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Foreign And Resident Taxation Proposals

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FOREIGN AND RESIDENT TAXATION PROPOSALS

Completing India's transition to residence-based taxation of foreign portfolio investments, and achieving tax neutrality for resident financial savings

The Government's June 2026 decision to exempt foreign portfolio investments in Government of India securities from both capital gains tax and tax on coupon income was a landmark reform. By moving investment in Government securities towards residence-based taxation, the Government recognised that India must remain internationally competitive in attracting long-term foreign savings. The reform, however, should be viewed as the first step rather than as the destination.

An overwhelming majority of global capital markets exempt non-controlling foreign portfolio investments in listed securities from source-country capital gains taxation. The global norm is instead one of residence-based taxation, under which portfolio investment is taxed in the investor's jurisdiction of residence. India remains one of the few countries that still applies source-based capital gains taxation to foreign portfolio investments in listed corporate bonds and equities. A comparison of the investment taxation of major jurisdictions is provided in Annexure 1.

India's Double Taxation Avoidance Agreements (DTAAs) do not eliminate the burden of source-based taxation. Many institutional investors are unable to fully utilise foreign tax credits, while others continue to face operational complexity, currency-related distortions, and tax uncertainty. These issues are explained in Annexure 2.

This note accordingly makes proposals in two parts. Part A proposes that India complete its transition towards residence-based taxation of non-controlling foreign portfolio investments in listed corporate bonds and listed equities, accompanied by a calibrated increase in the Securities Transaction Tax (STT) on equity index options to address market-design and fiscal implications. Part B proposes reforms to the taxation of capital gains, interest, and dividends for residents, directed at making the taxation of financial savings more neutral across comparable investment vehicles.

None of the proposals in Part A should be seen as a tax concession to foreign investors. Rather, they reallocate taxing rights from the source jurisdiction to the residence jurisdiction, in line with internationally accepted practice. The proposals apply only to non-controlling foreign portfolio investments in listed and specified securities. They do not extend to controlling shareholdings, investments by permanent establishments, or investments into unlisted equities or other unlisted assets.

Part A: Taxation of Non-Controlling Foreign Portfolio Investments in Listed and Specified Securities

Issue 1: Listed corporate bonds remain outside the June 2026 framework.

The case for extending the June 2026 reform to listed corporate bonds is straightforward. Government securities and listed corporate bonds compete for allocations from the same pool of global savings into fixed income. Maintaining different tax regimes for sovereign and corporate debt artificially biases international capital allocation towards Government securities and effectively increases funding costs for Indian companies. India has long sought to deepen its corporate bond market alongside its government bond market. Tax policy should support that objective and offer a level playing field for investments in government bonds and corporate bonds.

The fiscal revenue at stake appears relatively modest in relation to the broader capital-market objectives. Foreign investors held less than INR 3 lakh crores of corporate bonds as of July 8, 2026. At an 8 per cent coupon, the annual interest income currently at stake is of the order of INR 24,000 crores. Depending on the applicable withholding tax rate (5 per cent for specified bonds, and up to 15 per cent effective in other cases), the annual fiscal revenue at stake is of the order of INR 1,200–3,600 crores, a relatively small sum given the overall fiscal balance, and the principles and capital flows at stake.

International practice is admittedly stronger and more uniform with respect to exempting capital gains than with respect to exempting withholding tax on interest income. Nevertheless, many jurisdictions provide reduced or zero withholding tax for qualifying foreign investments in debt securities, particularly where the objective is to deepen domestic bond markets. A full exemption of both capital gains tax and tax on coupon income would significantly improve ease of doing business, without a material impact on revenues.

Recommendation: The June 2026 framework should be extended to listed corporate bonds. Foreign portfolio investments in listed corporate bonds should be exempt from both capital gains tax and tax on coupon income. This would represent an important next step in developing deeper, broader and more liquid corporate bond markets while lowering the cost of long-term financing for Indian businesses.

Issue 2: India remains an outlier in applying source-based capital gains taxation to foreign portfolio investments in listed equities.

The same economic logic applies to listed equities. Foreign portfolio investment reduces the cost of equity capital for Indian companies, improves liquidity, strengthens price discovery, and ultimately supports investment and capital formation. Among major global capital markets, the overwhelming majority exempt ordinary non-controlling foreign portfolio investments in listed securities from source-country capital gains taxation. India's continued taxation of foreign portfolio capital gains on listed equities therefore places it at a competitive disadvantage in attracting global capital.

The implications of any move towards residence-based taxation for India's equity derivatives markets, however, deserve additional attention. Foreign investors currently pay capital gains tax on their dealings in cash equities as well as in derivatives (Futures and Options, or F&O). Over the past few years, India has developed an exceptionally large equity F&O market, particularly in index options, characterised by extraordinarily high turnover in short-term speculative contracts amidst substantial retail participation. SEBI's studies have consistently shown high aggregate losses among individual participants in F&O, particularly in index options, with a significant proportion of the offsetting gains residing with sophisticated proprietary trading firms and high-frequency market makers, including foreign participants.

Extending residence-based taxation to listed equities would exempt not only long-term foreign portfolio investment but also the substantial profits earned through high-frequency index-options trading. Without an accompanying adjustment to transaction taxes, the reform could unintentionally support further growth of this already highly speculative market segment.

Recommendation: Ordinary non-controlling foreign portfolio investments in listed equities should be exempt from capital gains taxation. This exemption should be accompanied by a concomitant increase in the Securities Transaction Tax (STT) on equity derivatives, particularly on index options, as set out in Issue 3 below.

Issue 3: A calibrated increase in STT on index options can substantially offset the fiscal cost of the reform.

While the capital gains exemption is intended to encourage foreign portfolio investment in cash equities, its benefit would in practice also extend to high-frequency trading in equity derivatives. A calibrated increase in STT on derivatives would ensure that the reform does not inadvertently provide a significant tax benefit to such exceptionally high-turnover trading activity. It would also substantially help offset the broader fiscal cost of extending residence-based taxation to equities.

The idea is that rather than taxing the act of bringing foreign capital into India, the tax burden should progressively shift towards exceptionally high-turnover speculative trading activity.

During FY2025-26, index-options premium turnover across NSE and BSE was around INR 173 lakh crores. The current STT on index-options premium is 0.15 per cent. All else remaining the same, every additional 0.01 per cent of STT on index options would generate around INR 1,730 crores of additional revenue. Overall, increasing STT on index-options premium from 0.15 per cent to 0.30 per cent would generate an additional INR 25,000–26,000 crores of tax revenue, assuming trading volumes stay unchanged. Actual revenues will depend upon behavioural responses, trading volumes, and the elasticity of market activity; equally, the actual revenue foregone from exempting capital gains tax on foreign portfolio investment will depend upon market conditions, investor behaviour, and realised gains in any particular year.

The precise calibration should therefore be undertaken after examining actual capital gains tax collections from foreign portfolio investment; expected behavioural responses to changes in STT; the desired degree of fiscal neutrality; and broader capital-market objectives, including protecting investors and ensuring sustained capital formation amidst orderly markets.

Recommendation: STT on equity index options should be increased through calibrated adjustments designed to substantially offset any revenue foregone through capital gains tax reform; to ensure that high-frequency index-options trading continues to contribute tax; and to ensure that the move to residence-based taxation does not inadvertently incentivise speculative activity in the market segment where persistent retail losses have been pronounced. The central principle is that India should replace a tax on bringing foreign savings into the country with a transaction-based levy on exceptionally high-turnover trading activity.

Part B: Capital Gains, Interest, and Dividend Taxation Proposals for Residents

The overall objective of the proposals in this Part is tax neutrality across financial assets, so that household savings are allocated primarily according to risk-return preferences, distortions in household portfolio allocation are reduced, and balanced capital formation is supported.

Issue 4: The capital gains regime treats comparable listed financial assets differently.

The tenor for determining long-term capital gains, and the applicable rates, currently differ across comparable listed financial assets. This means that risk and portfolio asset-allocation decisions of households are dictated in part by tax considerations rather than by underlying risk-return preferences. It also places debt securities at a disadvantage relative to equities, at a time when India seeks to promote its debt and fixed income markets.

Recommendation: The capital gains regime should be harmonised across listed equity shares, listed debt securities, government securities, units of mutual funds, and units of business trusts (REITs and InvITs). Specifically: (i) a uniform tenor of 12 months should apply for determining long-term capital gains, bringing debt under the LTCG/STCG regime; (ii) a uniform LTCG rate of 12.5 per cent should apply across these asset classes; and (iii) a uniform STCG rate of 20 per cent should apply across these asset classes. This gives debt securities equal status to equities, so that risk and asset-allocation decisions are not dictated by tax considerations and promotes debt and fixed income markets.

Issue 5: Taxing interest income at slab rates taxes inflation and disincentivises fixed income savings.

A significant portion of nominal interest merely compensates savers for inflation. Taxing the entire nominal return at marginal slab rates, without indexation, can result in a high effective tax rate on the real return on fixed-income savings. In addition, taxing interest income at slab rates disincentivises discretionary savings from flowing into bank fixed deposits and other fixed income products, in favour of other securities, even though these avenues are crucial for balanced capital formation.

The fiscal revenue loss from a lower rate will have to be computed by the Ministry of Finance. However, it may be smaller than a static calculation would suggest, since tax-sensitive discretionary savings are likely already to avoid highly taxed fixed-income instruments in favor of more tax-efficient alternatives. The Ministry may wish to assess this using available taxpayer data.

Recommendation: Interest on debt instruments and fixed deposits should be taxed at a flat rate of 20 per cent, with the option for the taxpayer to elect the slab rate where the slab rate is lower.

Issue 6: The taxation of dividend income requires a via media between neutrality and progressivity.

Unlike fixed income products, it is difficult to argue that dividends are compensation for inflation; they are distributed profits. However, dividends are distributed from profits that have already been taxed at the applicable corporate tax rate. In addition, a high tax rate on dividends alongside low STCG and LTCG rates can create distortions.

Recommendation: As a via media, aggregate dividend income up to INR 2 crores should be taxed at 20 per cent, identical to the proposed rate on interest income, and aggregate dividend income above that threshold at the maximum income tax slab rate. The threshold of INR 2 crores is illustrative and can be calibrated to preserve progressivity at higher levels of dividend income.

Conclusion

The June 2026 reforms established an important policy direction. The next logical step is to extend the same residence-based taxation framework to ordinary non-controlling foreign portfolio investments in listed corporate bonds and listed equities. Such a framework would align India with prevailing international practice, improve India's competitiveness in attracting global savings, deepen corporate debt and equity markets, reduce the cost of capital for Indian businesses, and support India's long-term growth ambitions. The proposal can be designed to remain revenue neutral: by redesigning STT to focus more heavily on index options, India can preserve fiscal discipline while continuing to tax the market segment characterised by exceptionally high turnover and persistent speculative activity.

Alongside, the proposed reforms to the taxation of capital gains, interest, and dividends for residents would make India's taxation of financial savings more neutral across comparable investment vehicles, reduce distortions in household portfolio allocation, and better support balanced capital formation. Taken together, India's taxation framework would be better aligned with the long-term objectives of attracting global savings, encouraging sustained capital formation, and fostering orderly markets.

Annexure 1

International Comparison of Tax Treatment of Ordinary Non-Controlling Foreign Portfolio Investments in Listed Securities

Country / Jurisdiction	ST Capital Gains for Foreign Portfolio Investors	LT Capital Gains for Foreign Portfolio Investors	Interest: Domestic Rate; India-DTAA Rate for Indian Investor	Transaction Tax on Securities	Ordinary Foreign Portfolio Investors Broadly Exempt from Listed Securities CGT?
India	Listed equity: 20%; eligible government securities for notified foreign investors exempt from Apr 1, 2026	Listed equity: 12.5%; eligible government securities for notified foreign investors exempt from Apr 1, 2026	20% WHT generally; 5%/lower rates for specified bonds; eligible government securities exempt from Apr 1, 2026	STT on listed equity / equity derivatives	No, except eligible government securities
US	0%, generally	0%, generally	30% where taxable; India-DTAA: 15%	No federal STT	Yes
UK	0%, generally	0%, generally	20%; India-DTAA: 10% for banks / 15% others	0.5% stamp duty / SDRT on UK shares	Yes
Germany	0%, generally	0%, generally	Usually 0%; India-DTAA ceiling: 10% where taxable	No broad STT	Yes
France	0%, generally	0%, generally	Usually 0%; India-DTAA ceiling: 10% where taxable	0.4% FTT on large French listed equities	Yes
Switzerland	0%, generally	0%, generally	35% on certain Swiss-source interest; India-DTAA: 10%	Swiss transfer stamp duty if Swiss dealer involved	Yes
Japan	0%, generally	0%, generally	15.315% / 20.42%; India-DTAA: 10%	None	Yes
Singapore	0%	0%	15%; India-DTAA: 15%	0.2% stamp duty on share transfers	Yes

Country / Jurisdiction	ST Capital Gains for Foreign Portfolio Investors	LT Capital Gains for Foreign Portfolio Investors	Interest: Domestic Rate; India-DTAA Rate for Indian Investor	Transaction Tax on Securities	Ordinary Foreign Portfolio Investors Broadly Exempt from Listed Securities CGT?
South Korea	Listed shares generally exempt for ordinary non-resident portfolio investors; major shareholders taxable	Same	15.4% / 22%; India-DTAA: 15%	KOSPI effective 0.35%; KOSDAQ 0.20%; KONEX 0.10%	Yes, for ordinary listed portfolio investors
Brazil	Generally exempt for qualifying non-resident market investors; exceptions for tax-haven / special cases	Same	17.5% under new regime; India-DTAA generally 15%	IOF may apply	Yes, for standard market-route investors
Turkey	Generally exempt for listed equities / many listed securities	Same	Generally 0–10%; India-DTAA ceiling around 15% where taxable	Limited transaction taxes / BITT may apply	Broadly yes
Indonesia	Listed shares subject to 0.1% final tax on sale proceeds	Same	20%; India-DTAA: 10%	0.1% final tax on listed share sales	No
China	A-share gains currently exempt under administrative policy	Same	Bond interest currently exempt for qualifying foreign investors; India-DTAA ceiling 10% where taxable	Equity stamp duty	Yes, under current policy
Taiwan	0% on listed shares	0%	15–20%; India-DTAA: 10%	Securities transaction tax	Yes
Canada	0%, unless Taxable Canadian Property	0%, unless Taxable Canadian Property	Generally 0% for arm's-length interest; India-DTAA ceiling 15% where taxable	None	Yes
Argentina	Public-offer listed securities generally	Same	Varies / often exempt for qualifying public	None	Broadly yes

Country / Jurisdiction	ST Capital Gains for Foreign Portfolio Investors	LT Capital Gains for Foreign Portfolio Investors	Interest: Domestic Rate; India-DTAA Rate for Indian Investor	Transaction Tax on Securities	Ordinary Foreign Portfolio Investors Broadly Exempt from Listed Securities CGT?
	exempt		debt; India-DTAA: 12%		

Notes

[1] United States (FIRPTA & ECI caveats): The "0%, generally" rate applies strictly to passive portfolio investments in US listed equities and debt instruments. It does not apply if the gain is Effectively Connected Income (ECI) with a US trade or business. Furthermore, under the Foreign Investment in Real Property Tax Act (FIRPTA), gains from the disposition of US Real Property Interests, including shares in US Real Property Holding Corporations, are fully taxable at ordinary rates and subject to primary withholding tax.

[2] United Kingdom (property-rich rule): Non-residents are exempt from UK CGT on standard equity holdings. However, since April 2019, the UK levies CGT on non-residents for direct and indirect disposals of UK land. An indirect disposal occurs when a non-resident sells shares in a "property-rich company" (deriving 75 per cent or more of its gross asset value from UK land) and the investor holds or has held at least a 25 per cent interest in the entity.

[3] Germany (substantial-shareholder caveat): German domestic law can tax gains where a non-resident has held, directly or indirectly, at least 1 per cent of a German corporation at any point during the preceding five years. In practice, treaty protection may limit Germany's taxing right, so this should be treated as a substantial-shareholding caveat rather than the rule for ordinary portfolio investors.

[4] Canada (Taxable Canadian Property restriction): Non-residents are exempt from Canadian CGT only if the asset sold is not "Taxable Canadian Property" (TCP). TCP includes Canadian real estate, resource properties, and shares of corporations (listed or unlisted) if, at any time in the preceding 60 months, more than 50 per cent of the fair market value of the shares was derived directly or indirectly from Canadian real property, timber, or resource interests.

Annexure 2

Double Taxation Avoidance Agreements do not eliminate the burden of source-based taxation

A common response to proposals for residence-based taxation is that India's network of Double Taxation Avoidance Agreements (DTAAs) protects foreign investors from double taxation. While DTAAs may reduce statutory tax rates or provide foreign tax credits in some circumstances, they frequently do not eliminate either the economic burden or the operational friction created by India's source-based taxation of portfolio investment. Several practical issues arise.

First, a large class of global investors face little or no tax liability in their home jurisdictions. For such investors, Indian capital gains tax or withholding tax often becomes a permanent reduction in post-tax returns rather than something that can be set off against their overall tax liability.

Second, many international investments are made through pooled investment vehicles. The ultimate investors only see the deduction of a provision for Indian tax when they redeem their investments, and are frequently unable to claim tax credits in their own jurisdictions against such provisions.

Third, foreign investors evaluate investment performance in their reporting currency, whereas Indian capital gains taxation is computed in INR. During periods of INR depreciation, investors may incur substantial Indian tax liabilities on nominal INR gains even when their returns in USD, EUR or JPY are modest, or even negative. This materially increases the effective tax burden from the perspective of the foreign investor.

Fourth, India's source-based taxation framework imposes significant operational complexity. Jurisdiction-specific withholding procedures, tax compliances, and documentation requirements increase the cost of investing in India, particularly for large global institutions allocating capital across multiple jurisdictions.

Finally, recent tax litigation and differing interpretations have contributed to a perception of uncertainty regarding the application of India's tax framework. Even where investors ultimately succeed, uncertainty itself raises the perceived cost of allocating capital to India.

Accordingly, the existence of a DTAA should not be viewed as eliminating the competitive disadvantage created by India's source-based taxation of foreign portfolio investment. The issue is not just the statutory tax rate. It is the combined effect of permanent tax leakage for some investors, incomplete tax set-off for others, currency-related distortions, operational complexity, and tax uncertainty. The June 2026 reforms for Government securities implicitly recognise this reality. Extending the same residence-based approach to ordinary non-controlling foreign portfolio investments in listed corporate bonds and equities would remove these frictions more comprehensively.