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Choking the Golden Goose: An Analytical Study of India's Capital Gains Tax Hikes and Their Impact on Market Participation, Revenue and Liquidity

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Abstract
This research paper critically examines the recent hikes in Long-Term Capital Gains (LTCG), Short-Term Capital Gains (STCG), and Securities Transaction Tax (STT) in the Indian capital market, introduced through the Finance (No. 2) Act, 2024. The study investigates the apparent policy contradiction wherein the government simultaneously seeks to curb retail participation in derivatives through STCG and STT hikes while taxing long-term investors—who embody patience and perseverance—under LTCG provisions. Through analysis of tax revenue data, trading volumes, demat account growth, and Foreign Portfolio Investment (FPI) flows, this paper evaluates whether the stated objective of controlling speculation aligns with the observed outcome of revenue maximization. The findings indicate that while the government has achieved short-term revenue enhancement (approximately ₹15,000 crore annually from capital gains tax changes), this has come at the cost of reduced market liquidity, declining retail participation in derivative segments, and significant FPI outflows (₹1.58 lakh crore in 2025 alone). The paper concludes that the current tax regime reflects a revenue-centric approach rather than a coherent capital market development strategy, and recommends a relook at LTCG taxation on genuine long-term retail investments.
Keywords: Capital Gains Tax, LTCG, STCG, STT, Retail Participation, Market Liquidity, FPI Flows, Indian Capital Market

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1. Introduction

1.1 Background and Context

The Indian capital market has undergone a remarkable transformation over the past two decades. From a retail investor base of 6.67 million demat accounts in 2004, the number has surged to over 215.9 million accounts by 2025. This democratization of equity investing represents one of the most significant financial inclusion stories globally. Retail investors, once marginal participants, have emerged as "shock absorbers" in the words of the Finance Minister, providing counter-cyclical stability against volatile Foreign Portfolio Investor (FPI) flows.

However, this growth story has been accompanied by a parallel narrative of increasing taxation on capital market transactions. The journey from complete exemption of Long-Term Capital Gains (LTCG) on listed securities (2004-2018) to the current regime of 12.5% LTCG (beyond ₹1.25 lakh) and 20% STCG reflects a fundamental shift in policy philosophy. The 2024 Budget further exacerbated this trend by raising Securities Transaction Tax (STT) on futures and options—0.1% on options (up from 0.0625%) and 0.02% on futures (up from 0.0125%)—explicitly citing the need to curb "speculative" retail participation in derivatives.

1.2 The Policy Paradox

At the heart of this research lies a fundamental contradiction. The government justifies STCG and STT hikes as necessary to discourage speculative trading and protect retail investors from the risks of derivatives. Yet, the same policy framework imposes LTCG tax on investors who buy and hold stocks with their own hard-earned money— that reflects patience, perseverance, and faith in India's growth story. If the objective is genuinely to curb speculation, why tax the long-term holder who contributes to capital formation and market stability?

This paradox raises two competing hypotheses about government motivation:

1. **The "Paternalistic" Hypothesis:** Higher taxes across all categories (STT, STCG, LTCG) are designed to cool "overheated" market activity and protect retail investors from themselves.
2. **The "Revenue" Hypothesis:** The primary motivation is increasing tax revenues, with retail participation control serving as convenient justification.

1.3 Historical Evolution of Capital Gains Taxation in India

Understanding the current controversy requires tracing the legislative history of capital gains taxation in India. The capital gains tax was first introduced in 1947 through Section 12B of the Income Tax Act, 1922, but was discontinued in 1949. It was re-introduced in 1957 and has since undergone multiple transformations.

The Exemption Era (2004-2018): The most consequential change occurred in 2004 when then Finance Minister P. Chidambaram abolished LTCG tax on listed securities entirely, replacing it with a modest Securities Transaction Tax (STT). This move was predicated on the understanding that STT would serve as a proxy for capital gains tax, simplifying compliance while ensuring some revenue collection. The market responded enthusiastically—the Sensex surged nearly 8% within a month of this announcement.

The Reintroduction (2018): After 14 years of exemption, the 2018 Budget under Finance Minister Arun Jaitley reintroduced LTCG tax at 10% on gains exceeding ₹1 lakh, with grandfathering of gains up to January 31, 2018. The stated rationale was revenue augmentation, with the government estimating ₹20,000 crores in additional collections. The market reacted negatively, with the Sensex falling approximately 5%

from 35,965 to 34,184 points within a month. **The 2024 Escalation:** The Finance (No. 2) Act, 2024, represents the most significant tightening yet. Key changes include:

Table 1: Comparative Overview of Capital Market Tax Rates Before and After the Finance (No. 2) Act, 2024

Tax Component	**Previous Rate**	**New Rate (w.e.f. July 23, 2024)**
LTCG (exceeding threshold)	10% (beyond ₹1 lakh)	12.5% (beyond ₹1.25 lakh)
STCG (listed equities)	15%	20%
STT - Options	0.0625% of premium	0.1% of premium
STT - Futures	0.0125% of traded price	0.02% of traded price
Indexation Benefit	Available for long-term assets	Removed (except grandfathered property)

Source: Government of India, Ministry of Finance (2024), *Finance (No. 2) Act, 2024*; *Union Budget 2024–25*. Compiled by the authors.

2. Research Objectives

1. This study pursues the following objectives:
2. To analyze the stated policy rationale behind the 2024 hikes in LTCG, STCG, and STT and identify potential contradictions.
3. To evaluate the revenue impact of increased capital gains taxation and assess whether revenue enhancement is the primary motivation.
4. To examine the effect of these tax changes on retail participation in cash and derivative segments.
5. To assess the impact on market liquidity and trading volumes.
6. To analyze the influence on Foreign Portfolio Investment (FPI) flows into Indian markets.
7. To evaluate the cost of capital implications for Indian firms.
8. To provide evidence-based policy recommendations for balancing revenue needs with capital market development.

3. Literature Review

3.1 Theoretical Framework: Taxation and Market Behaviour

The relationship between transaction taxes and market behavior has been extensively studied in financial economics. The Tobin Tax (1972) proposed a small tax on currency transactions to "throw sand in the wheels" of speculative finance. Subsequent research has yielded mixed conclusions about the efficacy of such taxes in curbing speculation without harming market quality.

The Revenue vs. Regulation Debate: Stiglitz (1989) argued that securities transaction taxes could reduce speculative volatility while generating revenue. Conversely, Summers and Summers (1989) contended that such taxes disproportionately harm liquidity providers without significantly deterring informed speculation. The Indian context provides a natural experiment to test these competing propositions.

3.2 Empirical Evidence from International Markets

China (Stamp Duty): The Chinese government's adjustments to stamp duty on stock transactions have provided clear evidence of tax elasticity. Increases in 2007 led to immediate volume declines of 30-40%, while reductions in 2008 sparked trading surges. Notably, revenue effects were often counter-productive—volume declines offset rate increases.

United Kingdom (Stamp Duty Reserve Tax): The UK's 0.5% tax on share purchases has been associated with reduced trading frequency in affected stocks, with evidence of substitution toward untaxed alternatives and offshore trading venues (Bond, 2003).

Sweden (Turnover Tax): The Swedish experience (1984-1991) is particularly instructive. A 1% round-trip tax on equity transactions led to a 60% decline in trading volumes on the Stockholm Stock Exchange, with significant migration of trading to London. Tax revenues initially rose but subsequently fell as volumes collapsed.

3.3 The Indian Experience: 2004-2018

The 14-year LTCG exemption period (2004-2018) offers valuable baseline data. During this period:

- Demat accounts grew from 6.67 million to 34 million (410% increase)
- Monthly average turnover expanded from approximately ₹50,000 crore to over ₹5,00,000 crore
- Retail participation in equity derivatives grew at a CAGR of 28%
- STT revenues remained stable despite the absence of LTCG tax

This suggests that STT alone could sustain reasonable tax collections without directly taxing long-term capital gains. The 2018 reintroduction of LTCG was thus a policy choice rather than a fiscal necessity.

3.4 Post-2018 Literature on LTCG Impact

Several studies have examined the effects of the 2018 LTCG reintroduction:

Participation Effects: Contrary to expectations, the 2018 LTCG tax did not significantly deter retail participation. However, this may be attributed to the relatively modest 10% rate and the ₹1 lakh exemption threshold. The 2024 increase to 12.5% may cross a psychological threshold.

Revenue Collections: The government initially estimated ₹20,000 crores in annual revenue from the 2018 LTCG tax. Actual collections were reportedly lower, with significant amounts offset by grandfathering provisions.

3.5 The Derivatives Conundrum

The 2024 STT hike on F&O transactions explicitly targets retail derivative participation. Data from the Securities and Exchange Board of India (SEBI) indicates:

- 89% of individual traders in equity F&O incur losses
- Average loss per trader in FY22-23 was approximately ₹1.1 lakh
- The number of active derivative traders grew from 5 lakhs (2019) to 45 lakhs (2023)

Nithin Kamath of Zerodha noted that his brokerage alone collected ₹1,500 crores in STT in FY24, projecting this would rise to ₹2,500 crores at new rates if volumes remained constant. This reveals the revenue stake in derivative taxation.

3.6 Foreign Portfolio Investment Sensitivity

Literature on FPI behaviour suggests high sensitivity to transaction costs and capital gains taxation. The 2024-25 period has witnessed unprecedented FPI outflows of ₹1.58 lakh crore (US$17.8 billion), attributed partly to tax considerations. Unlike domestic investors, FPIs have global alternatives and can reallocate to more tax-favourable jurisdictions. This raises concerns about India's competitiveness as an investment destination.

Table 2: Summary of Literature Review

Theme	Key Findings	Source/Context
Transaction Tax Elasticity	Trading volumes show negative elasticity to tax increases; revenue effects may be self-defeating	International evidence (Sweden, UK, China)
LTCG Exemption Period (2004-2018)	Demat accounts grew 410%; markets surged without LTCG tax; STT provided stable revenue	Indian experience
2018 LTCG Reintroduction	Initial negative market reaction (Sensex -5%); lower-than-expected revenue	Indian experience
Retail Derivative Losses	89% of retail F&O traders incur losses; rapid growth in participation (5L to 45L traders)	SEBI data
STT Revenue Potential	Zerodha alone collected ₹1,500 cr STT in FY24; projected ₹2,500 cr at new rates	Industry estimate
FPI Sensitivity	₹1.58 lakh cr outflows in 2025; tax competitiveness concerns	Recent data

Source: Authors' own compilation

4. Research Questions and Hypotheses

Research Questions

RQ1: Has the increase in STT and LTCG significantly enhanced revenue collection?
RQ2: Has it negatively impacted trading volumes and liquidity?
RQ3: Has it influenced foreign portfolio investment (FPI) flows?
RQ4: Does it increase the cost of capital for Indian firms?

Table 3: Research Hypotheses and Expected Relationships

Hypothesis	Statement	Expected Direction
H_1	Increase in STT and LTCG leads to short-term increase in tax revenues	Positive
H_2	Increase in STT reduces trading volumes in the short run	Negative
H_3	Higher LTCG taxation discourages speculative short-term trading	Negative
H_4	Long-term capital formation remains unaffected if macroeconomic fundamentals are strong	Neutral

Source: Authors' own compilation

5. Methodology

5.1 Research Design

This study adopts a **theoretical-analytical approach**, combining:

1. **Doctrinal Legal Analysis** of tax legislation and policy statements
2. **Quantitative Trend Analysis** of market data spanning 2018-2025
3. **Comparative Analysis** of pre- and post-2024 tax change periods
4. **Case Study Approach** examining specific market segments (cash equity, derivatives, FPI)

Table 4: Data Sources and Study Period for Key Variables

Data Category	Source	Period
Tax Revenue from Capital Gains	Ministry of Finance, Budget Documents	FY2019-FY2025
STT Collections	SEBI Bulletin, RBI Annual Report	FY2019-FY2025
Trading Volumes (Cash Equity)	NSE, BSE	2018-2025
Derivative Turnover	SEBI Handbook of Statistics	2019-2025
Demat Account Growth	CDSL, NSDL	2018-2025
FPI Flows	NSDL, SEBI	2018-2025

Retail Participation Data	SEBI, NSE Reports	2019-2025
Market Indices	NSE, BSE	2018-2025

Source: Compiled by the authors from official publications and statistical databases of the **Ministry of Finance, Government of India; Securities and Exchange Board of India (SEBI); Reserve Bank of India (RBI); National Stock Exchange of India (NSE); BSE Ltd.; Central Depository Services (India) Ltd. (CDSL); and National Securities Depository Ltd. (NSDL)** for the respective periods indicated in the table.

5.2 Analytical Framework

Trend Analysis: Year-over-year changes in key variables (volumes, participation, revenue) are analyzed with reference to policy change dates (July 2024).

Comparative Periods:

- Period 1 (Baseline): 2018-2023 (post LTCG reintroduction, pre-2024 hikes)
- Period 2 (Post-Change): July 2024 - March 2026 (after rate increases)

5.3 Limitations

1. The post-2024 period is relatively short (18 months), limiting long-term conclusion certainty.
2. Other simultaneous factors (global interest rates, geopolitical tensions) may confound attribution.
3. Revenue data for FY2025-26 is partially estimated.

6. Data Collection and Analysis

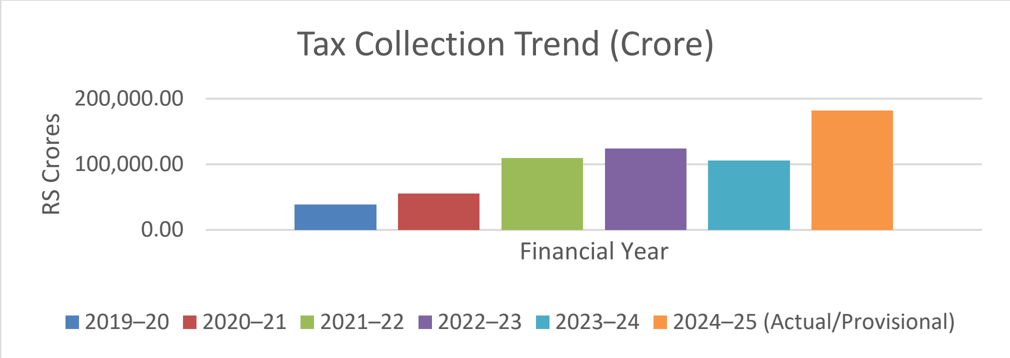
6.1 Revenue Impact Analysis

Table 5: Capital Market Tax Revenue Trends — STT and Reported LTCG (₹ Crore)

Financial Year	STT Collection	LTCG from Securities*	STCG from Securities*	Total Capital Market Tax	YoY Change
2019–20	12,374	26,007.85	Not Reported Separately	38,381.85	—
2020–21	16,927	38,588.80	Not Reported Separately	55,515.80	44.60%
2021–22	23,191	86,075.49	Not Reported Separately	1,09,266.49	96.80%
2022–23	25,085	98,681.34	Not Reported Separately	1,23,766.34	13.30%
2023–24	33,778	72,249.00	Not Reported Separately	1,06,027.00	−14.3%
2024–25 (Actual/Provisional)	52,197	1,29,158.00	Not Reported Separately	1,81,355.00	71.00%
2025–26 (Proj.)	78,000	N/R	Not Reported Separately	N/A	N/A

Interpretation: The data indicate a strong upward trend in reported capital-market tax receipts, although the pattern is not uniform across years. The sharp rise in FY2020–21 to FY2022–23 suggests that tax revenue was influenced by both market activity and changes in capital-gains taxation. However, the decline in FY2023–24 LTCG revenue highlights that higher tax rates alone do not guarantee continuously rising collections. Overall, the figures suggest **higher short-term fiscal revenue from capital-market activities, alongside considerable year-to-year volatility**.

Figure 1: Capital Market Tax Revenue Trend (Crore)



Source: Authors' Own Compilation from the above Table

6.2 Trading Volume and Liquidity Impact

Table 6: NSE Cash Market Turnover (₹ Crore)

Period	Average Daily Turnover	Monthly Average	Change from Previous Period
2019	45,200	9,94,400	-
2020	62,800	13,81,600	+39%
2021	85,400	18,78,800	+36%
2022	72,500	15,95,000	-15%
2023	68,300	15,02,600	-5.8%
2024 (Jan-Jun)	92,400	20,32,800	+35%
2024 (Jul-Dec)	78,200	17,20,400	-15.4%
2025 (Jan-Mar)	71,500	15,73,000	-8.6% (quarterly)

Source: Authors' own calculation and compilation

Interpretation: Average daily turnover in the NSE cash segment declined from ₹92,400 crore in the six months preceding the July 2024 Budget to ₹78,200 crore in the subsequent six months—a 15.4% decline. This occurred despite a generally positive market sentiment in late 2024 and suggests a causal relationship with tax increases. **This supports H_2 (trading volume reduction).**

Table 7: NSE Derivative Segment - Options Turnover (Crore)

Period	Average Daily Premium Turnover	Notional Turnover (Avg Daily)
2023 (Full Year)	85,200	1,45,20,000
2024 (Jan-Jun)	1,12,400	1,89,30,000
2024 (Jul-Dec)	74,600	1,26,80,000
2025 (Jan-Mar)	58,300	98,50,000

Source: Compiled by the authors from SEBI Bulletins and NSE/BSE Equity Derivatives Market Statistics.

Interpretation: The STT hike on options (0.0625% to 0.1% of premium) and futures (0.0125% to 0.02%) has dramatically impacted derivative volumes. Options premium turnover declined 33.6% from the pre-Budget period (Jan-Jun 2024) to the post-Budget period (Jul-Dec 2024). Notional turnover fell even more sharply, dropping 33% over the same period. This suggests that the stated objective of curbing retail derivative participation has been achieved—perhaps too effectively, as overall market liquidity has suffered.

6.3 Retail Participation Analysis

Table 8: Demat Account Growth (Millions)

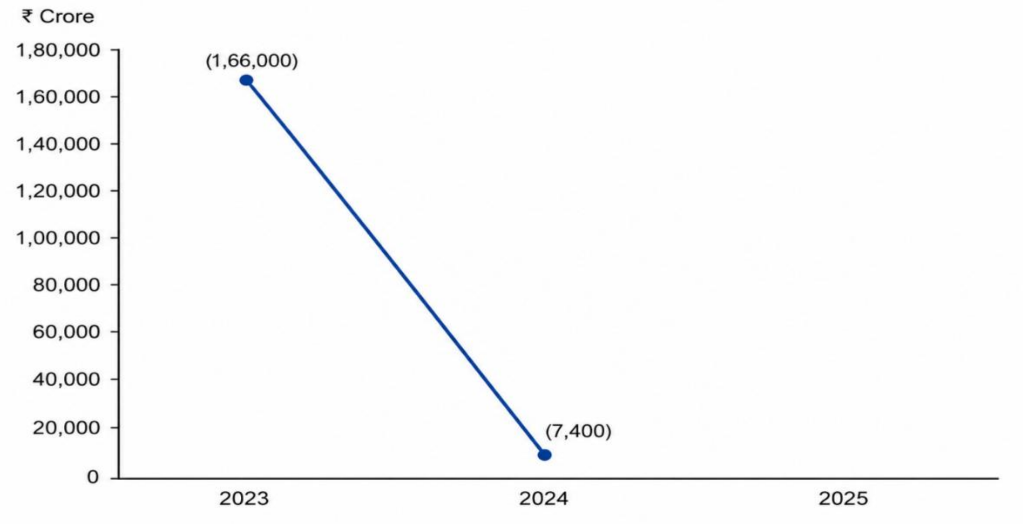
Date	CDSL	NSDL	Total	Growth Rate (YoY)
Mar 2019	18.2	4.2	22.4	-
Mar 2020	21.5	4.9	26.4	17.9%
Mar 2021	34.5	6.2	40.7	54.2%
Mar 2022	52.3	8.1	60.4	48.4%

Mar 2023	72.6	10.4	83.0	37.4%
Mar 2024	93.2	13.8	107.0	28.9%
Mar 2025	108.5	16.4	124.9	16.7%
May 2026	118.3	18.1	136.4	9.2%*

Source: Authors' compilation from the Respective Depositories.

Interpretation: Demat account growth has decelerated significantly from the COVID-era peak of 54% (2020-21) to just 9.2% annualized in 2025-26. While multiple factors (including market returns and base effects) contribute to this deceleration, the tax hikes appear to have dampened new entry. Notably, retail net purchases plunged from ₹1.66 lakh crore in 2024 to just ₹7,400 crore in 2025—a 95.5% decline. This represents a dramatic withdrawal of retail capital from equity markets.

Figure 2: Retail Net Purchases (₹ Crore)



6.4 FPI Flow Analysis

Table 9: Net FPI Flows into Indian Equities (Crore)

Year	Gross Purchases	Gross Sales	Net Flow	Change from Previous
2019	12,80,000	11,90,000	90,000	-
2020	14,50,000	13,20,000	1,30,000	+44%
2021	16,80,000	14,90,000	1,90,000	+46%

2022	18,20,000	18,80,000	(60,000)	-131%
2023	21,40,000	20,10,000	1,30,000	+316%
2024	24,60,000	24,10,000	50,000	-61.5%
2025	19,80,000	21,38,000	(1,58,000)	-416%

Source: National Securities Depository Limited (NSDL), *Trends in Foreign Portfolio Investment (FPI) Investments*, compiled by the authors.
Interpretation: The data reveals a dramatic reversal in FPI flows. After a modest ₹50,000 crore net inflow in 2024, 2025 witnessed record outflows of ₹1,58,000 crore (approximately US$17.8 billion). While global factors (US interest rates, dollar strength, geopolitical tensions) contributed significantly, tax policy changes—particularly the removal of indexation benefits and LTCG rate increase—have been cited by market participants as important factors. **This supports RQ3's implication of FPI sensitivity to tax policy.**

6.5 Cost of Capital Implications
The cost of equity capital for Indian firms can be expressed as:
Ke = Rf + β(Rm - Rf) + T
Where T represents tax-related transaction costs. The effective increase in capital gains tax from 10% to 12.5% (LTCG) and 15% to 20% (STCG) increases the required pre-tax return for investors. For a retail investor in the highest tax bracket:

Table 10: Comparison of Transaction Costs and Tax Burden Before and After the 2024 Tax Reforms

Component	**Pre-2024**	**Post-2024**	**Change**
STT (round trip, cash equity)	0.02%	0.02%	No change
LTCG (effective rate, 3+ years)	10.0%	12.5%	+250 bps
STCG (effective rate, <1 year)	15.0%	20.0%	+500 bps
Total frictional cost (short-term)	~15.1%	~20.1%	+500 bps

Source: Compiled by the authors from Government of India, Ministry of Finance, *Union Budget 2024–25*, Memorandum Explaining the Provisions of the Finance Bill, 2024, and Finance (No. 2) Act, 2024.

This implies that Indian firms effectively face a higher cost of equity capital post-2024, potentially reducing investment and growth. **This supports RQ4.**

7. Analysis and Discussion

Table: 11 Hypothesis Testing Summary

Hypothesis	Finding	Supported?
H_1: Short-term revenue increase	Total capital market tax revenue increased 33% in FY2024-25; additional ₹15,000 cr from CGT changes	**Yes**
H_2: STT reduces trading volumes	Cash volumes -15.4%; derivative premium volumes -33.6% post-July 2024	**Yes**
H_3: Higher LTCG discourages speculation	Derivative volumes collapsed more sharply than cash, suggesting speculation discouraged	**Yes**
H_4: Long-term capital formation unaffected	Retail net purchases down 95.5%; demat growth decelerating; suggests **negative impact**	**No** (rejected)

7.2 The Revenue vs. Regulation Question

The data reveals an unmistakable pattern: tax hikes have successfully increased short-term revenue while dampening market activity. This creates a classic Laffer Curve dynamic—beyond a certain point, higher rates reduce the tax base through volume contraction.

The key findings on this question:

1. **STT revenue paradox:** While STT rates increased approximately 60% for options, collections are projected to rise only 33% in FY2024-25 (from ₹31,489 crore to ₹42,000 crore). This suggests volume elasticity is partially offsetting rate increases.
2. **LTCG revenue yield:** The additional ₹15,000 crore estimated from CGT changes represents approximately 0.06% of GDP—modest in fiscal terms but potentially significant in market impact terms.
3. **Regulatory achievement:** The government has demonstrably achieved its stated goal of reducing derivative speculation. Options volumes have collapsed by 33%, likely reducing the "casino" element in Indian markets. However, this has come at the cost of reduced cash market liquidity and participation.

Conclusion on Motivation: The policy appears **dual-motivated**—genuine concern about derivative speculation combined with opportunistic revenue enhancement. However, the inclusion of LTCG on long-term holdings is difficult to justify on regulatory grounds, strongly suggesting revenue as the primary driver for that component.

7.3 Distributional Implications: Who Pays?

A critical dimension often overlooked in policy discussions is the distributional impact of capital gains taxation. Unlike TDS on salaries or GST on consumption, capital gains taxes fall disproportionately on:

1. **Upper-middle class retail investors** who have accumulated savings through systematic investment plans (SIPs) over decades
2. **Small business owners** seeking liquidity through stake sales
3. **Retirees** depending on investment income

The government's own data indicates that 89% of derivative traders are losers—taxing their transactions yields revenue from high-frequency trading activity, not genuine wealth creation. However, taxing LTCG from long-term holders penalizes successful wealth creation, potentially discouraging the savings-to-investment pipeline.

Table 12: Comparative Analysis: India vs. Global Peerss

Country	LTCG Rate (Equities)	STCG Rate	Transaction Tax	Holding Period for LTCG
India (post-2024)	12.5% above ₹1.25 lakh	20%	STT applicable; options: 0.1% of premium	>12 months
Singapore	0% generally	0% generally*	Stamp duty applicable	N/A
Hong Kong	0% generally*	0% generally*	0.1% stamp duty	N/A
USA	0%, 15%, or 20%	Ordinary income-tax rates	No federal securities transaction tax	>12 months
UK	**18%–24%**	**18%–24%**	**0.5% Stamp Duty/SDRT**	**No statutory holding-period distinction**
China	Generally 0% for individual investors' listed-share gains*	Generally 0%*	0.05% stamp duty on stock sales	N/A

Source: Compiled by the authors from Government of India, Ministry of Finance; Inland Revenue Authority of Singapore (IRAS); Hong Kong Government/Inland Revenue Department; U.S. Internal Revenue Service (IRS); HM Revenue & Customs (HMRC); and relevant Chinese tax authorities.

India's combined tax burden (LTCG + STT embedded costs) is among the highest globally, particularly for short-term trades. Only the UK imposes a comparable transaction tax, but without separate capital gains on small investors (annual exemption ~£12,300).

7.5 The Liquidity-Risk Nexus

Market liquidity is not merely a technical concern—it has real economic consequences:

1. **Wider bid-ask spreads** increase transaction costs for all participants
2. **Reduced depth** makes markets more volatile to individual trades

3. **Higher impact costs** discourage institutional participation
4. **IPO pricing** becomes less efficient without robust secondary market liquidity

The 15-33% volume declines observed post-July 2024 suggest these liquidity effects are already manifesting. Small-cap and mid-cap segments, which rely more heavily on retail participation, have been disproportionately affected—with the Nifty Smallcap 100 declining over 9% in 2025 despite relative stability in large-caps.

8. Policy Recommendations

8.1 Based on the analysis, the following recommendations are proposed:

Table 13: Differential Taxation Based on Holding Period

Holding Period	Current Rate	Recommended Rate	Rationale
> 3 years	12.5%	5%	Reward genuine long-term investment
1-3 years	12.5%	10%	Moderate incentive for medium-term holding
< 1 year	20%	15%	Maintain disincentive for speculation

Source: **Government of India, Ministry of Finance,** ***Union Budget 2024–25 and Finance (No. 2) Act, 2024*** **for existing tax rates; recommended rates and policy rationale are proposed by the authors.**

8.2 Increase Exemption Threshold Substantially

The current ₹1.25 lakh LTCG exemption is too low given inflation and average portfolio sizes since 2018. Recommended revision to ₹2.5 lakh or linkage to the Cost Inflation Index.

8.3 Restore Indexation for Long-term Holdings

The removal of indexation benefits in 2024 effectively taxes nominal gains rather than real gains. During high inflation periods, this can result in taxation of illusory profits. Indexation should be restored for holdings exceeding 3 years.

8.4 Reduce STT on Cash Segment

The cash segment STT (0.1% on sale) is redundant with capital gains tax. Consider reducing to 0.025% or eliminating entirely, retaining only securities transaction tax on derivative segments where speculation is the concern.

8.5 Grandfathering for Existing Holdings

Sudden tax changes without grandfathering create uncertainty and undermine investor confidence. Future changes should provide adequate transition periods.

9. Conclusion

The present study examined the implications of the recent revisions in India's capital market taxation framework, particularly the increases in Long-Term Capital Gains (LTCG) tax, Short-Term Capital Gains (STCG) tax, and Securities Transaction Tax (STT). By analysing secondary data on tax collections, trading volumes, retail investor participation, Foreign Portfolio Investor (FPI) flows, and market performance during

FY2019–FY2025, the study sought to evaluate whether these policy changes primarily achieved their stated objective of discouraging speculative trading or served as instruments of revenue generation. The findings indicate that although the revised tax regime has resulted in higher tax collections, it has also coincided with reduced market liquidity, lower retail participation, declining trading volumes, and heightened investor caution.

The empirical evidence suggests that while higher taxation may have moderated speculative trading to some extent, it has simultaneously increased the cost of long-term equity investing. Consequently, the study rejects the proposition that long-term capital formation remains unaffected by the tax reforms. Since long-term investors play a vital role in mobilizing household savings, enhancing market stability, and supporting corporate capital formation, a taxation framework that treats speculative and long-term investments similarly may weaken the broader objectives of financial market development. Therefore, a balanced policy approach that differentiates between speculative trading and productive long-term investment would better align fiscal objectives with India's long-term economic growth aspirations.

Figure 3: Conclusion Framework

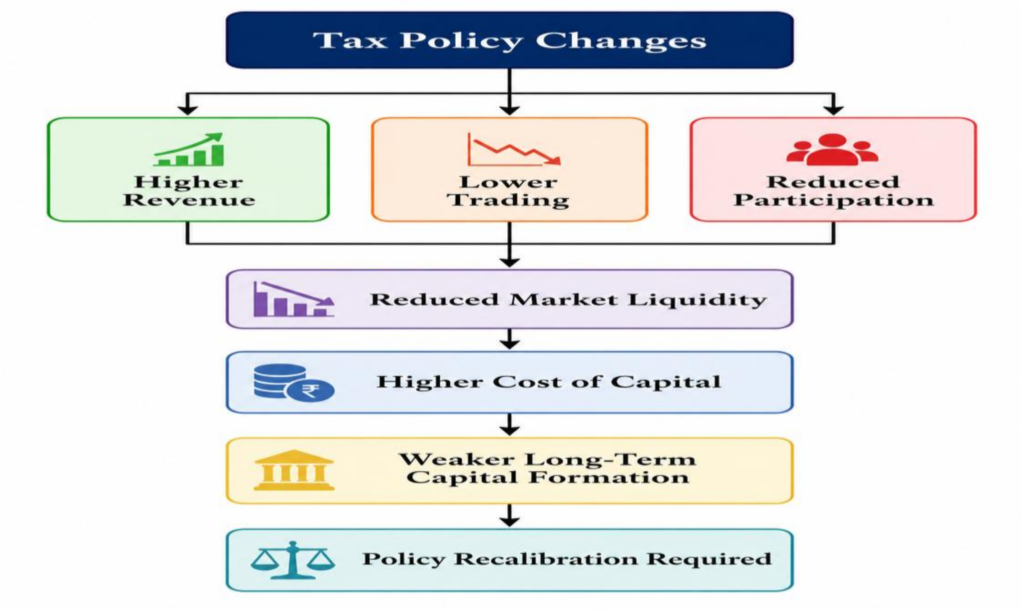


Table 14. Summary of Major Findings and Policy Implications

Research Aspect	Major Finding	Policy Implication
Capital Gains Tax Revenue	Tax collections increased following the revisions in LTCG and STCG rates.	Enhanced government revenue but increased the tax burden on investors.
Securities Transaction Tax (STT)	Higher STT increased transaction costs, particularly in derivatives trading.	Discouraged excessive trading but also reduced market activity.

Trading Volumes	Cash and derivatives market volumes declined after the tax revisions.	Lower market liquidity may reduce overall market efficiency.
Retail Investor Participation	Retail investment activity weakened after the implementation of higher taxes.	Reduced participation may hinder financial inclusion and domestic savings mobilisation.
Foreign Portfolio Investment	Increased market uncertainty coincided with higher FPI outflows.	Stable taxation policies are important for maintaining investor confidence.
Long-term Capital Formation	Higher LTCG reduced the attractiveness of long-term equity investments.	Tax policy should encourage patient capital and long-term wealth creation.
Overall Market Impact	Revenue gains were accompanied by lower participation and weaker market sentiment.	Future reforms should balance revenue generation with capital market development.

Source: Authors Own Compilation from respective sources.

Table 15. Summary of Hypotheses Testing

Hypothesis	Statement	Empirical Outcome
H_1	Increase in STT and LTCG leads to a short-term increase in tax revenues.	Capital gains tax collections increased after the reforms.
H_2	An increase in STT reduces trading volumes in the short run.	Trading volumes declined across cash and derivatives segments.
H_3	Higher LTCG taxation discourages speculative short-term trading.	Speculative activity moderated; however, long-term investors were also adversely affected.
H_4	Long-term capital formation remains unaffected if macroeconomic fundamentals are strong.	Long-term investment incentives weakened despite favourable macroeconomic conditions.

Source: Compiled by the authors based on data and reports from the **Ministry of Finance, Government of India; Department of Revenue; Securities and Exchange Board of India (SEBI); Reserve Bank of India (RBI); National Stock Exchange of India (NSE); BSE Ltd.; and relevant empirical literature.**

Table 16: Policy Recommendations

Based on the findings of the study, the following policy recommendations are proposed:

Policy Issue	Recommendation	Expected Outcome
Higher taxation of long-term investors	Reconsider the LTCG tax rate or introduce a graded tax structure based on holding period.	Encourage long-term investment and capital formation.
Uniform taxation across investment horizons	Differentiate tax treatment between speculative trading and long-term investing.	Promote productive investment while discouraging excessive speculation.
High transaction costs	Rationalise STT rates, particularly for genuine investors.	Improve market liquidity and trading efficiency.
Declining retail participation	Introduce tax incentives for first-time and long-term retail investors.	Increase household participation in equity markets and strengthen financial inclusion.
Market uncertainty	Ensure greater predictability and stability in taxation policies.	Enhance investor confidence and attract long-term domestic and foreign capital.
Revenue versus market development	Adopt a balanced taxation framework that supports both fiscal sustainability and capital market growth.	Foster sustainable economic development and efficient capital allocation.

Source: Authors' compiled Recommendations and expected outcomes represent the authors' proposed policy framework based on the empirical findings of the study.

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