Indian Economy · GS - III

Discuss how changes in capital gains taxation can influence foreign portfolio investment, domestic investors and India's financial markets.

EXAM YEAR	PAPER	SUBJECT
DAILY PRACTICE 02/11/2026	GS - III	Indian Economy

MARKS	WORD LIMIT
10	~150 words

Answer Hint

FPI flows; capital gains taxation; market competitiveness; tax revenue; investor confidence; fiscal policy trade-offs

Model Answer

Introduction

Capital gains taxation influences the post-tax returns earned by investors. Changes in such taxation can affect investment decisions, financial market liquidity and government revenue.

Potential Benefits of Tax Relief

1. Foreign investment: Lower taxes may improve the attractiveness of Indian equities relative to competing markets and potentially moderate capital outflows.

2. Market liquidity: Greater portfolio investment can support trading activity, market depth and access to capital for businesses.

3. Domestic investors: Appropriate tax treatment of eligible mutual fund switches may improve investment flexibility, subject to safeguards against tax avoidance.

Concerns and Trade-offs

1. Revenue implications: Reducing capital gains taxes may lower government revenue, depending on the behavioural response of investors.

2. Equity considerations: Tax concessions for certain investor groups can raise concerns about fairness between domestic and foreign investors or among different income groups.

3. Market volatility: Foreign portfolio flows can respond rapidly to global interest rates, currency movements and geopolitical developments. Tax relief alone cannot guarantee stable inflows.

Way Forward

Tax policy should be evaluated using evidence on investment flows, revenue effects and distributional consequences. Regulatory recommendations, including those from SEBI, should be assessed alongside fiscal priorities and market stability.

Conclusion

A predictable and balanced tax framework can support investment and competitiveness while protecting revenue needs and maintaining fairness.

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