

Report Part Title: Taxation of Agricultural Land — Issues and Options

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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