Tax Wire

Green or not Green?

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Background

"Agriculture is the backbone of the Indian economy". This is a statement that all of us are familiar with right from elementary school. Rightly so, as agriculture contributes around 22% to our country's GDP[1] and about 65% of India's population is dependent on Agriculture. It provides food, gives employment and also has vital supply and demand links with the manufacturing sector.

In order to support the nation's cause and to support the growth of the agricultural sector, the incomes derived from agriculture have been provided exemptions and kept out of the tax regime of the country. However, in order to ensure there is no misuse of the benefit, what constitutes agricultural income has been defined in the Income Tax Act (the Act) and exemptions have been restricted to the income that qualifies accordingly.

The Controversy and the subsequent legal proceedings

A matter of the classification of income as agricultural or not came up before the Hon'ble Bombay High Court. It was in the case of Forest Development Corporation of Maharashtra Ltd.[2] (taxpayer).

The taxpayer is a company incorporated under the Companies Act, and wholly owned by the Government of Maharashtra. The taxpayer was engaged inter-alia in the activity of Turn-key plantation i.e., to create and develop plantations, rock gardens etc. for companies/institutions such as Western Coal fields Ltd. (WCL Ltd.), ONGC etc. in terms of a contract entered into with them.

The taxpayer in its Turn-key plantation activity undertook the work of sowing seeds and developing Nurseries on its own land. The taxpayer would tend to these plants till they achieved a certain height and would thereafter transplant the same to the lands specified by its customers after which it maintained them for a period of 2 to 3 years until they achieved the desired health not requiring further professional care. The taxpayer's contracts with its customers ensured payment of 80% of the amount by the time of the transplant of the plants to the customers' premises.

The taxpayer had claimed the income received from the above activity as Agricultural income exempt under the Act in its returns filed for the AY 1998-99 and AY 1999-2000. These were however disallowed by the Assessing Officer (AO) who added to the income declared by the taxpayer, an amount of Rs.49.29 Lakhs (AY 1998-99) as business income from turn-key plantation activity.

The taxpayer aggrieved by the order of the AO, filed an appeal with the Commissioner of Income Tax (Appeals) [CIT(A)] and then a further appeal to the ITAT when the CIT(A) upheld the AO's decision.

The ITAT split the activities of the taxpayer into 2 stages as under:

- Stage 1: Where the taxpayer in its own land sows the seeds and maintains the plant until a desired height is achieved.
- Stage 2: Where the taxpayer transplants the grown plants to the premises of the customer and offers care and maintenance at the premises of the customer.

The ITAT identified the activities at the 1st Stage as being agricultural in nature and allowed 80% of the income (received before the transplantation) as agricultural income and brought to tax the other 20% of the income of the taxpayer.

The taxpayer however, still not in acceptance of the decision of the Tribunal, appealed to the High Court on the matter.

[1] Federation of Indian Chambers of Commerce & Industry
[2] Forest Development Corporation of Maharashtra Ltd. vs. ACIT [2017] 84 taxmann.com 214 (Bombay)

Taxpayer's contention

- The taxpayer was of the opinion that the "***artificial division***" of its activities by the Tribunal into stages was 'uncalled for' when the whole operation was agricultural in nature.
- The taxpayer relied on a decision of the Supreme Court[3] to contend that when the income from basic operations (Stage-1) was considered as agricultural income, then the income from the subsequent operations (Stage- 2) was also to be considered as agricultural in nature as it was an integrated activity.
- That the establishment of interest in the land was not necessary and since the contract itself indicated an area in which the plantation program would be required to be carried out by the taxpayer at "Stage-2", it would constitute agricultural income.

Revenue's contention

- The revenue contended that the income received by the taxpayer at stage 2 was in the nature of payments received for the services rendered and was therefore not agricultural in nature.
- That the taxpayer did not at Stage-2, have any interest in land and that the taxpayer was merely providing ***maintenance services*** to its customers at their premises as per the contract.

The verdict of the High Court

The High Court pointing to the definition of Agricultural income as per the Income Tax Act emphasized that the *sin qua non* for an income to be considered as agricultural in nature is that,

a) It should be "**derived from land**"
b) Land should be situated in India and
c) Land should be used for agriculture.

It was highlighted by the Hon'ble court that the words "derived from" have a narrower meaning than the words "attributable to"[4] and that the use of the words 'derived from' indicates that it does not cover sources beyond the first degree (that is from **land only**).

The Hon'ble Court thus upheld the view of the Tribunal in holding the income from Stage-1 as agricultural in nature, since the taxpayer derived this income from growing plants in its land before transposing the same.

Discussing the income from Stage 2, the Hon'ble court stated that the taxpayer had no interest in the land where the plants had been transplanted and the taxpayer, as its contract itself indicated, was obligated to **provide services** till such time as required for the plants to reach a certain height and/ or health for which he would be paid some consideration.

The High Court referring to the contention of the taxpayer that the activity it provided was integrated, ruled against them by stating that the activities at Stage 2 could have been done by some other person if not by the taxpayer after the plants had been placed at the customers' premise and it was not necessary that the same agent had to undertake the activity at both the stages.

In saying so, the High Court confirmed that the splitting of the entire activity of the taxpayer by the Tribunal into two stages could not be found fault with.

The Hon'ble Court in this matter also noted that remuneration earned by the Managing agent of a Company which is engaged in agricultural operations could not be treated as agricultural income.[5] This was because it was not derived from land but was in the nature of salary paid to the agent pursuant to his contract of service with the company.

[3] CIT vs. Raja Benoy Kumar Sahas Roy (1957) 32 ITR 466 (SC)

[4] Liberty India v. CIT (2009) 317 ITR 218/183 Taxman 349 (SC)

[5] Premier Construction Co. Ltd. vs. CIT (1948) 16 ITR 380 (PC); E.C. Danby vs. CIT (1944) 12 ITR 351 (Patna); Maharajadhiraj Sir Kameshwar Singh v. State of Bihar (1959) 37 ITR 388

Similarly, the income of the taxpayer at Stage 2 was derived from the **contract of the taxpayer with its customers** and not from land and could therefore not be characterized as agricultural income.

The Hon'ble High Court emphasizing the importance of derivation of income from land to be agricultural in nature, ruled against the taxpayer and in favor of the revenue, confirming the addition as business income, 20% of the revenue earned from the Turnkey plantation activity of the taxpayer.

Advith Comments

The decision of the Bombay High Court in this case has yet again emphasized the importance of the income to have a direct connection with the land for it to be classified as agricultural income.

It was held by the Madras High court in the case of *CIT vs. Maddi Venkatasubbaya (1951) 20 ITR 151*,

"Agricultural income cannot be said to accrue to every person in whose hands the produce of the land passes. It is only of the owner, landlord or ryot, or persons having a derivative interest in the land from these persons that can be said to "derive" income from land by the performance of agricultural operations on it."

It has been a settled principle via the many cases in this matter like the above that land needs to be at the first degree of association of income for it to be classified as agricultural.

This ruling by the Hon'ble court has gone on to confirm that nobody can take advantage of the beneficial provisions of the law unless they are actually eligible for such exemptions.

In the backdrop of increased organized farming methodologies and contract farming being undertaken by large corporate, eCommerce sellers and large multi brand stores, the above ruling holds a significant importance.

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Reach us at:

Advith Consulting LLP

No. 72/1, 1st Floor, Jnanodaya School Road
Shankarapark, Shankarpuram, Bangalore 560 004
Contact: 080 22426484;
e-mail: info@advithconsulting.in
Visit us at: www.advithconsulting.in

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