
CHAPTER - SEVEN

Chapter 7

FUTURE COURSE OF AGRICULTURAL TAXATION

7.1 AGRICULTURAL TAXATION IN RETROSPECT

It is claimed that for both historical and constitutional reasons, agricultural taxation in India has come to lack uniformity and equity and has also become a medium of tax evasion on non-agricultural incomes. It is claimed that instead of taxing agricultural sector on par with non-agricultural sectors in the country, the states have shown a marked degree of favour to agriculture. Even the Central Government has been subsidizing various agricultural inputs (which help the richer farmers instead of the poorer ones) instead of tapping their tax potential¹.

Through historical evolution agricultural taxation in India came to lack a uniformity not only between different states but also between different regions of the same state. At the time of Independence, the British provinces had different forms of land revenue assessment coupled with (in some cases) exemptions and remissions. The British Government had evolved zamindari, mahalwari and ryotwari systems. Furthermore, the land revenue did not reflect the relative productivity or fertility of different lands, Land development like irrigation had been more or less ignored in fixing the land revenue. A levy for the use of irrigation water was collected more in the

form of a rate or a tax on the use of an input than to tax any resultant extra paying capacity of the farmer. Very few princely states had an organized system of land revenue. Lands were not even surveyed and settled. The picture became all the more complicated when attempts at land reforms were made after Independence. Different States adopted different laws and there were variations in the degree of their implementation as well. In some cases legal difficulties were also encountered by attempts at bringing about uniformity. At the same time, financial needs of states prompted some of them to levy surcharges, betterment levies and cesses based on land revenue or crops. These surcharges and cesses were also expected to introduce an element of progressiveness in land revenue. The picture gets further complicated when one notes that in some states land development tax has been imposed. An important cause for lack of uniformity lies in the fact that in many cases the states have followed a different rate policy project-wise, within a state, water rates vary on the basis of crops grown, the area of district and whether water is being supplied from an old or a new irrigation scheme. Rates are higher in the case of new scheme and as a rule, cash crops are subjected to higher water rates than other crops. All told, there are wide variations in rates within each state and still wider differences as between states. This state of affairs not only indicates a lack of proper fiscal policy on the part of the state government but also the fact of huge untapped resource potential.

Similarly though agricultural income tax has a long history, some states impose agricultural income tax and others do not. The first distinction between agricultural and non-agricultural incomes was introduced in 1886 when agricultural income was excluded from the payment of central income tax. This system continued till 1937 when the permission was granted to the Provincial Governments for levying a tax on agricultural incomes. The first province to levy this tax was Bihar (in 1938-39) followed by Assam (in 1939-40) and Bengal (in 1941). Even currently the main yield of agricultural income tax is in the case of states having plantations.

The Indian economy is primarily on agrain economy, agriculture is of key importance both from the point of view of generating national income and providing employment opportunities to the people. It is however unfortunate that despite its strategic position the agricultural sector has not made adequate contribution towards the development efforts of the country. As the agricultural sector contributes a very small percentages of its income in taxes, it has remained inadequately taxed. It has also resulted in relatively heavier burden on the non-agricultural sector and there have developed fresh inequities between the agricultural and non-agricultural sector as also within the agricultural sector. This is not a happy development in the Indian fiscal system and immediate steps are called for to wipe out such a unhealthy trend.

It is beyond doubt that the tax paying capacity of the agricultural sector specially the large landholders has increased considerably during the era of planned economic development. While the agricultural sector pays much less as compared to the non-agricultural sector, its fiscal capacity has also increased due to increase in income owing to rise in prices of agricultural products and increase in productivity of land and also due to the agriculture-oriented expenditure policy of the Government.

However, for various reasons agricultural sector is believed to be taxed lightly as compared with non-agricultural sectors. The tax structure in agricultural sector itself needs a remodelling so as to conform to various criteria of justice and efficiency².

The Government needs huge resources for developmental efforts. Agriculture is the biggest contributor to our national income and is naturally expected to contribute its share in raising the necessary resources for economic development. Like industrial and services sectors, agricultural sector should also yield an economic surplus in order to accelerate the pace of capital accumulation and economic growth. If the agricultural sector has remained under taxed in the past, the mistake should not be repeated now and it is still better late than never that the state governments should take suitable steps to raise the fiscal contribution of the agricultural sector.

This can be done by introducing a graduated surcharge on land revenue, full integration of agricultural and non-agricultural incomes, introducing a tax on plantations and a cess on commercial crops, raising irrigation rates and effectively imposing betterment levies in all the states. It may also be emphasised that income from livestock breeding, poultry and dairy farming should also be brought within the tax net. Many tax reform proposals were put forth by different experts, but hardly any reform proposals have been implemented by the Government. The same old system with slight modifications here and there continues to exist. In addition, some state governments have abolished land revenue and in some state exemption limits have been fixed very high. Why this could shoulder treatment on the part of the Government?

7.2 PROPOSALS FOR TAX REFORM

The specific objectives which have been kept in view while making the proposals for agricultural tax reform are

- (i) to introduce dynamism in the system of agricultural taxation with a view to bring it in agreement with the goals of agricultural and general economic development;
- (ii) to prevent uneconomic use of under cultivation of land or holding of land for speculative purposes and
- (iii) to prevent land accumulation by the wealthier class of agriculturists.

The present anomalous system of agricultural taxation of the country has to be radically revised if these objectives of tax reform are to be fulfilled. But the prevailing political and social conditions in this country do not appear to be favourable for a radical change in the existing system of agricultural taxation. At least in the present political setting of the country any sensible proposal for tax reform would be not only unwelcome, but may also face outright rejection. In view of these hurdles in the way of implementation of the proposals for tax reform, the reform proposals have been designed in two sets. The first set comprises the short-term measures which may be implemented within the existing political and social conditions of the various states and the second set of proposals consists of the measures which aim at radical change in the agricultural taxation system and can be implemented one by one in the long run when political and social conditions provide a favourable climate³.

7.2.1 SHORT TERM MEASURES OF AGRICULTURAL TAX REFORM

7.2.1.1 Uniform Rate of Land Revenue for all Types of Cultivators

One of the irregularities of land taxation system is that different types of tenure holders pay land revenue at different rates in various states. There is no justification for such tax rate differentials. Rather there is every justification for bringing the tax rates on par. If this proposal

is implemented and land revenue rates are made uniform the state governments will be able to raise an additional revenue for their exchequer per annum. Although the implementation of this proposal may meet a legal objection some minor amendments in the land revenue acts in various states may remove this barrier. The effect of such revision cannot be said to be deterrent to production because it is not likely to create any disincentive for the agriculturist, It merely aims of removing the unjustified extra benefits or concessions in tax enjoyed by them.

7.2.1.2 Surcharge on Land Revenue

One of the various defects of land taxation system is that it lacks progression; rather, it appears to be regressive. In order to make land revenue progressive and to tap up a part of residual taxable capacity, a surcharge may be levied on the land revenue at progressive rates. This proposal is not new, More or less similar suggestions have already been made by some eminent economists. K.N. Raj⁴ has suggested the doubling of land tax on holdings above five acres and imposing an additional surcharge on holdings above five acres under commercial crops. His suggestion, however, suffers from some serious limitations. He has not given factual justification for his suggestion to double. The land tax and hence it appears to be arbitrary. Commenting on his suggestion. A.M. Khusro⁵ has rightly remarked that it involves

a continuous check-up of the nature of crops grown from season to season and requires a much larger administrative machinery than at present.

In his paper entitled "Tax policy and the Third Plan" I.M.D. Little⁶ has suggested the raising of land revenue and making it progressive by a system of surcharge based on the amount of land revenue. He has suggested exemption of all holdings below 5 acres from land tax and an imposition of progressive surcharge on every additional acre in the land holdings which ultimately rise to Rs.30 per acre from Rs.3 per acre on an all-India average. A.M. Khusro has rightly commented that there are obvious limitations to Little's scheme of progression. The exemption of holdings below the five acres from land tax will not only reduce revenue to a considerable extent but it will also lead to fictitious distribution of economic holdings and transfer of land among sons and relations with a view to avoid the land tax. Therefore, it appears reasonable to retain the land tax on the small landholders also. Further, if tax rates vary from farmer to farmer they may also involve administrative difficulties.

Khusro⁷ has himself suggested a simple three-tier land revenue system as follows :

- (1) To retain the current rate of land revenue on the holdings up to five acres,

(ii) To enhance land revenue rate by 66 percent on the landholdings above five acres and below to 10 acres.

(iii) To enhancement the rate of land revenue by 100 percent of the new rates for category as the holdings above 10 acres. Khusro's scheme appears to be free from the shortcomings of the previous two schemes and hence plausible. But the common defect in all the three schemes is the arbitrariness in the rates of progression of surcharge of land revenue.

7.2.1.3 Quasitaxation of the agricultural sector

One of the various measures for taxing the agricultural sector is the method of quasi taxation. It can serve as a measure to mobilise resources which are untapped and also as a preparatory measure for long-run strategy in the agricultural tax reform.

There are at present two points where quasi taxes may be introduced, viz. (a) procurement prices and (b) irrigation rates. The government can tax a part of taxable surplus by inserting tax element in the procurement price at which government purchases the food-grain levies from the farmers. The method is simple one. It can be implemented only by keeping the procurement price of a level lower than the market prices. But the tax element in the purchase price should be reasonable, otherwise it will affect the production by reducing the income, saving and investment of the farmer. In the initial stage it

should not exceed five percent of the market price because a wider differences between the two prices market and procurement may lead to discontent among the farmers.

A similar procedure may be adopted with respect to the irrigation rates paid by the farmers. Irrigation rates are generally determined by the 'no loss no gain' principle and not on the commercial basis, Therefore, in the case of underutilisation of the irrigation potential the irrigation project are bound to incur loss. In order to plug this drainage irrigation rates may be revised upwards to the extent of net loss. Otherwise a compulsory levy in the form of capital levy or betterment levy may be imposed on the area where irrigation works have been installed.

7.2.2 LONG-TERM MEASURES OF AGRICULTURAL TAX REFORM

7.2.2.1 Conversion of land revenue into wealth or property tax

The long run strategy in agricultural taxation should be to convert land revenue into wealth or property tax. The wealth or property assessed for taxation purposes should not consist of only land but should include other components of agricultural wealth also such as livestock, and pukka and semipukka building. It should, however, exclude agricultural implements including irrigation instruments. It will encourage investment in land improvements, construction of irrigation channels and purchase of modern agricultural tools and

implements which are conducive to the enhancement of their income in future. Such a provision in the taxation of agricultural wealth and property will not only broaden the base of agricultural taxation but will also help in generating saving and investment within the sector.

7.2.2.2 Reforming taxation of Agricultural income

The long-run strategy in reforming the taxation of agricultural income should be designed to make it much more scientific and absorb major part of the existing taxable capacity. It will required radical changes in the present method of assessment of agricultural income and fixation of rates of taxation in a manner which is in no way deterrent to agricultural production and can yield maximum revenue to the government.

7.2.2.3 Introduction of Labour Tax

A tax in kind. Taxing the surplus labour which is one of the dominant features of the agricultural economy may prove to be a very important source of rural development. Surplus labour in the agricultural sector, which generally goes waste, may be mobilised through labour taxation for the construction of irrigation canals and subsidiary channels, roads, drainage system, dams and barrages etc. The idea of labour taxation may be said to have emerged from the very idea

of raising resources through taxation of income, wealth and commodities for development purposes. Taxation helps in raising financial resources which are supposedly utilised for purchasing physical resources and employing the labour force for capital formation. But in an economy where levels of income and wealth are very low, prospects for commodity taxation are limited and number of tax bases is also small, labour taxation can be employed as a direct measure to employ surplus labour force in the capital formation activities.

If the scheme of labour taxation could be implemented successfully, it may, of course, not increase the revenue of the government but it will fulfil the purpose of raising revenue to a large extent. Labour tax intends to utilise the labour going waste. It is in no way related to the income, saving and investment of the farmers. Therefore, it will not be deforrent to agricultural production, but it will increase agricultural productivity⁸.

7.2.2.4 Land Revenue Vs Agricultural Income Tax

The present difect tax system in Indian agriculture mainly consists of land revenue and agricultural incometax. Experts are of the opinion that either of the two has to be removed from the picture in order to make the tax system consistent. Opinions differ as to which of the two taxes-land revenue and agricultural income tax should be retained abolishing

the other. It is interesting to note the arguments briefly-
of both land.

As pointed out by Gulati and Kothari⁹, land revenue is absolutely superior to agricultural income tax from the point of view of ensuring efficient use of land and land revenue is based on potential productivity whereas income tax is based on realised income. Since land revenue is based on potential production, any increase in production as a result of improved efficiency on the part of the farmer will be retained by the farmer himself and will not be subject to tax. Also since it is a fixed charge per unit of land it will fall heavily on relatively less efficient farmers. Therefore, the land tax will induce (or compel) the farmers to improve their efficiency. Such an inducement will not be provided by the agricultural income tax which taxes realised income thereby taxing the efforts of the farmers.

Ved Gandhi¹⁰ has observed that the argument that a tax on agricultural income would act as disincentive to agricultural production, is weak. He has further pointed out that it is quite possible that an income-tax on agriculture might motivate the farmers to adopt new technology and encourage the farmers to increase production. The land revenue is incapable of inducing inefficient farmers to become more efficient. At least in principle, agricultural income-tax fares better than land revenue with reference to taking an account of diverse situations in

terms of human capacity and production conditions alongwith equity considerations.

Presently, agricultural income-tax is levied only in some states. They are Assam, Bihar, Karnataka, Kerala, Maharashtra, Orissa, Tamil Nadu, Tripura and West Bengal. Each of the states has different exemption limits ranging from Rs.9,000 to Rs.36,000 per year. This has created inter-state inequity in tax burden. In order to eradicate this inter-state inequality, it has been suggested to extent the Central Income Tax to the agricultural sector. The benefits of bringing taxation of agricultural incomes within the purview of Central Income Tax, as enumerated by Ved Gandhi, are as follows. Firstly, such an extension would increase tax revenue of the government by reducing the scope for tax avoidance which is done by splitting the incomes as agricultural and non-agricultural such a splitting is because the present tax system accords different treatment to the two types of income. Secondly, extension of Central Income-Tax. will introduce uniformity in the tax rates throughout the country as the states levying agricultural income tax have different exemption limits and rate schedules. Also the states which do not levy agricultural income tax will come under the purview, thereby increasing the tax yield and introducing equity in the system. Thirdly, in the interest of balanced economic development, a unified income tax structure may

regulate inter sectoral flow of resources. Fourthly, it will help to arrest inflationary tendencies in the economy to some extent as high agricultural incomes, which presently go unfaxed, will be taxed. Lastly, there would be some sort of fiscal balance between governments expenditure on and revenue from agricultural sector. Against the above mentioned benefits the costs of extension of Central Income Tax to agricultural incomes as foreseen by Gandhi seem to be mainly of administrative and legislative in character which can be overcome.

As pointed out by K.N. Raj¹¹, Y.K. Alagh¹² and Mahesh Batt¹³, in India lack of proper accounts maintained by the farmers poses a major problem in assessing agricultural income. with various systems of landholdings and tenancy locating the assessee further increases the problems. Thus with respect to administrative and other problems, the land revenue stands superior to agricultural income tax, As land is the object of taxation under land revenue, locating the assessee is not difficult and since the tax rate is fixed for a certain period of time it facilitates prompt and convenient collection.

To conclude, in principle land revenue is superior to agricultural income tax from the point of view of providing inducement to increase production and on the other hand agricultural income-tax is better than land revenue by equity considerations. In practice, due to the way they are operated at present both the taxes are unable to fulfil their aims.

The policy-maker in such a case faces a dilemma of choice. Nevertheless, his choice is certainly going to be affected by other factors such as existing level of taxation in the economy, political sanction, administrative costs, etc.

7.2.2.5 Alternative to the existing direct tax system

Despite the considerable appeal for extending income-tax to agriculture most of the authors have recognized the need for an alternative method of direct taxation of agriculture. The common features of the alternatives suggested are as follows (i) the tax should be based on potential productivity of land and (ii) it should have a progressive rate structure. Such a tax system will tax non-use of land, because it will basically be a land tax linked to productivity and that too at a progressive rate. Such a tax is Agricultural Holdings Tax (AHT) which has been devised by the Raj Committee¹⁴. Details of the proposal have already been given in chapter 2. AHT can be said to be refined and a detailed version of tax formulated by T.M. Joshi and his collaborators¹⁵. Also Raj Krishna¹⁶ put forth a tax reform proposal which is quite akin to the AHT.

7.3 CONCLUSION

A more conformable solution to the problem of agricultural taxation can be obtained by undertaking a much more intensive and exhaustive study of the problem particularly

in regard to allocation of indirect taxes between agricultural and non-agricultural sectors, cost of cultivation and net returns in the different regions of the state, the impact of total tax burden on the farmers belonging to different categories of land holdings, valuation of capital value of agricultural wealth and a relatively more appropriate formula for assessing the taxable capacity of the agricultural sector. Nevertheless, so long as the study of these problems is awaited, the reform activities can safely be started with the aforementioned proposals. The success will, however, depend on how they are implemented and how the authorities concerned carry out the proposals for agricultural taxation reform.

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