Himachal Pradesh National Law University, Shimla (India)

A UGC CARE Listed Journal

Journal Articles | *ISSN:2582-1903* | *Shimla Law Review*

Volume: VI (2023)

CULTIVATING INEQUALITY: Judicial Approach in Defining Agricultural Income Under Income Tax

Girjesh Shukla & Alok Kumar

https://doi.org/10.70556/hpnlu-slr-v6-I1-2023-11

This article can be downloaded from: https://www.hpnlu.ac.in/journal-level-3.aspx?ref-id=18

Recommended Citation:
Girjesh Shukla & Alok Kumar, *Cultivating Inequality: Judicial Approach in Defining Agricultural Income Under Income Tax*, VI SML. L. REV. 274 (2023).

https://doi.org/10.70556/hpnlu-slr-v6-I1-2023-11

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Contents

Volume VI	*ISSN: 2582-1903*	*April 2023 - March 2024*

Special Article *Page*

1. SPECIFIC LAWS GOVERNING USE OF AI IN CRIMINAL PROCEDURE AND ATTENTIVE CRIMINAL JUDGES: American Songbook for Global Listeners
Paul De Hert & Georgios Bouchagiar 1

Articles

2. ENFORCEMENT OF SOCIO-ECONOMIC RIGHTS: Re-thinking the 'Right' Model in a Liberal Democratic State
Swaril Dania 32

3. EQUITABLE INCLUSIVE SOCIETY: Evolving Strategies for Realisation of our Constitutional Vision in *Swatantra Bharat*
Virendra Kumar 65

4. CONSTITUTIONAL JURISPRUDENCE ON HARMONISING AUTONOMY AND INCLUSIVITY OF MINORITY RIGHTS: An Analysis of the Supreme Court Verdict on AMU
Priti Saxena & Tamesh Kumar Pandey 88

5. THE DOCTRINE OF ALTERNATIVE REMEDY: Balancing Procedural Efficiency and Fundamental Rights in Writ Jurisdiction
Ashish Kumar & Santosh Kumar Sharma 119

6. DELIVERY OF 'CIVIL JUSTICE' AND JUDICIAL DISCRETION: A Critical Analysis of Use of Order I Rule 10 of CPC by the Civil Courts
Jasper Vikas 140

7. SHIELDING PRIVACY IN THE SURVEILLANCE ERA: A Comparative Study of India, USA, and South Africa
Stency Mariya Mark & Aaratrika Pandey 174

Notes and Comments

8. FREEDOM AND COPYRIGHT LAW: Examining from the Perspective of Human Rights
Raman Mittal 191

9. EXAMINING THE DICHOTOMOUS RELATIONSHIP BETWEEN UNIVERSALS AND PARTICULARS
Aditi Sharma 205

10. FROM PIXELS TO PROSECUTION: Tackling Crime in the Immersive Realms of Metaverse
Moulika Sharma & Sanvi Mathur 220

11. REDEFINING HUMAN RIGHTS IN 21ST CENTURY: A Search for New Universal Values
Vinay Kumar Kashyap & Ajay Kumar Singh 253

12. CULTIVATING INEQUALITY: Judicial Approach in Defining Agricultural Income Under Income Tax
Girjesh Shukla & Alok Kumar 274

13. ACCESSIBLE EDUCATION FOR PERSONS WITH DISABILITY: A Critical Appraisal in Light of the New Education Policy, 2020
Sachin Sharma & Saheb Chowdhary 292

14. UCC AND RELATIONS BEYOND MARRIAGE: Exploring the Legal challenges of Live-In Relationships in India
Nalin Agnihotri & Shyam Gandhi 313

CULTIVATING INEQUALITY:
Judicial Approach in Defining Agricultural Income Under Income Tax

Girjesh Shukla[*] *& Alok Kumar*[**]

[Abstract: *As a matter of policy, and with intent to achieve a more significant goal of economic justice, the Income Tax Act of 1961 excludes agricultural income from the income of the Assessee and thus provides an exemption from taxation. The exemption will be available only when the agricultural product is sold in the market while retaining its original nature. The Supreme Court of India ruled that if the farmer, in search of the appropriate market, converts the product into another suitable product, but by performing ordinary or otherwise processing, and thereby, the said agricultural product loses its original nature, the exemption from taxation will not be available. The rulings of the Supreme Court and other High Courts have restricted the very scope of the exemption explicitly available otherwise under the Income Tax Act of 1961. This results in the denial of full benefits to poor and middle-class farmers engaged in agricultural activities, along with much more serious damage to village and cottage industries. The present work, through legislation and judicial decision, explores the development of law on tax exemptions granted to agricultural income under direct taxes and provides a critique of the restrictive interpretation of Section 2(1A) of the Income Tax Act, 1961. It offers an alternative approach towards interpreting Section 2(1A) based on the expression used in the legislative provision itself.*]

Keywords: *Constitution, tax, agricultural income, inequality, economic justice, Supreme Court etc.*

I

Introduction

The objectives of levying and collecting taxes are not merely to fetch revenue for the state. It has three distinct functions *vis* the *state, paternalistic, and economic justice*

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functions. It is often understood that through the imposition and collection of taxes, the government performs police functions such as mining the police, army security services, etc. The collection of taxes assists the government in performing paternalistic functions vis. health, education, other social welfare services and the infrastructure development through which the society and the market develop. However, levying taxes, especially through progressive taxation, ensures the re-distribution of income, and thus it results in economic justice. The economic justice function of the tax system often gets instrumentalised through numerous methods, such as graded tax rate, i.e., the higher the income, the higher the tax rate;[1] income below the minimum subsistence level gets exempted from direct taxation;[2] special exemption to specific categories of income[3] or categories of person, etc.[4] The objectives behind these tax policies are primarily to ensure a humane tax policy, progressive taxation and easy compliance. The Income Tax Act, 1961 provides a list of exemptions, relief and adjustments ensuring compliance with humane taxation. The present work is limited to tax exemption granted in favour of agricultural income.[5]

By virtue of Section 4 of the Income Tax Act, 1961, tax is levied on the '*total income*' of the person in a given previous year.[6] The scope of the '*total income*' income is prescribed under Section 5 of the Act.[7] However, Section 10 of the Income Tax Act,

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1 Income Tax Act, 1961 provides different tax rates for various income levels, from 5% to 30%.

2 From the Assessment year 2024-25, the Income of an individual up to 3 lakhs is exempted from taxation under the Income Tax Act, 1961.

3 *See*, Income Tax Act, 1961, Section 10.

4 *See*, Income Tax Act, 1961, Section 80DD.

5 The Income Tax Act, 1961, Section 10(1).

6 The Income Tax Act, 1961 reads as follows: Section 4(1) Where any Central Act enacts that income-tax shall be charged for any assessment year at any rate or rates, income-tax at that rate or those rates shall be charged for that year in accordance with, and subject to the provisions (including provisions for the levy of additional income-tax) of, this Act in respect of the total income of the previous year of every person :

7 The Income Tax Act, 1961. Section 5(1). Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which— (a) is received or is deemed to be received in India in such year by or on behalf of such person; or (b) accrues or arises or is deemed to accrue or arise to him in India during such year, or (c) accrues or arises to him outside India during such year: Provided that, in the case of a person not ordinarily resident in India within the meaning of sub-section (6) of section 6, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India. (2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which— (a) is received or is deemed to be received in India in

Contd…

1961 provides categories of income that do not fall under the definition of '*total income*'. Section 10(1) lists the first such category and that is '*agricultural income*'. The reasons behind exemption of agricultural income getting exclusion from forming the part of 'total income' is obvious. It may not be exaggeration to say that since the beginning of the civilisation engaged into cultivation, the agriculture and activities connected therewith has always been treated as essential for human survival, and the same had never been treated at par with any trade or business. It is also true that the then prevailing *barter system*[8] has brought the foodgrains in the marketplace, ensuring availability of daily needs to the farmers, yet the exchange of foodgrains, in any form, was far from being treated as trade or business.[9] Similarly, the conversion of foodgrains into some other form (for ex., converting wheat into flour etc.) were never a loss making thing for the cultivators.

For academic convenience, the present work is divided into four parts. Part-I provides a brief introduction to the issue raised through this work and narrates the tax treatment to the agricultural income. Part-II provides the legislative framework under which the agricultural income has been excluded from tax treatment under the Income Tax Act, 1961.Part-III deals with judicial approach in limiting the meaning of agricultural income, and thus the larger impact on taxation of agricultural income. Part-IV provides a critique on the judicial approach and the way forward.

II

Agricultural Income and Exemption from Income Tax

Agricultural income, as defined under Section 2(1A) of the Income Tax Act, 1961, refers to revenue derived from land in India and used for agricultural purposes. This encompasses activities such as farming, cultivation, and operations linked to producing and selling agricultural produce. The section 2(1A) of the Income Tax Act, 1961 is reproduced below:

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such year by or on behalf of such person; or (b) accrues or arises or is deemed to accrue or arise to him in India during such year.

[8] Barter system is a system wherein people procure goods including good for daily not through direct purchasing but through exchange of goods including exchange with the food grains.

[9] In practice, the *barter system* had never resulted into diminished value of any foodgrains, getting exchanged for some other goods. In fact, as an when these foodgrains were converted into some other acceptable form (vis., conversion of wheat into flour), they often attract higher value.

S. 2(1A) "agricultural income" means—

(a) any rent or revenue derived from land which is situated in India and is used for agricultural purposes;

(b) any income derived from such land by—

(i) agriculture; or

(ii) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market; or

(iii) the sale by a cultivator or receiver of rent-in-kind of the produce raised or received by him, in respect of which no process has been performed other than a process of the nature described in paragraph (ii) of this sub-clause;

(c) any income derived from any building owned and occupied by the receiver of the rent or revenue of any such land, or occupied by the cultivator or the receiver of rent-in-kind, of any land with respect to which, or the produce of which, any process mentioned in paragraphs (ii) and (iii) of sub-clause (b) is carried on.

Provided that—

(i) the building is on or in the immediate vicinity of the land, and is a building which the receiver of the rent or revenue or the cultivator, or the receiver of rent-in-kind, by reason of his connection with the land, requires as a dwelling house, or as a store-house, or other out-building, and

(ii) the land is either assessed to land revenue in India or is subject to a local rate assessed and collected by officers of the Government as such or where the land is not so assessed to land revenue or subject to a local rate, it is not situated—

(A) in any area which is comprised within the jurisdiction of a municipality (whether known as a municipality, municipal corporation, notified area committee, town area commit-tee, town committee or by any other name) or a cantonment board and which has a population of not less than ten thousand; or

(B) in any area within the distance, measured aerially,—

(I) not being more than two kilometres, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than ten thousand but not exceeding one lakh; or

(II) not being more than six kilometres, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than one lakh but not exceeding ten lakh; or

(III) not being more than eight kilometres, from the local limits of any municipality or cantonment board referred to in item (A) and which has a population of more than ten lakh.

Explanation 1.—For the removal of doubts, it is hereby declared that revenue derived from land shall not include and shall be deemed never to have included any income arising from the transfer of any land referred to in item (a) or item (b) of sub-clause (iii) of clause (14) of this section.

Explanation 2.—For the removal of doubts, it is hereby declared that income derived from any building or land referred to in sub-clause (c) arising from the use of such building or land for any purpose (including letting for residential purpose or for the purpose of any business or profession) other than agriculture falling under sub-clause (a) or sub-clause (b) shall not be agricultural income.

Explanation 3.—For the purposes of this clause, any income de-rived from saplings or seedlings grown in a nursery shall be deemed to be agricultural income.

Explanation 4.—For the purposes of clause (ii) of the proviso to sub-clause (c), "population" means the population according to the last preceding census of which the relevant figures have been published before the first day of the previous year;

Traditionally, the expression '*agricultural activities*' is used in a rigid and limited sense. It often denotes tilling of soil, sowing of seeds and thereby raising crops. However, a bare reading of Section 2(1A) would unequivocally suggest a wider meaning of the expression and thus, the very legislative intent to provide much greater meaning and scope to agricultural income. The definition clause would include three distinct categories of income associated with agricultural work directly and indirectly. The agricultural income would thus include,

Firstly, rent or revenue derived from agricultural land situated in India;
Secondly, any income either derived from agriculture OR [additional income] derived by cultivator or receiver of rent in kind by *the performance of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market;*
Thirdly, income derived from any building owned and occupied by the receiver of the rent or revenue of any such land, or occupied by the cultivator or the receiver of rent-in-kind, of any land with respect to which, or the produce of which, any [ordinary] process is carried on.

The Income Tax Act of 1961 exempts such agricultural income under Section 10(1). This highlights the sector's socio-economic importance in a predominantly agrarian country like India. This exemption is rooted in the need to support the agricultural community, mitigate rural poverty, and acknowledge the inherent uncertainties and dependencies of farming on natural conditions.

The rationale behind providing such a wide exemption under Section 10(1) could easily be located under the legal set up as such. *Primarily*, "agriculture" forms part of the Seventh Schedule of the Constitution, in List II (State List), Entry 14, and thus, the Income Tax Act, 1961, being central legislation, cannot have legislative competency to impose a tax on agricultural income. Only the state legislature can

do so.[10] It may not be out of context to state that the constitution framers have put this item in state list, assuming that the respective state would be in a better position to understand and analyse the types of agricultural activities which could probably be listed as agricultural activities at par with trade of business, and thus, income from such activities may be taxed accordingly. *Secondly*, as per the latest Report, 76.5% of land in rural India is in the form of critical land holding. Further, only 0.1% of landholding is large, i.e. more than 10 hectares. Thus, the small, medium and marginal land holdings, which are around 99% of the total holdings, cannot be considered 'productive' for taxation purposes.[11] *Thirdly*, the very scheme of taxation prescribed under the Income Tax Act, 1961 presupposes certain activities which either essential generates income either through trade, business or profession etc., and which is over and above the subsistence level. This characteristics of progressive taxation is visible when the Income Tax Act, 1961 provides no tax till 2.5 Lakhs income, further standard deductions (fifty thousands under Salary head, thirty percent of the annual value under income from House Property; no taxation when value of gift is below fifty thousand etc.) and list of expenditures which is allowed to be adjusted before a business income could be taxed. Agricultural income, due to the very nature of the land holding, dependency, productivity etc., and essentially an activity for the mere survival goes out from the domain of income generating activity, thus not considered good for taxation.

III

Agricultural Income: Judicial Approach

Once an income falls under any one of the categories prescribed under Section 2(1A) of the Income Tax Act, 1961, such income would not be part of total income, and thus would be excluded from taxation under the Income Tax Act. The bare reading would make at least two things absolutely clear. *Firstly*, there is no definition of 'agricultural' as such prescribed under the Income Tax Act, 1961, and the three categories prescribed under Section 2(1A), which fall under the definition clause,

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[10] Under the terms of the Constitution, Parliament is empowered to legislate to say what "agricultural income" means. What Parliament says in this regard in the statute then current relating to income tax is the definition of "agricultural income" for the purposes of the Constitution. In regard to such agricultural income the States may legislate. In regard to all other income it is for Parliament to legislate. See *Karimtharuvi Tea Estates Ltd.* v. *State of Kerala,* AIR 1963 SC 760.

[11] NSS 77th Round Report on *Situation Assessment of Agricultural House Holds and Land and Holdings of House Holds in Rurla India, 2019*, *available at*: https://mospi.gov.in/sites/default/files/publication_reports/Report_587m_0.pdf (last visited Nov. 30, 2024)

are not definitions of 'agriculture' but of 'agricultural income'. *Secondly*, Section 2(1A) merely provides three broad and distinct categories of 'agricultural income', which are mutually exclusive and independent. For categorising an income as an 'agricultural income', neither agricultural activities by the Assessee is always required, nor the ownership of an agricultural land is mandatory in every case. For example, rent or revenue 'derived' from agricultural land would be an 'agricultural income' in the hands of the landowner, even though the landowner was nowhere engaged himself in an agricultural activities i.e. tilling of soil or sowing of seeds.[12] Further, a person merely having possession of agricultural land, without being an owner, will enjoy income tax exemption in the name of '*agricultural income*' if his income is derived by way of agriculture i.e. tilling of soil and sowing of seeds etc.[13] Again, a person who enjoys monetary benefit through a building, such as rent, which is part and parcel of the agricultural land, the said rent would be '*agricultural income*'.[14] Here, under last category, the landowner, who receives rent by renting his building, adjacent to his agricultural land, would continue to enjoy tax exemption, even though the building *per se* is not the subject matter of agricultural operation i.e. tiling of soil and sowing of seeds. Thus, it could safely be reiterated that the three categories of '*agricultural income*' prescribed under Section 2(1A) are mutually exclusive and controlled by their own provisions and have nothing to do with 'agriculture' *per se*.

While examining the approach of the courts in permitting the exemption to agricultural income, the approach can be divided into two group i.e. formalist and contextualist approach. The courts have adopted formalist approach when they have faced question as to very nature of income where in the Assessee himself was not engaged into agricultural activities *viz*., tilling of soil and sowing of seeds. For brevity, such income would necessarily fall under Section 2(1A) clause (a) or (c) of the Income Tax Act, 1961. However, while examining the scope of exemption prescribed under Section 2(1A), the courts have adopted contextualist approach. Here, the courts have always been cautious and tried to limit the scope of exemption from the perspective of 'agricultural'. The courts have been careful enough to provide the benefit of tax exemption only to those cases that fall directly within the purview of *qua* agriculture.

While interpreting Section 2(1A)(a), the courts have ruled that in cases where income arises out of contractual obligation with a person or entity, and there is no direct relation between 'income' and the 'agricultural land', such income would not be covered under 'agricultural income', and shall not attract exemption. For example, where the landlord charges interest on arrears of rent, the interest so received is generated out of contractual obligation and cannot be termed as 'derived

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[12] The Income Tax Act, 1961, Section 2(1A)(a).

[13] The Income Tax Act, 1961, Section 2(1A)(b)(i).

[14] The Income Tax Act, 1961, Section 2(1A)(c)

from agricultural land'.[15] Taking up the formalist approach, the courts have ruled that, interest on arrears of rent is neither rent nor revenue derived from land within the meaning of section 2(1A) of the Income Tax Act, 1961/1922. This approach was so much visible in observation made by the Privy Council, when it stated that "*the word 'derived' is not a term of art. Its use in the definition indeed demands an enquiry into the genealogy of the product. But the enquiry should stop as soon as the effective source is discovered. In the genealogical tree of the interest land indeed appears in the second degree, but the immediate and effective source is rent which has suffered the accident of non-payment. And rent is not land within the meaning of the definition*."[16] Similarly, if a landowner imposes a 'penalty' for non-payment of rent, the 'penalty' cannot form part of the agricultural income. The Supreme Court of India in *Bacha F. Guzdar* v. *Commissioner of Income-Tax, Bombay*,[17] faced the question 'of whether 60% of the dividend received by the assessee from the two Tea companies is agricultural income in the hands of shareholders and, as such, exempt under section 4(3) of the Income Tax Act, 1922.

Applying the scope of the word '*derived*' used in section 2(1) of the Income Tax Ac, 1961, the Supreme Court rules that a dividend is paid out of the contractual relation of a shareholder with the company, and it has nothing to do with agricultural business/agricultural land where the company is engaged. The term "*derived from land*" used in the provision is not just an expression of literation, but provides an essential test to examine that rent and revenue have a "*immediate and direct nexus*" with the land. The *causa causens* of the revenue must be the land.[18] The person who is using such land, need not be the owner of the land but can have an entitlement in any form. Lastly, the nature of the land being agricultural, residential, commercial etc. in the land records hold no relevance while determining the taxability of the produce. Further, the connotation of the phrase "*used for agricultural purposes*" makes it mandatory that the land is not used for any other purpose. For instance, the agricultural land has been given out on lease, from which rent in cash is being received. This does not constitute 'Agricultural income' within the meaning of this section. However, depending upon the circumstances, this rule could be applied a little more flexibly since some crops, by their very nature don't need these operations to performed in every year or in every season. Any activity such as packaging, cutting, chopping, selling etc. when carried out on the produce from the agricultural land constitute 'business income' in absence of the aforementioned requisites. However, as per Section 2(1A)(a), the receiver of rent in kind of such produce from someone who carried out such activities may further sell it, and claim the exemption under the scope of agricultural income.

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[15] *CIT* v. *Raja Bahadur Kamakshya Narayan Singh* [1935] 3 ITR 305.

[16] [1948] 16 ITR 325.

[17] *Bacha F. Guzdar* v. *Commissioner of Income-Tax, Bombay* AIR 1955 SC 740.

[18] *Id*.

However, while examining the scope of Section 2(1A), the court looked for contextualising the income through basic agricultural operations i.e. tilling of soil and sowing of seeds. Thus, when Assessee is simply purchasing a standing crop without being directly/indirectly engaged in agricultural operation (often referred to as 'basic operation', i.e. tilling of soil and sowing of seeds), the court have denied the benefit of exemption. The Madras High Court in *CIT* v. *Maddi Venkatasubbayya*,[19] held that when the Assessee purchased the standing crop and sold the grains to market, his income could not be considered as agricultural income. According to the court, the Assessee did not carry out any agricultural operations to claim the benefit of exemption. Similarly, in *CIT* v. *Benoy Kumar Sahas Roy*,[20] Supreme Court rules that a person selling spontaneous growth would not be entitled to tax exemption unless he has performed some '*subsequent operations*' [watering, removal of unwanted growths, giving fertilisers, etc.] in continuation to the '*basic operations*'. A Division Bench of M.P. High Court in *Commissioner of Income-tax, Madhya Pradesh* v. *Kisan Co-operative Rice Mills, Mahasamund*,[21] has held that the Assessee, having purchased paddy from its cooperative society members and sold the rice in the market by milling the paddy, shall not get the exemption.

The application of a contextualist approach on Section 2(1A)(b)(ii) has given a very distinct result. Section 2(1A)(b)(ii) refers to those situations where the cultivator [or receiver of rent in kind] grows something that perfectly comes under the definition of agriculture. However, the product grown is non-marketable. Let's take some examples. These days, selling corn would be either difficult or even less profitable if it were saleable. Similarly, sugarcane growers would require sugar industries to purchase their crops. Otherwise, they would have no or limited purchasers. The same applies to specific varieties of fruits, vegetables, etc.

The Income Tax Act, 1961, through Section 2(1A)(b)(ii), provides relief to the farmers/cultivators. It permits them to apply the 'process ordinarily employed by cultivators' to '*render the produced raised fit to be taken to market*'. The clause, thus, permits 'subsequent operations' [anything other than tilling or soil and sowing of seeds], which makes the product fit for the market. A bare reading of the provision categorically indicates that the cultivator would be free to opt for all or any process '*ordinarily employed by cultivators*' to make the product so raised '*fit for market*'. However, the Supreme Court full bench in *Dooars Tea Co. Ltd.* v. *CIT*,[22] added the third criterion, i.e. the original character of the product should be changed. The appellant, the Dooars Tea Co. Ltd., was a public limited company carrying on the business of growing, manufacturing and selling tea. In the relevant assessment year, it submitted a return in respect of its agricultural income. However, the Income Tax

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[19] *CIT* v. *Maddi Venkatasubbayya* 20 ITR 151.

[20] *CIT* v. *Benoy Kumar Sahas Roy* 32 ITR 466

[21] (1951) 20 ITR 151.

[22] *Dooars Tea Co. Ltd.* v. *CIT* (1962) 44 ITR 6.

Officer did not accept the correctness of the said return and increased it by adding the market value of the appellant's agricultural income from bamboo, thatching grass and fuel timber. The fact is that the appellant holds a large tract of land, and in a part of the said land, it grows bamboo, thatching grass and fuel timber. During the relevant year, it cut down some bamboo, some thatching grass, and fuel timber and used them for its business. The bamboo, the thatching grass and fuel timber were grown by the appellant on its land by agricultural operations carried on by the servants and labourers employed by the appellant. After they were grown, they were utilised by the appellant for its tea business and were not sold either in the market or otherwise. Before the tax authorities, the appellant urged that the agricultural produce in question did not constitute agricultural income within the meaning of the Act because it had not been sold. The Tribunal agreed with the conclusion of the tax authorities and held that the produce in question constituted the agricultural income of the appellant. On request of the appellant, one of the questions referred by the Tribunal for the opinion of the High Court was, 'Is bamboo, thatch, fuel, etc., grown by the assessee company and utilised for its own benefits in its tea business, agricultural income within the meaning of the Bengal Agricultural Income Tax Act? The High Court has answered the questions in the affirmative against the appellant. The matter thus reaches the Supreme Court. The Court while analysing what is the true scope of Section 2(1)(b) of the Act, 1922 (which is in *pari materia* Section 2(1A)(b)(ii)) observed as follows:

> *"Going back to Section 2(1)(b) it refers to income derived from land which means arising from land and denotes income the immediate and effective source of which is land. Section 2(1)(b) consists of three clauses. Let us first construe clauses (ii) and (iii). Clause (ii) includes cases of income derived from the performance of any process therein specified. The process must be one which is usually employed by the cultivator or receiver of rent-in-kind; it may be simple manual process or it may involve the use and assistance of machinery. That is the first requirement of this proviso. The second requirement is that the said process must have been employed with the object of making the produce marketable. It is, however, clear that the employment of the process contemplated by the second clause must not alter the character of the produce. The produce must retain its original character and the only change that may have been brought about in the produce is to make it marketable. The said change in the condition of the produce is only intended to make the produce a saleable commodity in the market."*

Thus, the court ruled that '*the employment of the process'* contemplated by the second clause *'must not alter the character of the produce'*. The produce must retain its original character; the only change that may have been brought about in it is to make it marketable. The court has not given any justification for the addition of this additional requirement.

The application of this rule has resulting into denial of benefit, otherwise avilabe under Section 2(1A)(b)(ii) of the Income Tax Act, 1961. Thus, in *Sakarlal Naranlal* v.

CIT,[23] where the assessee grew a vegetable product commonly called *Galka* (*Luffa Pentandra*), and converted the same into '*Galka*' by 'de-skinning, acetic acid bath, holding them in salicylic acid, drying them in the sun and then putting them in cold water for two days', was considered not be covered under the exemptions. In *Bhikanpur Sugar Concern*,[24] the processing of sugar from the sugarcane crop was declared as not ordinary process, and thus excluded from the scope of exemption. It was held that this process was not undertaken to make the produce marketable but was done to gain additional profits. The court in *Killing Valley Tea Co. Ltd.* v. *Secy. of State,*[25] proceeded on the basis that if there is a market for the produce grown by the assessee and despite that, some process is performed on it, such process cannot be said to be a process to render the produce fit to be taken to the market. Thus, the process of processing the tea leaves into tea is considered to be outside the scope of the section. In *J.M. Casey* v. *CIT,*[26] the Court laid down the propositions "(1) that to attract the applicability of Section 2(1A)(b)(ii), the produce in its raw state must not have a ready and available market where goods of that kind are bought and sold and (2) that even if the assessee is the only cultivator, a generalisation can be made from the single instance of the assessee and the process employed by the assessee can be regarded as a process ordinarily employed by a cultivator to render the produce marketable. In *Sheolal* v. *CIT,*[27] the court found that unginned cotton had sufficient market available and the process of ginning could not be held to have been carried out in order to render the produce marketable. In *Brihan Maharashtra Sugar Syndicate Ltd.* v. *CIT,*[28] it was propounded that under Section 2(1)(b)(ii), the produce must retain its original character in spite of the process unless there is no market for selling it in that condition. If there is no market to sell the produce, then any process that is ordinarily employed to render it fit to reach the market, where it can be sold, would be covered by the definition. in *Boggavarapu Peda Ammaiah* v. *CIT,*[29] it was observed that the tobacco after flue-curing had a large market in the country, and the operations of re-drying, stripping and grinding were, therefore, not quite essential to make the tobacco marketable.

This approach is vividly reflected through the case of *K. Lakshmanan and Co. and Ors.* v. *CIT,*[30] where the supreme court rules that "*what is taken to the market and sold must be the produce which is raised by the cultivator*", thus "*this section does not contemplate the sale of an item or a commodity which is different from what is cultivated and processed*".

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23 *Sakarlal Naranlal* v. *CIT*, AIR 1965 Guj 165.

24 *In re Bhikanpur Sugar Concern*, AIR 1919 Pat 260**.**

25 *Killing Valley Tea Co. Ltd.* v. *Secy. of State*, AIR 1921 Cal 40.

26 *J.M. Casey* v. *CIT*, AIR 1930 Pat 44 (SB).

27 *Sheolal* v. *CIT*, AIR 1932 Nag 61.

28 *Brihan Maharashtra Sugar Syndicate Ltd.* v. *CIT, Bombay* (1946) 14 ITR 611: (AIR 1947 Bom 166).

29 *Boggavarapu Peda Ammaiah* v. *CIT* (1964) 1 ITJ 197 (Andhra Pradesh).

30 *K. Lakshmanan and Co. and Ors.* v. *CIT*, MANU/SC/1569/1998.

Thus, converting sugarcane into gaggery was not allowed to avail agricultural income exemption. According to court, it is a *sine qua non* for the applicability of section 2(1A)(b)(ii) that the produce must retain its original character and only those changes are acceptable that are done in an attempt to make the product marketable. In the case of *E. Palaniappan* v. *Income Tax Officer, Ward-II (1) Salem,*[31], which demarcates the contours of the application of the exemption under the section, the assessee grew sugarcane on his agricultural land and converted the same into jaggery, on which he later claimed exemption under Section 2(1)(b)(ii). The court held that the immediate source of income must be land of the description or character mentioned in the definition. There exists no nexus between jaggery and agricultural operations. The nature of the commodity becomes different after the application of the process. When sugarcane was converted into jaggery, it resulted in the production of a different commodity. Conversion of sugarcane into jaggery is not a necessary process performed by the cultivator to render sugarcane fit for being taken to the market. In *Aspinwall & Co. Ltd.* v. *CIT,*[32] the Supreme Court has analysed the entire process of converting the coffee fruit into seeds, stage by stage, before holding that the Assessee is engaged in the manufacture of coffee eligible for deduction of investment allowance. The Court has viewed raw berry as one commodity and the coffee seeds ultimately obtained after all the processes as a different commodity and observed that they are two distinct and separate commodities satisfying the test of manufacture, and thus converting berries into coffee will not be considered as the "*process ordinarily involved to make the produce fit for the market*".

Reference should also be made to the case of *Pioneer Overseas Corporation* v. *Deputy rid Director of Income-tax, Circle-2(1), International Taxation, New Delhi,*[33] wherein the court held that the process used by the applicant to create hybrid breeds of seeds with better qualities was not a 'process ordinarily employed' by any cultivator engaging in the process of agriculture. In addition, the development of the hybrid seed was undertaken by the assessee with an intention of profit making in a systematic and organised business carried on by it and not for the intention 'to make the good marketable'. Thus, the exemption from taxability under Section 2(1)(b)(ii) was not available to the assessee.

What is categorical here is that the courts are consistent on the contextualisation of exemption and would allow exemption to agricultural income under Section 2(1A)(b)(ii) when "*the produce retains its original character even after the processing*',

[31] *E. Palaniappan* v. *Income Tax Officer, Ward-II (1) Salem* [2009] 119 ITD 385 (Chennai)/[2009] 121 TTJ 541 (Chennai)[18-03-2008]; affirmed through [2021] 130 taxmann.com 278 (Madras)[22-06-2021].

[32] [2001] 118 Taxman 771.

[33] [2010] 35 SOT 467 (Delhi)/[2010] 127 TTJ 640 (Delhi)[30-11-2009].

along with the fact that the process must be '*ordinary process*' employed by the cultivators to make the produce '*fit for the market*'.

IV

Analysing Agricultural Income: From Process to Nature

Before embarking on the subject matter, it would be relevant to quote the most often observation of courts with respect to interpretation of tax legislations. In *Commissioner of Customs* v. *Dilip Kumar & Co.*,[34] a constitutional bench of the Supreme Court held that in every taxing statute—the charging, the computation and exemption provisions at the threshold stage should be interpreted strictly. In case of ambiguity in the charging provision, the benefit must necessarily go in the favour of the subject/ assessee. This means that the subject of tax, the person liable to pay tax and the rate at which the tax is to be levied have to be interpreted and construed strictly. If there is any ambiguity in any of these three components, no tax can be levied until the legislature removes the ambiguity or defect.[35] However, in case of exemption notification or clause, the same is to be allowed based wholly on the notification's language, and exemption cannot be gathered by necessary implication or on a construction different from the words used by reference to the object and purpose of granting exemption.[36] In *Giridhar G. Yadalam* v. *CWT*,[37] it was held that in a taxing statute, the provision's plain language has to be preferred where language is plain and capable of one definite meaning. It is further observed that the strict interpretation to the exemption provision is to be accorded. It is observed that the purposive interpretation can be given only when there is some ambiguity in the language of the statutory provision or it leads to absurd results.

In *Star Industries* v. *Commissioner of Customs*,[38] it was held that the eligibility criteria laid down for exemption notification are required to be construed strictly. Once it is found that the applicant satisfies the same, the exemption notification should be construed liberally. Therefore, there is no new room for intendment in the context of exemption notification. Regard must be to the clear meaning of the words. Claim to exemption is governed wholly by the notification's language, which means by plain terms of the exemption clause. In *Godrej & Boyce Mfg. Co. Ltd.* v. *CIT*,[39] it is

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[34] *Commr. of Customs* v. *Dilip Kumar & Co.*, (2018) 9 SCC 1.

[35] *Id*. para 53.

[36] *Hansraj Gordhandas* v. *CCE*, AIR 1970 SC 755.

[37] *Giridhar G. Yadalam* v. *CWT*, (2015) 17 SCC 664.

[38] *Star Industries* v. *Commr. of Customs*, (2016) 2 SCC 362. See also *Novopan (India) Ltd.* v. *CCE*, 1994 Supp (3) SCC 606.

[39] *Godrej & Boyce Mfg. Co. Ltd.* v. *CIT* (2017) 7 SCC 421].

observed and held by this Court that where the words of the statute are clear and unambiguous, recourse cannot be had to principles of interpretation other than the literal view. It is further observed that it is the bounden duty and obligation of the court to interpret the statute as it is. It is further observed that it is contrary to all rules of construction to read words into a statute that the legislature, in its wisdom, has deliberately not incorporated.

The courts, across the jurisdictions, have always been rigid while interpreting the provisions of tax legislations. Recently, in, the Supreme Court observed that '*an exception and/or an exempting provision in a taxing statute should be construed strictly and it is not open to the court to ignore the conditions prescribed in the relevant policy and the exemption notifications issued in that regard. The exemption notification should be strictly construed and given a meaning according to legislative intendment. The statutory provisions providing for exemption have to be interpreted in light of the words employed in them and there cannot be any addition or subtraction from the statutory provisions*."[40] The court further said that "*as per the law laid down by this Court in a catena of decisions, in a taxing statute, it is the plain language of the provision that has to be preferred, where language is plain and is capable of determining a defined meaning. Strict interpretation of the provision is to be accorded to each case on hand. Purposive interpretation can be given only when there is an ambiguity in the statutory provision or it results in absurdity, which is so not found in the present case*."[41]

The judgments cited above outlines two things categorically. Firstly, taxing statute should be interpreted strictly i.e. *it is the plain language of the provision that has to be preferred.* Secondly, *purposive interpretation can be given only when there is an ambiguity in the statutory provision or it results in absurdity*. In view of this understanding, the judgment of *Dooars Tea Co. Ltd,*[42] and the resulting impact of this judgment on the scope of Section 2(1A)(b)(ii) could be critiqued as under.

The Text is Explicit: Ordinary Process vs. *Industrial Process*

It can be pointed out that when the Supreme Court in the case of *Dooars Tea Co. Ltd.*[43] ruled that the product should retain its '*original character*', it ended up into the realm of interpretation without citing the possible 'ambiguity' in the plain reading of the language or 'absurdity 'which would result if plain reading would be applied. For academic convenience, the provision of Section 2(1A)(b)(ii) is reproduced below:-

> *(ii) the performance by a cultivator or receiver of rent-in-kind of any process ordinarily employed by a cultivator or receiver of rent-in-kind to render the produce raised or received by him fit to be taken to market;*

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[40] Krishi Upaj Mandi Samiti v. CCE & Service Tax, (2022) 5 SCC 62

[41] *Id*., Para 8.3

[42] *Dooars Tea Co. Ltd.* v. *CIT*, (1962) 44 ITR 6

[43] *Dooars Tea Co. Ltd.* v. *CIT*, (1962) 44 ITR 6

The above provision explicitly outline only two condition i.e. application of '*any process ordinarily employed by cultivator*..' and the same was done '*to render the produce raised…fit to be taken to market*.' Thus, the provision of the statute explicitly uses the expression '*process*' whereas, quite interestingly, the court drifted away from explicit expression i.e. '*process*', and focusses on the '*character of the produce*'. This [un]intentional drifting is not only against the settled principles of interpretation, but also resulted into denial of benefit, what is otherwise available in the statute, along with the positivist jurisprudence. When the statute was enacted in 1961 [also of 1922], the legislative intent is quite visible through the use of simple expression, categorical and unambiguous. It was assumed that people engaged into agricultural activities will necessarily grow different crops, based om demand from the market, and accordingly they would inherently use distinct 'process' to not only raise the crop but also 'making it fit for the market'. The only restriction which the statute could visualise was that the 'process' should be '*ordinary*' and not the *industrial*. It seems that when the court focussed on '*original character*' of the produced, it attempted to exclude application of industrial operations over agricultural products, and thus rationalise the exemptions available under Section 2(1A) of the Act. The Court assumed that conversion of sugarcane into gaggery, wheat into flour, rice into flour, selling of silkworm-cocoons etc., are not ordinary process but rather industrial operations. However, rather saying that these operations are industrial operations, the court adopted more simplistic approach, and said that these processes are resulting into change of the 'original character' of the product raised. It is worth to note here that this short-cut in the interpretation is resulting into full application and intended benefit thereof to the farmers.

'Absurdity' clause: Impact Human Choices and the Village /Homemade Economy

The idea of India lies in villages which have been visualised by native political thinkers as village-swaraj. The idea was to explore and reward all form of creativity and related productivity without being causing any hinderance. As stated earlier, no purposive interpretation can be applied it results in *absurdity*. The absurdity could be of any type. It can cause enormous economic loss, de-settling the economic order etc. The agriculture and the agricultural activities has been the backbone of growth for many developing countries, especially India. Till 1990s agriculture sector has been the highest contributor in the Gross Domestic Product (GDP) along with providing employment to the substantial part of the population. Even today, a majority of the people survive of agricultural activities only.

When the statute gave cultivators a benefit of tax exemptions, it was intended to apply with full force without any exception beyond the scope of the provision. For example, farmers engaged in growing sugarcane crops would have to necessarily look for a sugar industry to purchase their crop, and even if they are having their own traditional of producing home-made gaggery related items, all be will out of

the exemption scope. Probably, this was the reason why the statute has not defined the meaning of agriculture, rather defines what is agricultural income. The legislature realises their limit in defining 'agriculture' or 'ordinary process' employed while doing agricultural activities, and thus, it made it open ended so that in future, with the growth of technology, cultivators can use different technology in their agricultural operations and thereby enhance their Agri-products. When the court went into the question of 'original character' of the product, it has limited the possibilities of tax exemption, and thereby very profitability in engaging in raising such product. Thus, a cultivator, who also happens to be a carpenter also, if raises plants, but wishes to sell furniture or related small artefacts, would be in trouble by the above interpretation. A cultivator of sesame seeds, would be in trouble by the above interpretation if he sells sesame oil. These days when the successive governments are trying to promote village and cottage industry, probably the one reason why it is failing is due to the possible tax implication.

The problem of '*absurdity*' originating through *Dooar Tea Case* can be understood through this hypothetical illustration. A prestigious temple of a locality, where hundreds of the devotees across state visit and offer their payers, lighting small lamp with sesame oil only. This religious practise requires hundreds of Liters of sesame oil daily. The local cultivators, with intent to increase their profitability, started growing sesame seed, but rather selling sesame seed, every house converts the same into sesame oil using manually operated machines.

The plane reading of section 2(1A)(b)(ii) would make their income an agricultural income. As problem narrates, the seller of sesame oil are cultivator themselves, growing the sesame seeds i.e. basic operation, and did nothing more than processing it for exploiting the available market with additional profit. The expression 'ordinary process' used in Section 2(1A) of the Act, cannot be conceived as 'traditional process', and thus mitted to tilling of soil, sowing of seed and then harvesting it. The expression should be given its true meaning which must encompasses all form of processing unless the process turn into 'industrial processing'. Here, it becomes relevant to distinguish between 'process' ordinarily employed by a cultivator from the cultivator's perspective and a 'non-ordinary process' from non-cultivator's perspective. This approach would necessarily lead to only one conclusion i.e. from non-agriculturist perspective, the process would always be a process in the nature of industrial, indicating high volume, specialised nature of processing, highly skilled or professionals engaged in the process with expectation of profit. Thus, when this approach will be take, it is not the 'original character' of the product, but rather 'industrial processing', which will the defining factor to indent an income as non-agricultural income. However, in *Dooar Tea Co. case*, the court jumped to save the 'original character' of the product in defining the meaning of 'ordinary process', which resulted into exclusion of such 'processing' from the domain of agricultural activities.

Why the court took that approach? Was that to ensure the extra revenue keep coming from agricultural activities? Or it was assumed that as when a cultivator would change the 'original character', he would be necessarily be engaged in industrial activity? The judgment provides no explanation in this regard. However, what it does, it limits the human choices in terms of exploiting his economic means to the fullest. So, the oil seeds grower cannot sell oil; sugarcane grower cannot sell gaggery or other sweeteners etc., even though no industrial operation even done on these products. The list is endless, and the damage is tremendous, specially of village economy.

Equality Clause and Perpetuation of Inequality

In Weavers Constitutional Law, Article 275 (at page 405), it is stated that "*a state does not have to tax everything in order to tax something. It is allowed to pick and choose districts, objects persons, methods, and even rates for taxation if it does so reasonably*." This is how the Supreme Court of India look into the issue of taxation from equality argument. In *V. Venugopala Ravi Varma Rajah* v. *Union of India*,[44] Supreme Court stated that '*a taxing statute may contravene Article 14 of the Constitution if it seeks to impose on the same class of property, persons, transactions or occupations similarly situate incidence of taxation, which leads to obvious inequality. A taxing statute is not, therefore, exposed to attack on the ground of discrimination merely because different rates of taxation are prescribed for different categories of persons, transactions, occupations or objects*.' What is pertinent here to note is that a tax statute can be questioned on the ground of Article 14 when it '*seeks to impose on the same class of property, persons, transactions or occupations similarly situate incidence of taxation, which leads to obvious inequality.'* There are plethora of judgments wherein the court have clarified that '*classification must not be arbitrary, artificial or evasive and there must be a reasonable, natural and substantial distinction in the nature of the class or classes upon which the law operates*.'[45] Even though, in respect of tax legislation a legislative body has a wide discretion, an Act will not be held invalid unless the classification is clearly unreasonable and arbitrary.[46]

Even after having a settled jurisprudence in this regard, it seems that the present interpretation is resulting into unreasonable classification, and two similar person situated alike are being treated differently [cultivator with non-industrial processing, who has changed the character of the product, and other who has retain the product so raised] OR two different person situated differently are being treated alike [industrial processing are at par with non-industrial processing but with change in the character of the product].

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[44] *V. Venugopala Ravi Varma Rajah* v. *Union of India*, (1969) 74 ITR 49; See also, *Ram Krishna Dalmia* v. *S. R. Tendolkar* [AIR 1958 SC 538] on the question of classification.

[45] *Charanjit Lal Chowdhury* v. *Union of India*, 1950 SCR 869; *State Of West Bengal* v. *Anwar Ali Sarkar*, AIR 1952 SC 75; *Navtej Singh Johar* v. *Union of India*, (2018) 10 SCC 1.

[46] *Amalgamated Tea Estate Co.* v. *State of Kerala*, (1974) CTR (S.C) 192

V

Conclusion

A brief survey of decision involving interpretation would reveal that Indian courts are very cautious while interpreting the tax legislation. They often get guided by the self-created bar of non-interference into the tax or financial matter. However, sometime, as happened in the *Dooar Tea Co.* case, this self-created bar has resulted into larger scrutiny mandated by the constitutional provisions. The court in *Dooar Tea Co.*, should have explored the genealogy of the agricultural activities through focussing on agricultural land - agricultural activities – and related operations [basic i.e. tilling of soil and sowing of seeds; and subsequent operations i.e. ordinary process to render the produce fit for the market]. The court should have restricted itself to the expressions used in the provision, as often required while interpreting tax legislations. The addition of extra element i.e. 'original character' of the produce, is not only out of the realm of the enquiry, but also unconnected to the genealogy of the agricultural activities.