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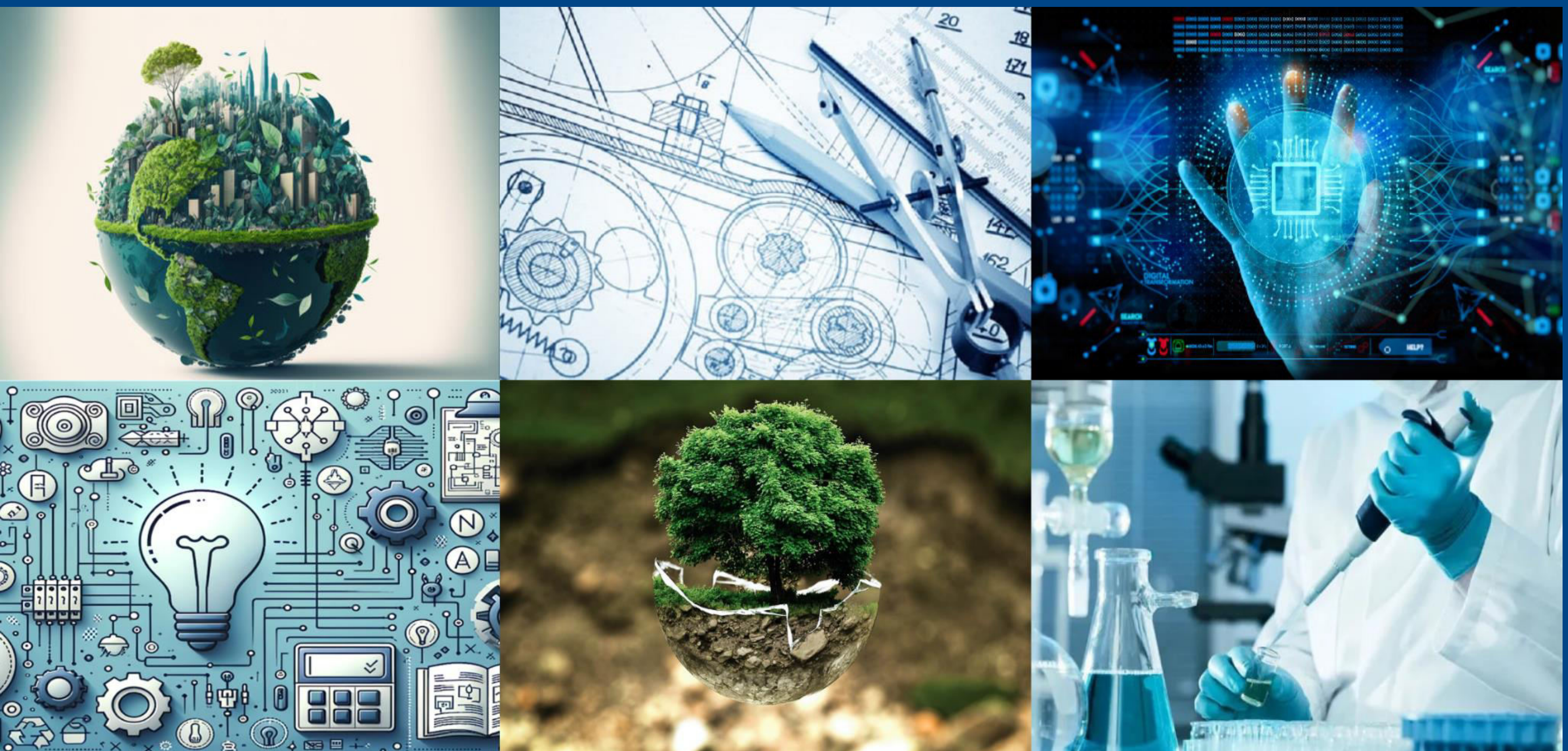

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Impact of Tax on Capital Equity

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ABSTRACT: Tax policy becomes one of the most significant factors that determine the level of capital equity and, concurrently, the state of wealth in society and allocation of investments in various sectors thereof. This work will focus on the link existing between tax policy and capital equity, particularly examining the impact that tax structures could have on investors, whether corporates or individual investors. Through advanced tax reform analysis across economies, this study analyzes the way that capital gains tax, corporate tax rates, and other tax mechanisms affect equity distribution and investment behavior. The paper analyzes, in a quantitative way, the historical tax data and qualitative case studies coming from developed and developing countries in order to underline the contrasting effects that progressive versus regressive tax policies have on wealth accumulation and capital formation.

The results were that tax system progress—that is to say, imposing higher levies on richer individuals and corporations—worked toward more even capital distribution and thus fostered wider opportunities for investment. On the other hand, regressive tax policies tend to favor the wealthy and contribute to increasing inequalities in the economy. Specific tax policies, including those on long-term capital gains, either encourage or discourage investment in the equity of capital.

KEY WORDS: Tax policy, capital equity, wealth distribution, investment allocation, progressive tax policies, regressive tax policies, capital gains tax, economic inequality

I. INTRODUCTION

The policy of taxation is among the most important instruments available to governments, shaping economic behavior, the distribution of wealth, and the way that capital markets operate. One important dimension of tax policy relates to its effects on capital equity, namely, how wealth and investment opportunities are distributed across society. On this view, capital equity refers to ownership of financial assets in the form of stocks, bonds, and real estate, and the extent to which those assets are available to different sectors of the population. Tax policies directly influence the accumulation and distribution of capital equity, shaping investment decisions and determining the extent of economic inequality within and across nations.. Since capital equity often corresponds with economic power, one needs to understand how tax policy influences capital allocation to develop fair and efficient fiscal strategies.

A good deal of research concludes that tax policies can either attenuate or worsen economic inequalities. For instance, progressive tax systems, where the rich are taxed at a higher rate, contribute to a more equal distribution of capital. A policy like this one would, of course, encourage the redistribution of wealth and make it simpler for those having lower incomes to invest in capital and accumulate it. In contrast, regressive tax policies—whereby the richest members of society reap the greatest benefits—often reinforce existing wealth disparities and reduce access to capital equity for lower-income households, therefore exacerbating economic inequality.

II. PROBLEM STATEMENT- DEFINITIONS

1. TAXATION IN CAPITAL EQUITY:

Capital equity refers to the proper and just allocation of money and investment opportunities across varying income

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brackets. It governs the easy accessibility and accumulation of wealth by individuals and businesses through taxes by individuals and taxes such as wealth tax, corporate tax, capital gains tax, etc.

2. POLICIES ON TAXATION AND ECONOMIC EQUITY:

An opportunity to consider the positive effects of tax policy as far as equity economics is by looking at the way mechanisms that distribute wealth, like progressive taxation, flourish against the accumulation of wealth through regressive taxation. Because it requires a balanced budgetary approach for long-term economic growth, the general fusion of tax laws with capital markets, investment behavior, and income disparities makes a lot of sense.

III. LITERATURE REVIEW

1. **Nakamoto, S. (2008). Bitcoin: A Peer-to-Peer Electronic Cash System. Bitcoin Whitepaper. Athey, S., & Parashkevov, I. (2016). Bitcoin and the Future of Digital Payments.**

Journal of Economic Perspectives, 30(3), 69-92.

This study examines the implications of taxing digital assets such as cryptocurrencies and NFTs on investor behavior and market dynamics. With the rapid rise of digital assets, governments worldwide are grappling with how to tax these new asset classes effectively. The paper explores the challenges of implementing fair and efficient tax policies for digital assets, including issues related to valuation, compliance, and cross-border transactions. It also analyzes how these tax policies influence investor decisions, market liquidity, and the overall growth of the digital asset ecosystem. Data will be gathered from government tax reports, blockchain analytics platforms, and interviews with cryptocurrency investors and tax experts. Qualitative Insights from tax professionals, financial analysts, and digital asset investors will be evaluated to understand the behavioral impact of digital asset taxation.. The study lacks empirical data on how digital asset taxation influences long-term investment strategies. There is no detailed analysis of the compliance challenges faced by retail investors in reporting digital asset transactions.

2. **Friede, G., Busch, T., & Bassen, A. (2015). ESG and Financial Performance: Aggregated Evidence from More than 2000 Empirical Studies. Journal of Sustainable Finance & Investment, 5(4), 210- 233.** This paper investigates the intersection of ESG factors and capital gains taxation policies. As sustainable investing gains traction, governments are exploring ways to incentivize ESG-aligned investments through tax reforms. The study evaluates how capital gains tax policies can be designed to promote environmentally and socially responsible investments while maintaining fiscal sustainability. It also examines the potential economic and behavioral impacts of such policies on investors, corporations, and financial markets. The study lacks empirical data on how ESG-focused capital gains tax policies influence corporate behavior and investment patterns. There is no detailed analysis of the potential trade-offs between ESG incentives and government revenue generation. Limited exploration of how ESG tax policies impact retail investors and small businesses.

3. **Reuters. (2024, July 23). India hikes taxes on equity investments; fund managers see short-term hit. Reuters.** The article highlights the influence of India's new tax hikes on equity investments, concentrating on short-term capital gain (STCG) and derivative trading. The Union Budget 2024 increased STCG tax rates from 15% to 20% for certain financial instruments with the objective of curtailing speculative trading and encouraging long-term investments. The shift in policy has drawn mixed responses from investors and fund managers, particularly relating to short-term volatility and reduced trading volumes. The article also examines regulatory measures in effect and their implications for institutional and retail investors in the Indian financial markets. The article employs data from market analysts, government budget reports, and interviews with financial market experts.The article lacks empirical data on the impacts of the tax equalization increase on trading volumes and investment behavior. There is no complex statistical analysis or economic modelling performed to project long-term effects on capital markets. The article does not put forward alternative modes of taxation that may achieve similar policy objectives without unfavorable repercussions on investor sentiment.

4. **Jesrani, A. R. (2024). Impact of tax on investments in capital markets in India. GAP** This study seeks to establish the extent to which the taxation policies governing investments into capital markets in India; both direct and indirect tax implications on different financial instruments- direct and indirect securities, mutual funds, and derivatives are evaluated. The paper discusses how tax law amendments including the Goods and Services Tax

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(GST), introduction of capital gains tax reforms affects the investor behavior, market efficiency, and growth of the economy. It further stresses that tax rationalization is paramount to investor confidence, reducing capital flight, and enhancing capital formation in the financial sector of the country. It studies historical tax reforms as well as their economic impacts and comparison with taxation models in other economies. Lack of econometric modelling for measuring the quantitative impact of taxation on market liquidity and investment trends. The study does not review international best practices on capital gains taxation and their applicability to India.

5. **Uppal, R. (2009). Structure and reform of capital gains taxation in India. IUP Journal of Applied Finance, 15(4), 69.** This paper dives into how capital gains taxes work in India and the recent changes aimed at reshaping investment patterns. It breaks down the difference between short-term and long-term capital gains, the applicable tax rates, and key exemptions that influence investor decisions. The study also looks at how these reforms are impacting market efficiency, investor confidence, and overall economic growth. Information was sourced from government budget Announcements, policy documents, and expert analyses on market behavior. Limited analysis exists on innovative tax models that balance revenue generation with investor growth incentives.

6. **Cuccia, A. D., & Carnes, G. A. (2001). A closer look at the relation between tax complexity and tax equity perceptions. Journal of Economic Psychology, 22(2), 113–140.** The paper explores taxpayer behavior, with a focus on factors such as fairness perceptions, the effects of penalties and audits, and the role of social norms. It highlights why people or companies may choose to comply or not comply with tax regulations; it focuses mainly on subjective norms, risk perception, and other economic considerations. It integrates the concepts of behavioral economics and cognitive psychology to explain the deviations from expected rational decision-making models. It aims to show the implications of emotions, moral beliefs, and cognitive biases on tax compliance beyond economic incentives. Although not easily seen in these extracted sections, the paper surely employs surveys, experiments, or secondary data analysis that would help underpin its discussions on taxpayer

7. **Stiglitz, J. E. (1973). Taxation, corporate financial policy, and the cost of capital. Journal of Public Economics.** The paper discusses the financial policies of firms, focusing on their effects on consumption, investment, and tax issues. Discusses the relationship between corporate financial policies and taxation. Analyze optimal financial policies under different taxation regimes. Examine the debt-equity ratio and its implications for firm valuation. Investigate the effect of investor taxation on corporate financing decisions. The study explores tax implications on corporate financial policy, detailing how firms make an optimization regarding investment, debt issuance, and shareholders' returns. The author introduces key financial identities governing retained earnings of the firms while assessing the impact of corporate tax on financial decisions. Corporate tax structures can either incentivize or deter certain financial strategies. The choice between debt and equity financing is heavily influenced by tax considerations. Investors' personal tax rates alter corporate financial behavior, impacting market valuation and returns.

8. **Auerbach, A. J. (1984). Taxes, firm financial policy and the cost of capital: An empirical analysis. Journal of Public Economics,** The study aims to Develop a theoretical model of firm behavior consistent with shareholder utility maximization. Evaluate alternative theories of equity finance, and empirical implications and assess whether firms consider new share issues a more costly source of finance compared to retained earnings. Analyze how the cost of capital is different among firms due to differences in estimated tax clienteles. The paper develops a theoretical model of corporate financial policy and its interaction with taxation and tests whether firms make new share issues appear more expensive than retained earnings and if that results in variation based on the shareholder composition. It uses firm's earnings data and historical financial decisions to determine whether firms do make new share issues the most expensive financing option, and if the cost of capital is different for firms with different tax clienteles. The study concludes that Firms perceive new share issues as a more expensive financing source than retained earnings.

9. **Faccio, M., & Xu, J. (2018). Taxes, Capital Structure Choices, and Equity Value. Journal of Financial and Quantitative Analysis,** The study aims to estimate the market value of tax benefits derived from debt financing by analyzing various tax reforms across OECD countries. It investigates how corporate and personal tax changes impact firms' capital structure and overall equity value. Using financial data from OECD firms, with control

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variables such as leverage ratios, earnings, and tax rates. Controlling for country-specific and firm-level factors affecting equity values. It extends beyond prior literature by considering variations in enforcement levels, tax evasion, and corporate governance structures across different countries.

10. **Musgrave, R. A., & Musgrave, P. B. (1989). Public finance in theory and practice. McGraw-Hill. Tanzi, V. (1987). Quantitative characteristics of the tax systems of developing countries. In The Theory of Taxation for Developing Countries.**

Direct taxation represents a major source of revenue to governments spending on public goods like infrastructure, education, and health. Taxation rates typically go up as revenues rise, sometimes stifling efficiency in production by the private sector. The study, therefore, attempts to strike between optimizing taxation and economic productivity, looking at how the various tax structures directly affect the fiscal sustainability of a country. To investigate the extent and contribution of direct taxes as part of the governmental total revenue. To establish the efficiencies of tax collection systems for various countries. To determine how tax evasion and avoidance influence public finances. Government budget report, IMF and survey on tax compliance. The revenue structures of tax income in developed versus developing economies. Taking limited studies on the efficiency of digital tax collection methods.

IV. RESEARCH METHODS

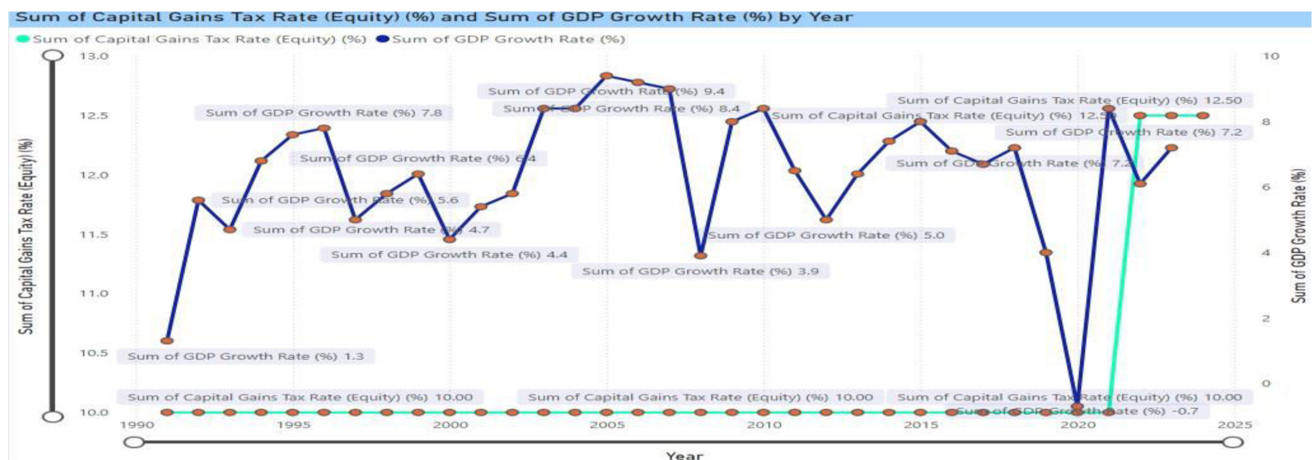
Using both numerical analysis and real-world examples, this research paper discusses the effects of taxation on capital equity. The arguments presented here draw on experience from government reports, financial records, academic studies, and experts' opinions concerning changes in past taxes and the subsequent implications of these changes for investment behavior and stock markets.

FINDINGS:

- Tax policies decide capital equity distribution and investment behavior. Progressive tax systems improve wealth equality and increase wider investment, whereas regressive tax policies benefit the rich, which improves economic inequality.
- High corporate tax rates discourage investment and capital formation, but tax incentives encourage business growth and economic expansion.
- Granger causality test confirms that corporate tax rates significantly influence the stock market trend. Frequent changes in tax rates create uncertainty and discourage long-run investments.
- Taxation impacts capital equity, investment trends, and finances directly. Balanced taxation policies are essential for maintaining sustainable economic growth, distribution of wealth, and investor confidence.

DATA FINDINGS AND REFERENCES:

FIG 1: TREND ANALYSIS BETWEEN CAPITAL GAINS TAX RATE EQUITY AND GDP GROWTH RATE



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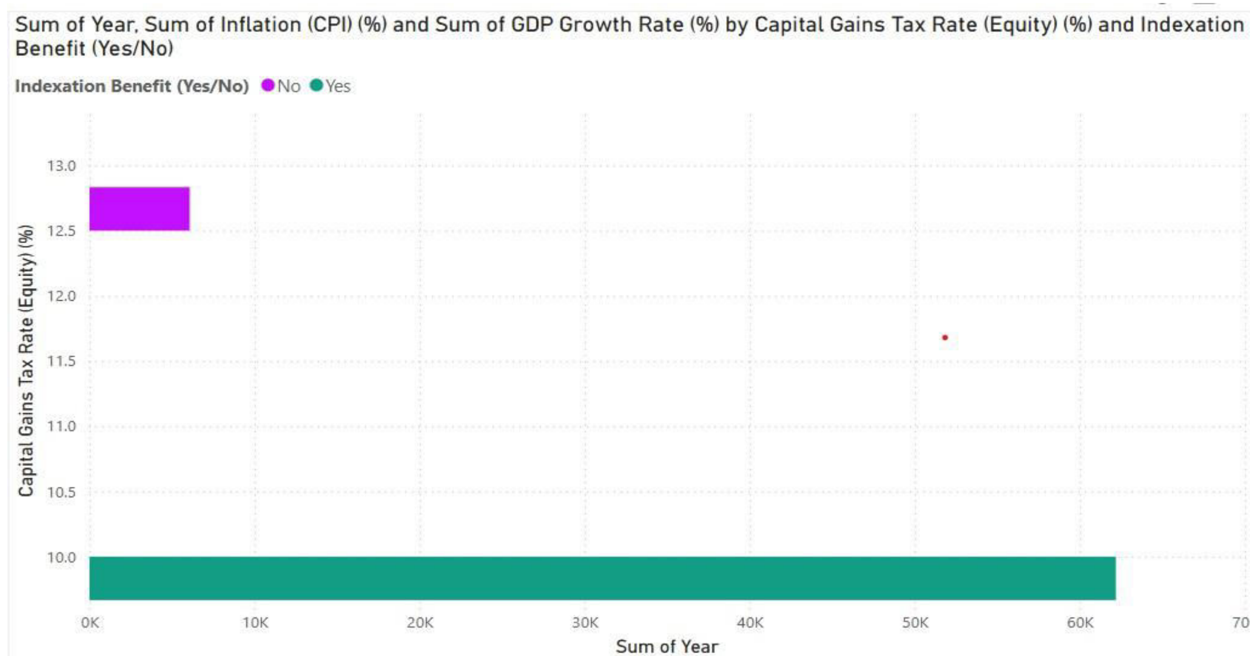
Key Observations

- Tax Policy Shift: Capital gains tax rate increased from 10% to 12.5% in 2022, after remaining stable for 30+ years (1991–2021).
    - GDP Growth Trends
    - Peaked at 9.4% (2005) and 9% (2007) during low-tax periods.
    - Declined sharply to -0.7% (2020) due to COVID-19, then rebounded to 8.4% (2021).
    - Post-tax hike (2022–2023): GDP growth moderated to 6.1% (2022) and 7.2% (2023)

FIG 2: BAR CHART PROVIDES INSIGHTS INTO THE CAPITAL GAINS TAX RATE (EQUITY) (%), INDEXATION BENEFIT (YES/NO), SUM OF YEAR, INFLATION (CPI) (%), AND GDP GROWTH RATE (%)



Key Inferences:

Capital Gains Tax Rate Variation:

- The tax rate for equity seems to have two different values: ~10% and ~12.5-13%.
- The higher tax rate (~12.5-13%) applies to no indexation benefit (purple bar).
- The lower tax rate (~10%) applies to indexation benefit (green bar).

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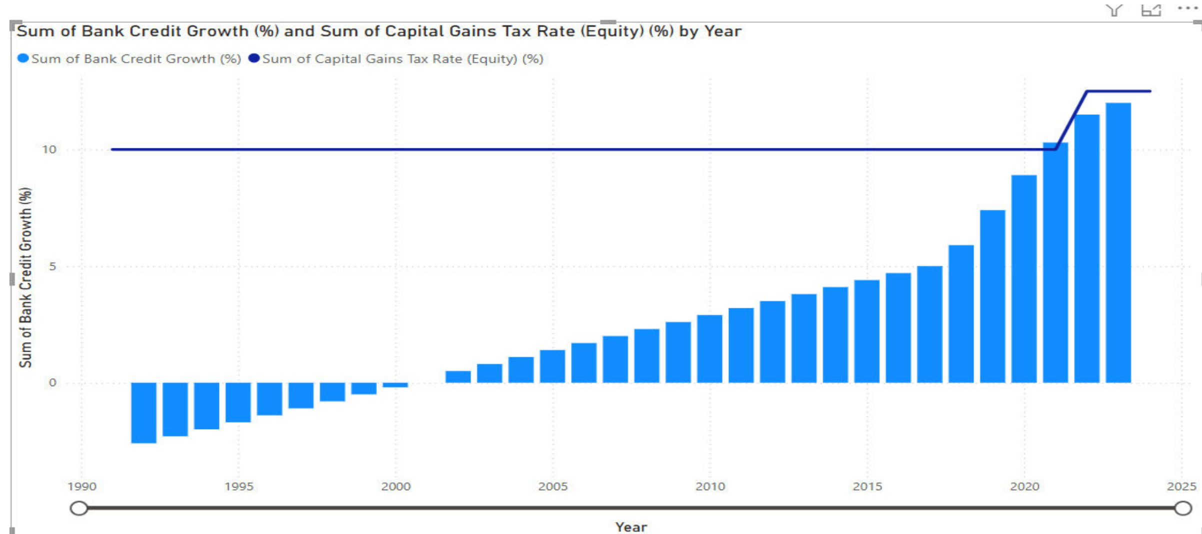
FIG 3: COMBO CHART (BAR AND LINE GRAPH) BANK CREDIT GROWTH, CAPITAL GAINS TAX RATE (EQUITY) (%), TIME PERIOD: 1990–2025 ON THE X-AXIS.



Key Inferences:

Bank Credit Growth Trends:

- From 1990 to early 2000s, bank credit growth was negative or near zero, indicating economic challenges, low credit demand, or stringent banking policies.
- After 2000, there was a steady increase in bank credit growth, indicating improved financial stability, increasing credit demand, and economic expansion.
- Post 2015, the growth accelerated significantly, reaching its highest levels around 2020-2025.

SUGGESTIONS:

- Tax policies decide capital equity distribution and investment behavior. Progressive tax systems improve wealth equality and increase wider investment, whereas regressive tax policies benefit the rich, which improves economic inequality.
- Increased capital gains tax reduces trading volumes and influences investor holding patterns. The recent tax increases in India have reduced short-term market activity.
- Consistent tax policies have a strong relation with economic growth, while uncertain and frequently changing tax laws discourage investment.

V. CONCLUSION

An overall review of this study on how tax affects capital equity identifies the role that tax policy plays in investment behaviors, wealth allocation, and markets to become effective. Findings are that higher capital gains taxes and corporate income taxes for affluent individuals and entities increase the proportional capital distribution; this tends to decrease income disparities. Furthermore, the emerging themes of taxing digital assets and ESG-centric tax policies are restructuring capital markets, and it is imperative to evolve tax policies according to the shifting financial scenario that cryptocurrencies and sustainable investing create. The key factors in an effective tax policy should be a balance between economic growth and fair capital distribution. Such policies should be clear, transparent, and predictable, promoting capital formation while ensuring equitable contributions from all income groups.

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