



Indian Agricultural Income Lessens the Income Tax Burden: A Fiscal Illusion

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ABSTRACT

The Indian income tax law spares the Indian agricultural income from payment of income tax because charging tax on agriculture produce or keeping it exempted is a state subject. But from the financial year 1974-75 by an amendment the Union government increased the tax burden on the taxpayer having both agricultural as well as non-agricultural income. This system was executed as an enforcement of the provisions of “Partial Integration of agricultural income with non-agricultural income” for tax rate purposes. As a result taxpayer bears more tax burden on his non-agricultural income due to his agricultural income which otherwise comes under the category of exempted incomes. The paper highlights the fact that how a fiscal illusion is created by increasing the tax rates. State governments need to raise this issue at appropriate platforms to question why government is collecting additional tax revenue against the agricultural income which is the state subject.

Keywords: *Agriculture income; Non-agricultural incomes; Tax rates; Exempted agriculture incomes; Partial integration of agricultural income with non-agricultural income.*

1.0 Introduction

Taxation plays an important role in fighting the problems like fiscal deficit, recession, the balance of payment etc. Fiscal policy is a major instrument with the government which influence the mobilization of resources through efficient usage of taxation policy. Taxation policy is an integral part of fiscal policy which was framed by taking into account the nation's social, economic, political, technological and legal factors. Therefore taxation is one of the basic and definitive components in the working

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of the apparatus of a nation. It plays an important role in the development of any country. The revenue collected from various taxes is used to provide goods and services by the government to its public like infrastructure, transportation, education, health, and many other basic facilities. On the other side tax is a liability on the general public, which they have to pay from their earnings. So, every amount collected should be used to provide better infrastructure facilities to the public at large.

The agriculture sector plays an important role in the development of the Indian economy. India is one of the biggest producer and exporter of agricultural items, for example, rice, wheat, sugarcane and spices. It contributes more than 15 per cent of India's total GDP and is one of the significant sectors for employment in rural India. Since independence, there was no unified taxation structure in India. Income Tax Act of 1860, introduces the income tax in India and till 1886 agricultural income was taxed. After this period, income tax in India is levied on income as determined by the provisions of the Income Tax Act, 1961. The Income Tax Act, 1961 extends to the whole India and came into force with effect from 1st April, 1962.

2.0 Review of Literature

Although, several studies have been undertaken on exemptions, deductions, rebates and reliefs provided under the Income tax act in India; but the number of research studies elucidating the real impact of exempted agricultural income due 'integrated tax rates' remains quite scant. The following section highlights the literature reviewed about researches conducted to check the impact of exemptions allowed for and taxes imposed on the agriculture income:

Neog & Gaur (2020) in their paper examines the relationship between tax structure and state-level growth performance in India for the period 1991-2016. As per their analysis they conclude that for faster growth of Indian states, policymakers should give more focus on property taxes along with the reduction of income taxes.

Compliance Audit Report No.-9 on Direct Taxes (2019)- Chapter-5 'Assessment relating to Agriculture income' published by Department of Revenue-Direct taxes Union Government, India, concludes that claims of exemption allowance of agricultural income are based on inadequate verification or incomplete documentation. This has been pointed out by the committee on the basis of test check of 6,778 cases, in a sample drawn from 22,195 scrutiny cases. It was recommended that ITD needs to re-examine not only the remaining scrutiny cases, but also all cases where income has been allowed as agricultural income, to ensure that exemption has been allowed only to eligible assesseees, and is based on appropriate documents and their verification.

Raghavan (2019) in his article first explains the concept of black money with other several terms, such as, parallel economy, black income, illegal economy, irregular economy and unaccounted money. Second, discusses the reasons that why it is difficult to measure it. Third, suggested three methods i.e. Monetary method, Global indicator or Input-based method, and Straightforward survey method, those can be used by the government to curb black money in agricultural sector also. Taneja (2018) in his paper discusses the provisions connected with agricultural taxation; explain the method provides for integration of agricultural and non- agricultural incomes with examples. And concludes that-it can be said that agriculture income is not really exempt. The tax is levied in indirect way and this concept is known as partial integration of taxes.

Krishna *et al.*, (2018) in their paper study that agriculture is the main source of income for most of the rural Indian population. According to their results it is also true that while the small-scale farmers have been barely impacted by the tax exemptions under the Indian Income Tax Act, wealthy farmers have reaped the benefits by abusing them. Thus, need to amend the 1) definition of 'agricultural income'; and 2) impose an appropriate monetary threshold after careful deliberation and study. So that the high-income farmers come under the purview of taxation and the interest of small scale and mid-scale farmers would be protected.

The Economic Times (2017) highlights the opinions of Rajul Awasthi (Vice President- The World bank) & Amit Singhania (Tax partner-Shardul Amarchand mangaldas & company) those favouring taxation on agriculture; and views of Devinder Sharma (Independent food policy Analyst) who was not in favour of taxing all farmers' agriculture income and said, 'imposing tax on farm incomes is nothing short of a Financial crime'.

Working Party (2019) of OECD,- Chapter-3 on report 'Agricultural Policies and Markets' published the cross-country comparison covers a wide range of tax areas. The Chapter-3 provides an overview of taxation in agriculture comparing general systems and special tax provisions for agriculture among 35 OECD and emerging economies.

James (2004) in his research paper brought out the policy options with respect to the direct taxation of agricultural income in India. He suggested that Central government be given complete powers over taxation of all form of income because limiting the Union government's tax powers only to non-agricultural income is likely to reduce their effectiveness and provides a convenient route to evasion.

3.0 History of Agricultural Taxation

In India, the system of direct taxation has been in force in one form or another even from ancient times. The ancient sage Manu, commented that traders and artisans

should pay 1/5th of their profits in gold and silver; and the agriculturist should pay 1/6th, 1/8th and 1/10th of their produce. Likewise, during the Mauryan system, the State also collected 1/6th part of the agricultural produce as a tax on agriculture in addition to other taxes, viz., water rates, octroi, duties, tolls and customs duties-according to 'Kautilya's Arthashastra. Kautilya described in detail, the domestic as well as foreign trade & commerce and the system of the tax administration in the Maurian Empire. In the modern times, the history of income tax department starts from the year, 1922, when for the first time the Income Tax Act, 1922 gave a special nomenclature to various income tax authorities. After that, with many amendments Income Tax Act, 1961 came into existence.

4.0 Discussion

As per Indian income tax act, 1961 every revenue receipt is taxable in India unless it is specifically declared as exempted income. The tax treatment of various exempted incomes is provided under section 10 of the IT act. Under section 10(i) tax treatment of 'Agricultural Income' is specified, where it is cleared that income earned from agricultural operations is not taxable, hence, exempted. Agricultural income does not merely include rent and revenue derived from land but it also includes income earned from the cultivation of land eg., income received from the production and sale of produce like grains, fruits, tea, coffee, spices, plantations and commercial crops etc. According to section 2(1A)(a), if the following three conditions are satisfied, income derived from land can be termed as "agricultural income":

- Rent or revenue should be derived from land;
- The land is one which is situated in India; and
- The land is used for agricultural purposes .

4.1 Test to treat an income as agriculture income

Following are the three tests which must be satisfied to treat a particular income as agricultural income (Singhania & Singhania, 2022):

Test (a) : Income derived from Land

Test (b) : Land is used for agricultural purposes

Test (c) : Land is situated in India

Test (a) - Income derived from Land: It is essential for any income to be treated as agricultural income, that land must be effective and immediate source of income and not indirect and secondary sources. Although, in the following decided cases even land is not the effective or immediate Source of income but incomes are considered

as agricultural income. Generally, such incomes are not agricultural incomes because in all these cases land is not the effective and immediate source of income. For instance: 1) Interest on arrears of land revenue (C.I.T. Vs. Kamakshya Narain Singh); 2) Dividend paid by a company out of its profits which included agricultural income also (Bacha Guzdar vs. C.I.T.); 3) Salary paid to a manager for managing agricultural farms (Premier Construction Co. Ltd. Vs. C.I.T.) (Sekhon, 2021).

Test (b) - Land is used for agricultural purposes: Agricultural operations mean efforts have been induced for the crop to sprout out the land. It also includes processing of agriculture produce to make it fit for sale. Agriculture means performance of some basic operations i.e. ploughing, sowing, irrigating and harvesting and some subsequent operations-weeding, digging, pruning, cutting etc. It involves employment of some human skill, labour and energy to get some income from land, for instance Income earned from Nursery Operations is also considered as agricultural income. Thus, according to second test it is necessary that income must be result of agricultural operations performed on agricultural land to term it as Agricultural income.

Test (c) - Land is situated in India: To avail the exemption allowed u/s 10(1) of the Act, it is necessary that agricultural income must be derived from land situated in India. As per third test, if income is derived from agricultural land situated outside India e.g. from Pakistan; or from any other country, it will not be exempted u/s 10(1). Hence, such income is taxable under the head 'Income from other sources).'

In this way, agricultural income covers all products those all produced from the performance of basic as well as subsequent operations on land. The basic reason of exemption of agricultural income in 'Indian Income Tax law' is that- *The Income tax in India is governed by Entry 82 of the Union List of the Seventh Schedule to the Constitution of India, empowering the central government to tax non-agricultural income; agricultural income is defined in Section 10(1) of the Income-tax Act, 1961* (Maity, 2020). Thus, the Parliament has no power under the constitution of India to levy tax on agricultural income because the Constitution gives exclusive power to the State legislature to make laws with respect to levying taxes on agricultural income. Therefore, taxes on agricultural income fall under Entry 46 in "State List" under the Constitution of India. In this situation, only the State Governments are competent to enact legislations for taxation of agricultural income therefore, States can implement acts with regard to agricultural income tax, such as plantations. And in many states of India, agricultural Income Tax Acts are applicable as in most of the North-East States, Uttar Pradesh, Hyderabad, Travancore, Cochin, Madras, etc.

Under current income tax law agricultural income is considered for rate purposes while determining the income tax liability viz. the rate of tax applicable to other taxable

income of Individuals, Hindu Undivided Families (HUF), Association of Persons (AOP), Bodies of individuals (BOI) and artificial juridical persons. Exemption under the Income Tax law may be claimed as agricultural income, income from sale of agriculture land, income earned as compensation received from government for acquiring the agriculture land etc.

The earlier discussion shows that tax payer needs to distinguish between agricultural and non-agricultural income before computing his final tax liability, so that he can reduce his total taxable income with the exempted agricultural income, to find out his final tax liability. This situation was true till the assessment year, 1973-74; but from the financial year 1974-75, one major amendment was made in the law. (Bhargava, 2021) As a result w.e.f. assessment year 1974-75, the agricultural income has been taken into consideration for determining the rate of tax applicable to the non-agricultural incomes of the tax payers. In other words, with this amendment, while computing tax on non-agricultural income, agricultural income of person will also be taken into consideration for determining the tax rates applicable on his non-agricultural income. This process of computation of 'tax rate' is known as Partial Integration of agricultural income with non-agricultural income. Additionally, one needs to understand the concept and system of 'Partial Integration of agricultural income with non agricultural income' for tax rate purposes. The forthcoming part of the paper elaborates the steps of Partial Integration Process of agricultural income with non agricultural income:

Step-1 – Take Agriculture and non-agriculture income together and, compute the income tax on this total income without adding education cess in it.

Step-2 – Take total of agricultural income and the exemption limit i.e. 2,50,000 or 3,00,000 or 5,00,000 as the case of the 'other taxpayer', 'senior citizen taxpayer' or 'super senior citizen taxpayer' respectively. And then calculate income tax on this total figure without adding education cess in it.

Step-3 – Deduct the amount found in step-2 from the step-1. And then compute education cess on the balance figure and add it to find out the final tax amount of the person.

Note : The system of partial integration is not applicable where person's income comes from long term capital gains and from other casual income u/s 111A (i.e. STCG). (Harsh, 2020).

Here the question arises - Is Agricultural income really exempted?

The Answer is 'yes'- Agricultural income is exempted; 'but' nevertheless, the tax burden of the taxpayer will also be increased on his non-agricultural income due to his agricultural income, if the agricultural Income is more than INR. 5000.

Ironically, the real impact of above stated 'affirmative answer', is that the taxpayer has to bear more tax burden on his non-agricultural income due to his agricultural income (which is otherwise exempted u/s 10 of the Indian income tax law). To simply illustrate the net effect on tax liability of a person having agricultural income two examples have been mentioned in the annexure (see annexure 1). These examples clarify that how additional amount of tax is required to be paid by the person who has agricultural as well as non-agricultural income due to the system of "partial integration of agricultural and non-agricultural income".

The example-1 & 2 clearly show two calculations under case-I & II respectively. One can see the difference of final tax burden on the person which is higher by Rs. 22,500 (i.e. 55,000-32,500) in Example-1 and Rs. 77,500 (i.e. 1,60,000-82,500) in Example-2. Section-10 of income tax act, 1961 enumerates the list of incomes fully or partially exempted and those that can be utilized to minimize tax liability. In these provisions section 10(i) clearly mentions that agriculture income is also exempted from income tax, therefore, contributes to lighten the tax burden. Parakh, (2017) also advocates the aforesaid statement that, "all the terms Viz. 'allowances', 'tax deduction' and 'tax exemptions' refers to lowering of taxable income; these are the various tax reliefs and tax breaks as provided by the government to a tax payer". Despite this, the existing Indian income tax system even exempts the agriculture income but actually it is contributing towards enhancing the tax burden of the person. Hence all the stakeholders (Viz., taxpayers, State governments and farmer unions) need to check these provisions that are creating fiscal illusion.

4.2 Issues associated with enhancing the agricultural tax burden

The idea of continuing the system of integration of agricultural income with non-agricultural (for tax rates purposes); or directly taxing agricultural income by introducing new system is looking reasonable at the growth and development of the country. But many issues/problems are associated with the implementation of such policies especially in India as discussed below:

- Enhancing more tax burden on public is politically motivated issue, as the implementation of such systems would affect the lives of numerous people which have a direct relation to casting votes at the time of the election, so a strong political will is needed. Ultimately, the progressivity of a nation's tax system depends on each society's view of what is fair, as expressed through the political process (Moses *et al.*, 2022).
- The system of 'directly tax agricultural income' requires the farmers to be classified as socially and economically deprived of resources. As acceptance of income tax is

based on the premise that an individual's income is the best single index of one's ability to contribute to the support of government (Moses *et al.*, 2022). The most of the farmers hold small pieces of land and many people are landless labourers, so taxable agricultural income would be negligible.

- Many farmers/people are illiterate so they don't have tax knowledge. They need to create tax literate at the village level which would aid in avoiding tax evasion in the name of agricultural income. Kamil (2015) defines the concept & scope of basic tax knowledge and concludes in her study that due to awareness taxpayers ready to pay taxes. Furthermore, Oladipupo & Obazee (2016) in their study states that tax knowledge are the level of awareness or the level of sensitivity of taxpayers to tax legislation.
- Uncertainty of income is always here because huge dependence of farmers on natural climate for the quantity and quality of their production. To reduce rural poverty small farm-holders' development is necessary, but the challenge is to improve the working markets for outputs, inputs, land and financial services.
- In India the role of insurance companies is very limited to cover the agricultural risk faced by the farmers so, now-a-days they are losing their interest in this business /profession. Around 83% of the agricultural industry is comprised small and marginal farmers so; bringing all agricultural income under the tax net is a financial crime (The Economic Times 2017).
- Reports states that taxpayers those have ability to pay agricultural taxes use unfair means to convert their black money into white money. The claims of exemptions against agricultural income are based on inadequate verification or incomplete documentation which has been pointed out by the audit committee of the union government of India (CAG Audit committee report, 2019).
- MSP (Minimum Support Price) is not approved for all the food grains so, it is difficult to identify the value of each kind produce hence, quite difficult to find out the net income earned by the farmer.
- Administrative cost would be uncertain and expected to be more than the tax revenue collection. Therefore it's not advisable to charge Income tax on the agricultural income in India.
- In the present time the income of the farmers is still outside the sphere of income tax and they can consider an exemption for specific crops. Neog & Gaur (2020) with their research study establish the fact that promotion of growth performance at the state level concerning income taxes is very crucial as income tax has a direct effect

on individuals and their saving and investment behavior. Thus, in such situation enhancing tax burden is not justified.

4.3 Suggestions to settle the issue of indirectly taxing the agricultural income

Following are the areas that are needed to be further explored and deliberated upon by the governments at both levels (Central and States) and farmer unions to settle the issue of indirectly taxing the agricultural income by applying 'Partial integration of tax rates':

- Under the Constitution of India, the centre has powers to amend the definition of agricultural income, to bring the taxation of agricultural income tax directly under its powers. So, the states need to intervene- in case where centre changes the scope of agricultural income by amending its definition, because such amendments will affect the boundaries of states' taxing powers.
- Presently, with the enforcement of a system of 'Partial integration of tax rates' a person has to pay more tax on non-agricultural income if he has agricultural income also, therefore taxpayers try to evade the taxes imposed upon non-agricultural income:
 - by claiming non-agricultural receipts as a exempted agricultural receipts; and
 - by hiding the agricultural income to by-pass the system of 'Partial integration of tax rates'.
 - Therefore, an amendment is required in agricultural income tax policy.
- As per current system of disbursement of Union tax resources among the States a defined criterion recommended by the 15th Finance Commission of India has been used. The Finance commission recommendations provide following parameters to define State's share in common resources, such as, Population (i.e. 15%), Area (i.e. 15%), Forest and ecology (i.e. 10%), Income distance (i.e. 45%), Tax & Fiscal efforts (i.e. 2.5%), and Demographic performance (i.e. 12.50%). I believe that as above mentioned parameters define the basis for division of common resources and Union tax among the states, similarly some criteria or parameter must have been laid down for division of extra tax collected indirectly on agricultural income.
- It is suggested that the proportion in which the tax payers of different States pay additional tax on the non-agricultural income due to their agricultural income, the Finance committee should recommend parameter to divide the additional tax collected in the same proportion. The main objective of such a policy would result in compensating back the additional tax collected to the same State, so that from where it has been collected it can be used for the upliftment of people of that State itself.

- Government reports showed that new forms of tax avoidance or evasion have come into existence by using the agriculture route. For instance, “the returns filed by a number of taxpayers in Mumbai claimed large incomes from agriculture in areas which were infertile. Based on such returns, the revenue losses from laundering were pegged at Rs. 1,000 crore. As a result it was proposed that the states pass a resolution under Article 252 of the Constitution authorising the Centre to impose a tax on agricultural income”. (Kelkar Committee report, 2002). To stop such practices under ‘new agricultural tax policy’ rich farmers should be considered in the tax net, and small farmers income should remain exempted from income tax on agriculture receipts.
- A new clear cut agriculture income tax policy should be formed to guide whether to tax or exempt the agricultural receipts instead of indirectly collecting more taxes from a person due to his agricultural income. Under this policy the State governments or Panchayats could be made more empowered by devolution of taxing powers of agricultural income with respect to following matters-
 - fixing clear cut tax base for agricultural receipts;
 - exempted agricultural receipts in case any;
 - agricultural tax rates;
 - collection of agricultural tax revenue; and
 - distribution of agricultural tax revenue etc.
 - his benefit is reportedly being misused by wealthy farmers with large incomes to evade taxes.

5.0 Conclusion

Despite the constitutional limitations, the centre has repeatedly tried to tax agriculture indirectly (James, 2004). The income tax law was amended and Union government became authorize to collect more tax from the taxpayers due to clubbing agricultural income. Both examples clarify that as tax burden of the person having both (agricultural and non-agricultural income) is high in comparison to that person who has only non-agricultural income. In the present situation it is not justified to sate that agricultural income will not burden the person with the income tax because it is exempted. Undoubtedly, the aim is to charge the higher tax rate on the total income of the person through the process of integration of agricultural & non-agricultural income. The Centre and State governments need to intervene in this issue. Some suggestions are mentioned at the end of the paper to settle the issue of indirectly taxing the agricultural income.

6.0 Illustrate the Net Effect on Tax Liability of a Person having Agricultural Income

Annexure 1

In case a person is having agricultural income of INR more than 5000/- in a financial year, then it will be accounted for tax rate purposes of non-agricultural income. Such taxpayer has to file ITR-2, wherein a separate column for declaring the details of the agricultural income is provided.

Example-1

Case-I : A taxpayer earned an agricultural income of Rs. 1,50,000 and non agricultural income of Rs. 6,00,000 during the financial year 2021-22. (i.e. as on 31-03-2022). Following is the method of computing tax liability of the person:

Step-1 : Add agricultural income and non-agricultural income.

$$= 1,50,000 + 6,00,000 = 7,50,000$$

(a) Compute income tax on Rs.7,50,000 i.e. Rs. 62,500 before Health and education cess 4%.

Step-2 : Add agricultural income with basic exemption limit applicable on this tax payer (In this case emption limit is taken Rs. 2,50,000).

Therefore, total of agricultural income and exempted limit is Rs. 1,50,000 + 2,50,000
= Rs. 4,00,000

(b) Compute tax on Rs. 4,00,000

i.e. Rs. 7,500 before adding HEC 4%.

Step-3 : Deduct amount found in step-1 from amount found in step-2

$$\text{i.e. (a)-(b) = } 62,500 - 7,500 = \text{Rs. } 55,000$$

Case-II: A tax payer has only non-agricultural income of Rs. 6,00,000. In other words, he does not have any agricultural income, then following is the method of calculating tax liability of a person:-

Step-1: Take non-agricultural income of the person Rs. 6,00,000.

Step-2: Calculate income tax on Rs. 6,00,000 before adding Health and education cess @ 4%.

i.e. Rs. 32,500/-

The calculation shows that tax liability of a person is Rs. 55,000 , if he has agricultural as well as non-agricultural income. But if this person has only non-agricultural income then his tax liability will come only Rs. 32,500 which is less than Rs. 55,000. That is the case of enhancing tax burden of Rs. 22,500 due to the process of partial integration of agricultural income with non-agricultural income for tax rate purposes.

Example-2

Case-I : A taxpayer earned an agricultural income of Rs. 5,50,000 and non agricultural income of Rs. 8,50,000 during the financial year 2021-22. (i.e. as on 31-03-2022). Following is the method of computing tax liability of the person:

Step-1 : Add agricultural income and non-agricultural income.

$$= 5,50,000 + 8,50,000 = 14,00,000$$

(a) Compute income tax on Rs.14,00,000 i.e. Rs. 2,32,500 before Health and education cess 4%.

Step-2 : Add agricultural income with basic exemption limit applicable on this tax payer (In this case exemption limit is taken Rs. 2,50,000).

$$\text{Therefore total agricultural income and exempted limit is Rs. } 5,50,000 + 2,50,000 = 8,00,000$$

(b) Compute tax on Rs. 8,00,000
i.e. Rs. 72,500 before adding HEC 4%.

Step-3 : Deduct amount found in step-1 from amount found in step-2

$$\text{i.e. (a)-(b) = } 2,32,500 - 72,500 = \text{Rs. } 1,60,000$$

Case-II : A tax payer has only non-agricultural income of Rs. 8,50,000. In other words, he does not have any agricultural income, then following is the method of calculating tax liability of a person:-

Step-1: Take non-agricultural income of the person Rs. 8,50,000.

Step-2: Calculate income tax on Rs. 8,50,000 before adding Health and education cess @ 4%.

$$\text{i.e. Rs. } 82,500/-$$

The calculation shows that tax liability of a person is Rs. 1,60,000 , if he has agricultural as well as non-agricultural income. But if this person has only non-agricultural income then his tax liability will come only Rs. 82,500 which is less than Rs. 1,60,000. That is the case of enhancing tax burden of Rs. 77,500 due to the process of partial integration of agricultural income with non-agricultural income for tax rate purposes.

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