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STEERING INFLUENCE OF TAX LAWS OVER M&A TRANSACTIONS: REFLECTIONS ON CHANGING LANDSCAPE IN INDIA

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STEERING INFLUENCE OF TAX LAWS OVER M&A TRANSACTIONS: REFLECTIONS ON CHANGING LANDSCAPE IN INDIA

Tarun Jain*

[***Abstract:*** *The decision of the Supreme Court of India in the famous Vodafone case came exactly a decade back in 2012. Irrespective of the consequences which followed qua the parties and the subsequent legislative amendments, the judgment has pivoted a steering trend in the tax landscape. To recall, the case Vodafone involved a simple issue whether Vodafone, being a buyer, was required to deduct tax on the payment made by it to the seller Hutchinson. However, the seller being based offshore, the Indian tax authorities chose to enforce the tax liability qua the transaction, which was admittedly of the seller, from the buyer Vodafone. As a consequence, Vodafone had to contest the tax proceedings, in multiple rounds of litigation before various courts. Irrespective of the merits of the dispute, the perspective which settled home amongst the M&A participants, perhaps an extension of the caveat emptor principle, is the extended vigilance required on their part. This aspect has been significantly multiplied by further amendments in the tax laws which call for greater introspection of tax as a variable in the M&A space. This article attempts to sketch the landscape with the relevant developments in the Indian fiscal regulations in the last decade, to reflect upon the highly interwoven interface of tax laws and the corporate world. These developments, overwhelmingly, have reshaped corporate negotiations and deal-making, thereby resulting into a steering confluence of tax laws in M&A space.*]

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I

INTRODUCTION

> '*Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow tax-payers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so-called doctrine of 'the substance' seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from him is not legally claimable*.'[1]

Endorsing the ability of the citizens to manoeuvre within the maze of fiscal regulations so as to reduce their tax incidence – the *Duke of Westminster* principle as it is commonly referred to – has stood the test of time in balancing the rights of the taxpayers *vis-à-vis* the strain of liabilities under strenuous tax legislations. While the tussle is common across the globe, in the context of India, the decisions of the Supreme Court, such as in *Raman & Co*,[2] *Mathuram*,[3] *Arvind Narottam*,[4] *Azadi Bachao*,[5] *Walfort Share*,[6] *Vodafone*,[7] etc., have sought to vindicate the rights of the taxpayers, notwithstanding the tremulous vibrations of the observations in *McDowell*[8] which is considered as an extreme reflection on the troubled dividing lines between tax-planning and tax-avoidance.[9]

The overwhelming judicial tide in favour of taxpayer has not received a kind accommodation by the legislator. Instead, the ability of the taxpayers to plan their affairs has been injuncted measure after measure by legislative attempts to fix, if they can be considered such, the leakages in the tax system. However, it would be incorrect to perceive the legislative interjection as a mere annulment of the judicial rulings which it disagreed with. Perhaps the pressure

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[1] *Duke of Westminster v. Commissioners of Inland Revenue* (1935) 19 TC 490 (HL), per Lord Tomlin.

[2] *Commissioner of Income Tax v. A. Raman & Co.* (1968) 67 ITR 11 (SC).

[3] *Mathuram Agrawal v. State of Madhya Pradesh* (1999) 8 SCC 667.

[4] *Commissioner of Wealth Tax v. Arvind Narottam* (1988) 173 ITR 479 (SC).

[5] *Union of India v. Azadi Bachao Andolan* (2003) 263 ITR 1 (SC).

[6] *Commissioner of Income Tax v. Walfort Share and Stock Brokers Pvt. Ltd.* (2010) 326 ITR 1 (SC).

[7] *Vodafone International Holding BV v. Union of India* (2012) 341 ITR 1 (SC).

[8] *McDowell & Co. Ltd. v. Commercial Tax Officer* (1985) 154 ITR 148 (SC), per Chinnappa Reddy J.

[9] *See generally*, Tarun Jain, *Deciphering the judicial approach to Tax Avoidance: The ultimate test for GAAR*, pp. 574-602 in Mukesh Butani & Tarun Jain (Ed.), *General Anti-Avoidance Rules: The Final Tax Frontier?*, Thompson Reuters (2021).

to finance increasing pangs for national growth are equally culpable towards wide-scale expansion of the tax laws. Nonetheless fact remains that, some of the tax measures, particularly in the last decade, have been so wide and overarching that they not only scuttle the planning attempts but in fact go beyond to introduce more substantive tax liabilities upon the taxpayers. Most of these measures have been instituted post the decision of the Supreme Court in *Vodafone* (supra) which categorically approved the jurisprudential canon of *onus* to establish tax liability upon the tax officers.

As a mirror reflection, from the scope of the merger and acquisitions ('**M&A**') space and transaction tax perspective, a review of the developments in Indian tax landscape in the last decades reveals emergence of multiple variables of significance, many of which have a steering influence on how tax structuring has been perceived and undertaken in the past. In the context of this larger background, this article attempts a stock-taking exercise to paint the canvass of recently introduced tax measures affecting the M&A space which overwhelmingly influence the transaction landscape in India.

To set the context, it is appropriate to clarify that M&A is a generic expression employed to represent the variety of corporate reorganisations whereby corporate legal entities consolidate or split up with the objective of attaining business synergies. M&A subsumes within its fold amalgamation, merger, demerger, take over, stake sale, asset sale, etc. in both domestic and cross-border situations. Each of these forms of corporate reorganisations are under the enabling provisions of the corporate law and in most cases have their distinct own nuances in business paradigm. The differences in their corporate form are vivid and consequently the specific tax consequences may widely different between any two classes of M&A transactions. Nonetheless, the common theme presented in this article is the increasing intensity with which the Indian tax law is examining these transactions. For illustration, in both *Sanofi*[10] and *Vodafone Essar*[11] the *lis* involved alleged tax avoidance even though in *Sanofi* the M&A transaction examined was the alleged capital gains tax liability in India on sale of shares of a French company to another French company whereas *Vodafone Essar* involved a consideration asset demerger and its acquisition within a corporate group in the domestic law setting.

II

DIRECT TAX PERSPECTIVE

The Income Tax Act, 1961 ('**1961 Act**') is the core repository of Indian corporate

[10] *Sanofi Pasteur Holding SA v. Department of Revenue* (2013) 354 ITR 316 (AP).

[11] *Vodafone Essar Gujarat Ltd. v. Department of Income Tax* 2012 SCC Online 4141 (Guj).

tax and income tax regulations. Every year it undergoes various amendments (in the form of Finance Act) towards realigning with the changing priorities of the incumbent Government or addressing such eventualities which tax policy dictates as requiring a legislative response. This is also the trend as regards transformation of tax rules in the M&A transaction space, as the discussion in this section reveals.

General Anti-Avoidance Rules

"On considerations of economic efficiency and fiscal justice, a taxpayer should not be allowed to use legal constructions or transactions to violate horizontal equity. … [Hence] it is necessary and desirable to introduce a general anti-avoidance rule which will serve as a deterrent against such practices. This is also consistent with the international trend." It was *inter alia* for this reason that enactment of General Anti-Avoidance Rules ('**GAAR**') was first proposed in the Discussion Paper accompanying the Direct Tax Code Bill 2009.[12] Cast in widest of terms, enacted close to the heels of the *Vodafone* (*supra*) decision of the Supreme Court, in 2012 GAAR found their feet in the 1961 Act. Toning down its rigours[13] in the wake of an expert committee report,[14] finally these rules were enforced effective from 2017.

Notwithstanding their refined scope and significant administrative safeguards regulating their enforcement,[15] the fact remains that GAAR have single-handedly transformed the M&A landscape as they interject any 'impermissible avoidance arrangement' ('**IAA**') above the specified threshold. An IAA is defined to mean an arrangement whose main purpose to obtain a tax benefit, and it "(a) creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length; (b) results, directly or indirectly, in the misuse, or abuse, of the provisions of [the 1961] Act; (c) lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or (d) is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for *bona fide* purposes." As if this wide scope was not sufficient in itself, the presumption is against the taxpayer in so far as it is further provided that an IAA "shall be presumed, unless it is proved

[12] Available at https://prsindia.org/files/bills_acts/bills_parliament/1970/Discussion_Paper.pdf, pg. A-75.

[13] See, *Major recommendations of Expert Committee on GAAR accepted*, available at https://pib.gov.in/newsite/PrintRelease.aspx?relid=91556.

[14] Available at https://dea.gov.in/sites/default/files/report_gaar_itact1961.pdf.

[15] *See generally*, Satya Pinisetty, *Ground level challenges for administering GAAR*, pp. 212-230, in Mukesh Butani & Tarun Jain (Ed.), *General Anti-Avoidance Rules: The Final Tax Frontier?*, Thompson Reuters (2021).

to the contrary by the assessee, to have been entered into, or carried out, for the main purpose of obtaining a tax benefit, if the main purpose of a step in, or a part of, the arrangement is to obtain a tax benefit, notwithstanding the fact that the main purpose of the whole arrangement is not to obtain a tax benefit."[16]

The GAAR provisions *inter alia* categorically reverse the form over substance test given that the form of the transaction, as prioritised by *Duke of Westminster* principle, is no longer the sole point of examination and instead the intention of the taxpayer and related parties dominate the inquiry on the tax-propriety of the transaction. The steering impact on M&A transactions is evident from *inter alia* specific legislative prohibitions of arrangements such as round tripping; accommodating parties; offsetting or self-cancelling elements; or transactions conducted through one or more persons which disguise value, location, source, ownership or control of funds of such transaction; etc.[17] The operational provisions of GAAR permit the tax authorities to *inter alia* disregard / combine / recharacterising any step / part / whole arrangement; ignore the IAA altogether; disregard any accommodating party; reallocate the accruals / receipt / expenses / deductions, etc. amongst the parties; redefine the tax-residence of any party or the situs of assets / transactions; look through the arrangement by disregarding any corporate structure; etc.[18] Thus, their powers appear to be very wide and all pervasive.

In brief, the enforcement of GAAR has single-handedly rewritten the negotiating check-list and the M&A templates; forcing unlearning of decades of settled practices even for routine inbound/outbound investments in India and instituting offshore corporate structures. A decision of the Authority for Advance Ruling,[19] albeit without invoking GAAR, nonetheless in similar context, reveals the accentuating depth of anti-avoidance considerations in corporate structures, which confirms the overwhelming significance of GAAR as a crucial variable in M&A space.

Offshore Indirect Transfer Tax

Besides GAAR, another legislative reaction to *Vodafone* (supra) was the introduction in 2012 of offshore indirect transfer tax by expanding the scope of deemed income under the 1961 Act. In the wake of recommendations by an

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[16] Section 96, Income Tax Act, 1961.

[17] Section 97, *ibid*.

[18] Section 98, *ibid*.

[19] *In Re. Tiger Global International II Holding Mauritius*, AAR/4/2019 dated 26.03.2020. *Available at* https://taxguru.in/wp-content/uploads/2020/06/Tiger-Global-International-II-Holdings-Mauritius-Ors-AAR-Delhi.pdf

expert committee,[20] the scope of this substantive liability was pruned subsequently, and its rough edges were streamlined. Under the incumbent provisions, even an offshore deal between two non-resident entities can trigger tax consequences in India under the 1961 Act if shares / interest in an offshore company being transferred "derives, directly or indirectly, its value substantially from the assets located in India".[21] The liability is subject to exceeding a monetary threshold of INR 100mn and if the Indian assets represents at least half the value of total assets owned by the offshore entity being transferred.[22]

There are statutory exceptions to certain global reorganisations,[23] but the fact remains that the very enactment of this provision turns on its head the ratio of *Vodafone* (supra) by stipulating that Indian assets / step-down subsidiaries of an offshore entity can give rise to tax consequence in India in case of an offshore transfer. The consequence of this provision is that any global reorganisation or offshore transfer must invariably factor tax consequences in India in the wake of substantial Indian assets. In fact, this development turned the tide globally, with now an international movement towards taxing such offshore transfers.[24]

Another related aspect of the same provision is the requirement for fair market valuation ('**FMV**'). This is because determination of coverage under this provision is basis the FMV of Indian assets as per stipulated methodology.[25] Thus, a valuation of Indian assets now is a pre-requisite even in case of an offshore transaction, putting further strain to the M&A checklist.

Ability of tax authorities to annul transfers and transactions

The 1961 Act has always carried a provision empowering tax authorities towards securing outstanding tax dues by ability to declare a charge on property or it's transfer as 'void'.[26] There are certain exceptions to the exercise of this power. However, those imply long drawn court proceedings. Accordingly, another escape route, also statutorily envisaged, is often explored. In terms thereof, prior permission of the tax officer is obtained to avoid uncertainty and pre-empt the exercise of power by the tax authorities.

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[20] *Available at*- https://incometaxindia.gov.in/Lists/Press%20Releases/Attachments/21/Draft_Report.pdf.

[21] Explanation 5 to Section 9, Income Tax Act, 1961.

[22] Explanation 6, *ibid*.

[23] Section 47(via), (viab), *ibid*.

[24] *See generally*, *The Taxation of Offshore Indirect Transfers – A Toolkit*, available at https://www.oecd.org/tax/taxation-of-offshore-indirect-transfers.htm

[25] Rule 11UB, 11UC, Income Tax Rules, 1962.

[26] Section 281, Income Tax Act, 1961.

Given the relatively high magnitude of tax exposure and precipitate consequences relating to exercise of such power, advance certificate has virtually evolved from being a hygiene aspect in M&A deals involving India to become an overwhelming variable requiring serious consideration.[27]

Specific anti-abuse provisions

The movement against graft, corruption and menace of black money in India has not just resulted into enactment of a special legislation[28] but also led to addition of a host of provisions in the already detailed scheme anti-avoidance provisions under the 1961 Act targeting specific situations. Quite a few are relevant in the context of M&A transactions. To illustrate, the 1961 Act insists upon FMV as the basis for transfer of unlisted shares.[29] Additionally, India has adopted the trend of notifying non-cooperative jurisdictions, the transactions relating to which invite adverse consequences.[30] India has also adopted rules against thin-capitalisation.[31] *Inter alia* these changes, all in the last decade, reveal that the M&A-Tax space is undergoing a swift revisit being implored by the amendments to the 1961 Act.

III

INDIRECT TAX PERSPECTIVE

It is not that the direct tax law alone is the harbinger driving change in the Indian M&A segment. The indirect tax regulations are making their own contribution, the major ones being summarised below.

GST: Subjecting all related party transactions to arm's length standard

A major change witnessed in India few years back was a substantive reform in the indirect tax landscape through the introduction of Goods and Services Tax

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[27] *See generally*, Nishith Desai Associates, *Tax issues in M&A Transactions* (https://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research_Papers/Tax_Issues_in_M_A.pdf); KNAV, *A closer look at taxation of private equity and funds in India* (https://www.internationaltaxreview.com/article/2a6aaqgdb5cor53wgs3cw/a-closer-look-at-taxation-of-private-equity-and-funds-in-india); Business Standard, *I-T department nod not needed for Adani to acquire NDTV shares* (https://www.business-standard.com/article/companies/i-t-department-nod-not-needed-for-adani-to-acquire-ndtv-shares-report-122090400238_1.html).

[28] Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015.

[29] Sections 50CA, 56(2)(viia), 56(viib), Income Tax Act, 1961.

[30] Section 94A, *ibid*.

[31] Section 94B, *ibid*.

(‘**GST**’),[32] which replaced virtually the entire very basis on which indirect taxes are levied and collected in India. To illustrate, GST has subsumed a bulk of central excise duty (on manufacture of goods), value added tax (on sale of goods), etc. and completely subsumed various other indirect taxes such as service tax, entry tax, advertisement tax, luxury tax, betting and gambling tax, etc. Most of these laws were archaic and rarely amended, their replacement by GST therefore ushering reform. With their replacement by GST, which is based on internationally accepted VAT model,[33] the indirect tax regime has now been streamlined and principles considered *de minimus* internationally now find space in this regime.

One key principle is the introduction of provisions addressing valuation of related-party transactions. To highlight the importance of this change, in the pre-GST law governing sale of goods and supply of services there were literally no rules interjecting valuation of transactions in such cases, neither domestic nor cross-border. In contrast, all related-party transactions are subject to special GST valuation rules.[34] This change has ushered significant changes particularly in space of cross-border group activities, resulting into a rethink from M&A perspective as well. Arm’s length pricing is no longer an exclusive direct tax concern; transfer pricing now also needs to be examined from indirect tax perspective, besides reconciling the differences between the two laws, given the divergences in their respective valuation rules.[35]

GST: Tax liability on asset transfers

Share transfers are exempt from purview of GST,[36] however, asset transfers are not.[37] An exception is carved out for transfer of business by way of ‘going concern’.[38] Thus, limited space is available for M&A space to carve out a tax-efficient transaction or corporate structure. This change, in vogue since 2017, has significantly altered the rules of the game for M&A transactions, particularly since the taxable transactions are subject to GST on the merit rate of 18%.

GST: Provisions for Acquirer’s Liability

[32] *Union of India v. Mohit Mineral Pvt. Ltd.* 2022 SCC Online SC 657.

[33] *See generally*, Tarun Jain, *Goods and Services Tax: Constitutional Law and Policy*, Eastern Book Co., 2018, pp. 303-312.

[34] Chapter IV, Central Goods and Services Tax Rules, 2017.

[35] *See generally*, Tarun Jain, *Transfer Pricing Rules for India’s Goods and Services Tax*, (2019) 30(2) IBFD International VAT Monitor 1-5.

[36] Section 2(52), Central Goods and Services Tax Act, 2017.

[37] Schedule I(1), *ibid*.

[38] Notification No. 12/2017-Central Tax (Rate) dated 28.06.2017.

In the new framework, tax officers are empowered to recover GST debts from corporate debtors generally.[39] Additionally, the GST law also stipulates 'joint and several' liability of the transferor and transferee in case of business transfer.[40] Supplementing these are special provisions addressing situations where the M&A transaction involves liquidation of company,[41] private company,[42] partnership firms,[43] etc. Thus, the GST laws also considerably adds to post-transaction woes in M&A space and require additional inquiries in the due diligence phase itself so as to avoid post-merger woes.

Customs: CAROTAR

The Free Trade Agreement (FTA) regime of India is also a significant impetus driving the manner in which corporate structures are position and goods are imported / exported from India. The FTA regimes is similar to the WTO framework and therefore compliances are not significant. However, in the year 2020 the Indian customs law was amended whereby additional obligations have been imposed on the importers seeking to avail FTA benefits.[44] The importers claiming FTA benefits are now obliged to *inter alia* "possess sufficient information as regards the manner in which country of origin criteria, including the regional value content and product specific criteria, specified in the rules of origin" under the concerned FTA and the satisfaction of these rules. In terms of these changes, the concerned importer is now also obliged to demonstrate diligent compliance with the terms of the FTA, which responsibilities hitherto have been traditionally rested on the certification by the offshore exporter and the FTA partner country. In view of this change in the customs law, the tax authorities are being impressed upon to ensure due verification of the claims for exemption under the FTA regime.[45] Thus, M&A corporate structures seeking to avail FTA benefits need to revisit the strengths and merits of the FTA claims.

IV

INTERNATIONAL TAX PERSPECTIVE

The last decade has also witnessed global convergence on tax avoidance. The

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[39] Section 79(1)(c), Central Goods and Services Tax Act, 2017.
[40] Section 85, *ibid*.
[41] Section 88, *ibid*.
[42] Section 89, *ibid*.
[43] Section 90, *ibid*.
[44] Chapter VAA, Customs Act, 1962.
[45] *See generally*, CBIC Circular No. 38/2020-Cus dated 21.08.2020; CBIC Instruction No. 20/2020-Cus dated 17.12.2020.

Base Erosion and Profit Shifting ('**BEPS**') agenda of the OECD has received active participation of 135 countries and has resulted into 15 action points to *inter alia* "equip governments with domestic and international rules and instruments to address tax avoidance, ensuring that profits are taxed where economic activities generating the profits are performed and where value is created."[46] India has been an active participant in the BEPS discussions and has emulated various changes in its domestic laws towards incorporating such global consensus. *Inter alia* in wake of this development, there are considerable changes in the Indian international taxation rules, which affect M&A considerations, the key ones being highlighted in this part.

Accession to MLI

The biggest development in the international tax treaty framework – the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS ('**MLI**') negotiated under the aegis of OECD[47] – has not left India unaffected. India has ratified the MLI and as a follow-up the 1961 Act has been amended[48] to permit the enforcement of MLI. This has limited the availability of tax treaty benefits such that the benefit are only allowed "without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions".[49] As a subsequent measure, the Government has also notified the 'covered tax agreements' i.e. the Indian tax treaties which would stand amended on account of the MLI.[50]

The key facet in this change is the amendment of the preamble to the Indian tax treaties and, in most cases, incorporation of the 'principal purpose test' which accentuates the 'object and purpose' of the tax treaties to avoid benefits to abusive or concocted transactions.[51] As a consequence, international tax treaty network now houses an embargo to historically available benefits where the structures and transactions seeking benefit must now satisfy the additional

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[46] OECD, *BEPS Actions*, available at https://www.oecd.org/tax/beps/beps-actions/.

[47] Government of India, *Ratification of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, available at https://pib.gov.in/Pressreleaseshare.aspx?PRID=1574096.

[48] Section 90(1), Income Tax Act, 1961.

[49] Article 6, MLI.

[50] *See generally, OECD MLI Matching Database*, available at https://www.oecd.org/tax/treaties/mli-matching-database.htm

[51] *See generally*, Tarun Jain, *Exploring contours of 'purpose' in the 'Principal Purpose Test': Enlisting the outcome from a review of Indian Jurisprudence*, (2022) 440 Income Tax Reports (Journal) 1-31.

conditions introduced on account of the MLI. This implies a significant revisit to the traditional investment routes in India and also *de-novo* appraisal of corporate structures in the wake of MLI-induced increased conditionalities for obtaining tax treaty relief.

Equalisation levy

In 2016 India enacted its version of digital services tax – known as Equalisation Levy[52] – which was introduced to *inter alia* usher horizontal tax equity amongst domestic and non-resident digital service providers and their *inter se* tax neutrality.[53] However, the scope of the 2016 enactment was limited[54] and it was in the year 2020 that the scope of Equalisation Levy was substantially expanded to tax supplies of goods and services made by Non-Resident e-commerce operators to Indian residents or those using Indian IP addresses, including consideration from sale of advertisements targeting Indian consumer and sale of data collected from Indian residents.[55] Crucially, the Equalisation Levy is on gross consideration collected by the Non-Residents[56] and tax treaty relief is not available *qua* this Levy.[57] Thus, structuring of e-commerce operations is critically affected by this development, which is expected to evolve as a crucial variable affecting M&A negotiations in this industry.

Significant Economic Presence

Supplementing the Equalisation Levy, another expansion of tax on Non-Resident digital service providers has been enacted in the form of Significant Economic Presence ('**SEP**'). It covers within its scope, "(a) transaction in respect of any goods, services or property carried out by a non-resident with any person in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed,[58] or (b) systematic and continuous soliciting of business activities or engaging in

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[52] Vide Chapter VIII, Finance Act, 2016.

[53] See generally, *Report of Committee on Taxation of E-Commerce*: *Proposal for Equalization Levy on Specified Transactions*, available at https://incometaxindia.gov.in/news/report-of-committee-on-taxation-of-e-commerce-feb-2016.pdf.

[54] Section 165, Finance Act, 2016.

[55] Section 165A, *ibid*.

[56] *Ibid*.

[57] Vikas Vasal, *Equalisation Levy: Prevailing Issues*, available at https://www.livemint.com/opinion/columns/equalisation-levy-prevailing-issues-11637257670320.html.

[58] Currently notified as INR 20mn as monetary threshold. Rule 11UD, Income Tax Rules, 1962.

interaction with such number of users in India, as may be prescribed[59]."[60] The scope of SEP is wide and its exposure arises "whether or not— (i) the agreement for such transactions or activities is entered in India; or (ii) the non-resident has a residence or place of business in India; or (iii) the non-resident renders services in India".[61] However, unlike the Equalisation Levy, tax treaty relief is available *qua* SEP[62] and thus this measure only affects corporate structures which cannot avail benefits under India's tax treaty network. Nonetheless, SEP is another variable influencing M&A negotiations in digital service industry.

Corporate residence in India

The rules governing residence of corporations have also been revisited in India. Replacing the 'control and management' test under the 1961 Act, now a corporation is considered to be tax resident of India if it's place of effective management ('**POEM**') is in India.[63] In the wake of this change, the "place where key management and commercial decisions that are necessary for the conduct of business of an entity as a whole are, in substance made" is considered as the basis for a corporation to have its POEM in India, thereby giving rise to global taxation of such corporation in India. Official guidelines[64] oblige examination of multifarious and complex variables to determine POEM, whereby appraisal of active business interests, sourcing of passive income, the place of conduct of board meetings, presence of key managerial personnel, etc. become relevant. Thus, more challenges have arisen in the M&A space relating to corporate tax residence.

Amendment to tax treaties with traditional investment routes

Mauritius has been a frequent investment route for India. This has typically been on account of liberal capital gains regime in Mauritius along with a favourable bilateral tax treaty which has ensured a nil capital gain position on transfer of shares.[65] This long-standing tax arbitrage opportunity was interjected with India seeking a review of the India-Mauritius Tax Treaty, which has resulted in amendment of the relevant treaty provision, bringing to

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[59] Currently notified as 0.3mn as user threshold. *Ibid*.
[60] Explanation 2A to Section 9, Income Tax Act, 1961.
[61] *Ibid*.
[62] Government of India, *Taxation of Digital Businesses*, available at https://pib.gov.in/PressReleasePage.aspx?PRID=1564086.
[63] Section 6(3), Income Tax Act, 1961.
[64] CBDT Circular No. 6/2017 dated 24.01.2017.
[65] *See generally*, *Azadi Bachao* (supra).

tax in India capital gains from 2017 onwards,[66] thereby interjecting the rationale for continued selection of Mauritius as the investment route. Similar to Mauritius, many other Indian tax treaties have been revisited and amended in the last few years,[67] which compel exploration of alternate investment routes from an international tax perspective, adding another variable in the M&A checklist.

Exemptions qua IFSC, Sovereign Wealth Funds, etc.

In the quest to expand the sources of foreign investment in India, the 1961 Act has been amended to offer various fiscal benefits to large investors, such as Sovereign Wealth Funds, pension funds and alternate investment funds,[68] venture capital funds,[69] etc. These benefits are in addition to the introduction of a new regulatory and tax regime,[70] namely the International Financial Services Centre, the intent of which is to *inter alia* promote India as a hub for offshore financial transactions.[71] The intent underlying these is to promote large scale foreign inward investments / transactions in India, which imply that M&A transactions must necessarily evaluate these structures from a tax-efficiency perspective when considering India as a destination.

Cross-border employee secondment arrangements

A recent decision of the Supreme Court[72], albeit in the context of service tax, has resulted in large-scale ramifications *qua* international hiring of labour including *vis-à-vis* the international and direct tax paradigm. This decision has directed a detailed factual appraisal of secondment and deputation arrangement *qua* group entities employees to highlight that it is not just a *de jure* assessment of the relationship but also a *de facto* appraisal of the arrangement which would determine the tax consequences. This decision has induced revisit to cross-border employment movements within the M&A space.

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[66] *See*, Article 13(3A), India-Mauritius Tax Treaty.

[67] For illustration, see amended Article 13, India-Singapore Tax Treaty.

[68] For illustration, see Section 10(23FE), Income Tax Act, 1961.

[69] For illustration, see Section 10(23F) – (23FB), *ibid*.

[70] For illustration, Section 10(4D) – (4G), *ibid*.

[71] *See generally, What is an IFSC and how does it work?* https://www.livemint.com/Industry/XmEtCCZklNL5w0LmQ9K7lJ/What-is-an-IFSC-and-how-does-it-work.html

[72] *Commissioner of Customs, Central Excise and Service Tax v. Northern Operating Systems* 2022 SCC Online SC 658.

CONCLUSION

The reference alluded in the earlier sections relating to the changes in the tax space, though illustrative, clearly reveal the substantive redrawing of the contours determining the M&A landscape. Even though the impact of each of the measures is limited to the concerned subject-matter of tax, on an overall basis these measures have already overwhelmed the M&A community with 'M&A Tax' emerging as a distinct field of opportunity and expertise. At the ground-level too, the changes are visible. To illustrate, traditionally the legal agreement effectuating the M&A deal would carry an omnibus indemnity clause which would subsume all envisioned and unforeseen eventualities and assign the consequent risks *inter se* the parties. The *Vodafone* experience and other subsequent developments have put the focus on such indemnities, virtually elevating 'tax indemnity' clauses as a distinct part of such agreements. These clauses can be gainfully relied upon by the parties for passing the tax incidence or recovering (proportionately or otherwise) the costs for defending tax proceedings. The hypothesis sought to be tested in the paper, therefore, is in the affirmative and clearly, both anecdotally and theoretically too, the changes occasioned in the tax laws appear to be heralding major revisit to M&A transactions.

The take aways of the inquiry are wide and variety, requiring distinct enumeration;

(A) On an overall basis, at a policy level, this inquiry institutes an accentuating need for corporate managers and leaders to revisit their priorities in M&A deals and accord overwhelming significance to tax considerations as these now frequently inject as deal-breakers.

(B) Simultaneously, at a pragmatic level, the inquiry culminates into redesignating the stage of tax-impact evaluation exercise in M&A negotiations. Instead of relegating tax as a cost of the prospective deal (and thus using tax incidence as the basis to haggle over the valuation of the deal towards the fag end of the negotiations), tax considerations should actually shape the contours of the deal from an early stage.

(C) At another level, given the hefty interest costs, penalties, fines and criminal prosecution as a frequent near-confirmed consequence in high-stake tax disputes, it has perhaps imperative to obtain appropriate advance tax-certifications / rulings, especially before executing large M&A deals.

At the very least, there is high merit in voluntary disclosures of the contours of the M&A deals to the tax authorities to prevent precipitate enforcement action by authorities alleging evasion laced with suppression.