



**CA. Harish Paliwal**

Member of the Institute

## From Soil to Soilless: Redefining Agricultural Taxation in Modern India

This article examines the evolving landscape of agricultural taxation in India amid modern farming techniques like hydroponics and aeroponics. The central government lacks authority to tax agricultural income, a power reserved for states under the Constitution's State List, Entry 46. The states of Assam and West Bengal currently tax plantation crops, though other states are deterred by high administrative costs

and political sensitivities. The rise of soilless farming challenges tax exemptions, as seen in the 2025 Madras High Court, which classified mushroom cultivation as business income. To navigate these changes, Agri-entrepreneurs should maintain land connections, document processes, and secure licenses to ensure compliance and preserve tax exemptions.

### Introduction

India's agricultural sector is shifting from traditional land-based cultivation to technology-driven methods like hydroponics, aeroponics, and controlled-environment farming. These advancements challenge the definition of "agricultural income" under the Income Tax Act, 1961, designed for traditional farming. This article analyzes the constitutional framework, judicial interpretations, and administrative challenges, focusing on recent rulings like the 2025 Madras High Court decision on mushroom cultivation, to assess how tax law adapts to agricultural innovation and its implications for policy and enforcement.

### Historical Context of Taxation in Indian Agriculture

In its 2002 report<sup>1</sup>, the Task Force on Direct Taxes recommended taxing agricultural income, but no action

was taken as the central government lacks authority<sup>2</sup>; this power lies with states under Entry 46, State List, Seventh Schedule of the Constitution of India. Historically, states like Bihar, Odisha, Tamil Nadu, and Kerala taxed agricultural income, but currently, only Assam and West Bengal tax plantation crops (tea, coffee, rubber). Under the Income Tax Act, these crops have a portion treated as business income (40% tea, 25% coffee, 35% rubber), with the rest state taxable. West Bengal waived tea garden taxes for 2023-2025<sup>3</sup>.

High administrative costs and political sensitivities deter uniform taxation of agricultural income. Tax collection requires detailed land records and compliance, which is challenging in India's informal agricultural sector. Agriculture contributes 16% to GDP (FY24<sup>4</sup>) and employs 46.1% of the population, linking it to food security and rural livelihoods. Taxing farmers risks

evoking colonial-era taxation memories, making it politically sensitive. Thus, most states avoid taxing agricultural income, limiting it to commercially organized plantation crops.

### Evolution of Farming Practices

Technological advancements have transformed Indian agriculture from a rainfall-dependent livelihood into a profitable enterprise. Methods like drip irrigation, greenhouse farming, hydroponics, aquaponics, and aeroponics, supported by drone monitoring and soil sensors, boost yields and efficiency. However, adoption is uneven, and the tax-exempt status of income from commercial setups like soilless systems or mushroom cultivation is debated. Without clear Central Board of Direct Taxes (CBDT) guidance, tax classification relies on judicial interpretation.

<sup>1</sup> [https://www.indiabudget.gov.in/budget\\_archive/es2002-03/chapt2003/chap29.pdf](https://www.indiabudget.gov.in/budget_archive/es2002-03/chapt2003/chap29.pdf)

<sup>2</sup> Refer Article 246 in Constitution of India

<sup>3</sup> [https://finance.wb.gov.in/writereaddata/Budget\\_Speech/2022\\_English.pdf](https://finance.wb.gov.in/writereaddata/Budget_Speech/2022_English.pdf)

<sup>4</sup> Ministry of Statistics and Program Implementation (MOSPI). <https://pib.gov.in/PressReleaseIframePage.aspx?PRID=2079024>

## Advanced Farming Techniques

### Greenhouse farming

Greenhouses enable controlled cultivation, protecting crops and regulating temperature, humidity, and light. They support soil-based, grow-bag, or soilless methods, ideal for high-value crops and urban farming.

### Hydroponics

Hydroponics involves growing plants in nutrient-enriched water, enabling faster growth and higher yields for lettuce, tomatoes, and herbs. It suits urban spaces and reduces soil-borne pests, gaining traction in Maharashtra, Karnataka, and Telangana.

### Aquaponics

Aquaponics integrates hydroponics with aquaculture, using fish waste to nourish plants, which filter water for fish. It conserves water and supports sustainable cultivation of greens and fish like tilapia in Kerala and Tamil Nadu.

### Aeroponics

Aeroponics involves misting plant roots with nutrients, offering resource efficiency and rapid growth for basil, lettuce, and microgreens. It suits vertical farms in urban areas like Delhi NCR and Mumbai.

## Understanding the Law: Agricultural Income Tax Law

### Indirect Taxes

Under GST, unprocessed agricultural produce is exempt, regardless of cultivation method (soil, hydroponics, or aeroponics). Button mushrooms are classified as “Edible vegetables” (GST Chapter 07), supported by APEDA and FSSAI.

However, processed goods (e.g., mushroom powder, frozen spinach) incur GST at ‘5% or 12%’.

### Direct Taxes

Let us now examine the treatment of agricultural income under direct taxes.

Under the Income Tax Act, 1961, the term agricultural income is defined in

clause (1A) of Section 2. This income is exempt under Section 10, subsection (1), of the Act. The exemption is granted specifically to agricultural income, so it is important to understand what constitutes agricultural income under the law.

Clause (1A) of Section 2 can be broken down into three distinct components:

- Income from rent or revenue derived from agricultural land
- Income from agricultural operations
- Income from buildings associated with agricultural activity

Let us begin with item (a) of clause 1A to Section 2, which reads:

“agricultural income” means-

- any rent or revenue derived from land which is situated in India and is used for agricultural purposes

This part establishes two essential conditions:

- The land must be located in India, and
- It must be used for agricultural purposes.

Rent typically refers to lease or tenancy payments received from agricultural land. Revenue may also include



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sharecropping arrangements or rent-in-kind, where the landlord receives a portion of the agricultural produce instead of monetary consideration. However, the key condition remains that the land must be used for agricultural purposes, a phrase not defined in the Income Tax Act, 1961, but interpreted through judicial pronouncements. The Supreme Court in CIT vs. Raja Benoy Kumar Sahas Roy (1957) clarified that land must be subjected to integrated agricultural operations, both basic (tilling, sowing) and subsequent (weeding, harvesting), to qualify.

Basic operations such as tilling of the land, sowing of the seeds, planting, and similar operations on the land require expenditure of human skill and labour upon the land itself. Subsequent operations in conjunction with the primary operations after the produce sprouts from the land, such as weeding, digging the soil around the growth, removing undesirable undergrowth, tending, pruning, cutting, harvesting, and marketing.

Only when the land is subjected to such integrated activity can it be said to be used for agricultural purposes, and its income is considered agricultural income within the meaning of the Act.

Moving to item (b) of clause (1A), it states:

- 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.*

This part covers three types of income:

1. Income directly from agricultural operations
2. Income from processing carried out by the cultivator or rent-in-kind recipient to make the produce market-ready
3. Income from the sale of such produce, either as is or after applying only such ordinary processes

The processing or sale must relate to produce originating from the same land and carried out by the person who cultivated the land or received produce in lieu of rent. Industrial or commercial processing that goes beyond what is ordinarily done to preserve or prepare produce for sale would not qualify under this clause.

Item (c) of clause (1A) provides that:

- 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 :*

This clause extends the definition of agricultural income to include

income from buildings used in relation to agricultural land. For this to apply, the building must either be owned as well as occupied by the receiver of rent or revenue or occupied by the cultivator or rent-in-kind recipient. The building must be located in the immediate vicinity of the land and used in connection with ordinary agricultural processes such as cleaning, sorting, or storing. Even if these processes are carried out within the building, as long as they relate to produce from that land and do not exceed ordinary processing, the resulting income is treated as agricultural income.

In conclusion, for income to qualify as agricultural under the Income Tax Act, it must arise from activities integrally connected to the use of land for agricultural purposes. The activity must involve both basic land operations and subsequent related efforts, conforming to judicially established tests such as those in the Raja Benoy Kumar case. The focus is not only on the nature of the income but also on how and where it arises.

### Partnership Firm Warehousing Case and Interpretation of Section 2(1A)(c)

*ITO, Budaun vs. Assessee (ITAT Delhi, 24 March 2009)*

A case before the Income Tax Appellate Tribunal, Delhi, a significant question arose regarding the taxability of rental income earned from a warehouse operation. Three individuals, each owning agricultural land in their personal capacity, formed a partnership firm to operate a warehousing business. The firm constructed storage facilities on the land and rented them to government agencies for storing food grains such as wheat and rice. The firm claimed this rental income as exempt under Section 10 Sub-section (1) of the Income Tax Act, treating it as agricultural income.

To assess this claim, the Tribunal applied the conditions outlined in Section 2 clause (1A), particularly the

third item concerning income from buildings associated with agricultural activity. The Tribunal examined the following three criteria:

#### 1. Ownership and Occupancy Requirement

The provision requires that the building must be owned and occupied by the person receiving rent or revenue from the land, or by the cultivator or receiver of rent in kind. In this case, the partnership firm earned the rental income but did not own the land, which was held individually by the partners. Therefore, this requirement was not satisfied.

#### 2. Cultivator Connection

The building must be occupied by a cultivator or a person receiving rent in kind. The firm did not cultivate any agricultural produce, nor did it receive any rent in kind. The produce stored in the warehouse belonged to government departments. Thus, the firm lacked any direct connection with cultivation.

#### 3. Link Between Land and Produce

The law requires that the income from the building must relate to processing or marketing of produce from that very land or from adjacent land. In this case, the warehouse was used to store food grains that had no connection with the land on which the warehouse was constructed. This criterion also failed.



Based on the failure to meet all three conditions, the Tribunal ruled that the income earned by the firm was not agricultural income and therefore not eligible for exemption under Section 10. It was held to be taxable as business income.

### Summary Interpretation of Section 2 Clause (1A)

Section 2 clause (1A) defines agricultural income and its interpretation requires several cumulative conditions to be satisfied:

- The land must be located in India.
- The land must be used for agricultural purposes.
- There must be basic and subsequent operations on the land.
- The produce must result from human skill and labour applied to land and must be intended for consumption or trade and commerce.
- The use of controlled environments such as polyhouses or greenhouses does not disqualify the activity from being agricultural, so long as operations connected with land continue to exist.
- Activities conducted in factory-like settings, such as climate-controlled units for mushroom cultivation without any basic operations on land, are treated as manufacturing and do not qualify as agriculture under the Act.

## Button-Mushroom Cultivation

### Market and Classification

Button mushrooms, which account for nearly 85%<sup>5</sup> of India's edible mushroom market, significantly contribute to agricultural income, particularly in states such as Bihar, India's largest producer,<sup>6</sup> Odisha, and Maharashtra. State horticulture departments support farmers, including small landholders, through training, financial aid, and technical assistance, promoting modern

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farming practices. Unlike traditional field crops, button mushrooms are grown in compost beds within enclosed structures.

Income treatment varies; small-scale units may qualify as agricultural income, while large, controlled commercial setups face uncertainty over tax exemptions due to their factory-like nature. Without clear policy guidelines, tax eligibility often depends on judicial interpretation.

### Biological and Cultivation Basics

Button mushrooms (*Agaricus bisporus*) are neither vegetables nor fruits in biological terms. They belong to the fungal kingdom, which is entirely separate from both the plant and animal kingdoms.

Fungi are heterotrophic organisms. They secrete enzymes to break down organic matter, whether dead or living, and absorb the resulting nutrients. Button mushrooms, in particular, are saprophytic fungi, meaning they feed on decaying organic material. In contrast, plants are autotrophic. They use chlorophyll to capture sunlight and convert carbon dioxide and water into sugars through photosynthesis.

## Legal Perspective on Taxation

### Madras High Court Ruling (2025)

On 9 May 2025, in Principal Commissioner of Income Tax vs. M/s British Agro Products (India) Pvt.



Ltd., the Madras High Court ruled that income from button-mushroom cultivation in climate-controlled facilities does not qualify as agricultural income under Section 10(1) of the Income Tax Act, 1961. The assessee claimed exemption, citing Inventaa Industries (2018), but the Revenue argued: (i) mushrooms are fungi, not plants; (ii) cultivation used compost trays, not land; and (iii) industrial features (e.g., depreciation on machinery) suggested manufacturing. The Court, applying the test from CIT vs. Raja Benoy Kumar Sahas Roy (1957), held that the absence of land-based operations disqualified the income, treating it as business income. The biological classification was irrelevant; the lack of land nexus was decisive. The Court rejected Inventaa Industries for insufficiently examining the statutory land requirement, contrasting it with Best Roses Biotech Pvt. Ltd. (ITAT Ahmedabad), where floriculture with 75% soil was deemed agricultural.

### Tax Implications of Modern Farming Techniques

Under Indian tax law, *agricultural income* traditionally hinges on land-based operations like tilling

<sup>5</sup> <https://nhb.gov.in/pdf/Cultivation.pdf>

<sup>6</sup> <https://agriexchange.apeda.gov.in/Production/Indiacat/Index?>

and sowing. Modern soilless methods such as hydroponics and aeroponics challenge this framework, as they eliminate the use of soil entirely. Income from such methods is typically ineligible for exemption under Section 10(1), unless a clear connection to land exists.

This legal debate first surfaced in nursery operations. Courts were divided—some upheld the tax exemption for plants grown in pots, while others denied it due to lack of land use, referencing the Supreme Court's *Raja Benoy Kumar Sahas Roy* ruling, which requires basic and subsequent agricultural operations on land.

To resolve these inconsistencies, Finance Minister P. Chidambaram clarified in the 2008–09 Budget that income from saplings or seedlings grown in a nursery, whether in pots or soil, should be tax-exempt. This led to Explanation 3 to Section 2(1A) of the Income Tax Act, which deems such nursery income to be agricultural, without mentioning soil or land.

This legal fiction must be applied fully, as affirmed in *CIT vs. S. Teja Singh (1959)*. Thus, nursery income from soilless methods like hydroponics may still qualify for exemption, even though the provision predates such technologies. However, the exemption only applies to the nursery phase from seed germination to sapling. Once plants mature (e.g., hydroponic lettuce), the income becomes taxable business income.

This creates a legal grey area:

- Hydroponically sprouted seedlings: Exempt
- Mature crops grown hydroponically: Taxable

Therefore, Explanation 3 is a narrow carve-out for nursery operations, not



a blanket exemption for all soilless agriculture. Entrepreneurs must carefully structure their operations and maintain documentation to remain within this protective legal scope.

While the new Income-tax Act, 2025, maintains the same substantive definition of agricultural income, it introduces a more coherent drafting approach. The provision now consolidates the former explanations within the principal clause, resulting in a cleaner and more integrated formulation.

### Moving Ahead

As Indian agriculture modernizes, tax law remains anchored in land-based definitions of agricultural income. Techniques like hydroponics and controlled-environment farming increasingly fall outside the exemption under Section 10(1), with courts treating such income as business income, especially in factory-style setups like button-mushroom cultivation.

To manage this evolving legal landscape, Agri-entrepreneurs should:

- **Maintain a Land Link:** Design operations to involve soil-based or land-connected cultivation where possible.
- **Document Activities:** Use digital tools (e.g., FarmERP) to track all agricultural processes from land preparation to harvesting.
- **Obtain Licenses:** Secure nursery or horticulture licenses from

state bodies or the NHB to legitimize seedling and soilless operations.

■ **Structure Nurseries Strategically:** Operate nurseries as standalone seedling units to qualify under Explanation 3 to Section 2(1A). For soilless setups, obtain proper licensing and seek clarity through CBDT applications or advance rulings.

■ **Pursue Certifications:** Obtain organic or pesticide-free certifications (e.g., APEDA, NPOP) to reinforce the agricultural nature of your business.

These steps help mitigate tax risk and clarify the classification of income under an increasingly complex framework. Notably, countries like Australia classify hydroponics as business income unless clearly tied to land, highlighting the importance of legal and operational foresight in India's context.

### Key Takeaways

Ultimately, the Income Tax Department is likely to rely on the “British Agro Products” judgment to challenge exemptions for factory-like setups. As such, Agri-tech entrepreneurs must design their businesses with tax clarity in mind. The key takeaway is that the exemption under Section 10(1) hinges not on the type of crop or technology used, but on whether the activity involves genuine, integrated operations on or from land.

Author may be reached at  
harishpaliwal@outlook.com  
and eboard@icai.in