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BA Economics Honours | Semester 3 | Calicut University

Tax Policy in India

Course Code: ECO3MN201 • Module 2

Module II: Direct Taxes in India

Direct taxes constitute the progressive pillar of Indian public finance. In recent financial years, direct tax collections have surpassed indirect tax collections, reflecting structural economic formalization, expanded digital surveillance, and progressive broadening of the direct taxpayer base. This module examines the Income Tax Act, corporate tax regimes, and landmark structural administrative reforms.

Unit 5, 6 & 7: The Income Tax Act, 1961 and Modern Computation Rules

Under the Income Tax Act, 1961, individual tax liability is computed on **Total Income** ($TI = \text{Gross Total Income} - \text{Chapter VI-A Deductions}$). The structural landscape of personal income taxation in India underwent a monumental transformation through the introduction of the dual regime architecture:

1. The Old Tax Regime

Retains the traditional progressive three-tier slab structure:

- Up to ₹250,000: Nil.
- ₹250,001 to ₹500,000: 5% (with 100% tax rebate u/s 87A up to ₹500,000).
- ₹500,001 to ₹1,000,000: 20%.
- Above ₹1,000,000: 30%.

Taxpayers retain full statutory eligibility to claim extensive exemptions and deductions: House Rent Allowance (HRA u/s 10(13A)), Leave Travel Concession (LTC), standard deduction on salary (₹50,000), housing loan interest (₹200,000 u/s 24(b)), Chapter VI-A deductions: Section 80C (₹150,000), 80D (health insurance), 80CCD(1B) (NPS ₹50,000), and 80TTA.

2. The New Tax Regime (Section 115BAC)

Introduced in Budget 2020 and established as the **Default Tax Regime** in Budget 2023. The New Regime offers substantially lower, finely graduated tax slab rates in exchange for the forfeiture of approximately 70 itemized deductions and exemptions (including 80C, 80D, and HRA):

- Up to ₹300,000: Nil.
- ₹300,001 to ₹700,000: 5%.
- ₹700,001 to ₹1,000,000: 10%.
- ₹1,000,001 to ₹1,200,000: 15%.
- ₹1,200,001 to ₹1,500,000: 20%.
- Above ₹1,500,000: 30%.

Crucial Rebate Provision: Under Section 87A, resident individuals with Total Income up to **₹700,000** receive a 100% tax rebate (up to ₹25,000), rendering income up to ₹700,000 completely tax-free! Furthermore, Budget 2024 expanded the Standard Deduction for salaried taxpayers under the New Regime to **₹75,000**, ensuring salaried employees earning up to ₹775,000 pay zero income tax.

Unit 8: Corporate Tax in India

Corporate Income Tax (CIT) is levied directly on the net taxable profits earned by registered corporate business enterprises during the previous financial year:

- **The Historic September 2019 Corporate Tax Reforms:** Prior to 2019, India's statutory corporate tax rate was among the highest in emerging Asia (averaging ~35% including surcharges), deterring multinational manufacturing investment. Via the Taxation Laws (Amendment) Act, 2019, the government slashed corporate tax rates:
  - *Section 115BAA:* Existing domestic corporate enterprises were granted the statutory option to pay tax at a flat rate of **22%** (effective rate ~25.17% inclusive of surcharge and cess), provided they forfeit sector-specific tax holidays and profit-linked deductions. Over 80% of corporate profits migrated to this regime.
  - *Section 115BAB:* Newly incorporated domestic manufacturing companies commencing commercial production before designated deadlines were offered an ultra-competitive global tax rate of **15%** (effective rate ~17.16%), aligning India with Singapore and Vietnam to attract global supply chain relocation.
- **Minimum Alternate Tax (MAT - Section 115JB):** Introduced historically to tax "zero-tax companies"—highly profitable corporations that paid zero corporate tax by aggressively claiming accelerated depreciation and statutory exemptions. MAT is levied at 15% on the "Book Profits" of the company if normal corporate tax liability falls below 15% of book profits. (Companies opting under Section 115BAA/115BAB are permanently exempted from MAT).

Unit 9: Direct Tax Administration Reforms: The Faceless Architecture

To eliminate administrative corruption, reduce compliance harassment, and enhance citizen trust, the Income Tax Department engineered the **Transparent Taxation Platform (2020)**:

- **National Faceless Assessment Centre (NFAC):** Replaced geographic jurisdiction with an automated, algorithm-driven central hub. Scrutiny cases are assigned dynamically across the nation to assessment units using artificial intelligence, with zero physical interface between taxpayer and tax officer.
- **Faceless Appeals and Taxpayers' Charter:** Statutory recognition of taxpayer rights (fair, courteous treatment, privacy, and timely resolution) alongside faceless appellate hearings before CIT (Appeals).
- **Annual Information Statement (AIS) and Form 26AS:** A comprehensive financial statement displaying all high-value financial transactions (stock trades, mutual fund purchases, foreign remittances, real estate deals, credit card spending) captured by the tax department's automated algorithms, making concealment of income virtually impossible.

Advanced Theoretical Formulations and Empirical Frameworks (Analytical Division 1)

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Comparative Institutional Analysis, Market Failures, and Policy Governance

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Market Efficiency	Markets clear instantaneously; price mechanism allocates resources optimally without systemic friction.	Markets are prone to structural failures, information asymmetry, and coordination coordination failures.	Targeted regulatory oversight, public investment in 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.

Policy Synthesis and Analytical Evaluation

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