Able Taxation: Bridging Fiscal Inequity And Environmental Responsibility In Indian Agriculture

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Abstract

In the context of fiscal sustainability and environmental stewardship, this paper presents a critical analysis of the case of taxation of agricultural income in India in the context of both equity and efficiency. Agricultural income has traditionally been tax-exempt because of its socio-economic weaknesses and food security needs, even though the economic character of the sector has undergone substantial transformation. The paper assesses the unfairness of exempting high-income farmers yet the other sectors are subjected to the burden of the tax and how the exemption causes distortion of both vertical and horizontal equity and tax evasion. Based on empirical evidence, policy reviews, and international comparative experiences, the paper considers the economic inefficiencies and environmental externalities, including resource misallocation, land misuse and unsustainable agricultural expansion which are facilitated under the existing tax system. It suggests a graded taxation system that will be applied to the wealthy farmers without harming the smallholders, thereby saving the lives of the rural folk and ensuring environmental equity. This discussion indicates that agricultural income taxation that has a proper structure, with digital land records, environmental compliance systems, and intergovernmental collaboration, can be part of a more equal, transparent, and environmentally sound tax regime. Recommended measures are high exemption thresholds, increased income verification and re-investment of tax proceeds on sustainable agriculture and rural development. This will be in line with the concept of environmental economics and climate-resilient development and will help in the development of a more inclusive and accountable tax structure in India.

INTRODUCTION

The historical socio-economic circumstances have led to the Indian agricultural income to be free of income taxation. When India became independent, farmers were mostly poor and agriculture was regarded as the key to food security, and taxing agricultural income was not politically or economically desirable. The agricultural sector has however changed over the decades. In the current times, agriculture is contributing to approximately 15 per cent of the GDP but nearly 50 per cent of the labour force, i.e., a significant number of the people earn money in a sector that hardly pays any direct taxes. This injustice has created apprehensions regarding fairness of the taxation system where all other sectors take the entire direct tax burden and agricultural incomes have tax exemption. Many farmers have earned substantial incomes over the last few decades but do not pay any income tax on their income. Case in point, at approximately the turn of the 2000s agriculture was contributing about a quarter of India GDP but less than 1 percent of overall tax revenue (James, 2004). Contrastingly, other industries whose output is similar have high taxation, which shows a significant imbalance.

The recent policy debates have brought the interest of reviewing the tax-exempt status of the agricultural income. The Kelkar Task Force on Direct Taxes (Government of India, 2002) has notoriously pointed out that the agricultural income exemption "distorts both horizontal and vertical equity in the tax structure and also acts as a conduit to tax evasion since non-agricultural income can be reported as agricultural." Over the years since, these concerns have been echoed by various economists and official committees, as it was noted that the total exemption of such a large sector would undermine the principles of fairness and stimulate tax avoidance (Samantara, 2021; Tax Administration Reform Commission, 2014). Conversely, the critics of the taxing of farm income point to the administrative challenges and political nature of the matter. Some say that the expense of collecting taxes on millions of small farmers may be higher than the amount of revenue collected and that an income tax on a mainly poor farming community may be considered anti-poor (James, 2004; Press Trust of India, 2018).

This research paper assesses the equity (fairness) and efficiency (economic impact and administrative feasibility) arguments on agricultural income to be brought under the tax net. It looks at the existing legal system and position of agricultural income tax in India, looks at the reasons as to why there has been the long-term exemption and looks at the advantages and disadvantages of taxing farm income. The paper also talks about the political and administrative limitations that have been a barrier to the implementation of reforms in the past and suggests potential strategies to implement an equitable and efficient agricultural income tax in Indian context.

LITERATURE REVIEW

Taxation on agricultural income is a state issue under the Indian constitution, and central government lacks powers to impose income tax on agriculture. Consequently, the agricultural income has been kept out of the central income tax since independence. In practice, the majority of states have decided not to impose any important tax on the farm-income, beyond nominal land-taxes, or special cesses. Some of the states also tax some crops on plantations (tea, coffee, or rubber), but these are limited and bring little income (Samantara, 2021). In general, the agricultural income taxes have contributed insignificantly to the state treasuries.

Income Tax Act, 1961 defines agricultural income to include income of cultivation of land, rent or revenue of land and income of farmhouses or processing of produce which are closely related with cultivation. Such activities as dairy farming, poultry farming, or livestock breeding are not considered taxable as agricultural (Singhania & Singhania, 2020). As a matter of fact, the tax exemption is well defined by law, it is limited to income that is strictly agricultural in character.

The exemption has continued even though there have been occasional debates on reform. Interestingly, even after the government developed a new Direct Taxes Code in 2010 to simplify and reform the tax legislation, they did not feel the need to remove the agricultural income exemption. This ended up being termed by observers as a missed opportunity to resolve the anomaly (Sengupta, 2012).

To avoid the abuse of the exemption by the central level, the Income Tax Act introduces a mechanism of partial integration of agricultural income with non-agricultural income in determining the calculation of tax rates. In short, where someone earns both farm and non-farm, the farm income (in excess of a given amount) is aggregated with the non-farm income, only to arrive at the tax bracket, but not the farm income. This is so that an individual cannot end up in a lower tax bracket simply because he/she reports a high agricultural income and a low taxable income. But it is only indirect and does not directly tax agricultural income. Since farming profits are not being directly taxed, agricultural income has become a common tax avoidance route- incomes received on other sources are occasionally reported as farm income so as to avoid taxation (Mishra & Kulkarni, 2017). This issue is also worsened by the fact that there is no strong system to verify agricultural income that is reported on the tax returns.

In the past, the issue of taxing farm income has been considered by a number of expert organizations and economists. Back in the 1960s, researchers such as Y. K. Alagh (1961) and V. P. Gandhi (1969) presented a case based on equity grounds to introduce an agricultural income tax arguing that tax exemption of an entire sector was against the principle of horizontal equity (the equal treatment of equals). Other voices of the 1960s and 1970s reinforced the necessity to include affluent farmers in the tax net (Ojha, 1969). The problem of using the agricultural exemption as a means of concealing non-agricultural incomes was also highlighted in government-appointed committees of the 1970s, including the Raj Committee (1972) and the Wanchoo Committee (1971). Although these recommendations were suggested early, political opposition and logistic difficulties did not allow changing the policy nationwide. There was a continuation of the status quo except that there were some isolated attempts by some states to tax agricultural incomes.

New interest in the 2000s, especially following the Kelkar Committee report (2002) added new data and impetus to the argument. Kelkar Task Force reported that there was evidence of growing affluence of a part of rural landowners and how blanket exemption led to grave unfairness between the rural rich and other taxpayers (Government of India, 2002). The most recent audit of the agricultural income claims made in tax assessments was done by the Comptroller and Auditor General of India (CAG, 2019) that revealed significant irregularities. The report of the CAG showed that in a sample size of 6,778 scrutiny cases in which persons had claimed over 5 lakh rupees each as agricultural income during the mid-2010s, the tax officers had allowed exemptions amounting to more than 2,500 crore rupees without satisfactory verification. These results reaffirm the fact that the existing framework does not only fail to tax agricultural income on equity basis, but it also creates a loophole through which agricultural income can be tax evaded, thereby compromising the effectiveness of the entire tax system. **Equity Considerations**

The first reason behind taxing agricultural income is based on equity and fairness. In a good tax regime, there should be a similar burden on the taxpayers with an equal ability to pay taxes, irrespective of the nature of their income. The rule of blanket exemption of income earned in agriculture contravenes this principle of horizontal equity. A case in point is that a professional or businessman with an annual income of 20 lakh rupees is required to pay income tax but a farmer (or one who poses as a farmer) with the same 20 lakh rupees of income through farming is not required to pay any income tax. This inequality is quite unjust to the taxpayers who are not agriculturalists (Alagh, 1961; Gandhi, 1969). It generates an impression that taxes are unfairly levied, which would generate resentment and diminish voluntary tax compliance on a general level (Samantara, 2021).

Vertical equity is also an issue i.e. that taxpayers who are better able to pay (i.e. those with higher income or wealth) should pay a higher share of taxes. In India, most farmers are in fact poor or marginal, but there are a small number of agriculturists, who receive very high incomes (usually in plantations or large commercial farms) and are richer than most urban taxpayers. Tax exemption of these rich farmers is a violation of vertical equity because these wealthy citizens will not pay any taxes to the country. It has been shown by the surveys that a notable proportion of the high-net-worth individuals in India are located in rural regions where the main source of income is agriculture (James, 2004). Even though there is no doubt that small and marginal farmers ought to be taken care of, it is not clear why millionaires in the farms should enjoy zero income tax when even the middle-class salaried workers are taxed.

In addition to theoretical fairness, the equity argument takes on reinforcement because of evidence of the non-farmer abuse of the exemption. The Kelkar Task Force (Government of India, 2002) found that the exemption on agricultural income taxes was being used as a means to evade taxes and rich people were laundering their taxable income as agricultural income. This is in effect because business incomes or other incomes can be misrepresented as farm incomes (usually by reporting sales of unrealistic amounts of farm products) in order to be exempted 100 percent from paying taxes. The Tax Administration Reform Commission (2014) also observed that agricultural income has become a source of tax evasion and money laundering and that this needs to be stopped immediately. Concrete examples were given in the audit by the CAG (2019), where in more than 22 per cent of the cases that it examined, exemptions to agricultural income were granted without any checks as to whether such claims were genuine. Not only does this kind of misuse cost the exchequer revenue, it also contravenes the principle of fairness, the exemption is intended to go to real farmers, but it is being used by tax dodgers and shell companies.

The opposition of taxing farm incomes usually argues that the majority of farmers already suffer under poverty and income fluctuations, and an income tax will increase their misery. They note that farmers also pay tax indirectly (fuel, fertilizer, farm equipment, and consumer goods) and that agriculture delivers such basic public goods as food security, which they believe should be subsidized not taxed. Other people also add that the rural sector is already implicitly taxed, e.g. by lower government-set crop prices or user charges on electricity and water, and that farmers are not completely outside the fiscal system. These reasons show the significance of the protection of the subsistence farmers. But they do not require the wholesale exclusion of all agricultural incomes, but instead they support the necessity to distinguish between poor farmers and rich agricultural producers in the tax policy. The policy will not hurt those at the bottom by taxing the rich and still maintaining the notion of fairness to the rest of the society. To conclude, the equity considerations are very much in favour of inclusion of agricultural income in the tax net in one way or the other. The taxation of the sector on a preferential basis has resulted in a two tier system of taxation, one on agricultural income and the other on all other income, which is unfair, unreasonable and open to abuse. The taxation of the big farmers and the reduction of exemption abuse would bring about equality and would indicate that the Indian tax policy does not excessively favour any specific group of income earners (Kelkar Committee, as cited in Government of India, 2002). The equity considerations therefore present a strong case of reform as long as the livelihoods of the small farmers are not compromised by the usage of suitable thresholds and exemptions. **Efficiency Considerations**

Other than equity, efficiency arguments exist as far as taxing agricultural income is concerned. Economic efficiency in taxation is the maximization of revenue in a way that has least distortive effect on economic choices and at least administrative cost. The way the agricultural income is treated these days in India has a bearing on both the allocative efficiency of the economy and the efficiency of tax administration.

1. **Expanding the tax base and minimizing distortions:** The tax base may be broadened by covering a significant portion of the economy and minimizing the distortions in resource allocation. The tax exemption of one type of income gives a great incentive to people and companies to direct their investments and gains to that type, not because the type is more productive, but merely to evade taxes. Economists have observed that a tax regime that has these loopholes distorts the allocation of resources and may also reduce aggregate economic productivity (Khan, 2001). In the case of India, the tax-free nature of agriculture can induce a certain level of spurious investment in farmland or farming projects by the rich mostly as a tax haven. India can minimize these distortions by expanding the tax base to cover agricultural income (at least above a reasonable level). A wider base permits the use of less radical tax rates by all (as the load is distributed further), enhancing efficiency and growth performance.
2. **Mobilizing revenue to invest in the public:** efficiency is not just a matter of preventing distortions, but also of raising the revenue required to finance government activities in a sustainable manner. Exemption of agriculture is a big waste of revenue that would have been utilized in development. The total amount of surplus that is subject to taxation in agriculture might not be an extensive one in comparison to the total GDP of India, but a small payment of the rich farmers could be used to support the rural infrastructure and service. In that regard, taxing farm income and reinvesting the taxation in the rural development may be an effective step in boosting the productivity of the sector. Besides, the local governments (Panchayats and States) frequently face the problem of insufficient revenues; agricultural income tax may bring them a source of income they so badly need to provide people in the countryside with the services (James, 2004). Farm efficiency and incomes may rise when local public goods (such as irrigation, roads or markets) are supplied more efficiently, and the result is a positive feedback cycle between taxation and agricultural development.
3. **Minimizing tax evasion and enhancing general compliance:** In the view of the tax administration, the agricultural exemption has created a big loophole that makes it hard to enforce the tax laws. Tax collection agencies have to dedicate resources to ensure that people who claim agricultural incomes are truly eligible to the exemption or they are under-reporting other incomes as agricultural incomes. This takes away limited administrative time. By taxing agricultural income (or income in excess of a threshold amount) the incentive to underreport other income and claim tax credits on agricultural income would be reduced, and enforcement would be simplified. Agricultural income tax, properly designed (with information sharing between the agricultural marketing boards and tax authorities and verification with land and crop databases) may lead to better overall compliance with tax and less black money (Mishra & Kulkarni, 2017). That is, sealing the loophole would ensure that the tax regime is more sound and effective because it will remove one of the known methods of evasion.
4. **Administrative feasibility and cost**: The administrative difficulty and cost of taxing agriculture is a major counter-argument in terms of efficiency. India has more than 120 million farmers, majority of them being small, illiterate and spread all over the extensive rural fields. It is intimidating to assess and collect income tax of so many people. It may be expensive in terms of the bureaucracy, record-keeping and enforcement that will be needed to fulfil it. That is why the proposals on agricultural income tax almost unanimously insist on a high exemption threshold. The tax administration can concentrate on a relatively small number of taxpayers by taxing only the biggest agricultural earners (say the top few percent of farmers), which makes it more feasible. Previous studies have indicated that when the tax is imposed on a specific group of individuals, such as plantation firms, large scale agribusiness, and big landlords with a certain amount of income, the assesses will be small and manageable (Trumboo, 2022; Government of India, 2002). This will significantly reduce the cost per rupee of revenue collected which is an issue of

efficiency. Conversely, attempting to tax all marginal farmers would actually be inefficient and is not pursued seriously in policy circles.

5. **Effects on economic behaviour and growth:** Other critics fear that agricultural taxes will discourage agricultural production or investment, possibly affecting food security. Nevertheless, in case the tax is properly targeted to avoid the smallholders, then most of the cultivators would not be affected and their production decisions would be the same. To the small number of large players, who would be taxed, their farming activities are normally profit oriented and will not easily contract just because of a tax just as businesses in other industries do not stop operation because of tax. Actually, the taxation of agriculture may have beneficial side effects: it would promote accounting and financial transparency in the farm sector, which could make farmers more able to access credit and insurance (Das, 2024). Empirical evidence in developing nations has revealed that moderate taxes on agricultural proceeds or on the land values do not necessarily lead to a decrease in output; rather, it could enhance efficient utilization of land and resources (Khan, 2001). Also, tax on agricultural income will give governments more incentive to invest in the agricultural sector (as it will be a source of revenue), and this may result in increased government investment in agriculture, which will eventually benefit growth.

In short, the efficiency argument of taxing agricultural income is one of eliminating distortions, base broadening and administrative efficiency. These advantages should be balanced with the administration efficiency expenses. Many experts recommend a solution that would be selective and implementable in the sense that it would target high-income agricultural taxpayers and would rely on modern information systems to monitor the large farm transactions (Trumboo, 2022; Tax Administration Reform Commission, 2014). The increment in efficiency in the allocation of resources, increment in revenue, and decreased evasion are likely to be more than the administrative expenses with such an approach.

Global Comparative Insights

The problem of taxation of agricultural income is not peculiar to India only, and a lot of nations, particularly developing economies have experienced this problem. International experiences are helpful in giving context and lessons of what may or may not work in India:

In Pakistan, as an example, agricultural income tax is a provincial subject under the constitution (similar to the state-level power in India). Although some provinces nominally charge taxes on farm incomes or land holdings, the amounts collected are very low because of political leverage of the big land owners and weak administration. Practically, the same case applies to Pakistan where the agricultural elite is mostly non-taxable and reform efforts have been opposed (Khan, 2001). The same trend is repeated in other South Asian countries, and the political economy of the rural landowning system is likely to be a hindering factor in the taxation of farm incomes (Khan, 2001).

Developed countries, by contrast, almost always tax agricultural income as regular income tax, but offset this with large subsidies and assistance to farmers. As an example, in the United States and European Union, farmers pay taxes on profit just as any other business. Yet, there are also large farm support programs (price supports, crop insurance subsidies, direct payments, etc.) in these countries which in practice dish out a lot of resources to the agricultural sector. The effect of this is that even though farm incomes are taxable in principle (horizontal equity is upheld), the industry is given financial buffers to guarantee the livelihood of farmers and to provide incentive to produce. India and other developing countries may lack the fiscal room to make major subsidies, but this comparison shows that taxing farmers does not necessarily involve dropping them forgotten, the policy can be combined with support programs or specific tax credits to small farmers.

A number of African nations have used indirect forms of taxing agriculture e.g. export duties on cash crops, state controlled marketing boards which pay farmers below market prices (the difference being an implicit tax). Such means increased revenues but frequently by distorting agricultural incentives, and were much criticized as harmful to farmers. In more recent reforms in Africa and Latin America, reforms have been shifting towards land value taxes/ area-based presumptive taxes to agriculture (Khan, 2001). Although land tax is said to be economically efficient and fair as land cannot be concealed or transported and owners of large land would pay more, it has been politically difficult. It has been pointed out, although not without disagreement, that a well-structured land tax can not only raise efficiency but also enhance equity (Strasma, 1987; Skinner, 1991). In most countries, which attempted to introduce land or farm taxes, revenues were small and poor administrative capacity, together with opposition by landed elites, meant that they were rarely collected.

A good illustration is Kenya, which previously used a graduated agricultural land tax, which over time was undermined through political influence by the rich land owners. On the other hand, land-use fees and agricultural income taxes have been partially successful in Ethiopia in some of the regions, but they form a small percentage of the government revenue. The moral of these examples is that political will and administration investment are key - where governments have made a special effort to find out who the large farmers are and to collect taxes (usually in combination with giving visible benefits to the rural folk) compliance has been better (Khan, 2001).

In general, the comparative approach shows that taxation of agricultural income is possible and is applied in a number of ways in different parts of the globe, but it almost always involves political economy minefields. Those countries which managed to introduce agricultural taxation successfully did it over time and combined it with some objective advantages or covering of farmers (by directing revenues towards rural programs or exemptions of smallholders). In the Indian case, these experiences confirm the need to have a calibrated consensus-seeking strategy, e.g., by starting with taxation of the most obvious and largescale farm enterprises and by making a case to the farming community as the reform evolves.

Political and Administrative Problems

Although it has very solid equity and efficiency grounds, an agricultural income tax in India has very high political and administrative barriers. These are the main obstacles that have not allowed such propositions to be passed and any reform agenda should tackle them directly.

Political sensitivities: Taxation of agricultural sector is a very sensitive political fact in India. The farmers form a big and powerful voting bloc and there is a long held perception (bolstered by political rhetoric) that the poor would be punished by taxing the farmers and it would be political suicide to impose taxes on them. Although the majority of proposals to tax farm income are clearly aimed only at high-income farmers, the critics tend to present them as attacks on the farmers as a whole. There has been no central or state ruling party that has wanted to be considered as being anti-farmer. As an example, when a member of NITI Aayog proposed in 2017 that agricultural incomes above a high limit be taxed, this caused a public furor; Union Finance Minister clarified promptly that the central government had no such proposal and, in fact, no constitutional authority to tax agricultural income (Press Trust of India, 2018). The political taboo on the subject was emphasized by this episode. All the governments have over the years toyed with the concept of taxing farm income in one way or another, but backed out under pressure (Press Trust of India, 2018). It is a third rail of Indian politics that is easily politicized and farmer unions and opposition parties are quick to jump on any suggestion of an attempt at an farm tax.

Centre-state fiscal dynamics: The responsibility of any change is on the states because only state governments can impose a tax on agricultural income. But there is a collective action problem on the part of states. When one state taxes its farmers (the large farmers in particular) it is afraid of scaring away investment and having its farmers disadvantaged relative to the farmers in neighbouring states that do not have a tax. Another risk is the political risk that any one state government may go it alone and lose its rural constituency and thus its electoral chances. A farm income tax would probably require cooperation between states or an umbrella system that the central government can offer to make taxation consistent. Theoretically, the central government can reward states such as provision of a part of central taxes in case states introduce agricultural income into the net or even offer a constitutional amendment to harmonize policy. Such measures, however, need the wide political agreement, which has been missing. So, federal structure makes the way to reform more complicated: there should be the coordination and consensus-building process between Centre and states.

Administrative capacity: An agricultural income tax is administratively complex:

Identification of taxpayers: It is not so easy to construct a credible database of high income earners in agriculture. A lot of farmers do not keep formal books. The size of landholdings might be one measure of possible income, but even on identical acreage income might differ widely according to kind of crop, yield, and market prices. States would be required to use agricultural produce marketing information (e.g. which farmer sells large amount of crops at mandis or procurement centers) and land records to capture information about high-income farmers. Combining such data sources and maintaining them current would demand new systems and capacity.

- Measuring income and its variability: Agricultural income may be variable because of weather, pests and price changes. The tax assessment would have to consider the variability of year to year and this may include permitting averaging of incomes between good and bad years or providing carry-forward of losses in drought years. The calculation of taxable income may be complicated in case the farmers combine farming with other operations. There would have to be clear guidelines (as are the case with plantation companies, where a certain percentage of income is deemed agricultural). The administrative machinery would need to be trained to handle such nuances and would need to handle disputes or appeals.
- Evasion and enforcement: When tax is levied on farm income, it is probable that there will be an attempt to evade tax, e.g. under-reporting of crop yields or moving to selling informally in cash to conceal income. It is a logistical challenge to monitor and audit the farm income claims in large rural regions. There may be lack of enforcement unless there are strong audit measures and tax collection offices at the local levels. The past experience in India with even the mere collection of land revenue (land taxes) has indicated that tax collection at the rural level is prone to leakages and under-collection unless it is closely monitored (Sengupta, 2012).

Corruption risk: The introduction of new tax regime in rural areas will present the risk of rent-seeking by authorities. Previous experience in collecting land revenue indicates that intricate rural taxes may result in small scale corruption. Without being designed properly, tax collectors may harass farmers or even demand bribes in case farmers are not well informed about tax regulations. Thus, any agricultural tax should be simple and transparent, with high-level supervision, so that administrative abuse could be avoided and trust could be established between the farming community and the tax (Sengupta, 2012).

Perception and trust: Trust deficit problem exists, many farmers are afraid that despite the beginning of the tax by only the wealthy farmers, it may be extended to small farmers. Since there has been a history of agrarian stress and the status of the farmer is so highly regarded in politics, new tax is always looked upon with suspicion. To get the reform passed (or at least get it passed without a fight), the argument that this policy is not anti-farmer but anti-tax evader, and that the real farmers will be the beneficiaries of the change (e.g. by reinvesting the tax revenues in agriculture) will have to be compelling.

Against this background, it is not enough to show the virtues of taxing agricultural income. A strategy to reduce political resistance and facilitate administrative enforcement has to be developed by the reformers as well. This implies that the tax policy should be well thought out and perhaps introduced gradually as outlined in the following section.

Way Forward and Policy Recommendations

Given the good equity and efficiency reasoning, yet also wary of the political and administrative challenges, the decision to tax agricultural income in India must be well balanced. According to the analysis, the following policy recommendations may contribute to the realization of a balanced and realistic approach:

1. Establish a high agricultural income tax threshold: Introduce a high income tax threshold at which an agricultural income tax is levied (e.g. 10 lakh or 20 lakh of annual farm income, adjusting in real terms over time). This makes sure that only the best few percent of the wealthy farmers are brought within the tax net and the rest of the small and medium farmers being exempted. Experts have proposed a threshold-based system that focuses on tax avoidance without overloading individuals with low incomes (Trumboo, 2022). By establishing such threshold, the policy can truthfully say that it is not targeting the common farmer but only the very affluent. The threshold may be set according to data (e.g. one may begin with a level where about 1 percent of cultivators would be liable) and may be reviewed periodically. 2. Use cooperative federalism to build political consensus: Since the constitution has allocated the agricultural income to states, central government can act as a facilitator and create political consensus among states. Such a forum as GST Council or NITI Aayog can be employed to discuss this issue and reach an agreement on a common approach. A constitutional amendment may also be brought about by the central government to enable it to tax agricultural income, at least half of the proceeds to be shared with the states, but this is politically difficult. As a half-way house, the Centre might stimulate the adoption of agricultural income tax by states, by providing incentives e.g. by promising that in the event that states tax

farm income, an equal offset might be provided in central transfers or borrowing constraints. The trick is to have an orderly introduction so that no one state feels put at a competitive disadvantage. States with large populations of affluent farmers (Punjab, Haryana, Western UP, etc.) must be persuaded to join in with the emphasis on the revenue gain and the equity factor.

3. Enhance agricultural income reporting and verification: The government can enhance reporting of agricultural income and verification of these reports before enacting a new tax to reduce the level of evasion under the current exemption. As an example, had any taxpayer (individual or entity) declared an agricultural income of over a specific large amount in his/her return (e.g. > 10 lakh), then such a claim may be subjected to scrutiny as a matter of course. These people might be requested to provide certificates of land ownership or lease, produce yields data, sales bills at mandi or purchasing agencies etc. The Income Tax Department must liaise with the state agriculture marketing boards and revenue departments to cross check large agricultural income claims. The government can remedy the situation by enhancing verification (as CAG has suggested in 2019) without enacting a law to curb the misuse of the exemption (Comptroller and Auditor General of India, 2019). Simultaneously, the establishment of a national landholding and large farm producer database will be necessary to set the stage in determining who would be subject to an agricultural tax should one be implemented, and this may be accomplished through remote sensing and digital land records.

4. Invest in administrative capacity and simplicity: To introduce the tax on agricultural income, the capacity of tax administration in the rural regions will have to be increased. This may include the establishment of special assessment units on the agricultural income (maybe under the current Income Tax Department or as part of the state tax departments). The officers would require to be trained in agricultural economics so that they could learn cropping patterns and farm accounts. Administration might be simplified by simple, presumptive procedures, e.g. in some crops or geographical areas tax might be charged on an assumed amount of income per hectare (above a certain size of landholding) instead of attempting to estimate actual income. Such simplified evaluation would eliminate the necessity of detailed accounts and would minimize conflicts. There is also the need to digitize and harmonize land and crop data with tax data such that a lot of the verification can be done on a data basis. The administrative procedures could be tested in pilot projects in some of the few districts (where there are many large farmers) before being extended.

5. Communicate and phase-in the reform: To deal with the political risk, the introduction of agricultural income tax is to be phased in and well-communicated. It can be done by first taxing agribusiness firms, plantation companies which are already in better position to maintain accounts and are much easier to tax. A lot of plantation businesses (tea, coffee, etc.) are now partially taxed (part of their revenues are regarded as non-agricultural). The government might as well start by taxing such entities to the full or include large corporate farmers in the net. Later, the net may go to individual farmers who are above the income level. Every step may be followed by public outreach - explaining that small farmers will be still exempted and telling stories of very rich “farmers” who do not pay now. It is important to focus on the angle of fairness: e.g. by pointing at examples of people with crores of income who managed to avoid tax by using the farm exemption, one can create a favorable opinion among the population. The government can also pledge to reinvest any revenue collected as farm income tax in agriculture e.g. in improved irrigation, rural infrastructure or direct payments to poor farmers. This earmarking of the revenue would make such a policy more acceptable to the farming community since they have a direct tangible gain.

6. Complementary actions to assist the farmers: It would also be prudent to implement measures to assist the farmers concurrently to eliminate the perception that the government is antagonizing the farmers. As an example, the government can make improvements in crop insurance programs, enlarge the minimum support price (MSP) coverage, or provide greater subsidies to small farmers alongside the introduction of the tax to the rich farmers. The other suggestion is to introduce tax credits or deductions in the agricultural tax on farm improvement investments, i.e. In case a farmer reinvests in irrigation or technology, that part would be tax-deductible. These concessions can promote productivity and mellow resistance by demonstrating that there is no intention to divert resources away form agriculture but to formalize it and make it stronger.

Making these recommendations, the policymakers will be able to shift to the system with agricultural income taxation that is introduced in a fair, gradual, and efficient manner. The guiding principle ought to be: defend the poor, tax the rich and plow back benefits to the farm. Such a subtle method might assist in avoiding the classical reservations and turning the reform into a win-win situation: the expansion of the tax base and fairness without damaging the interests of the agricultural community.

CONCLUSION

The taxation of agricultural income in India is ultimately an argument between equitable and efficient and the political and administrative realities. The argument in favor of the inclusion of agricultural income in the tax net is strong on the basis of pure principle of public finance. Leaving out such an important industry in terms of production and more so in terms of wealth possessed by the largest farmers is to introduce distortion and unfairness that economists and committees have been highlighting over the decades. The idea of a tax system with one large part of the economy being tax-free at all times is against the principle that every citizen should pay his/her share based on his/her ability. The experience of India itself (e.g. the Kelkar Committee report and CAG audit) support this view empirically, that the exemption has been used to obtain undue benefits and has served to undermine the fairness and efficiency of the tax system.

Nevertheless, such a step to tax farm incomes should be planned and implemented with utmost caution. In India, farmers take a hallowed position in the polity and social structure and agriculture is not only an economic activity but also a life-line to a sizeable part of the population. Political opposition to taxation of agricultural income is not fictional and is based on both sincere interest in the welfare of farmers and less noble defense of the interests of the rich. The solution therefore is a measured way: focus the policy on the proper beneficiary i.e. the rich farmers and pseudo farmers who can afford to pay and continue to defend the poor farmer. This paper has shown that this can be achieved by high thresholds, explicit carveouts and effective communication.

It is also clear that the reform will involve consensus building. This involves agreement between political parties, the Centre and the states and between the government and the citizens (farming community in particular). Fears could be allayed by pilot programs and evidence of the same (that moderate taxation of large farmers can be imposed without damaging production). However, the opposition has the potential to reduce in the long-term as the agricultural industry becomes more modernized and more farmers are commercially oriented, although one cannot wait forever in case India wants to widen its tax base and enhance fiscal fairness.

To sum up, taxing agricultural income in India should not remain an unimaginable taboo but a rational move on the way to a more efficient and fair tax system. Perhaps, the agricultural income exemption could be justified in the early years following independence when farming was more subsistence oriented and prevalent rural poverty. The situation is not the same nowadays India is a developing economy, and a significant portion of agricultural production is made by rather affluent farmers. This reality is best ignored, which further increases inequalities and promotes evasion. Agricultural income tax can be introduced in India with careful planning and political determination to consider the welfare of the small farmers as well as prevent the privileged minority using the cover of agriculture to evade their contribution to the tax. This would help maintain the fairness and effectiveness of the Indian tax regime towards a more equitable and responsible tax regime in the future.

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