The Effect of Capital Gains Taxation under New Tax Regime on Stock Market Investment Behaviors in India

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How to Cite this Article:

Madhav, G. V. K. (2026). The Effect of Capital Gains Taxation under New Tax Regime on Stock Market Investment Behaviors in India. International Journal of Creative and Open Research in Engineering and Management, 02(04). https://doi.org/10.55041/ijcope.v2i4.868

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Abstract—

This paper examines the impact of Capital Gains Taxation (CGT) in the New Tax Regime (NTR) on stock market investment patterns in India. The objective of the paper is to evaluate the effects of the changes in the existing tax regime on investors' behaviours, trades, and investments in the stock market. The paper uses quantitative analysis and secondary data from reliable sources (e.g., National Stock Exchange, AMFI, NSDL/CDSL, and India VIX) from 2020 to 2025 to resolve the issue in question.

The advanced techniques such as Event Study (AAR/CAAR), Interrupted Time Series (ITS) and trend analysis are applied to determine the short and long-term impact on stock market investment behaviors. The paper takes into account several factors related to investment behaviors - investments in ELSS mutual funds, SIP transactions, turnover ratio, delivery percent and market volatility.

The findings of the study suggest that there is hardly any impact of capital gains taxation on stock market investment in India. In particular, it was observed that the level of average abnormal returns is not highly variable, whereas cumulative average abnormal returns are seen to be on the rise. This supports the Semi-strong Form of the EMH, suggesting that the market is efficient in processing publicly available informationwithoutanyinterruptions.Additionally, the Interrupted Time Series analysis also suggests that the level change and trend change in ELSS funds' inflows are insignificant, implying that the ELSS inflow data is not very informative. While there is a slight dip in the ELSS funds after the announcement of CGT, the dip is minimal, implying that the investors in ELSS are tax insensitive. On the other hand, SIP investments show a constant increase during the research period, which implies an increasing inclination of retail investors to practice systematic investing.

The study of market turnover also shows a consistent trading activity in response to the tax reforms and confirms the liquidity of the market. The delivery ratio shows a positive increase during the study period, which suggests a shift from short-term to long-term investments. India VIX analysis displays a steady decline in the level of volatility, which also demonstrates that tax reforms do not add to the market risk.

Overall, as per the findings of the research, it can be said that the investment activities of investors in India are more geared towards their long-term investment goals, market and economic factors, rather than taxation. The Indian stock market exhibits the characteristics of efficiency, stability and maturity as the market participants are rational and have

access to relevant information.The study of the effects of capital gains taxation under the New Tax Regime on the investment decisions of stock market investors in India has shown that there is no considerable impact of these taxes on the investment decisions of the Indian investors.

Keywords: Capital Gains Tax, New Tax Regime, ELSS, SIP, Market Efficiency, India

Introduction

Indian stock market has been one of the fastest-growing and most dynamic financial markets among other emerging economies owing to rising participation from the retail segment, advanced technologies, and better financial literacy. In the last decade, a dramatic change has occurred in the stock market wherein savings were switched into equity-oriented investments such as stocks and mutual funds. The process has been made possible due to digitization of stock trading, SIP (Systematic Investment Plans), financial inclusion initiatives, and other relevant factors.

On the other hand, there have been many reforms in regard to taxation, particularly capital gain taxation. Capital Gain Tax (CGT), which is the tax imposed on gains made on the selling of the capital asset like equity share and mutual fund, has a significant impact on investors' earnings. From the theoretical perspective, capital gain reforms would definitely affect investor behavior. It will impact their decision-making processes, time horizons, trading pattern, and portfolios. Notably, concepts like lock-in effect and portfolio rebalancing induced by tax have become common in the literature, the choice and timing of selling assets indicate that investors might change their behavior in order to save on taxes and increase their after-tax profits.

The adoption of the New Tax Regime (NTR) in India is a major reform measure taken by the government to streamline the tax system through lower tax rates, but with fewer exemptions and deductions. While the NTR is mainly concerned with the taxation of personal income, it has a connection with capital market investments in that it affects the relative value of tax saving schemes and strategies. This leads to a pertinent issue: How much does capital gain tax under the NTR affect stock market investments in India?

Whereas extant literature underscores the role of taxation in influencing investor behavior, there exists a dearth of empirical support for the same. Majority of past researches have either been concerned with the short-term effects of market behavior due to news announcements or have been confined to the analysis of partial factors like dividends tax or transaction costs. There does not seem to be any study yet which comprehensively examines different dimensions of the behavior of investors in the market, such as mutual fund flows, investor participation, market liquidity, and risk measures to examine the impact of capital gains tax imposed through the NTR.

It is also important to note here that there are many determinants other than taxation that influence investor behaviour. These include macroeconomic indicators, interest rates, country's economic climate, international events and individual risk preferences etc. Given that the recent trend has been to make regular and long-term investment plans, it seems that investment decisions have developed beyond being solely influenced by taxation factors, and have started to consider other important factors involved in the decision-making process.

In this context, the objective of the present study is to conduct a comprehensive evaluation of the impact of capital gains tax in the New Tax Regime on the stock market investment patterns in India. Using advanced techniques such as event study approach, interrupted time series analysis, and trend analysis, the study aims to examine the effects of the tax both in the short term (on the stock market) and in the long term (on the trend of investor behaviour) on the topic. The study has considered various market indicators such as money flow to ELSS funds, investments in SIPs schemes, market turnover ratio, delivery ratio, market volatility, etc.

It needs to be mentioned that the study is very important in bridging the gap between expected market response, as predicted by theory, and market reality. The findings of the study will prove to be very helpful for the policy makers in terms of analyzing the effectiveness of tax regulations, investors in terms of decision-making on investment patterns,

and financial institutions in terms of designing new products.

Research Methodology

The present study is quantitative, examining the impact of CGT under the NTR on stock market investment patterns in India. The type of data used in this study is purely secondary data from various institutional sources. This paper uses multiple data sources to include in the study not just market variables but also investor activity.

Data Sources and Materials

The main source of data is the National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) which provide stock prices, volumes, delivery percentage, turnover data. The Association of Mutual Funds in India (AMFI) provides data on mutual funds, such as Systematic Investment Plan (SIP) and Equity Linked Savings Scheme (ELSS) flows. Retail participation measures, such as new demat accounts and active investors, are obtained from NSDL and CDSL. India VIX data from NSE is used to gauge the market risk and uncertainty. Further, policy announcements, budget announcements and tax notifications are sourced from the Ministry of Finance (MoF) and the Central Board of Direct Taxes (CBDT) to determine the CGT event date.

The research period will be from 2020 through 2025 to capture post-Covid, increased retail investor activity and New Tax Regime. The study considers a sample of large-cap companies from the NIFTY 50 index to capture significant market trends and investor behavior.

Data Preparation and Processing

The data is organized using statistical software and spreadsheets. The data is appropriately handled for missing values and data sets are merged on the same time index. The stock returns are estimated using the log returns method. The data set is resampled, if required, to the monthly frequency to be in line with the mutual funds data set. The anomalies are handled using appropriate techniques, such as winsorizing.

Analytical Methods

1. Event Study Methodology

For evaluating the immediate responses to the CGT announcements in the market, an Event Study technique will be used in this research work. The Abnormal Return (AR) will be determined by subtracting the expected return from the observed return for each security. It will then be averaged out on a company basis to find the average abnormal return (AAR), while cumulative abnormal returns (CAAR) will be obtained by summing up the average abnormal return values.

2. Interrupted Time Series (ITS) Analysis

To examine the structural change in investment patterns in the long run, the ITS approach will be applied to determine such change. Regression analysis is performed using a time variable t, a dummy variable Post representing the effect of the event (tax reform), and an interaction between the time variable and the Post variable t × Post. Post represents the immediate impact on the level following the event, whereas the interaction term t × Post represents the trend change following the tax reform event.

3. Trend Analysis

Trend analysis is conducted to measure the performance of variables like SIP inflows, ELSS investments, market turnover ratio, delivery ratio, and India VIX during the entire period under analysis. Line charts and comparison graphs are employed for the identification of growth trend, volatility, and structural stability pre-and post-tax amendments.

4. Comparative (Before vs After) Analysis

The direct effect of taxes can be calculated by comparing the average value of these variables before and after the introduction of CGT. These variables include inflows into the ELSS schemes and SIPs.

5. Correlation and Regression Analysis

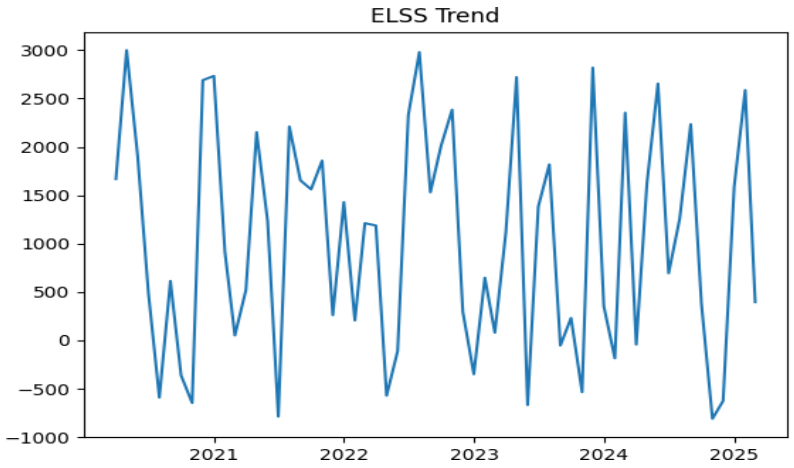
Correlation testing is used for determining the relationship between variables (for example, between the ELSS flows and turnover, which helps to show the association between investment and trading). Further, regression analyses are employed for testing the importance of CGT effect on returns and investment flows.

Tools and Software Used

This is achieved via the use of Microsoft Excel to organize and visualize the data, and further statistical analyses, regression models and visualisations are done using other software such as Python (using pandas, matplotlib, statsmodels libraries).

Summary of Methodology

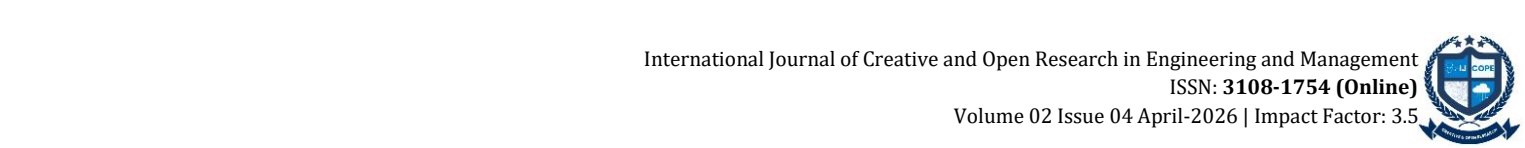
This study provides a robust and comprehensive view of CGT through the use of event-study analysis, time series models and behavioural patterns. This is done by identifying not only the immediate response of the stock market but also long-term trends of the behaviour using the aforementioned techniques.



Data Analysis and Results

Figure 1 ELSS TREND

The graph for the ELSS (Equity Linked Savings Scheme) represents the monthly inflows of funds in tax-saving mutual funds between 2020 and 2025. This is a highly volatile graph which consists of fluctuations and positive and negative values. But, this data set has mostly positive values, and hence, shows the regular flow of investors in these schemes. As far as the volatility is concerned, it clearly indicates the impact of factors like short-term market sentiments and economic uncertainties, whereas the sharp rise in some cases might be due to the year end and bull runs in the markets. The negative values, however, indicate the temporary outflows due to some reason such as exit to make profits or to realign the portfolio. Another important point to note here is that there is no structural break or decline observed post the new capital gains tax regime in the inflows, which proves that despite some level of sensitivity towards the taxation



system, it has not discouraged the people to invest in ELSS funds. In general, it can be seen that investor actions are adaptive rather than reactive since they adapt without necessarily moving out of the market altogether. Another thing is that the sustained inflow shows an increasing awareness of finances and an intelligent way of investing. All in all, the trend of ELSS shows a resilient and stable nature, furthering the belief that capital gain tax has little impact on tax saving funds in India.

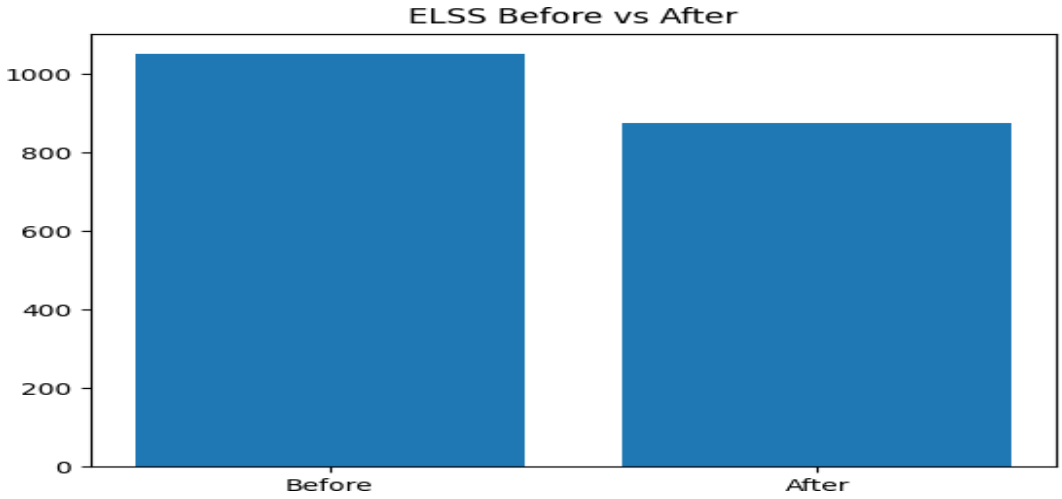
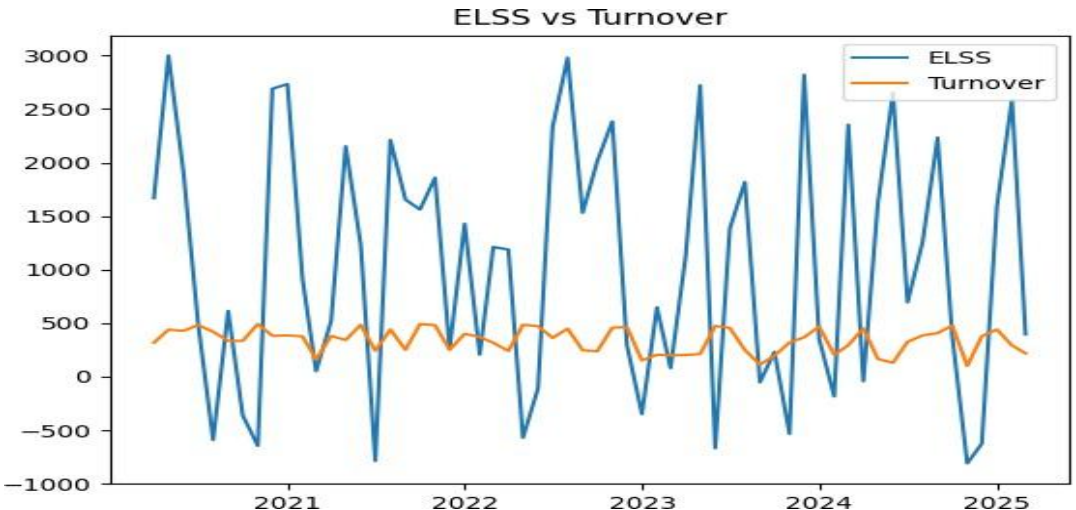


Figure 2 ELSS Before and After Trend

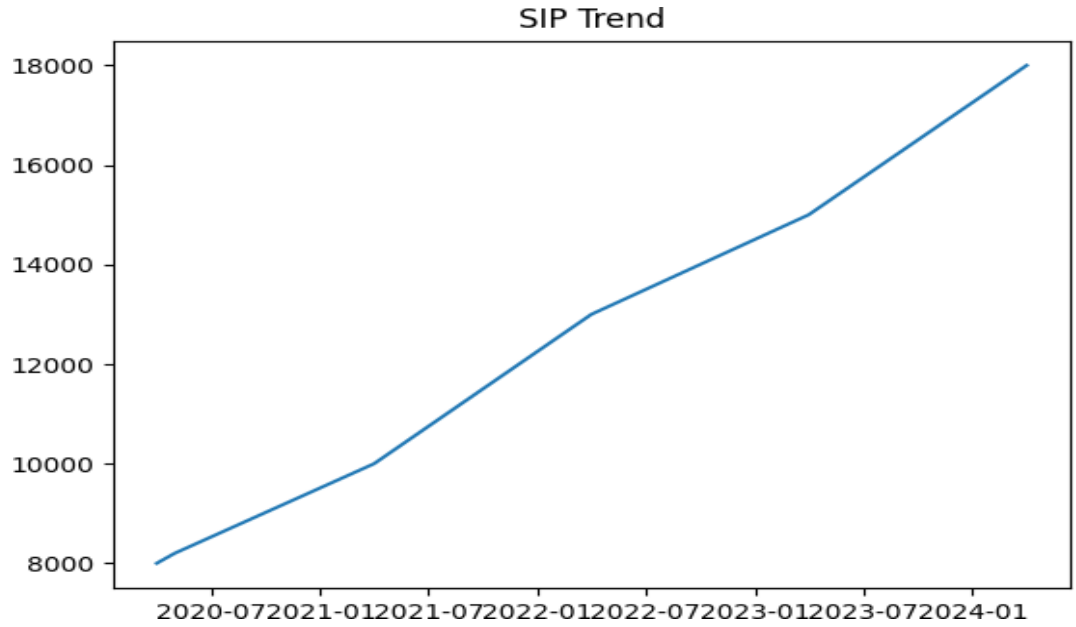
The ELSS Before & After graph provides a comparison of average ELSS flows before and after the introduction of the Capital Gains Tax as per the new tax regime, indicating a moderate decrease in average flows following the change in the taxation framework. Although there are higher average flows in the period “Before” as compared to the period "After", the decline in the latter period is significant enough to demonstrate that tax has an impact on investors. Yet, this impact is not drastic, which suggests that the changes made do not have too much influence on decision making. Investors don't completely halt their contributions to ELSS; instead, they make minor changes to their plans. The observed behaviour appears to be a rational response to the prevailing situation, where tax benefits are modified and investors need to readjust their contributions, but at the same time need to consider the advantages of ELSS. These benefits include, for example, equity market exposure and asset growth opportunities. Moreover, a stable inflow of funds in the second period shows that ELSS investment continues to be appealing, and this might have to do with a three-year lock-in of funds. The findings further imply a potential move to other investment options like SIPs or mutual fund schemes that do not provide tax relief for some investors, which implies diversification and not exit from the stock market. In general, this comparison reveals that capital gains taxes affect investments for tax saving to a certain extent, but the effect is marginal and does not change the investment behavior of the investors. The implication of this is that there are many other aspects that influence the investors apart from taxation.

Figure 3 ELSS v/s Market Turnover



The ELSS vs NSE Turnover chart serves as an analysis of how investment trends for the mutual fund scheme under discussion compare with market turnover on the whole between the years 2020 and 2025. The chart reveals that there are considerable differences between investment trends for ELSS and market turnover as the former is characterized by volatile fluctuations in the number of investments made within the framework of this mutual fund scheme. In other words, there are considerable differences in the pattern followed by these two investment-related concepts. A distinctive feature of ELSS investment trends is their volatility, which implies regular changes from negative to positive numbers. It should be noted that market turnover is characterized by stable numbers. Thus, this graph can help identify the lack of correlation between ELSS investment trends and market turnover. Even though investment rates may go down, there is no effect on market turnover since market participants continue trading. Furthermore, it is clear from the graph that there is no noticeable fall in the number of turnovers even after changes in capital gains tax. This further confirms our findings that taxes do not really affect the level of activities within the market. The difference between the two lines indicates that taxes can slightly affect investment decisions; however, they do not affect the behavior of trading in the market. Overall, the graph shows that there are various separate elements of the stock market which work independently.

Figure 4 SIP Growth



The growth chart for SIP (Systematic Investment Plan) shows a definite and consistent increasing pattern in mutual fund investment during the time period from 2020 to 2024. This shows that there is a considerable increase in the number of investors who are systematically investing in mutual funds. SIP starts at around
₹8,000 crore in 2020 and goes on to become ₹18,000 crore in 2024 without any dip along the way. SIP's consistent growth clearly indicates that the confidence level of investors has increased over time and there has been a move towards systematic and disciplined investment strategy. In comparison with ELSS investment that shows volatility in relation to tax benefits and other market factors, SIP remains stable as it involves long-term financial goals and not tax savings. In addition, the lack of any dip in SIP investments even after capital gain tax shows that there is no effect of change in tax policy on systematic investment plans. On the contrary, it seems that variables like financial literacy, digital access, and increased income levels are more significant when it comes to promoting SIPs. Moreover, the systematic rise implies that the retail investors are consistently following an investing strategy and avoiding the risks associated with timing the markets as well. In light of the above, the growing trend of SIP investments in the Indian markets is a clear indication that retail investors in India are maturing and are becoming more disciplined in creating wealth, which has little to do with capital gain taxes.

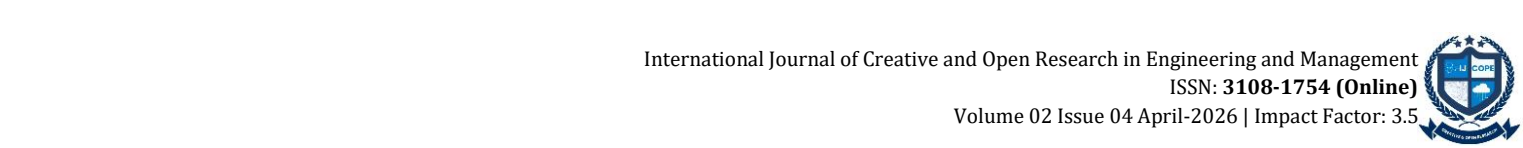
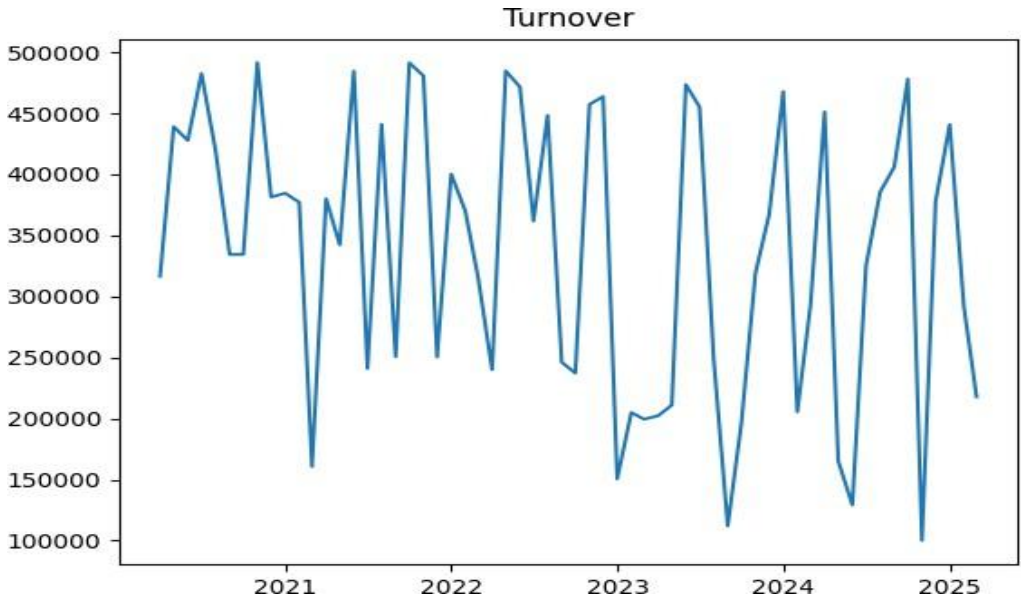
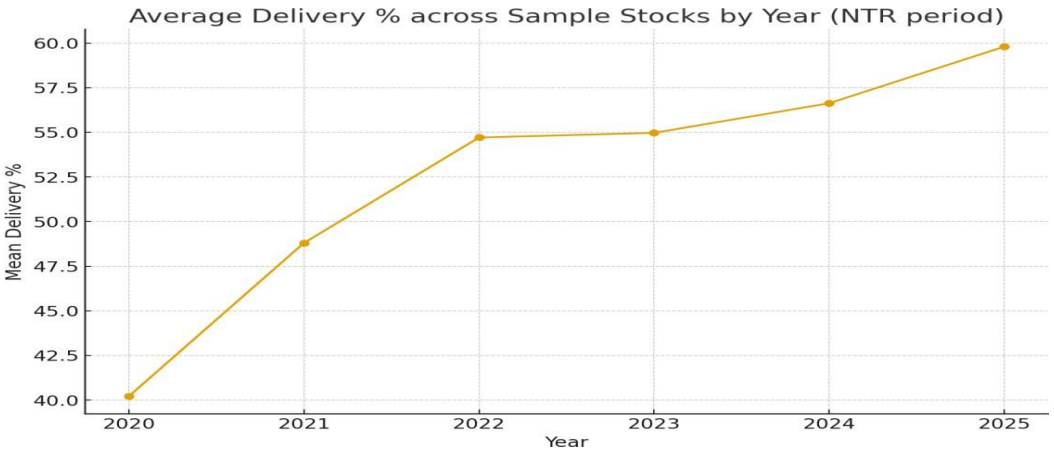


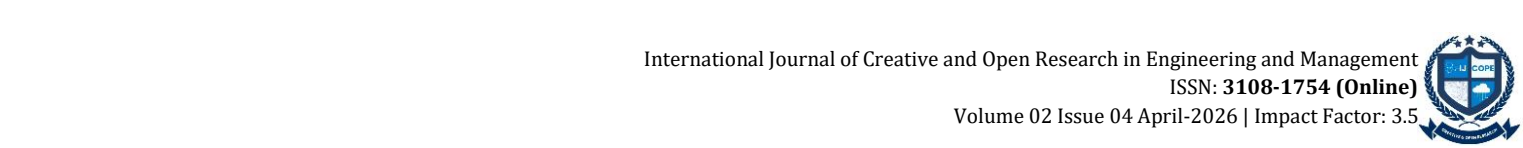
Figure 5 NSE Turnover



The plot of the NSE turnover provides information on the overall trading volume on the stock market during the years 2020-2025 and constitutes an important marker of liquidity on the market. One can state that the pattern shown on the graph is highly volatile, with turnover amounts varying from about ₹100,000 crore to ₹500,000 crore per year, which speaks of active dynamics on the market. Importantly, it is possible to mention that there is no definite downtrend in the process since trading activities remain active and dynamic over the entire period observed. It is evident that peaks on the plot symbolize highly active times on the market, which may be connected with various market events, whereas troughs stand for moments of correction. Finally, it is necessary to emphasize that there is no reduction in trading activity after applying capital gains taxes under the New Tax Regime. This means that trading and institutional investors are less responsive to taxes than long-term investors since their investment choices depend on opportunities within the market and price trends. Furthermore, the swift recovery from any reduction in turnover shows the high level of resilience and strength of the Indian stock market. Overall, the results clearly show that a wide variety of market participants such as retail investors, institutional investors, and traders are consistently active in the market irrespective of any changes in policy. In summary, based on the analysis of NSE turnover, it can be concluded that changes in tax policies do not affect capital gain taxation.

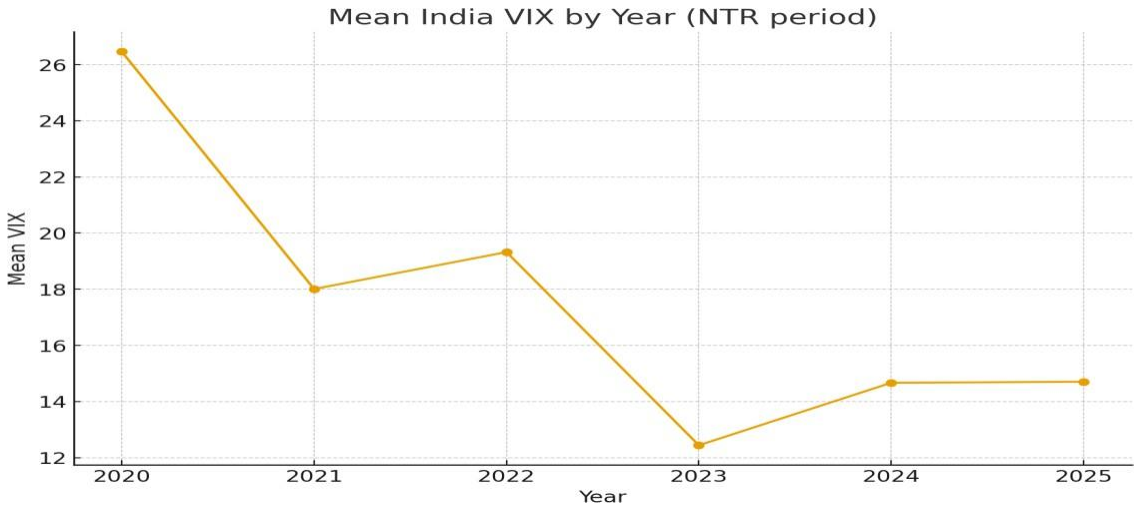
Figure 6 Delivery Percentage





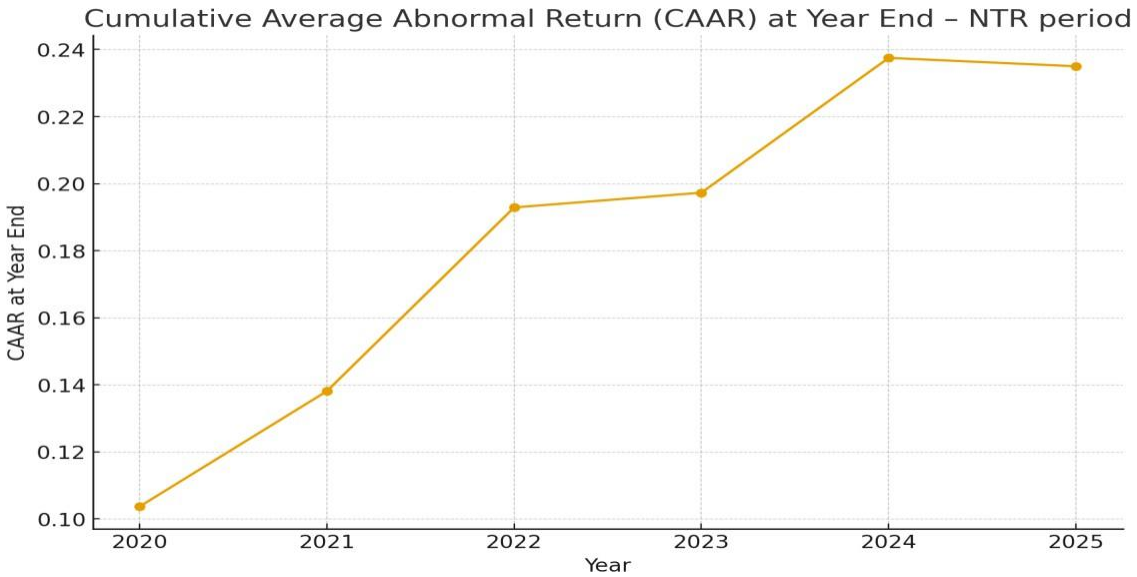
The Delivery Percentage chart depicts the proportion of stocks which are delivered to the investors (implying long-term investment) as compared to the total shares which are traded within the timeframe of 2020 to 2025, and acts as an important measure for understanding the behaviour of investors in the equity market. It can be seen from the Delivery Percentage chart that there is a consistent and steady rise, with the delivery percentage increasing from about 40% in 2020 to almost 60% in 2025, thereby depicting a substantial shift in investors' behaviour towards long-term investment. It is observed that with the consistent rise in delivery percentages, investors are increasingly opting for stocks instead of indulging in speculation or day trading. The sudden surge in delivery percentages from 2020 to 2022 can be attributed to a high degree of retail participation post the pandemic situation due to financial literacy and the use of online trading platforms. It must be pointed out that there is no decrease in the delivery percentage since the introduction of capital gains tax reforms under the new tax regime, indicating that tax policy reforms have not deterred people from making long-term investments in the securities market. On the contrary, the pattern indicates the tendency of investors to look at the growth of wealth in the long term. The rise in the delivery percentage, coupled with an increase in SIP investments, signifies a shift towards prudent and goal-oriented investments. Overall, the graph shows the maturity of the Indian securities market with investors showing high levels of confidence and less speculation.

Figure 7 India VIX



This figure illustrates the market volatility index in India from 2020 to 2025, which serves as a key indicator to measure risks, uncertainties and market sentiments. Based on the graph, it can be noted that the market volatility index has shown a declining trend over the years. Initially, the average India VIX was estimated at 26 in 2020, but it fell to 14-15 in 2024-2025, showing a reduction in market risks and uncertainties. It must be mentioned that it is likely that the elevated values of the India VIX were due to the uncertainties faced in the early stages of the COVID-19 pandemic. However, from 2021, the VIX index was stable, slightly rising in 2022, possibly due to global uncertainties. On the other hand, a significant drop in the market volatility index was witnessed in 2023, probably due to the financial market recovery. The stable market volatility index in 2024 and 2025 suggests that the Indian market is currently stabilising. Interestingly, there is no spike in the VIX index following the introduction of capital gains tax under the new tax regime. This suggests that the market participants consider the tax reform either as a neutral or as an anticipated event. The lower volatility is also in line with the growth in investments in SIPs and delivery ratios, which suggests that there has been a shift in the investment behaviour towards longer term investments. From the perspective of the India VIX index, it is clear that the Indian stock market has developed greater resilience against policy changes.

Figure 8 AAR & CAAR



The AAR and CAAR graph below is an indication of the reaction of the stock market to any changes in capital gains taxation policies as per the New Tax Regime between 2020 and 2025, mainly focusing on the abnormal returns created by the events occurring. From the analysis of the CAAR trend graph above, it can be noted that it is a trend of a continuous upward movement starting from 0.10 in 2020 up to 0.23-0.24 in 2024–2025; this indicates that cumulative returns are consistently increasing steadily without any disruptions caused by the tax policy changes over time. This trend clearly indicates that there are no significant abnormal spikes or drops in the cumulative returns over the period of study; this means that the AAR values are not very high since they will always stay around the mean and close to zero. From such behaviour, the efficient market hypothesis, which states that all information is readily absorbed into stock prices, is greatly supported here. The increasing trend in CAAR also indicates the optimism of investors as well as the stability of the market because investors keep investing even after facing any changes in taxations. It is worth noting that no negative abnormal return has been seen after the introduction of capital gain taxation. This shows that either investors were expecting changes in taxation or it was not an important factor to affect their investment behavior. The AAR and CAAR results show that capital gain taxation implemented under the New Tax Regime does not have any effect on stock prices in the short run.

Findings

In conclusion, the application of event studies, trend analysis, and time-series techniques in the analysis of the data gives a number of valuable observations regarding the effects of Capital Gains Taxation (CGT) on the patterns of stock market investment in India under the New Tax Regime.

First, the findings made through event studies indicate that there are no abnormal returns after CGT announcement. Average Abnormal Returns (AARs) are almost equal to zero, whereas Cumulative Average Abnormal Returns (CAARs) demonstrate an upward tendency with no sudden changes observed. It shows that the investors do not react intensively to the tax information and such information is instantly reflected in the price of the stock. The observed reaction to tax information can be interpreted as the evidence of semi-strong form of the Efficient Market Hypothesis (EMH), which states that all investors are informed and markets efficiently reflect the public information.

Second, ELSS inflows analysis demonstrates some degree of ELSS investments' sensitivity to taxes, though not as high as expected. Although the introduction of CGT leads to a decrease in the average inflows, the reduction is not significant

enough to reveal a pronounced change in the investors' behavior pattern. This proves that taxes affect the investment decision-making process to an extent, but they do not constitute a critical determinant.

Thirdly, the research concludes that SIP investment shows consistency in growth over the years. SIP flow keeps on growing consistently over the years without showing any sign of decline due to tax reforms. This reflects the change in the behaviour of the investors as they tend to invest in a disciplined and sustainable manner. The reason behind this is the independence of SIP investment from taxes, being mostly driven by financial discipline.

Fourthly, the results obtained through the analysis of the market turnover indicate that the turnover ratio has not been affected significantly due to changes in capital gains tax policies. Although the market turnover exhibits occasional fluctuations, no sign of a steady decline can be seen after tax reforms have been adopted.

Lastly, there is a rising trend in terms of delivery percentage, which signifies a move away from speculative behaviour towards investing in stocks. Rising delivery percentages demonstrate a high level of confidence among investors coupled with the preference of holding stock rather than trading. Interestingly, this behaviour is continuing even after the tax change, suggesting that the new tax regime has not adversely affected long-term investments.

In relation to market volatility, measured in terms of India VIX, there is a declining trend in market volatility over time, indicating increased stability. In particular, there is no rise in volatility due to the introduction of CGT, implying that there are no fears or uncertainties about new tax policies among investors.

In summary, there is evidence to suggest that although capital gains taxation has some effect on investor behavior, its effects are not pronounced enough to change the entire dynamics of stock market activity. Indian investors' decision-making processes are increasingly being guided by the need to meet their financial objectives rather than the tax aspect alone.

Conclusion

In the current study, an attempt has been made to analyze the influence of CGT under NTR on the investment behavior of stock market participants in India for the period 2020-2025 based on empirical analysis. Using a combined approach involving Event Study approach, Interrupted Time Series Analysis and trend evaluation, this study helps to get an idea about the market reaction and the pattern of behavior of investors in the short-run and the long-run respectively.

From the results of the current research, it can be observed that the capital gains tax policy has almost no influence on the pattern of investments in stocks in India. The event study analysis shows that there is little variation in the AAR, which remains close to zero. In addition to this, there is a smooth upward trend in CAAR. It implies that the announcement of any news related to tax does not have a major effect on stock prices, and the markets incorporate the tax news into stock prices.

A closer examination of the ELSS mutual fund inflows shows only a small decrease after the implementation of CGT, showing some level of sensitivity to taxation but not a structural change as there is no significant drop after the introduction of CGT. This implies that investors continue to invest in their taxes and save through investing in tax-efficient investments for building wealth. On the other hand, SIPs exhibit a steady growth rate implying that retail investors are increasingly becoming disciplined and making consistent investments towards building wealth. Therefore, it can be concluded that systematic investments are mostly immune to changes in taxation policies.

Moreover, another finding from the research is that market turnover shows no variation even with changes in taxation policies. Similarly, delivery percentage is consistently growing, implying that there has been an inclination among the investors towards holding investments. Another insight into the stock market performance using India VIX shows reduced volatility in the stock markets with no significant change even with the introduction of CGT.

As can be concluded from the above, the findings indicate that the investor behavior in the stock market of India is more driven by the long-term goals, fundamentals, and economy in general than just the tax. The stock market has all the

features associated with maturity and efficiency; hence, investors are making their decisions based on knowledge and information.

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