**Agricultural Tax: What to do and What not do?**
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The issue of agricultural tax has recently gained the spotlight as it does every year in Pakistan especially during the Annual Budget season. We often hear the phrase that "*agriculture sector needs to be taxed*" as it is one of the exempted sectors causing added burden on the other heavily taxed sectors. In this piece, we attempt to explore the do's and don'ts of agricultural taxes in Pakistan, based on different examples from other countries.

For context, in Pakistan, agriculture tax is a provincial subject as per Income Tax Ordinance 2001. Agricultural income is defined as *"rents and revenues derived from land use for agricultural purposes. It even covers income derived from any building in the immediate vicinity of the land to cover poultry farms, livestock sheds, etc".* In most cases, debate has now transcended to *how* agriculture sector should be taxed in Pakistan rather than *if* it should be taxed or not. This seems fair given the sector's contribution to GDP is around 22% and it employs 37% of the population[1]. To balance resource allocation in economy, skewed taxation policies can be detrimental.

Having said so, it is imperative to understand the sensitivity of this sector as it directly impacts the public through food supply and thus inflation. Any quick fix tax policy can lead to negative outcomes, especially for small farmers and for public welfare. Moreover, the sector has serious value chain issues where factors like lack of reliable data, documentation, fragmentation of land, poor infrastructure, outdated records for land valuation, inconsistent methods being used to record sector activities, complex land ownership and rental structures, presence of informal players that make accountability and implementation of tax policies challenging.

Contrary to the popular perception, agriculture sector in Pakistan is subject to taxation though mostly via indirect measures that distort the allocation of resources in economy and hamper sector productivity. (price controls, exchange rate control, output control, heavy government intervention, commodity taxes etc).

On the other hand, direct taxes in agriculture mainly include: land revenue as a tax on land that generates income and wealth tax on agricultural land as immovable asset. As evident from above, there are serious administrative challenges when it comes to collection of direct taxes. Not only this, several distortions and loopholes in the system allow individuals/corporates to avail tax exemptions on agriculture income based on their income from other non-agriculture sources. For the same reason, the definition of agriculture income has been a subject of misuse leading to tax evasion by misreporting income from non-agri-sectors within agriculture. The role of political economy in rural areas cannot be ignored when it enforcement of reforms. Several attempts have been made to address this issue over time but not with much effect.

Granting tax exemptions in agriculture is not just a Pakistan issue. As per data shared by OECD[2](Refer to link for detailed comparisons), there are examples of several countries offering concessions to the

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[1] Pakistan Bureau of Statistics
[2] https://www.oecd-ilibrary.org//sites/073bdf99-en/1/2/1/1/index.html?itemId=/content/publication/073bdf99-en&_csp_=eff68945dd337defc6e9948e27bfdfd6&itemIGO=oecd&itemContentType=book#section-d1e434

agriculture sector. These concessions can be categorized into: Personal, Corporate, Property and Tax on goods and services produced by agriculture sector.

In Pakistan, the topic of imposing taxes on should revolve around how to impose taxes in the best possible manner which offers the right balance between generating revenue and tacking structural issues of the sector. Taking cue from the other countries, there needs to be a clear distinction between the type of taxes and their treatment as those mentioned above especially between tax burden on agri-sector versus taxes on personal income/wealth of landowners and farmers. Moreover, the current tax exemptions based on land area are very generous as majority of the agricultural land in Pakistan is fragmented (small size). Such taxation policies discourage farm consolidation which itself has its own serious negative implications for the agriculture sector.

Other than this, the current taxation system is not just a failure on an implementation level, it lacks the creativity aspect. Tax reforms should focus on targeting the right stakeholders in the value chain to mitigate harmful impact on final consumers.

For instance, countries are not liberal when it comes to concessions for corporate while they are willing to concede in case of small farmers operating on a personal level. This could be a good starting point to distinguish the exemptions granted not just on the basis of land size but farming practices, type and value of crops, technique, owner background, output/produce. Land tax on agriculture in Pakistan is still based on the outdated PIUs[3] and since limited data is available of market values, current estimated value based on the true productive capacity of the agriculture land are not available for taxation.

Pakistan already suffers from land fragmentation and tax reforms should target inheritance/transfer tax in a manner that encourages continuity of farming, ownership within family and consolidation. These concessions/exemptions are built around encouraging families to continue farming and pass it to generations plus not disintegrate it to evade taxes. Canada, Austria, for instance, do not impose any tax on inheritance of agriculture land. Other countries including Japan and Lithuania have linked these concessions to certain pre-conditions including not abandoning farm land, not leaving farmland idle for a long period, tax discounts on soil conservation practices and tax benefits for young farmers. Similarly, many countries have been using thresholds to incentivize the small and large farmers to improve their performance to avail taxation benefits. In Pakistan, there are few generic thresholds based on land size and income which is insufficient at this point. The right question should now be what tax reforms can be introduced to balance the sector and its stakeholders' growth prospects and Government's taxation goals. For instance, redefining agriculture income to exclude rental payment & revenue from orchards, livestock and poultry & developing methods (averaging income to reduce variability, using current values of land for tax) to arrive at true representation of agriculture income[4]. Using structures like Farm REITs can offer a solution to document agriculture land better for taxation purposes, encouraging land consolidation and higher income, in a more transparent manner[5].

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[3] PIU is Produce Index Unit- based on gross value of crop output of a unit of land by soil type. Any two pieces of agri land are in diff locations (revenue circles) are assigned same PIU if they are capable of producing an equal amount of GVCO in a year

[4] Currently it is based on PIU method

[5] https://www.arx.cfa/research/2023/04/soc170423-exploring-the-case-of-farm-reits-in-pakistan?s_cid=smo_ARX23weekly_Investmentproductsandassetclass20230421_tw

It is important to note that any form of tax concession or policy must address sustainability as well. On this front, Pakistan is moving towards solarization of tube wells but fuel concessions are still offered. Subsidies on pesticides/fertilizers are offered to farmers that encourages their use in most cases. Some countries have experimented with tax on water resources (canal, ground water) to manage the limited resources which could be another key area to work on.  Although these are deemed necessary need to be revisited to see the net impact on agriculture produce, farmer's welfare and economy. Despite the interventions, local agriculture productivity is almost at a 50% discount to some other countries[6].

It is safe to say that discussions regarding taxation on agriculture should move beyond sweeping statements and more nuanced to address the sector challenges especially food security and government's fiscal objectives.

[6] Report by Pakistan Business Council, Pakistan Agricultural Council