The tax transition India needs

The Budget should consider moving to a residence-based tax regime, exempting foreign investors from long-term capital gains tax

ANANTH NARAYAN

For years, our government has propelled the economy with its focus on infrastructure investments. However, for sustainable public debt and sustained capital formation, the investment baton must pass on to the private sector.

This requires a conducive, competitive, and stable tax regime that treats capital as a partner, not a target.

The quest for expertise

When a global major invests in a semiconductor fab, an artificial intelligence (AI) data centre or electronics assembly under the Production Linked Incentive (PLI) scheme, it brings patented processes, integration into global supply chains, research and development, and other specialised skills that can drive future growth. Fostering investment, therefore, remains a top national priority.

Global investment, particularly in AI, remains resilient. Yet, net foreign investments into India have struggled. While gross foreign direct investment (FDI) inflows are robust, high repatriation has weakened net FDI. Net Foreign Portfolio Investment (FPI) flows have also disappointed. In a competitive global context, we aren't giving capital enough reasons to stay.

Despite manageable current account deficits by historical standards, weak net capital flows have also pressured India's external balance.

The withholding irritant

While several issues impact foreign flows, the elephant in the tax office is the withholding tax on capital gains.

Major jurisdictions adopt the Organisation of Economic Cooperation and Development-recommended residence-based taxation, under which any capital gains tax incidence arises only in the investor's home jurisdiction. However, India follows source-based taxation. Despite treaties between India and other countries, many investors therefore see India as a taxation outlier, with legal uncertainties, upfront withholding, and friction in obtaining tax credits.

Taxes withheld in India are a drag for investors exempt from capital gains taxes in their country. In other cases, FPIs struggle to get credit for Indian taxes because our withholding categories do not map onto their own tax credit regimes. Finally, computing gains in rupee terms amid rupee depreciation adds significantly to their drag.

To compete for global savings and attract investment, the upcoming Budget should consider moving to a residence-based tax regime, exempting foreign investors from long-term capital gains (LTCG) tax in India.

If such a blanket move were to raise fears of misuse by some, we could at least start with investors identified under the recently introduced SWAGAT-FI (Single Window Automatic and Generalised Access for Trusted Foreign Investors) framework. Comprising objectively identified institutions like sovereign wealth funds and regulated public retail funds, SWAGAT-FI potentially covers over 70 per cent of FPI assets under management. While adding to complexity, such an approach could provide risk-based tax relief to major investors.

The government could then consider a calibrated increase in the Securities Transaction Tax (STT) for some segments for revenue compensation, without penalising patient, long-term investors. The STT was originally designed as an alternative to LTCG tax.

In the wake of the Tiger Global Supreme Court judgment, researchers Ajay Shah and Renuka Sane have also argued for a residence-based tax regime. Durably adopting this, in line with global best practice, should help attract and retain global savings.

Asset-agnostic domestic reform

Alongside, we must address issues faced by domestic investors. The current tax framework interferes with risk-based asset allocation. By taxing equity LTCG lower than fixed income, we are telling retirees: "Take more risk than your appetite allows, or watch inflation eat your principal."

Taxing interest without indexation is not an income tax – it is a wealth tax. For a senior citizen living on fixed income returns, a 6 per cent interest rate amid 5 per cent inflation yields a 1 per cent real return. Taxing that 6 per cent interest at a 30 per cent slab rate leaves the investor with a negative real return, even before expenses. Additionally, even when investing in fixed income, the investor bears market and credit risk, both crucial for capital formation.

The solution is not to raise LTCG tax on equity — that would dampen investment — but to reduce fixed-income and other asset class LTCG taxes to equity levels. Indexation and risk-taking arguments justify lower, uniform LTCG taxes across asset classes, even if interest expense is deductible at the borrower level.

Furthermore, as in the US, introducing a 0 per cent tier for all LTCG across asset classes up to a reasonable threshold (say, ₹12 lakh, the current effective income tax-free limit), followed by the current 12.5 per cent tax tier, would encourage small savers and pensioners to invest in capital formation.

Addressing the sceptics

This is admittedly an involved and emotive subject. Critics can point to three issues: Fiscal considerations, inequity, and market volatility.

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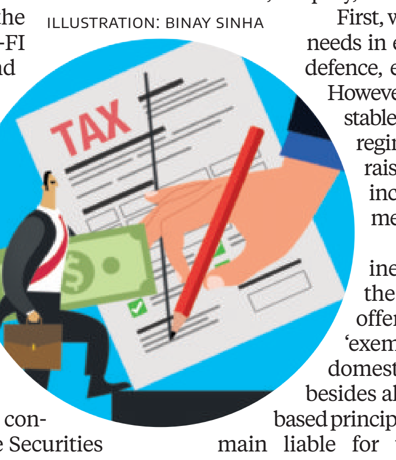

First, with increased spending needs in education, skilling, and defence, every tax rupee counts. However, in the medium-term, a stable, investment-friendly tax regime as proposed should raise collections through increased activity, investment, and value addition.

Second is the risk of inequity. One concern is the optics of appearing to offer foreigners LTCG 'exemptions' while taxing domestic investors. However, besides aligning with residence-based principles, foreigners would remain liable for taxes in their home jurisdictions; the issue would be one of comparing our LTCG regime with that of other nations. Then there is the optical inequity of lower uniform LTCG tax versus higher income tax rates. Without indexation, however, higher LTCG tax effectively becomes a tax on wealth and risk-taking. We must reward investments.

Finally, easing LTCG tax might prompt fears of short-term market volatility. In the medium run, however, rebalancing would ensure asset allocations mirror investor risk appetite rather than tax considerations. This should also channel more savings into fixed income and critical hybrid instruments like InvITs (Infrastructure Investment Trusts) and REITs (Real Estate Investment Trusts).

The 2026 mandate

To become a global economic superpower, we must stop seeing long-term investment primarily as a taxable event and start treating it as a crucial national resource. Shifting to a residence-based tax regime for foreign investors, and an asset-agnostic, risk-appreciative LTCG regime for domestic investors would be pro-investment, in line with global best practices, and would strengthen financial stability. For predictability, these underlying principles should be affirmed for the next decade. This would stop us from hitting the brakes just as we look to press the investment accelerator.

The writer is a former whole-time member, Sebi. The views are personal

Thoughts from Davos 2026

India is being recognised as a trusted partner in value chains

RAJIV MEMANI

True to its theme, 'A Spirit of Dialogue,' the World Economic Forum's (WEF's) annual meeting 2026 concluded on a reassuring note. Amid a temporary easing of tariff-related concerns and a more measured stance on recent geopolitical issues, the development offered some comfort for the broader global economy.

One thing that has stood out for me during my more-than-a-decade of visits to the WEF is the steadily growing crowds at Davos. This growth underscores the forum's significance as a global melting pot of ideas, intellect, and dialogue on the issues that matter most to the world.

As I return from the cold weather and the charged atmosphere of the WEF — along with the scheduling challenges posed by high-profile visits — I would like to share a few key takeaways from the nearly 40–50 meetings I attended or observed from the sidelines.

AI: The dominant agenda

■ Artificial intelligence (AI) consistently dominated the conversations among business leaders, permeating every company pavilion and pit stop along the promenade.

■ The consensus among participants is that the AI 'honeymoon' is maturing into an implementation marathon. To derive real value, businesses must focus on foundational elements: Building a solid data infrastructure, reimagining work in an AI-first era, and strengthening guardrails for privacy and safety. Leaders will need long-term conviction and significant investments in infrastructure and skilling to succeed.

■ At a broader level, an interesting debate emerged as leaders weighed the return on investment of building large, capital-intensive AI models with broad capabilities against deploying cost-effective solutions that yield high returns, particularly relevant for emerging markets. For the first time, the relevance of parameter counts as a benchmark for measuring economic value or competitive advantage came into question.

■ Pressing issues surrounding AI governance, sovereignty, infrastructure, concentration and national priorities took centre stage. Notably, Satya Nadella's emphatic call for "AI diffusion" underscored the need for AI benefits to reach ordinary citizens across geographies and industries.

Vibrant India@Davos

As an Indian, I felt immense pride witnessing the India story unfold vibrantly this year. It was truly an honour to lead the CII (Confederation of Indian Industry) delegation and experience the confidence and positivity surrounding the country, especially in comparison to previous years.

■ **Written in the stars:** Bharti Enterprises chairman Sunil Bharti Mittal aptly stated during one of his rare panels at WEF 2026 that India's journey to becoming the world's third-largest economy is indeed "written in the stars" — and I could not agree more! The sentiment was palpable in the confident presence of Indian delegations and leaders at various sessions.

■ **States made an impression:** One of the striking aspects was witnessing India's competitive federalism in action. With 10 Indian states participating, each state showcased its initiatives to attract investment and towards ease of doing business, welcoming investors with open arms. Now, they must ensure that they walk the talk.

■ **Communication of reforms and ease of doing business:** India's strong macroeconomic fundamentals are widely acknowledged by business leaders. Now, to accelerate foreign direct investment, the silver bullet is policy consistency and continued focus on ease and predictability of doing business. The government's numerous reforms must also be communicated more effectively to all stakeholders to overcome the lingering 'muscle memory' that plagues perceptions of India. Indian businesses would find it liberating. This becomes even more critical at a time when many other economies are embracing the spirit of deregulation. Similar attention should be paid to consistently highlight the opportunities in emerging growth sectors such as defence, electronics, space, semiconductors, and global capability centres.

■ **Investing in R&D:** Another significant takeaway from several sessions was the aggressive investment in research and development (R&D) by companies in competing economies to develop future-ready, cutting-edge products. In this shifting landscape, Indian companies will have no choice but to increase their R&D investments, leveraging core research and AI to remain competitive both domestically and globally.

■ **India as a 'living lab' for AI applications:** In the realm of AI, India is no longer a 'follower' nation. With daily active users ranging from approximately 65 million to 73 million — the highest globally — we are the world's largest 'living lab' for AI applications. Union minister for electronics and information technology Ashwani Vaishnaw highlighted Stanford rankings that place India favourably in AI preparedness and penetration. However, our goal is to achieve Sovereign AI, working across all layers, including infrastructure and domestic foundational models.

■ **A trusted partner:** Lastly, numerous discussions at WEF 2026 pointed to the melting away of multilateralism and growing significance of bilateral agreements, with nations increasingly seeking partners they can trust or share common values with. India's recent bilateral agreements, including the landmark India-EU free trade agreement, reflect this shift. It bodes well that India is being recognised as a trusted partner in value chains and supply chains, which, however, will require greater collaboration with global companies to co-create and design solutions together.

Even as I return feeling optimistic and energised, I recognise that the WEF consensus rarely mirrors reality. Only time will tell whether this year's forum sets a new precedent.

The writer is chairman and CEO, EY India. The views are personal