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IMPACT OF DOUBLE TAXATION AGREEMENTS ON CROSS-BORDER MERGERS AND ACQUISITIONS

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"The Power of Taxing People and their property is essential to the very existence of government."

~ James Madison

ABSTRACT

Mergers and acquisitions (M&As) across borders have become a key approach through which multinational corporations aim to expand, diversify their markets and enhance operating efficiency. Nevertheless, the problem of occurrence of the concept of a double taxation where a single income, capital gains, or dividends can be taxed in both the home and host countries is one of the most important issues when organizing such transactions. Bilateral negotiations with states between states are vital in reducing these tax barriers, and determining the financial feasibility of cross-border M&As through the agreements formed between the two states (Double Taxation Avoidance Agreements or DTAAs). This paper analyses the effects that DTAAs have on the international M&A activity, including the effects that treaty provisions have on deal structuring, valuation, and the integration of a deal after a merger. Withholding tax relief, capital gains exemptions, residency regulations and the removal of tax on inter-company dividends are provided, which decreases the cost of transactions and also increases

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the certainty of investors. DTAAAs bring transparency by delegating taxation powers and deterring evasion of tax. DTAAAs also help address the issue of fiscal evasion and distribution of taxing rights, thereby being beneficial to reduce jurisdictional claims, thereby reducing controversy and enhancing certainty of deal-making across borders. Moreover, positive treaty networks usually serve as encouragement to companies to channel investments across the focal intermediary jurisdictions and thus influence the global M and A movements. Despite the illumination of these benefits, the implications of DTAAAs are one-sided. They enable such treaties that result in capital mobility and barriers to tax inefficiency but at the same time, they also enable the incidences where it can be used to treaty-shop and destabilize tax base and transfer of profits-that is why the anti-abuse provisions were also improved in both the OECD BEPS framework and the Multilateral Instrument. Moreover, this has contributed to the increasing trend in modern treaty policy to ensure that a balance is found between protection of the tax base and ensuring that sufficient space is allowed to allow true cross-border investments to be made. Comprehensively, DTAAAs impact the cross-border M&A operations by reducing frictions in taxes, providing predictability, and setting out a set of criteria under which the decision-making of investors is formed. The adaptable nature of DTAAAs shows changes in the strategies of companies and international taxation that affect the atmosphere of international M&A activity.

KEYWORDS: Double Taxation Avoidance Agreements, Cross-Border Mergers, Acquisitions, International Taxation, Treaty Shopping, BEPS, Multilateral Instrument.

INTRODUCTION

In the twenty first century, it is possible that cross-border M&A is the most vibrant field of business strategy around the world. As economies liberalize, and globalization rapidly gathers pace, companies are seeking competitive advantage and are therefore, increasingly forced to look outside of their own national borders: To access other markets, or to find other technologies, or to enhance global value chain. In a large

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number of instances, compared to greenfield investments MNCs discover that establishing international alliances by M&A is an even faster and more effective process to internationalization, possibly even more than establishing themselves by greenfield investments; thereupon such firms will enjoy access to ready positions and resources in respect of the market. UNCTAD argues that cross-border M&A activity contributes to a high proportion of global foreign direct investment (FDI) flows, which explains why cross-border M&A activity is central to patterns of global integration. Nevertheless, cross-border purchases are much more complicated compared to domestic M&As because they are forced to overcome not only regulatory, cultural and managerial disparities but also considerable fiscal obstacles. Such an issue as double taxation can be identified as a major obstacle among them. The simplest example of this is the case of double taxation wherein the same income or dividend or capital gains are assessed in two countries the country where the income is generated (the source country) and the country where the investor or parent company is located (the residence country). In the case of firms that are involved in international M&As, this type of taxation may lead to a significant decline in the returns of the deal, discouragement of investment, and the overvaluation of the target companies. In the absence of relief mechanisms, there is a heightened cost of capital in terms of double taxation and it defeats the purpose of making cross-border integration.

To overcome this issue, historically nations sign bilateral treaties (Double Taxation Avoidance Agreements) (DTAAs) that aim to spread the taxing authority between jurisdictions and to eliminate the risk of taxing the same income twice. The main goals of DTAAs are threefold: to stimulate cross-border investment by minimizing tax barriers and to achieve fairness and predictability in taxation, and to avert the tax evasion by cooperation among states. Such treaties normally include a provision on residency, permanent establishment, means of tax relief (exemption or credit) and a restriction on withholding taxes on dividends, interest, and royalties. DTAAs are

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considered instrumental in terms of deal structuring and strategic decision-making, in the context of cross-border M&As. Examples include the use of treaties in determining the jurisdiction in which holding companies are to be established, the debt/equity ratio of financing, and the tax treatment of post-merger profits and capital gains. Treaty networks permit investments to be directed in favour of an intermediate jurisdiction, e.g. Mauritius, Singapore or Netherlands, where tax benefits can be maximised. This makes the investors more predictable and legally definite besides the reduction of transaction costs that the investors bear. These DTAA's goodness's, however, are coupled with assumptions of the abuse of the treaties where we anticipate of treaty shopping and base erosion and profit shifting. This has cleared the path to international practices with Base Erosion and Profit Shifting (BEPS) framework and Multilateral Instrument (MLI) intended to present a treaty-level revision and anti-abuse measures. The tendency in the development of DTAA's as the instruments of relief into tax governance tools of the world gives the world the image of intensification of the interdependence of international taxation and corporate strategy. It is in this light that the impacts of DTAA's on cross-border M&As must be addressed by a policy on taxation that affects the cross-border investment flows. Beside the responses to the questions regarding the financial sustainability of transactions, it addresses the bigger issue of the economic sovereignty, equity and developing the international business regulation.

CHAPTER 2

RESEARCH OBJECTIVES

The need to understand how transnational tax conventions influence flow of investment, transacting deals and proximal effects of cross-border corporate integration informs the study of the effects of Double Taxation Agreements (DTAAs) on Cross-Border Mergers and Acquisitions. The targeted goals include the following:

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1. To examine the contribution of DTAAs in the reducing risks of cross-border M&As of double taxation.
2. To determine how DTAAs impact the organisation of cross-border M&A transactions.
3. To determine the degree that DTAAs facilitate cross-border investment flows.
4. To critically discuss the issues of challenges and limitations of DTAAs within M&As.
5. To examine the effect of the latest international tax reform, such as the OECD BEPS framework and the Multilateral Instrument (MLI) on the efficiency of DTAAs in cross-border acquisitions.
6. To find policy proposals on how to strike a balance between the promotion to invest and the protection of revenue.

STATEMENT OF PROBLEM

The Cross-border acquisitions and mergers (M&As) in the modern globalized economy have become one of the useful means by which multinationals are seeking to expand markets, technology and resource optimization. They also form a significant aspect of the global foreign direct investment (FDI) flows and they also form a critical role in determining trends in global business integration. Transactions across borders, however, have many cross-border M&As legal, regulatory and fiscal complexities as opposed to the transactions within the country. One of the most prominent deterring factors to international investment is the hurdle of the double taxation. The question of a double taxation arises when the identical sum of income, dividends, capital gains are taxed in the country of origin and the home country. This issue can bring down the expected returns significantly to businesses in cross-border M&As, cause the increase in the cost of capital and undermine the valuation of target companies. Without adequate mechanisms to mitigate these risks, international expansion would

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not be good in terms of finances to the investors and movement of funds across borders would be limited.

To counter these, there has been the development of the Double Taxation Avoidance Agreements or DTAAs which are bilateral treaties that split taxing responsibilities between states and provide a means to relieve them such as exemptions or foreign tax credits. DTAAs as the form of decreasing withholding tax on dividends, interest and royalty, and clarification of the provisions on the taxation of capital gains and permanent establishment are aimed at eliminating fiscal barriers to international investment. In the case of M&As, these provisions are directly influential as far as the deal structuring, financing, and post-merger profit sharing are concerned. The impact of DTAAs on transnational M&As is not so balanced and trouble-free, however. Even though these treaties are intended to promote real investment flows, they are in the vast majority of cases misapplied to the practices of treaty shopping and unhealthy tax planning. A business can be lured to treaty friendly haven jurisdictions, like Mauritius, Singapore or the Netherlands not necessarily because it offers the best jurisdiction in which to do business but simply a tax break. This brings about the question, base erosion, profit shifting and massive losses in revenues, especially by the developing countries.

Besides, there is also the radical redefinition of the global tax environment based on the new developments in the development of global tax reforms, namely: the Base Erosion and Profit Shifting (BEPS) initiative by the OECD and the Multilateral Instrument (MLI). Such reforms are meant to guarantee that there is no abuse of the treaties, that taxes are brought into the economic reality and equity is recovered in the international tax system. The practical aspects of such policies must be explored because they add to the level of protection, but also bring new layers of complexity to the cross-border M&As organization. The primary question, therefore, is whether DTAAs could really facilitate cross-border M&As by reducing taxation obstacles or,

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on the contrary, they offer a platform of carrying out tax evasion at the cost of fiscal sovereignty. It is essential that the policymakers and the multinational corporations address this issue in making strategic investment decisions and in the process of harmonizing between the aim of protecting revenue and promoting investment.

RESEARCH METHODOLOGY

The study adopts a qualitative doctrinal research method with some few comparative aspects to investigate the effects of Double Taxation Avoidance Agreements (DTAAs) on the cross-border mergers and acquisitions (M&As). Primary sources used in the research are mainly bilateral tax treaties (India-Mauritius and India-Singapore DTAAs), international standards of treaties like the OECD and the UN Model Conventions, bilateral treaties on taxation (MLI) and domestic legislation such as the Income-tax Act, 1961 and judicial rulings where the treaty clauses are interpreted. Scholarly books, journal articles, organization policy reports issued by such organizations as the OECD and UNCTAD, as well as empirical studies of taxation and foreign direct investment can all be found in the category of secondary sources. The process of data collection involves library and online research that will focus on treaty texts, case law, and international reports; a case study approach is implemented on a few cross-border M&A transactions that were impacted by treaty benefits. The analysis is based on qualitative content analysis to explain treaty clauses and judicial rationale, comparative analysis to point out cross-jurisdictional discrepancies and critical analysis in order to balance the advantages of tax certainty and the potential abuse of treaty. The study scope is defined based on the impact of DTAAs in the deal structuring, financing and taxing of an M&A, and the Indian treaties and treaties globally with an understanding that it has limitations due to the emerging reforms, differences in treaty provisions and limited quantitative data on post-merger tax results.

CHAPTER 3

ANALYSIS

The Corporate, financial, and legal issues in several jurisdictions are all part of the complex process of cross-border mergers and acquisitions (M&As). Taxation is one of the barriers to these transactions, particularly the risk of double taxation. In Double taxation, the same income, or capital gain would be taxed in the parent country (where the income is earned) and the home country (where the parent company is based). Bilateral treaties to curb this are known as Double Taxation Avoidance Agreements (DTAAs). The provisions they make have a direct influence on the structure, cost and feasibility of cross border M & As.

The Relevant Legal Provisions: -

The domestic legal framework of taxation is found in the Income-tax Act, 1961, in India and Section 90³ grants the Central Government authority to enter into DTAAs with foreign countries. Section 90(2)⁴ also explains that the taxpayer may use the treaty in case the terms of a DTAA are more favourable to the taxpayer compared to domestic law. Section 91 gives unilateral relief in the absence of a DTAA. These clauses are essential in the development of cross-border transactions.

DTAAs provisions which affect M&As are:

i.) Article 5 (Permanent Establishment): It specifies whether the profits of a business of a non-resident company can be assessed in the source country. This influences the tax position of multinational firms after the mergers.⁵

³ The Income Tax Act, 1991 § 90.

⁴ The Income Tax Act, 1991 § 90 (2).

⁵ Organisation for Economic Co-operation and Development (OECD), Model Tax Convention on Income and on Capital art. 5 (OECD 2017).

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ii.) Article 10 (Dividends): Withholding tax on repatriated profits is reduced and acquisition is more economical.⁶

iii.) Article 13 (Capital Gains): The provision that is decisive in any M&A cases and that defines whether the source country or residence country has the right to tax capital gains on the transfer of shares.⁷

iv.) Article 23 (Elimination of Double Taxation): It gives the ES mechanisms like credit or exemption to prevent the double taxation of income.⁸

Judicial Interpretation and Case Laws:

The Indian courts have played a pivotal role in clarifying the scope of treaty benefits in the context of M&As:

In the case of *Union of India v. Azadi Bachao Andolan (2003)*,⁹ the Supreme Court held the validity of the India-Mauritius DTAA, which held that Indian capital gains should not be taxed in case of transfer of shares of an entity that was based in Mauritius. The ruling gave Mauritius a legitimate status as a choice of cross-border investment and cross-border mergers and acquisitions over decades as the treaty divided taxation authority of capital gains exclusively to the residence country.

In another case of *Vodafone International Holdings B.V. v. Union of India (2012)*¹⁰ Vodafone purchased shares in a Cayman Islands based company that had a majority stake in Hutchison Essar Ltd., an Indian based telecommunication company. The

⁶ Organisation for Economic Co-operation and Development (OECD), Model Tax Convention on Income and on Capital art. 10 (OECD 2017).

⁷ Organisation for Economic Co-operation and Development (OECD), Model Tax Convention on Income and on Capital art. 13 (OECD 2017).

⁸ Organisation for Economic Co-operation and Development (OECD), Model Tax Convention on Income and on Capital art. 23 (OECD 2017).

⁹ *Union of India v. Azadi Bachao Andolan*, (2004) 10 SCC 1 (India).

¹⁰ *Vodafone Int'l Holdings B.V. v. Union of India*, (2012) 6 SCC 613 (India).

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Indian tax potential attempted to collect capital gains tax on Vodafone; however, the Supreme Court decided against Vodafone in its decision stating that the deal was an interchange of shares outside India and not liable to taxation by the Indian law. The case brought to the fore the importance of corporate structuring and treaties in protecting cross-border M&As against the emergence of hidden costs in terms of taxes.

The case *Cairn Energy PLC v. Union of India*¹¹. Although it is mainly rated as an arbitration case, Cairn pointed out the retrospective adjustments to the Income-tax Act after the Vodafone, which aimed to bring indirect transfers under Indian tax remit (under Section 9(1)(i)). This brought a sense of uncertainty to cross-border M&As, highlighting the conflict between the treaty protection of investor rights and sovereign taxation.

Further, the case of *Indofood International Finance Ltd. v. JP Morgan Chase Bank*,¹² this case, although not in India, highlighted the principle of beneficial ownership in the interpretation of treaties, which today is incorporated into numerous DTAAAs, and which is essential in establishing eligibility as a beneficiary of reduced withholding taxes.

Impact of Treaty Amendments and Global Reforms

In 2016, the India-Mauritius DTAA was amended and the blanket exemption on capital gains was eliminated. The right to tax capital gains on transfer of Indian shares was obtained by India since April 1, 2017. The same amendments were done in the India- Singapore and India- Cyprus treaties. These reforms greatly diminished treaty-based benefits in structuring M&As and deterring treaty shopping.

¹¹ Cairn Energy PLC & Cairn UK Holdings Ltd. v. Republic of India, PCA Case No. 2016-7, Award (Perm. Ct. Arb. Dec. 21, 2020).

¹² Indofood Int'l Fin. Ltd. v. JP Morgan Chase Bank N.A., London Branch, [2006] EWCA (Civ) 158, [2006] STC 1195 (Eng.).

The treaty landscape has also been redefined by Base Erosion and Profit Shifting (BEPS) Project of the OECD especially Action 6 (Preventing Treaty Abuse). Anti-abuse rules, including the Principal Purpose Test (PPT), have been introduced to the Multilateral Instrument (MLI) to the effect that where a transaction is one of the principal purposes, the benefits of the treaty are denied. In the case of M&A deals, this translates to the investors having to now prove to have actual commercial substance besides tax benefits.

Balancing Investment Promotion and Revenue Protection

Although the DTAAs are essential in supporting cross-border M&As by eliminating tax frictions, the effect of the DTAAs is loss of revenue to the tax framework and particularly to developing economies such as India. Low-tax jurisdictions have traditionally enabled multinational corporations to evade their international tax burden, at the cost in some cases of the fiscal sovereignty of the country of origin. The reforms made in the amendments of Indian treaties and introduction of BEPS-led reforms is a turn towards the balance between the promotion of investment and protection of revenues.

At the same time, multinational companies still go over the advantages of treaties when they design M&A deals. Jurisdictions such as Singapore, Netherlands and Luxembourg have remained appealing based on their well-developed treaty networks, advanced legal systems and business-friendly environments. Nevertheless, with the heightened attention that the world has been showing towards the tax planning practices, companies are now compelled to focus on the economic substance and conformity.

DTAAs have two functions in cross-border M&A: they lower transaction costs and promote foreign investment by providing legal certainty, but they also invite treaty abuse and proactive tax planning. Azadi Bachao Andolan and Vodafone are two examples of how the courts' interpretations have first expanded the nature of the

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treaties' advantages; nevertheless, reforms in the form of major treaty modifications and the application of the BEPS framework have aimed to limit abuse. The provisions of sections 90 and 91 of the Income-tax Act, along with provisions related to capital gains and dividends in treaties, continue to play a pivotal role in the determination of the outcome of tax in M&As. With changes in global tax governance, the legitimacy of benefits of treaties vis-a-vis the non-compliance with stricter anti-abuse norms, the success of cross-border M&As will be more dependent on how it balances the legitimate benefits of treaties.

CHAPTER 4

CONCLUSION

DTAAs, or double taxation avoidance agreements, have a significant and intricate impact on international mergers and acquisitions (M&As). On the one hand, DTAAs are excellent instruments that reduce financial barriers, give investors peace of mind, and make international transactions more attractive. On the other hand, by distributing taxing authority, lowering withholding taxes, and eliminating double taxation, they directly lower transaction costs and make cross-border acquisitions more feasible. Higher M&A volumes, higher deal prices, and greater investor confidence are often associated with well-designed DTAAs, according to studies, particularly for emerging nations whose treaty networks provide as entry points for foreign investment.

However, the subtleties and unintended consequences of the application of treaties are also demonstrated by judicial tradition and literature. Examples of historic examples such as Vodafone and Azadi Bachao Andolan show how advantageous treaty provisions, especially in the context of India and Mauritius, stimulated significant amounts of investment but also sparked debate about tax loss and treaty shopping. Multinational corporations' ease of access to medium-sized states for transaction channelling highlights the tension between promoting investment and

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maintaining fiscal sovereignty. Such programs undermine source countries' developmental goals in addition to their tax bases.

More accountability and substance-based investment are currently the direction of the global tax environment. Anti-abuse provisions such as the Principal Purpose Test (PPT), which reserves treaty benefits for actual commercial substance cases of transactions, were introduced by the Multilateral Instrument (MLI) and the OECD's Base Erosion and Profit Shifting (BEPS) system. Treaties are now clearly being used as equilateral instruments of global tax regulation, rather than as a means of evading taxes.

In conclusion, being both forces of globalization and contentious areas of fiscal policy, DTAAAs clearly affect the structure, cost, and strategy of cross-border. The problem facing policymakers is to design treaties that would deter abuse but be attractive to real investment. Businesses must find a compromise between tax efficiency, compliance, and long-term strategic objectives such as technical development, access to the market and innovation. The changing dynamics indicate that financial synergies and the extent to which treaties balance between objectives of promoting investment and fair taxes will contribute to a larger proportion of defining future of cross-border M&As.

CHAPTER 5

SUGGESTIONS AND POLICY RECOMMENDATIONS

It is important to strike a balance between the two aims of promoting investment and safeguarding tax revenues in the view of the study of Double Taxation Avoidance Agreements (DTAAs) and its impact on cross-border mergers and acquisitions (M&As). To minimize the risks of treaty, abuse and base erosion, the following policy concepts aim at creating an equitable, open and investor friendly framework.

1. Strengthening Anti-Abuse Provisions

One of the most pressing problems is treaty shopping when investors exploit favourable countries just to enjoy the benefits of taxation. The policy makers should include strong anti-abuse provisions such as the Limitation of Benefits (LOB) provisions and the Principal Purpose Test (PPT) in DTAA's. These clauses protect round-tripping and the existence of fake structures by making sure that only organizations with a valid business substance are accessed to treaty benefits.

2. Promoting Substance over Form

Governments should come up with treaty regulations that require visible economic substance in the home country of the investor. This may include either local-employment benchmarks, physical-asset benchmarks, or operating business-benchmarks. Such measures bring investment flows into accord with the real economic activity but not paper structures, and discourage shell corporations from receiving treaty benefits.

3. Harmonizing Treaty Provisions with Domestic Law

In particular, indirect transfer provisions (such as Section 9(1)(i) of the Indian Income-tax Act) should be aligned with treaty responsibilities. This is something that India and other growing economies should make sure of. In addition to providing confidence for global firms involved in M&A, this will avoid contradictions between domestic laws and international commitments.

4. Encouraging Transparency and Information Sharing

Provisions pertaining to indirect transfers, like Section 9(1)(i) of the Indian Income-tax Act, should specifically be in line with obligations under treaties. It is important for developing economies like India to ensure this. This would not only give multinational companies engaged in M&A confidence, but it will also prevent inconsistencies between national laws and international agreements.

5. Modernizing Legacy Treaties

Broad capital gains exemptions were previously provided by a number of Indian tax treaties, including those with Mauritius, Singapore, and Cyprus. This allowed for large M&A inflows but also encouraged abuse. Legacy treaties must be renegotiated and updated to meet BEPS-aligned norms. Future agreements ought to find a middle ground between preserving the source state's taxing authority and encouraging investment.

6. Facilitating Investor Certainty through Advance Rulings

In cross-border M&A, complicated tax issues are frequently raised. It is possible to lower uncertainty, boost investor confidence, and avoid drawn-out litigation by extending the reach of Advance Pricing Agreements (APAs) and issuing legally enforceable Advance Rulings on treaty applicability. For international corporations planning acquisitions in emerging markets, this policy will be very advantageous.

7. Regional Cooperation on Tax Policy

To standardize the tax treatment of cross-border transactions, regional frameworks (such those found in ASEAN, SAARC, or BRICS) should be investigated in addition to bilateral treaties. Multilateral initiatives level the playing field for all investors in a region and lessen treaty shopping opportunities.

8. Balancing Investment Incentives with Revenue Safeguards

Although DTAAAs can encourage foreign mergers and acquisitions, policymakers should be aware that making too many concessions could weaken the domestic tax base. To assess the net economic impact of tax treaties and make sure that incentives are not unduly skewed in favour of foreign investors at the expense of domestic revenues, periodic cost-benefit studies should be carried out.