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Tax worries shape merger and acquisition negotiations between strategic buyers and seller

By Sachin Dave & Maulik Vyas, ET Bureau | 24 Sep, 2015, 05.56AM IST

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MUMBAI: At a time when the merger and acquisition space is heating up, many private equity and strategic buyers are asking for an indemnity bond or insurance from the seller to cover a tax demand that may emerge in the future.

Industry trackers say that although the number of deals in India has jumped in the last one year, a sudden tax demand emerging in future remains a huge concern.

Many buyers, especially the private equity funds in the secondary deals, are asking the seller to give an indemnity bond, say industry experts.

"Parties spend a lot of time to get the structure of the deal correct from a legal and tax perspective to mitigate various risks and putting adequate protective clauses, including indemnity," said [Vaishali Sharma](#), founder of Agram Legal Consultants. "The government, on its part, has issued many clarifications under various

tries to frame their deal structures more effectively." Recently, Agram Legal advised [Gammon Infrastructure Projects](#) [BSE 3.11 %] to sell six road and three power projects to [BIF India Holdings](#) for over Rs 560 crore.

While Indian insurance firms do not offer cover for tax liability in an M&A, some multinationals do. "Given the uncertainties involved in availability of tax treaty benefits to a seller involved in a deal, buyers and sellers often negotiate an extensive tax indemnity covenant in the transaction documentation.

At times, to substitute or supplement the tax indemnification, the parties, at a fiscal cost, obtain a tax indemnity insurance offered by certain foreign insurance companies to compensate for tax, interest and penalties that may be demanded. In that sense, from the

Gammon Infrastructure Projects Ltd.

BSE	8.62 ▼	NSE	8.60 ▼
	0.26(3.11%)		0.30(3.61%)
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buyers perspective, there is a third party that is seeking to insulate them from the future tax risks," said Sameer Gupta, Partner and FS Tax leader, EY.

The way it works is at the time of the deal, the seller and the buyer agree upon the potential tax liability that could arise. The seller would then take an insurance cover for that amount and pay the premium for next seven years. If the tax demand arises during that time then the insurance money is paid to the buyer. The Indian law permits the income tax department to raise a tax demand retrospectively for seven years.

"The insurance cover for the contingent liability is being brought in the discussions where foreign funds or entities are involved," said Sumchit Anand, managing director, Acquisory Consulting, an M&A advisory and asset management firm. "The insurance is now being brought up in almost all the discussions, however, it is tough negotiating that when an Indian firm is involved in the transaction, as the Indian regulations around the same are unclear," he said.

Industry trackers say an indemnity bond is given by the seller in most of the cases in the deal. The bond basically means that the seller would be responsible for any tax demand arising from the past years. If the bond has been dishonoured, many in the industry are especially in cases where

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