UNION BUDGET 2026

Key Highlights and Reforms
Focusing on Financial Sector Entities

Vinod Kothari Consultants
Consultants to Financial Intermediaries

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Key Highlights

- Stable tax regime
    - Was there a headroom for any liberalisation in tax regime? Really no, with the tax receipts from FY 25-26 considerably lesser than the budgeted number
    - Non-tax revenues remarkably, dividends, have been a major source of revenue
- Long-term growth with focus on manufacturing, infrastructure, and MSMEs
    - The focus on manufacturing-sector-led growth is quite clear, as there is increasing realisation that India has to reduce dependence on services sector
        - Currently, services take over 51% share of the country's GDP
        - Services are getting increasingly vulnerable to tariff environment
- No major tax reforms or institutional reforms
    - Legislative reforms in consolidation of several economic laws already done
    - FEMA rules for foreign equity to be reviewed
- Bond markets and capital markets
    - Some significant measures - market-making, and introduction of Total return swaps, but regrettably, credit default swaps on bonds are still in infancy.

Promoting MSMEs (1/2)

- **Capital and liquidity support :**

Equity support - Additional support through SME Growth Fund and Self Reliant India Fund

- **SME Growth Fund**
  - SEBI-registered Venture Capital Fund investing in equity/equity-related instruments of high-growth Indian SMEs.
  - Deliver attractive risk-adjusted returns through long-term capital appreciation.
  - Budget proposal - **Dedicate ₹10,000 crore to the fund, to develop and scale "champion SMEs" with high growth potential.**

- **Self Reliant India Fund**
  - SRI Fund aims to provide support for MSMEs across the country through equity infusion. It provides capital to funds for onward investment in MSMEs via equity and quasi-equity.
  - It targets MSMEs having scale up potential and national/international champions, especially in critical technologies supporting India's self-reliance.
  - Budget proposal - **allocation of top-up ₹4,000 crore fund to the Self-Reliant India Fund to support MSMEs.**
    - ₹2,000 crore is specifically earmarked for micro enterprises.

Our resources:

- FAQs on TReDS
- Ushering the new-age TReDS Platform
- Embracing a Wider Scope for TReDS

Promoting MSMEs (2/2)

- **Professional support**
  - ICAI, ICSI, and ICMAI to design short-term modular courses
  - Creation of a cadre of “Corporate Mitras”, especially in Tier-II and Tier-III towns, to help MSMEs with compliance at affordable cost.
  - Revival of 200 legacy industry clusters : facilitate modular training courses for “Corporate Mitras”

- **Liquidity Support through TreDS**
  - Refer slide 5 & 6

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MSME Financing: TReDS as the liquidity option

Mandatory Settlement Platform

- TReDS has significantly improved MSME liquidity, with total financing growing from ~₹950 crore (FY2018) to ~₹2,33,000 crore (FY2025).
- CPSEs were previously mandatorily required to register on TReDS; invoice settlement was optional, but now all CPSE–MSME invoices must be settled through the platform.
- All buyers with turnover > ₹250 crore are mandatorily required to register, encouraging broader corporate adoption. Further, this mandatory settlement with CPEs is expected to encourage settlement by other non CPE buyers as well.
- This will help improve MSME liquidity and reduce financing costs;

Credit Guarantee Support Mechanism

- The Ministry of MSME implements the Credit Guarantee Scheme (CGS) for Micro and Small Enterprises (MSEs) through the CGTMSE;
- CGS via CGTMSE covers collateral-free term loans and working capital for MSEs. without collateral security or third-party guarantees.
- **Proposal includes credit guarantee for invoice discounting through the TReDS platform.**
- Expands guarantee coverage to receivables financing, enabling easier access to short-term liquidity for MSEs.

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MSME Financing: TReDS as the liquidity option

- **Linking of Government e-Marketplace (GeM) Sahay with TreDs**
  - GeM Sahay is a digital financing solution that provides instant, collateral-free loans to proprietorships and MSMEs against government purchase orders, without requiring buyer consent.
  - Integration with TReDS allows MSMEs to discount actual invoices, not just purchase orders, through multiple financiers;
  - Inclusion of government invoices boosts financier confidence, increasing funding availability and lowering borrowing costs.

- **Introduction of TReDS receivables as asset-backed securities - Refer next slide**

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Asset-backed securities out of TReDS receivables

- **What is an asset backed security?**
  - Securitisation is a process of pooling of receivables and in turn issuing securities that are backed by these receivables, hence, commonly referred to as asset backed securities.
- **Currently, is securitisation of trade receivables possible?**
  - Currently, there are issues on securitisation of short term receivables, except in case of factoring transactions
- **What may be the structure of the proposed scheme?**
  - Potentially, banks or factoring entities which finance TReDS receivables may pool them in a replenishing transaction, and come up with asset backed securities out of the same.
- **Who may be the beneficiaries of the proposal?**
  - Banks, factoring entities.
  - It may enable them to release their capital by raising funding from the capital markets

Our existing resources:

- Securitisation of MSME receivables in India – Vinod Kothari Consultants
- What is securitisation
- Securitisation & Structured Finance

Infrastructure Financing

- Infrastructure financing:
  - Proposal for an Infrastructure Risk Guarantee Fund: To strengthen confidence of private developers, an Infrastructure Risk Guarantee Fund will be set up to provide Partial Credit Guarantee (PCE) to infrastructure lenders specifically to cover development and construction phase risk.
  - Assets of CPSEs to be recycled under the REITs: Significant real estate asset of CPSEs will be monetized under REITs platform.
- Why is the construction risk under infrastructure financing important?
  - Infrastructure projects have a construction period, and a payback period. During construction period, there are major risks (construction delays, public agitation, litigation, etc). Once operational, the project has relatively minor risks
- What is partial credit guarantee (PCG)?
  - PCGs are a liquidity support available to an issuer to take care of temporary inability to service the obligations under a loan/bond issuance. The liquidity support is typically subordinated to the claims of the lenders/bond issuers
- Is this scheme going to make a difference?
  - depends on the structure of the scheme, but usually, liquidity facilities are more relevant after the project has achieved DCCO

Our existing resources:

- Roads to Riches: A snapshot of InvITs in India
- Infrastructure Securitisation
- Economic Survey 2026: Key Insights on Infrastructure Financing

Total Return Swaps and Municipal Bonds

- Introduction of Total Return Swaps (TRS) on corporate bonds
  - Aimed at deepening the bond market and encourage larger issuances.
  - What is a TRS ?
    - A TRS is designed to provide total protection on all the volatility that the reference asset has. Protection buyers in a TRS are protected against the variability of the “total return” from the asset pool.
    - Thus, protection buyers swap the “total return” from the asset pool, with a return computed at a fixed spread on a base rate, say LIBOR.
    - Protection sellers in a TRS guarantee a prefixed spread to protection buyers, who in turn, agree to pass on the actual collections and actual variations in prices on the credit asset to protection sellers.
    - Since protection sellers receive the total return from the asset, protection sellers also have the benefit of upside, if any, from the reference asset.
    - The maturity of the TRS on the expiry of the term or the happening of a credit event.
- Incentive of ₹100 crore for single issuance of municipal bonds of more than ₹1000 crore
  - This is proposed to encourage issuance of municipal bonds of higher value by large cities.
  - The Indian municipal bond market remains in a nascent stage. As of March 2024, the total municipal bonds outstanding at ₹4,204 crore was just 0.09 per cent of the total corporate bonds outstanding.
  - The current scheme under AMRUT will continue for smaller and medium towns.

Our existing resources:

- Introduction to Credit Derivatives
- Municipal Bonds-Way Forward – Vinod Kothari Consultants
- The Munis of India: Facilitating municipal bonds – Vinod Kothari Consultants
- Municipal Bonds - An understanding

Non-Debt Instruments

- Comprehensive Review of the FEMA (Non-debt Instruments) Rules (NDI Rules) proposed
  - to make it more contemporary and user friendly, aligned with India's evolving economic priorities.
- Individual PROI eligible to invest in equity instruments in listed Indian Companies through the Portfolio Investment Scheme (PIS).
  - PIS is a framework prescribed under Rule 12 (1) read with Schedule III to NDI Rules that enables NRIs or OCIs to purchase and sell equity instruments of listed Indian companies company on repatriation basis, on a recognized stock exchange in India through a designated branch of an authorised dealer.
  - Investments made by NRIs/ OCIs under Schedule III to NDI Rules which is considered as Foreign Portfolio Investment within the meaning of Rule 2(t) of NDI Rules is reported by AD Bank on daily basis to RBI in Form LEC(NRI).
    - "foreign portfolio investment" means any investment made by a person resident outside India through equity instruments **where such investment is less than ten percent of the post issue paid-up share capital on a fully diluted basis of a listed Indian company** or less than ten percent of the paid-up value of each series of equity instrument of a listed Indian company
  - It is proposed to extend PIS to all individual PROIs and not just NRIs/ OCIs.
- Individual investment limits under PIS to be doubled from 5% to 10%
  - Presently, the total holding by any individual NRI or OCI cannot exceed 5 % of the total paid-up equity capital on a fully diluted basis.
  - **Here, the Limit should be less than 10% (like it is for FPIs under Schedule II to NDI Rules) - otherwise it will be considered as foreign direct investment.**
- Increase in the overall investment limit under PIS from 10% to 24%
  - Presently,the total holdings of all NRIs and OCIs put together cannot exceed 10% of the total paid-up equity capital on a fully diluted basis.
  - The aggregate ceiling of 10 % could be raised to 24 % by way of a special resolution.
  - Pursuant to the increase in the the aggregate ceiling to 24%, special resolution will not be required.

Our existing resources:

- Resource center on FEMA
- Resource center on FPI
- Resource center on FDI
- Introduction to foreign investment rules & recent amendments

Financial Sector Entities

- High Level Committee for Banking
  - A high-level committee on banking for Viksit Bharat. This committee will comprehensively review the banking sector.
  - Why is it needed?
    - While Indian banks are competing globally, but there are sweeping changes world-over. India’s banking system was last reviewed comprehensively by the Narasimham Committee in 1998.
    - Since then, private banks came, several SFBs were turned universal banks, and there is increasing competition from NBFCs
    - Hence, Indian banking needs a thorough review
- Review of public sector NBFCs
  - Proposal to restructure Power Finance Corporation (PFC) and REC Limited, two of India's premier, state-owned non-banking financial companies (NBFCs) under the Ministry of Power
  - Public sector NBFCs enjoy several relaxations under the regulatory framework
    - Shall not fall under UL
  - PFC has an AUM of approx Rs 11.70 lakh crores, and REC has Rs 6 lakh crores
- What may the restructuring involve?
  - Potentially, equity dilution

Banks and financial institutions in IFSC

- Extension of tax holiday for units in IFSC and rationalization of tax rate
  - Amendments in Section 147 of the Income-tax Act 2025 relating to deductions for income of Offshore Banking Units and Units of International Financial Services Centre
    - Period of deduction to be increased to 20 consecutive years out of 25 years for units in IFSC and 20 consecutive years for OBUs
    - Units shall be entitled to benefit only it it is not formed by splitting up, reconstruction, reorganisation or transfer a business.
  - Business income of IFSC units after the expiry of deduction period will be taxed at rate of 15%.
- Impact
  - More interest in setting up financial sector entities in IFSC
  - Most of the leading Indian and foreign banks already have IFSC units. The proposed tax holiday will accelerate the use of IFSC for global financial transactions

Our existing resources:

- Financial entities in IFSC: A primer
- Finance Companies / Units in International Financial Services Centre (IFSC)

ICDS to be merged with IndAS

- IndAS prescribes accounting standards for preparation of financial statements by specified classes of companies, while ICDS, issued by CBDT, governs the computation of taxable income under ‘PGBP’ and ‘Other Sources’.
- The present Union Budget proposed merging of ICDS with Ind AS:
  - to align tax computation with accounting standards;
  - minimize discrepancies between book profits and taxable income;
  - simplifying tax computations;
  - mitigate preparation of parallel books of accounts for tax purposes.
- In view of the above, separate accounting requirement based on ICDS is proposed to be done away with from the tax year 2027-28.
- For the purpose of giving effect to the above, a Joint Committee of Ministry of Corporate Affairs and Central Board of Direct Taxes shall be constituted.
- What may be the potential implications of imposing IndAS for tax computation?
  - The basis of tax computation and reporting of profits under Ind AS are not aligned in many respects:
    - Fair value gains/losses under Ind AS are not taxable/deductible for tax purposes
    - Financial liabilities are recognised at fair value - gain on initial recognition is taken to P/L and unwound over time
    - Accounting for mergers is quite different
    - Construction contracts are booked on progressive completion
    - ROU assets are depreciation

Buybacks taxation rationalised

- Existing regime:
  - Entire consideration included u/s 2(40)(f) of IT Act, and taxable as “dividend”
  - Taxable at slab rates as applicable to respective shareholders, with a flat surcharge @ 15%
  - Entire cost of acquisition in respect of shares bought back to be booked as “capital loss” [S. 69(2)]
  - Such capital loss may be set off against capital gains subsequently
    - Set-off available for a period of 8 tax years immediately after the year in which loss arise [S. 111]
  - No deductions allowed for any type of expense made in connection therewith [S. 93]
- Proposals under the Finance Bill:
  - Effective from 1st April, 2026:
  - Buyback consideration not to be treated as deemed dividend [omission of clause (f) to Sec 2(40)]
  - Difference between consideration received & cost of acquisition taxable as **capital gains** [S. 69(1)]
    - In the hands of the recipient shareholder
    - In case of promoter shareholders, tax payable at higher rates depending on whether promoter is a domestic company or not

Our existing resources:

- Resource Centre on Buyback
- Article based on the Finance Act, 2024 amendment - Bye-bye, buybacks

Illustration to understand buyback taxation

Buy: 100 shares @ INR 40 per share (A)	INR 4000
Buy back: 20 shares @ INR 60 per share (B)	INR 1200
Income taxable as capital gains (C) = 20*INR (60-40)	INR 400

	Any person	**Promoter is a domestic company**	**Promoter, other than domestic company**
Short-term capital gains (S. 196)	20%	20% + 2% = 22%	20% + 10% = 30%
Long-term capital gains (S. 197/ 198)	12.5%*	12.5% + 9.5% =22%	12.5% + 17.5% =30%
*** In specified cases u/s 198, LTCG exceeding ₹ 1,25,000 are taxable @12.5%.			

Meaning of Promoter:

- In case of listed company,
  - as per SEBI Buyback Regulations
- In any other case,
  - as per S. 2(69) of Companies Act, or
  - a person who holds, directly or indirectly, more than 10% of the shareholding in the company

Increase in the rate of STT

- India's derivatives market becomes world's largest (Source: ET).
- In a recent address, SEBI Chairman urged retail investors to assess their risk capacity while dealing in derivatives and avoid speculative trades:

  SEBI studies, however, have consistently shown that retail investors trading in derivatives end up facing losses, often because they do not fully understand the risk in these products. Derivatives are meant for hedging and risk management, not for quick gains. Retail investors should therefore assess their risk capacity, learn how these contracts work, and avoid speculative trades.
- Massive retail losses in derivatives: In FY 2024-25, 91% of individual traders in the Equity Derivatives Segment incurred net losses. Net losses of retail traders widened to ₹1.05 lakh crore in FY 2024-25 (up 41% from ₹74,812 crore in FY 2023-24). Average loss per trader in FY 2024-25: ₹1.1 lakh (up 27%).
- The Finance Bill, 2026, accordingly, proposed to increase the STT rates applicable to certain derivatives transactions, namely options and futures in securities, resulting in:
  - discouraging excessive retail speculation in the F&O market;
  - generating additional revenues for the Government.
- Revised rates (see next slide) to be applicable to transactions entered into on or after 1st April, 2026.

What is STT?

STT is levied on transactions in specified securities carried out through recognised SEs. It is not based on profit or income. Instead, it is charged at the time of executing the transaction itself.

Direct Taxes

- Minimum Alternate TAX (MAT)
  - MAT to be made the final tax and no new MAT credit to be allowed
  - Tax rate of MAT has been reduced from 15% to 14% of book profits
  - Set off of MAT credit in case of domestic companies to be allowed in the new tax regime to the extent of 25% of the tax liability
  - Set off of MAT credit in case of foreign companies to be allowed to the extent of the difference between the tax on the total income and MAT
- Increase of STT rates on futures and options:

Instrument	Transaction type	Existing rate	Revised rate	% Change
Options	Sale of option	0.1%	0.15%	50%
Options	Exercise of option	0.125%	0.15%	20%
Futures	Sale of futures	0.02%	0.05%	150%

- All types of shareholders to be charged Capital gains on all buyback of shares transactions, promoters to pay additional tax on buyback, effective tax rate of 22% for corporate promoters and 30% for non corporate promoters

Rs. 20,000 Crs outlay towards Carbon capture, utilisation and storage (CCUS)

- ₹20,000 crore allocation over next 5 years for CCUS
  - Aimed at reducing industrial emissions, particularly in high-emission sectors like steel and cement, signalling a strong push for long-term decarbonisation.
- What is CCUS?
  - CCUS refers to technologies that capture CO_2 emissions at the source (e.g., factories, power plants) or from the air and either store them underground or convert them into useful products.
- In December, 2025, The Department of Science and Technology launched a R&D roadmap, aimed at achieving net zero target through CCUS
  - Chapter 5 of the Roadmap deals with financing models, funding schemes and policy frameworks for CCUS - see here

Our existing resources:

- Resource on climate finance
- Resource on sustainability finance
- Resource center on ESG and Sustainability
- Resource on measures on climate change

Vinod Kothari Consultants P. Ltd.

Kolkata	Mumbai	New Delhi	Bengaluru
Anjaneyam, B42, Metropolitan Cooperative Housing Society, Kolkata 700 105	403-406, 175 Shreyas Chambers, D.N. Road, Fort, Mumbai – 400 001	Nukleus, 501 & 501A, 5th Floor, Salcon Rasvilas, District Centre, Saket, Delhi 110 017	4, Union Street, Infantry Rd, Shivaji Nagar, Bengaluru. 560001
+91 33 45017864/ 23233742	+91 22 40056953	+91 11 4131 5340	+91 22 40056953
kolkata@vinodkothari.com	bombay@vinodkothari.com	delhi@vinodkothari.com	info@vinodkothari.com
www.vinodkothari.com			