# InvAsset's Voice

STRATEGIC RESEARCH • FIXED INCOME / FLOWS


## The Tax Wall Falls — Why India Just Re-Opened Its Bond Market to the World

*A June ordinance scrapped the tax on foreign holdings of government bonds — removing the last friction the 2024 index inclusion couldn't clear. A structural re-rating and a rupee tailwind, but a grind, not a flood.*

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THE THESIS IN FIVE SENTENCES

On 5 June 2026 the government issued the Income-tax (Amendment) Ordinance, scrapping the tax on foreign investors' government-bond income — the 12.5% capital-gains rate and the 20% withholding on interest — retroactive to 1 April 2026, while the RBI widened the Fully Accessible Route to 15-year, 30-year and 40-year bonds and sovereign green bonds. This removes the last friction that had blunted India's 2024 entry into the JP Morgan and Bloomberg emerging-market bond indices — the tax drag that kept active foreign money on the sidelines even after the index doors opened. India's sovereign bonds are dramatically underowned: as of 12 May 2026 foreign investors held just 3.34% of the ₹112.42 lakh crore of eligible stock, so the runway is almost the entire market. But the re-rating is a grind, not a flood — estimates run from $7–11 billion near-term to, should the remaining global indices include India, roughly $25 billion over about ten months, and, on official projections, up to ~$50 billion over time as the package helps bridge the balance-of-payments gap. For the portfolio this is a carry-and-stability trade: supportive of the rupee and a gentle cap on the long end of the curve — but with heavy government borrowing as the ceiling, position for a steadier currency and a capped long end, not a bond bull market.

AT A GLANCE

THE CHANGE

**01** A June ordinance scraps the 12.5% capital-gains and 20% interest tax for foreign G-sec holders; the FAR opens to 15-year, 30-year and 40-year tenors and green bonds.

THE OWNERSHIP

**02** Foreigners own just 3.34% of the ₹112.42 lakh crore of eligible government bonds — the runway is almost the whole market.

THE FLOWS

**03** Estimates rise with the horizon — $7–11bn near-term, ~$25bn over ~10 months, up to ~$50bn over time.

THE DRIVERS

*The 10-year eased to ~6.89–6.91% and FPIs turned net buyers (~₹10,000 cr in four sessions). A carry-and-stability trade and a rupee tailwind — capped by heavy government supply, not a bond boom.*

## 1. What Changed — the Tax Wall Comes Down

### In one ordinance, the government removed every tax on a foreign holder of Indian government debt.

The change is clean and sweeping. The Income-tax (Amendment) Ordinance, issued on 5 June 2026 and effective retroactively from 1 April 2026, exempts foreign portfolio investors, foreign institutions and the Bank for International Settlements from tax on both the interest income and the capital gains from government securities. Before it, a foreign holder faced a 20% withholding tax on interest and a

12.5% rate on long-term gains — a stack of frictions that quietly taxed the carry out of the trade.

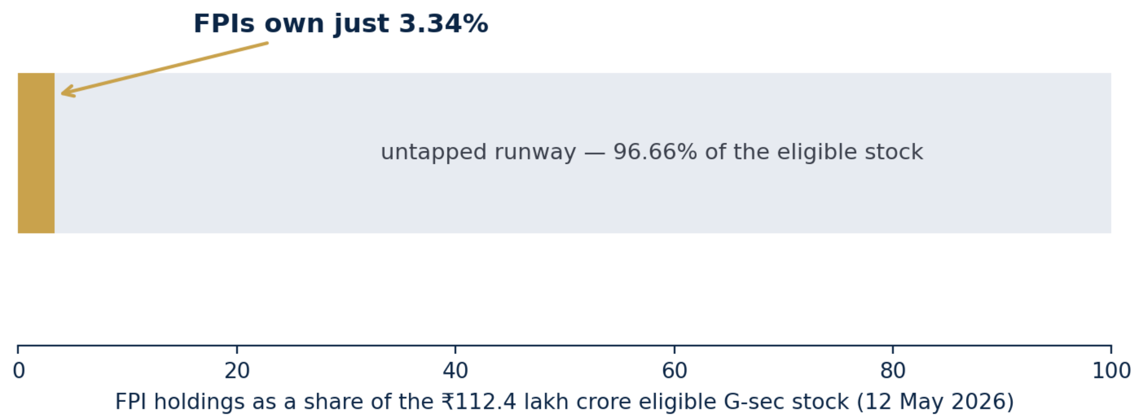


***Chart 1.*** *The runway: foreign investors own just 3.34% of India's eligible government-bond stock.*

Source: depository / regulatory data (12 May 2026) — FPI G-sec holdings ₹3.75 lakh crore = 3.34% of ₹112.42 lakh crore eligible (FAR 6.74%; General Route 0.83%).

Alongside the tax change, the RBI broadened the Fully Accessible Route — the unrestricted channel through which foreigners can buy Indian government bonds — to include new issuances in the 15-year, 30-year and 40-year tenors and sovereign green bonds, extending a route that had previously centred on shorter-dated bonds. The message is deliberate: open the long end, and make it tax-free to own.

## 2. Why It Matters — Finishing What the Index Inclusion Started

### Index inclusion opened the door in 2024; the tax wall kept active money from walking through it.

India joined the JP Morgan emerging-market government-bond index in June 2024, with its weight scaling to the 10% cap by early 2025, followed by inclusion in Bloomberg's emerging-market local-currency index from January 2025. Passive money followed the rulebook. But active managers — the larger, stickier pool — weighed the after-tax return and stayed underweight, because the withholding and capital-gains levies ate into the yield that made Indian duration attractive in the first place.

That is the friction the ordinance removes. By making the income tax-free, the government has aligned the after-tax return with the headline yield, which is what active global bond funds actually price. The index inclusion built the road in 2024; this is the toll booth being taken down — and it is the step that lets the catalytic flows the inclusion was supposed to unlock actually arrive.

The context underneath it is fiscal. With a sizeable government borrowing programme to fund — and a financing gap the measures are explicitly designed to help bridge — widening and deepening the foreign bid for G-secs is as much about the balance of payments and the rupee as it is about the bond market itself.

## 3. The Size of the Prize — Real, but Measured

### The numbers are large in aggregate and slow in arrival.

The flow estimates fan out by horizon. Government officials have pointed to $7–11 billion of near-term inflows, including flows from the Bank for International Settlements; index-consultation work suggests full global-index inclusion could draw roughly $25 billion over about ten months; and the broader official framing is that the package of measures could attract up to ~$50 billion over time as it helps close the balance-of-payments gap.

To size the bid, set it against the other side of the ledger. India saw roughly ₹2.2 lakh crore — about $26 billion — of foreign equity outflows in 2026 through May; even the near-term debt estimate of $7–11 billion could offset a large part of that drain, and at the upper end more than cover it. The point is not that bonds replace equities as the foreign bid, but that a fresh, structural source of dollar inflows arrives precisely as the equity flow has been negative — which is exactly why the measure is as much a balance-of-payments and currency tool as a bond-market one.

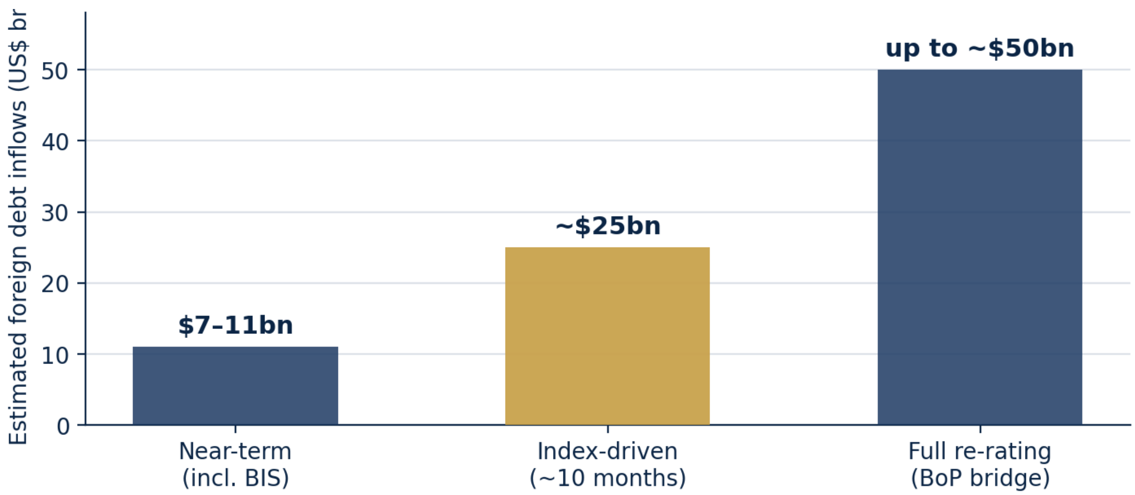


***Chart 2.*** *A ladder, not a wave: inflow estimates rise with the horizon, from near-term billions to a multi-year re-rating.*

Source: government and market estimates — near-term $7–11bn (incl. BIS); index-driven ~$25bn over ~10 months; up to ~$50bn over time (BoP bridge).

The right way to hold these figures is as a staircase rather than a flood. Even the largest of them arrives over months and years, not weeks, and is contingent on the next steps — chiefly inclusion in the remaining global indices, for which the tax change strengthens the case. For a long-horizon portfolio, the slow cadence is the appeal: a structural, multi-year bid building under the market rather than a hot-money spike.

## 4. The Transmission — Yields and the Rupee

### The first evidence is already in the price: yields eased and foreigners turned buyers.

The market did not wait for the money to arrive. India's 10-year government bond yield eased to roughly 6.89–6.91% in early June — near a two-month low — as the measures landed, and foreign investors, net sellers of Indian debt for much of the prior year, turned buyers, purchasing on the order of ₹10,000 crore over four trading sessions on the announcement.

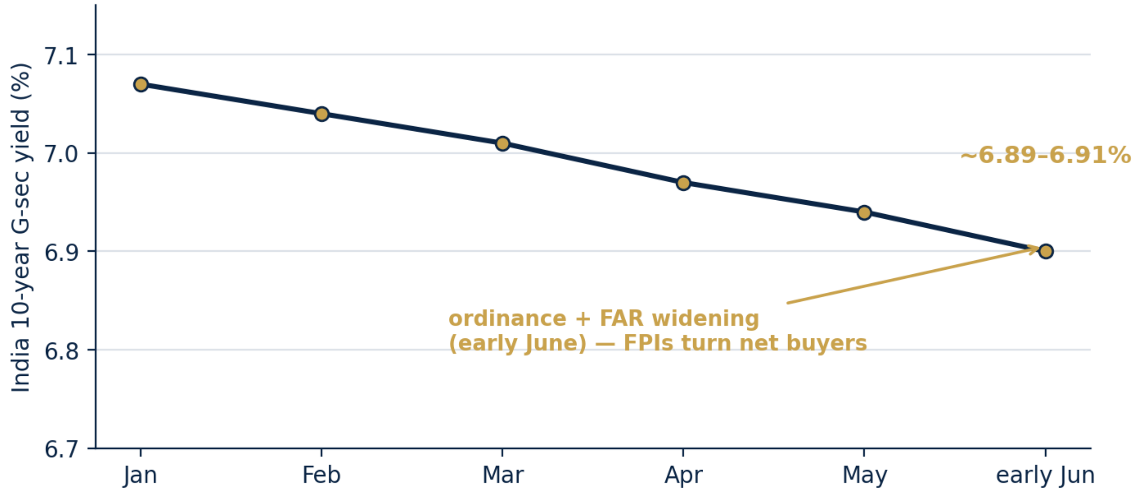


***Chart 3.*** *The foreign bid shows up first in the yield: the 10-year eased toward ~6.9% as the measures landed (monthly path illustrative).*

Source: market data — India 10-year G-sec yield ~6.89–6.91% (early June 2026); FPIs net buyers of debt (~₹10,000 cr over four sessions) after the ordinance and FAR widening. Intermediate monthly points are illustrative.

The cleaner beneficiary may be the currency. Dollar debt inflows are a direct credit to the balance of payments, and with the rupee having hovered near ₹95–96 over the past year, a structural foreign bid for G-secs is exactly the kind of offset that steadies it. A firmer, less volatile rupee is, in turn, the channel through which the bond-market opening flows back into the equity book — lower imported-inflation risk and a calmer cost of capital.

## 5. The Catch — Supply Is the Ceiling

### A new buyer does not repeal the arithmetic of a large borrowing programme.

The discipline is to respect the supply side. The government remains a heavy net issuer of bonds, and that gross supply is what caps how far a foreign bid can push yields down. The realistic read is a long end that is firmer and better-anchored than it would otherwise be — not one in a runaway rally. The bid is a cushion under prices and a support for the rupee; it is not a one-way ticket to sharply lower yields.

***Table 1.*** *The read-through across the book — what the bond-market opening does, and to what.*

| Segment | Read | Why |
|---|---|---|
| **Long-duration G-secs** | **Constructive, capped** | A structural foreign bid caps the long end — but heavy government supply limits how far yields can fall |
| **The rupee (INR)** | **Supported** | Dollar debt inflows are a direct balance-of-payments offset — the clearest beneficiary of the measure |
| **Banks / treasury books** | **Positive** | Easing yields lift mark-to-market gains on large sovereign holdings as the foreign bid firms prices |
| **Rate-sensitive equities** | **Modest tailwind** | Lower, steadier yields ease the cost of capital — but this is a flows-and-currency story first |

Read across the segments, the trade is coherent: own quality duration for the carry and the cushion, hold the rupee as the cleanest beneficiary, take the mark-to-market lift in bank treasury books, and treat the equity read-through as a second-order, flows-and-currency effect rather than the headline.

## 6. Positioning — Carry and Stability, Not a Bond Boom

### Hold quality duration for the accrual; lean on the rupee; size the rally to the supply.

The strategic lean is to own quality government duration for carry, hold a constructive view on the rupee as the direct beneficiary of dollar inflows, and resist the temptation to extrapolate a collapse in yields against a heavy supply calendar.

***Table 2.*** *Base / Risk / Resolution — what the flow path does to yields and the rupee.*

| Scenario | Flows | Yields & rupee |
|---|---|---|
| **Base case** | $7–11bn near-term; index flows over ~10 months | 10-yr drifts toward 6.7%; rupee steadies |
| **Risk case** | Borrowing overshoot swamps the foreign bid | Long end backs up; rupee soft again |
| **Resolution** | Full global-index inclusion; ~$25–50bn lands | Yields grind lower; rupee firms |

The signposts are concrete: confirmation and sizing of inclusion in the remaining global bond indices, the cadence of actual foreign debt purchases in the depository data, and the government's borrowing calendar. Steady flows against a disciplined supply path broaden this into a multi-year re-rating; a borrowing overshoot or a global risk-off turns the cushion into a headwind — which is why this is a carry-and-stability trade, sized to the supply, rather than a bet on a bond boom.

**THE INVASSET READ**

**Stance.** Constructive on Indian duration as a carry-and-stability trade, not a bond bull market. The structural foreign bid caps the long end and supports the rupee; favour quality government bonds for accrual, hold the rupee view as the cleanest beneficiary, and don't extrapolate a runaway rally.

**Horizon.** 12–24 months. Index-driven flows arrive over ten months and beyond; this is a slow re-rating, not a one-week event.

**View.** InvAsset's view is that the tax ordinance removes the last friction on a structurally underowned market — foreign investors hold just 3.34% of the eligible G-sec stock, so the runway is years long. But government borrowing supply is the ceiling: the bid firms prices and steadies the rupee without delivering a collapse in yields.

**What flips the view.** A fiscal slippage or gross-borrowing overshoot that swamps the foreign bid, or a global risk-off that reverses emerging-market debt flows — either would turn the cushion into a headwind.

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