For more equity: on long-term capital gains tax

The Centre’s decision to bring back the **long-term capital gains tax** (LTCG) on equities, which was scrapped in 2004-05, seems to be a hasty move to plug the widening fiscal deficit ahead of an election year. With investors in equities enjoying terrific returns over the last few years, it is not a surprise that they have become targets for the government to secure additional revenue. The decision to announce the imposition of 10% tax on gains of over 1 lakh made on any form of investment in listed equities and mutual funds with a holding period of over one year will hit the average middle class investor. Not surprisingly, the sharp fall in both the Nifty and the Sensex after Budget day has been linked to the new tax, along with the government’s abandonment of fiscal goals. But given that the sell-off was part of a wider correction in global stock indices, it may be hard to draw a definite conclusion on the **exact impact of the LTCG**. The Centre has justified the new tax arguing that it helps avoid the erosion of its tax base and levels the playing field between financial assets and investment in manufacturing.

One legitimate concern is whether raising the tax burden on equities, rather than lowering the tax and other barriers to investing in alternative assets, is the right way to address the distortionary effect of taxes. Further, the smaller differential between short and long-term capital gains tax itself will discourage the long-term holding of stocks in favour of short-term trading activity. While this might serve to improve liquidity in Indian markets and add to the government’s revenue, it is also likely to discourage to some extent the growing culture of investing in equities for the long run. Besides, the securities transaction tax (STT), which was introduced in lieu of the LTCG in 2004 and penalises the buying of stocks for purposes other than just intra-day trading, has been left untouched by the government. The double whammy of the STT and LTCG will further privilege short-term trading in stocks over long-term investment. Being the only country in the world to impose both the STT and LTCG, India is also likely to become a little less attractive to foreign investors when compared to its peers. A complete rollback of the new tax is too much to expect — Finance Secretary Hasmukh Adhia has justified the higher tax levy saying that the capital gains accrue from zero effort. Despite the constraints, the government would do well to at least soften the negative impact of the new tax by allowing indexation (allowing a set-off based on inflation rate) of capital gains and removing the STT on equity investments. Tough love for the well-off is not a bad strategy for a pre-election Budget, but it is important to be careful about maintaining India’s credibility in the global money markets in the process.

The draft of Assam’s National Register of Citizens is a first step, but it opens up concerns

END