

## TAXING THE RENTAL INCOME IN AGRICULTURE: ANALYSIS OF ALTERNATE OPTIONS

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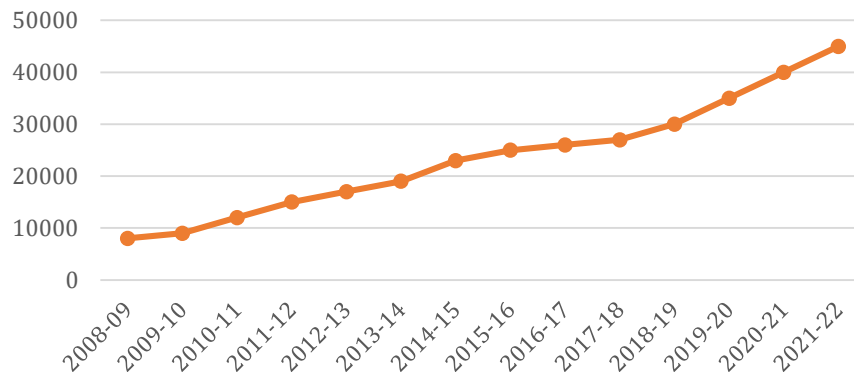
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### INTRODUCTION

Agriculture is a vital sector of Pakistan's economy, which is characterized by highly skewed land distribution as only 2% of large farmers hold 45% of the land. These large landholders dominate land ownership and have better access to off-farm income opportunities, creating a significant disparity with smallholder farmers who struggle to secure additional land for their livelihoods. On the other hand, the trend of leasing out the lands among large landlords is also increasing over time along with land rents (Figure 1).

Absentee landlords have a less personal connection to the ground and the people who work on it and grab the rent. Taxing absentee landlords may provide a better source of revenue for the government, which can be used to fund public services, infrastructure development, and other essential community needs. These imperatives raise the need of a comprehensive agrarian tax reform in developing countries. Thus, developing countries need a comprehensive agricultural income tax system under changing agribusiness structures and land markets.

*Figure 1: Agricultural Land Rent in Punjab (Rs. / acre)*



*Source: Government of Pakistan. 2022. Pakistan economic survey 2021-22.*

Worldwide, there are differential tax systems for agriculture and land rental income. While some countries apply land-based taxes, others prefer to tax income directly. Similarly, agricultural land rents are also considered rental incomes in many tax systems. as Landlords who are absentee—that is, who do not live on or oversee their property—often encounter distinct tax consequences. Due to computation difficulties, taxes on agricultural revenue can be complicated, while land taxes are fixed.

Agriculture taxation in Pakistan has been subject to many challenges for long. So, an improvised

agrarian income tax under different tenancy arrangements and its compliance in Pakistan is of prime importance to ensure wealth redistribution, equitable growth as well and higher tax collections.

Taxation on agricultural income or land varies globally. Some countries levy land taxes, while others opt for income taxes. Land tax is fixed and straightforward, whereas agricultural income tax faces calculation issues. In Egypt, taxes are on land rents, while countries like Chile, Croatia, Australia, and Nepal tax gross agricultural income. Developed countries have a high tax-to-GDP ratio, but in Pakistan, it is just 9.1%, with direct tax contributing 4.3%. In Pakistan, agricultural income taxation falls under the provincial domain and is poorly implemented, generating minimal revenue.

Poor tax collection is due to outdated administrative structures and compliance issues. Tax compliance depends on farmers' knowledge, perception, and attitudes. The Theory of Planned Behavior explains farmers' tax compliance, influenced by attitudes, subjective norms, and perceived control. [Click or tap here to enter text.](#)

In conclusion, the literature emphasizes the multifaceted nature of land rents, leasing decisions, and agricultural taxation. Understanding these dynamics is crucial for fostering equitable relationships between landlords and tenants, promoting sustainable agricultural practices, and establishing effective taxation systems to support rural development. Therefore, the specific objectives of the projects are as follows:

- Investigate the causes of renting land and the possible implications of absentee landlords' land on water management and technology adoption.
- Tax collection estimates under various tenancy arrangements.
- Analyze the farmers' compliance behaviors towards agricultural income tax under various tenancy arrangements.
- Examine the institutional hurdles in agricultural income tax collection.

## METHODOLOGY

This study employs multiple research techniques to meet the objectives and is based on both primary and secondary data sources. The primary data is collected through multistage random sampling process through a well-structured questionnaire in Punjab via Kobocollect. Four districts from Punjab, namely Lodhran (Cotton-Wheat zone), Bhakkar (Low-intensity Punjab), Toba Tek Singh (Mix zone), and Nankana (Rice-Wheat Punjab), were randomly selected, and tenants, sharecroppers, owners, and absentee landlords (relevant) were selected for the interview. From each district, one tehsil and two mouzas were randomly chosen. The total sample of 557 respondents (with 436 farmers (owner, tenant, owner-cum-tenants, and 121 lessors). Different econometrics techniques used such as multinomial logistic regression (renting decision), ordered probit model (of land and water management practices and technology), scenario analysis (tax collection), and logit model (farmers' tax compliance behavior) were employed.

## FINDINGS

The multinomial logistic regression analysis reveals the factors influencing the likelihood of renting land among different categories of farmers in Punjab. A year increase in education and farming experience significantly decreases the likelihood of renting-in land and joint family type, livestock

farming, total cultivated area, tube-well irrigation, and land rent increases the likelihood of renting-in land for owner-cum-tenant category. Education, farming experience, agricultural machinery, and agriculture prices index significantly decrease the likelihood of renting-in land, and distance to market, number of family labor, cultivated area, and tube-well irrigation increase the likelihood of renting-in land for tenant category. Land leasing likelihood is more common in District Nankana Sahib and Lodhran compared to Toba Tek Singh and Bhakkar district.

The results of an ordered probit regression analysis examining the effects of various factors on land and water management practice. In owner-cum-tenant category, age, weather information, and total cultivated area have a significant positive impact, and farming experience, distance to market, and Lodhran district significantly negatively impact land and water management practices. In the tenant category, total cultivated area, documents for govt. subsidy and district Lodhran have a significant positive impact and no variables have a significant negative impact on land and water management practices.

The effect of absentee landlords on the technology adoption of farmers. In owner-cum-tenant category, education, total cultivated area, canal + tube-well irrigation, landlord visit, and documents for govt. subsidy has a significant positive impact on technology adoption. In the tenant category, education, age, and total cultivated area have significant positive impacts while farming experience has a significant negative impact on technology adoption.

The results estimate the tax scenarios under various tax collection regimes. Total tax collection will be Rs. 65.48 billion per year based on flat tax rate estimates without differentiating lessor income (1.2% based on farmers' perceptions). Total tax collection will be Rs. 79.61 billion based on different Taxes on farmers and Property Tax Lessors (Progressive tax on farmers' income and 5% on lessors' incomes).

Simplicity of the procedure, transparency in the tax collection system, tax contribution to society, tax contribution to agri. Sector and responsiveness of the policies towards farming problems are those factors which can enhance the tax collection. Similarly, there behavioral factors dissatisfaction with the governance system, indirect taxes in agriculture, and poor agri. Services have a negative impact on the compliance behavior of farmers. In owner-cum-tenant category, tax contribution to the agriculture sector and education has significant positive impacts while the perception that govt. wastes tax money has a negative impact on the compliance behavior of farmers. In the tenant category, respondents with long term land contracts, improved profitability from crops, provision of civic amenities in the area also have significant positive impact on compliance to the tax system.

Three focus group discussions were held in May 2024 in Nankana Sahib, Lodhran, and Bhakkar with farmers, and tax authorities. These reveal that young people move away from rural areas with better access to amenities and off-farm income while using their rental income for consumption. Farmers are already paying land-based tax through the village 'Numberdar'. The provision of formal receipt of the tax amount would improve their trust in the tax collection system. Abiana (water tax) is paid by tenants while land-based tax (if applies) is paid by landlords. Long-term secure formalized land tenure arrangements will encourage farmers to make investments in land and water management. Uncertainty in input and output markets discourages farmers from paying agricultural income tax. Local tax authorities are of the view that income-based tax is a better option compared to land-based tax. Lack of cooperation among various government departments (revenue department, land record authority, and agri. Department) hinders tax collection.

## CONCLUSION

The increasing number of absentee landlords and tenants lack a personal connection to their land and workers, leading to short-term thinking and a focus on quick wins rather than sustainable practices. Effective taxation of absentee landlords could generate significant government revenue, promoting equitable growth and improving public services.

Results of analysis reflected that farmers living away from urban areas and with family labor tend to rent in the land. Similarly, farmers having livestock also tend to rent-in land. The likelihood of renting in land in low-intensity districts like Bhakkar is higher than other districts owing to more surplus land available with large landholders. Canal-irrigated areas have better land retention likelihood as compared to tubewell or arid areas. Interestingly, absentee landlords who frequently visit their land and provide support to tenants to acquire government subsidies and bank loans have a significant positive effect on the technology adoption of the farmers.

Currently, Punjab province generates around Rs. 2.5 billion against the target of Rs. 4.5 billion through land-based tax on agriculture. However, converting to progressive income-based agricultural tax AIT could raise the tax collection to Rs. 65 billion and further implementing 5%<sup>1</sup> tax on lessors' income may generate an extra 14 billion rupees (Rs. 79.61 billion in total).

Tax compliance behavior of the farmers is positively influenced by the satisfaction toward tax authorities, transparency in collection process, access to the government authorities and tax system knowledge. However, the perception that there are huge indirect taxes on agriculture reduces the farmers' compliance behavior. Similarly, the perception of poor agricultural services also decreases tax compliance behavior. Study shows that the centuries-old patwari system is an important institutional hurdle in income-based agriculture tax.

## POLICY RECOMMENDATION

Land leasing arrangements have significant effects on agricultural productivity as these affect land-based investments, especially investments in land structure improvement and high-efficiency irrigation. Negative effects of leasing arrangements can be minimized through formal leasing agreements for a specified longer time period. There is a need to regulate the land leasing agreements by promoting long-term land leases.

Historical evidence suggests that a high percentage of large farmers have opted for leasing out their agricultural lands and switching their livelihoods in urban centers. These enjoy the rental income without the imposition of property rental taxes as they declare the income from agriculture source. There is a need to re-design the agri. Taxation tools especially for the farmers who have leased out their lands and are earning rental income. Our analysis showed that considering the agricultural leasing income as rental income and subjecting such income to the property tax regime would enhance the agricultural income tax collection to Rs. 79 billion.

Building the capacity of the provincial tax authorities and bringing transparency in the agriculture income tax estimation and collection would build the confidence of the farmers in the tax regime. Bringing in digitalization and IoT tools would improve efficiency in the tax system.

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<sup>1</sup> 7.5 % of the annual tax is imposed on residential rented property in Punjab.