Defining Agricultural Income

THE FINANCIAL WORLD

Chandigarh, Wednesday, January 8, 2003

Query: I am a retired Army officer and running a nursery wherein I am developing fruit plants, flower plants and vegetable plants and selling them on commercial basis. Since I am developing the plants by doing basic operations and later replanting them in pots and selling them. I think that the income earned is agricultural in nature. Please give your opinion.

Opinion: Where agricultural activity is carried out on a land situated in India, the income is eligible for exemption under Section 10 (1). The word agricultural income defined in Section 2 (1A) says that the assessee should derive income from the land used for agricultural purposes. To characterise an income as an agricultural income, there must be basic operations and subsequent operations.

The basic operations are tilling of the land, planting seeds and the subsequent operations will include watering, weeding, manuring of the plants therein. Trees of spontaneous growth will not be treated as agricultural income when they are sold. Similarly, standing crops when sold, the buyer cannot claim the same as an agricultural income.

If you are carrying on the business of nursery of various types of fruit plants, flower plants, vegetable plants and the activities are to prepare seedlings on scientific basis and after a stage when they are transplanted into pots and sold by keeping them in green houses or in shade, there is presence of both basic and subsequent operations and that would characterise the income as agricultural income. [As held in CIT v. Soundarya Nursery (2000) 14 DTC 405 (Mad-HC)

Is loss due to theft of ornaments in money lending business a deductible expense?

Query: I lend money against ornaments pledged by the borrowers. Unfortunately, I have lost gold ornaments worth Rs 68,000 due to theft in my house. The borrower now demands the actual cost of ornaments ie., Rs 68,000 and Rs15,000 for the sentimental value attached to it since they were his khandani ornaments. How do I Proceed? Are these two expenses deductible under Income Tax Act?

Opinion: Section 37 of the Income Tax Act allows expenses wholly, necessarily and exclusively incurred in the course of business by the assesseee. Therefore, the amount ofRs15,000 which you are paying to the borrower for full and final settlement of a transaction during normal course of business is deductible under this provision.

While making good for the cost of the ornaments, you should keep the following in mind:

A loss is not deductible unless it is incurred in carrying out the operation of the business of the assessee and it is incidental there to.

In CIT v. Nainital Bank Ltd. (1966) 62 ITR 638 (SC), it was held that the assessee is eligible to claim only the actual amount paid out by him. Simple adjustment by posting entries in the books of account by writing off the loan against the cost of ornaments would not be proper. Therefore, it is advisable that when you settle things with the borrower, be careful to make the payment separately for the lost ornaments after you separately receive your loan amount with interest thereon. If you do so only, then the expenditure would be deemed expenditure done for protecting and furthering the business of money lending and to enforce its claim to recover the loans advanced, then you can claim this payment as your expense otherwise it shall not be allowed.

Is Pre-incorporation profit taxable ?

Query: Kohinoor foods (P) Ltd. was incorporated on 8-5-2001 and commenced activities in milk products manufacture from that date. The directors of the company entered into certain transactions even before incorporation in the capacity of promoters. The company made a profit of Rs 1,28,000 before the date of incorporation. At the first Board meeting after incorporation, it was decided that the company will accept the transactions made by the promoters and the profit of Rs 1,28,000 was accounted in the company's books. For the year 31-3-2002, the company however claimed that the profit earned before incorporation is not chargeable to tax in its assessment. The Assessing Officer is now contending that it is chargeable to tax as income from other sources. ? Please give your opinion.

Opinion: A company comes into existence only on the date it is incorporated and it could not make profit when it did not exist. The Apex court in CIT v. City Mills Distributors (P) Ltd. (1996) 219 ITR 1 (SC) has held that a company which has not existed when the incomes were earned could not be charged to tax.

The fact that the company or the Board ratifies the action of the promoters and accepts the profit or income will not in any way change the character of income which in effect has not accrued during its existence. Incomes earned before the incorporation of company hence is not chargeable to tax in the assessment of the company.