Editorial

GST implications in BioPharma Sector of India and world

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India is the largest producer for generics and the country's Pharmaceutical Industry is currently the 3rd largest in the world in terms of volume and ranks 14th in terms of value. Currently, 5 percent of the country's GDP is expended on the Healthcare sector. The healthcare sector is expected to touch $150 bn by end of 2017, from $80 bn in the year 2012.

The passing of the GST (Goods and Services Tax) Bill has grabbed the attention across all the industries in the country. It would benefit most of the sectors and make the taxation process easier as it will replace a number of different taxes and duties like Central level taxes including Countervailing duty, service tax, central excise duty, additional excise duties, special additional duties of customs, and excise duties under the medicinal and toilet preparations Act 1955 will get abolished by the new taxation system and State level taxes including Sales Tax and VAT at the state level, CST, Entry tax, purchase tax, luxury tax, State level entertainment tax (over and above the tax at the local level), taxes on lottery and gamble will be merged under the GST head. Also, surcharges on the supply of goods and services at the state level will also get abolished.

How GST works?

GST is an evolution of the current tax regime, transforming the complex and cascading structure into a unified value added system of taxation. Under this, a value added tax would be levied at every point of the supply chain providing for credit for any / all taxes paid previously. Keveping in line with the governance structure of the country GST would be levied simultaneously by the Centre and State (CGST and SGST respectively). All essential characteristics in terms of its structure, design applicability, etc. would be common between CGST and SGST, across all states.

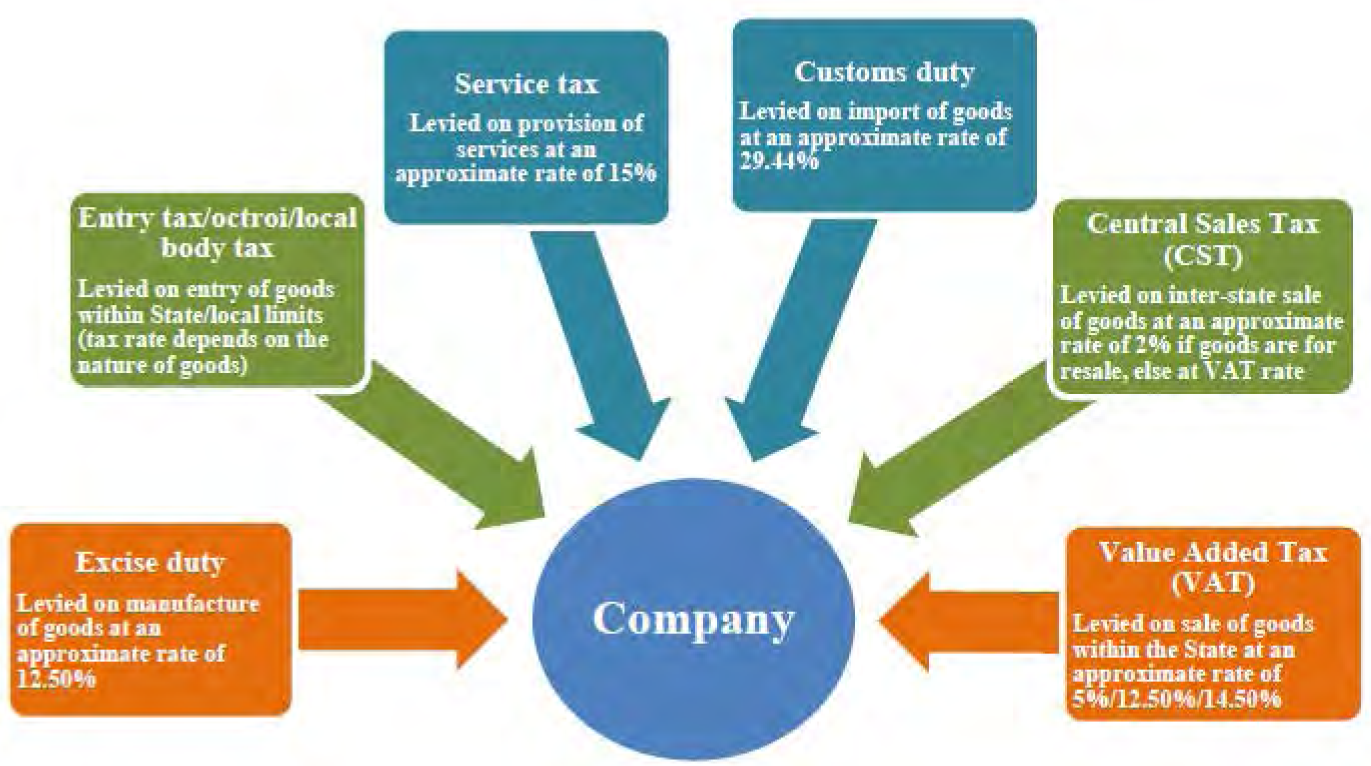
With the implementation of GST, cost of any service, including logistics, will be considered as value add, and the manufacturer will get tax credit for the service tax paid. Under GST inter-state sales transactions between two dealers would be cost equivalent and comparable with stock transfers / branch transfers. Inter-state transactions would become tax neutral, making India one single common market no longer divided by state borders. This will result in lower cost which can add to margins or can be passed on to customers.

GST would help the industries by streamlining the taxation structure since 8 different types of taxes are imposed on the Pharmaceutical Industry today. An amalgamation of all the taxes into one uniform tax will ease the way of doing business in the country, as well as minimising the cascading effects of manifold taxes that is applied to one product.

Benefits of GST in Pharma Industry

Overall Reduction in cost of technology

Onebenefit likely to accrue due to GST is the reduction in the overall cost of technology. Currently, the technical machinery and equipment which are imported into the country by the healthcare sector are very costly. Also, the duty which is levied is not allowed as a tax credit under the present tax regulations. However, with GST this scenario might change. Under GST, duty charged on the import of such equipment and machinery would be allowed as a credit.



Less Logistics Cost

While the qualitative benefits arising out of GST are well established, there is a definite impact to economics of companies as well. Logistics cost accounts for nearly 13-14% of our GDP. Of the total logistics cost transportation contributes ~35%, warehousing & storage ~10%, inventory holding cost ~25% and other inefficiencies' make up the balance 30%. Implementation of GST and alignment of a firm's supply chain to it will directly help in reducing cost on transportation, warehousing and inventory holding by 5- 8%, 10-12% and upto 28% respectively for each of the cost heads, leading to an overall savings in the range of 10-12% of the total logistics cost.

Inverted duty structure

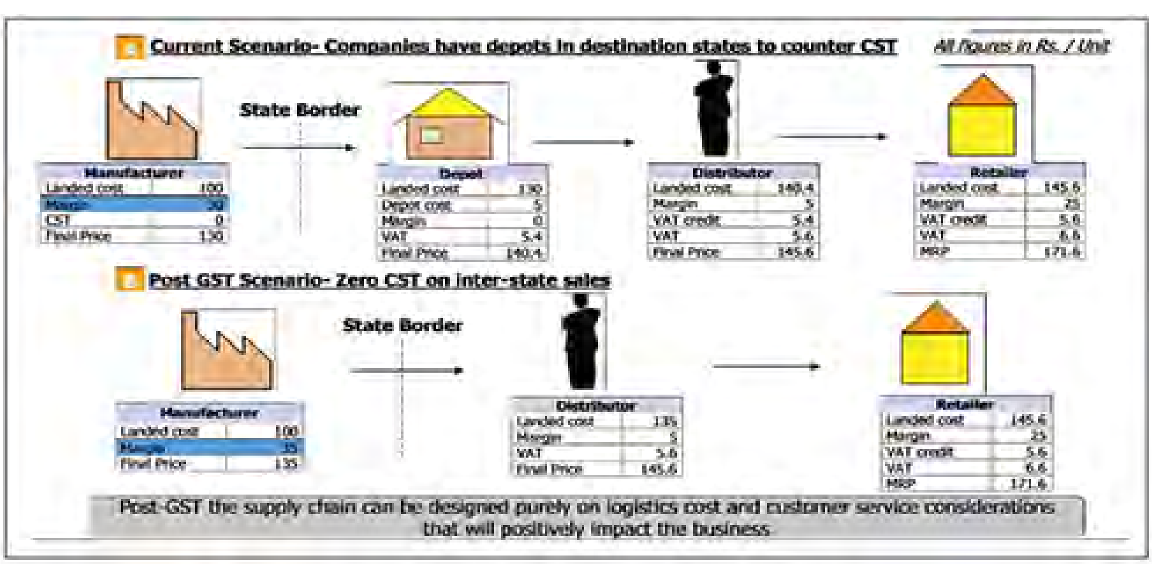
One of the prime concerns for the healthcare sector is the inverted duty structure that adversely impacts the domestic manufacturers. The cost of inputs is much higher than output, i.e., the raw materials are more costly in terms of duty than the finished product itself hence depressing investments from the manufacturers. For addressing this issue, the GST structure proposes either to dispose of the inverted duty structure or bring in a refund of the accrued credit. If this is implemented, it would prove to be the biggest advantage for the healthcare sector and would act as a booster for the growth of healthcare industry.

Opportunities to create supply chain efficiencies

It is not uncommon for midsize to big Pharma companies to control 20–25 warehousing locations in India; one in every of the key reasons for this arrangement is the current indirect tax regime. Underneath this regime, interstate sale of goods attracts tax (Central Sales Tax) which is not creditable to the buyer, whereas interstate movement of goods across warehouses of the constant company isn't subject to tax.

Hence, pharmaceutical corporations have acquired a decentralized supply chain model whereby multiple warehouses placed in several states in India have been operated to avoid tax outpouring from the direct interstate sale of goods.

Since GST on interstate sale of goods would be worthy underneath the Model GST Law, there exists a chance for companies to revisit current supply chain structures, the quantity of warehouses being operated, etc. Similarly, there could exist opportunities to optimize sourcing strategies to attain significant supply chain cost savings. For example, companies have traditionally designed their sourcing strategies with the primary goal of minimizing indirect taxes incurred under the current regime (i.e., whether to procure from within the state or from outside the state).



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implementation of GST, these tax limitations/ restrictions would stop to exist, thereby affording a lot of flexibility and enabling companies to shift their focus to non-tax sourcing considerations, which may be including purchase price, logistics cost, etc. As a result, through earlier planning, the transition to GST law may provide Pharmaceutical Corporation with a competitive advantage in terms of pricing and big margins. For example: By setting up a large warehouse in a place like Mohali, a large logistics hub with good infrastructure, a company can serve markets across the states of J&K, Himachal, Punjab, Uttrakhand and Haryana as against having five different warehouses to serve these markets in the current scenario.

Outsourcing work model

Corporations within the pharmaceutical industry in India usually depend upon third-party entities to manufacture finished product for and on their behalf. This arrangement is often spoken to as a "job work" model or "loan licensee" model. Beneath the current regime, tax obligations of parties under a job work model are relatively clear and straight forward.

The principal supplies input material to the job worker's premises with no tax implication and limited documentation. The job worker makes the payment of excise duty on the manufactured formulations based on the MRP of said goods as declared by the principal. Special provisions for GST-free movement of input goods/ material for job work have been provided in the Model GST law. However, the process that companies will need to follow to permit for such free movement of input goods/material might become comparatively cumbersome under the GST regime. In cases in which the permission is not granted or delayed, the supply of input materials for job work would attract GST. This requirement of obtaining permission could be time-consuming, especially during the transition phase, and may create operational and financial challenges for companies.

The pharmaceutical industry would greatly benefit to the extent the Government was to convert the proposed job-work-related approvals requirement to a self-declaration model. This would result in greater efficiency and permit companies to avoid the possibility of a GST outlay (i.e., negative cash outflow).

Benefits to Medical Tourism after GST

India has a definite competitive advantage over the First world countries. Several studies have proved that the cost of health care package including accommodation and travel to India is about 30-40 percent of the similar medical treatment and procedures in First World countries. India brags of having one of the largest healthcare workforces with 50,000 or more doctors and nurses produced every year. As of today, there is a boom in the country's medical tourism that generates extra returns for Healthcare Industry. The revenue from medical tourism in the country has grown from $334 million in 2004 to $2 billion this year.

With the implementation of GST, Medical Tourism is also projected to grow manifold. Also, the formation of National Medical Tourism Board has initiated their policies for solving the issues which are faced by the medical travellers. With the roll out of GST, the cost of insurance, pharmaceuticals, and international travel together with quality health care is expected to reduce which would culminate into better prospects of medical tourism in the country.

GST for Alternative medicines

India is home to several alternative medicine practices such as Yoga, Ayurveda, Unani, Sidha, Homeopathy and Acupuncture which are popular among the foreigners. Such alternative medicine practices give India an important edge over most of its competitors such as Thailand, Malaysia, Singapore, UAE and South Korea. It is expected that GST would have a positive effect on these alternative medicine sector and will significantly contribute towards the growth of medical tourism in the country.

After GST there is no need to pay tax on discounted price, for example before preparing Invoice if dealer gives 10 Rs discount on 100 Rs product then GST will be applicable to 90 Rs and not 100.

GST Rate on Pharmaceutical Products

NIL GST RATE;

1. Human Blood and its components [GST HSN chapter code 3002].
2. All types of contraceptives [GST HSN chapter code 3006]

5% GST RATE;

1. Animal or Human Blood Vaccines [GST HSN chapter code 3002, GST HSN chapter code 3006]
2. Diagnostic kits for detection of all types of hepatitis
3. Desferrioxamine injection or deferiprone
4. Cyclosporin
5. Medicaments (including veterinary medicaments) used in bio-chemic systems and not bearing a brand name
6. Oral re-hydration salts
7. Drugs or medicines including their salts and esters and diagnostic test kits, specified in List 3 or List 4 appended to the notification No.12/2012- Customs, dated the 17th March, 2012, dated the 17th March, 2012.
8. Formulations manufactured from the bulk drugs specified in List 1 of notification No.12/2012-Central Excise, dated the 17th March, 2012, dated the 17th March, 2012.

12%GST RATE;

All goods not specified elsewhere

1. GST HSN chapter code 3001 Glands and other organs for organo-therapeutic uses, dried, whether or not powdered; extracts of glands or other organs or of their secretions for organo-therapeutic uses; heparin and its salts; other human or animal substances prepared for therapeutic or prophylactic uses, not elsewhere specified or included
2. GST HSN chapter code 3002 Animal blood prepared for therapeutic, prophylactic or diagnostic uses; antisera and other blood fractions and modified immunological products, whether or not obtained by means of biotechnological processes; toxins, cultures of microorganisms (excluding yeasts) and similar products
3. GST HSN chapter code 3003 Medicaments (excluding goods of heading 30.02, 30.05 or 30.06) consisting of two or more constituents which have been mixed together for therapeutic or prophylactic uses, not put up in measured doses or in forms or packings for retail sale, including Ayurvaedic, Unani, Siddha, homoeopathic or Bio-chemic systems medicaments.
4. GST HSN chapter code 3004 Medicaments (excluding goods of heading 30.02, 30.05 or 30.06) consisting of mixed or unmixed products for therapeutic or prophylactic uses, put up in measured doses (including those in the form of transdermal administration systems) or in forms or packings for retail sale, including Ayurvaedic, Unani, homoeopathic siddha or Biochemic systems medicaments, put up for retail sale.
5. GST HSN chapter code 3005 Wadding, gauze, bandages and similar articles (for example, dressings, adhesive plasters, poultices), impregnated or coated with pharmaceutical substances or put up in forms or packings for retail sale on medical, surgical, dental or veterinary purposes.
6. GST HSN chapter code 3006Pharmaceutical goods specified in Note 4 to this Chapter such as Sterile surgical catgut, similar sterile suture materials (including sterile absorbable surgical or dental yarns) and sterile tissue adhesives for surgical wound closure; sterile laminaria and sterile laminaria tents; sterile absorbable surgical or dental haemostatics; sterile surgical or denatal adhesion barriers, whether or not absorbable, etc., Waste pharmaceuticals [other than contraceptives].

18%GST RATE;

1. Nicotine polacrilex gum

How are free product samples treated under GST?

According to credit provisions in the GST Act, input tax credit shall not be allowed for goods lost, stolen, destroyed, written off or disposed of by way of gift or free samples. Accordingly, input tax credit is required to be reversed pertaining to goods which have been disposed of by way of free samples.

Negatives of GST in Pharma Industry

GST will also have some negative effects on pharmaceutical sector. Many medicines which are taxed currently at 5% would attract 12% tax once GST comes into effect.

There is an uncertainty if the life-saving drugs, Healthcare services, and medical devices would continue to be tax-free once GST comes into force. Till now, life-saving drugs are exempted from the Excise and Customs Duties. Some of the States charge 5 percent taxes on the medicines; it might change once GST comes to play.

Excise free zones

in GST Council, it was decided that 'all entities exempted under payment of indirect tax under any existing incentives scheme of central or state governments shall not continue under the GST regime and existing units shall pay tax under the GST regime'.

Under the discretionary powers left to it by the Council regarding these incentives, the finance ministry has proposed to provide budgetary support for refunding its share in GST to such units to which exemptions in indirect taxes were granted, for promoting industrialisation.

Excise-free zones were a crucial step in providing relief to small manufacturers in remote places to be competitive in the national market. Manufacturers operating from excise-free manufacturing zones had to pay excise at the rate of 1.5% in comparison to the 12.5% from every other manufacturer of pharmaceutical products.

Earlier, Ayurvedic drugs or medicines were charged an average VAT of 4% and excise of 1.5% due to the excise free manufacturing zone benefit.

What's Next?

Since the government has implemented GST w.e.f. 1st April 2016 midnight, it will be quite interesting to see the change happening in next six months. Industries closely watch the happenings around and the recommendations of the steering committee about things like dual threshold and exemption in the GST regime. Also, it will be very interesting to see the recommendations about Revenue Neutral Rate for GST and SGST.

Suresh Nair the tax partner in lifesciences practice, EY India in an article in Financial Express expressed his views that GST is likely to have a far-reaching impact on several aspects of business including pricing of products and services, supply chain, IT systems, accounting, tax compliance framework & re-skilling of talent.

It is advisable for the industry to plan its transition to the GST regime in advance to enable the three key objectives-(i) no business disruption as on the cut over date, (ii) 100% compliance of all legal and procedural requirements under the new law, and (iii) managing opportunities effectively to generate business value by plugging leakages in the current indirect tax law.

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