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BA Economics Honours | Semester 1 | Calicut University

Basics of Income Tax

Course Code: ECO1VN101 • Module 2

Module II: Income Tax Calculation

Under Section 14 of the Income Tax Act, 1961, all income for the purpose of charge of income tax and computation of total income is methodically classified under **Five Statutory Heads of Income**. Each head possesses distinct statutory rules, permissible standard deductions, and specific charging sections.

Unit 6: The Five Heads of Income

1. Income from Salaries (Sections 15 to 17)

The charging Section 15 taxes any remuneration, wage, annuity, pension, gratuity, fee, commission, or perquisite received by an individual under an explicit *employer-employee relationship*. Key computation rules include:

- **Gross Salary:** Basic salary + Dearness Allowance (DA) + Bonuses + Taxable allowances (House Rent Allowance HRA u/s 10(13A), Children Education Allowance) + Taxable value of perquisites (rent-free accommodation, company car u/s 17(2)).
- **Standard Deduction (Section 16(ia)):** A flat statutory deduction of **₹50,000** (expanded to ₹75,000 under the New Tax Regime in Budget 2024) is allowed from gross salary without requiring production of expense receipts.
- **Entertainment Allowance (Section 16(ii)) & Professional Tax (Section 16(iii)):** Permissible deductions from gross salary.

2. Income from House Property (Sections 22 to 27)

Section 22 taxes the annual value of property consisting of any buildings or lands appurtenant thereto, of which the assessee is the owner, provided the property is not occupied for the assessee's own business or profession.

- **Gross Annual Value (GAV):** Higher of Municipal Value and Fair Rental Value (capped by Standard Rent under Rent Control Act), compared with Actual Rent Received.
- **Net Annual Value (NAV):**

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>
> $$NAV = GAV - \text{Municipal Taxes paid by Owner}$$

- **Deductions under Section 24:**
  1. *Statutory Standard Deduction (Section 24(a)):* A flat **30% of NAV** is deducted for repairs and maintenance.
  2. *Interest on Housing Borrowed Capital (Section 24(b)):* Deduction up to **₹200,000** per annum for self-occupied residential property (actual interest without cap for let-out property).

3. Profits and Gains of Business or Profession (PGBP) (Sections 28 to 44DB)

Section 28 taxes income derived from any trade, commerce, manufacturing, or professional vocation carried on by the assessee during the previous year. Taxable profit is computed in accordance with commercial accounting principles adjusted for statutory tax rules:

- *Allowable Expenses:* Rent, rates, taxes, repairs, insurance for premises (Sec 30-31), Depreciation on block of assets on Written Down Value (WDV) method (Sec 32), scientific research expenditures (Sec 35), and general commercial expenditures incurred wholly and exclusively for business purposes (Sec 37).
- *Presumptive Taxation Schemes:* Section 44AD (for eligible small businesses with turnover up to ₹2–3 Crore, presuming 6%–8% profit), Section 44ADA (for specified professionals with receipts up to ₹50–75 Lakhs, presuming 50% profit), eliminating the cumbersome requirement to maintain detailed books of accounts.

4. Capital Gains (Sections 45 to 55A)

Section 45 taxes any profit or gain arising from the transfer of a **Capital Asset** (equity shares, mutual funds, immovable property, gold jewelry). Capital gains are partitioned into two types:

- **Short-Term Capital Gains (STCG):** Gains arising from transfer of assets held for less than the statutory holding threshold (e.g., 12 months for listed equities, 24 months for immovable real estate). STCG on listed equities subject to STT is taxed at concessional rates u/s 111A.
- **Long-Term Capital Gains (LTCG):** Gains from assets held beyond the statutory period. LTCG on listed equities u/s 112A is taxed at 12.5% for gains exceeding ₹1.25 Lakh per annum. LTCG on real estate is taxed u/s 112. Tax exemptions are available under Sections 54, 54EC, and 54F for reinvesting capital gains into residential houses or designated infrastructure bonds.

5. Income from Other Sources (Sections 56 to 59)

The residuary head of income. Any taxable income that cannot legally be classified under the first four heads is taxed under Section 56: dividend income from corporate shares, bank savings interest, fixed deposit interest, lottery and gambling winnings (taxed at flat 30% u/s 115BB), family pensions, and gifts exceeding ₹50,000 received from non-relatives.

Unit 7: Deductions under Chapter VI-A (Sections 80C to 80U)

From Gross Total Income, individual assessees can claim deductions to calculate Total Income (under the Old Tax Regime):

- **Section 80C:** Deduction up to **₹150,000** for specified investments: Employees' Provident Fund (EPF), Public Provident Fund (PPF), National Savings Certificates (NSC), life insurance premiums, Equity Linked Savings Schemes (ELSS), tuition fees for up to two children, and repayment of housing loan principal.
- **Section 80CCD(1B):** Additional deduction up to **₹50,000** exclusively for voluntary contributions to the National Pension System (NPS).
- **Section 80D:** Medical insurance premiums: up to ₹25,000 for self and family, and an additional ₹25,000 (₹50,000 if senior citizen) for parents.
- **Section 80E:** Full interest paid on loans taken for higher education (allowed for 8 consecutive assessment years without an upper monetary ceiling).
- **Section 80G:** Donations to approved charitable institutions and relief funds (PM-CARES, National Defense Fund).
- **Section 80TTA / 80TTB:** Deduction up to ₹10,000 for savings bank interest (up to ₹50,000 for senior citizens covering all bank/post office interest u/s 80TTB).
- **Section 80U:** Fixed deduction of ₹75,000 (₹125,000 for severe disability $\geq 80\%$) for a resident individual certified with a disability.

Unit 8 & 9: Tax Regimes and Rebate under Section 87A

Assessees can select between two competing taxation regimes:

- **Old Tax Regime:** Retains standard progressive slabs (5%, 20%, 30%) with full eligibility for all Chapter VI-A deductions and exemptions (80C, 80D, HRA, home loan interest).
- **New Tax Regime (Section 115BAC):** The default regime offering lower, simplified tax slab rates, but requiring forfeiture of most deductions (except standard deduction of ₹75,000 and employer NPS contribution u/s 80CCD(2)).
- **Rebate under Section 87A:** Under the New Regime, assessees with Total Income up to **₹700,000** receive a 100% tax rebate up to ₹25,000, effectively rendering income up to ₹700,000 completely tax-free! Under the Old Regime, the 87A rebate caps at ₹12,500 for total income up to ₹500,000.
- **Health and Education Cess:** A mandatory **4% cess** is added onto the calculated income tax plus surcharge across all taxpayers.

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Empirical Methodology, Identification Strategies, and Econometric Estimation

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

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	mechanism allocates resources optimally without systemic friction.	information asymmetry, and 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.
Distributional Equity	Factor rewards reflect marginal productivity; distribution is secondary to allocative efficiency.	Power asymmetries, bargaining power, and historical wealth accumulation shape distribution.	Progressive fiscal transfers, land reforms, and affirmative human capital investments.
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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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Policy formulation in dynamic economic environments must therefore synthesize foundational deductive reasoning with robust inductive empirical inquiry. Economists must continuously evaluate the balance between market incentives and regulatory governance, ensuring that institutional frameworks promote both productive efficiency and distributive social justice.

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