

THE STANDARD STANCE

The Denominator Games: Decoding
Common Dilution Puzzles under Ind AS 33

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INTRODUCTION

Earnings per Share (EPS) is arguably the single most-quoted number in equity research or financial analysis, yet questions on how to apply the standard are still frequent. EPS also forms the basis for calculating the ‘price-earnings ratio,’ which is widely used by investors and analysts to value shares. Most of the analytical difficulty in EPS does not lie in the numerator (profit attributable to equity shareholders¹); it lies in the denominator specifically, in identifying which instruments are “equity shares²,” which are merely “potential equity shares,” and whether those potential equity shares (PES) are dilutive (reduce EPS) or anti-dilutive (increase EPS).

Ind AS 33 “Earnings Per Share” requires two EPS figures on the face of the statement of profit and loss³

Basic EPS	Profit attributable to equity shareholders ¹ ÷ Weighted average number of equity shares outstanding during the period
Diluted EPS	Adjusted profit ÷ Weighted average equity shares adjusted for the dilutive effect of all PES

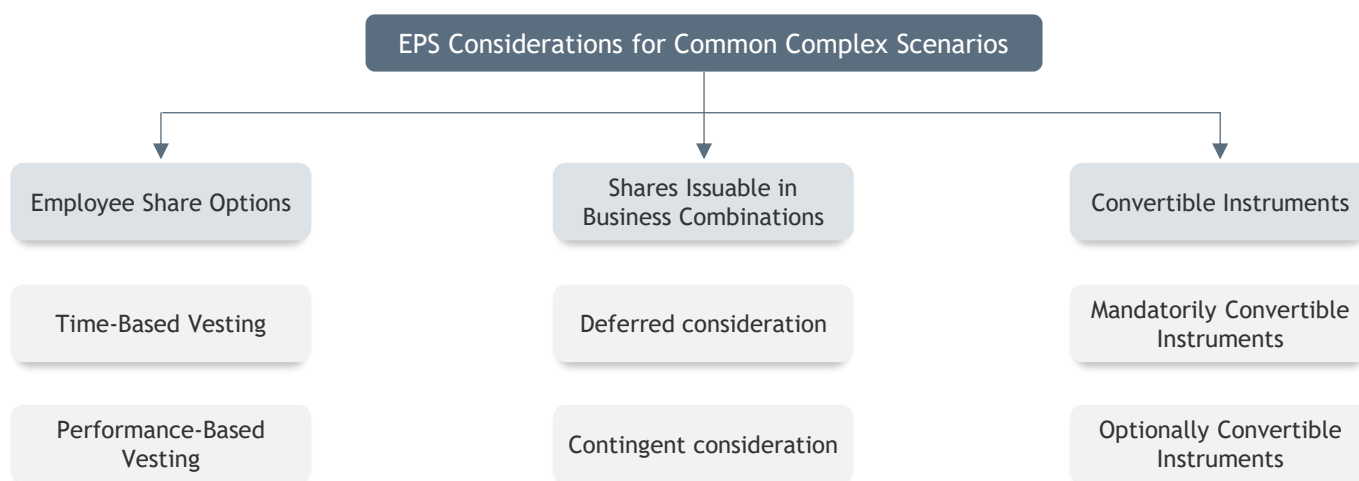
POTENTIAL EQUITY SHARES

A PES is any financial instrument or contract that may entitle its holder to equity shares of the entity, e.g., options, convertible preference shares, convertible debentures, contingently issuable shares, and so on. PES matter only to Diluted EPS. They never enter Basic EPS unless and until they actually become equity shares, typically on exercise, conversion, or vesting. PES are included in the Diluted EPS calculation on a time-weighted basis only for the period they were outstanding.

Only PES that are dilutive are considered in the calculation of Diluted EPS, i.e., when their conversion to equity shares would decrease profit per share or increase loss per share from continuing operations attributable to equity shareholders. An entity might have a number of different types of PES in issue. Each one must be considered separately rather than in aggregate. Each issue or series of PES is considered in sequence, from the most dilutive to the least dilutive to ensure that the final Diluted EPS figure reflects maximum dilution of Basic EPS.

The number of dilutive PES is determined independently for each period presented, and is not subsequently revisited. What may be regarded as dilutive in one reporting period may be anti-dilutive in another period. As a consequence, the number of dilutive PES included in the annual (or year-to-date) computation is not a weighted average of the dilutive PES included in each interim computation.

The rest of this article works through three main categories of complexity that recur constantly in Indian corporate reporting, with illustrative examples, followed by a few other common scenarios.



1. Employee Share Options

Employee Share Options (ESOPs) are the most common PES in Indian companies. Ind AS 33 draws an important line within ESOP schemes: whether vesting depends only on the passage of time (a service condition) or also on meeting a performance condition. The mechanics of testing and including the resulting shares in Diluted EPS differ between the two and are addressed in turn below.

A second question cuts across both categories: how much does the employee pay for the shares? The answer decides when the shares enter Basic EPS and how they are treated in Diluted EPS as explained below.

¹ profit or loss attributable to equity shareholders of the parent entity in case of consolidated financial statements.

² In Indian context, the term ‘ordinary shares’ is equivalent to ‘equity shares’ and more commonly used, hence ‘equity shares’ have been stated at all relevant places in the document.

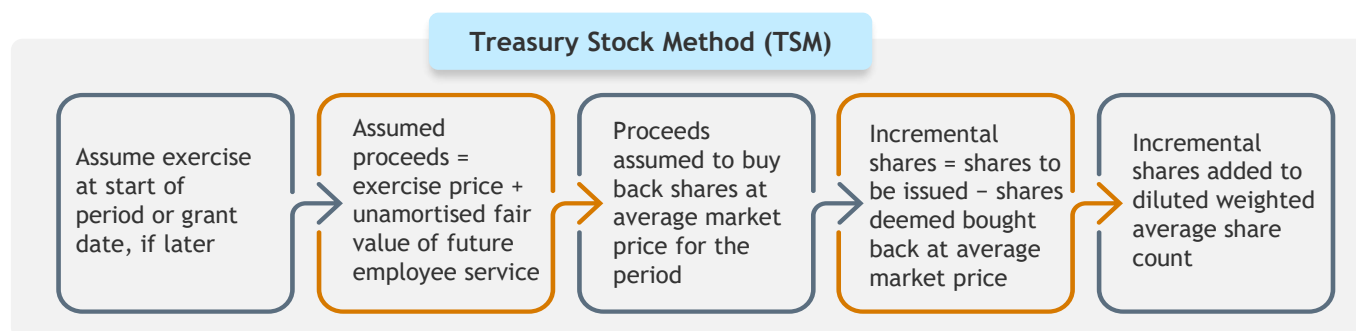
³ Where relevant, EPS disclosure is required separately for continuing operations, for discontinued operations and in total.

1.1 Time-Based Vesting

Under Ind AS 33, both vested and unvested time-based options (or restricted stock units, “RSUs”) are included in Diluted EPS if they are dilutive. Vesting status affects when the employee can exercise, not whether the option counts as a PES today. They should be considered to be outstanding from the grant date, for the purpose of computing Diluted EPS, even though their exercise might be contingent upon vesting (i.e., employee completing the specified service period).

The standard treats the unrecognised future employee service still to be rendered (for options not yet fully expensed under Ind AS 102) as if it were additional consideration received, alongside the exercise price.

The Treasury Stock Method (“TSM”) is generally used, as set out below.



Effect of the exercise price

- **Nil or little consideration (e.g., RSUs with nil exercise price).** In such cases, the employee pays nothing, or only a nominal amount at vesting. Unvested units stay out of Basic EPS. Vested units enter Basic EPS from the vesting date, even if allotment or transfer happens later. For Diluted EPS, the TSM is applied from the later of the start of the period and the grant date to the vesting date, or to the period end, if earlier. Assumed proceeds are mainly the unrecognised future service cost, so such units are generally dilutive.
- **More than little consideration (e.g., options at or near market price).** The employee must exercise and pay, so vesting alone does not bring the shares into Basic EPS. The shares enter Basic EPS from the date of exercise and allotment. For Diluted EPS, the TSM is applied from the later of the start of the period and the grant date to the exercise date, or to the period end, if earlier. Assumed proceeds are the exercise price plus unrecognised service cost. Once options are fully vested, the unrecognised service cost is nil and only the exercise price counts. Options whose exercise price plus unrecognised service cost exceeds the average market price are anti-dilutive and excluded.

Illustration 1 – Time-Vested Options (application of TSM)

On 1 April 2026, Company A grants 1,00,000 time-vested options at an exercise price of INR 200, vesting after four years, with grant-date fair value of INR 300 per option. The average market price for the year is INR 500.

- Assumed proceeds per option = INR 200 (exercise price) + unamortised compensation cost per option at the year-end (say INR 225) = INR 425
- Total assumed proceeds = 1,00,000 × INR 425 = INR 4,25,00,000
- Shares deemed repurchased at market price = INR 4,25,00,000 ÷ INR 500 = 85,000 shares
- Incremental dilutive shares = 1,00,000 – 85,000 = 15,000 shares, added to the diluted weighted average number of shares. As the options were granted on the first day of the year, all 15,000 shares are included for the full year.

1.2 Performance-Based Vesting

Performance-linked ESOPs (also known as performance share units, or “PSUs”) are a type of contingently issuable shares under Ind AS 33. The number of shares that will ultimately vest depends on satisfying a performance condition, e.g., a revenue CAGR, an ROE threshold, a TSR (total shareholder return) ranking versus peers, and so on – not merely the passage of time.

Generally, the number of contingently issuable shares included in Basic or Diluted EPS is the number that would be issuable if the end of the reporting period were the end of the contingency period, based on conditions existing at that date, without reflecting future expectations (the “contingency test”).

Type of condition	Test applied at the reporting date	Result
Non-market condition (e.g., revenue / ROE target)	Treat the reporting date as the end of the contingency period – is the condition already met?	Met → include in Diluted EPS and also in Basic EPS if the exercise price is nil or nominal and any service condition is also met. Not met → exclude from Basic and Diluted EPS this period.
Market condition (e.g., share price / TSR)	Use the period-end market price to estimate the number of shares issuable.	Include the resulting number of shares in Diluted EPS only.

Once actual performance is known and shares vest, the TSM is then applied to the vested tranche.

Effect of the exercise price

- **Nil or little consideration (for example, PSUs with a nominal exercise price).** These are contingently issuable shares in the strict sense. They enter Basic EPS from the date all conditions (performance and service) are satisfied, i.e., the vesting date. Before then, apply the above contingency test for Diluted EPS. If the shares would vest on that test, include them from the later of the period start or grant date to the earlier of the reporting date or the vesting date. Assumed proceeds are mainly the unrecognised service cost.
- **More than little consideration (for example, PSUs at or near market price).** Meeting the performance condition does not bring the shares into Basic EPS, because the employee must still exercise. For Diluted EPS, apply two steps in order. First, the above contingency test decides whether the options count. Second, the TSM decides how many incremental shares result, using the exercise price plus unrecognised service cost. Once the condition is met and the options vest, treat them as vested options until exercised.

Summary of EPS denominator considerations for the ESOP schemes discussed above:

Award	Basic EPS – included from	Diluted EPS – basis and weighting
Time-based vesting, nil or little consideration (e.g., RSUs)	The vesting date, even if allotment or transfer is pending.	TSM, weighted from the period start date (or a later date, if granted mid-period) to the vesting date, or period end if earlier.
Time-based vesting, more than little consideration	The date of exercise.	TSM, weighted from the period start date (or a later date, if granted mid-period) to the exercise date, or period end if earlier.
Performance-based vesting, nil or little consideration (e.g., PSUs)	The date all conditions (performance and service) are satisfied, i.e., the vesting date.	If the shares would vest applying the contingency test explained above, include them from the later of period start or grant date to the earlier of the reporting date or the vesting date, using the TSM. If not, exclude them.
Performance-based vesting, more than little consideration	The date of exercise.	If the shares would vest applying the contingency test explained above, include them from the later of the period start or grant date to the earlier of the reporting date or the exercise date, using the TSM. Once vested, treat as vested options until exercised.

1.3 Options with Multiple Tranches

Where an ESOP scheme has several tranches at different exercise prices, each tranche is tested for dilution separately using its own exercise price and remaining unamortised fair value. A single blended exercise price is not appropriate, because some tranches may be anti-dilutive (exercise price plus unrecognised service cost above the average market price) while others are dilutive in the same period.

2. Shares Issuable in Business Combinations

When an acquirer's consideration for a business combination includes equity shares to be transferred after the acquisition date, the Ind AS 33 treatment turns on whether the number of shares is fixed but deferred or contingent:

(a) Deferred consideration - The number of shares to be issued is already fixed (or determinable) at the acquisition date, and issuance is deferred only by the passage of time (e.g., shares to be issued on the first and second anniversaries of the acquisition date). Because the obligation to issue these shares is unconditional, they are treated as issued equity shares from the acquisition date for Basic EPS (and therefore Diluted EPS).

(b) Contingent consideration - The number of additional shares depends on a future event or condition not yet certain at the acquisition date, e.g., a revenue or EBITDA milestone or a regulatory approval. These are contingently issuable equity shares under Ind AS 33, and follow the same test set out in Section 1.2 above:

- If the condition is already satisfied at the reporting date, the shares are included in Basic EPS (and therefore Diluted EPS) from the date when all conditions are met.
- If the condition depends on future earnings, the number of shares presently issuable as if the reporting date were the end of the contingency period is included in Diluted EPS only.
- If the condition depends on a future share price, the number of shares issuable based on the current market price is used in Diluted EPS if the effect is dilutive.
- If the condition depends on both future earnings and the future market price of equity shares, the number of equity shares included in the Diluted EPS calculation is based on both conditions. Unless both conditions are deemed to be met, the contingently issuable shares are not included in Diluted EPS.

In the above cases, the potential adjustment to the numerator for Diluted EPS depends on the accounting treatment followed for contingent consideration. For example, where the contingent consideration in a business combination is accounted for as a financial liability and carried at fair value through profit or loss, the numerator adjustment will arise from fair value gains or losses recognised in profit or loss and the related income tax effects during the period.

Illustration 2 – Deferred and contingent consideration

Company B acquires another company for a mix of upfront cash, deferred consideration in the form of 5,00,000 equity shares (fixed in number, issuable on the first anniversary of completion) and contingent consideration in the form of equity shares (up to 20,00,000 in number, payable only if the acquired business crosses INR 500 crore in quarterly revenues within the next 24 months).

- The 5,00,000 deferred shares are unconditional in number – they are included in Basic (and therefore Diluted) EPS from the acquisition date itself, notwithstanding that legal issuance occurs a year later.
- If, at a given reporting date, the revenue milestone has already been crossed, the corresponding contingent shares are also included in Basic and Diluted EPS from that date.
- If the milestone is linked to a 24-month average and is not yet met, only the number issuable “as if the reporting date were the test date” flows into Diluted EPS.

Summary of EPS denominator considerations for shares issuable in business combinations:

Consideration	Basic EPS – included from	Diluted EPS – basis and weighting
Deferred consideration: shares issuable subject only to the passage of time	The acquisition date. The number of shares is unconditional.	Not applicable. Only time must pass, so these shares are not PES. They are already in Basic EPS.
Contingent consideration: specified conditions fully satisfied	The date all specified conditions (other than the passage of time) are satisfied.	Include from the later of the period start or acquisition date to the date all conditions are satisfied. From that date, the shares are in Basic EPS.
Contingent consideration: conditions not fully satisfied, but some shares would be issuable if the reporting date were the end of the contingency period	Not included, as the conditions are not yet fully satisfied.	Include those shares from the later of period start or acquisition date to the reporting date.
Contingent consideration: conditions not satisfied, and no shares would be issuable on that basis	Not included.	Not included.

3. Convertible Instruments

3.1 Mandatorily convertible instruments

Compulsorily Convertible Preference Shares (“CCPS”) and Compulsorily Convertible Debentures (“CCDs”) are ubiquitous in Indian capital structures and are used heavily by private-equity investors before an IPO.

If neither the holder nor the issuer has any option to require settlement in cash and the instrument is mandatorily convertible into a fixed number of shares within a specified time, the shares that would be issued on conversion are included in the weighted average number of equity shares used in the calculation of Basic EPS (and, therefore, also Diluted EPS) from the date the contract is entered into for the issue of the instrument, since their issue is solely dependent on the passage of time. However, in case the conversion is into a variable number of shares, the guidance stated for contingently issuable equity shares under Ind AS 33 as stated in Section 2(b) above is usually followed.

3.2 Optionally convertible instruments

Optionally Convertible Preference Shares (“OCPS”) and Optionally Convertible Debentures (“OCDs”) differ from their compulsorily convertible counterparts in one key respect: the holder (or, less commonly, the issuer) has a choice between converting into equity shares and receiving redemption in cash (or other consideration) at maturity.

If the holder or issuer has an option that drives conversion, such shares are treated as PES, because they might never be issued if the conversion option is not exercised. Such PES are not considered outstanding for the purpose of calculating Basic EPS, but they are considered in the calculation of Diluted EPS.

Where the instrument may be settled in cash or shares at the issuer's election, Ind AS 33 requires the entity to presume that the contract will be settled in equity shares, and the resulting PES are included in Diluted EPS if the effect is dilutive.

In these cases, the numerator for Diluted EPS may need to be adjusted for the post-tax dividend or interest, fair value gains or losses and other consequential changes in income or expenses that would result from the assumed conversion of such instruments. The denominator adjustment for Diluted EPS is based on the additional equity shares resulting from the assumed conversion, regardless of how likely actual conversion is, or which alternative the holder is expected to prefer. Ind AS 33 requires the computation to assume the most advantageous conversion terms available to the holder, not the outcome management considers most probable. Conversion is assumed to have occurred at the beginning of the period, or if later, on the date of issue of the convertible instrument.

Illustration 3 – Compulsorily and optionally convertible instruments

Company C issues:

- a) CCPS of INR 200 crore to a private equity investor, compulsorily convertible into 40,00,000 equity shares at the end of two years.
- b) 1% OCDs of INR 150 crore to an NBFC investor. At the end of four years, the NBFC investor may elect to convert the OCDs into 30,00,000 equity shares at a fixed conversion price or redeem the OCDs for cash at face value.

The EPS implications for the above instruments are as follows:

- a) CCPS

The instrument is expected to be accounted for as an equity instrument under Ind AS 32.

40,00,000 equity shares are included in the weighted average number of shares outstanding for Basic EPS from the date of issue of the CCPS

- a) OCD

The instrument is expected to be accounted for as a compound instrument under Ind AS 32 and split into a liability component (present value of the cash redemption and coupon amount) and an equity component (the conversion option).

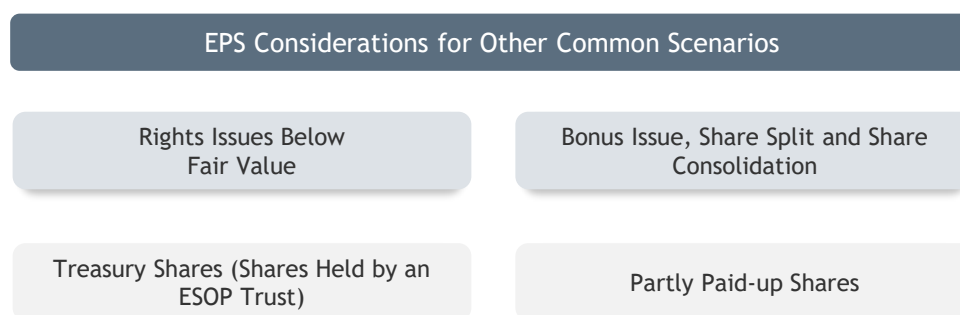
The number of shares that may be issued after four years is not considered in the computation of Basic EPS, as they might never be issued if the conversion option is not exercised by the investor. However, the Company needs to assess whether the effect of these potential shares is dilutive. For this purpose, 30,00,000 potential shares are added to the denominator from the date of issue and the post-tax interest expense on the liability component is added back to the numerator, irrespective of whether management expects the investor to actually convert or redeem. If the investor ultimately elects cash redemption, the potential shares simply drop out of Diluted EPS from the redemption date; if the investor converts, the shares move into Basic EPS from the conversion date.

Summary of EPS denominator considerations for convertible instruments:

Instrument	Basic EPS — included from	Diluted EPS — basis and weighting
CCPS / CCD: compulsorily convertible into a fixed number of shares	The date the contract is entered into because conversion is certain.	Not applicable. These shares are already in Basic EPS, so they are not PES.
OCPS / OCD: optionally convertible	The date of conversion, if converted. Not included if redeemed for cash.	Include from the later of period start or date of issue, for as long as the instrument is outstanding and unconverted.

4. Other Common Scenarios

A handful of additional situations recur often enough in the Indian context to merit specific mention.

**a) Rights Issues Below Fair Value**

When a rights issue is priced below the fair value of the shares (which is economically equivalent to a bonus issue combined with an issue at fair value), Ind AS 33 requires a bonus-element adjustment, effectively restating prior-period EPS for comparability. For this purpose, the weighted average number of shares outstanding before the rights issue for all periods presented, including comparatives, is adjusted by a factor equal to: (fair value per share immediately before the rights issue) / (theoretical ex-rights fair value per share).

b) Bonus Issue, Share Split and Share Consolidation

A bonus issue or share split increases the number of shares without a corresponding change in resources, so Ind AS 33 requires the weighted average number of shares for all periods presented, including comparatives, to be restated retrospectively as if the event had occurred at the beginning of the earliest period presented. A share consolidation (reverse split) is treated the same way, in the opposite direction.

For example, equity shares may be split into shares of smaller nominal value (a share of INR 10 face value is divided into 10 shares of INR 1 each) or consolidated into shares of a higher face value (10 shares of INR 1 each are consolidated into one share of INR 10). In both of these situations, the number of shares outstanding before the event is adjusted for the proportionate change in the number of shares outstanding after the event. For instance, if there were 1,00,000 shares in issue prior to the split or consolidation, the number of shares outstanding before the event becomes 10,00,000 or 10,000, respectively. This retrospective treatment is required because there was no corresponding change in the entity's resources.

Critically, this restatement extends to a bonus issue, split, or consolidation that occurs after the reporting period but before the financial statements are authorised for issue. EPS for the reporting period and for all comparatives is computed on the post-event number of shares, with a disclosure explaining the adjustment.

However, no adjustment to prior-period EPS should be made for a special dividend accompanied by a share consolidation, if the economic substance of the transaction is a share repurchase at fair value. A share consolidation combined with a special dividend can have the overall effect of a share repurchase at fair value because the reduction in equity shares outstanding is the result of a corresponding reduction in resources. The weighted average number of equity shares outstanding for the period in which the combined transaction takes place is adjusted for the reduction in the number of equity shares from the date the special dividend is recognised.

c) Treasury Shares (e.g., Shares Held by an ESOP Trust)

Many Indian companies operate their employee stock schemes through an ESOP Trust, which itself holds shares – either newly issued or purchased from the market – pending transfer to employees on exercise. Such trust-held shares are excluded from the weighted average number of shares for both Basic and Diluted EPS for as long as they are held by the trust, since they are not, in substance, shares held by outside shareholders. They re-enter the weighted average number of shares only from the date on which they become outstanding under the guidance in Section 1 above.

d) Partly Paid-Up Shares

Partly paid shares are treated as a fraction of an equity share (the payments received to date, as a proportion of the total subscription price). They are included in the weighted average number of shares only to the extent that they participate in dividends for the period, and that fraction is weighted for the period for which the partly paid shares were outstanding. Partly paid shares that do not participate in dividends are treated as equivalent to options in the calculation of Diluted EPS. The unpaid call money is, in effect, treated like the exercise price of an option under the TSM, to the extent the arrangement is dilutive.

CLOSING PERSPECTIVE

Ind AS 33's Diluted EPS mechanics are, at their core, a single recurring question asked of every instrument: if the holder converted, exercised, or earned their shares today, using today's information, would equity shareholders end up worse off per share? Answering it takes a method, not a formula. For each instrument, check four things in turn:

- When does it become a share? Vesting, exercise or conversion decides when it moves from Diluted EPS into Basic EPS.
- Is a condition still open? Apply the contingency test at each reporting date.
- What does the holder pay? Use the TSM for options and the if-converted approach for convertible instruments.
- Does it still dilute once ranked against everything else? Include only what reduces EPS, from the most dilutive to the least.

Indian companies give preparers plenty of practice – ESOP pools, private-equity CCPS and CCDs, structured OCDs, and acquisitions paid in shares. Get the denominator right, and the number analysts quote becomes one they can trust.



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CONTACT US

For any content related queries, you may please write to the service line experts at accountingadvisory@bdo.in

For any other queries or feedback, kindly write to us at marketing@bdo.in

BDO INDIA OFFICES

Ahmedabad

BDO India LLP
Westgate Business Bay, Block - A,
Level-6, Opp. Nirvana Party Plot,
S.G. Highway, Ahmedabad - 380051, INDIA

Bhopal

Floor 3, Pradhan Business Center
Ansal Pradhan Enclave, E 8 Arera
Colony Near Dana Pani Square,
Bhopal 462026, INDIA

Coimbatore

Pacom Square, Floor 3, 104/1, Sakthi
Main Road, Bharathi Nagar, Ganapathy
Coimbatore 641006, INDIA

Goa

BIZ - Nest, Floor 7
A Wing, Sunteck Corporate Park
Opp. Shram Shakti Bhavan, Patto
Panaji, Goa 403001, INDIA

Kolkata

Infinity Benchmark, Unit 1302, 13th Floor
Plot No. G-1, Block - EP & GP
Sector - V, Salt Lake
Kolkata - 700 091, INDIA

Mumbai - Office 3

Floor 20, 2001 & 2002 - A Wing, 2001-
F Wing Lotus Corporate Park, Western
Express Highway, Ram Mandir Fatak Road,
Goregaon (E) Mumbai 400063, INDIA

Pune - Office 1

Floor 6, Building No. 1
Cerebrum IT Park, Kalyani Nagar
Pune 411014, INDIA

Bengaluru - Office 1

Prestige Nebula, Floor 3
Infantry Road
Bengaluru 560001, INDIA

Chandigarh

Plot no. 55, Floor 5
Industrial & Business Park
Phase 1, Chandigarh 160002, INDIA

Delhi NCR - Office 1

Magnum Global Park, Floor 21, Archview
Drive, Sector 58, Golf Course Extn Road
Gurugram 122011, INDIA

Hyderabad

1101/B, Manjeera Trinity Corporate
JNTU-Hitech City Road, Kukatpally
Hyderabad 500072, INDIA

Mumbai - Office 1

The Ruby, Level 9, North West &
South East Wings, Senapati Bapat Marg
Dadar (W), Mumbai 400028, INDIA

Mumbai - Office 4

2nd floor, Empire Complex
414, Senapati Bapat Marg
Lower Parel West,
Mumbai 400013, INDIA

Pune - Office 2

Floor 2 & 4, Mantri Sterling, Deep Bungalow
Chowk, Model Colony, Shivaji Nagar
Pune 411016, INDIA

Bengaluru - Office 2

SV Tower, No. 27, Floor 3 & 4
80 Feet Road, 6th Block, Koramangala
Bengaluru 560095, INDIA

Chennai

Olympia Cyberspace, Floor 10, Module 4
No: 4/22 Arulayiammanpet, SIDCO Industrial
Estate Guindy, Chennai 600032, INDIA

Delhi NCR - Office 2

Windsor IT Park, Plot No: A-1
Floor 2, Tower B, Sector 125
Noida 201301, INDIA

Kochi

XL/215 A, Krishna Kripa
Layam Road, Ernakulam
Kochi 682011, INDIA

Mumbai - Office 2

601, Floor 6, Raheja Titanium, Western
Express Highway, Geetanjali Railway
Colony, Ram Nagar Goregaon (E),
Mumbai 400063, INDIA

Mumbai - Office 5

8th & 9th Floor, Kalpataru Infinia
Near Grand Hyatt, Shanti Nagar,
Vakola, Santacruz East
Mumbai 400055, INDIA

Vadodara

1008, Floor 10, "OCEAN", Sarabhai
Compound, Nr. Centre Square Mall,
Dr. Vikram Sarabhai Marg Vadodara
390023, INDIA

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