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INDIA'S BUDGET 2026-27 - KEY HIGHLIGHTS

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Introduction

India's Union Budget (the "**Budget**") for the financial year 2026-27 was announced on February 1, 2026, and the Finance Bill, 2026 (the "**Finance Bill**") was tabled in Parliament. The Finance Bill will undergo discussion in Parliament before its enactment. Once enacted, the income tax proposals in the Finance Bill will become effective on the dates specified therein.

We have summarized some of the key direct tax proposals made in the Budget.

Taxation of buybacks

Under the current law, the amount a shareholder receives from a company as proceeds from the buyback of shares is treated as dividend in the hands of such shareholder and is taxed at the rates applicable to such shareholder. As the proceeds are treated as dividends, no deduction of expenses is allowed while computing such dividend income.

Now, the proposed changes tax the buyback proceeds received by shareholders as capital gains instead of dividend. Consequently, the cost of acquisition can now be deducted from the buyback proceeds before computing taxable capital gains.

However, with the intent to avoid misuse of the buyback route for tax arbitrage, an additional tax has been proposed for promoters. For promoters that are domestic companies, the total effective tax on buyback proceeds (including tax under the capital gains provisions plus the additional tax) will be 22%. For promoters that are not domestic companies, the total effective tax on buyback proceeds (including tax under the capital gains provisions plus the additional tax) will be 30%.

For a listed company, "promoter" will have the same meaning as in Regulation 2(k) of the Securities and Exchange Board of India (Buy-Back of Securities) Regulations, 2018. In all other instances, a "promoter" will mean a promoter as defined under the Companies Act, 2013 or any person who directly or indirectly holds more than 10% of a company's shares.

These changes are proposed to apply from April 1, 2026, for the tax year 2026-27 onwards.

<u>In our view, taxing buyback proceeds as capital gains is a positive step, as it better aligns with the nature of the proceeds and allows deduction of the cost of acquisition of shares. However, the additional tax on promoters may lead the companies to evaluate how to return surplus cash to its shareholders, including assessing the choice between buybacks, dividends, or other payout mechanisms</u>.

Transfer pricing and safe harbour provisions

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Under the current law, safe harbour margins and eligibility thresholds differ across categories of services. The proposed changes consolidate software development services, IT-enabled services, knowledge process outsourcing services, and contract R&D relating to software development into one (1) category of "information technology services" with a common safe harbour margin of 15.5%. The proposed changes also raise the threshold value of services provided in a financial year for availing this safe harbour from INR3,000,000,000 (approx. USD33,191,730) to INR20,000,000,000 (approx. 221,278,200).

Importantly, approvals for safe harbour for IT services are also planned to be automated without any need for a tax officer to examine and accept the application. Once opted, the safe harbour benefit can be continued for a period of five (5) years at the taxpayer's choice.

Separately, the proposed changes introduce a tax holiday up to the year 2047 for foreign companies providing cloud services globally through data centre services procured from India, subject to certain conditions being fulfilled. Also, if the Indian data centre is a related party to the foreign cloud company, a safe harbour margin of 15% on cost can be availed.

Tax holiday for International Financial Services Centre ("IFSC") units and Offshore Banking Units ("OBU")

Under the current law, IFSC units enjoy a 100% deduction on certain income for ten (10) consecutive years chosen out of the first fifteen (15) years from their registration/ commencement. OBUs get a 100% deduction for ten (10) consecutive years. The proposed changes extend this to twenty (20) consecutive years out of twenty-five (25) years for IFSC units, and twenty (20) consecutive years for OBUs. Once the tax-holiday period is over, the business income of these units will be taxed at a concessional rate of 15%.

Additionally, for IFSC/OBU units commencing operations on or after April 1, 2026, the aforesaid deduction is available only if the unit is not formed by splitting up, reconstruction, reorganization, or transfer of an existing business in India.

These changes are proposed to apply from April 1, 2026, for the tax year 2026-27 onwards.

<u>In our view, the extension of the tax holiday period provides long-term tax certainty for IFSC and OBU units. The post tax holiday concessional tax rate of 15% also offers clarity on the long-term tax cost once the exemption period ends. However, for new IFSC and OBU units, the aforesaid restructuring condition will require careful review and compliance to ensure that the tax holiday can be availed</u>.

Securities transaction tax ("STT")

STT is levied on transactions in specified securities carried out through recognised stock exchanges. The proposed changes increase the STT rates for derivatives, i.e., options and futures. The revised rates are: (i) 0.15% on the sale of an option in securities (applied on the premium); (ii) 0.15% on the sale of an option in securities when the option is exercised (applied on intrinsic price); and (iii) 0.05% on the sale of a futures contract in securities

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(applied on the traded price). The rate applicable on selling an option in securities has increased from 0.1% to 0.15% of the option premium. The rate applicable on selling an option when it is exercised has increased from 0.125% to 0.15% of the intrinsic price. The rate applicable on selling a futures contract has increased from 0.02% to 0.05% of the traded price.

The new rates are proposed to apply from April 1, 2026, to derivatives transactions in securities entered into on or after that date.

The increase in STT rates will directly increase transaction costs for participants trading in futures and options. The apparent intent is to discourage speculative trading and reduce excessive risk-taking in the securities market.

No changes in tax rates

The Budget does not change the income-tax rates for individuals (in both the new or the old tax regime) and does not change the corporate tax rates or the applicable surcharge/cess.