior to transfer for agricultural operations.
5. Such transfer is by way of compulsory acquisition under any law, or a transfer the consideration for which is determined or approved by the Central Government or the Reserve Bank of India.

6. Such income has arisen from compensation or consideration for such transfer received by such assessee on or after 01.04.2004.

Compensation would also include enhanced compensation.

Some issues which may arise are: -

1. Whether transfers prior to 01.04.2004 are also covered?
2. What do words “or a transfer the consideration for which is determined or approved by the Central Government or the Reserve Bank of India” signify?

6.2 What exemption is covered u/s. 54B?

Section 54B provides an exemption from capital gains on transfer of an agricultural land. The exemption is relevant only in respect of urban agricultural land as rural agricultural land is already exempt from capital gains.

The exemption is available if following conditions are satisfied: -

1. Land is an agricultural land in India.
2. The land was used by assessee individual or his parents during two years immediately prior to transfer for agricultural operations.
3. Within two years from date of transfer of such land, assessee acquires another land for being used for agricultural purposes. Such land may be rural or urban.
4. Such new land shall be held for 3 years by the assessee.

The capital exempt is: -

- (a) If Capital Gain > cost of new land Then capital gain – cost of new land is taxable.
- (b) If Capital Gain <= cost of new land ... then whole amount is exempt.

If the new agricultural land is transferred within 3 years of its purchase, for computing Capital gain on new land: -

- i) In case (a) above applied, the cost shall be nil
- ii) In case (b) above applied, cost = cost – capital gain.

6.3 Explain the provisions of capital gain account scheme applicable?

The investment in new agricultural land is to be made within two years. In the intermediate period, if prior to filing of return, the investment if not so made, the same shall be deposited in capital gain account scheme.

If after depositing the amount, the same is not utilized within 2 years as above, then: -

- (i) The assessee shall be entitled to withdraw the amount; and
- (ii) The amount not so utilized shall be income chargeable to tax in the previous year in which such period of two years expires.

6.4 Whether exemption u/s. 54B can be claimed by HUF?

From the language of section 54B, which states that the land was held by assessee or his parent, it was interpreted that the exemption was available only to individuals and HUF cannot claim exemption.

6.5 Where the assessee held the agricultural land for one year as coparcener of HUF and one year in his individual capacity after partition of HUF, whether on sale of land, he was entitled to exemption u/s. 54B?

Assessee was held to be entitled to exemption.

6.6 Can assessee claim exemption where the old agricultural land was purchased on 27.03.2004 and sold on 04.04.2005?

Held by Pune ITAT in *Ramesh Narhari Jakhadi 41 ITD 368*, that section 54B contemplates user of agricultural and in the two years immediately preceding the date of transfer, and therefore, the reference is to the years and not during the whole period of two years. Thus, where the asset had been used for the whole of the immediately preceding year and some days of the year earlier to the preceding year, still the requirement of section 54B would be satisfied.

The decision is not free from doubts.

6.7 Whether the old land shall be a short term or a long term asset?

It may be a short term or a long term capital asset.

6.8 Whether where prior to date of transfer, assessee invests in new asset, out of advance received or earnest money, can he still claim exemption?

Held by Pune ITAT that he can still claim exemption.

6.9 The assessee is in possession of a land for more than 2 years which had no water facility. He cultivated a part of its land and no further cultivation was possible due to scarcity of water. He sold such land and invested in another agricultural land. Whether he was eligible for exemption?

The use referred to in section 54B could only be regarded as such use as the lands were capable of with the aid of available resources. The assessee could not be deprived of the admissible relief because he was actually unable to put the land to use due to vagaries of nature and non-availability of resources. He should be encouraged to replace a non-cultivable land with a cultivable land. The exemption was therefore held allowable by Hon'ble Madras ITAT.

6.10 Whether the amount can be deposited in capital gain account scheme, after due date of filing of return?

The ITAT Bangalore, in a recent decision in context of section 54F held that the amount can be invested after due date of filing of return u/s. 139(1) but before due date as prescribed u/s. 139(4). Section 54F uses the same language as section 54B. The ratio can therefore be adopted for section 54B also.

However, with due respect, it may be noted that the Act itself uses the language that the investment has to be made prior to due date of filing of return u/s. 139(1). The decision in context of the same seems to be doubtful.

7.0 Wealth-tax

7.1 Whether agricultural land is taxable under Wealth-tax Act.?

Prior to A.Y. 1993-94, definition of asset was covered u/s. 2(e) of the Wealth-tax Act, which included agricultural land as an exempted asset. However, “asset” has since been defined in section 2(ea) which defines asset exhaustively.

Agricultural land is not considered. It is neither treated as asset nor excluded therefrom.

However, “urban land” is made an asset. Urban land has same meaning as under section 2(14)(iii) of the Income-tax Act, 1961. Following are not included in urban land: -

1. Land on which construction of a building is not possible under any law or the land on which building is constructed with the approval of the appropriate authority
2. Any unused land held by the assessee for industrial purposes for a period of two years from the date of its acquisition by him;
3. Any land held by the assessee as stock-in-trade for a period of ten years from the date of its acquisition by him.

The provisions of section 2(ea) has still to see the light of the day. However, it seems that in a case where

- the land was acquired in urban area as investment,
- and there is no restriction on construction of building, and
- any agricultural income therefrom is shown,

It may be liable for wealth-tax. However, even in such cases exemption of one house or plot of land not exceeding 500 sq. mts. is allowable.

7.2 What are the provisions relating to Farm House?

A farm house situated within 25 kms from local limits of any municipality is a taxable asset. However, following exemptions are provided: -

1. a house meant exclusively for residential purposes and which is allotted by a company to an employee or an officer or a director who is in whole time employment, having gross annual salary of less than Rs. 5,00,000
2. Any residential house/ commercial house forming part of stock-in-trade.

3. Any house which is occupied by the assessee for the purposes of any business or profession carried on by him;
4. Any residential property that has been let-out for a minimum period of 300 days in the previous year, and
5. Any property in the nature of commercial establishments or complexes.