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**TAX EXEMPTION IN AGRICULTURAL INCOME: TAX EVASION
AND ECONOMIC CRIMES – A SOCIO-ECONOMIC
PERSPECTIVE**- Adv. Kshitij Singh¹**ABSTRACT**

Tax exemption on agricultural income in India has been a subject of significant debate and discussion due to its implications for the country's economy, fiscal policy, and social welfare. This study provides an overview of the concept of agricultural income tax exemption, its historical context, and the rationale behind its implementation.

Tax evasion related to agricultural income in India presents a multifaceted socio-legal challenge that intersects with issues of economic development, governance, and social equity. Despite the exemption of agricultural income from taxation, concerns persist regarding widespread tax evasion practices in the agricultural sector. This paper explores the socio-legal dimensions of tax evasion in agricultural income, examining its underlying causes, mechanisms, and consequences. It analyzes the legal framework governing agricultural taxation in India and identifies loopholes and enforcement challenges that facilitate tax evasion. Additionally, the paper investigates the socio-economic implications of agricultural income tax evasion, including its impact on government revenue, income inequality, and rural development. By synthesizing legal analysis, empirical research, and socio-economic perspectives, this paper aims to deepen

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understanding of the socio-legal dynamics of agricultural income tax evasion in India and provide insights for policy interventions aimed at addressing this complex issue.

Keywords: Agriculture Income, Tax Exemption, Tax Evasion

INTRODUCTION

Taxation plays an important role in the processes of expansion and development of Indian economy. Tax evasion takes place when individuals intentionally fail to fulfill with their tax obligation. The resulting tax revenue losses might cause serious damage to the appropriate working of the public sector, threatening its capacity to finance its essential expenditures. India has been confronting severe issues such as tax evasion, black money; the existence of parallel economy evidences the Indian taxation system needs few key reforms in future to identify all these issues.

The Income Tax Act defines agricultural income as income derived from any land located in India that is used for agricultural purposes. This includes income from cultivating land, income from buildings on that land (farmhouses, storage facilities, etc.), income from selling produce grown on that land, and income from agricultural operations like processing agricultural produce. Agricultural income is exempt from income tax under Section 10(1) of the Income Tax Act, 1961. There is no limit on the amount of agricultural income that can be exempted.²

While the Income Tax Act governs the taxation of agricultural income at the national level, states have their own laws and regulations related to agricultural income. These laws may include provisions related to land revenue, agricultural land use, etc. Agricultural income can be used for tax planning purposes, especially for individuals or entities with significant agricultural income. Proper structuring of affairs can help in minimizing overall tax liability.³

² Anaya Nandish, The Game Unmasked: Tax Exemption in Indian Agriculture, GNLU Journal of Law & Economics, 2023

³ Khushi Sharma, Tax on agricultural income in India : overview, Ipleaders, 2021

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Benami transactions involve holding property or assets in the name of another person to conceal the real beneficial owner. In the context of agricultural income, individuals may use benami transactions to channel their non-agricultural income through individuals who have legitimate agricultural income, thus avoiding tax liability. Agricultural income is exempt from income tax, and this exemption may be exploited to launder black money (income generated through illegal means). By claiming income as agricultural, individuals may attempt to legitimize illicit funds and evade taxes.

Even legitimate agricultural income may be underreported to evade taxes. Farmers may understate their actual agricultural produce or income generated from agricultural activities to lower their tax liability. Some investment schemes may be structured in a way that exploits the tax exemption on agricultural income. These schemes may promise high returns by investing in agricultural activities but could be fraudulent or unsustainable.

To tackle tax evasion and economic crimes related to agricultural income, tax authorities in India often conduct audits, investigations, and implement measures such as data analytics to identify suspicious transactions and enforce compliance with tax laws. Additionally, legal reforms and stricter enforcement measures may be necessary to curb such activities effectively.

PROBLEM STATEMENT

Tax evasion in the agricultural sector poses significant socio-economic challenges in India. Despite the exemption provided under the Income Tax Act, 1961, agricultural income tax evasion remains prevalent, leading to detrimental effects on government revenue, wealth distribution, rural development, and overall economic growth. The problem is multifaceted, involving various stakeholders, complex socio-economic dynamics, and systemic weaknesses in tax administration and enforcement mechanisms.

The extent of agricultural income tax evasion in India is not well-quantified, making it difficult to assess the full impact on government revenue and socio-economic

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development. There is a lack of comprehensive data and analysis to understand the scale of the problem. Tax evasion distorts resource allocation by diverting funds away from productive investments and into tax evasion schemes. This leads to inefficiencies in the allocation of resources and inhibits sustainable economic development in the agricultural sector. Weaknesses in tax administration and enforcement mechanisms contribute to the prevalence of tax evasion in agriculture. Limited capacity, inadequate monitoring, and enforcement resources, coupled with loopholes in tax laws, create opportunities for evasion. Tax evasion in agriculture can exacerbate environmental degradation by incentivizing unsustainable farming practices aimed at maximizing short-term profits. This poses long-term risks to soil fertility, water resources, biodiversity, and ecosystem health.

RESEARCH OBJECTIVES

- To examine the legal provisions and regulations governing the exemption of agricultural income from taxation in India
- To examine the magnitude of tax evasion related to agricultural income in India.
- To examine the socio-economic factors driving tax evasion and economic crimes in the agricultural sector.

TAX ON AGRICULTURAL INCOME IN INDIA

In India, agricultural income refers to income earned from agricultural activities conducted on land situated in India. Article 366 of the Constitution of India primarily deals with the definitions used in the Constitution. However, it does not specifically mention agricultural income. The concept of agricultural income and its taxation is primarily governed by the Income Tax Act of India, as well as state laws related to agriculture and land revenue.

The Constitution of India does mention agriculture and related topics in several articles, including Article 246 which delineates the subject matters on which the Parliament and the State Legislatures can make laws. Entry 46 of the State List (List II) of the Seventh

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Schedule of the Constitution grants states the power to legislate on matters related to agriculture, including agricultural income.

While the Constitution provides the framework for governance in India, specific laws related to agricultural income, its definition, and taxation are enacted by the central government under the Income Tax Act and by state governments under their respective agricultural and land revenue laws.⁴

According to the Income Tax Act of India, agricultural income is defined as:

Any rent or revenue derived from land which is situated in India and is used for agricultural purposes.

Any income derived from such land by agriculture operations including processing of agricultural produce so as to render it fit for the market or sale of such produce.

Agricultural income is exempt from income tax under the Income Tax Act of India. This exemption is based on the principle that agriculture is a state subject under the Indian Constitution, and therefore, the central government does not have the authority to levy tax on agricultural income. As a result, agricultural income is not included in the total income of an individual for tax purposes. However, it's important to note that any income earned from agricultural activities outside India is not considered agricultural income for tax purposes in India.

In the case of *Paras Chinubhai Jani v. Principal Commissioner of Income-tax*⁵, Ahmedabad, the Tribunal ruled that the exemption on capital gains from the transfer of urban agricultural land under Section 54B of the Income Tax Act can only be availed if the agricultural land is purchased after the transfer of the original capital asset. The Tribunal found that claiming the deduction under Section 54B for land acquired before the transfer of the capital asset goes against the language of the Act and is not permissible. Additionally, the Tribunal observed that the intention of the legislature is

⁴Gupta and Kavita Rao, "Direct Tax Code and Taxation of Agricultural Income: A Missed Opportunity" 44 EPWJ (2014)

⁵ (2019) 177 ITD 591

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evident, as various sections of the Act use phrases such as "before or after the transfer of the capital asset." Therefore, the Tribunal upheld the decision of the Commissioner to disallow the exemption under Section 54B since the assessee had purchased the land before the date of transfer of his agricultural land.

Various Methods of Tax Evasion in Agricultural sector

Tax evasion can take many forms, and individuals or businesses may employ various methods to evade taxes. Here are some common methods of tax evasion:

Underreporting Income: Deliberately failing to report all income earned from sources such as wages, investments, business profits, or rental income.

Concealing Income: Hiding sources of income from tax authorities by using cash transactions, offshore bank accounts, or complex financial arrangements.

Inflating Deductions and Expenses: Overstating business expenses, deductions, or credits to reduce taxable income. This can include claiming personal expenses as business expenses or inflating the value of deductions.

Misrepresenting Transactions: Falsifying documents or misrepresenting transactions to understate income or overstate expenses. This can involve creating fake invoices, receipts, or contracts.

Offshore Accounts and Tax Havens: Using offshore bank accounts, shell companies, or entities in tax havens to hide income and assets from tax authorities.

Abusive Tax Shelters: Participating in illegal or abusive tax shelters or schemes designed to artificially reduce tax liabilities.

Structuring Transactions: Structuring financial transactions to avoid triggering reporting requirements or to circumvent tax laws. This can involve splitting transactions into smaller amounts to avoid detection.

Employment Tax Evasion: Misclassifying employees as independent contractors, paying workers under the table, or failing to withhold and remit payroll taxes.

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Phantom Employees or Expenses: Creating fictitious employees or suppliers to generate false payroll or expense records.

Asset Transfers and Gifts: Transferring assets or property to family members or associates to avoid taxes on capital gains, income, or inheritance.

Tax Identity Theft: Stealing someone else's identity to file fraudulent tax returns and claim refunds.

Failure to File or Pay Taxes: Simply failing to file tax returns or pay taxes owed.

These methods can vary in complexity and sophistication, but they all involve intentionally deceiving tax authorities to evade taxes. Tax evasion is illegal and can result in severe penalties, including fines, interest on unpaid taxes, and criminal prosecution.

GAAR and tax evasion

GAAR stands for General Anti-Avoidance Rules, and it's a set of provisions aimed at preventing tax avoidance schemes that exploit gaps or mismatches in tax laws. These rules empower tax authorities to disregard transactions or arrangements that they deem to be artificial or lacking in commercial substance, solely designed to avoid taxes.

In India, GAAR was introduced through the Finance Act of 2012 and became effective from April 1, 2017. The primary objective of GAAR is to curb aggressive tax planning and tax evasion by targeting transactions or arrangements that lack commercial substance or are undertaken primarily for tax avoidance purposes.

While GAAR doesn't specifically target tax evasion in agriculture, its provisions are applicable across all sectors, including agriculture. Therefore, agricultural transactions or arrangements that are found to be abusive or lacking commercial substance may be scrutinized under GAAR by Indian tax authorities.

However, it's worth noting that agricultural income is generally subject to specific tax treatment in India. As per the Income Tax Act, agricultural income is exempt from tax in

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India. Therefore, legitimate agricultural income derived from agricultural activities is not subject to taxation.

Nevertheless, if there are instances of abusive tax planning or arrangements aimed at exploiting agricultural income exemptions to evade taxes, such transactions could potentially fall under the purview of GAAR.

Overall, while GAAR doesn't specifically target tax evasion in agriculture, it serves as a deterrent against abusive tax planning practices across all sectors, including agriculture, by empowering tax authorities to disregard transactions lacking commercial substance or undertaken primarily for tax avoidance purposes.

Tax evasion Effect on Indian Financial System

Tax evasion can have several negative effects on the Indian financial system:

Revenue Loss: The most direct impact of tax evasion is the loss of revenue for the government. This reduces the funds available for public services such as healthcare, education, infrastructure development, and social welfare programs.

Budget Deficit: Reduced tax revenues can contribute to budget deficits, forcing the government to borrow more to cover its expenses. This can lead to increased public debt, which can have long-term implications for the economy.

Inequity: Tax evasion exacerbates income inequality by allowing wealthy individuals and corporations to avoid paying their fair share of taxes. This places a disproportionate burden on lower-income individuals who are unable to exploit loopholes or engage in tax evasion schemes.

Distortion of Economic Activity: Tax evasion distorts economic decision-making by incentivizing activities that are aimed at avoiding taxes rather than maximizing economic efficiency. This can lead to misallocation of resources and hinder long-term economic growth.

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Undermining Rule of Law: Widespread tax evasion undermines the rule of law and erodes trust in the government and financial institutions. It can also lead to a culture of corruption and impunity, further weakening governance structures.

Impact on Foreign Investment: High levels of tax evasion can deter foreign investors who may perceive the country as having an unreliable and inefficient tax system. This can reduce foreign direct investment (FDI) inflows, which are crucial for economic development and growth.

Resource Constraints: The government may need to allocate additional resources towards enforcing tax laws and combating evasion, diverting funds that could otherwise be used for productive investments or public services.⁶

To mitigate these effects, governments need to strengthen tax administration and enforcement, improve transparency and accountability, close loopholes in tax laws, promote tax compliance through education and incentives, and foster international cooperation to combat cross-border tax evasion.

Legal challenges of agriculture tax evasion

Agricultural tax evasion presents several legal challenges, which include:

Complex Tax Laws: Agricultural taxation often involves a complex web of regulations, exemptions, and deductions, which can create loopholes that are exploited for tax evasion. Clarifying and simplifying tax laws can make it easier for tax authorities to identify and prosecute cases of evasion.

Difficulty in Income Assessment: Assessing agricultural income accurately can be challenging due to factors such as fluctuating crop yields, varying commodity prices, and informal cash transactions common in rural areas. Developing robust mechanisms for income assessment, such as satellite imaging for land use or digital record-keeping systems, can help overcome this challenge.

⁶ Tax Evasion <https://www.bajajfinserv.in/investments/tax-evasion>

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Taxation of Informal Economy: Much of agricultural activity, especially in developing countries, occurs in the informal economy, where transactions are not recorded and income often goes unreported. Enforcing tax compliance in the informal sector requires innovative strategies such as incentivizing electronic payments or offering simplified tax regimes for small farmers.

Cross-Border Transactions: Agricultural tax evasion may involve cross-border transactions, such as smuggling of agricultural products or tax evasion through offshore entities. International cooperation and information exchange agreements between tax authorities are essential for addressing such cases and preventing tax evasion schemes that exploit differences in tax regimes between countries.

Fraudulent Schemes: Farmers and agricultural businesses may employ various fraudulent schemes to evade taxes, such as underreporting income, inflating expenses, or misclassifying taxable activities. Implementing rigorous auditing procedures and penalties for tax fraud can deter such behavior and promote compliance with tax laws.

Legal Protections and Rights of Farmers: In some cases, agricultural tax evasion may be driven by socio-economic factors such as poverty or lack of access to legal resources. Ensuring that farmers have adequate legal protections and access to justice can help address underlying causes of tax evasion and promote voluntary compliance with tax laws.

Enforcement Challenges: Tax authorities may face challenges in enforcing tax laws in rural areas due to factors such as limited resources, lack of infrastructure, or resistance from powerful landowners. Strengthening tax administration capacity, investing in technology for data analysis and compliance monitoring, and providing training for tax officials can enhance enforcement efforts.⁷

Addressing legal challenges associated with agricultural tax evasion requires a coordinated effort involving legislative reforms, capacity building for tax authorities,

⁷ Mishra, and Kulkarni A study on various ways of tax avoidance and tax evasion in agriculture sector and their effect. Journal for Research (2017)

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adoption of technology-enabled solutions, and collaboration between governments, international organizations, and civil society stakeholders.

CONCLUSION AND SUGGESTIONS

Tax exemption provides vital financial support to farmers, enabling them to invest more in their farms, improve productivity, and enhance their livelihoods. Tax exemption encourages investment in agriculture, leading to increased productivity, modernization of farming practices, and overall growth in the agricultural sector.

Tax exemption can be exploited for tax evasion and misuse, with individuals falsely declaring non-agricultural income as agricultural to avoid taxes. Exempting agricultural income from taxation creates disparities in the tax system, potentially leading to perceptions of unfairness among taxpayers in other sectors.

To leverage the opportunities of tax exemption for agriculture while addressing its limitations, policymakers need to strike a balance. This may involve implementing measures to prevent misuse, improve tax compliance, invest in agricultural infrastructure and technology, and provide support to farmers during periods of distress. Ultimately, a comprehensive approach is needed to ensure that tax exemption effectively supports the agricultural sector's growth and development while maintaining the integrity of the tax system.

The primary opposition to taxing agricultural incomes in India stems from political reasons, largely due to the significant reliance of rural populations on agriculture, either directly or indirectly. This resistance isn't surprising, especially given the lack of comprehensive social insurance schemes provided by the government to the majority of farmers, many of whom rely heavily on rainfall for their crops and are barely above the poverty line. Consequently, any attempt to raise tax burdens on these farmers would likely be met with resistance and protest. This circumstance has benefited wealthy farmers, who have been particularly vocal in their opposition to increased taxation of agricultural income in India.

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By identifying tax evasion and economic crimes in agriculture, India can strengthen its tax base, promote fairness in taxation, and support the sustainable development of the agricultural sector, contributing to overall economic prosperity and social welfare.

SUGGESTIONS

- Strengthening monitoring mechanisms and increasing enforcement efforts to detect tax evasion and economic crimes in the agriculture sector. This could involve leveraging technology such as satellite imagery and data analytics to identify discrepancies in income declarations and transactions.
- Implementing measures to improve reporting and transparency in agricultural transactions. This could include mandating the use of digital platforms for financial transactions in agriculture and enhancing reporting requirements for agricultural income.
- Linking Aadhaar with agricultural land records and financial transactions to create a digital trail and prevent misuse of agricultural income for tax evasion purposes.
- Considering the feasibility of taxing agricultural income above a certain threshold to prevent misuse and evasion. This could involve conducting studies to assess the potential impact of taxing agricultural income and consulting stakeholders before implementing any changes.
- Providing training and capacity building programs for tax officials to enhance their skills in detecting and investigating tax evasion and economic crimes in the agriculture sector.
- Introducing whistleblower incentives to encourage individuals with information about tax evasion and economic crimes in agriculture to come forward and report such activities.
- Conducting public awareness campaigns to educate farmers and other stakeholders about their tax obligations, the benefits of tax compliance, and the consequences of tax evasion and economic crimes.

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- Providing incentives for tax compliance in the agriculture sector, such as tax credits or deductions for investments in agricultural infrastructure, technology, and sustainable farming practices.

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