



Achintya Securities Limited

Turbocharging the Debt Market

Inside India's Bold Tax Exemption
for Foreign Investors



July 25, 2026

Introduction

The global macroeconomic landscape is currently navigating a period of heightened volatility. With geopolitical tensions in West Asia acting as a catalyst, crude oil prices experiencing sharp fluctuations, and global supply chains under persistent strain, emerging markets face a formidable challenge: defending their domestic currencies while maintaining capital inflows.

In response, the Indian government has initiated a masterstroke in financial legislation. By introducing the Income Tax (Amendment) Bill, 2026, the government aims to abolish the tax burden on foreign investors participating in the Indian sovereign debt market. This is not merely a tax concession; it is a calculated structural reform designed to attract billions in stable foreign capital, deepen the domestic bond market, and create a powerful defensive shield for the Indian Rupee.



The Legislative Catalyst: From Ordinance to Permanent Law

The Income Tax (Amendment) Bill, 2026 has been listed as a priority for introduction during Parliament's Monsoon Session, which commenced on July 20, 2026. This bill is tasked with replacing the earlier Income Tax (Amendment) Ordinance, 2026, which was enacted last month under Article 123 of the Constitution.

The ordinance was a rapid-response measure. When global headwinds began threatening the stability of the Rupee, the government needed immediate action while Parliament was not in session. According to the Gazette Notification dated June 5, the tax exemptions were backdated to become effective from April 1, 2026.

Additionally, the ordinance officially defined the Bank for International Settlements (BIS) established in 1930 and headquartered in Basel, Switzerland as an international financial institution, seamlessly integrating it and the definitions of Foreign Institutional Investors (FIIs) into the new legal framework.



The Mathematical Edge: Quantifying the Tax Relief

To truly understand why this legislation is causing a stir among global institutional investors, we must look at the exact financial mechanics. Prior to this amendment, investing in Indian Government Securities (G-Secs) carried a hefty tax burden for foreign participants:

1. **Interest Income:** Subjected to a steep 20% withholding tax.
2. **Capital Gains:** Long-term capital gains (held for over 12 months) were taxed at 12.5%.

Under the new provisions, both the interest income and the capital gains arising from the sale, exchange, or transfer of eligible government securities are entirely exempted from income tax.

By instantly unlocking over 140 basis points of extra yield, India's sovereign debt instruments are transformed from being reasonably attractive to highly competitive, especially when compared to the bonds of other emerging markets or US Treasuries.



Global Synergies: Bond Index Inclusions and Liquidity

This tax exemption does not operate in a vacuum; it synergizes perfectly with India's recent financial milestones. Over the past two years, Indian government bonds specifically those under the Fully Accessible Route (FAR) have been included in prestigious global indices like the JPMorgan Government Bond Index-Emerging Markets (GBI-EM) and the Bloomberg EM Local Currency Government Index.

These index inclusions mandate passive global funds to allocate capital to Indian debt. By removing the tax friction just as billions of dollars of passive inflows are mandated to enter the country, the Indian government ensures that active fund managers will also aggressively increase their allocations. Greater participation means higher liquidity, narrower bid-ask spreads, and better price discovery, allowing the government to execute massive borrowing programs with ease.



Defending the Rupee: The Macroeconomic Transmission

One of the most critical objectives of this bill is currency stabilization. India imports nearly 85% of its crude oil requirements. When global oil prices spike due to Middle Eastern tensions, India's import bill swells, draining foreign exchange reserves and depreciating the Rupee.

By making G-Secs tax free, the government invites a flood of US Dollars into the domestic market. Here is a visual representation of how this mechanism operates:

A stable Rupee lowers imported inflation, meaning everyday goods (fuel, electronics, edible oils) remain affordable for the Indian consumer, thereby protecting the broader economy.



Expanding the Legislative Horizon: MSME Reforms

While foreign capital is crucial, domestic manufacturing remains the backbone of the economy. Alongside the IT amendment, the government has listed five new bills for the Monsoon Session, notably the Micro, Small and Medium Enterprises Development (Amendment) Bill, 2026.

This bill aims to overhaul the MSME framework by:

- Addressing pending payment disputes that severely choke the working capital of small enterprises.
- Strengthening the enforcement of arbitral awards.
- Granting states greater flexibility in structuring MSE Facilitation Councils.
- Promoting trust-based regulation to drastically improve the ease of doing business at the grassroots level.

Together, these legislative moves highlight a dual-engine strategy: attracting elite global capital from the top down, while structurally empowering small businesses from the bottom up.



What Does This Mean for Investors?

The introduction of this bill is a watershed moment for different classes of investors:

For Foreign Portfolio Investors (FPIs): The elimination of the 20% withholding tax and capital gains tax is a green light to aggressively scale up allocations in Indian debt. It significantly improves their risk adjusted, post-tax returns, making Indian bonds a premier destination for yield-hungry global capital, particularly while Western central banks maintain elevated interest rates.

For Domestic Investors and Markets: While retail Indian investors do not get direct tax benefits from this specific bill, they are major indirect beneficiaries.

- **Bond Markets:** Massive FPI buying drives bond prices up, which conversely pushes bond yields down. This lowers the borrowing costs for the Indian government and corporate sectors.
- **Equity Markets:** A stable Rupee and lower domestic interest rates generally create a highly favourable environment for equity valuations, benefiting domestic mutual funds and retail stockholders.

Caveat: Investors must note that this remains a proposed bill. The exact legalities will only cement once it successfully passes through both houses of Parliament, receives Presidential assent, and the final rules are notified by the Central Board of Direct Taxes (CBDT).

What's Next?

As the Monsoon Session progresses, all eyes will be on Parliament. Alongside replacing the ordinance with permanent law, the government is also expected to table supplementary demands for grants for the year 2022-23 to finalize previous budgetary allocations.

Ultimately, the true success of this tax exemption will be tested against global factors out of India's control such as the US Federal Reserve's rate decisions, the trajectory of crude oil, and geopolitical peace. However, by proactively removing tax hurdles, India is decisively laying down the red carpet, ensuring that when global capital decides to move, the Indian sovereign debt market is its first destination.





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