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# Taxing Agricultural Incomes

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Despite the country having a combined Federal and provincial tax to GDP ratio of less than 10 percent the income of one segment of the population, farmers, seems to escape taxation, causing anger among other tax payers, especially since legislation was promulgated at the provincial level way back in 2000/01 to tax incomes earned from agriculture. Provincial governments have not been raising revenue from this source, primarily because the bulk of the political and civil and military bureaucratic leadership either has rural connections or camouflages its earnings by reporting them as having been derived from agriculture.

Moreover, large landowners oppose taxation of agricultural activities citing three main reasons:

- a) Agriculture is already over taxed
- b) There is a ceiling on land holdings
- c) There is lack of crop insurance that would cover losses on account of drought or floods

The most common method used by those arguing for or against taxation of agricultural incomes is to show how the agriculture sector is under or over taxed compared with say the industrial sector. However, the concept of a sector being under or over-taxed (the ratio of taxes paid as a percentage of the sector's contribution to national income as against the same ratio for other sectors) confuses the issue. From the fiscal stand-point sector is neither an income earning nor a tax paying unit. The entire value added in a sector belongs to individuals, families or companies operating in the sector, who are the tax-paying entities.

Only the income earned by a tax paying entity is relevant for determining its tax liability. Thus, the identity of the activity or sector as the source of income is irrelevant. Those earning equal incomes should be treated equally irrespective of the source of incomes. People own businesses and they liable to taxation. Therefore, a sector is under or over taxed only in the sense that those in a particular income group on the basis of income earned from the sector pay less or more taxes than those falling in the same income bracket in other sectors. And we know that those in the upper income segments of the agricultural community pay far less taxes than their counterparts, or those in comparable segments, in the non-agricultural sectors. The incidence should be roughly the same on similar amounts of income, irrespective of the source from which the income is derived. Hence, it is pointless estimating the tax burden of a sector to evaluate the equity of a fiscal system.

The argument generally made about exempting farmers with small sized holdings from taxation is similarly flawed. How do we define a small sized holding? The assumption underlying this contention is that small farmers only have low levels of earnings. But then the earnings of a 5

acre farmer growing strawberries or apples is several times that of a farmer growing wheat, making the foundation of this line of reasoning for exempting or taxing incomes derived from agricultural pursuits somewhat shaky, if not untenable.

Yet another confusion is created by the claim that since there is a ceiling on land holdings there is no justification for a tax. However, the ceiling applies to ownership (ignoring for the moment the issue of land held 'benami' to get around legislation restricting holding of land, a limited resource) and not to holdings operated. Land-rented-in adds to incomes substantially without these earnings being liable for tax. Moreover, as the issue revolves around taxation of incomes generated, such arguments fail to impress.

Although under the Constitution, taxation of agricultural incomes is a provincial subject, the term "agricultural income" is actually defined in Section 41 of the Income Tax Ordinance. And under the Ordinance even rental incomes derived from agriculture escapes assessment. This is because while exempting the taxation of agricultural incomes it defines agricultural incomes as "any rent or revenue from land .... which is used for agricultural purposes". But then can it be logically argued that the rental income derived from leasing out agricultural land to a tenant is in any way, form or nature different from the rent derived by leasing out land in urban areas? Whereas the latter income is considered taxable (and correctly) as rental income, the income from the former activity is under some convoluted logic exempt.

There is certainly an anomaly in the tax law under which income earned from leasing out agricultural land is not covered because, logically, income cannot be categorised on the basis of the sector from which it originates. Incomes have to be identified on the basis of the activities from which they accrue. If this were not so and rental income from agricultural land were deemed to be agricultural income then on the same reasoning should interest earned from loans given for agricultural activities or dividends derived from share held in a company engaged in agri-business be exempt from taxation?

This definition can be altered without requiring sympathetic changes in the Constitution. Rental income from agriculture can legitimately, and legally, be treated as non-agricultural income by redefining agricultural income in the Income Tax Ordinance as merely "revenue derived from land" without having to amend the Constitution and the income tax can be levied on it and collected by FBR.

As regards the need for crop insurance, while supporting the demand for such a facility, lest we forget, no similar option exists for salaried employees or industrial and commercial entrepreneurs. A salaried employee can lose his job but would still be liable for the tax on earnings for the year, while businesses can carry forward (in coming years) their losses without being allowed to adjust them against taxes paid in previous years.

Finally, to simplify the process of assessing agricultural incomes liable for taxation, while simultaneously minimizing interaction between tax payers and revenue authorities, provincial governments can use a 'proxy' by either:

- a) The Federal Government levying something like an 'excise duty' on cash crops sold by farmers to government agencies (e.g. wheat and rice) or the private sector (e.g. cotton, sugarcane, etc.); or
- b) estimating taxable incomes on the basis of land lease rent (the 'patta' rate) in the area-information that is readily available and easy to compile.