

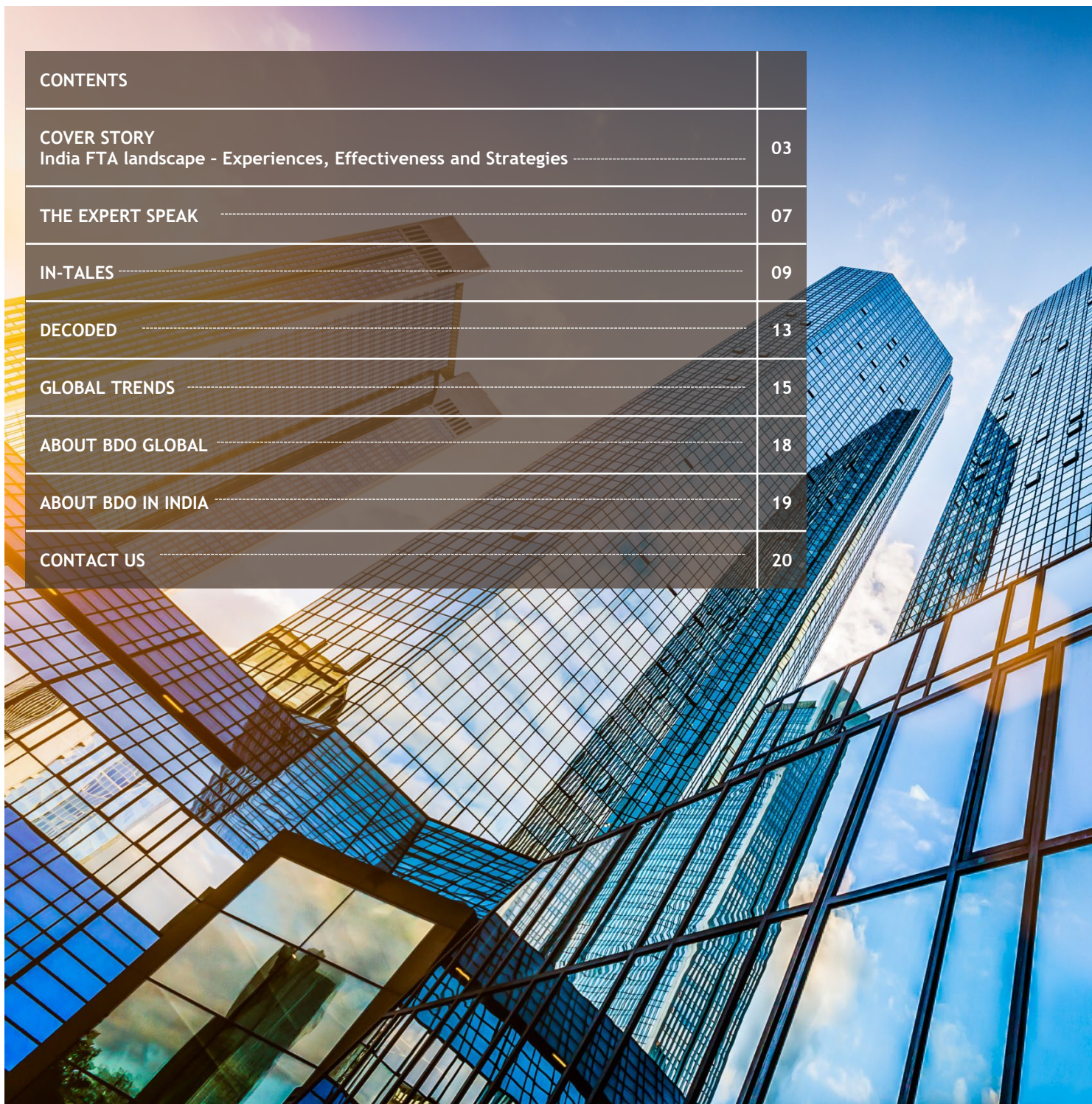


# The **TAX** POST

A bimonthly bulletin on the world of Indirect Taxes

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## PREFACE

Earlier this month, the Union Finance Minister Ms. Nirmala Sitharaman had announced that India overtook the UK to become the world's fifth-largest economy. As per the IMF projections India is now only behind the US, China, Japan and Germany. This is a good reason for India to celebrate, it being an important milestone if it were to reach the aspiration and rather aggressive goal of being a USD 5tn economy, by 2025.

The unprecedented COVID outbreak in early 2020 followed by the global lockdowns, multiple rounds of relief packages announced by the Government, armed conflict between Russia and Ukraine, etc. have lowered the enthusiasm for aggressive growth plans and raised doubts about traversing the path to the eventual USD 5bn economy dream early.

The statement by the Union Minister of Commerce and Industry Mr. Piyush Goyal in March 2022 thus becomes relevant here when he announced that "If we want to be a 5 trillion-dollar economy, our exports of Goods and Services will have to be a trillion dollars at least - ideally 25%, but at the very least 20%. And why I said 25% because we need to support our import of oil. And therefore, our exports will have to really go up by leaps and bounds so that we can continue to finance our imports and strengthen the Rupee in the days to come"<sup>1</sup>.

FTA negotiations are an important part of India's broader strategy to forge balanced trade agreements with key economies and revamp existing trade pacts to improve exports and grab a larger share of global trade and investment. However, in the past India had raised several issues regarding FTAs and their implications for its local markets. The Cover Story of this edition of 'The Tax Post' takes a closer look at the various FTAs India has executed and the impact of these agreements on India's external trade.

Technology has been the harbinger of change and innovations permeate in an overarching manner, be it in information technology, interplanetary travel, warfare, medicines, agriculture, mobility solutions or in the administration of taxes. In our 'Expert Speak' segment, we discuss how the technology-enabled compliance framework can significantly reduce tax disputes and litigations.

'Sustainable growth' has been the buzzword of developing economies in the current decade specifically in the context of the momentum towards reduction in the usage of fossil fuels and containing carbon emissions with a particular focus on the Electric Vehicle (EV) Industry which requires much-needed acceleration and drive towards growth. The 'In Tales' segment of this edition delves deep into this sector and discusses the various initiatives the country has taken.

This edition's 'Decoded' bisects an important judgment of the Supreme Court which has settled the dispute on the taxability of software sold on CD/DVD. The Court concluded that a transaction of a 'sale' of an antivirus software replicated on a CD/DVD along with the license key/code, cannot be artificially vivisected into two parts, viz. 'Sale' of goods and provision of 'Service' to levy VAT/CST and Service tax at the same time.

The section 'Global Updates', continues to bring news from other jurisdictions and we hope this edition of 'The Tax Post' would also be an interesting read.



**GUNJAN PRABHAKARAN**  
Partner & Leader  
Indirect Tax

<sup>1</sup> <https://theprint.in/india/indias-exports-share-in-gdp-should-rise-to-at-least-20-pc-to-achieve-a-5-trillion-dollar-economy-piyush-goyal/863015/#:~:text=%E2%80%9CIf%20we%20want%20to%20be,very%20least%2020%20per%20cent>

# COVER STORY

## INDIA FTA LANDSCAPE - EXPERIENCES, EFFECTIVENESS, AND STRATEGIES

The continuous spread of Free Trade Agreements (FTAs) in the developing world has spurred an intense debate. FTAs can promote continued trade liberalisation, induce structural reforms in economies and widen market access across a vibrant economic region, where the demand for greater intra-regional trade is increasing rapidly.

On the negative side, the proliferation of bilateral FTAs can create the so-called 'spaghetti bowl effect' as multiple 'Rules of Origin' arising from overlapping agreements could cause harm, particularly to small and medium enterprises with limited capacity to comply with them. The resulting market fragmentation would be more costly even for major multinational companies because of rising transaction costs and regulatory barriers. The flow of foreign direct investment and the associated transfer of technology and know-how to smaller economies may decline.

The FTA negotiations are also India's broader strategy to forge balanced trade agreements with key economies and revamp existing trade pacts to improve trade and investment. After concluding FTAs with Australia and the United Arab Emirates earlier this year, it is preparing to formalise two key trade pacts with the United Kingdom and the European Union. The FTA talks with Canada and the UK are also underway. Experts say that the FTAs could help economies to boost their exports and create employment opportunities within the country. They, however, also warn that countries must tread cautiously while signing FTA and these pacts must be evenly balanced.

Earlier, India raised several issues regarding FTAs and their implications for its local markets. Many of these issues were flagged during India's negotiations before eventually opting out of the Regional Comprehensive Economic Partnership (RCEP) in 2019. One of the major concerns highlighted by the Government of India is the impact of FTAs on local supply chains. Moreover, as data suggests, FTAs have not served the Indian economy and built capacities as much as it was expected. Thus, the challenge for India remains to maintain a balance between global economic integration and enhance the capacity of local markets to be able to serve as a global exporter.

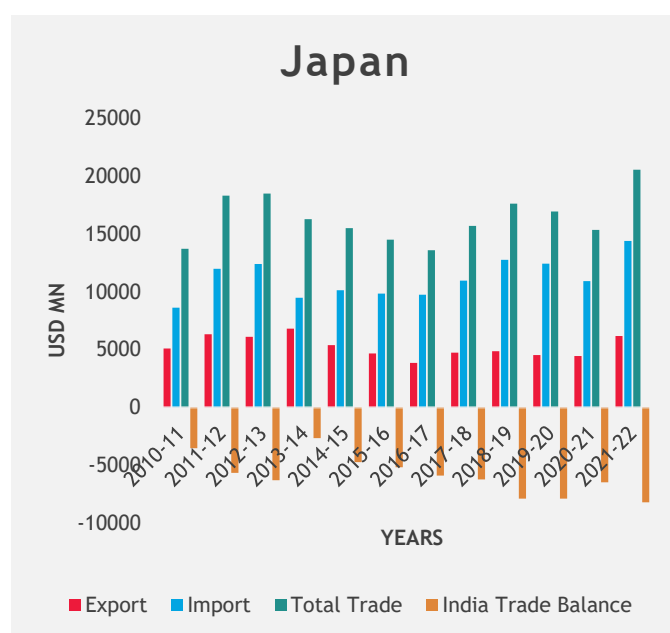
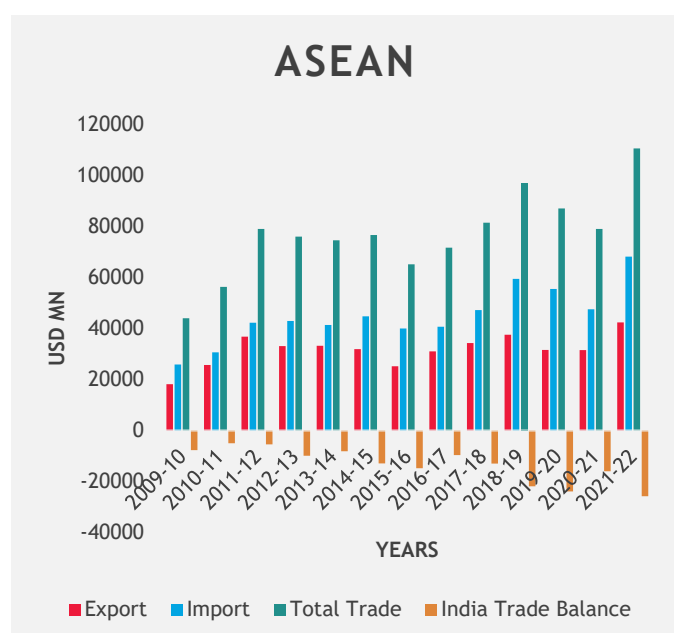
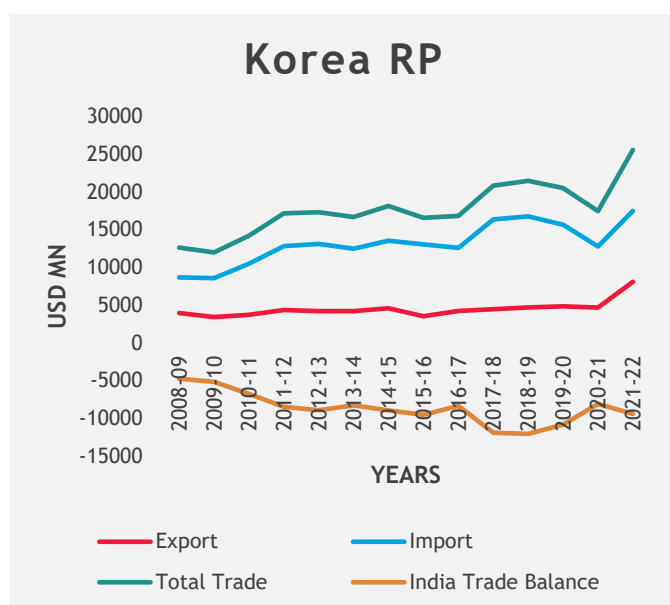
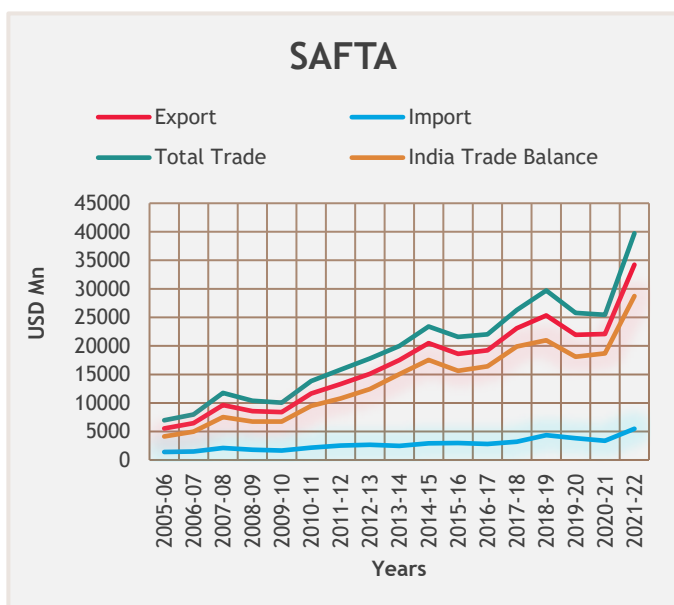
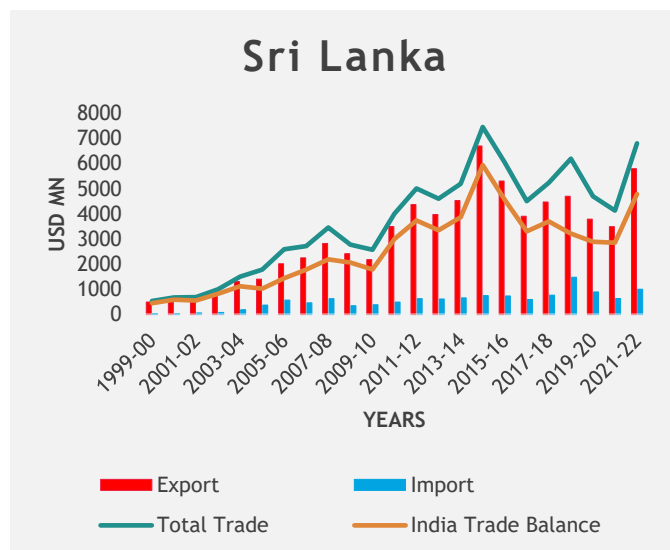
India has seen some notable positives from the FTAs in the recent past as the data shows a significant increase in exports to some of the countries/blocs. According to data sourced from the Ministry of Commerce<sup>2</sup>, India's merchandise exports to countries/regions with which India shares trade agreements such as FTAs have registered growth. Exports to Japan, Korea, Sri Lanka, the ASEAN bloc and the South Asia bloc have witnessed a significant spurt in 2021-2022 (USD 597bn) with exports growing 39%, 73%, 66%, 34% and 55% respectively to these countries/blocs over the previous year (USD 66bn). However, the year 2021-2022 has been an outlier, especially if the trend of the past period is any indication.



<sup>2</sup> <https://tradestat.commerce.gov.in/eidb/ecntq.asp>

While, this is just one side of the story, the imports from Japan had increased from USD 11bn (2020-2021) to over USD 14bn (2021-2022). Imports from Korea also witnessed a significant spurt from USD 13bn (2020-2021) to USD 18bn (2021-2022) and this trend continued in the ASEAN bloc also, where the imports increased from USD 47bn (2020-2021) to USD 68bn (2021-2022). The Trade balance also witnessed an adverse trend with the trade gap widening with Japan (USD 8bn), Korea (USD 9bn) and the ASEAN bloc (USD 25bn) in FY 2021-2022.

While key FTAs with the ASEAN bloc, Japan and Korea did not fare too well, especially in the context of adverse trade balance, negative or modest export growth and continuous increase in imports, the experience with other FTAs namely Sri Lanka and SAFTA have been encouraging and stands as an argument in favour of formalising more FTAs. A comparative analysis of statistics sourced from the Ministry of Commerce of five key FTAs is given in the diagrams below:



The above statistics indicate to not too favourable trends for India except for the FTA's with SAFTA and Sri Lanka. The growing presence of China and the widening gap in trade with China had been key concerns when India opted out of the RCEP. Pertinently 'A Note on Free Trade Agreements and their Costs'<sup>3</sup> published by NITI Ayog, it was recommended:

"Before getting into any multilateral trade deal India should firstly, review and assess its existing FTAs in terms of benefits to various stakeholders like industry and consumers, trade complementarities and changing trade patterns in the past decade. Second, negotiating bilateral FTAs with countries where trade complementarities and margin of preference is high may benefit India in the long run. Third, higher compliance costs nullify the benefits of margin of preference, thus reducing compliance cost and administrative delays is extremely critical to increase utilisation rate of FTAs. Fourth, proper safety and quality standards should be set to avoid dumping of lower quality hazardous goods into the Indian market. Fifth, circumvention of rules of origin should be strictly dealt with by the authorities. In case of India- Sri Lanka FTA, Sri Lanka had started exporting copper to India by under invoicing of imported scrap to in order to show higher value addition for qualifying for preferential rates under the FTA. Thus, Rules of Origin (ROO) norms can easily be circumvented by simple accounting manipulation to flood Indian markets. The overarching conclusion of this report is that FTAs have to be signed keeping two things in mind, mutually reciprocal terms and focusing on products and services with maximum export potential".

One may also argue that getting fixated on India's trade deficit with any particular country or group of nations may not be the correct yardstick to evaluate the effectiveness of an FTA. It is argued that despite the deficit, such agreements have raised the flow of trade and enabled India to achieve greater integration with the global supply chain. Other indirect benefits such as the easy flow of electronic goods may have caused the deficit to rise in this segment, but it helped India turn into a software power globally. However, given the broader impact of trade imbalance on the current account and in the interests of fairness in a trading system, India is well within its right to review the pacts that haven't worked in its favour and possibly negotiate for suitable structures within the overall trade agreement to factor eventualities.

A case in point is India tightening the rules of origin and value-addition norms in the UAE FTA to address fears of round-tripping and illegal dumping. To be eligible for duty-free access in India, products must have witnessed at least a 40% value addition in the UAE. This is higher than the requirement of 30%-35% under earlier FTAs that India has signed.

It is said that a country's participation in an FTA does not begin and end with the actual negotiations and inking of the deal. The FTA trail entails various pre and post-negotiation procedures and extends until its enforcement and evaluation.

A well-thought-out plan assists negotiators, implementers and evaluators in effectively delivering their duties and properly coordinating their functions.

In many countries, the decision to enter into an FTA is politically motivated and is sometimes determined by the heads of the government and FTA initiation precedes the pre-negotiation consultations. The idea of entering into an FTA is usually introduced in bilateral meetings (such as state visits) to further the economic relations between the parties involved.

FTA negotiation (which takes years depending on the issues covered and the depth of the proposed agreement) occurs at two levels – externally with the negotiating counterparts and domestically with national stakeholders. External negotiations are conducted between chief negotiators (especially on sensitive issues) and between sub-teams at plenary sessions and the working group level (for specialised or technical matters). Domestic negotiations take place with stakeholders from both the public sector (e.g. policymakers, cabinet members and regulatory bodies) and the private sector (e.g. business or industry groups, NGOs, workers' unions, environmental lobbyists, civil society and consumer groups).

The creation of a viable free trade area is a complex legal and economic process that requires strategic planning. Before beginning FTA negotiations, a country should consider its economic, political and legal objectives and its reasons for wanting to join an FTA. Before the process is started, the following key points would merit consideration. The country must:

- Develop an economic model of the country in its present state and project the economic results of commitments made in various sectors
- Consult industry and trade associations, consumer groups, farmers and farm groups, NGOs, and other stakeholders and ascertain their FTA needs, objectives and concerns
- Examine the objectives in terms of the country's trade relations with other countries, the needs of stakeholders and the country's WTO obligations
- View objectives from an economic perspective:
  - Can the FTA be used to promote domestic economic reform and competition?
  - Will exempting sectors from coverage (protectionism) make a domestic sector inefficient?
  - Will exemptions raise the price of certain inputs and diminish competitiveness?
  - Will exemptions protect infant industries?
  - Should long transition periods be used to protect such industries?
  - Would exclusion of specific products/services from the scheme of FTA, starve the industry/trade of critical resources?
  - Complementary growth prospects
- Sectors that require time to mature and which product lines have matured to withstand and compete with global brands
- The mechanism is to be instituted to prevent misuse of FTAs
- Need for changes in the national laws to address the needs of the time

<sup>3</sup> [https://www.niti.gov.in/writereaddata/files/document\\_publication/FTA-NITI-FINAL.pdf](https://www.niti.gov.in/writereaddata/files/document_publication/FTA-NITI-FINAL.pdf)

- Consultative mechanism and relevant and accurate background information
- Monitoring and enforcement mechanism of the FTAs

Public participation especially the involvement of the industry, trade and other key stakeholders is a critical aspect of a defined FTA negotiation strategy. In the Indian context, despite the outreach efforts made by the Government, the response and participation from the industry and trade in the past have not been timely and encouraging. This has caused heartburn in the implementation of the FTA and the post-execution challenges. A well-oiled machinery, working in tandem with various stakeholders is imperative for formalising a pact, which can benefit various stakeholders.

While the experiences and historical data could be important pointers of the past, the past is like a rearview mirror of a car, it is good to take a quick glance back, but if you stare too long, you will miss what is right in front of you.



# THE EXPERT SPEAK



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## TAX TECHNOLOGY: AN ENABLER TO LIMIT LITIGATION

Goods and Services Tax (GST) has come a long way since its launch in 2017 when it replaced a plethora of Central and State level taxes with a uniform tax. It has been over half a decade since its implementation and GST has been nothing short of a roller coaster ride for both the industry and the Government.

Despite a bumpy ride, the Government and industry have recognised that stability can be achieved only through a 'give and take' in equal measure. This is probably one of the main reasons why the Government has given incredible weightage to the stated objective of mitigating avoidable litigations and controversies. This is evident from the various measures adopted by the government, such as introducing amnesty schemes to resolve legacy indirect tax disputes.

There is no doubt that GST is at a very crucial juncture where litigations are still at a rather nascent stage. As time passes and the assessments pick up the pace, one can only expect more and more disputes to crop up. Considering the complexities of the legislation, administrative difficulties and historical experiences, one has come to accept that this is an unavoidable feature of any tax regime.

The litigations are primarily on either interpretation-based substantive issues or factual/processual issues like data mismatch or reconciliation level challenges.

### Interpretation Issues

With regard to interpretational issues under litigation, at present, in the absence of the GST tribunal, many of the substantive questions of law remain unanswered. This leaves trade in a precarious situation with no choice but to approach the Honorable High courts. The costs and efforts involved in such litigations and the drain it creates on the judiciary is worth noting.

While the GST Council is working towards addressing these complications, an aspect that may be considered for mitigating several avoidable disputes is leeway to taxpayers, particularly for procedural irregularities. The same would go a long way in reducing the burden of litigation.

### Factual/Procedural Issues

The bulk of the litigations or proceedings is due to data or facts-related matters. Problems related to transitional credit, refunds of taxes, export and import complexities, e-way bill structures, taxability of vouchers and other areas have created a lot of scope for further dispute and litigations.

The Government has been facing its fair share of criticism for various aspects of implementing GST, however, it is also to be commended for its accomplishments in digitising the tax regime and the various compliance processes. This has expanded the tax base and has created much-needed checks and balances to curb tax evasion.

The tax authorities are now privy to voluminous, relevant data at their fingertips, which can be used to detect potential tax avoidance, basis which the Government can issue notices to errant taxpayers.

Increasingly tax authorities across jurisdictions, are leaning towards 'Advanced analytics', which is proving to be an extremely valuable tool in improving the effectiveness of the tax administration.

Advanced analytics is the practice of using statistical techniques to draw inferences about cause and effect and make predictions. Both inferences and predictions are everyday tasks within the tax administration. Whether selecting an audit case, determining the next step for the tax recovery process, taxpayer communication or analysing root causes, tax officials are constantly making predictions and concluding the likely impact of their actions, using Advanced analytics techniques.

On the other hand, some businesses, which hopped onto the digital bandwagon are now using cutting-edge digital technologies provided by 'SaaS' platforms to detect cash flow leakages and optimise taxes. Further, technology has also helped them in getting over the need of keeping physical documents and data is easily available on platforms that can be promptly shared with authorities whenever required. These businesses although very small in number have been able to keep the litigations at bay with the availability of adequate and correct data.

The others which form the majority are still coming to turn with the tsunami of data that is available and needs to be reconciled. They are still at a nascent stage in automation and rely on a largely manual process in compliance or data handling. This usually results in separate data sets being independently provided on various occasions resulting in reconciliation issues.



The use of standalone tools for different processes with no interconnection may ease the compliance burden momentarily but in the long run, would always be detrimental when responding in different proceedings when the entire data is looked at holistically. In most cases, glaring reconciliation issues like GSTR 1 not matching with GSTR 3B, e-waybills not matching in sales declared, purchases not tallying with inward waybill data and so on.

In light of the above, one can safely say that technology has become a must in every area of taxation especially to weed-out avoidable litigation, tax costs and loss of tax credits. Authorities demanding 5-year-old data can be readily reconciled and made available with the help of technological tools which are interconnected and capable of communicating with each other.

It has become imperative now for companies to invest in technologies to create a sustainable and well-thought-out tax administration ecosystem, which uses a single stream of data for all requirements. It should also be scalable and future-proof so that it can keep pace with evolving needs.

To conclude, to reduce the burden of litigation and proceedings which are factual/procedural in nature, an interconnected tax ecosystem with a stable ERP and automation is the need of the hour. This would avoid the investment of substantial time and effort in unproductive litigation for businesses and tax administration.



# IN-TALES

## ELECTRIC VEHICLES - INDIA'S PUSH FOR LONG-TERM SUSTAINABILITY

### Global Outlook

With the increased momentum towards sustainable growth and focus on reduction in carbon emissions, the Electric Vehicle (EV) Industry has received the much-needed acceleration and drive to grow. The sale of EVs doubled in 2021 from the preceding fiscal year to the new record sale of 6.6mn units. In 2022, the global sale of EVs continued its growth with approximately 2mn units sold in Q1<sup>4</sup>. The success of EVs is driven by numerous factors such as increased public spending on subsidies and incentives for EVs, pledges by countries to phase-out Internal Combustion Engine (ICE), ambitious electrification targets, etc.

### EV Market in India

Currently, the Indian automobile industry is the fifth largest in the world and is expected to become the third largest by 2030. As per India Energy Storage Alliance, the Indian EV industry is expected to expand at a CAGR of 36%. Similarly, the EV battery market is projected to grow at a CAGR of 30%<sup>5</sup>. NITI Aayog aims to achieve EV sales penetration of 70% for all commercial cars, 30% for private cars, 40% for buses and 80% for two and three-wheelers by 2030. The aforesaid target is in line with India's goal to achieve net zero carbon emission.

### Central Government Initiatives

To increase the acceptance of EVs in India, the Central Government has announced various promotional measures during the last decade. The timeline for the various initiatives undertaken by the Government (viz. policymakers and regulators) are set out below<sup>7</sup>:



The EV push in India opens a diverse range of business opportunities across various segments viz. mobility, infrastructure and energy. According to NITI Aayog, a complete transition to EVs would require a total investment of approximately USD 267bn in EVs, battery infrastructure and charging infrastructure<sup>6</sup>.

### Types of EVs

- Battery Electric Vehicle (BEV): BEV uses electricity as the source of energy for running the vehicle. The electricity is stored in a large battery pack which can be charged by plugging it into the electricity grid.
- Hybrid Electric Vehicle (HEV):
  - HEVs: As the name suggests, HEVs represent a hybrid version of ICE and BEV and simultaneously use both engine and electric motor for running the vehicle
  - Plug-in Hybrid Electric Vehicle (PHEV): Similar to HEV, PHEV simultaneously uses both an engine and an electric motor for running the vehicle. PHEVs have a larger battery size than HEVs
- Fuel Cell Electric Vehicle (FCEV): FCEVs are often known as zero-emission vehicles. FCEVs employ 'fuel-cell technology' to generate the electricity required to run and operate the vehicle. The chemical energy of the fuel is converted directly into electric energy. (Example Hydrogen)

<sup>4</sup> Data from International Energy Agency's report on Global EV Outlook 2022

<sup>6</sup> Data from IBEF

<sup>5</sup> Data from International Energy Agency's report on Global EV Outlook 2022

<sup>7</sup> Timeline as uploaded on the e-Amrit portal

Key initiatives by the Central Government in respect of promoting the manufacturing, sale and use of EVs are as follows:

- National Electric Mobility Mission Plan 2020 (NEMMP): NEMPP was launched in 2013 by the Department of Heavy Industry (DHI) as a roadmap for faster manufacture and adoption of EVs in India.
  - As a part of NEMMP, the Faster Adoption and Manufacturing of Hybrid and Electric Vehicles in India Scheme (FAME) was notified in April 2015. The FAME framework seeks to incentivise and encourage the adoption of electric and hybrid vehicles
  - FAME Phase I was operational for a period of 4 years i.e., till 2019. Phase I mainly focused on 4 areas viz. demand creation, technology platform, pilot projects and charging infrastructure
  - FAME Phase II was launched in 2019, for a period of 3 years and focuses on supporting the electrification of public and shared transportation and also aims to support through subsidies for about 7,000 e-buses, 0.5mn e-three wheelers, 55,000 e-four wheelers passenger cars and 1mn e-two wheelers
  - Under FAME Phase II, till 1 February 2022, approximately 0.231mn EVs have been supported by way of incentives amounting to INR 8.27bn for the purchase of EVs. Moreover, the Ministry of Heavy Industry (MHI) has sanctioned 6,315 e-buses for procuring 6,315 electrical buses to 65 cities/STUs/CTUs/State Government entities for intra-city and inter-city operations across 25 States/Union Territories. In addition to the above, MHI has also sanctioned 2,877 EV charging stations across 25 States/Union Territories<sup>8</sup>
  - On 11 June 2021, DHI announced further amendments to FAME Phase II Scheme to give a boost to EV demand among consumers. Under the revised policy, the subsidy per electric two-wheeler (linked to its battery size) has been increased to INR 15,000 per kWh (subject to 40% of the cost of two-wheeler)<sup>9</sup>
  - Under the FAME Phase II scheme, the approximate incentives provided are tabulated below:

Class of vehicles	Total Approximate Incentives	Battery Size (Approx)
2 Wheelers	INR 15,000 per kWh upto 40% of unit cost	2 kWh
3 Wheelers	INR 10,000 per kWh	5 kWh
4 Wheelers	INR 10,000 per kWh	15 kWh
E Buses	INR 20,000 per kWh	250 kWh
E Trucks	INR 20,000 per kWh	

- Battery Swapping Policy: In addition to the above, recently, NITI Aayog has released a draft Battery Swapping Policy. As per the said policy, battery swapping falls under the broader umbrella of the Battery as a Service (BaaS) business model which enables the users to purchase an EV without the battery, thereby significantly lowering the upfront purchase cost of EVs. The right for using the battery is procured on payment of a periodic subscription fee to the service providers for battery services throughout the vehicle's lifetime. BaaS business model would apply to both fixed and removable batteries and is the channel to implement swapping solutions.
- Production-linked Incentive (PLI) Scheme for Advance Chemistry Cell (ACC) Battery Storage:
  - In July 2022, the Government of India (GoI) signed the Program Agreement under the PLI scheme for ACC Battery Storage with Reliance New Energy Solar Ltd., Ola Electric Mobility Pvt. Ltd. and Rajesh Exports Ltd. An outlay of INR 181bn is earmarked by the GoI towards the scheme, which is intended to establish a local manufacturing capacity of 50 Giga Watt Hour (GWh) of ACC and 5 GWh of Niche ACC capacity
  - As per the PLI scheme, each selected ACC Battery Storage manufacturer would set up an ACC manufacturing facility of minimum 5 GWh capacity and achieve a domestic value addition of at least 25% and make the mandatory investment of INR 2.25bn/GWh at 'Mother Unit Level' within two years
  - The PLI scheme would result in Import substitution of around INR 200bn - INR 250bn every year, on account of oil imports as this scheme is expected to accelerate EV adoption in India
- PLI Scheme for Automobile and Auto Component: The PLI scheme for Automobile and Auto Component was intended to incentivise high-value advanced automotive technology vehicles and products. The PLI scheme for the auto sector was open to the existing automotive companies as well as new investors, who were not in the automotive or auto component manufacturing business. The PLI scheme had two components:
  - Champion Original Equipment Manufacturer (OEM) Incentive scheme: This is 'sales value linked' which applies to battery electric vehicles and hydrogen fuel-cell vehicles of all segments



<sup>8</sup> Press Release dated 4 February 2022 (<https://pib.gov.in/PressReleaseDetailm.aspx?PRID=1795444>)

<sup>9</sup> Data from India Briefing report on "Electric Vehicle Industry in India: Why Foreign Investors Should Pay Attention"

- Component Champion Incentive scheme: This too is ‘sales value linked’ which applies to advanced automotive components of vehicles, completely knocked down (CKD) / semi knocked down (SKD) kits, vehicle aggregates of 2-wheelers, 3-wheelers, passenger vehicles, commercial vehicles, tractors, etc.
- Under the PLI scheme, an incentive between 13% and 18% of the Determined Sales Value will be provided to Champion OEM and New-Automotive OEM Investor Company. In March 2022, the GoI approved the application of various companies for claiming the benefit of the PLI scheme. Similarly, the incentive slab for the Component Champion Incentive scheme will range between 8% and 11%.
- Initiatives by the Ministry of Power: It has been clarified that charging EVs is considered a service and hence, operating EV charging stations will not require a license. In January 2022, the revised consolidated “Guidelines and Standards for Charging Infrastructure for Electric Vehicles” were issued containing the minimum standards with regard to the density of/distance between the Public Charging Infrastructure at the local level and the private charging infrastructure (for non-commercial use by individuals) facilities in building premise/urban precincts to be followed as per the Model Building Bye-Laws, 2016 prepared by the Town and Country Planning Organisation, Ministry of Urban Development.
- Poor infrastructure and battery range (for fully charged EVs) is yet another issue faced by the EV industry. Poor infrastructure includes a lack of charging infrastructure as well as a lack of power charging set-up at the homes of EV owners
- The EV industry in India is at its nascent stage and hence, the industry offers an extremely limited range of products
- Lack of standardisation as regards inter-operability of batteries among various EVs: While the battery-swapping policy is to be introduced, it will also lead to challenges of inter-operability of batteries across various EV manufacturers. Considering the above, suitable SOPs are required to stipulate the standard battery size, dimensions, capacity, etc. which needs to be followed by various EV and battery manufacturers to enable inter-operability of batteries and suitably implement battery-swapping methods
- Isolated incidences of EVs catching fire point to the need of building user confidence and introduction of stringent and effective vehicle safety and testing norms. In the absence of the same, the instances of EVs catching may dent customer confidence and resistance from the customers to the faster adoption of EVs
- Increased use of EVs would also result in increased consumption of electricity. Since India is still reliant on fossil fuels for generating electricity, such increased electricity usage would still continue to deplete fossil fuel reserves and also emit carbon dioxide, till the time renewable sources of generating electricity contribute a major part of electricity generation
- While the GoI has increased the customs duty on the import of batteries to promote manufacturing in India, till the time India becomes a manufacturing hub, the EV industry would need to rely heavily on the import of batteries.

#### EV Incentives provided by the Central Government and the State Governments<sup>10</sup>

- Buyers of EVs (4-wheelers and 2-wheelers) are entitled to claim deduction under Section 80EEB of the Income-tax Act, 1961 upto INR 1,50,000 in respect of interest paid on vehicle loans. The benefit of the deduction is subject to various conditions inter alia including that the EV must be purchased between 1 April 2019 and 31 March 2023
- The GST rate on EVs has been reduced to 5% as against the 28% GST rate of motor vehicles with ICE. Compensation cess has also been reduced to NIL for a certain class of EVs
- The customs duty on nickel ore, which is one of the key components in the manufacture of the lithium-ion battery was reduced to 0%
- Purchase incentives in the form of direct discounts and Financial Incentive in the form of Coupons have been provided
- Interest subvention/discount is offered on the interest rate while availing loan for the purchase of EVs
- Road tax payable at the time of purchase of EV is waived off
- The one-time registration fee applicable on a new EV purchase is waived off
- Scrapping incentives are provided at the time of de-registering old Petrol and Diesel vehicles

#### Challenges faced by the EV industry

Despite the various fiscal incentives granted by the Central Government and the respective State Governments, the EV industry still faces the following challenges:

- EV Costs and battery costs are high in comparison to motor vehicles with ICE

#### GST - Key open issues concerning the EV industry

In addition to the above, as regards to the taxability of EVs and their parts and components, the EV industry may also encounter the following challenges under the GST regime:

- Battery-swapping - Goods vs. Services and applicable tax rate on such supplies
  - As highlighted above, battery swapping would fall under the broader umbrella of the BaaS business model which enables the users the right for using the battery on payment of periodic subscription fees
  - While the draft policy settles the issue that battery-swapping would be considered as a supply of services, a suitable clarification should also be provided by the GST Council affirming the aforesaid position
  - Battery-swapping can also be said to involve the supply of goods (viz. electrical energy) and services (viz. transfer of right to use batteries). The issue that needs to be examined is whether the subscription fee charged to the users would be considered as a mixed supply and hence, the entire amount would be taxable as a transfer of the right to use batteries which is taxable at the same rate of GST as the supply of batteries. This aspect needs clarification

<sup>10</sup> As per e-Amrit portal - Electric Vehicle Incentives

- Another subset of battery swapping would be the applicable GST implication in a situation where the user is initially the owner of the battery. The applicable GST implications on the battery procured from the user along with the corresponding subscription fees charged from the user would also need to be clarified given the complexity of the transaction and the user's ownership of the battery affixed to the EVs
- Inverted duty structure for EV manufacturers:
  - EVs are leviable to 5% GST in terms of Sl. No. 242A of Notification no:01/2017-Central Tax (Rate) dated 28 June 2017. However, certain procurements used in manufacturing EVs viz. lithium-ion batteries, tires, etc. attract a higher rate of GST and hence, result in a situation of inverted duty structure
  - While the EV manufacturers can claim a refund of an unutilised input tax credit on inputs, no refund would be available in respect of input services and capital goods, which would continue to accumulate, effectively, becoming part of the cost of an EV. This would increase the cost of EVs in the hands of the purchaser
  - As regards the refund of unutilised ITC on inputs, the EV manufacturers can claim a refund of the same under the GST law. However, considering the timelines involved in making an application for a refund and the actual receipt of refunds, the EV manufacturers would be burdened with an enhanced working capital requirement for their day-to-day business operations, causing financial hardship to the EV manufacturers. To eliminate the aforesaid hardship, suitable representations would be needed so that GST Council can examine a reduced rate (say, 5%) subject to the certification provided by the EV manufacturer stipulating the end-use of such goods for the manufacture of EVs (similar to end-use based exemptions)
- Taxability of Electric Highways
  - Recently, the Union Minister for Road Transport and Highways coined the idea of an electric highway from Delhi to Mumbai. The electric highway refers to the road which supplies power to it, including through overhead power lines
  - The aforesaid model is identical to the electric car charging lanes in the United Kingdom
  - The provisions concerning the taxability of such transactions along with the place of supply for such transactions would also need requisite clarifications
- Focussing on enhancing EV charging infrastructure by policy measures and providing fiscal incentives for developing and maintaining EV charging infrastructure
- Clarification concerning the open indirect tax issues by the GST Council

### Way Forward

The scope of India's EV sector is dependent on the availability of capital for OEMs, battery manufacturers and charge point operators as well as the improvements to the charging infrastructure. Considering India's ambition in being a net-zero emission nation, the following key action points could be anticipated from the Government:

- Incentives provided by the Central Government and the respective State Governments need to be continued on an ongoing basis



# DECODED

## Taxation of Software - Apex Court settles conflict on 'Goods' vis-à-vis 'Services' saga

### Introduction

In an important judgement, the Honorable Supreme Court<sup>11</sup> has inter alia held that a transaction of 'Sale' of antivirus software replicated in a CD/DVD along with the license key/code, cannot be artificially vivisected into two parts, viz. 'Sale' of goods and provision of 'Service'. The transaction in question is, in substance, a transaction of 'Sale' of software, and once the said software is etched into a CD and classified as 'Goods', there cannot be a separate 'Service' element in the transaction. Consequently, the Honorable Supreme Court had held that the said transaction would not attract the levy of Service tax.

### Brief Facts

The brief facts of the case are as follows:

- Quick Heal Technologies Ltd. (Taxpayer) is a developer of 'Quick Heal' brand Antivirus Software, which is supplied along with the license code/product code either online or replicated on CDs/DVDs, to the end customers in India
- The Service tax authorities noticed that Service tax was not paid on the Quick Heal brand Antivirus Software license key/code which was supplied along with the CD/DVD replicated with the antivirus software, through its dealers/distributors
- Accordingly, the Taxpayer was served with a Show cause notice, which was adjudicated and the demand of Service tax was confirmed on the aforesaid transaction. On appeal before the CESTAT, it was held that the transaction in question is a transfer of 'right to use' of software which would amount to 'deemed sale'. Consequently, it was concluded that the question of levy of Service tax on such transactions would not arise
- Aggrieved by the aforesaid order, the Tax authorities filed an appeal before the Honorable Supreme Court

### Rival Contentions

#### Tax authorities

- The principal contention before the Honorable Supreme Court in an identical matter, in the case of Tata Consultancy Services Ltd (TCS) which was relied upon in this case, was whether the canned software was 'Intangible property' and hence, would not come within the definition of the term 'Goods'. The ratio of TCS would not be relevant in this case as the issue before the Supreme Court in TCS was not whether canned software is 'Goods' or 'Service'



- The issue in the present case pertains to the supply made by the Taxpayer to the end-users under a separate End User Licensing Agreement (EULA) which comprises of two parts viz. supply of antivirus software in the CD and providing electronic updates to the software which is originally supplied
- Applying the ratio laid down by the Honorable Supreme Court in Bharat Sanchar Nigam Ltd.<sup>13</sup> (BSNL), the Tax authorities contended that the test for a composite contract other than those mentioned under Article 366(29A) of the Constitution of India is "did the parties have in mind or intend separate rights arising out of the sale of goods?". If there was no such intention, there is no 'Sale' even if the contract could be disintegrated
- The Tax authorities also placed reliance on the decision of the Honorable Madras High Court in Infotech Software Dealers Association<sup>14</sup> wherein it was held that supply of packaged antivirus software to the end-user by charging a license fee as per EULA amounts to the provision of 'Service' and not 'Sale'

<sup>11</sup> Commissioner of Service Tax, Delhi Vs. Quick Heal Technologies Limited [2022 (8) TMI 283 - Supreme Court]

<sup>12</sup> Tata Consultancy Services Ltd Vs. State of Andhra Pradesh [2004 (11) TMI 11 - SC]

<sup>13</sup> Bharat Sanchar Nigam Ltd. ("BSNL") Vs. Union of India [2006 (3) SCC 1]

<sup>14</sup> Infotech Software Dealers Association Vs. Union of India [2010 (20) STR 289 Madras HC]

## Taxpayer

- Relying on the decision of TCS (supra), the taxpayer submitted that:
  - Even though the copyright in a software program may remain with the originator of the program, the moment the software is etched onto a CD and copies are made and marketed, they become ‘Goods’ which are susceptible only to Sales tax/VAT
  - Software and the medium cannot be split up into a ‘Sale’ of computer software, which is a sale of goods. Once the software is put up in media and marketed, it would become ‘Goods’
- CBEC Education Guide had clarified that if pre-packaged or canned software were sold, then such transaction would be in the nature of ‘Sale of Goods’ and hence, not leviable to Service tax
- The transaction in question cannot be bifurcated into two components viz. sale of CD and supply of updates. The updates are part and parcel of the sale of software and cannot be divorced from the transaction and treated separately as a ‘Service’. Moreover, no separate consideration is charged for the updates. Once a lumpsum amount has been charged for the sale of CD and applicable sales tax has been paid thereon, the Tax authorities cannot levy Service tax on the entire consideration once again on the ground that updates are being provided
- The software in question is not an interactive software. The software can be said to be interactive only when it involves the user to exchange information or when there is action and communication between the user and the software. In the case of the software supplied by the Taxpayer, there is no interactivity as there is no requirement of giving any command for detecting and removing the virus
- The Taxpayer also placed reliance on the decision of the Honorable Supreme Court in *Imagic Creative Pvt. Ltd.*<sup>15</sup> wherein it was held that the levy of VAT and Service tax are mutually exclusive

## Honorable Supreme Court decision

- After hearing the rival contentions, the Honorable Supreme Court decided the matter in favour of the Taxpayer. The key observations are as follows:
- The Court referred to the various excerpts of the CESTAT decision and summarised that the CESTAT laid much emphasis on the fact that as per the agreement, the licensee has the right to use the software subject to the terms and conditions provided in the agreement. Accordingly, the CESTAT held that the right to use the software would amount to ‘deemed sale’ and hence, not leviable to Service tax.
- On perusal of the definition of ‘Service’, the Honorable Supreme Court noted that ‘Service’ will not include those activities which include transfer, delivery or supply of any ‘Goods’ which is deemed to be a sale under Article 366(29A) of the Constitution of India.
- Relying on the various decisions passed by the Honorable Supreme Court<sup>16</sup>, it was summarised that the settled essential requirement of a transaction of ‘transfer of the right to use ‘Goods’ are:

- Article 366(29A)(d) of the Constitution of India would indicate that the tax is not on the delivery of the goods used but on the ‘transfer of the right to use ‘Goods’ regardless of when or whether the goods are delivered for use subject to the condition that the goods should be in existence for use
- In the transaction for the transfer of the right to use ‘Goods’, delivery of the ‘Goods’ is not a condition precedent, but the delivery of ‘Goods’ may be one of the elements of the transaction
- The effective or general control does not mean physical control always and even if the manner, method, modalities and the time of the use of ‘Goods’ are decided by the lessee or the customer, it would be under the effective or general control over the ‘Goods’
- Approvals, concessions, licenses and permits in relation to ‘Goods’ would also be available to the user of ‘Goods’, even if such licences or permits are in the name of the owner/transferor of the ‘Goods’
- During the period of the contract, the exclusive right to use ‘Goods’ along with permits, licenses, etc. vests in the lessee
- On perusal of the judgement in the case of *BSNL* (supra), the Honorable Supreme Court concluded that the artificial segregation of the present transaction, into two parts, is not tenable. The transaction in question, is in substance, one transaction for ‘Sale of software’ and once it is accepted that the software put in the CD is ‘Goods’, there cannot be a separate ‘Service’ element in the transaction, not such supply can be vivisected into one of ‘Goods’ and the other of ‘Service’. As a result, the transaction in question amounts to a ‘deemed sale’ which would not attract Service tax.

## BDO Comments

- The question as to the levy of applicable taxes on the sale of software has been a subject matter of many litigations despite binding legal precedents
- The decision of the Honorable Supreme Court in *TCS* (supra) inter alia had held that pre-packaged/canned software would be treated as ‘Goods’ and once the software is put-upon a medium like a CD and sold such transaction would be that of ‘sale of Goods’
- Despite the aforesaid ruling, the controversy with regard to the applicability of the Service tax on the sale of software continued to remain. Moreover, the Madras High Court in *Infotech Software Dealers Association Vs. Union of India*, supra had held that the antivirus software which is installed in the hardware would interact whenever the user of the computer engages the system
- The present judgement is a welcome decision and is expected to settle the pending disputes concerning the taxability of software

<sup>15</sup> *Imagic Creative Pvt. Ltd. Vs. CCT* [2008 (2) SCC 614]

<sup>16</sup> *Tata Consultancy Services* (supra), *BSNL* (supra), *Associated Cement Companies Ltd. Vs. Commissioner of Customs* [2001 (4) SCC 593], *20th Century Finance Corporation Ltd. Vs. State of Maharashtra* [2000 (6) SCC 12]

# GLOBAL TRENDS

## VAT/GST News:

### International:



#### Singapore: Property developers updates of their E-Tax Guide on Goods and Service Tax (GST)

The Tax Authority of Singapore released an updated e-Tax Guide on GST. The guide clarifies proper GST treatment on the supplies made with regards to the selling of properties from a developer and the declaration of GST upon the construction of properties.

(Source:

<https://www.globalvatcompliance.com/globalvatnews/singapore-etax-guide/>)



#### Bulgaria: Government issues Decree on increasing Value Added Tax (VAT) registration threshold

The Bulgarian National Assembly announced an increase in the threshold for VAT registration. The mandatory increase of the VAT registration threshold for taxpayers supplying VAT chargeable goods covers the zero-rated supplies, financial services, and even insurance services.

(Source:

<https://www.globalvatcompliance.com/globalvatnews/bulgaria-vat-threshold/>)



#### Russia: Government clarifies changes on VAT treatment for digital services

The Russian Tax Authority prepared an amendment clarifying the changes in VAT treatment to transactions that involve digital services by foreign organisations. There are certain measures upon the application of VAT on services being delivered via electronics.

(Source:

<https://www.globalvatcompliance.com/globalvatnews/russia-vat-treatment/>)



#### Ukraine: VAT exemption on the sale of software products until 2028

The Ukrainian Parliament may prolong the VAT exemption on the delivery of software goods from 1 January 2023, until 1 January 2028. The country's achievements in European and global leadership in the IT sector are the primary goal of the proposed law.

(Source:

<https://www.globalvatcompliance.com/globalvatnews/ukraine-vat-exemption-2/>)



#### Thailand digital VAT revenues beat forecast

Thailand's digital services VAT has surpassed revenue estimates. As of 1 September 2021, non-resident companies that supply digital services to customers in Thailand are liable for VAT. The Revenue Department previously said it expected around 100 non-resident suppliers to register for VAT in 2021. However, according to the latest reports, 120 suppliers have registered. Revenue also exceeded forecasts.

(Source:

<https://www.vatglobal.com/thailand-digital-vat-revenues-beat-forecast/>)



#### Kenya mandates VAT on non-resident B2B digital services

Kenya's Finance Act 2022, which amends the country's national VAT Act, has updated the VAT registration rules for non-resident suppliers of digital services.

(Source:

<https://www.avalara.com/blog/en/europe/2022/09/kenya-mandates-vat-on-non-resident-b2b-digital-services.html>)





### Her Majesty's Revenue and Customs (HMRC) to issue VAT Assessments to overseas businesses trading on online marketplaces

With the effect of September 2022, HMRC, the UK tax authority, will change the way it carries out historic UK VAT assessments for overseas online marketplace traders. Instead of the current process, whereby information requests are sent out by businesses, HMRC will send VAT assessments where information indicates that the UK VAT returns up to 31 December 2020, are inaccurate.

(Source:

<https://www.avalara.com/blog/en/europe/2022/08/hmrc-to-issue-vat-assessments-to-overseas-businesses-trading-on-online-marketplaces.html>)

### India



### August GST revenue collection up 28% YoY at INR 1.44 lakh cr

The gross GST revenue collected in the month of August 2022 stood at INR 1.4tn, up 28% on a year-on-year basis. With this, the monthly GST revenues have exceeded INR 1.4tn for six months in a row.

(Source: <https://economictimes.indiatimes.com/small-biz/gst/august-gst-revenue-collection-up-28-yoy-at-rs-1-44-lakh-cr/articleshow/93944718.cms>)

### E-invoice mandatory for turnover above 10 crore from October 2

The central government has made E-invoicing mandatory for businesses with aggregate turnover exceeding INR 100mn from 1 October 2022, a move which will further plug revenue leakages and will ensure better tax compliance from businesses.

(Source: <https://economictimes.indiatimes.com/small-biz/gst/e-invoice-mandatory-for-turnover-above-10-crore-from-october-2/articleshow/93294488.cms>)

### Special window to file transitional credit under GST, all can file the application

Supreme Court of India allows the GST network to open a special window to file transition credit declarations related to the pre-GST period, from 1 October 2022 for 60 days. GST network will provide a special window facility to all the assesses to file their claim for transitional credit from 1 October 2022.

(Source:

<https://www.thehindubusinessline.com/economy/special-window-to-file-transitional-credit-under-gst-all-can-file-the-application/article65848588.ece>)

### Customs News:

#### International:



### Belarus-Russia agreement on customs legislation ratified by lower chamber of Russian parliament

Russia's State Duma ratified the Belarusian-Russian agreement on harmonising customs legislation and on cooperation in customs affairs on 13 September 2022. Belarus and Russia signed the agreement in February-March 2022. The document has been worked out with a view to realising the union state program on harmonising Belarusian and Russian taxation and customs legislation.

(Source: <https://eng.belta.by/economics/view/belarus-russia-agreement-on-customs-legislation-ratified-by-lower-chamber-of-russian-parliament-153081-2022/>)



### Ukraine: New agreements on closer cooperation between the EU and Ukraine on customs and taxation

Two agreements were signed between the EU and Ukraine which pave the way for Ukraine's participation in the EU's Customs and Fiscal programmes. Ukraine will be able to take part in the activities of both programmes with EU member states and other participating countries. It is a major boost for cooperation between the EU and Ukraine on customs and tax matters.

(Source: [https://taxation-customs.ec.europa.eu/news/ukraine-new-agreements-closer-cooperation-between-eu-and-ukraine-customs-and-taxation-2022-09-05\\_en](https://taxation-customs.ec.europa.eu/news/ukraine-new-agreements-closer-cooperation-between-eu-and-ukraine-customs-and-taxation-2022-09-05_en))

### India



### CBIC vetting paperless customs rules for SEZs

A proposal for a completely paperless customs compliance framework for SEZs is being reviewed by the CBIC. The framework will be in sync with new legislation proposed by the Central Government to turn the SEZs into comprehensive economic hubs, with a larger participation of states and further ease of compliance to attract investment.

(Source:

<https://economictimes.indiatimes.com/news/economy/policy/cbic-vetting-paperless-customs-rules-for-sezs/articleshow/93037965.cms>)

### Customs to start uniform risk-based scrutiny of imported goods in phases from Sep 5

The Customs department will begin a standardised risk-based faceless assessment system across the country for clearance of imported consignments in phases, starting with metal from 5 September 2022.

This risk-based scrutiny would be meant for the 'Second Check Bill of Entry', under which imported goods do not have to mandatorily go through physical examination. Customs officers assess the imported goods based on the documents submitted to the authorities.

(Source:

<https://economictimes.indiatimes.com/news/economy/foreign-trade/customs-to-start-uniform-risk-based-scrutiny-of-imported-goods-in-phases-from-sep-5/articleshow/93895028.cms>)

### CBIC revises guidelines on arrest, prosecution for Customs violations

CBIC has streamlined the monetary limit for exercising arrest, prosecution and bail with respect to offences committed under the Customs Act, 1962. Circulars issued on 16 August 2022 also provided detailed scenarios, which could trigger action like an arrest for violating the Customs rules.

(Source:

[https://www.business-standard.com/article/current-affairs/cbic-revises-guidelines-on-arrest-prosecution-for-customs-violations-122081701033\\_1.html](https://www.business-standard.com/article/current-affairs/cbic-revises-guidelines-on-arrest-prosecution-for-customs-violations-122081701033_1.html))

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