

June 12, 2026

Direct Tax & Regulatory Alert

Background

The Government of India and the Reserve Bank of India have introduced a coordinated series of fiscal and regulatory reforms to deepen the domestic sovereign debt market and increase foreign institutional investment. This policy update is implemented through three official instruments: Ministry of Finance Press Release¹, the Income-tax (Amendment) Ordinance, 2026² (the 'Ordinance'), and the RBI's A.P. (DIR Series) Circular No. 11 issued on June 05, 2026³. This alert summarizes the changes and outlines key investment changes for foreign institutional investors as defined under Section 210(6)(a) of the Income Tax Act, 2025 ('IT Act, 2025')

Tax Exemption in case of Interest Income & Capital Gains for investment in G-Secs FIIs (Ordinance, 2026)

A. Prior to the latest reform, Foreign Institutional Investors (FIIs), including SEBI-registered Foreign Portfolio Investors (FPIs) to the extent covered under section 210(6)(a) of the IT Act, 2025, were taxed on income earned from investments in Government Securities (G-Secs). The breakdown of the said taxation is as below enumerated-

1. Interest income earned on G-Secs was taxed at 20% for FIIs;
2. Short-term capital gains arising from the sale of G-Secs were taxed at 30%, depending on the nature of the transaction;
3. Long-term capital gains were taxed at 12.5%.

As a result, a portion of the returns earned by foreign institutional investors from holding or trading G-Secs was payable as tax in India.

B. After the implementation of the Income Tax (Amendment) Ordinance, 2026, the following income are exempt from taxation*, arising on or after April 01, 2026

1. Interest Income on government securities;
2. Capital Gains arising on sale, exchange or transfer thereof.

C. The said exemption shall only be available to income arising to eligible Foreign Institutional Investors and Bank for International Settlements (BIS) from government securities.

D. Since the income is exempt, any corresponding capital loss on such Government securities may not be available for set-off / carry-forward in computation of taxable income.

**The exemption is subject to furnishing information in such form and manner as may be prescribed; therefore, eligible investors, custodians and banks should monitor the subsequent CBDT notification / rules prescribing the reporting format*

Amendments in General Route of Investment and Expansion of FAR Investments (Press Release & RBI Notification dated June 05, 2026)

A. Currently, investors can invest in Indian G-Secs through the following routes-

- General Route
- Voluntary Retention Route
- Fully Accessible Route (FAR)

B. In an attempt to liberalize investment under the investment under the General Route, the Reserve Bank of India has done away with the capping of investment limit on Central and State Government Securities with residual maturity up to one year at maximum 30 per cent of the total investment of the FII in each category.

Also, the aggregate investment limit by all FIIs in Central G-Secs capped at 30 per cent of the outstanding stock of that security has also been removed.

C. To facilitate greater FII participation in G-Secs, the Government has removed-

- Short Term Investment Limits;
- Concentration Limit;
- Security Wise investment limit;

However, the overall macro limits remain unchanged at 6% of outstanding stock for Central G-Secs and 2% for State Government Securities.

D. Further, the separate investment sub-categories for 'General' and 'Long-Term FIIs' have been merged into single, unified limits for Central and State government debt respectively.

Expansion of FAR

Fully Accessible Route (FAR) is an open-access channel where foreign investors can invest in select G-Secs without restrictions that apply under the General Route.

As detailed by the said Press Release, as on 12 May 2026, FPIs held G-Secs worth ₹3,75,171 crore, accounting for 3.34% of the total outstanding G-Secs stock of ₹112.42 lakh crore. Notably, FAR accounted for the majority of these investments, with FPI holdings of ₹3.21 lakh crore, representing 6.74% of the ₹47.63 lakh crore outstanding stock eligible under FAR.

The Ministry of Finance has now expanded the list of securities eligible under the FAR, broadening investment opportunities for foreign investors across a wider range of G-Secs.

The FAR Framework shall now include-

- New issuances of 15-year Government Securities;
- New issuances of 30-year Government Securities;
- New issuances of 40-year Government Securities; and
- Sovereign Green Bonds (SGrBs) issued in FAR-eligible tenors along with certain existing securities as detailed in the RBI Circular.

SHM Comments

- The simultaneous alignment of fiscal and macro-prudential policies marks a structural shift in India's approach to global capital integration. By reducing the domestic tax rate on sovereign investment in GSecs to nil, the government has created a framework that supersedes standard treaty routing. Historically, Foreign Institutional Investors (FIIs) heavily navigated Double Taxation Avoidance Agreements (DTAAs) to mitigate withholding taxes on coupon income or shelter capital gains. The Income-tax (Amendment) Ordinance, 2026, effectively offers a superior, frictionless domestic alternative.
- From a treasury and portfolio management perspective, the regulatory ease introduced by the Reserve Bank of India is as significant as the tax relief. The elimination of the 30% short-term investment ceiling and individual concentration limits under the General Route fundamentally transforms liquidity management.
- FIIs are no longer constrained by residual maturity parameters, allowing fund managers to execute dynamic tactical duration plays at the short end of the yield curve without breaching macro-prudential boundaries. Concurrently, expanding the Fully Accessible Route (FAR) to encompass ultra-long 15, 30, and 40-year tenors directly addresses the liability-matching requirements of patient, long-term global institutional pools, such as pension funds and sovereign wealth funds.

¹ [Press Release dated June 05, 2026](#)

² [RBI Notification dated June 05, 2026](#)

³ [Ordinance, 2026 w.e.f April 01, 2026](#)

Please note that the above narration is only a summary based on our understanding of the regulations. This summary should not be construed as advice, including any advice that may only be provided by a qualified legal professional. It serves as a technical summary to keep you informed about the latest tax issues. Please reach out to your SHM SPOC for specific queries and applicability.

We hope you find this update useful.