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# New direct tax code to hit cross-border M&A: experts

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***The new Direct Tax Code, whose draft was released by the Finance Minister Pranab Mukherjee this week for public comments, introduces a number of constructive measures including a reduction in tax rates, yet they have been overshadowed by the negative ramifications of certain provisions, aver experts.***

For instance, the Code has incorporated the much feared general anti-avoidance rules (GAAR) which will have an adverse effect on both Indian and offshore M&As (merger & acquisitions) involving Indian subsidiaries.

In effect, the GAAR codify the economic substance doctrine and reject long-settled jurisprudence confirming the validity of form over substance in India. Nishit Desai Associates (legal and tax counselling worldwide) point out that the GAAR provisions seem to provide unfettered authority to Indian tax authorities (Commissioner of Income Tax) to disregard specific legal entities or individual steps in a series of transactions. Besides it provides them powers to re-characterise and re-allocate income between parties apart from re-characterise legal instruments used in transactions. It has been indicated that the GAAR provisions even permit the tax authorities to disregard provisions of a double taxation avoidance treaty between Indian and any other country!

**Tax treaty**

The Code also adopts the later-in-time doctrine implying that the provisions of the new 2011 law could override every tax treaty that India has entered into in the past! The Code was seeking to tax every offshore transaction resulting in an indirect transfer of a capital asset situated in India. It seems that the object behind this provision is to specifically target foreign M&As having underlying Indian subsidiaries or interests.

Recent cases like Vodafone, ETrade, GE and Aditya Birla Nuva exemplify instances of Indian tax authorities having already taken such aggressive positions. Currently, the transfer of shares of an Indian company pursuant to an offshore merger of two foreign companies is tax exempt. Due to a possible drafting error, such transfer of shares would not qualify for the tax exemption under the Code. Further no provision has been made to cover outbound mergers of Indian companies.