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BA Economics Honours | Semester 1 | Calicut University

Basics of Income Tax

Course Code: ECO1VN101 • Module 1

Module I: Introduction to Income Tax

Direct taxation constitutes the fiscal cornerstone of sovereign statecraft, mobilizing essential financial resources for public administration, infrastructural development, and socio-economic equity. In India, direct taxation is governed primarily by the **Income Tax Act, 1961**, administered by the Central Board of Direct Taxes (CBDT) under the Department of Revenue, Ministry of Finance. Understanding foundational statutory concepts, historical evolutions, and residency determinations is essential for comprehending the Indian fiscal framework.

Unit 1 & 2: Purpose, Constitutional Framework, and Historical Evolution

Income tax in modern India was first introduced in 1860 by Sir James Wilson (India's first Finance Member under British rule) to overcome the fiscal deficit caused by the military expenditures of the 1857 uprising. Following successive enactments, the current comprehensive codification—the **Income Tax Act, 1961**—came into statutory force on 1 April 1962, extending across the entire territory of India.

Under Entry 82 of List I (Union List) in the Seventh Schedule to the Constitution of India, Parliament possesses exclusive legislative power to levy *"Taxes on income other than agricultural income."* Entry 46 of List II (State List) reserves the taxation of agricultural income exclusively to State Legislatures. Each year, Parliament enacts the **Finance Act** following the presentation of the Union Budget, amending tax rates, deduction ceilings, and compliance rules.

Core Statutory Definitions under the Income Tax Act

- **Person (Section 2(31)):** The term "person" is the foundational legal entity subject to tax liability, encompassing:
  1. An Individual (natural human being).
  2. A Hindu Undivided Family (HUF).
  3. A Company (domestic or foreign corporate enterprise).
  4. A Firm (including a Limited Liability Partnership - LLP).
  5. An Association of Persons (AOP) or Body of Individuals (BOI), whether incorporated or not.
  6. A Local Authority (municipal corporations, district panchayats).
  7. Every Artificial Juridical Person not falling within any of the preceding categories.
- **Assessee (Section 2(7)):** Every person by whom any tax, interest, penalty, or other sum of money is payable under the Act. It includes deemed assessees (legal representatives of deceased persons) and assessees-in-default.
- **Assessment Year (AY) (Section 2(9)):** The twelve-month statutory financial period commencing on **1 April and ending on 31 March** immediately succeeding the Previous Year. Income earned during the Previous Year is assessed and taxed during the corresponding Assessment Year (e.g., income earned in PY 2023–24 is assessed in AY 2024–25).
- **Previous Year (PY) (Section 3):** The financial year immediately preceding the Assessment Year in which income is actually earned. For a newly established business, the previous year commences on the date of setting up the business and terminates on the subsequent 31 March.
- **Gross Total Income (GTI) (Section 80B(5)):** The aggregate sum of taxable income computed under the five statutory heads of income, before making any deductions permissible under Chapter VI-A (Sections 80C to 80U).

- **Total Income (Taxable Income) (Section 2(45)):** The net amount of income arrived at after subtracting all eligible Chapter VI-A deductions from Gross Total Income ($TI = GTI - \text{Deductions}$). Tax liability is calculated strictly on Total Income, rounded off to the nearest multiple of ten rupees under Section 288A.
- **Agricultural Income (Section 2(1A)):** Any rent or revenue derived from land situated in India and used for agricultural purposes, income derived from agriculture (tillage, cultivation, harvesting), and income from farm buildings directly connected to agricultural land. Under Section 10(1), agricultural income is 100% exempt from Central income tax, though it is integrated for rate-determination purposes for individual assessees earning non-agricultural income (partial integration method).

Unit 3 & 4: Residential Status of an Individual (Section 6)

Tax liability under the Income Tax Act is determined not by citizenship or nationality, but strictly by the **residential status** of the assessee during the relevant Previous Year. The residential status of an individual is categorized into three classes based on physical presence in India:

1. Basic Conditions for Determining "Resident" Status (Section 6(1))

An individual is deemed to be a **Resident in India** during a previous year if they satisfy *at least one* of the following two basic conditions:

- **Condition (a):** The individual is in India for a period or periods amounting in all to **182 days or more** during the relevant Previous Year; OR
- **Condition (b):** The individual is in India for a period or periods amounting in all to **60 days or more** during the relevant Previous Year, AND for **365 days or more** across the 4 preceding Previous Years. (Note: For Indian citizens leaving India for overseas employment or as crew members of an Indian ship, and Indian citizens/PIOs visiting India, the 60-day threshold is extended to 182 days, or 120 days if total Indian income exceeds ₹15 Lakhs).

An individual who satisfies neither basic condition is classified as a **Non-Resident (NR)**.

2. Additional Conditions for Determining "Ordinarily Resident" (Section 6(6))

A resident individual is classified as a **Resident and Ordinarily Resident (ROR)** if they satisfy *both* of the following additional conditions:

1. They have been a resident of India in at least **2 out of the 10 preceding Previous Years**; AND
2. They have been physically present in India for an aggregate of **730 days or more** during the 7 preceding Previous Years.

A resident who fails to satisfy both additional conditions is classified as a **Resident but Not Ordinarily Resident (RNOR)**.

Scope of Total Income Based on Residential Status (Section 5)

Nature / Source of Income	Resident & Ordinarily Resident (ROR)	Resident but Not Ordinarily Resident (RNOR)	Non-Resident (NR)
Income received or deemed to be received in India	Taxable in India	Taxable in India	Taxable in India

Nature / Source of Income	Resident & Ordinarily Resident (ROR)	Resident but Not Ordinarily Resident (RNOR)	Non-Resident (NR)
Income accruing or arising (or deemed to accrue) in India	Taxable in India	Taxable in India	Taxable in India
Income accruing and received outside India from a business controlled from or profession set up in India	Taxable in India	Taxable in India	Not Taxable in India
Income accruing and received outside India from any other source (pure foreign income)	Taxable in India (Global Income)	Not Taxable in India	Not Taxable in India

Advanced Theoretical Formulations and Empirical Frameworks (Analytical Division 1)

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Empirical Methodology, Identification Strategies, and Econometric Estimation

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Consider the structural estimation of policy impacts across decentralized economic agents. When evaluating macroeconomic interventions or microeconomic regulatory changes, parameters estimated from observational datasets must account for expectations formation and structural parameter stability in accordance with the Lucas Critique. Consequently, contemporary applied economics bridges micro-foundations with aggregate macroeconomic phenomena through dynamic stochastic general equilibrium (DSGE) modeling and micro-econometric panel estimations.

Comparative Institutional Analysis, Market Failures, and Policy Governance

Economic outcomes are fundamentally mediated by institutional architectures, legal property rights regimes, and regulatory governance. In emerging market economies such as India, market imperfections—including asymmetric information, transaction costs, infrastructural bottlenecks, and credit constraints—often necessitate nuanced policy interventions that differ substantially from textbook laissez-faire predictions.

Analytical Dimension	Orthodox / Classical Perspective	Heterodox / Institutional Framework	Empirical Policy Manifestations in India
Market Efficiency	Markets clear instantaneously; price mechanism allocates	Markets are prone to structural failures, information asymmetry, and	Targeted regulatory oversight, public investment in

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	resources optimally without systemic friction.	coordination coordination failures.	infrastructure, and social safety nets.
Behavioral Motivation	Hyper-rational agents maximizing expected utility with complete cognitive computational capacity.	Bounded rationality, behavioral heuristics, loss aversion, and institutional anchoring effects.	Choice architecture, behavioral nudges (NITI Aayog initiatives), and consumer financial protection mandates.
State Intervention	State role restricted to core public goods, contract enforcement, and national defense (minimalist state).	State acts as developmental catalyst, risk-absorber of last resort, and promoter of equitable distribution.	Strategic industrial policy (PLI schemes), counter-cyclical fiscal intervention, and universal public services.
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Comprehensive Empirical Analysis: The Kerala Model and Sub-National Development

In the context of the Indian economy and sub-national development paradigms, the Kerala Model of Development provides a seminal empirical case study illustrating the complex trade-offs between social development and economic growth. Characterized by high physical quality of life indicators—including near-universal adult literacy, high life expectancy, and low infant mortality rates comparable to advanced Western economies—achieved despite historically modest per capita state domestic product, Kerala demonstrates the transformative power of public social expenditure, agrarian land reforms, and decentralized local governance (Panchayati Raj institutions).

However, contemporary economic analysis also highlights structural challenges confronting this development paradigm: high educated unemployment, fiscal constraints stemming from escalating public debt servicing and pension obligations, and heavy reliance on external remittance inflows from migrant workers in the Persian Gulf. Sustaining this high-welfare equilibrium necessitates transitioning toward a knowledge-driven economy, incentivizing high-tech manufacturing, and mobilizing sustainable sub-national fiscal resources.

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