

**Policy Options for the
Taxation of Agriculture Land and
Agricultural Income in India**

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Abstract

This paper is a study of the policy options for the taxation of Agricultural Land and Agricultural Income in India at the levels of the Local, State and Central Government. This study has come to the conclusion that the continued under-taxation of the agricultural sector in India could lead to serious distortions and result in lower overall tax compliance. It has been therefore proposed that the taxation of all forms of income, including Agricultural Income, should be with the Central Government, while the taxation of Agricultural Land should be devolved to the Local Government at the District level. It has also been suggested that this Tax on Agricultural Land should be converted to a simple Property Tax so that can be easily implemented by the Local Governments. In supporting the recommended policy options and the rationale for increased taxation of agriculture, the author has drawn from his experience while working with the Ministry of Finance, Government of India and studies on Tax Reform by Academics and Committees of the Government of India and the State Governments.

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Introduction

*'It is not hard to find a tax expert who has not at any time of his/her career made a recommendation for increased taxation of agriculture, while it was even harder to find one whose recommendations were accepted'*¹

Richard Bird

In the light of this comment made thirty years before, it might seem a futile exercise to re-examine the issue of the taxation of the agriculture sector in India. This paper has been prompted by the renewed interest in the taxation of agriculture in India because of the findings of the Kelkar Report in 2002, that the presence of a large untaxed agricultural sector has presented easy avenues for tax evasion. The report has also brought the serious inequity in the tax system due to the increasing evidence of rising wealth of the rural rich who are considered to be the main beneficiaries of the 'tax-free' status of agriculture. There is little doubt that the contribution from the agriculture sector in India in the form of explicit taxes is extremely low, less than one per-cent of the total national tax revenue, for a sector whose size is a quarter of the GDP. Leaving a fourth of the economy effectively free of tax has resulted in a highly inequitable tax structure and has given rise to grave distortions with overall negative consequences for the economy. There have been numerous recommendations over the last forty years for the increased taxation of agriculture both from economists and government committees². There have also been others who have justified the low taxation of the agricultural sector on the grounds that the cost of collection of tax from this sector was very high and that it was likely the cost of collecting the tax would be even higher than the revenue that could be raised from it³. On the other hand as Agriculture is the main source of income in the rural areas, a sustainable local government in the rural areas would require some form of tax on agriculture at the local level. The decision to tax agriculture is a difficult policy question that has to balance the practicality of taxing a vast unorganized sector due to the high costs, with the benefits of equity in taxation, increase in overall tax compliance and providing a source of revenue for the local government in rural areas. The policy also has to take into consideration the shape that the economy is likely to take in the future and what the tax administration needs to do in order to be prepared for it.

The biggest opposition to taxing agriculture however has been political, which is not surprising as more than two-thirds of the population who live in rural areas are either directly or indirectly dependent on agriculture. Further, the incidence of poverty in India has been greatest among those who earn their livelihood from agriculture and taxing this sector was likely to convey the signal that the government was anti-poor. Over the last fifty years agriculture was supported through fertilizer and food subsidies with the primary aim to achieve self-sufficiency in food production and in this context it was considered the right policy to keep the tax burden on agriculture low. During the last decade though with an over flowing and almost unmanageable buffer stock of food grains, the fear of food shortfall has receded and the government has also lifted many restrictions on agricultural exports.

This paper would suggest ways and means of improving the current system of direct taxation of the agricultural sector in India and increase its contribution to the exchequer. This paper would stress on the taxation of agricultural land and agricultural income as a source of revenue and examine the issues of equity and the administrative feasibility of implementing it. It would not go into the taxation of agriculture as a policy instrument for the transfer of resources out of agriculture, though that might result from such taxation. It would also seek to address the tax design issues in the Indian context, the political economy questions and also discuss the implications of recent proposals to tax this sector⁴. It has to be said that due to the low productivity of agriculture in India and the large number of small and marginal farmers, total tax collection from the agricultural sector cannot be expected to be a significant portion of revenue. On the other hand it has been the experience in developing countries that the share of agricultural land tax in the total taxes of the local governments have been high when the powers to levy this tax was devolved to them⁵. Further, the tax collected from the agricultural sector is likely to rise in the future with the increasing commercialization of agriculture that is already evident in certain parts of the country.

The Case for Taxing Agriculture

Agricultural taxation is a state subject in the Indian federal system⁶. The low taxation of agriculture has to be seen in the light of the deterioration of the finances of the States. The combined fiscal deficit of the States increased from 2.7% of GDP in 1996-97 to 4.3% in 2000-01, and further to 4.6% (revised estimate) in 2001-02. The consolidated fiscal deficit of the Centre and the States was 10.0 percent of GDP⁷. In the face of decelerating revenues, the States have been resorting to borrowing to meet increased expenditure. The revenue deficit has accounted for around 59% of the gross deficit of the states and in the recent years this had an effect of a 10% drop over the last decade in share of developmental expenditure to the total expenditure of the States⁸ and this has reduced their capacity to fight poverty and invest in education and health. The government and policy makers have now focused their attention towards ways to arrest the fiscal decline of the State governments who have increasingly started relying on the Central tax revenues.

In 2002, the Ministry of Finance of the Central Government constituted two Task Forces, one on Direct and another on Indirect Taxes under the advisor to the Finance Minister, Vijay Kelkar, to suggest ways to address the worsening fiscal situation of the Center. One of the most talked about recommendations of the Task Force on Direct Taxes was that there was an urgent need for the Central Government to step in and take from the State Government the power to tax agricultural income⁹. This according to the Task Force was necessary because the almost negligible taxation of the sector by the States has resulted in serious distortions in horizontal and vertical equity and that it encouraged laundering of taxable non-agricultural income as agricultural income and has been a major route for tax evasion¹⁰.

According to NCAER¹¹, approximately one sixth of persons in India with annual income of more than 2 million rupees 'the super rich', reside in rural India¹². Rural areas are

slowly getting richer while taxes levied primarily on agriculturists such as land revenue has dropped in real terms. The incomes among some sections of the farmers in the rural areas of Punjab, Haryana and Western Uttar Pradesh have been rising rapidly, far surpassing the incomes of the middle-class in the urban areas that form a bulk of the income-tax payers. This has given rise to serious distortions to equity and the resulting clamor among the urban middle class that the rich agriculturists be subjected to increased taxation.

With approximately 70% of the population dependent on agriculture whose size is only a quarter of the GDP, one would expect that the per-capita income of those in rural areas to be much lower than those in the urban areas. Rural areas also have significant amount of non-farm income¹³, and even after incorporating this fact one would draw the conclusion that the per-capita income of those living in rural areas would be about half of those in urban areas. However, that does not take into consideration that there are a large number of rural rich and when one incorporates the level of inequality that is prevalent in India, the top 10% of those who live in rural areas, whom we could call the rural rich, would have combined income of approximately 15% of the GDP¹⁴. Hence, the per-capita income of the rural rich would turn out to be 30% higher than the per-capita income of the urban residents with half of it constituting tax-free agricultural income. This gives rise to the conclusion that the rural rich have been the main beneficiaries of the government policy to exempt agricultural income from taxation. Hence, in the interest of equity, the agricultural income of the rural rich has to be subject to increased taxation.

The main taxes levied on the agriculture sector are Land Revenue and the Agricultural Income Tax. While the Agricultural income tax is levied only by six states, almost all the States in the country levy Land Revenue. Agriculture income tax is collected from a small base as it is levied only on income from certain plantation crops and the collections from this tax have been low. Land Revenue uses costly survey and settlement procedures to determine tax liability and the collection from this tax is about 1% of the tax revenue of the States. In the light of this there is an urgent need for reform of these two taxes and increased collections from them.

It has been argued that the agricultural sector is already facing a high tax in the form of agrarian structures characterized by an unsupportive regulatory environment, dominance of parastatals, export restrictions and others. Recent reforms on the other hand are slowly removing many of these restrictions¹⁵. The profitability of agriculture, especially for the rich farmer, has been rising while these restrictions are being removed. A sign of the increasing profitability of agriculture has been the rise in agricultural exports, which is 50% more in 2000 than what it was in 1990¹⁶. There have also been proposals to reduce the subsidies on agriculture because the country has achieved self-sufficiency in food production. The need to continue with some of these subsidies has been to use it as a resource transfer to the poor farmers and also in order to maintain the political support from the large population of agriculturists. Doubts have been raised as to which section of farmers are actually benefiting from the subsidies especially as maximum procurement of food grains have been from Punjab and Haryana where the incidence of poverty among agriculturists is much lower than in other parts of the country.

One suggestion for taxing the hard to tax groups such as agriculture has been to increase the portion of indirect taxes to direct taxes¹⁷. While this would ensure that all sectors end up contributing to the exchequer, it is likely to be regressive unless very finely targeted and hence such taxes should be levied on farm implements and machinery that the rich farmers typically use. Hence the scope of these taxes are limited. In the next section, I would examine the policy options for taxing agricultural income.

Center vs. State for the Taxation of Agricultural Income

Under the Indian Constitution, the power of the Center to tax income is restricted to the income that arises from sources other than agriculture. The State Government has the exclusive power to tax agricultural income, tax land and buildings, and assess and collect Land Revenue under the Seventh Schedule of the Indian Constitution¹⁸. Not all the State governments have used their power to collect agricultural income tax. Only six states are levying this tax and that too on a limited base such as income from plantation crops like rubber, coffee and tea, though at one time eleven States levied this tax. The agricultural income tax is levied on income from tea plantations by West Bengal, Tripura and Assam while Karnataka and Tamil Nadu levies it on income derived from growing a range of cash crops like tea, coffee, cardamom etc. Kerala on the other hand has an exempted list of seventeen crops on which this tax is not levied, with income from the rest being taxed¹⁹. The tax collected from agricultural income has been less than half of a percent of the tax revenue collected by each of the states.

Despite the constitutional limitations, the Center has repeatedly tried to tax agriculture indirectly. Since 1973 on the recommendation of the Raj Committee, the Central Government has been using a system of partial integration of the tax bases by taking the agricultural income of a person into account for determining the rates of income tax to be applied to his/her non-agricultural income²⁰. The Indian Constitution has given the Central Government the power to define as to what constitutes agricultural income²¹. The Center under its ordinary legislative power can amend the definition of agricultural income and define the boundaries of the States taxing powers, while remaining within the bounds of the Constitution. What constitutes agriculture is important because it determines the fiscal boundary between the Center and the State.

Agriculture - Definitional issues

The Income Tax Act, 1961 defines agriculture to be either '(i) Rent or Revenue derived from land and used for agricultural purposes or, (ii) Income derived from such land by agricultural operations including processing of the agricultural produce raised or received as rent-in-kind so as to render it fit for the market, or sale of such produce or, (iii) Income attributable to a farm house subject to the condition that the building is situated on or the immediate vicinity of the land and is used as a dwelling house, store house...'. The judicial interpretation of the term agriculture has been given in various Court rulings with the most widely used one given by the Income Tax Appellate Tribunal in the case of CIT

v. Raja Benoy Kumar Sahas Roy²², where it laid down the principles of defining the term 'agriculture' and 'agricultural purposes'. According to this definition, agriculture consists of a combination of basic processes involving human skill and labor prior to germination of the crops to make the land fit for cultivation and subsequent operations that arise after germination of the crops. In addition, mere connection with land does not make an activity constitute agriculture. Hence, breeding and rearing livestock, dairy farming, and poultry farming would not by themselves constitute agriculture. The ordinary process employed to make a produce fit to be taken to the market would constitute agricultural operations and any process over and above the basic minimum required to do that would not be an agricultural operation. As a result, income derived from subsequent sales would not constitute agricultural income. In addition, the term agriculture does not extend to the breeding and rearing of livestock, dairy farming or poultry farming²³.

According to the Central Statistical organization of the Government of India, the agriculture sector comprises agriculture proper, livestock and livestock products and operation of irrigation system²⁴. Out of these activities only agriculture proper and that too the growing of field crops, fruit, nuts, seeds and vegetables (without any subsequent processing) would not be taxable, being under the accepted legal definition of agriculture for tax purposes. The other agricultural activities would be taxable under the Central Income-Tax as non-agricultural income. The importance of this can be gauged by the fact that the contribution of the livestock sector to the agricultural GDP was 22.6% in 1998-99 and is rising²⁵.

From this, it can be concluded that the size of the agricultural sector outside the purview of Central Income taxation is smaller than what it was assumed to be, as the size of the agricultural sector that would not be taxable under the Income tax would constitute only 15% of the GDP. Hence, this would suggest that the powers of the Center to tax income are much wider. The challenge before the Income Tax Department²⁶ is to widen its tax net into the rural areas and collect more of the non-agricultural income that is traditionally grouped with agriculture.

Tax Administration and the Cost of Collecting Agricultural Income Tax

The Income-Tax administration machinery in the rural areas have been small as they are in general much poorer than the urban areas and also because substantial sources of income in these areas comes from agriculture which is not taxed under the Central Income Tax. On the other hand over the years there has been a trend of farmers shifting from basic crops to cash crops and on to non-farm activities. NCAER estimates that while 75% of all people in rural India are engaged in agriculture, only 53% of income comes from there, the rest comes from these non-farm activities. This poses serious problems to tax administrators, entrusted with the responsibility of taxing non-agricultural income in the rural areas as many households have both sources of income which provides easy opportunities to evade by showing taxable non-agricultural receipts as non-taxable agricultural receipts.

The fact that the agriculture sector has been a popular source of tax planning by the urban taxpayers is well known in the tax administration. The Kelkar Report had mentioned a study of a sample of Mumbai tax returns where an estimated 10 billion rupees have been evaded by misrepresenting taxable income as non-taxable agricultural income. The difficulty in separating non-agricultural income disguised as agricultural income can be gauged by the fact that routine audit of the Income Tax Department for the year 2003 conducted by the Comptroller and Auditor General²⁷, has brought out instances where 110 million rupees of non-agricultural income which was interpreted and claimed as agricultural income and erroneously accepted by the Income Tax Department even after intensive scrutiny of the returns²⁸. In many cases, false declaration of agricultural income is used as a mechanism to launder black money that is then used as equity or working capital margin in business or invested in real estate. The usual method adopted is the declaration of high yield figures for agricultural crops and/or artificial depression of expenses to produce inflated figures of non-taxable agricultural income that is then brought back into circulation. Also illegal collections like bribes, brokerage for government contracts are legitimized in the same manner²⁹.

The argument for keeping agricultural income tax out of the purview of the Central income tax due to the high cost of collection is outweighed by the disadvantages of retaining the exemption on agriculture and continuing to allow an easy route for evasion. It is even possible that tax collections can be increased when extending the tax net to sectors not previously taxed due to the compliance effect on the already taxed sectors³⁰. On the other hand, the popularity of such misrepresentation of income as a route for tax evasion also reflects on the failure of the income tax department to catch and punish such cases of evasion. The large amount of evasion using this route in general could be tackled by routine audit of tax returns and deterrent punitive action on those caught. As mentioned by Raja Chelliah, the solution to curbing laundering of non-agricultural income as agricultural income lies with the tax administration itself³¹. It is true that tax compliance for persons earning income from a particular sector can theoretically be raised by increasing the detection of evasion and increase penalty on discovering cases of evasion, but the presence of a large untaxed sector places limits on the ability of the tax administration to detect tax evasion. Relying on penalties is unlikely to offset this shortcoming, as they have to be within reasonable limits because steep penalties can breed corruption without reducing compliance in any big way. Large-scale evasion reflects on systemic defects necessitating the use of extraordinary measures, though there is little doubt that using this argument to tax agricultural income has not been enough to enlist the support of the political parties³². In order to improve the tax administration so that it could better tackle cases of evasion using the agriculture route, the Income Tax Department would need to create a database to include details of agricultural holdings and crops grown of all persons so as to correctly estimate the correct income of a person claiming to earn agricultural income. The motivation for this is low because it is unlikely that tax administration would invest so much to create a database for incomes arising from a sector that it does not tax. At the very least, there is a need for integrating the database that is emerging out of the computerization of land records in the States to tackle false declaration of ownership of agricultural land.

An issue of worry to the tax administration is the fact that due to the non-taxability of agricultural income, reporting requirements for ordinary taxpayers are not being extended to those who earn tax free agricultural income³³. As an example, while in general, bank accounts require the Tax identification numbers³⁴ of the owner, bank accounts of those earning income from agriculture are exempted from this requirement. This makes the laundering of non-agricultural income into tax free agricultural income even more attractive. This can be tackled only when all citizens by law are made to adhere to the reporting requirements regardless of source of income³⁵.

In recent years, new forms of evasion using the agriculture route have appeared. An example of which was brought out by the Tax Reform Commission of Karnataka have been the cases where large corporations have now started entering the field of agriculture by entering into structured arrangements with farmers where they finance and provide inputs and extension to them, as well as, buy back their produce. Seed companies have also been attempting to do this with the resulting income being passed off as agricultural income in most cases³⁶. As such activities grow and the agricultural sector gets increasingly commercialized and profitable, it would then become necessary to include the rich farmers in the tax net or else the agriculture sector would become a convenient vehicle for tax avoidance even if not tax evasion.

Options for the Central Government

In this scenario it is not surprising that the Kelkar Committee suggested that the Center take up the taxation of agricultural income. The report recommended that this could be achieved by asking the States to voluntarily give up their powers under Article 252 of the Indian Constitution so as to avoid a lengthy Constitutional Amendment. Under this provision the Center cannot force any State Government to give up their taxing powers, and the taxation using this method is unlikely to get the backing of all the States for it to serve any useful purpose. The other way forward for the Center is a Constitutional Amendment that brings the taxation of agricultural income tax under its powers. As such an amendment affects the balance of power between the Center and States, it not only requires a 2/3rd majority in both houses of Parliament but also requires the ratification by a majority of State Legislatures. At the present juncture the requisite political will to push through with such an amendment is lacking and the benefits of such a move are not seen by the political parties to be too great to merit expending such a large amount of political energy. The political economy issues in this regard are discussed later in this paper with the various methods that the government could use to get support for such legislation.

The taxation of agricultural income by an authority other than the Central Government as is presently the case involves a duplication of tax effort in respect of those taxpayers who have both taxable agricultural and taxable non-agricultural income. This would be an issue that needs to be considered by policy makers especially when designing a tax policy for the next ten-twenty years, when it is expected that the size of the industrial sector and the service sector would expand at the cost of the agricultural sector. There is already increasing evidence of growth of small-scale industrial activities and increasing non-farm

income in the rural areas³⁷ and the presence of a tax administration that is well-experienced to work in the rural areas would be a big advantage. There are definite advantages in bringing the taxation of agricultural income under the Center in the immediate future and build up the necessary infrastructure to be able to effectively tax rural incomes, especially when one projects the increasing industrialization of the rural economy over the next ten years.

In the interim, Rajaraman had suggested that the problems arising from the non-taxation of agricultural income can be tackled by first, doing away with the exemption given to those earning income from agriculture (and who do not receive any other taxable income) from having a Tax ID number. The second, to extend the one-by six scheme³⁸ to the rural areas, and Third, to widen the scope of the Central taxation by amending the definition of agricultural income in the Income Tax Act through a simple legislation and include only those who earn income from agriculture and who have their principal residence in the rural areas³⁹. The last option might run into difficulties because it would go against the Constitutional intent of giving the taxing power over agricultural income solely to the State Governments. Agricultural land is also exempt from Wealth Tax which is levied by the Central Government. The Central Government can at the very least remove this exemption and bring in farmers with large agricultural land holdings into its tax net as a first step.

In the absence of a Central Income Tax, the State Government could, expand the scope of the agricultural income tax to include all crops. The task of administering such a comprehensive tax could be left to the Land Revenue Administration who have access to detailed information of crops grown, yield and total output. The administrative costs could be kept low with computerization of land records and keeping the exemption limit high so as to keep most of the poor farmers outside the tax net. While this would not involve the constitutional questions discussed above, the problems of duplication of effort of taxing income by two different agencies and the resulting inefficiencies arising from imperfect exchange of information between them would continue.

Hence, in order to increase the tax payable by the agriculture sector, the Center should be allowed to widen its power to be able to tax all forms of income. In the long term it would help to strengthen the Central Government tax administration in the rural areas to tax the rising incomes from non-farm activities in these areas. In the short term the result of this policy would be that its resources would be stretched too thinly in the rural areas from where tax collection per capita is expected to be small for some time to come. It has been observed that in countries that have not exempted agricultural income such as Indonesia, Malaysia, Bolivia and Uruguay that the incidence of evasion among the agricultural taxpayers is high and there is a tendency for farm incomes to fall below the exemption limit⁴⁰. This could reduce over all tax compliance and affect revenue collections. A feasible strategy to obviate and keep cost of collections low is to concentrate in the short term to the One-by-Six scheme⁴¹ where persons engaging in high value transactions or possessing property of high value have to compulsorily file tax returns regardless of the amount of their taxable income. This scheme is currently only applicable to persons living in urban areas and could be extended to the rural areas and to

include all forms of incomes. This would have the effect of increasing the tax compliance of the rural rich. The Kelkar Report had recommended that keeping an exemption level of 100,000 Rupees for agricultural income that was much above the exemption level for non-agricultural income⁴². This would reduce the number of potential taxpayers in the rural areas and reduce the administrative difficulty of taxing agricultural income. This higher exemption also takes into consideration the fact that the agricultural sector faces risks that are far higher than in the other sectors and equating incomes from two sectors facing such different levels of risk would not be equitable. In the long term, the exemption limits for all kinds of income need to be aligned so as to provide a semblance of uniform taxation across sectors, even while providing sector specific provisions for agriculture just like other special industries.

Taxation of Agricultural Land – Issues and Options

The Land Revenue Administration was inherited from the British that was itself based on the system followed by the Mughal rulers for many centuries and its current structure has changed little over the last 100 years. While some states like Punjab, Haryana, Orissa and Goa have abolished Land Revenue, other states such as Andhra Pradesh have in effect renamed the tax and collect it in the form of water tax that continues to be administered by the same Land Revenue Administration. The system of Land Revenue Administration is very well defined and the revenue officials have a considerable degree of experience in administering the tax. Even while they have been abolished in some states, the administration continues to function and performs functions that they have developed considerable expertise in such as the maintenance of land records. Total collection from agricultural income tax and from Land Revenue was Rupees 17.8 billion in 2000-01 which amounted to 1.5% of the State's own tax revenue with Land Revenue accounting for 90% of the total⁴³. Land Revenue has been the main form of taxation of agricultural land in rural areas.

Present State of Land Revenue

Land Revenue has been the biggest source of revenue from the agricultural sector for the State Government and is basically a presumptive levy in relation to the productive capacity of land. The original cadastres which incorporate a detailed classification of the soil type, and permitted land use form the basis of the land revenue. For example in Karnataka, a total of eleven factors are used for grouping land. These are physical configuration, climate and rainfall and yield and prices of main crops, the secondary factors used are marketing and communication facilities, the standard of husbandry, population and supply of labour, agricultural resources, variations in the area of occupied and cultivated lands during the previous thirty years, wages, costs of cultivation of principal crops and sale values of land⁴⁴. The process of creating this grouping is called a Settlement and is done once every thirty years. Considering the extensive set of factors that are used to rate a piece of land it is not surprising that settlements are extremely tedious, time-consuming and costly. The last settlement was done in 1964 and the next

one was due in 1994, but was not done even after 10 years. In trying to achieve equity to the utmost level by having so many parameters to group land, the government has made it administratively infeasible. The State governments have not indexed their Land Revenue to inflation and hence while over the years the nominal collection has remained the same, the real amount of land revenue has dropped over time. Land Revenue is no longer a significant source of revenue for the States. Land Revenue constituted 26% of the total State taxes in the early 1950s⁴⁵ while coming down to less than 1% in recent years⁴⁶. Indexing the Land Revenue to inflation is the first step so the collection from this tax is to be of any significance to the States.

Apart from indexing the Land Revenue, State Governments need to incorporate high technology and do away with a physical plot-to-plot survey method for the classification of land. GIS technology has become quite advanced and the process of computerizing land records started in 1988-89, is complete in some states and at an advanced stage in many others⁴⁷. The conversion of the computerized land records into a full-fledged GIS database is yet to be done in any of the States in India. This is the basic pre-requisite to incorporate satellite based survey data for the purpose of grouping land. The technology and research manpower are widely available in India with significant private presence that uses local expertise. The expected cost for conducting Survey and Settlement operations for the whole of the country through these modern techniques is quite high, approximately, 100 billion Rupees (\$ 2 billion)⁴⁸. During the past, Manual Survey and Settlement operations have taken more than 10 years to complete in some States. Despite the high cost of a GIS based valuation of agricultural land, the investment is very useful because of the advantages of having up-to-date information of land holdings serves as an input for various other uses such as agricultural planning and design of irrigation systems. They could also serve as the basis for a modern property tax system. Also this modern system of land records would greatly improve the quality of life in the villages by reducing litigation and introducing transparency and accountability in land transactions. Land Disputes form one of the biggest sources of litigation in India and have been affecting the delivery of justice in all walks of life.

In the interim it is not possible to raise Land Revenue rates based on past Settlement because of Court rulings not permitting across the board revision of Land Revenue rates without a formal settlement process, as is the case in Karnataka. An option that is being considered in Karnataka is the levy of a cess equal to the Land Revenue that could then be given to the local bodies (Panchayats). This is only a temporary solution because valuation of land based on surveys done thirty years previously would be out dated and most likely highly undervalued. During the time of the British, the rate at which land revenue was to be paid was in most cases based on the personal equation between the Zamindar⁴⁹ and the tenant, and this valuation was incorporated into subsequent settlements in many cases⁵⁰. Using satellite based surveys and reducing the time between settlements to ten years along with inflation indexing would make the valuation of agricultural land more objective, transparent and reflect its true value as on date that would be reflected in higher tax collection.

Converting Land Revenue to a Property Tax.

The State government has a well-defined administration to collect land revenue. Many states levy a fee for maintaining the Land Records. Land Revenue is a costly tax to collect in India apart from the high cost for survey and settlements, because the Land Revenue Administration also performs functions other than land tax⁵¹. While the collection under the Land Revenue account in 2000-02 was Rupees 431.6 million, the expenditure under this account was 1114.2 million⁵². In many States while Land tax was abolished, the administration continued to remain on the ground performing other tasks and collecting taxes such as Water Tax. This is a sign of a major shift in the way Land Revenue is implemented and is a sign that there is acceptance of the desire to re-orient the current Land Revenue system.

Land Revenue has over the years ceased to be an important source of revenue as it was used as an indirect measure for income generated from land and hence required costly valuation methods. In the event of implementing a comprehensive income tax covering all forms of income, a proxy for agricultural income would not be necessary. Land Revenue could be simplified and converted to a tax on property. Such a tax could be implemented by the local governments. A modern system of property tax should be less complicated and cheaper to administer than some of the cadastral systems presently in use. The original Cadastres can be adapted to form a modern valuation list to implement a Property Tax as in theory cadastres are in fact valuation lists that have become fossilized. The present day cadastres suffer from two defects. First, they do not include the non-agricultural properties in the tax base. Second, they do not reflect present day agricultural values. In any case many of the skills required to maintain a cadastre are relevant, with adaptation, to the assessment process for implementing a Property Tax. The difficulties are that evidence of market value are difficult to find in rural areas as most of the land transactions are in the form of leases rather than sales⁵³. This problem can be tackled by valuation methods (even if approximate) that reflect the peculiarities of the land market in rural areas. The advantages of converting the present day complicated Land Revenue system to a Property Tax based on a few sets of factors that determine its rough value could go a long way to make it a simple and effective source of revenue for the local governments. Such a simple tax could be implemented at the local level as they have a lot of experience in collecting Property Tax.

Examining Rajaraman's Crop Specific Levy

It is almost impossible to assess agricultural income accurately, and there is a need to continue to rely on systems of taxation based on presumptive income⁵⁴. Collection of information necessary to administer an income tax is costly considering the large number of taxpayers and the cost for the tax administration. Taxpayers would also have to incur additional costs in the form of maintenance of detailed accounts and retaining proof of expenditure. Agricultural taxation has in general used presumptive taxes that are based on criteria that approximate the ability to pay. Land revenue tries as far as possible to calculate the earning potential of every plot of land but this has its limitations. For example, assume that there are two farmers, one rich and the other poor, having adjoining

plots of the same area and growing the same crop. In the absence of a comprehensive income tax on agricultural income, a land tax based only on area and not on yield, would be inequitable when comparing the two agriculturists as the rich farmer is able to use costly inputs and in the process have higher yield than the poor farmer.

The tax should as far as possible reflect the ability to pay. Rajaraman's crop specific levy is superior in this respect. Rajaraman has suggested that the Land Tax should be supplemented by a levy per acre sown to a designated crop. The levy is only applied when the yield crosses a certain threshold. Hence this tax uses the selection of the crop as an indicator for ability to pay. This is true because as farmers get richer they graduate to crops that give higher returns but which also requires a lot of costly inputs. This is seen in India especially in Punjab and Haryana. Rajaraman's tax introduces another level of equity by using a yield threshold in order to be subject to this tax. Thus in order to obviate the situation where two farmers with different income levels would use different levels of inputs for the same crop, the ability to pay can be observed by the higher yields. The final tax is calculated on the basis of land area on those who crossed a designated yield threshold. These thresholds can be easily worked down to the district level or village level. Rajaraman further suggested that the tax be collected and retained by the Panchayats.

On the other hand the crop specific levy would suffer from the problem that it would dissuade farmers who grow crops that are previously untaxed to shift to a more profitable crop or superior varieties and in the process get taxed on crossing the yield threshold. If the levy is not too high and does not eat into the additional profits of the farmer due to the shifting to a more productive crop, this problem could be obviated to a great extent. Further it can be assumed that farmers who venture into new crops would take some time to master the skills in growing the new crop and this would reflect in the lower yield in the interregnum and hence remain out of the tax net during this period. At the same time, individual efforts by some farmers to grow new and superior crops and varieties could initially go untaxed before the potential for taxation of the new crops becomes apparent to the policy makers and include these crops and superior varieties within the tax net.

Another issue that could be very crucial in the design of a proper tax policy is the taxability of the tenant. Land Revenue is traditionally levied on the owner of the land, though it could also be levied on the cultivator. In most states the tenant has substantial rights over the property and is for all practical purposes the owner. Ownership of land is directly related to greater ability to pay and the actual operation of the law on the ground could tip the balance in favor of the owner or the tenant. It has been the experience in many states that large landlords periodically change the tenancies of their holdings so as to avoid the possibility of the latter claiming ownership-like rights that they would become entitled to under land reform laws⁵⁵ or even have oral contracts. While the number of tenancies in the official records has been low, it has been observed that this is because of large-scale under-reporting of tenancies because owners do not officially admit to leasing out property for the fear of land-to-tiller legislation⁵⁶. Traditionally, it is the landlord who has the upper hand with respect to economic power vis-à-vis the tenant. On the other hand there have been cases of 'reverse tenancies' seen in Haryana and

Punjab where rich farmers get farmland on lease from poor landlords. In the presence of market imperfections which are common, it is highly likely that markets do not adjust easily and the statutory taxpayer would end up bearing a greater portion of the tax liability. The detailed economic implication of a land tax is being examined in a subsequent paper with special reference to its affect on tenancy. Rajaraman's proposed tax which is based on the choice of crop and the yield should be levied on the cultivator to work properly. This is especially true in cases of reverse tenancies because the poor landlord would be held responsible for paying the tax even when the inputs and cropping decisions are made by the rich farmer in case the tax is levied on the landlord. When such contracts are oral, the poor landlords would be slapped with high tax liabilities and would need to get paid by the rich tenant farmers. If Rajaraman's tax is levied on the cultivator, it begins to look more like an agricultural produce tax. Hence, it would work best if this tax is integrated into the Central Income-tax as a presumptive levy of agricultural income, while continuing to levy Land Tax in the form of a simple property tax on the landlords.

While the share of Land Revenue to the total tax revenue of the States have been low, its importance as a source of revenue for the local bodies is likely to be much higher. It is a classic tax that can be levied by the local government. In the next section, I analyze the administrative feasibility, issues of equity and efficiency in shifting the land revenue to the local government level.

Taxation of Agricultural Land by the Panchayats

It has been the experience in developing countries that tax revenue from land tax while being a small portion of total revenues in countries where local governments collect taxes from agricultural land, the share of land revenue to total tax have been high⁵⁷. The power to levy Land Revenue rests with the State Governments and it is only in four states out of twenty-eight that the Land Revenue is fully assigned to the Local Government called the Panchayat. The constitution amendment that introduced the Panchayats intended to give them extensive powers. The Local government in India consists of three tiers with executive powers being vested at the lowest level, called the Gram Panchayat or Village Panchayat whose jurisdiction covers a village. The level above this is called the Panchayat Samiti or Panchayat Union also called the Block Panchayat, while the local government at the district level is called the Zilla Parishad or District Panchayat. The Panchayats were given separate powers and responsibilities that forms a part of the Indian Constitution⁵⁸. By providing the Panchayats with a wide array of power and responsibilities, the intention of the 73rd Amendment was to encourage and strengthen democracy at the grassroots and also give the local governments greater freedom to manage their own resources. The devolution of fiscal powers was left to the States who were to be guided by their respective State Finance Commission. Based on this, most States have devolved the power of taxing Property to the Panchayats. Some Panchayats like those in Tamil Nadu also levy tax on professionals. A large portion of funds are disbursed down to the Panchayats from the State Government. The principles that should govern the distribution between the State and the Panchayats of the net proceeds of the

taxes, duties, tolls and fees leviable by the State, is also based on the recommendation of the State Finance Commission which is set up every five years.

The success of Panchayat institutions in States such as Kerala, West Bengal, Karnataka and Madhya Pradesh has been attributed to greater fiscal devolution. Allowing the Panchayats to collect and retain Land Revenue would greatly strengthen it. While in the year 2000, Kerala and West Bengal have allotted local bodies 40 per cent and 50 per cent respectively of their plan funds, Tamil Nadu Government on the other hand allotted only 8 per cent of its total annual income and has been regarded as one of the main reasons why the local government there is in a weak state⁵⁹. An innovative means to improve the local infrastructure facilities and also to compensate use of local resources by industries has been the Haryana Local Area Development Tax that is collected by the State Government and distributed to local governments⁶⁰. This tax is levied on all goods on their entry into a local area for use by an importer from out of the State, though this tax is also levied on consumers who bring in goods for consumption above a certain amount⁶¹.

Panchayats and their Administrative Capacity

In deciding the appropriate level to levy land tax one would need to take into consideration the administrative capacity and the availability of information at each level. The implementation of any tax is greatly aided by the easy availability of the relevant information about the taxpayers to be able to verify their tax liability. Due to poor availability information of rural taxpayers in the computerized form, physical proximity to the taxpayers are necessary in order to implement a hard-to-tax such Land Revenue. In the case of Land Tax, detailed information about ownership of land and the crops grown is available at the level of the Village Panchayat and Block Panchayat level and the devolution of the taxing power to these levels would result in greater administrative efficiency and increased tax collection.

The decision to grant greater tax powers to the Panchayat level also has to take into consideration their limited (though increasing) administrative capacity. Evaluation studies conducted by research organizations and voluntary groups have consistently highlighted weak individual and institutional capabilities in the rural areas. There have been many examples of dominant interest groups and entrenched communities, though these tendencies are expected to abate with time⁶². The administrative capacity of the Panchayats varies across States and even among different regions within States. According to a Study of two Panchayats of Villages in Bihar, the Panchayat Raj functionaries had been elected as late as the year 2001, and possessed limited experience of the implementation and execution of their constitutional rights and powers. It goes on to say that neither have they been apprised of their responsibilities nor have they been trained to handle them⁶³. In such a scenario it would not be an effective policy to give the Village Panchayats greater taxing powers. In a study of the functioning of Panchayats and the implementation of grass-root democracy, Sudha Pai has brought out the social conflicts that plague the Panchayats. While the process of democratic de-centralization has indeed mobilized a large section of society that was previously oppressed, the large scale disequilibrium in the power structure caused by the implementation of the 73rd

Amendment has resulted in reduced trust and sharing across members of the same Panchayat from different segments of society. While the process of conflict resolution, negotiation and bargaining among the different groups would take time, in the long run it is expected to lead to a more democratic functioning of the Panchayats⁶⁴.

Increasing the fiscal powers to the lowest level would also require that the members of the Panchayat have basic educational qualifications and management skills. It is not financially feasible to have an elaborate supporting administrative set-up at the village level. On the other hand, there is a fairly large administrative set-up at the Block and District level. In a Study of the working of the Panchayats in West Bengal, Bhattacharya gives a detailed description of the Panchayats of two Villages in West Bengal, Jaugram and Raghunathpur. The Village Panchayat of Jaugram consisted of 22 members, out of which one was illiterate, five barely literate, ten members had been to Primary School, five members to Secondary School and one member had been to Higher Secondary School. The Village Panchayat of Raghunathpur had ten members out of which two members had been to Primary school, two to Secondary school, two to Higher Secondary School, while four members were graduates. Jaugram's Panchayat were assisted by a staff of four members whose salaries were directly paid by the State Government. Jaugram's Panchayat raised a total funds of Rupees 72,614 while Raghunathpur's raised ten times the amount. Jaugram's funds were from felling trees, levying taxes on houses vehicles and business and fees on approval of housing plans and were just enough to spend on administrative costs, organize sports in the village and build one culvert. In West Bengal land is taxed tax if one has more than 4 acres of agricultural land or 6 acres of non-agricultural land. In 1993-94 the Village Panchayat of Raghunathpur collected land tax from 1,384 out of 7088 total population, yielding a total of Rupees 13,067. As a means of comparison, the Salary of the Panchayat's secretary was 37,294 Rupees⁶⁵. This situation is quite representative of the situation in West Bengal and of most of India. In general most of the Village Panchayats are under-funded under-staffed and in many states its members possess limited educational qualifications.

While the Panchayats in States like Kerala are way above the learning curve, others would require some time to catch up. It is only to be expected that Panchayats would be capable to take up significant fiscal powers such as collection and administration of Land Revenue only when the members of the Panchayats are better educated, acquire greater management skills and also are able to function cohesively as a unit. Until such a time, the taxation of the agricultural sector should be devolved only up to the higher levels of the local government such as the Zilla (District) Panchayat. In States with strong Panchayats, Land Revenue could be devolved down to the Block Panchayats.

Devolution of Fiscal Powers to Panchayats

Devolution of fiscal powers to the local bodies could have various forms. It could be the devolution of the power to fix the tax base, the power to fix the tax rate, the power to collect the tax, and the power to retain the tax collected. In many countries for the sake of uniformity, the power to fix the tax base and rates are retained by the higher level and the

local government is given the power to collect and spend the tax collected even though a tax levied on land and property could easily be made to vary between jurisdictions.

The rate and base for levy of Land Revenue in India is fixed under the respective Land Revenue Act of the States. At present the Panchayats have no power to change the rate of levy and have in general no role in the collection of this tax. The collection is done by the Land Revenue Department of the State Government through their functionaries who have their presence in almost all villages. The rate and base of levy of local taxes is to a large extent governed by the Panchayat Acts of the States with the subsequent power to modify the rates being left to the Panchayats. For example in Tamil Nadu, the Gram Panchayats are entitled to vary professions tax every five years by not more than 25% and not less than 30%. The Gram Panchayat is also entitled to levy a license fee on those wishing to establish private Village Markets but the fees cannot exceed 15% of the total income of the owner from the market during the previous year (and hence in the case of new markets this would be an estimated amount). Similarly the Panchayat Union, which is at a higher level (called the Block Level) than the Village Panchayat are entitled to levy a local cess at the rate of one rupee on every rupee of land revenue payable to the Government in respect of any land. Further out of this cess so collected in every Panchayat development block, a sum representing twenty percent of the proceeds is credited to the Panchayat Union (Education) Fund and the balance is credited to the funds of the Panchayat Union Council. The Panchayat Union is also entitled to a sum of one rupee for each individual of the population of the Panchayat development block from out of the total Land Revenue (including water-cess collected in the State during that year. In the case of Surcharge on Stamp Duty that is levied on transfer of immovable property and at a rate set by the State Government, the amount collected in each Panchayat Village is pooled at the Panchayat Union level and re-distributed in proportion to the Land Revenue collected in each village⁶⁶.

Hence in the State of Tamil Nadu we see various techniques of fiscal decentralization in action and this is typical of most of the other States in the country. The state of Tamil Nadu has given a larger share of the fiscal powers to the intermediate level of Local Government, the Panchayat Union, which is not surprising because they have greater administrative resources than those at the village level. The problems that Panchayats face in Tamil Nadu have been more on the expenditure side. The multiplicity of representatives in a given constituency with executive powers has caused imbalance in allocation of resources and development works, and has resulted in tussles between the Panchayati Union and Village Panchayats over sharing of powers and responsibilities. In Tamil Nadu most of the welfare programs are effectively being operated by officials, though the administration of welfare programs is one of the main tasks of the Panchayats as enshrined in the Constitution. This has meant that the officials have spent little attention on collecting local taxes leaving the commons without any proper attention⁶⁷. This is not surprising because the newly empowered Panchayat system would need time to mature (especially in some States) and over time it is expected that the elected Panchayat would claim their rights as envisioned by the Constitution. Due to the fact fiscal devolution to the Panchayats is a relatively new feature, the funds that are provided for various welfare programs to the Panchayats are far bigger than the taxes collected by

them. This large supply of funds from outside the Panchayat reduces their incentive to collect local taxes and is a problem which needs to be addressed. If more than ninety percent of a Panchayat's funds come from sources other than its own tax receipts, it is natural that there would be limited motivation among the Panchayat officials to collect their taxes if assured of the remaining ninety percent. Hence there is a need to tie-up local tax efforts with grants.

Devolution of fiscal powers could also result in increasing disparities if not accompanied by appropriate adjustments in allocation of funds by the State Governments. Richer villages could end up collecting more tax revenue and spend more on public services than poorer villages. With farmers in India having traditionally a strong attachment to land (which in most cases they have inherited) it is unlikely to result in Tiebout mobility especially among the landowners. If the tax collected by the Panchayats is based on presumptive Income, like crop based land revenue with a yield threshold, then such disparities could be expected to increase if not accompanied by adjustments in fund allocations. Similarly, if the land revenue is based just on land area, then villages with a high population density could collect significantly less per-capita as compared to villages with a low population density. Equity in disbursement based on need could be assured by increasing the ratio of devolved funds to collected funds for poorer villages that collect less in taxes than the richer villages. For example, poorer villages could be allocated funds to the tune of ten times their collection in property taxes while in the case of richer villages this could be a smaller multiple thus retaining the incentive to collect more while seeking to achieve an equitable allocation of funds.

In deciding the level of tax, the cumulative amount collected by each level should be enough so as to pay for providing basic public services at that level. The cumulative tax collected by the villages could be so small, that it may not be able to pay for basic needs (as in the case of Jaugram Panchayat) for example, repairing the irrigation canal, or maintaining the village roads. In such a case it would be appropriate that a higher level collects the tax and use it to pay for public goods and services that require substantially larger amount of funds. The nature of the public goods could also serve as a useful indicator. Those Public Goods with large spatial externalities should as far as possible be funded by a tax at a higher level of government than the Village Panchayat.

Panchayats and the Bureaucracy

Giving greater fiscal powers to the Panchayats is likely to result in power sharing issues between the executive and the elected bodies at the village level. Historically, the powerful district officials command vast resources and this extends to the executive functionaries at the Block and the Village level. With the executive entrusted with the task of implementing various welfare schemes of the Central Government and State Government, their powers in general far exceed those of the Panchayats. This is despite the fact that most States have rules that ensure that executive officers work only under the overall guidance of the elected Panchayat. In the case of Tamil Nadu, which did not have elected Panchayat bodies for over 10 years before elections were finally held in 1996, the

long absence of democratic rule at the grassroots made people totally dependent on bureaucrats and members of the State Legislature and Parliament to address minor local problems. The reluctance of most bureaucrats and MLAs and MPs to yield space to newly empowered sections of the society manifested itself in their poor attitude to Panchayat functionaries and institutions. Thus it has been said to be one of the main reasons for the poor public interest in Tamil Nadu Panchayat Institutions⁶⁸. The other issue that needs to be tackled is the need to put in place appropriate checks and balances at the Panchayat Level as the powers of the Panchayat Functionaries are likely to increase substantially in the future. There continues to be a wide disparity in the powers between various sections of society in the villages today, which are particularly stark in states such as Bihar and Uttar Pradesh. This could pose serious challenges to the proper implementation of the Panchayat's fiscal powers especially when elected members of the Panchayats do not command the social status and even the muscle power of the rich farmers. In one Village surveyed by a Planning Commission Study in Bihar, the villagers were aware of powerful persons who held land much above the land ceiling but do not wish to make this public as they do not wish to make enemies of the powerful persons, especially in the light of fifty years of inaction by the government⁶⁹. Such an observation is likely to make the bureaucrats argue that devolution of fiscal powers could result in more problems than benefits. Similar arguments have also been propounded due to the increase in corruption among the Panchayats that has been observed and has been attributed to their much increased financial powers. But, as aptly quoted by Rajaraman, "local corruption is locally contained, whereas national-level corruption impinges on the whole country"⁷⁰. Local corruption is visible and felt locally and the loss of transparency rises with the level of government. The solution lies in strengthening the governance at the villages rather than rolling back the devolution of powers.

There is widespread political support to giving Panchayats more tax powers. On the one hand, as discussed above, certain taxes should be left to the higher levels of government. On the other hand political support for increased State and Central taxation of agricultural income is difficult to get and this is an issue that I address in the next section.

The Political Economy of Taxing Agriculture in India

The biggest opposition to the taxation of agriculture has been political, which is not surprising considering the fact that three-fourths of the population live in rural areas and depend on agriculture either directly or indirectly. Also Land Revenue was associated with the exploitative system followed during the time of the British and hence any comprehensive increase in rates strikes an emotional chord (disproportionate to its real impact) among the public and is severely opposed. The small contribution of agricultural producers in the developing countries have been mainly due to the political resistance of large landowners, low level of public investment and poor services and the existent (perceived or real) burden of implicit taxes⁷¹ and this holds true in the case of India.

The opposition to the taxation of agricultural income is not surprising especially considering a virtual absence of a system of social insurance offered by the government

in India. When a majority of agriculturists are barely above the poverty line and in most cases depend on the rains for their agriculture, it is not likely that they would accept any increase in tax liability without protest. This has been to the benefit of the rich farmers who in many States have also resisted any efforts by the State Governments to give up land that they continue to hold despite violating various Land Ceiling regulations that is crucial to the welfare of the poor. Previous efforts to tax the agriculture sector have been stymied by powerful politicians who in many cases also happen to be rich farmers. Quoting Khan in his survey on Agricultural Taxation in Developing Countries, "In most developing countries, the political and administrative aspects of taxing agriculture have hampered a rational and equitable tax regime affecting those in the agricultural sectors who own or control large land areas and have been the main beneficiaries of public investments, input subsidies and credit programs for agricultural development"⁷². In the case of India the increased taxation of agriculture would need to address the issue of the political opposition to it that has plagued it since 1947 when India became independent.

What are the options with the center to tax this sector when there is a great reluctance on behalf of the States to tax it? What kind of system could be implemented with least political costs? One way that has been suggested by the Kelkar Committee has been to keep a very high basic exemption limit that makes it very obvious that the intention is to tax only the rich farmers. This basic exemption limit can then be brought down after some years of introduction of the tax to reasonably align it with other sectors and provide sector specific exemptions to obviate any negative impact on investment. In order to reduce opposition to any tax proposal that increases the tax burden on agriculture, it would be necessary to precede any tax proposal with increased spending in social insurance for the poor in the rural areas. There is also a need for the Central government to remove the many restrictions on agriculture in the form of export controls and controls on marketing and transportation of agricultural produce as these controls have outlived their utility in most cases. Policies that give greater freedom to the farmers to manage their affairs could be packaged with a proposal to tax agricultural income tax by the Center to increase the chance of the latter's acceptance by the public. Public resistance for the increased taxation could be further reduced if the tax collected is kept in a Fund that is earmarked for the development of agriculture⁷³.

The center cannot shy away from spreading its tax net and increase its collection of non-agricultural income from the villages and small towns as these incomes are liable to tax in any case. This is a continuation of its existing powers of taxation and an efficient tax administration should be established so as make its presence felt in the rural areas. In some cases the government has presumptively estimated the non-agricultural component of the growing and manufacturing of tea. This has now been extended to the growing and processing of coffee and rubber under a similar presumptive levy⁷⁴. There is a need to do this for all commercial crops to provide a handle for the taxation of such composite income. These tax proposals can be levied through a simple majority in the Parliament, which is comparatively easy.

Some State Governments have done away with the land tax to earn political support especially from the farming community. On the other hand States such as Andhra

Pradesh have abolished Land Tax and replaced it with a Water Tax while continuing to retain the Land Revenue Administration (which levies the tax and continues to show the collection under the head Land Revenue). The suggestions of many policy makers to shift the land tax to the Panchayats is less likely to face political opposition. The taxation of the agricultural sector, especially agricultural land by the Panchayats, is likely to take into consideration local variations in land types, fertility types and also allow an appropriate adjustment for weather changes that have significant effects on farm output. Taxation at the level of the State Government could be just right at times of good weather and in the case of bad weather or attack by pests, can look exacting. In the latter case the necessary downward adjustment in taxes involves typical administrative delays and is unlikely to be fine-tuned to the local conditions. Hence a downward shifting of fiscal powers to the Panchayats could be accompanied by a higher tax even while keeping the farmers at the same level (of utility) as before. Converting the archaic Land Revenue to a property tax would provide the Panchayats with a tax that they can easily administer and collect.

Conclusion

This paper brought out the policy options with respect to the direct taxation of agriculture in India. In the interest of equity there is a need for the rural rich who mainly derive income from agriculture to contribute more in the form of taxes. Limiting the tax powers of the Central government only to non-agricultural income is likely to reduce their effectiveness and provides a convenient route to evasion. It has been suggested that the Central government be given complete power over taxation of all forms of income. The personal income tax thus collected could be allocated to a special fund that then could be used to finance investment in agriculture. There is a need to strengthen the local governments and reduce their dependence on grants from the State and Central Government. Land Taxation could be simplified and converted to a Property Tax and shifted entirely to the Panchayats. During the initial stages could be levied at the District Panchayat level accompanied by appropriate allocation formula to the Villages. This devolution of powers should be accompanied by the computerization of land records and updating of land valuation using modern GPS technology, the expertise of which is widely available in India. Rajaraman's tax proposal of a yield-based tax could be levied in the interim or incorporated into the Central presumptive tax formula. In the long run, the benefits of the increased taxation of agriculture should be used to address the needs of the very poor by introducing a comprehensive Social Security net and also by improving the Health and Education infrastructure in the rural areas. Only with such a comprehensive tax and expenditure package is there a likelihood of political support to the increased taxation of agriculture that in turn would help the economy as a whole.

Endnotes

¹ Bird M. Richard, p148-149, "Taxing Agricultural Land in Developing Countries", Harvard University Press, Cambridge, Massachusetts, 1974

² Notable among them have been the Raj Committee (1972), the Wanchoo Committee and the Kelkar Committee (2002).

³ Manmohan Singh a well known economist in India and also a former highly successful Finance Minister has advised against taxing agriculture due to the high costs.

⁴ See Rajaraman, Indira, A Fiscal domain for the Panchayat, 2003, Oxford University Press, New Delhi, for a detailed analysis of the fiscal devolution issues in India and her new crop-specific tax proposed for the local bodies.

⁵ See infra. Note 40.

⁶ The powers of the Center and States are governed by three lists in Schedule VII of the Indian Constitution, the Union List, the State List and the Concurrent List, which separates subjects over which each of them have power. The Concurrent List consists of subjects over which both the Center and States have power.

⁷ Economic Survey of India, 2002-03, Ministry of Finance, Government of India.

⁸ "State Finances : A Study of Budgets of 2002-03", A Reserve Bank of India Report (2003)

⁹ Report of the Task Force on Direct Taxes (2002) (Kelkar Committee), Ministry of Finance, Government of India, Page (90).

¹⁰ It is not surprising that there was strong political opposition to this suggestion of taxing agricultural income and this recommendation was not accepted, even if it ignited a vigorous debate on the issue.

¹¹ National Council of Applied Economic Research, New Delhi

¹² M. Rajashekhar, , "The Elusive Money" and, "Of Fat Cats and Piggy Banks", Business World, 28 July, 2003

¹³ NCEAR estimates that about 50% of the income from rural areas comes from non-farm activities. I have used the fact that the 25% of GDP from agriculture comes entirely from the rural areas, which gives about 50% of the GDP to the rural areas.

¹⁴ The gini coefficient of the rural areas in 1997 was about 0.30 while that for the urban areas was 0.36 which I sourced from Raghbendra, Jha (2002), Reducing poverty and inequality in India: has liberalization helped?, Technical Report Working papers in Trade and Development no.2002/04, Economics, RSPAS, ANU. The data on the distribution of income or consumption was taken from <http://www.worldbank.org/research/povmonitor/countrydetails/India.htm> accessed on 10th September, 2003. I used the fact that 33.5% of the total expenditure was by the richest 10% of the population for the whole of India and approximated that 30% of the income was in the hands of the richest 10% of the rural areas.

¹⁵ Biswanger, Hans. P & Delinger K, Explaining Agricultural and Agrarian Policies in Developing Countries, Journal of Economic Literature, 1997, vol. 35, issue 4, pages 1958-2005

¹⁶ Also see the discussion with respect to taxing Agriculture in Pakistan which has inherited a very similar system of government as India in Khan Mahmood .H and Khan Mohsin .S, Taxing Agriculture in Pakistan, 1998, IMF Paper on Policy Analysis and Assessment.

¹⁷ Bird R, and Wallace S, "Is it really hard to tax the Hard-to-Tax? The Context and Role of presumptive taxes," Paper for Conference on the Hard-to-Tax, Georgia State Iniversity, May 2003, pp 1-12.

¹⁸ Entry 45 of the State List under the Seventh Schedule - assess and Collect Land Revenue, Entry 46 Tax on Agricultural income, Entry 49 - Tax on Land buildings.

¹⁹ See Rajaraman, supra Note 4. (Page 75)

²⁰ Report of the Committee on Taxation of Agricultural Wealth and Income (Raj Committee), 1972 also recommended an Agricultural Holdings Tax to be implemented throughout India by the States which was not accepted.

²¹ 'agricultural income' is defined under the Income Tax Act.- a Central Legislation.

²² Income Tax Report (1957) – Citation 32 ITR 466.

²³ As ruled by the Supreme Court of India in the case of State of Orissa v. Ram Chandra Choudhary.

²⁴ The Central Statistical Orgainzation is the premier Central Government agency entrusted with the task of collection of Statistics for the whole of India. According to the CSO, 'The sector comprises agriculture proper, livestock and livestock products and operation of irrigation system. The economic activities included in agriculture proper are (i) growing of field crops, fruits, nuts, seeds and vegetables, (ii)

management of tea, coffee and rubber plantations (iii) agricultural and horticultural services on a fee or on contract basis such as harvesting, baling and thrashing, preparation of tobacco for marketing, pest control, spraying, pruning, picking and packing and (iv) ancillary activities of cultivators such as gur making, transportation of own produce to primary markets, activities yielding rental income from farm buildings and farm machinery and interest on agricultural loans. Livestock and livestock products include breeding and rearing of animals and poultry besides private veterinary services, production of milk, slaughtering, preparation and dressing of meat, production of raw hides and skins, eggs, dung, raw wool, honey and silk worm cocoons etc. Operation of irrigation system comprises supply of water through various Government channels to the agriculturists’.

²⁵ Report of the Steering Group on Agriculture and Allied Sectors (2002) for the 10th Five Year Plan (2002-2007), Planning Commission, Government of India.

²⁶ The agency that collects Income-tax for the Central Government.

²⁷ Report No. 13 of 2003 (Direct Taxes), Comptroller and Auditor General of India.

²⁸ This represents only the income that was declared as agricultural income on legal grounds during the course of regular audit of the tax returns by the Income Tax Department and erroneously accepted as the same. It does not tell of the number of cases of similar mis-declaration and found during audit of tax returns to be false.

²⁹ Chapter VII, Report of the Tax Reform Commission of Karnataka, 2001.

³⁰ James Sebastian, Tax Compliance and the Untaxed Sector, 2003a, Working Paper (mimeo.)

³¹ Chelliah, R.J, EPW Commentary on Task Force Recommendations on Direct Taxes, Economic and Political Weekly, December, 14, 2002.

³² Quoting the Central Government Minister for Agriculture, Ajit Singh : "If the intention is to check 'cheating' by non-agriculturists having farm income, it is the duty of the income tax authorities to do so."

³³ See Rule 114C of the Income Tax Rules, 1962.

³⁴ Called PAN, i.e. Permanent Account Number or PAN

³⁵ also see Rajaraman, note 4, supra. Page (73).

³⁶ See supra. Note 29.

³⁷ Lanjouw P, Shariff A, (2003), Rural Nonfarm Employment in India : Access, Incomes and Poverty Impact , referring to their earlier paper Lanjouw P, Shariff A, (2002).

³⁸ A system where potential taxpayers are tagged based on their high consumption or ownership of high value assets.

³⁹ See Rajaraman, supra. Note 4. (Page 74).

⁴⁰ Khan M.H. "Agricultural Taxation in Developing Countries : A survey of issues and Policy, " Agricultural Economics, Vol. 24 (2001), pp. 315-28.

⁴¹ Under the One-by Six Scheme, persons residing in any of the urban areas in the country (in 2003, 375 towns have been included in the list of urban areas) and fulfilling any one of the six prescribed economic criteria at any time during a year are required to file their return of income of that year even if they had no taxable income in that year. These six criteria are, (i) Occupation of a residential or commercial property exceeding the specified floor area; (ii) ownership or lease of a motor vehicle; (iii) subscription to a telephone; (iv) incurring of expenditure for self or any other person on foreign travel; (v) holding of a credit card (other than an add-on card or Kisan Credit Card); (vi) membership of a club where entrance fee charged is twenty five thousand rupees or more.

⁴² This was 50,000 Rupees for the financial year 2001-02.

⁴³ See Rajaraman, supra Note 4. (Pages 4-5)

⁴⁴ Karnataka Land Revenue Act, 1964

⁴⁵ See Bird supra. Note 1. Page 133.

⁴⁶ This is of course not the only reason, other source of taxes such as Sales Tax have grown to become the main source of revenue for the States even while the collection of Land Revenue in real terms was falling.

⁴⁷ Thakur V, Khadanga G, Venketesh, D.S, Shukla D.R, Land Management system in India – Past Present and Future, < <http://www.gisdevelopment.net/application/lis/overview/lisrp0004.htm> > (accessed 30-July-2003).

⁴⁸ Ahuja J.S (Brig.), Legal, Political, Technical and Commercial issues of Land Information Systems, <<http://www.gisdevelopment.net/application/lis/overview/lisrp00013.htm> > (accessed 30-July-2003).

⁴⁹ The agent of the British Government before independence who collected Land Revenue on its behalf and who for all practical purposes was made the landlord of all the areas from where he was authorized to collect revenue from.

⁵⁰ Jha, Ganganand (1987), Agricultural taxation in India – A Case Study of Bihar, Capital Publishing House, Delhi.

⁵¹ For example, the Village Accountant who is one of the key functionaries of the land revenue administration in the village also performs powers and duties under the Land Reform Act, The agricultural pests and diseases Act, the Karnataka Excise Act, and nine other Laws (accessed on 15th July, 2003), Source : Karnataka Land Revenue Manual, < <http://revdept.kar.nic.in> >. The Tahsildar, a key functionary of the Land Revenue Department is also in charge of collection of water charges in Karnataka under the Karnataka Irrigation (Levy of Water Rate) Rules, 1965, Source : Report of the Comptroller and Auditor General of India, 1999, Revenue Receipts, Karnataka, Chapter 6, Land Revenue.

⁵² Accounts Reckoner for 1992-2003, Finance Department, Computer Cell, Government of Karnataka.

⁵³ Rural Property Tax Systems in Central and Eastern Europe, (2002), FAO Land Tenure Studies.

⁵⁴ See Bird. *supra*. Note 1. Pages (148-149)

⁵⁵ As observed in Orissa by Mearns and Sinha (1999), Social Exclusion and Land Administration in Orissa, India, World Bank Research Working Paper 2124, May 1999.

⁵⁶ Jodha, N.S. (1981). "Agricultural Tenancy: Fresh evidence from Dryland Areas in India," Economic and Political Weekly, Annual Number, A-118-A128.

⁵⁷ See *supra*. Note 40.

⁵⁸ This was introduced in the 73rd Amendment of the Indian Constitution in 1992. The powers of the Panchayats are given in the Eleventh Schedule and include, 1. Agriculture, including agricultural extension. 2. Land improvement, implementation of land reforms, land consolidation and soil conservation. 3. Minor irrigation, water management and watershed development. 4. Animal husbandry, dairying and poultry. 5. Fisheries. 6. Social forestry and farm forestry. 7. Minor forest produce. 8. Small scale industries, including food processing industries. 9. Khadi, village and cottage industries. 10. Rural housing. 11. Drinking water. 12. Fuel and fodder. 13. Roads, culverts, bridges, ferries, waterways and other means of communication. 14. Rural electrification, including distribution of electricity. 15. Non-conventional energy sources. 16. Poverty alleviation programme. 17. Education, including primary and secondary schools. 18. Technical training and vocational education. 19. Adult and non-formal education. 20. Libraries. 21. Cultural activities. 22. Markets and fairs. 23. Health and sanitation, including hospitals, primary health centres and dispensaries. 24. Family welfare. 25. Women and child development. 26. Social welfare, including welfare of the handicapped and mentally retarded. ...27. Welfare of the weaker sections, and in particular, of the Scheduled Castes and the Scheduled Tribes. 28. Public distribution system. 29. Maintenance of community assets".

⁵⁹ VISWANATHAN, Overcoming disadvantages, Frontline, Volume 17 - Issue 14, July 08 - 21, 2000

⁶⁰ Section 22 of the The Haryana Local Area Development Tax Act, 2000 reads, "The tax collected under this Act shall be distributed by the State Government amongst the local bodies to be utilised for the development of local areas. Explanation.- In this section "the development of local areas" means developing and maintaining infrastructure facilities useful for free flow of trade and commerce". (I wish to thank Suresh Yadav for informing me of this tax.)

⁶¹ This amount is Rupees. 1,000,000. The constitutional validity of this tax has been challenged in the Supreme Court on the ground that it violated the Constitution as it impeded inter-State trade.

⁶² Report of the Steering Group on Rural Poverty Alleviation, Watershed Development, Decentralized Planning and Panchayat Raj Institutions (2001) for the 10th Five Year Plan (2002-2007), Planning Commission, Government of India.

⁶³ Development Intervention in Bihar and Preparation of Model Development Plan for Villages, Study Report given to the Planning Commission of India by the Lal Bahadur Shastri Institute of Rural Management and Rural Development, Patna, 2003.

⁶⁴ Pai, Sudha, Social Capital, Panchayats and Grass Roots Democracy, Economic and Political Weekly, February 24, 2001.

⁶⁵ Bhattacharya Moitree, 2002, Panchayati raj in West Bengal : Democratic Decentralisation or Democratic Centralism, Manak Publications, New Delhi.

⁶⁶ Tamil Nadu Panchayat Act. 1994

⁶⁷ Palanithurai G, (1999), New Panchayati raj system at work : an evaluation, Concept Publishing Company, New Delhi

⁶⁸ VISWANATHAN S., Frontline, Volume 17 - Issue 14, July 08 - 21, 2000

⁶⁹ See supra. Note 63.

⁷⁰ See Rajaraman, supra. Note 4. (Page 23)

⁷¹ See supra. Note 40.

⁷² Ibid.

⁷³ I wish to thank Rathnasamy Muthusamy for reminding me of this fact.

⁷⁴ Rules 7,7A, 7B and 8 of the Income Tax Rules, 1962