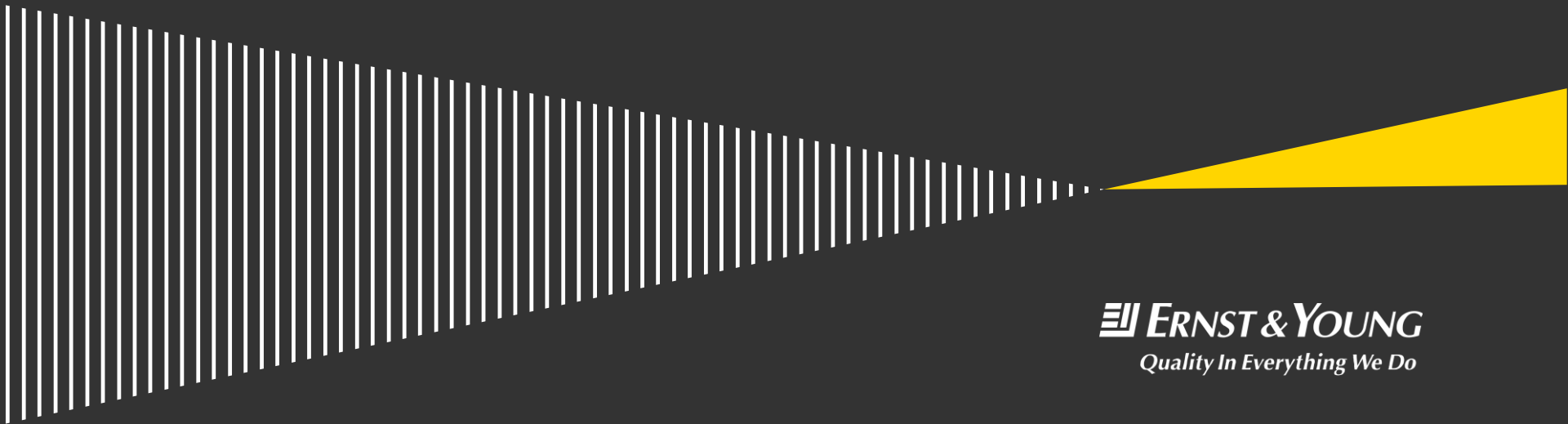


Budget PLUS 2011

A round up of Indirect Tax expectations

Ernst & Young Webcast

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1.

Introduction

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Indian economy introduction

- ▶ Indian Economy appears to be on a growth path post 2008 global financial crises
- ▶ Consensus amongst policy makers that GDP growth this fiscal should be approximately 8.5%
- ▶ Stimulus measures such as tax cuts, fiscal concession for exporters, bringing forward infrastructure projects etc helped India economy in the backdrop of the global meltdown
- ▶ With the next Budget around the corner, it is time for India to consolidate its economic condition
- ▶ Also due care be taken to ensure that the domestic economy is nurtured to immunize it against another slowdown in the western economies
- ▶ The following slides provide a roundup of Indirect tax expectations and clarifications from Budget 2011

2.

Round up of Indirect Tax expectations

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Service tax

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Likely steps by the Government

- ▶ Service tax net to be widened - Few more new services likely to be taxed
- ▶ The Point of Taxation Rules could be introduced in the Budget

Expectations / clarifications

- ▶ The service tax rate @ 10.30% should remain unchanged
- ▶ Double taxation – to be done away
 - ▶ Presently transactions like hire purchase, financial leasing, taxation of contractors and subcontractors, software etc attract both service tax and VAT on the same consideration
 - ▶ An amendment is required which should exclude from service tax such value which has already been subject to VAT/Sales Tax
 - ▶ Specific provisions be introduced in law to clarify that service tax should not be payable on the same transaction on which excise duty has already been paid like
 - ▶ Commissioning and installation done along with sale of machinery is presently forming part of the value of machinery subjected to excise duty and is also subjected to service tax

- ▶ Point of Taxation Rules – changes desired
 - ▶ The existing arrangement of paying service tax on receipt of consideration towards provision of services in vogue since 1998
 - ▶ Operationally efficient due to its simplicity
 - ▶ Provides a factually verifiable basis for the Department to collect service tax
 - ▶ Changes expected by way of Point of Taxation Rules
 - ▶ Issues presently covered in the Draft Rules such as linking the liability to pay tax to provision of service, raising of the invoice or receipt of payment for service provided or to be provided, whichever is earliest could create litigation due to its validity and interpretation
 - ▶ Adequate care will have to be taken to avoid various system and software issues for transition from payment of service tax on receipt basis to payment of service tax on provision of service
 - ▶ A suitable cut-off date should also be specified in the Rules - appropriate transitional provisions required to avoid hassles

- ▶ Service tax on renting of immovable property
 - ▶ Rental agreement attracts stamp duty for which no deduction is presently available under service tax legislation while computing value for service tax
 - ▶ It is suggested that a suitable deduction be provided so that no service tax would be paid on stamp duty component

- ▶ Works contract services
 - ▶ Works contract services may be expanded to include all works contract
 - ▶ All types of contracts which are taxed as works contracts under VAT may be brought in the category of “works contract service” to provide parity of taxation and to avoid double taxation under both VAT and Service Tax
 - ▶ Repair and maintenance services not covered under works contract services thereby not getting the benefit of composition schemes
 - ▶ Alternatively, benefit of composition scheme may be made available to all works contracts classified as such under VAT laws irrespective of its classification under service tax law

- ▶ Service tax rate under Works contract Composition ('WCC') Scheme
 - ▶ Rate of service tax under WCC Scheme be reduced from 4% to 3% to bring in line the rate of WCC scheme with the rate of reduced service tax (12% reduced to 10%)
- ▶ Man power recruitment and supply agency's service and security agency's service
 - ▶ Service tax is charged on the amount billed by the service provider
 - ▶ Amount includes salary component and charging service tax thereon a challenge to the Industry. Service element in such cases limited
 - ▶ It is suggested that suitable deduction be provided from the amount billed to service provider for payment of service tax

▶ Service Tax Valuation Rules

- ▶ Reimbursable expenditure/common expenses – Practical difficulties
 - ▶ Under Valuation Rules, the recovery expenses would form part of the value of taxable services unless incurred as a 'pure agent' of the client
 - ▶ However, certain conditions like
 - ▶ A person should enter into a contractual agreement with the recipient of service
 - ▶ A person should not use the goods or services procured
 - ▶ A person should not hold title to the goods or services procured mentioned in the definition of 'pure agent' are very difficult to comply with practically and therefore has given rise to litigation
- ▶ Accordingly, in order to simplify the said Rules and the definition of 'pure agent', the conditions should be reduced
 - ▶ Alternatively, actual reimbursements should be given deductions without conditions

- ▶ Import of services provided by non-resident service providers
 - ▶ Boards correspondence F No 275/7/2010-CX 8A, dated June 30, 2010 has opened up avenues for litigation on import of services
 - ▶ It was inferred therein that:
 - ▶ In case of taxable service provided by a non-resident and received in India, the service tax liability arises with effect from January 1, 2005 in the hands of service recipient (reference to decision of Tribunal in Hindustan Zinc); and
 - ▶ In case of taxable service received outside India, the service tax liability arises with effect from April 18, 2006, as decided by Supreme Court in the case of INSA, where services were received outside India for use in the ships and vessels located outside India
 - ▶ Suitable clarification by way of amendment in relevant provisions be introduced to effectively resolve the issue

Cenvat Credit Rules

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Expectations / clarifications

- ▶ Cenvat Credit Rules, 2004
 - ▶ CENVAT credit on High Speed Diesel (HSD) and Light Diesel Oil (LDO)
 - ▶ Bar on availability of credit on HSD and LDO under Cenvat Credit Rules continue
 - ▶ HSD and LDO are used by most of the industries as fuel for the purpose of generation of electricity and the electricity so generated is in turn, used in or in relation to manufacture of dutiable final products
 - ▶ It is suggested that HSD and LDO be included as eligible inputs for the purpose of availing CENVAT credit to avoid cascading effects of taxes and duties
 - ▶ This would encourage captive generation of power to tackle growing energy needs of the country
- ▶ Cenvat Credit of Special Additional Customs duty (SACD) for service providers
 - ▶ Under the present Cenvat Credit Rules, Cenvat credit in respect of 4% SACD levied under customs legislation can be availed only by a manufacturer of final products and not by a service provider

- ▶ Since the Credit Rules has given equal status to both a manufacturer and a service provider, there does not seem any reason to exclude the service provider for availing the said credit
- ▶ Therefore it is suggested that service providers also be permitted to avail the benefit of CENVAT credit in respect of 4% additional duty levied under Customs Tariff Act, 1985
- ▶ 100% CENVAT credit on capital goods in the year of receipt
 - ▶ Cenvat Credit Rules be suitably amended to extend 100% CENVAT credit on capital goods as well at par with inputs
 - ▶ Allowing full credit of duties paid on capital goods would help cash flow issues
 - ▶ This would be in line with the amendment made by the Government in 2010 of allowing 100% credit availment to SSI units

- ▶ Coverage of services under Rule 6(5)
 - ▶ Government should revisit coverage of services under Rule 6(5)
 - ▶ The following services may be added to the list of existing services mentioned in Rule 6(5) given the fact that such services are required in day to day activities of business

Courier Services [Section 65(105) (f)]	Works Contract [Section 65(105) (zzzza)]	Renting of Immovable Property [Section 65(105) (zzzz)]
Warehousing Services [Section 65(105) (zza)]	Legal Services [Section 65(105) (zzzzm)]	Chartered Accountant's Services [Section 65(105) (s)]

- ▶ Cenvat Credit on endorsed Bill of Entry
 - ▶ There is no provision under Credit Rules for availing Cenvat Credit on endorsed bill of entry against import of goods
 - ▶ Traders who import goods and desire to pass on the credit of CVD component of customs duty are required to register with the Central excise department

- ▶ In the past, Customs officers at the port of import were allowing endorsement of the Bill of entry to enable the importer to pass on the credit of CVD to the registered manufacturer / service provider / dealer, as the case may be
 - ▶ The said procedure was discontinued after issuance of Public Notice by certain Customs Commissionerates
- ▶ It is suggested that Credit Rules may be amended to recognize endorsed Bill of Entry as a valid document for availing credit of duty paid at the time of import
 - ▶ The erstwhile procedure of endorsement of Bill of Entry in such cases should be continued



Central Excise Duty and Customs

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Likely steps by Government

- ▶ Excise duty likely to be retained at the current rate of 10.3%
- ▶ Peak custom duty rate should be reduced. If not reduced, the basic customs duty rate of 10% or 7.5% as the case may be, should at least be retained
- ▶ Possible roll back of certain product specific excise exemption thereby broadening the excise net

Expectations / clarifications

- ▶ Instructions on composite and mutually acceptable approach to be adopted by transfer pricing authorities and Special Valuation Branch
- ▶ Excise duty exemption for goods imported to set-up Non Mega Power Plants
 - ▶ Currently, subject to conditions excise duty exemption is available on goods procured for setting up Mega Power Plants (Serial No 91 of Notification No 6/2006 – CE dated 1 March 2006)
 - ▶ However, no exemption is currently available to Non Mega Power Plants
 - ▶ Recently a Committee constituted by the Government to examine the disadvantages suffered by the domestic industry on account of this difference in benefits has recommended that the import duties for mega power projects should be brought in par with non mega power projects by way of levy of applicable custom duties
 - ▶ If these recommendations is accepted, Government could withdraw the benefits available on import of power plant equipments of mega power projects

- ▶ Reduction in the threshold exemption limit for excise duty
 - ▶ The Budget could widen the excise duty net to include more small & medium enterprises (SMEs), by reducing the threshold exemption limit from the current Rs.1.5 crore
 - ▶ This could be a step to ensure smooth transition to Goods and Service Tax
- ▶ Excise and customs duty exemption to all excisable inputs / capital goods used for research and development (R& D)
 - ▶ Capital goods / equipments / inputs necessary for carrying out R &D process are generally expensive
 - ▶ Burden of customs duty and excise duty adds to the costs of research & development
 - ▶ Import and domestic procurement of capital goods / inputs should be exempted
 - ▶ However, if outright exemption is not possible, then it is suggested that the existing Rules be amended to allow Cenvat credit on equipment's used for R&D purposes even if they are used in a location other than the factory premises

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- ▶ Cenvat credit so taken may be allowed to be utilized for payment of excise duty on finished goods manufactured in any of the factory of such Company.
 - ▶ **The Legal Metrology Act to replace Standard Weights and Measures Act**
 - ▶ The Legal Metrology Act 2009 is to be notified shortly and this law would replace the three decade old Standard Weights and Measures Act, 1976.
 - ▶ This change would require to be made effective to central excise law by making relevant amendments in the Maximum Retail Price related notifications.
 - ▶ Hopefully these changes should not have any significant impact on assesseees presently paying central excise duty on the basis of retail price mentioned on the packages.

- ▶ General Free Allowance under Baggage Rules
 - ▶ The duty free allowance of Rs 25000 as per Baggage Rules has remained unchanged for years
 - ▶ Government should consider revising this allowance limit for benefit of the travelling community
- ▶ Correction to inverted customs duty structure
 - ▶ The rates of customs duty on many inputs are higher than that of the finished goods
 - ▶ This has resulted in inverted duty structure
 - ▶ It is suggested that the rate of duties on industrial inputs and raw materials should be reduced to a reasonable rate between 5% to 7.5% to correct the inverted duty structure as also encourage value addition within the country
- ▶ Area based exemption to Uttarakhand and Himachal Pradesh to be given wide interpretation

- ▶ A recent clarification by the Department regarding continued exemption to existing industrial units in the state of Uttarakhand and Himachal Pradesh has been welcomed by the Industry
 - ▶ It was clarified that the central excise law does not bar any additional / modification to existing plant or machinery or on the production of new products after 31 March 2010 and accordingly the excise duty exemption would be available to industrial units even after undertaking changes in the existing setup
 - ▶ In order to ensure beneficial Circular does not attract avoidable litigation going forward, it is suggested that the corresponding central excise notifications are amended to legalise the above intention of the Government

- ▶ Condition for renewal of stay order granted by Tribunal to be removed
 - ▶ As per existing provisions under the central excise and customs law, the stay orders granted by the Tribunal requires to be renewed after every 180 days till final disposal of the appeal
 - ▶ Apart from clogging the Tribunal, this process also leads to unnecessary harassment for the Trade
 - ▶ It is suggested that the relevant sections be amended to make the stay order absolute till disposal of the appeal

Central Sales Tax

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Likely steps by Government

- ▶ Reduction in rate of CST to 1%
 - ▶ With GST roll out missing its deadline, it is suggested that Central Sales tax ('CST') on inter-state sale of goods be reduced from 2% to 1%

Expectations / clarifications

- ▶ Form 'C' for construction activities
 - ▶ The benefit for purchase of goods at a concessional rate of 2% by issuance of Form 'C' inter alia includes plant & machinery procured for manufacture or processing but does not cover:
 - ▶ material/goods purchased for manufacture / construction of such plant and machinery or for similar purposes; and
 - ▶ goods which are purchased by the dealers (contractors) for use in construction activities thereby not permitting issuance of Form 'C' in such cases,
 - ▶ This increases the cost of the transaction
 - ▶ It is suggested that the definition of the goods given in CST Act be amended
 - ▶ to include the goods purchased by the dealer for construction of plant & machinery to manufacture goods and
 - ▶ goods purchased for construction activities which itself constitutes works contract and attracts CST

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- ▶ Quarterly 'C'/'F' form requirement to be replaced by Annual 'C'/'F' form
 - ▶ Presently law requires the seller to submit Quarterly the requisite 'C' / 'F' form
 - ▶ This causes administrative issues - the said requirement may be amended to Annual Requirement of C' / 'F' form



Removal of double taxation, some specific sectors

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Removal of double taxation, some specific sectors

▶ Retail Sector

- ▶ Services such as Intellectual Property Rights / franchisee etc are subjected to both State VAT and service tax on the entire consideration
- ▶ Service tax and VAT are not creditable with each other
- ▶ A suitable clarification / abatement is required to ensure that such activities are either subjected to service tax or VAT

▶ Automobile sector

- ▶ This industry attracts multiple levies such as Auto Cess , NCCD etc
- ▶ It is suggested that the said levies may be removed or merged into the basic duty rate
- ▶ This would help in administrative convenience

▶ **Media Sector**

- ▶ The film and entertainment industry attracts tax rate of nearly 60% on activities like Copyrights etc on account of cascading of VAT, service tax and entertainment tax
 - ▶ Such disparity in taxation should be rationalized and multiple taxes should be avoided
- ▶ Even the television industry are subjected to entertainment tax and service tax on subscription charges received by cable operators
 - ▶ Central Government should grant relief from levy and collection of service tax on such subscription charges

▶ **Information technology sector**

- ▶ The State Governments have always levied state-VAT on “sale” of standard software, including licensing of software products
- ▶ From May 2008 onwards, the Central Government, through the service tax legislation, has introduced service tax on IT software services, encompassing licensing of standard software as a taxable service
 - ▶ This led to conflicts between the industry and Revenue authorities as both the Centre and State authorities attempted to recover service tax and state-VAT from the same transaction

- ▶ Information technology sector (continued)
 - ▶ Recent judicial precedents and amendments (such as the Madras High Court ruling for Infosys, amendments in the Karnataka state-VAT law, etc) have further expanded the debate as to whether service tax or state-VAT is applicable on customized software transactions
 - ▶ Given the controversies involved, an explicit clarification or amendment on this aspect is required

Goods and service tax

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Goods and service tax

- ▶ A significant reform that is eagerly awaited by the industry is the introduction of Goods and Services Tax (GST)
- ▶ As per a recent report, the Finance Minister could introduce the draft amendment Bill in the budget to initiate constitutional amendment and facilitate transition to GST
 - ▶ This could be followed by announcing the date of implementation of country wide GST
- ▶ Further in order to push the implementation of the GST regime and to convince the states to migrate to GST, the government is likely to announce a string of measures, including a compensation corpus to states

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- ▶ The following issues in the GST proposal maybe addressed
 - ▶ Certain important sectors like Power, petroleum (including natural gas) and real estate have been excluded from the scope of GST which is expected to be a cost to the industry on account of cascading taxes thus acting as a dampener on investment
 - ▶ All the central taxes should be subsumed under Central GST and all state level taxes under State GST and both Central GST and State GST should have a common set of rules and threshold limit. CST should be phased out before GST is in place

Sector analysis

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Infrastructure and power

- ▶ Service tax exemption to be extended to power projects and infrastructure maintenance projects
 - ▶ Presently, under service tax, only two services viz. Works contract service and Commercial & industrial construction service alone are exempted when provided in relation to Roads, Airports, Railways, Transport Terminals, Bridges, Tunnels & Dams and Major and other Ports
 - ▶ Power, Water Supply, Sewerage, Housing, Oil Production & Pipe lines, Mines should be given status of 'infrastructure projects' and service tax exemption be extended to all such infrastructure projects.
 - ▶ Furthermore, projects of maintenance of infrastructure must also be granted the benefit of such exemption
- ▶ Tax incentives to solar power
 - ▶ The Government is trying to promote Solar Energy and in order to achieve the objectives of the Jawaharlal Nehru National Solar Mission the government should provide service tax, VAT and CST exemption to units setup in Phase I of the mission. Besides solar energy, solar energy devices and spares and equipments should be exempted from VAT and sales tax

- ▶ Cenvat credit on telecom towers, shelters and other goods at tower site
 - ▶ The excise duties paid on telecom towers, pre-fabricated shelters and other goods which are installed at a tower site are availed as cenvat credit and used to discharge the service tax liability of the telecom operators
 - ▶ Recently, the authorities have taken a discriminatory stand for disallowing such credit
 - ▶ Denial of credit on these goods by the authorities not only leads to litigation and blockage of funds for the telecom players but defies the basic principles of the Credit Rules
 - ▶ Accordingly, appropriate amendment should be made in the Cenvat Credit Rules to clearly allow credit of the said goods to telecom operators

- ▶ Special Additional Duty on import of telecommunication equipments
 - ▶ Currently, telecom service provider is not entitled to avail credit of SACD, in lieu of VAT, which is a part of customs duty levied on import of network equipment
 - ▶ Eventually the non creditable SAD paid by the telecom operator is an added cost on the telecom operators
 - ▶ Accordingly, an amendment should be brought to either exempt SAD for telecom operators or make the same creditable
 - ▶ The said amendment would reduce the capital cost and help in faster rollout of telecom network especially in the rural sector

Automobiles

- ▶ Reduction in custom duty on natural rubber
 - ▶ Natural rubber which accounts for nearly 42% of the cost of raw materials of tyres is leviable to customs duty @ 20% while Customs duty rate on tyres is 10% thus placing domestic producers at a disadvantage to the importers
- ▶ Upfront SACD exemption should be uniform for all goods (including motor vehicles) imported for subsequent sale
 - ▶ Presently only MRP based goods imported by traders for subsequent sale in India are eligible for upfront exemption of 4% SACD
 - ▶ For import of motors (being valued on 'Transaction value'), 4% SACD is obtained by way of refund mechanism
 - ▶ It is suggested that such upfront exemption be granted for import of all goods (including motor vehicles) irrespective of the Valuation under Excise
 - ▶ This would avoid the current procedural hassles faced by importer of motor vehicles in claiming the refund and thereby reduce the pendency of refund claims at various ports

Textiles

- ▶ Excise duty on Polyester fibre and yarn fibre along with their raw material be brought down to 4%
 - ▶ Being the fabric used by the common man a high rate of excise duty will increase the cost of production of fibre and yarn and will have a cascading effect on the entire value chain
 - ▶ Such decrease in duty rates will be beneficial for fibre manufacturers, downstream users, texturisers and weavers
- ▶ Excise and Customs duty on plant and machinery for power projects upto 50MW should be abolished
 - ▶ Power constituting a significant production cost, textile companies setting up their small captive power plants should be encouraged to do so as surplus power from the same will be available for sale to the grid
 - ▶ It will also provide impetus to the capital goods industry

Pharmaceuticals

- ▶ Customs duty exemption to notified life saving drugs
 - ▶ All life saving drugs (including medical devices) should be exempted from Custom Duty (without the condition of them being notified under List 3 & List 4 of Customs Tariff)
 - ▶ This would reduce the cost of treatments and making the best medical facilities available at cheaper rates
 - ▶ Further presently different medical devices have partial / exemption under various entries in different notifications
 - ▶ This could be rationalised so as to bring about more clarity and less disputes from a classification aspect
- ▶ The excise duty rate of API may be made at par with Pharma goods
 - ▶ The levy of excise duty @ 10.30% on the Active Pharmaceutical Ingredients (API)(inputs) whereas the output is taxed @ 4.12%
 - ▶ The higher rate of duty paid on inputs has led to accumulation of Cenvat Credit in the books of Pharma manufacturers as the duty paid on inputs cannot be completely set off against the output central excise duty liability inspite of value addition on finished goods

- ▶ In case the excise duty is not reduced, then atleast the Government should introduce a refund mechanism to enable Pharma manufacturers to avail refund of excess cenvat credit especially in case of such an inverted duty structure
- ▶ Excise exemption to fluorine base radiopharmaceuticals manufactured
 - ▶ Presently there are two tracer molecules namely Technetium - 99M and Radioisotope TI 201 which enjoys exemption from payment of excise duty/ similar duty on import as the same are used in medical imaging which is very relevant for diagnosis of patients
 - ▶ However manufacturers engaged in other fluorine based radiopharmaceuticals do not enjoy this exemption
 - ▶ It is suggested that the Budget would correct this anomaly and make medical diagnosis cheaper and affordable to the common man

Oil and gas

- ▶ ‘Declared goods’ status should be granted for natural gas
 - ▶ In the absence of natural gas being granted declared goods status it is being subject to varying VAT rates across states thus impacting user industries like fertilisers, power etc
 - ▶ Besides coal and crude oil enjoy declared goods status and is subject to VAT @ 4% across states
 - ▶ Accordingly, it is suggested that natural gas also be given ‘declared goods’ status
- ▶ National Calamity Contingent Duty (NCCD) on Crude Oil
 - ▶ The Ministry of Finance introduced NCCD of excise @ Rs 50 per metric ton on indigenous crude oil and simultaneously an additional duty of customs at the rate of Rs 50 per metric ton on imported crude oil effective 1st March 2003
 - ▶ This duty was to be valid for one year i.e. up to 29th February 2004 so as to replenish the National Calamity Contingency Fund, but it continued after the expiry of the said period

- ▶ It is suggested that NCCD on Crude Oil should be abolished.
 - ▶ However, if the same is not possible then at least CENVAT credit may be allowed against payment of excise duty on finished petroleum products manufactured from crude.
- ▶ Allowing credit of service tax / excise duties against crude oil cess or refunds
 - ▶ No output service tax or excise duty is payable by E&P Companies
 - ▶ The service tax / excise duty paid on various input services / inputs consumed in their operations becomes a non-recoverable cost
 - ▶ It is suggested that credit of service tax / excise duty be available for setoff against crude oil cess
 - ▶ Alternatively, refund scheme of accumulated credit be introduced for E&P sector

Media and entertainment

▶ Filmed entertainment

- ▶ Based on recent discussions of Empowered Committee, States have agreed to retain the power to levy entertainment tax by local bodies in addition to GST
- ▶ Entertainment tax charged by the local bodies in addition to high rate of GST is detrimental to growth
- ▶ Internationally, no country under GST/ VAT regime charges supplementary tax
- ▶ Entertainment tax should be a part of GST as otherwise multiple taxation would continue

▶ Television entertainment

- ▶ Indian representative of the foreign broadcasters already pay service tax on the entire amount collected on behalf of the foreign company for assistance in selling of advertisement time slots etc
- ▶ However, the service tax authorities demand service tax also on the commission earned from foreign company

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- ▶ It is essential that appropriate clarifications are issued to clarify
 - ▶ That the Indian representative should not again be subjected to service tax on the commission so received,
 - ▶ Remittances so made to foreign channel company should not be taxed as import of broadcasting services in India
 - ▶ This would reduce litigation and taxation of the same revenue twice



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