



Impact of GST on Indian pharmaceutical industry: An overview

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Abstract

As GST is almost ready to implement from July 2017, every organization has started to make future strategies. Currently, Indian drugs are exported to more than 200 countries in the world. India is the largest provider of Generic drugs medicines globally and expected to expand further experiencing a boom in medical industry which will help in generating additional returns for the Industry.

Goods and Service Tax is expecting to have a positive impact on the Indian Pharmaceutical Industries as it will decrease the manufacturing cost, since eight different taxes are levied in the pharmaceutical industries helps in easy going business. It will eliminate the cascading effect of multiple taxes applied on one product.

Beside some positive impact, there are some negative impacts also. As GST is applicable on phases of the supply chain, it will have negative impact on Free-drugs samples, Bonus/Discount Schemes, Inter-state stock transfer, etc. Pharmaceutical companies will experience improved operational efficiency, reduced manufacturing & transaction costs as well as improved compliance.

Overall Impact of GST on the Pharmaceutical Industry is still uncertain as of now. It will reduce complexities and hurdles. It needs to be Tax Free under GST Regime to maintain the prices at Optimum Level.

Keywords: Indian pharmaceutical industry, GST, FDI, supply chain, inverted tax structure

Introduction

Goods and Service Tax is the biggest Tax reform in the era of Indian Indirect Taxation industry which will subsume various taxes like VAT, CST, Service tax, excise duty, additional excise duty, Luxury Tax, Entertainment Tax and many more. GST is the single taxation system in India which will help in eliminating time, cost and effort. An enactment of the most awaited Goods and Services Tax (GST) Bill caught the attention throughout all industries in India. It will benefit most of the sectors and make the taxation easier as compared to the current taxation system.

The Goods and Services tax (GST) is one of the India's biggest indirect tax renovations. It is expected to be beneficial for Indian drug makers in long run as its objective is to simplify tax structure and bring operational efficiency. However, the details such as the application of the rates to Pharma are not known and we think that the government will stress on the fact that essential medicines should have minimum taxes. However, GST is welcomed as it creates a level playing field for pharmaceutical companies and will eventually benefit the consumers. Considering the health care and Pharma industry, it is expected that the new GST regulation would benefit the consumers by making affordable health care. The whole industry is waiting for the details of tax rates, exemptions and legislative framework for implementation that is to be finalized by the GST Council.

What will be Its Effects on India's Pharmaceutical Industry?

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on the Indian Pharmaceutical Industries as it will decrease the manufacturing cost, since eight different taxes are levied in the pharmaceutical industries helps in easy going business. It will eliminate the cascading effect of multiple taxes applied on One Product. The Biggest advantages for the Industries, Traditional Cost and Distribution Model will get replaced by supply chain efficiencies due to discontinuance of the Central Sales tax and interstate transactions between two dealers will become tax neutral. This will lead to a decrease in cost which can be added to margins and even customers will get benefited from it.

The rate of GST should be kept at a comparative level in the lowest slab for the pharmaceutical industries. Analysts specify the GST rate up to 12% to be neutral tax rate whereas anything above will have an inflationary effect on pricing.

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Industry trends & market structure

- The pharma industry generally grows at about 1.5-1.6 times the Gross Domestic Product growth
 - In 2007-08, India exported drugs worth US\$7.2 billion in to the US and Europe followed by Central and Eastern Europe, Africa and Latin America
 - The Indian vaccine market which was worth US\$665 million in 2007-08 is growing at a rate of more than 20%
- The retail pharmaceutical market in India is expected to cross US\$ 15-18 billion by 2017

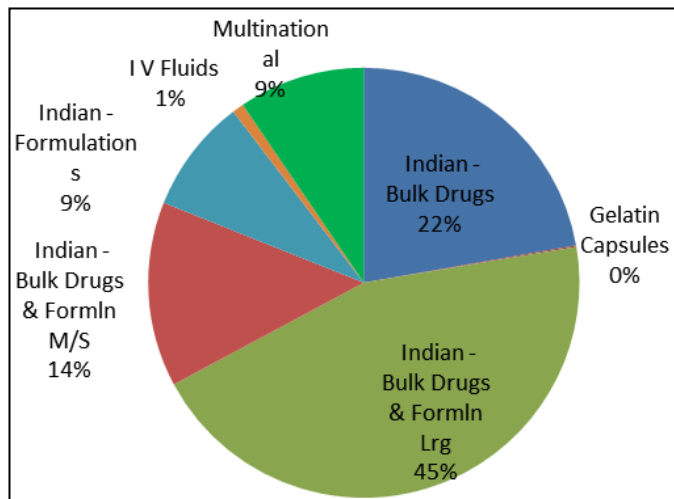


Fig 1: Market Structure.

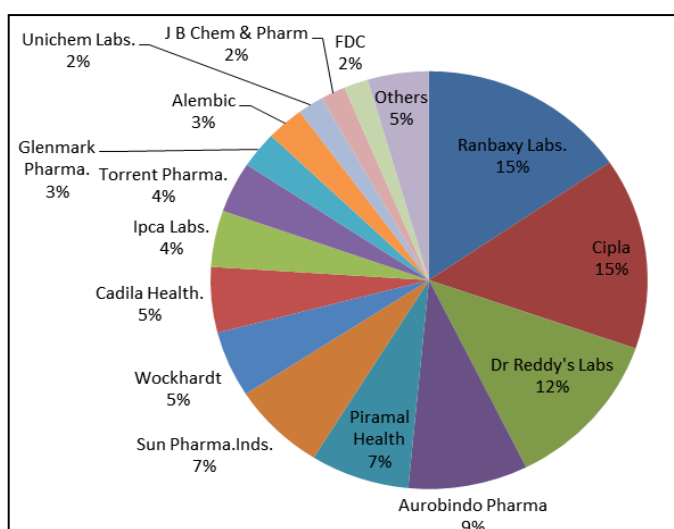


Fig 2: Market Share.

Export has become an important driving force for growth in this industry with more than 50 % revenue coming from the overseas markets. For the financial year 2016-17 the export of drugs is estimated to be \$8.25 billion as per the Pharmaceutical Export Council of India, which is an organization, set up by the Government of India.

- Over 60 per cent of India's bulk drug production is exported.
- The other major exporters are Wockhardt Limited, Sun Pharmaceutical Industries Ltd. And Lupin Laboratories.
- The formulations and exports are largely to developing nations in CIS, South East Asia, Africa and Latin America.

Table 1: Exports of medicinal and pharmaceuticals products for the last three years.

Year	Exports of Medicines & Pharmaceuticals Products (Rs. in Crore)
2011-12	544906.73
2012-13	602016.70
2013-14	690236.77

Source: Industryoutlook.cmie.com



Fig 3: Pharmaceutical Sale.

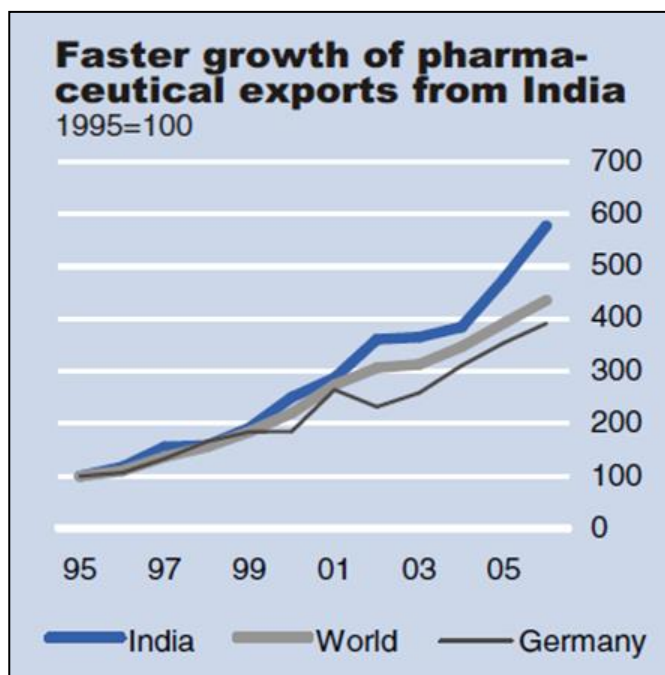


Fig 4: Pharmaceutical Exports.

GST provisions for pharma industry

1. Refund in case of Inverted Tax Structure: The Pharma industry has represented that the inverted tax structure should be addressed in GST. The industry is awaiting the finalization of GST rates. In this context, the Model GST Law provides for a refund of accumulated credit on account of an inverted tax structure. This is a welcome provision. However, it would be better if, in the first instance itself, the GST regime does not provide for an inverted tax structure.

2. Input tax credit: Scope The definition of capital goods has been drafted on the same lines as in the existing CENVAT

Credit Rules. Accordingly, Input Tax Credit will be allowed only of those goods falling within specified Chapters of the Model GST Law. Further, the definitions of inputs and input services also provide for exclusions. Therefore, it appears that even under GST, restrictions on Input Tax Credit will continue. Further, a nexus of goods and services received is also required to be established with outward supplies. Hence, the industry needs to represent for a broad-based credit mechanism.

3. Area based exemptions under the Excise legislation and State Industrial Policy: The First Discussion Paper on GST had stated that area-based exemptions under the Excise legislation and incentives under the State Industrial policies should be converted to a tax refund mechanism. However, the transition provisions prescribed under the Model GST Law do not provide for the treatment of such exemptions/ incentives. Further, the valuation provisions envisage that subsidies should be included in the transaction value. This would significantly impact benefits available to the industry.

4. Transition provisions for imported goods: The transition provisions provide that the credit balances which were admissible under the present regime would be carried forward under GST. In case of stocks of imported finished goods, Countervailing Duty is not admissible under the present regime, and in case of goods procured from contract manufacturers also, Excise Duty credit is not available. Accordingly, based on these provisions, under the GST regime, such stocks would suffer double taxation.

5. Taxability and valuation of Stock Transfers: The charging section of the IGST Act provides for the levy of IGST on the supply of goods made in the course of inter-state trade or commerce. Further, as per the Model GST Law, the term 'supply' includes transactions between a principal and an agent. Schedule 1 of the Model GST Law deems any supply between two persons without consideration as a 'supply'. It is unclear whether stock transfers within the State would also be subject to GST. It is to be noted that the GST framework was intended to tax only inter-state stock transfers, and not intra-state stock transfers. Additionally, with respect to valuation of stock transfers, the GST Valuation Rules provides that the value of goods shall be the transaction value. However, the GST Valuation Rules provides that if the transaction value is not available, then the transaction value of goods of like kind and quality should be considered. Further, if goods of like kind and quality are not available, then the computed value i.e. the cost of production, general expenses and profit should be adopted.

6. Taxability of Free Supplies: Supply of goods between persons without consideration is deemed to be a 'supply'. Accordingly, stock transfer of promotion materials/ free samples will be subject to GST. Subsequent supply of the said promotion materials to stockists/ end customers will also attract GST. PwC 4 The valuation of such samples/ materials will be as per the GST Valuation Rules, i.e. the transaction value of goods of like kind and quality or the cost of sales. Under the present regime, free supplies are not subject to

VAT. Hence, the promotion expenses of pharma companies will increase under the GST regime.

7. Discounts: Discounts/ incentives provided after the supply of goods will be excluded from the transaction value, provided they are known at or before the time of supply of goods, and are linked to invoices for the supply of goods. Further, discounts at the time of supply are excluded from the transaction value, only if they are in the course of normal trade practice, and are disclosed on the invoices. Discounts provided under secondary market schemes will therefore not be eligible for exclusion from the turnover.

GST constitutional amendment bill [cab] and its impact

India will have a dual GST i.e. both centre and states would levy GST on a common base (CGST and SGST). Integrated-GST (IGST) will be levied on inter-state supplies as well as on import of goods and services.

The CAB has proposed to subsume the following taxes/ levies at the central level

- Additional customs duty commonly known as countervailing duty, special additional duty of customs, service tax, central excise duty, additional excise duties and excise duty under the medicinal and toilet preparations (Excise Duties) Act, 1955 and central surcharges and cess relating to supply of goods and services.

Similarly the following taxes / levies are proposed to be subsumed at the state level

The bill has also proposed a GST Council with participation from centre and states alike. This council will play a key role in recommending the GST tax rates and approach towards exempting goods and services from the said levy, model GST law, principles of levy, threshold, preferential treatment to specific states etc. and resolve disputes arising there from.

Pharma industry – tax impacts

Notified life saving drugs / APIs used in manufacture of life saving drugs presently benefit by way of non-levy of excise duty to the extent covered under specific notifications under the central excise law. Given that the central excise duty would be subsumed under the proposed GST law, it would be relevant to ensure that the life saving drugs enjoy tax free status under GST. This would enable exemption from IGST on import of said goods also e.g. medical devices which enjoy exemption from CVD/SAD on import would be keen to hold on to the said beneficial treatment under GST.

From a pharma industry perspective, GST rate on formulations as compared to the GST rate on Active Pharmaceutical Ingredients (API) should be a key watch out area. In case the present deviation in central excise duty rate of pharma formulations *vis-à-vis* the duty rate of API is not addressed, the issue of accumulation of GST credit could continue even in the GST regime. The industry would be hoping for a favorable solution to this concern.

Pharma industry – other impact areas

GST would be a tax triggered business transformation and hence the transition to the GST regime should involve not only the indirect tax team but would require focused

participation of a cross functional team of the companies from IT, supply chain, procurement, accounts, HR etc.

The impact of IGST on stock transfers could open up the need for pharma companies to examine to the requirement to redesign supply chain network – to study the optimal number of warehouses, locations and linkages. Inventory management norms presently followed by the companies would also need to be re-evaluated in light of the proposed changes. It may be interesting to revisit the benefits of in house manufacturing vs outsourcing by way of contract manufacturing model.

Creating awareness with key stakeholders such as suppliers, distributors and internal stakeholders would be the need of the hour so that they are kept informed of the plan and progress on the GST implementation initiative of the company. Needles to reiterate, industry needs to ensure timely readiness for the GST. Delay in the implementation could have potential reputational, business and compliance risk. Hence senior management oversight to ensure timely completion of tasks for implementation of GST would be a defining part of in-house strategy.

Taxation issues before implementation of GST in India with respect pharmaceutical/health care industry

- 11 states have introduced a system of levying tax on MRP at a single point i.e. first sale in the state is subject to VAT on the basis of MRP and subsequent sales
- SAD (Special Additional Duty) refunds are taking more than a year to get processing the refund and the processes involved are cumbersome
- Government should reduce custom duty on all Life Saving medical devices to 5%
- Physician samples should be exempted from payment of Excise Duty
- As per the section 4A of the Central Excise Act, 1944, an abatement of 35% allowed for the purpose of levying Excise Duty on Pharmaceuticals
- The excise duty rate of APIs should be reduced from 10% to 4%, so as to make it at par with formulations
- Different VAT rates for pharma goods in different states / different description in schedule entries related to life saving drugs/ medical equipment
- Transfer Pricing is treated as concealment of income and harsh penalties of 100-300% are levied.

The likely implementation of GST will be closely watched by the pharmaceutical industry as the total tax rate might go up, if the GST rates are not fixed in line with current indirect tax incidence. And care must be taken to address issue and complications of existing indirect tax system so that, GST to look a boom for Pharma industry.

Conclusion

1. The Pharma Industry should file representations to the Government on the key issues arising out of the Model GST Law, as discussed above.

The industry needs to commence preparation for transition to GST as the Government makes progress on critical milestones in the coming months, such as passage of the Constitutional Amendment Bill in the Rajya Sabha. GST transition is not just

a transition of tax; it impacts every aspect of the business operations and therefore it requires a ‘whole of business’ approach to ensure a smooth transition.

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