1 February 2026

Tax Alert - Key announcements of Union Budget 2026

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Union
BUDGET
2026-27

Budget 2026-27: Reinforcing defence capability growth through enhanced capital allocation

This year's Budget allocation deepens investment in future-focused technologies, domestic industry and operational readiness, advancing India's steady march toward a future-ready force.

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The Union Budget 2026 underscores India's sharpened strategic focus on defence preparedness, with an expected significant increase in defence allocation that reinforces the twin imperatives of self-reliance and modernization. The Ministry of Defence has again emerged as one of the top-funded ministries, with total allocations rising by 15.18% over last year's Budget Estimates (BE) to INR7.84 lakh crore (US$85.7 billion).

A significant 22% surge in capital outlay to INR2.19 lakh crore (US$23.9 billion) with allocation of nearly two-thirds of it towards key segments notably aircraft and aero engines and other equipment signals a strong push toward capability enhancement and procurement of next-generation platforms and infrastructure. Complementing this, revenue expenditure has expanded to INR3.65 lakh crore (US$39.9 billion), a ~17% increase, ensuring robust support for operational readiness, troop sustenance and logistics.

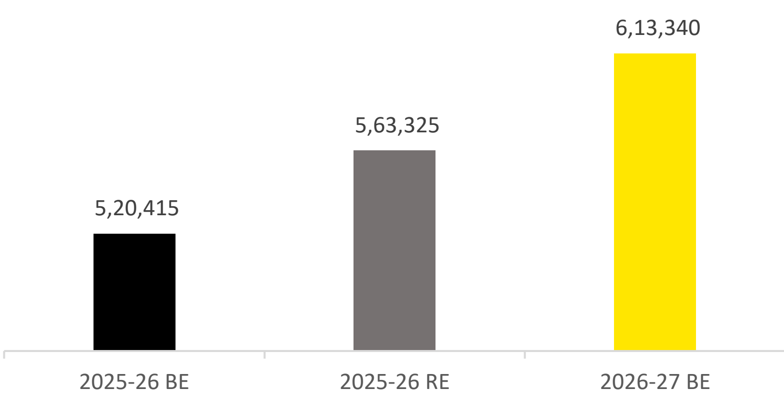
Notably, INR88,053 crore (US$9.62 billion) has been earmarked for repairs, stores and works, bringing the overall modernization envelope to INR3.07 lakh crore (US$33.55 billion). India's commitment to 'Atmanirbharta' is visible, with indigenous defence production reaching INR1.54 lakh crore (US$16.8 billion), reflecting growing confidence in domestic capabilities and a growing defence industrial base.

BCD exemption on imported components used in manufacturing aircraft parts to all manufacturers, and a dedicated BCD exemption for Defence PSUs importing raw materials for producing aircraft parts for MRO are welcome measures to lower input costs, stimulate domestic manufacturing and building a competitive and self-reliant defence value chain.

How does the Budget impact Defence sector?

- Defence allocation is accounted for under four demands for grants:
  - Demand No 19 – Ministry of Defence (Civil)
  - Demand No 20 – Defence services (revenue)
  - Demand No 21 – Capital outlay on Defence services
  - Demand No 22 – Defence pensions
- The total defence budget (excluding Defence pensions) for Financial Year (FY) 2026-27 is INR6,13,340 crore (US$67.03 billion).
- Budgetary allocation towards capital expenditure stands at INR2,19,306 crore (US$23.9 billion).
- Revenue expenditure allocation stands at INR3,65,479 crore (US$39.9 billion).

Total defence expenditure (excluding Defence pensions) (INR crore)



Brief on capital expenditure

- Modernization of military forces is mainly influenced by the annual capital allocation in the Budget.
- The current capital budget, expressed in INR, has seen an increase of ~21.83% over FY 2024-25 (BE).

Highlights

INR7.84 lakh crore (US$85.7 billion)

Budget for defence FY26-27

~15.18% increase over FY 2025-26 Budget Estimate

~14.67% of total Budget

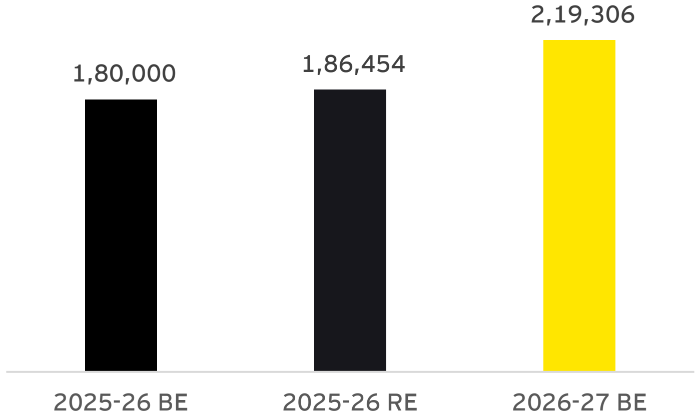
~22%

increase in capital outlay

INR2.19 lakh crore (US$23.9 billion)

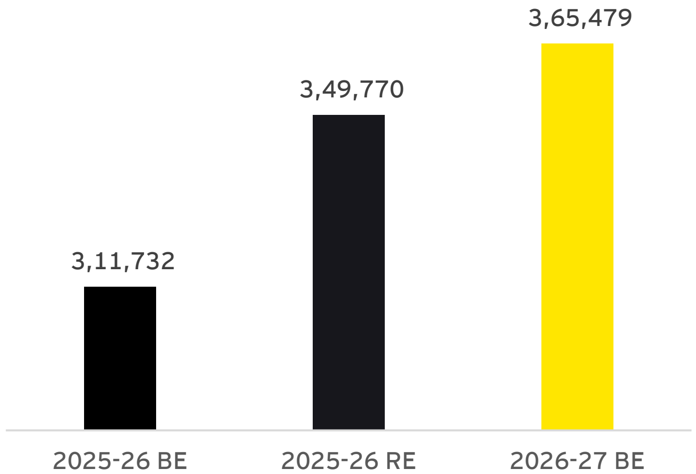
Capital expenditure

Capital expenditure (INR crore)



- Closer examination of capital expenditure in INR terms shows an increase of ~31% and ~30% for aircraft and aero-engines and other equipment requirements over FY 2025-26 (BE) for the Armed Forces, respectively.
- The allocation for Heavy and Medium Vehicles is INR4,580 crore (US$0.5 billion) for FY 2026-27 (BE), an increase of ~25% over FY 2025-26 (BE).

Revenue expenditure (INR crore)



- Budgetary allocation towards revenue expenditure for this year is INR3,65,478 crore (US$39.94 billion), an increase of ~17.23% from FY 2025-26 (BE).
- When measured in INR currency terms, the Armed Forces have witnessed an increase of 17.2% (Army), 22.7% (Navy), 17.6% (Air Force) respectively in revenue budget over FY 2025-26 (BE).
- The total allocation for Agnipath Scheme has seen an increase by 51% over FY 2025-26 (BE).
- Revenue R&D budget has been increased by 17% over FY 2025-26 (BE).

Highlights

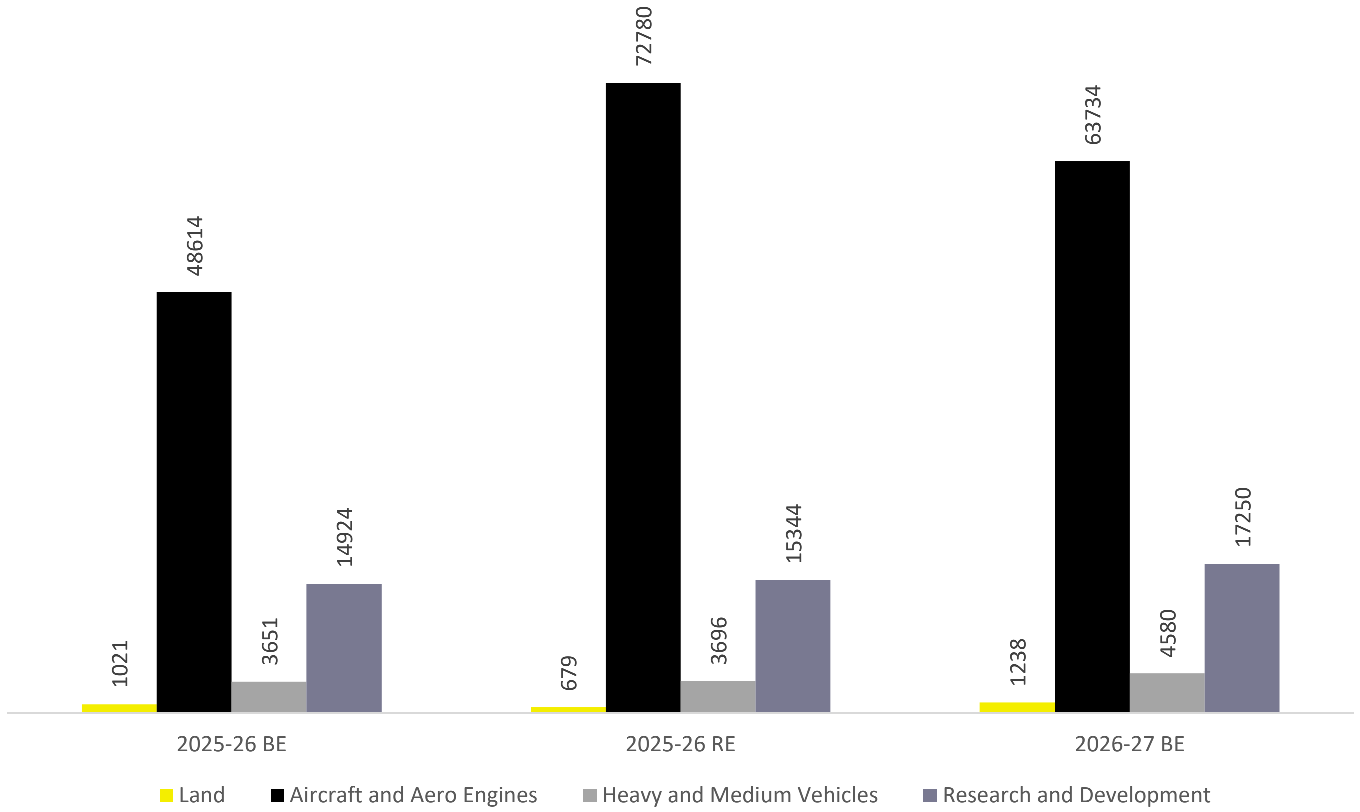
INR3.65 lakh crore (US$39.9 billion)

Revenue expenditure

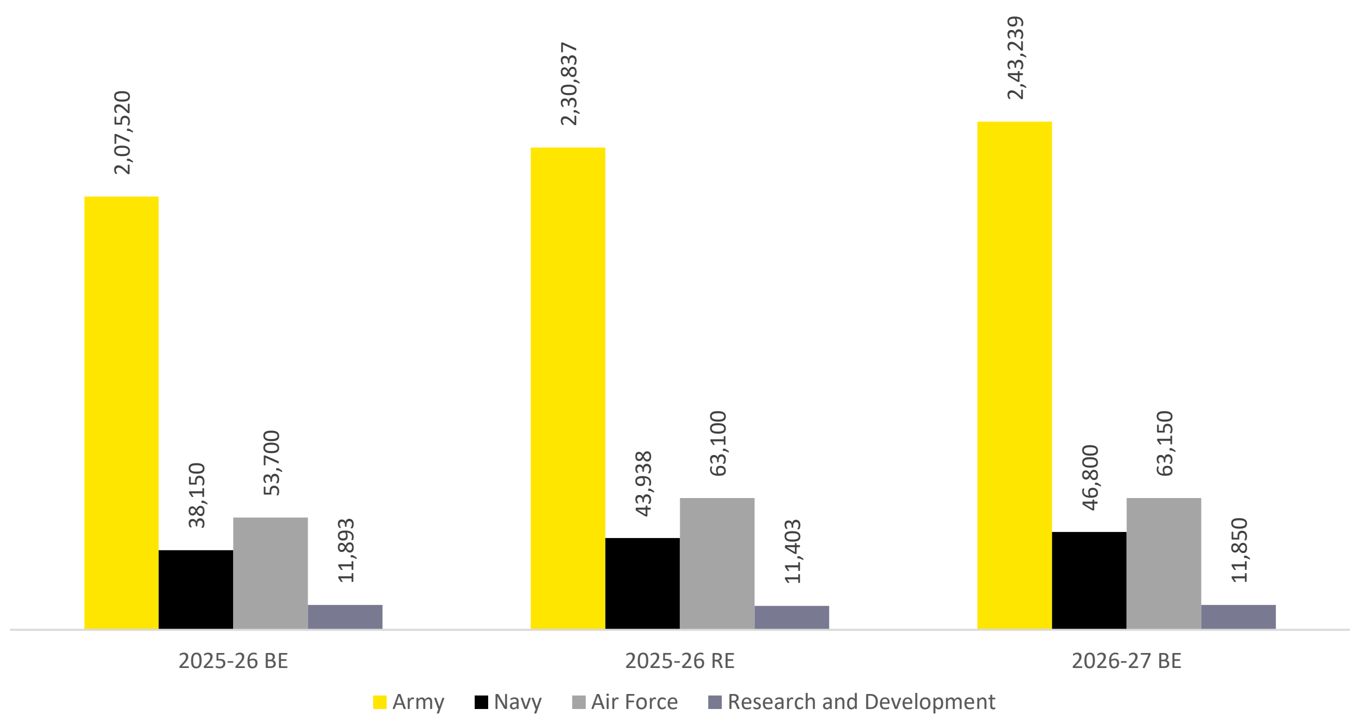
~17%

increase in revenue expenditure

Breakdown of capital expenditure (INR crore)



Breakdown of revenue expenditure (INR crore)



Tax announcements

Direct Tax:

- Extension in tax holiday period for units in IFSC engaged in leasing of aircrafts and ships.
  - Currently, a 100% tax deduction is available to IFSC units engaged in leasing of aircrafts and ships for a period of 10 consecutive years out of a block of 15 years.
  - Now, the tax holiday period has been proposed to be extended to 20 consecutive years out of a block of 25 years for such units.
- Eligible income of these IFSC units will now be taxed at 15% instead of the 22%/30% rate, applicable to income earned outside the tax holiday period. This is applicable from tax year 2026-27.
- The term "work" under withholding tax provisions (payment to contractor) has been amended to clarify that payment for supply of manpower would qualify as payment for "work" and consequently be subject to deduction of tax at the rate of 1% is paid to an individual or HUF and 2% in other case. This amendment is effective from 1 April 2026.
- Deductibility of employee's contribution to specified funds.
  - Currently, employees' contribution to specified funds such as provident fund and Employees' State Insurance is allowed as a deduction only if deposited within the statutory due date prescribed under the respective laws.
  - It is now proposed to allow deduction of employee's contribution if such contribution is deposited on or before the due date for filing the return of income, even where payment is not made within the statutory due date.
- Extended time limit to file Revised Income Tax Return - the prescribed time limit for filing of the revised income tax return is extended from its existing time limit of 9 months to 12 months from the end of the relevant tax year with a nominal fee. This will apply from tax year 2025-26 onwards.
- Significant changes proposed in respect of Minimum Alternate Tax.
  - MAT proposed to be reduced from existing 15% to 14%.
  - MAT would be a final tax, and no new MAT credit to be allowed.
  - No set-off of MAT credit if the company continues to be in old regime.
  - Set-off of MAT credit if transitioning to new regime during or after the tax year 2026-27, as follows: Set-off restricted to 25% of normal tax liability and balance credit can be carried forward to subsequent tax years (subject to existing limit of 15 years) and set off as above.

Indirect Tax:

Customs Duty

- BCD exemption has been provided on import of the following goods, effective from 2 February 2026.
  - Raw materials for manufacture of parts of aircraft for MRO of aircraft or components or parts of aircraft, provided that the goods are imported by Defence PSUs. The said exemption is subject to compliance of IGCR Rules, 2022 and certification from the Joint Secretary to the Government of India.
  - Components or parts, including engines, of aircraft, for the manufacture of aircraft and parts thereof, provided that the importer adheres to the procedure set out in the IGCR Rules, 2022.
- BCD exemption on import of the following goods has been extended till 31 March 2028.
  - Parts, tools, tool-kits for MRO of aircraft, components or parts of aircraft, subject to approval of DGCA.
  - Raw material for manufacture of aircraft and parts of such aircraft subject to compliance of IGCR Rules, 2022.
  - Components or parts for manufacture of aircraft and parts of such aircraft imported by Defence PSUs.
- Validity of Customs Advance Rulings has been proposed to be extended from three years to five years, unless there is a change in law or facts.

- Deferred Payment of Import Duty Rules, 2016 proposed to be amended to allow monthly duty payment in place of existing 15 days for all eligible importers. Benefit of deferred duty payment also proposed to be extended to 'manufacturer importer' till 31 March 2028.
- For SEZs, a special one-time measure has been proposed to transfer/sale of goods to DTA at concessional rates of duty. The quantum of such sales will be limited to a prescribed proportion of their exports.

Goods and Services Tax

- Current provision prescribing the place of supply of intermediary services as the location of the supplier to be omitted. Post omission, the place of supply for such services will be determined basis the general rule of location of recipient of service.
- Provision requiring discounts to be pre-agreed and linked to specific invoice to be omitted. Further, it is proposed that discount to be allowed as deduction only if a GST credit note is issued and corresponding input tax credit is reversed by the recipient.
- Provisional refund of 90% of the claimed amount to be granted in case of inverted tax refunds.
- Till the time NAAAR is constituted, the Government will be empowered to notify any existing authority constituted under any law (including a Tribunal) to hear appeals arising from conflicting advance rulings given by the Appellate Authorities of two or more states or union territories. Provisions relating to the constitution, structure, and procedural framework of NAAAR will not apply to such empowered authority.

Impact analysis

Amid high anticipation of a significant boost to defence allocation, the Union Budget 2026–27 has delivered a strategically calibrated response to India's evolving security landscape and national defence priority. The Ministry of Defence (MoD) has received a significant allocation, accounting for approximately 14.67% of the Union Budget.

Excluding pensions, the MoD's budget stands at INR6.13 lakh crore (US$67.03 billion), reflecting a robust 15.18% increase over FY 2025–26 (BE). This enhancement is strategically distributed across capital and revenue heads to ensure a balanced approach between capability acquisition and operational readiness.

The capital outlay has surged by 21.83% to INR2.19 lakh crore (US$23.9 billion), with a continued emphasis on domestic procurement i.e., nearly 75% of this outlay INR1.64 lakh crore (US$17.89 billion), is earmarked for the Indian defence industry. This aligns with the Government's Atmanirbhar Bharat (self-reliant India) vision and supports the growing defence industrial base.

Revenue expenditure has expanded to INR3.65 lakh crore (US$39.9 billion), a 17.24% increase over the previous year's BE. Notably, INR88,053 crore (US$9.62 billion) has been allocated for stores, repairs and works, bringing the total modernization budget to INR3.07 lakh crore (US$33.55 billion). This ensures that new acquisitions are matched by the resources required to sustain and deploy them effectively.

A steady rise of ~15% in defence R&D budget to bolster indigenous defence technology development, a cornerstone of the Atmanirbhar Bharat initiative. In line with previous announcements, 25% of the R&D allocation (INR4,312 crore) shall be earmarked for industry, startups and academia.

A ~31% increase in allocations for 'aircraft and aero-engines' signals movement on high-value platforms such as Multi Role Fighter Aircraft (MRFA) programme, Airborne Early Warning and Control (AEW&C) aircraft systems and Medium Transport Aircraft. A ~30.3% increase in allocations for 'other equipment' points to acquisitions of Electronic Warfare Systems, loitering munitions, lightweight radars, MLRS, heavyweight torpedoes, surveillance radars and BVR air-to-air missiles. A ~25.5% increase in allocations for vehicles indicates scaling up of mobility, logistics and combat support capabilities, including procurement of light specialist vehicles and armored recovery vehicles.

India's ambition to achieve INR3 lakh crore (US$32.72 billion) in indigenous defence production and INR50,000 crore (US$5.45 billion) in exports by 2029 is reflected in the Budget's orientation. This shall be achieved with greater industry participation i.e., by capacity and capability enhancement. These trends are underpinned by the Technology Perspective and Capability Roadmap (TPCR) 2025, which outlines a 15-year vision across land, air, maritime, cyber and space domains. With 457 products and services identified, TPCR 2025 provides a structured framework for capability development and industry alignment.

The expansion of existing industrial capacity, entry of new players and a growing pipeline of investments signal a positive trajectory for defence manufacturing.

In a shifting global security environment, the 2026–27 defence budget reflects a clear and balanced strategy—advancing modernization, sustaining operations and strengthening India's self-reliance in defence.

Glossary

IFSC – International Financial Services Centre

BE – Budgeted Estimate

RE – Revised Estimate

MAT – Minimum Alternate Tax

HUF – Hindu Undivided Family

MRO – Maintenance, Repair and Overhaul

BCD – Basic Customs Duty

PSU – Public Sector Undertaking

IGCR Rules - Import of Goods at Concessional Rate of Duty (IGCR) Rules, 2022

DGCA - Directorate General of Civil Aviation

GST – Goods and Services Tax

NAAAR - National Appellate Authority for Advance Ruling

MRFA - Multi Role Fighter Aircraft programme

AEW&C - Airborne Early Warning and Control

MLRS – Multiple Launch Rocket System

BVR – Beyond Visual Range

TPCR - Technology Perspective and Capability Roadmap

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