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Tax on offshore share transfers may hit cross-border M&A deals

Mehul Shah & Reghu Balakrishnan / Mumbai March 19, 2012, 0:24 IST

General anti-avoidance rules, proposed in Budget, also seen as major deterrent

India Inc, which saw a declining number of mergers & acquisitions (M&As) in 2011, is set to face another blow in the form of a new tax proposal from the finance ministry in the Union Budget.

The government has proposed to retrospectively tax offshore share transfers of foreign companies, the value of which is substantially derived from assets located in India, with effect from 1962.

Finance Minister Pranab Mukherjee's move to tax offshore share transfers will significantly increase tax costs for buyers and make planning of cross-border M&As and group restructurings difficult, industry says.

Nitin Potdar, partner (M&A), J Sagar Associates, said: "The proposed amendment was extremely regressive and self-defeating. The amendment will certainly jeopardise the conducive environment created by the string of the government's pro-investment policies. It would also impact cross border transactions negatively, and hence, India's foreign investment prospects."

Apart from making transactions such as the $11.1-billion Vodafone-Hutchinson deal in 2007 liable to tax, this amendment would have serious ramifications on deals such as Aditya Birla Nuvo's $150-million buyout of 16 per cent stake in Idea Cellular India from AT&T Mauritius, SAB Miller's acquisition of Foster and Vedanta's deal to buy a 51 per cent stake in Sesa Goa from Mitsui. Similarly, Tata Industries' acquisition of 17 per cent stake in Idea Cellular India from AT&T is also likely to be in trouble. Sanjay Sakhuja, CEO, Ambit Corporate Finance, said, "Investors, both foreign and Indian, took investment decisions based on long-term stability in tax and regulatory regimes. That the effective taxes applicable to a particular situation were increasing was not per se an issue. Rather, it was the retrospective nature of the proposed amendment that I found disturbing. This would certainly have a negative impact on FDI."

The country witnessed 644 M&A deals worth $45 billion in 2011, against 662 deals worth $50 billion in 2010, according to report from Grant Thornton.

The budget has also proposed to introduce comprehensive general anti-avoidance rules (GAAR), effective from April 1, 2013. These new norms, which will override the provisions of tax treaties signed by India, will capture most conventional structures for M&As and investments into the country.

"If implemented, GAAR would open up a Pandora's box of uncertainty and litigation, and investors might be forced to think twice before considering opportunities in India," said Nishith Desai, founder of law firm Nishith Desai Associates. "Several genuine legitimate tax planning arrangements and investments through popular jurisdictions such as Mauritius, Singapore and Cyprus might be hit by GAAR," he added.

GAAR provisions give wide discretionary powers to revenue authorities in taxing transactions on grounds of tax avoidance. "GAAR is indeed going to haunt us in times to come. What do the provisions mean to the India-Mauritius tax treaty? The safeguard of dispute resolution panel is not at all sufficient. These provisions are likely to result in huge tax litigation," said Dinesh Kanabar, deputy CEO & chairman, Tax, KPMG India.

Echoing similar views, Vipul Jhaveri, partner-M&A, Deloitte India said, "Introduction of GAAR, albeit with checks to prevent its abuse would add to uncertainty on tax positions regarding prevailing arrangements and structures. In cross-border M&A one would have to watch out for the tool box of counter measures for tax avoidance in respect of transactions with persons located in notified jurisdictions that do not effectively exchange information with India."