

To attract foreign investors, Government considers cut in withholding tax

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Written by: [Aanchal Magazine](#), [Siddharth Upasani](#) 7 min read New Delhi Updated: May 15, 2026 07:10 AM IST



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AFTER HIKING [import duty on gold](#), the government and the Reserve Bank of India are learnt to be considering multiple measures to attract foreign investment inflows including a cut in the

withholding tax rate on government bonds, if not completely eliminating it.

Withholding tax is akin to a tax deducted at source and is paid by foreign investors on interest income they receive on their holding of Indian bonds. At present, non-residents pay a withholding tax of about 20% on the interest they get on the government bonds they hold — one of the highest in the world — after a concessional rate of 5% ended in 2023.

The discussions on some of these proposals have been on over the past few weeks with policy makers keen to conserve foreign exchange reserves and secure the external account amid the ongoing West Asia conflict.

Prime Minister Narendra Modi too had recently [appealed to the people to stop buying gold](#), use public transport and car pool to cut fuel consumption, avoid foreign travel and destination weddings overseas to save foreign exchange.

Queries sent to the Finance Ministry and the RBI did not elicit a response.

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According to sources, the discussions have also precipitated in an internal wrangling among sections of the top policymakers if these measures will unfold as envisaged and actually translate into higher investment inflows in the current global economic situation given the prevailing high interest rates in the US and the lingering exogenous threats to the macroeconomy.

In one such meeting, The Indian Express has learnt, senior officials discussed threadbare if any special foreign deposit scheme needs to be brought in, a proposal which was eventually junked. Back in 2013, when the rupee had fallen sharply due to US Federal Reserve's 'taper tantrums', RBI had opened a Foreign Currency Non-Resident (Bank) deposit swap window for a period of just under three months, during which banks raised \$26 billion, helping boost the central bank's forex reserves.

EXPLAINED

Behind the worry

On top of a foreign capital strike, depletion of forex reserves by \$38 billion in two months has forced the government to not just conserve foreign exchange but also make Indian markets attractive for foreign capital. This will stabilise the capital account and prevent rupee fall.

Officials are also learnt to have discussed in detail the removal of the withholding tax on government bonds for foreign investors. But whether investment flows will actually increase after elimination of the tax was an apprehension holding back a final decision, a person aware of the developments said.

Instead, more austerity measures and forex conservation have been cited as a priority to tackle the evolving situation. Other steps to discourage imports and conserve forex, such as a hike in import duty on gold and other precious metals, have been announced in line with the Prime Minister's appeal to citizens.

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“A key concern with the proposal to remove withholding tax is that it might not work in the current context, exposing India to fresh scrutiny. Austerity measures and fuel hikes have happened almost in the entire Asia Pacific region two months ago. India has been comparatively behind the curve on this. A fuel price hike is inevitable and not hiking retail fuel prices will make the situation untenable. Investors and rating agencies would have an eye on this,” a person aware of the meetings on the issue told *The Indian Express*.

In contrast, while China has a withholding tax of 10% on interest income from bonds, a temporary exemption has been in place since November 2018, with interest on certain government debt also exempt, according to a report by global accountancy firm KPMG.

Among other Asian economies, while Vietnam levies a 5% withholding tax, Malaysia exempts government bonds from this levy.

Investors from countries with which India has double taxation avoidance agreements pay lower rates. Meanwhile, investors who don't have an Indian tax residency suffer even more because

the withholding tax must be paid on the gross amount and losses can't be set off against past gains.

Speaking earlier this month at an Ashoka University event, Ananth Narayan, who served as a Whole Time Member at the Securities and Exchange Board of India until October, had said that India's withholding tax caused a lot of "friction" for foreign investors. "I am not saying that if you solve this tomorrow, money will come in. But this is definitely a barrier for money to come into the country," he had said.

Meanwhile, another person aware of the discussions said any immediate measures are to be cautiously implemented, adding that the ability to prevent a further slide in the rupee is at present limited as the market is pricing in earlier interventions when the exchange rate was stabilised to a large extent over the span of roughly three years. "The slide now appears to be steeper because of the earlier interventions, which limits the possible use of forex to now defend a specific level of the rupee," the person said.

After selling less than a \$100 billion of foreign currency on a gross basis each in 2020-21 and 2021-22, the RBI sharply stepped up its foreign exchange market interventions in 2022-23, selling what was then a record \$213 billion to check exchange rate volatility. While this figure reduced to \$153 billion in 2023-24, it hit a new high of \$399 billion in 2024-25. This fell sharply to \$166 billion in the first 11 months of 2025-26, although the central bank has intervened aggressively in the forwards market, with its net short position at \$104 billion at the end of February.

The RBI's reduced forex intervention over the last year or so has meant the rupee has weakened by 11% against the US dollar over the period. Since the war began in late February, the rupee has fallen by 5%, with foreign portfolio investors having withdrawn about \$22.5 billion so far in 2026 from Indian financial markets.

On the positive side, February saw net foreign direct investment inflows return to positive territory after a gap of six months to a near-four-year high of \$4.6 billion following an interim trade deal agreed between India and US. In the first 11 months of 2025-26, net FDI inflows amounted to \$6.27 billion, up from a mere \$959 million in 2024-25, with repatriations by foreign investors of past investments and overseas foreign direct investments by Indian companies eating into net flows.

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