

# BDO

## TAX UPDATE

June, 2010

### DIRECT TAX

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### INDIRECT TAX

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## Domestic Tax

### 1. ACIT v. Kavuri Polymers [2010-TIOL-260-ITAT-HYD]

#### **Amount of sales tax deferred under the State Government's incentive scheme and later converted into interest-free loan cannot be disallowed under section 43B**

The assessee was awarded sales-tax deferral scheme under the State Incentive Scheme for setting up industries, vide order dated 11-03-1999, of the Department of Industries, Government of Andhra Pradesh. As per the scheme, the assessee was permitted to retain the sales tax collected from its customers for a period of 14 years.

The scheme was later revised to provide that the deferred amount of sales tax is converted into interest free loan in the records of the State Government. Accordingly, the assessee did not pay the sales tax and reflected the same as interest-free loan in the balance sheet.

The Department contended that the provisions of Section 43B are applicable to the amount of sales tax unpaid. It was also argued that the agreement with the State Government for converting the unpaid amount into loan was entered into after the assessment proceedings were completed.

The Honourable Tribunal ruling in favour of the assessee held that, as per the provisions of the revised scheme, the deferred amount of sales tax stands converted into an interest free loan thereby losing its character of current liability and hence the provisions of section 43B are not applicable.

The Tribunal also observed that, as per the decision of the Third Member Bench of the Hyderabad Tribunal dated 29-08-2006, in the case of DCIT vs.. Nagarjuna Agrotech Limited, once the agreement is executed, it dates back to the original date of sanction of the scheme.

### 2. Punjab Stainless Steel Industries vs CIT [2010-TIOL-347-HC-DEL-IT]

#### **A.O. was correct in disallowing proportionate interest paid on borrowed funds diverted to sister concerns as interest-free advance**

The assessee firm was engaged in the business of stainless steel and had borrowed funds for its business and was paying interest on the same.

The assessee had advanced interest-free loan to another firm in which two partners of the assessee firm were partners and holding 50% share.

The A.O. observed that the loan to the sister concern was advanced from the same cash credit account in which the interest bearing borrowed capital was received from the bank. He considered the loan given to the sister concern as diversion of funds for non business purposes and therefore disallowed proportionate interest paid to the bank.

The assessee argued that, it had sufficient interest-free funds in the current account of the partners from which an interest-free advance was given to the sister concern. It was also argued that, a part of the advance was on account of sale of import licenses and hence was for the purposes of the business of the assessee.

The Tribunal observed that, instead of getting back money on sale of licenses, the same was allowed to be used interest-free by the sister concern. It was also found by the Tribunal that there was direct nexus between interest bearing loans and the interest free advances, since the advances had been made from the cash credit account and this position had not been disputed before it. The Tribunal was of the view that the assessee had failed to establish commercial expediency in making the interest-free advance from the material available to the Assessing Officer.

Based on the findings of the Tribunal, the Court agreed that there was no commercial expediency in the loan advanced to the sister concern and dismissed the assessee's appeal.

### 3. CIT vs. Escorts Auto Components Ltd. [2010-TIOL-325-HC-P&H-IT]

**Expenditure incurred for developing/modification of products manufacture, by expanding the existing unit are revenue in nature**

The assessee had incurred expenditure for modification of existing products and had shown it in the notes to accounts as been incurred for diversification and expansion of new product range including acquisition of machinery to aid such expansion, and the amount had been shown pending technical qualification under the head 'capital work in progress'.

Later, the assessee revised its return of income and claimed the above expenditure as revenue expenditure.

The A.O., on the basis of the notes to the annual accounts, concluded that the expenditure related to new projects and is of capital nature.

On appeal by the assessee, the CIT(A) observed that the expenditure was incurred for modification of the product within the same organisation, within the existing infrastructure, common fund, common management and no 'capital asset' have been created out of the expenditure. The CIT(A) also noted that the A.O. had not made any comments on the nature of the expenditure nor has he commented on the accounting entries in the books of accounts. The CIT(A) therefore allowed the assessee's appeal and the same was upheld by the Tribunal also.

The High Court held that merely on the basis of the notes to accounts the A.O. cannot hold the expenditure as capital in nature. Moreover, the assessee had rectified the error committed in claiming the expenditure by filing a revised return under Section 139(5). Further, it was also never doubted by the Revenue that the expenditure was wholly and exclusively for business purpose.

### 4. CIT vs. Poddar Pigments Ltd. [2010-TIOL-380-HC-DEL-IT]

**Interest income on delayed realisation of sales proceeds falls within the expression 'derived from' the business of industrial undertaking**

The assessee had considered the interest received from debtors for the purpose of deduction under Section 80IB.

During the reassessment proceedings, the A.O. disallowed bad debts debited by the assessee as well as the deduction under Section 80IB in respect of interest received from trade debtors.

The CIT(A) allowed the appeal of the assessee.

In respect of deduction under Section 80IB for interest on trade debtors, the Tribunal relied on the decision of the Madras High Court in the case of Indomatsushita Co. Ltd.<sup>1</sup> and held that, the said interest income could not be excluded from the purview of deduction under Section 80IB.

The High Court further relying on the decisions of the Supreme Court in Liberty India<sup>2</sup> held that the interest on delayed payments was nothing but a higher sale price and is a part of the sale price.

Consequently, it was held that the interest received from trade debtors was the direct result of the sale of goods and the income would fall within the expression 'derived from' the business of industrial undertaking as per the provisions of Section 80IB.

<sup>1</sup> 286 ITR 201

<sup>2</sup> 317 ITR 218

# International Tax

## 1. Ashapura Minichem Limited v. ADIT-International Taxation 1(1) ITA No. 2508/Mum/08

**Fees for Technical Services ('FTS') rendered by a non-resident would be taxable in India even where such services are not rendered in India, in light of the retrospective amendment to the source rules under Section 9 of the Income Tax Act, 1961.**

The assessee is an Indian company and had entered into an agreement with a Chinese company, China Aluminium International Engineering Corp Ltd ('CAEC') for bauxite test laboratories (outside India) and for preparation of tests reports.

The assessee filed an application u/s 195(1) that as the services were rendered outside India and the recipient did not have permanent establishment in India, the payments were not chargeable to tax under the India-China DTAA and no tax was required to be withheld at source. The assessee has made a reference to Hon'ble Supreme Court Judgement in case of Ishikawajima-Harima Heavy Industries vs DIT and of Jurisdictional High Court Judgment in case of Clifford Chance vs DCIT where it was held that "fees for technical services" were not chargeable to tax in India if two conditions were not satisfied viz. that the services were (a) rendered in India and (b) were utilized in India. The Assessee has also made a reference stating that deeming source rules under Article 12(6) of India-China tax treaty, cannot be applied as they are inconsistent with the source rule in Article 12(4)

The revenue contended that FTS is taxable in India irrespective of the situs of rendition of services. The source rule under Article 12(6) clearly indicates that FTS arises in India, where the same is paid by an Indian tax resident.

The judgement of Hon'ble Supreme Court in the case of Ishikawajima and of Clifford Chance are clearly contrary to the legislative intent, and the doubts if any, have been set at rest by the retrospective amendment vide Finance Act, 2010.

The Tribunal held that the legal proposition relied upon based on existing judicial precedents are no longer good law in view of the retrospective amendment to Section 9 vide Finance Act, 2010. Rendition of services in India is a sine qua non for its taxability in India.

The testing charges are also taxable as FTS under the China Treaty. The source rules under Article 12(4) does not restrict the deeming source rules prescribed under Article 12(6). The concept of territorial nexus, for the purpose of determining the tax liability, is relevant only for a territorial tax system in which taxability in a tax jurisdiction is confined to the income earned within its borders.

Accordingly, the income of Chinese company, by way of impugned receipt of fees for technical services from an Indian company, is to be deemed to accrue or arise in India under Section 9 (1)(vii) of the Act.

## 2. Airlines Rotables Limited, UK [ITA NO. 3254/MUM/06]

**The constitution of fixed place PE requires three criteria to be satisfied i.e. the physical location, Right to use the location and carrying on business through that location.**

Airlines Rotables Limited, UK ("the assessee") is a company incorporated in UK, engaged in the business of providing spares and component support for Aircraft in India. The assessee has entered into an agreement with Jet Airways Ltd. ("Airline"), an Indian Company for providing support services in respect of Aircrafts. The services provided by the assessee includes repair or overhaul of Aircraft components ("Rotables") and replace the Aircraft component at the time of repair or overhaul. In order to ensure timely replacement of the Aircraft components, stock has been maintained in India. Since the assessee does not have storage or support facility in India, stock was maintained in the possession of Airline, as bailee, in addition to its main Depot of Stock in UK. Stock maintained with Airline always remains property of the assessee, except as permitted under the agreement itself, whenever component is sent for repair or overhaul, the Airline has a right to use replacement from the stock in its possession.

# International Tax

The AO had observed that the store staff of airline was acted as agent of the assessee and this relationship had resulted in Agency PE coming into existence. Also since stock was kept at fixed places in India, the assessee form fixed place PE.

The Tribunal while considering the issue on constitution of Agency PE has observed that no business is carried out through the agent, even if there be an agent in keeping the consignment stock, Because this consignment stock with the airline is the end result of the assessee's business and not an intermediate step to get business, hence, there is no Agency PE.

Regarding the Fixed place PE, Tribunal has held that three criterions needs to be satisfied for constitution of Basic Rule PE/ Fixed Place PE –

- Physical criterion i.e. existence of physical location,
- Subjective criterion i.e. right to use that place and
- Functionality criterion i.e. carrying out of business through that place.

On the facts of the case, Tribunal observed that stock of the assessee was stored at specific physical locations; but this storage was under control of the airline and the assessee did not have place at its disposal to carry out his business from that place. Also the assessee did not have any right to use the location of Airline and the location was not used for the purposes of assessee's business.

In view of the above, the Tribunal has held that the assessee did not have any fixed place PE in India and directed the lower authorities to consider the taxability of the assessee, if any, in the light of Article 13(3)(b) (Royalty – for use of, or right to use of, any industrial, scientific or commercial equipment) on gross basis.

# Transfer Pricing

## 1. M/s Intervet India Private Limited

**Appropriate adjustments for differences in economic and market conditions in different locations need to be made while applying Comparable Uncontrolled price ("CUP") method.**

The assessee is in the business of manufacturing and trading of animal health and veterinary products to its Associated Enterprises ('AE') and Non-Associated Enterprises ('NAE'). During the year under consideration, assessee exported five products to AE and NAE and used Transactional Net Margin Method (TNMM) to benchmark the international transactions undertaken with its AE. In case of one product the price charged was much less in comparison to that charged to NAE.

During the course of assessment proceedings, Transfer Pricing Officer (TPO) rejected TNMM, adopted CUP method and made additions on the following grounds:

- Specific characteristics of the property transferred in both the cases were identical.
- Functions performed taking into account assets employed and risks assumed by the respective parties to the transactions were same except the Credit Risk,
- The delivery terms were same in both the cases.
- Both the countries to which exports was made were in South East Asia and thereby had similar market conditions

On rejection of the application by the TPO, the assessee preferred an appeal to the Commissioner of Income Tax (Appeals) (CIT(A)). CIT(A) partly allowed the appeal of Assessee by allowing further adjustment to the price on account of volume discount and the credit period. Aggrieved by the order of the CIT(A), Assessee preferred an appeal before the Income Tax Appellate Tribunal (ITAT).

## Assessee's Contentions before the ITAT

- The TPO and CIT(A) have not taken into account all the adjustment factors while making adjustments in comparing the sale price to an AE and a third Party while adopting the CUP method.
- Both the mentioned countries have totally different market conditions, and hence the needs are different. Also the market sizes and level of competition in both countries is not comparable.

## ITAT ruling

- When there is a sale of identical product to an unrelated party, CUP will form the basis of determining the ALP in respect of sales to an AE, but one of the essential prerequisite is that reasonably accurate adjustments are to be made to eliminate material factors affecting price, cost or the profit arising from such transaction. But at least all material factors should be considered in arriving at the adjustments.
- The TPO and the CIT (A) have assumed similarity of markets and economic conditions and have made adjustments only for the volume discount, credit offered and a small adjustment of credit risk. They have, completely ignored the disparate economic land market conditions of the countries and have made no adjustment for the same. Mere geographical contiguity of two countries need not mean similarity in economic or market conditions. Thus, the adjustments merely for volume off take, credit period and credit risk, though material are not sufficient to make the sale price to AE in one country comparable with the sale to unrelated party in another country.
- The matter was set aside to the CIT (A) for deciding the matter afresh after giving reasonable opportunity to Assessee to present their case.

The Ruling of the ITAT has further emphasized that while analyzing a transaction between the AE vis-à-vis NAE, a transaction is required to be evaluated from end to end perspective for the purpose of determining the arm's length nature of such transaction.

# Service Tax

### Judicial Rulings

#### Tribunal Decisions

*Rules 6 (2) and 6 (3) of CENVAT Credit Rules, 2004 are not applicable when the assessee is engaged in 'trading activity' and providing 'output services'*

The Tribunal held that trading activity cannot be equated with exempt services; hence the restriction under Rule 6 of the CENVAT Credit Rules shall not apply in case where the assessee provides a taxable service as well as undertakes trading activities.

#### **Orion Appliances Ltd vs. CST (2010 VIL 10) (Ahmedabad)**

*Reconciliation differences cannot be treated as income from taxable services*

The Tribunal held that, in case any difference arises out of reconciliation of ST-3 return and Income Tax Balance Sheet and Cash/Bank Ledger, it cannot be treated by the Departmental authorities as income from taxable services and leviable to service tax, in the absence of proof by the department for treating the receipts as income from taxable services and thus the same would not be treated as short payment of service tax resulting into raising of demand.

#### **CST vs M/s Purni Ads Pvt Ltd (2010 TIOL 654) (Ahmedabad)**

*Certification for computation of income from international transactions*

Assessee approached the Tribunal on the grounds that the services provided are certified as international transactions and are exempt from service tax. The Tribunal observed that certification services fall under 'Auditing Services' and exemption under Notification No 59/98 ST dated 16.10.98 is not admissible for

certification relating to computation of income from international transactions as required under Section 92E and Rule 10 E of the Income Tax Act, 1961/ Rules.

#### **Price Waterhouse vs Commissioner of Service Tax, Chennai (2010 TIOL 662) (Madras)**

*Refund of service tax paid on CHA services used as inputs in export of final products*

The assessee approached the Tribunal against the order of the Commissioner, who denied the credit of the service tax paid on the services of Customs House Agents (CHA) on the basis that the services were used after the goods reached the port and these were not used directly or indirectly in relation to the manufacture of excisable goods. The tribunal held that the refund of service tax is allowed as the CHA services are used as input services in the export of final products.

#### **M/s Leela Scottish Lace Pvt Ltd vs CC, Bangalore (2010 TIOL 719) (Bangalore)**

*Service provided partly outside India is export of service*

The Tribunal held that courier service performed partly in India and partly abroad is referred to as export of service as observed in U.B. Xpress (South) Pvt. Ltd. vs. Commissioner of Central Excise & Service Tax, Coimbatore, 2008 (12) S.T.R. 152 (Tri.-Chennai). and therefore, the assessee is not liable to pay service tax on such services.

#### **M/s First Flight Couriers Ltd Cochin vs CCE, Cochin (2010 TIOL 744) (Bangalore)**

## Service Tax

*CENVAT Credit availed on the basis of valid supplementary invoices is not denied when on the original invoice the registration number of the service provider is not mentioned.*

The assessee was registered with the department to discharge its liability arising out of providing output services which are taxable. There was no dispute as regard to the receipt of taxable service by the assessee. During the impugned period, service providers were not registered and invoices issued by them do not mention registration number. Subsequently, the service provider got itself registered and paid service tax by way of issuing the supplementary invoices. The assessee availed the credit of the tax paid on such input services on the basis of supplementary invoices. The Tribunal held that, the credit can not be denied to the assessee just because at the time of receipt of input services, the service providers were not registered and registration number was not mentioned on the invoices so issued by them and accordingly, the credit taken on the basis of supplementary invoices is valid as per Rule 9 of CENVAT Credit Rules, 2004.

***Secure Meters Ltd. vs Commissioner of C.E. Jaipur – II (2010(18) S.T.R. 490) (Delhi)***

# Central Excise & Customs

## Circulars

### *Power of adjudication conferred upon Superintendents of Central Excise*

The power of adjudication upto Rs. One lakhs of duty and/ or CENVAT credit has now been conferred upon the Superintendents of Central Excise in individual show cause notices. The said power may not be used for cases involving rate of duty and valuation or where extended period of limitation is involved.

With this amendment the monetary limits of adjudication for the Assistant Commissioner/ Deputy Commissioner is extended/ revised as – upto Rs. Five lakhs.

### **Circular No. 922/12/2010 – CX dated May 18, 2010 (amending the Circular No. 752/68/2003-CX dated October 1, 2003)**

### *Inclusion of cost of return fare of vehicle in assessable value*

Earlier vide circular no. 634/34/2002-CX dated July 1, 2002 (as amended), it was clarified that cost of return fare of vehicles was to be included in the assessable value. Tribunal in case of Haldia Petrochemicals Limited observed that, “in case where the transaction value of the goods being cleared is available at the factory gate, value will be determined in accordance with section 4(1) (a) of the Central Excise Act, 1944 without any reference to Rule 5 of the Central Excise Valuation (Determination of Price of Excisable Goods, Rules, 2000”.

Based on the above decision of the Tribunal, the Board has clarified that cost of return fare of vehicles is not to be included in the assessable value. Accordingly, the clarifications issued vide circular no. 634/34/2002-CX is withdrawn.

### **Circular No. 923/13/2010 – CX dated May 19, 2010**

## Judicial Rulings

### **Tribunal Decisions**

#### *Excisability of waste and scrap on dismantling of capital goods*

The assessee was engaged in the manufacture of sugar and has dismantled in the course of repair & maintenance, old machinery which was not usable. The scrap generated during the dismantling process was sold. Subsequently, a show cause notice was issued to the assessee demanding duty on sale of scrap and waste arisen during the course of dismantling.

The assessee approached the Tribunal against the Order of the Commissioner on the grounds that, the waste and scrap has not arisen during the course of manufacture of any iron and steel products rather from the capital goods on which credit has not been taken. The Tribunal observed that, waste and scrap arising during course of dismantling of old machinery are not excisable and not liable to duty of excise on sale.

#### **Triveni Engg. & Industries Ltd. vs CCE (2010 (253) ELT 311) (Delhi)**

#### *Valuation of excisable goods*

The Tribunal held that excisable goods have to be assessed to duty in the form in which they are cleared and not based on activities undertaken subsequent to clearance.

#### **Colgate Palmolive (I) Ltd. vs. CCE (2010 (253) ELT 144)**

#### **CENVAT Credit**

The Tribunal held that no one to one correlation is required for usage of inputs in export goods and the exporter is hence entitled to refund of unutilized credit on inputs.

#### **CCE vs. Motherson Sumi Electric Wires (2010 (252) ELT 543)**

# Central Excise & Customs

## Customs

### Circulars

#### *Sale of warehoused goods before clearance for home consumption – determination of assessable value of imported goods*

According to Section 14 of the Customs Act, 1944, the value of the imported goods shall be the transaction value of goods, which is the price actually paid or payable for the goods when sold for export to India for delivery at the time and place of importation. In case of imported goods, the price at which they were sold after warehousing them in India does not qualify as the price actually paid or payable for the goods when sold for export to India for delivery at the time and place of importation.

Thus, it is clarified by the board that in case of sale of warehoused goods, the value of the transaction would not be regarded as the transaction value as per Section 14 and therefore transaction of sale of warehoused goods does not affect the valuation of imported goods.

***Circular No. 11/2010 dated June 3, 2010***

# All India Value Added Tax

## Assam

| Area  | Description  |
|---|--|
| <p><b>Rate Change</b></p> <p><i>Notification</i><br/>No. FTX.55/2005/78<br/>Dated 3rd May, 2010</p> | <p>In Fifth Schedule, the rate of tax of "Leasing Transaction" is now 5 percent.</p> |

## Bihar

| Area   | Description   |
|--|---|
| <p><b>E-payments &amp; E&gt;Returns made mandatory.</b></p> <p><i>Notification</i><br/>No. S. O. 2303<br/>Dated 27th May, 2010<br/>&amp;<br/><i>Notification</i><br/>No. S. O. 2304<br/>Dated 27th May, 2010</p> | <p>Dealers who have made an annual tax payment of above ten lakhs during financial year 2009-10, will pay their tax and file returns along with receipt of payment of tax, interest and penalty compulsorily by electronic means through departmental website. (With effect from 15th July, 2010)</p> |

## Delhi

| Area   | Description  |
|--|--|
| <p><b>Addition of annexures for purchase/sale summary and branch transfers</b></p> <p><i>Notification</i><br/>No.F.3(27)/Fin(T&amp;E)/2009-10/JSF/99<br/>Dated : 7th May, 2010</p> | <p>In Form DVAT-16, there is addition of "Annexure 2A &amp; 2B" i.e. Summary of Purchase/inward Branch Transfer Register and Summary of Sale/outward Branch Transfer Register.</p> |

## Goa

| Area   | Description   |
|--|---|
| <p><b>Rate Change</b></p> <p><i>Notification</i><br/>4/5/2005-Fin(R&amp;C)(78)<br/>Dated 4th May, 2010</p> | <p>In Schedule-B, Rate of tax is increased from 4 to 5 percent.</p> |

# All India Value Added Tax

## Maharashtra

| Area  | Description  |
|---|--|
| <p><b>E-Payment &amp; E&gt;Returns</b></p> <p><i>Trade Circular.</i><br/><i>No. 17 T of 2010</i><br/><i>Dated. 17th May, 2010</i></p>                   | <p>In Profession Tax, scheme of electronic return and electronic payment is implemented.</p>   |
| <p><b>Amendment in Schedule A.</b></p> <p><i>Notification</i><br/><i>No.VAT-1510/CR-63/</i><br/><i>Taxation-1.</i><br/><i>Dated 26th May, 2010.</i></p> | <ol style="list-style-type: none"> <li>1. Raisins and currants sold during the period starting on 1st June 2010 and ending on 31st May 2012 shall not be liable to MVAT vide addition of entry 59 in Schedule A.</li> <li>2. Entry 108 of Schedule C omitted w.e.f. 1st June, 2010.</li> </ol> |
| <p><b>E- Payment</b></p> <p><i>Notification</i><br/><i>No.VAT-1510/CR-64/</i><br/><i>Taxation-1.</i><br/><i>Dated 26th May, 2010</i></p>                | <p>Every registered dealer liable to file monthly returns shall make payment electronically of any amount under the Maharashtra Value Added Tax Act, 2002 w.e.f. 1st June, 2010.</p>   |

## Madhya Pradesh

| Area   | Description  |
|--|--|
| <p><b>Amendment Notifications of Entry tax, Profession Tax and CST</b></p> <p><i>Notification</i><br/><i>NO. F-A3-20/09/1/V(58)</i><br/><i>Dated 12th May, 2010.</i></p> | <p>In Entry Tax, Profession Tax and CST Electronic Return filing is implemented, namely:-</p> <ol style="list-style-type: none"> <li>1. Furnishing the return electronically under digital signature;</li> <li>2. Transmitting the data in the return electronically without digital signature.</li> </ol> |

## Foreign Trade Policy

### Public Notices

The Central Government has issued guidelines for issuance of the Free Sale and Commerce Certificate for goods which are not restricted or prohibited for export. This certificate would be valid for a period of two years.

#### ***Public Notice No. 64/2009-14 dated May 18, 2010***

The Central Government has clarified that all Status holder exporters can avail the benefit of the 12 months period for submission of Bank Realization Certificate (BRC) for realization of export proceeds.

#### ***Public Notice No. 52/2010 dated May 11, 2010***

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