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Agriculture Tax: Route To Evasion In Non-Agri Income

IN the seventh NFC award, the federal government was asked to raise the tax-to-GDP ratio to 15 per cent and the provinces were expected to effectively tax agricultural incomes. This would have enlarged the divisible pie and the provincial kitty. While the centre failed to reform the tax structure, the provincial governments paid no attention to mopping up the potential of agricultural incomes. The eighth NFC failed to give an award, leaving these issues — and more — to the ninth NFC.

The Constitution limits income tax to non-agricultural incomes, a federal subject. Agricultural income falls in the provincial domain and is subjected effectively to a tax on land. This distinction is unfair as it violates the principle of taxing equal incomes equally (the so-called horizontal equity). It is also against the principle of ability to pay, as a large number of earners are not taxed at all (the so-called vertical equity).

Worse, it provides a convenient route to non-agricultural income earners to evade federal income tax by declaring vast amounts as agricultural income. All the provinces together do not collect more than Rs2 billion. According to the latest annual report of the State Bank, this is 0.03pc of the agricultural GDP.

Here's the rub. Dominated by the large landholders, the provincial governments do not make the required effort to collect what is due under the existing tax laws. The attitude goes back to colonial times. With a view to creating and protecting the loyalty of feudals, the agriculturist/non-agriculturist distinction was encouraged not only in incomes, but also with regard to jobs and admissions to educational institutions.

When first introduced in 1860, income tax included income from agriculture in the definition of income. Writing in 1920, Shankar Madhav Pagar observed:

“For the first time in the history of the world it was demonstrated that India, an oriental country was ready to meet with equanimity and courage the greatest engine of Western finance — a modern income tax.”

By 1886, agricultural income had been exempted, as the landed class termed it a violation of the Permanent Settlement agreement. Today's argument, that agriculture is already overtaxed, also goes back to those days. The exemption continued after Independence. In 1977, Zulfikar Ali Bhutto's attempt to levy a presumptive agricultural income tax in place of land revenue was aborted by Gen Zia to appease the feudal lords.

Land reform was also declared un-Islamic. This opposition continues, although agriculture's share in total tax collection is a measly 0.6pc against its share of 19.2pc in GDP. The low share is the result of the elimination of taxation implicit in support prices and exchange rate, besides negligible explicit taxation. To confuse the issue, this is the argument sold by the large farmers to small farmers. Even today, there is little awareness among the small farmers that a vast majority of them will be exempted under any income tax formula.

The ninth NFC presents an opportunity to finally end the distinction between agricultural and non-agricultural incomes. Neither the PPP nor the PML-N had any interest in alienating the feudal support. The MQM represents middle-class opportunism more than the middle class. In 2011, one of its senators moved a private bill to include agricultural income in the definition of income. Despite being in the government, the move was to support the opposition, the PML-N, to thwart the imposition of the 'anti-urban' value-added tax.

For the first time, a nationwide party claiming the support of the middle class is in the saddle at the federal level and in three provinces. It has its share of landlords.

That is perhaps why the party manifesto is silent on the issue of agricultural income tax. But the party also has Jahangir Tareen, who has said many a time that he had to make special efforts to pay his due against whatever exists in the name of agricultural income tax. The authorities did not seem keen to collect it, as it would set a 'bad' precedent for the powerful farm lobby.

Be that as it may, championing a *“shift towards direct taxation as the primary source of tax revenue”* is the broader objective of the PTI manifesto. Effective taxation of agricultural income will further this objective.

Of course, this requires a constitutional amendment. Careful negotiations and a credible estimate of gains can make it happen. Back-of-the-envelope calculations place the yield between Rs150 billion to Rs200bn. The yield from plugging a hole for evasion will be in addition. All parties in the NFC will gain, in proportion to their respective shares in the divisible pool, without touching the sensitive vertical distribution.