Quote by Shravan Shetty- Managing Director, Primus Partners

Published in Money Control
Mar 05, 2025| 09:09 AM IST

Tweak LTCG structure if cutting rates not an option, say experts

Authored by Srushti Vaidya & Zoya Springwala

Read on: https://www.moneycontrol.com/news/business/markets/tweak-ltcg-structure-if-cutting-rates-not-an-option-say-experts-12956575.html

Article Content:

Market participants say that while the government may not be in favour of rolling back a tax levy as they might lose out on a revenue source, at least the structure can be reviewed so that the impact is minimised.

The clamour for a review of the long-term capital gains tax is getting louder with each passing day as investors reel under heavy losses amidst the ongoing corrections with a large section of market participants feeling that the attractiveness of the Indian markets is reducing due to timid returns and tax burdens among other things.

This assumes significance as India is one of the very few markets globally that levy a tax on foreign investors on the gains that they make in the Indian stock markets.

Market participants say that while the government may not be in favour of rolling back a tax levy as they might lose out on a revenue source, at least the structure can be reviewed so that the impact is minimised.

“I am of the firm opinion that government should scrap LTCG, not only on the foreign investors, even Indian investors also, but obviously they will not do that because they want revenue. But… you should elongate the holding period. Rather than the one-year period, you can make it 2-3 years and then scrap the taxes in any way,” said Devarsh Vakil, Head of Prime Research, HDFC Securities.

Last year while presenting the Union Budget, finance minister Nirmala Sitharaman announced a hike in capital gains tax rates. While the short term capital gains tax rate was increased from 15 percent to 20 percent, tax on long term capital gains was hiked from 10 percent to 12.5 percent. Profits booked within a year qualify as short-term gains.

“You don't generate that much revenue out of the long-term capital gain tax. And in such years, you are anyway not going to earn a lot of money because a lot of portfolios are already into deep losses. So, anyway, you are not going to get any revenue from capital gain tax,” adds Vakil.

Interestingly, when the hike in LTCG and STCG rates was announced last year, many in the market made representations seeking a rollback of the tax increases. But given the then liquidity-driven rally, the issue got factored in the market as investors were seeing hefty gains in their portfolio value.

Recently, Samir Arora of Helios Capital was very vocal in criticising the government on tax rates especially for foreign institutional investors (FIIs), terming it a "huge mistake".

"The biggest mistake they've made, and the one they need to accept, is the imposition of capital gains tax, especially on foreign investors. It is completely wrong," Arora said while speaking at a conference organised by Business Standard.

In a similar context, Divaspati Singh, Partner, Khaitan and Co, says that tax burdens coupled with the current downswings returns has made India unattractive for foreign investors.

"Timid returns, excerpted with regulatory complexities and tax burdens has reduced the attractiveness of Indian equity markets for foreign investors," he says.

"Also, global hedge funds face a tax problem when investing in India. Firstly, most prominent jurisdictions do not tax offshore investors. Even the current regime has double tax issues. When an investor in a hedge fund wants to withdraw their money, the fund sells some of its investments to pay them. Normally, the fund allocates the un-allocated tax liability to the investor by adjusting the NAV. Now, if a US investor pays tax on their investments in India, they should ideally get a credit for that amount when they file taxes in the US. However, since the tax has only been allocated and not actually paid (which would happen when the asset is sold eventually), there is a double whammy for the investor. As a result, the investor can't claim a tax credit in the US and ends up effectively paying tax on the same gains in both countries," explains Singh.

A mere tax reduction could be seen as insufficient if other regulatory barriers or uncertainties remain, said Rahul Charkha, Partner at Economic Laws Practice. "FIIs are looking for regulatory stability, ease of doing business, and structural reforms that improve the overall investment climate. FIIs are also concerned with other taxation aspects such as dividend distribution taxes and interest rates on repatriation of funds," Charkha added.

Interestingly, when Securities Transaction Tax (STT) was introduced way back in 2004, it was believed that LTCG and STCG would be completely done away but the exact opposite has happened.

"The idea is that when you introduce STT… it was in a tacit understanding that eventually we will do away with capital gain tax. But as we know, in any part of the world, once you introduce a tax, it is very difficult to remove it. Government will not remove those taxes… The expectation is that they will not do anything out of it. They will do certain measures, which will make life easier for foreigners to bring in capital," says Vakil.

Experts also highlight the fact that the government needs to understand that India needs long-term growth capital and at a time when many sovereign and pension funds are looking to invest in the country, a friendly tax regime could act as a big booster.

"India has traditionally looked at FIIs as large institutions investing in India. But over the last few years it's being dominated by sovereign and pension funds hence we believe India needs to change its stance and look at promoting investment. India does need long-term capital to grow at above 7% and hence there is a need to both simplify process of investments and reduce taxation," says Shravan Shetty, Managing Director, Primus Partners.

According to Shetty, a cut in LTCG rates would definitely help in attracting foreign flows especially at a time when rupee is depreciating and the interest rates in US have pulled down the differential returns compared to previous years.

To make India an attractive destination and to attract long-term capital it is important to reduce LTCG, he says.