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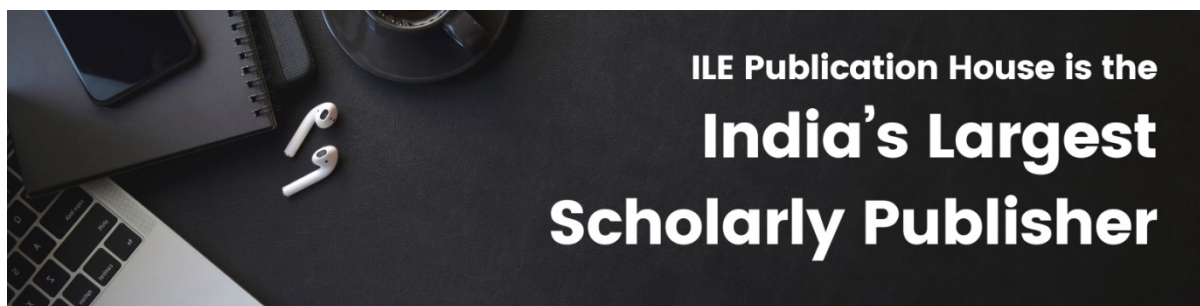
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TAXATION OF AGRICULTURAL INCOME UNDER INDIAN LAW

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Have you ever wondered why India frequently claims that agricultural income is "tax-free"? Are there unstated regulations and restrictions, or is it truly exempt from all taxes? Farmers, investors, landowners, and experts handling financial planning all need to grasp how agriculture fits into the tax system in a nation where it plays a significant role in the economy. This article will provide you with a clear and useful understanding of how agricultural INCOME is classified under the INCOME Tax Act, 1961. In this blog, we will dissect the idea of agricultural income under Indian INCOME tax law, 1961.

CONCEPT OF INCOME

The consistent flow of money that people or businesses receive on a daily, weekly, monthly, or annual basis is referred to as income. Both monetary wages and the worth of intangible benefits like allowances and perquisites are included. All types of income are liable to income tax unless they are expressly exempt.

Definition of Income: Sec. 2(24)

No comprehensive definition can possibly be given as to what is income. The Income Tax Act, 1961 itself does not attempt to define it exhaustively. Sec. 2(24) of the Act does define income, but is only an inclusive definition. As a matter of fact, it merely enumerates certain items which cannot be ordinarily treated as income, but are statutorily treated as such.

"Income" includes

(i) profits and gains

(ii) dividend

(iii) voluntary contributions received by a trust/institution formed wholly or partly for religious or charitable purposes, or by an association or institution

(iv) Perquisites

(v) Special or other allowances

(vi) Interest payments from a company to an assessee

(vii) Capital gains

(viii) Income from other sources

The Indian parliament is not authorized by the constitution to impose a tax on agricultural revenue. The central income tax does not apply to agricultural income. Agriculture income can only be taxed by the state government. It should be mentioned that, as of the assessment year 1974-75, agricultural income is now taken into account when calculating the tax on non-agricultural income. Net agricultural income is included in total income for individuals, Hindu undivided families, unregistered businesses, and associations of people (apart from companies, registered businesses, cooperative societies, and local authorities) if non-agricultural income surpasses the exemption level. As a result, non-agricultural income is subject to higher tax rates. It is the assessee's responsibility to demonstrate that an income is from agriculture.

Sec. 2(1A) of the Income Tax Act defines "agricultural income". The essential ingredients of the section are as follows:

(a) Clause (a) includes within agricultural income, any rent or revenue derived from land which is situated in India and is used for agricultural purposes;

(b) Clause (b) includes within agricultural income, income derived from such land by (i) agriculture, or (ii) the performance (by a cultivator or receiver of rent-in-kind) of any process ordinarily employed to render the produce fit to be taken to the market, or (iii) the sale of such produce made 'fit'.

(c) Clause (c) includes within agricultural income, income from buildings linked to agriculture i.e. agricultural house property. Such house property to be exempt from tax must be on or in the immediate vicinity of agricultural land and must be occupied by the cultivator or the recipient of agricultural income, and, the cultivator or the recipient should, by reason of his connection with land, require it as his dwelling house or storehouse or other out-building. Further, the land must be subject to land revenue/local tax, and where land is not assessed to land revenue, it should not be within jurisdiction of municipality cantonment board or within 8 km of it.

Explanation 1 - It provides that a surplus arising on transfer of agricultural derived from any building or land.

Explanation 2- For the removal of doubts, it is hereby declared that income derived from any building or land referred to in sub-cl.(c) arising from use of such building/land for any purpose (including letting for residential purpose or for the purpose of any business or profession), other than agriculture falling under sub-cl. (a) or (b) shall not be agricultural income.

Partly Agricultural Income (Rule 7)

When calculating the portion of income that is subject to income tax under the heading of "profits and gains of the business or profession"

that is partially agricultural income, the market value of the agricultural products that the assessee has grown and used as a raw material in that business must be taken into account in relation to any expenses incurred by the assessee as a cultivator.

Before a certain type of revenue to be classified as agricultural income, three main requirements must be met:

- (i) that the income has a connection to land,
- (ii) that the land is located in India, and
- (iii) that it is utilized for farming.

1) Income Derived from Land

The terms "rent" and "revenue" are used in **Sec. 2 (1A)(a)** of the Act. The term "rent" refers to the amount of money paid in cash or in kind (a share of crops) by any individual to the landowner in exchange for the owner granting them the right to utilize the land. "Revenue" does not refer just to land revenue; it also refers to yield, return, profit, or income [**Raza Buland Sugar Co. Ltd. v CIT (1980) 123 ITR 24 (All)**]. Therefore, the money collected in exchange for granting a lease renewal is money received from the land. To be 'derived' is to arise or accrue. Only when land is the primary source of income and not a subsidiary or indirect source can it be used to generate income. Since land is not the immediate and effective source, it stands to reason that interest on rent arrears cannot be obtained from it [**CIT v Kamakshya Narain Singh (1948) 16 ITR 325 (PC)**].

Even though the land had traditionally been used for agriculture, the owner's rent or compensation from the government would not be considered agricultural income if the government requisitioned the land and it was utilized for non-agricultural purposes. However, the portion of land revenue that the government collects and gives to the prior owner is considered agricultural income if the land is still used for agricultural purposes even after requisition. A landlord receives salami, or premium, when agricultural holdings are transferred from one

person to another. This is money the landlord receives because he owns the land. Therefore, such salami or premium is considered agricultural revenue.

(2) Land Must be Used for Agricultural Purposes

The Supreme Court in the below-discussed case explained as to what constitutes 'agriculture'.

LEADING CASE: CIT v RAJA BENOY KUMAR SAHAS ROY (1957) 32 ITR 466 (SC)

Facts and Issues: The Raja was the owner of a forest in this instance. The question is whether the forestry operations performed by the workers (pruning, weeding, felling, guarding, digging, etc.) constitute "agricultural income" or not. Originally, the forest was one of spontaneous development, with trees that were not developed with the help of human labour. The assessee argued that he could barely benefit from the trees until such operations were carried out on them. According to a liberal interpretation of the term, what he accomplished on the trees with the help of laborers and workers qualified as "agricultural operations."

Observations and Decision: The Supreme Court noted in its ruling that the term "agriculture" should primarily be interpreted in its root meaning, "ager," which means "field," and "culture," which means "cultivation." This includes field cultivation, which includes tilling, planting, and other similar land-based activities. These are fundamental activities that need the application of human labour and expertise to the soil itself. They are also all focused on causing the crop to emerge from the ground. The following tasks, such as weeding, excavating, removing unwanted undergrowth, etc., are required for the crop's effective production after it emerges from the ground. Only when combined with and as an extension of the fundamental operations are these later activities considered agricultural. Because the labour and human skill needed for

such operations cannot be attributed to the land itself, they cannot be classified as agricultural activities based solely on the performance of succeeding operations if such goods have not been raised by basic operations. Therefore, there would not be an agricultural activity in the sense of the definition if there were no land-based activities that involved tampering with the ground or soil. The court further noted that a fiscal statute must be interpreted rigorously and that the subject must be given the benefit of the doubt if there is any. However, the Income-tax Act's definition of "land used for agricultural purposes" clearly excludes forests of spontaneous growth, where no effort is made to prepare the soil for the planting of trees.

Even though the forest in this instance is 150 years old, certain of its sections have occasionally been cleared and "fresh trees" planted there; therefore, the revenue generated by those trees would be considered "agricultural income." However, it cannot be claimed that every tree was cultivated in this way; as a result, 'agricultural income' cannot be used to describe the total revenue from forest trees.

In CIT v. Jyotikana Chowdhurani (1957) 32 ITR 705, the Supreme Court likewise voiced the similar opinion that maintaining forest trees properly requires human labor and expertise, but this cannot be considered a "agricultural operation" on its own because the forest continues to develop naturally.

PRINCIPLE OF DIRECT NEXUS

The assessee must be directly involved in the production of agricultural income. Merely having an indirect relationship won't qualify as agricultural income if the source of money is something else. Accordingly, a Malikana allowance given by the government to an owner in accordance with the law is not revenue derived from land, but rather the government's legal duty to compensate the landowner [Pratap Singh v Province of Bihar (1949) 17 ITR 202].

LEADING CASE: BACHA F. GUZDAR v CIT (AIR 1955 SC 74)

Facts and Issue – The challenge in this case was whether dividends paid to shareholders by a business that earned some of its income from farming and some from other sources would qualify as agricultural income. The corporation continued to grow and manufacture tea, thus the sale of the manufactured tea generated both non-agricultural and agricultural revenue.

Observations and Decision– The Court held that a shareholder does not receive a dividend from his direct relationship with the land; rather, the income he receives from his ownership of company shares is based on the contractual relationships between the company and its shareholders. Land utilized for agricultural purposes is without a doubt the original source of the revenue, but it would be completely unjustified to give the phrase "revenue derived from land" any meaning other than that which is directly related to or associated with the land. Although the company was engaged in agricultural activities, the shareholder, a separate legal entity, is not bound by the actions of the company. Therefore, dividends paid to shareholders do not count as agricultural income, even if a company's total profits did.

LEADING CASE: CIT v R.M. CHIDAMBARAM PILLAI (AIR 1977 SC 489)

Facts and Issues– The assessee in this instance was a partner in a firm that grew and sold tea. As a partner in the firm, he was paid a specific sum by the company. The question was whether a partner's "salary" from the company that grew and sold tea qualified as "agricultural income."

Observations and Decision– The court ruled that a partner's compensation from the firm he works for cannot be viewed as coming from a different source than his portion of the company's profits. A "partnership" is defined as a relationship between individuals who have agreed to split the profits of a business

operated by all of them or by any one of them acting on behalf of all of them under Section 4 of the Partnership Act. The individuals are referred to as "partners" on an individual basis and as a "firm" collectively. A firm is not a distinct legal entity or personality. Salary payments to partners maintain the same nature as the firm's revenue and represent a special portion of the profits. A firm is not a whole person under income-tax law, but it is a unit of assessment under certain regulations. There cannot be a contract between a firm and its partner because a firm is not a legal person and an employment contract necessitates two separate parties, namely the employer and the employee. According to the court, the partner's remuneration from the company that grows and sells tea is exempt from tax under Rule 24 of the revenue Tax Rules, 1962, to the extent that 60% of it represents agricultural revenue. Only 40% of it is subject to tax.

Instances of non-agricultural income

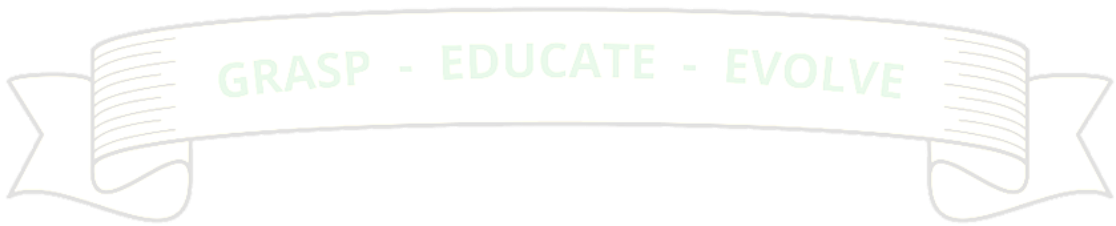
- (i) Activities such as dairy farming, fisheries, poultry, silk cocoons, and other activities that do not involve any fundamental land-based operations would not be considered agriculture only because they have a connection to land.
- (ii) Income from agricultural output storage land.
- (iii) Income from a tank located on agricultural land or from a water supply used for irrigation.
- (iv) Commission that the landlord receives on the sale of his tenant's agricultural products.
- (v) An annual income that a person receives in exchange for the transfer of agricultural land.
- (vi) Interest gained on loans obtained by the assessee through the hypothecation of agricultural products he has grown and sent to its sister companies does not constitute agricultural income.

- (vii) Income from tender forms sold by the assessee who grows sugarcane
- (viii) The "registration fee" that is collected from the contractor bidding at the plantation sale auction is not considered agricultural income because it has nothing to do with the land.
- (ix) Damage or compensation for lost agricultural income as a result of late installment payments for the consideration price of the rubber plantation land is not considered agricultural income.
- (x) Garden land used for agricultural purposes is exempt from taxes, although not all of the money earned there has to be related to agriculture.

As we've explored, not all income earned from land is tax-free, and knowing the fine print can make all the difference. In a country where agriculture plays a vital role in the economy, being informed isn't just helpful—it's essential.

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- **Taxation Laws: Kailash Rai**
- **Universal's the Income Tax Act, 1961**
- **Taxmann's Direct Taxes–Law and Practice: Singhania and Singhania**

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