GST and its impact on pharma

February 24, 2015

***Dr Milind Antani**, Legal & Tax Counseling Worldwide, Nishith Desai Associates and **Ashish Sodhani**, Member, International Tax Practice elaborate on how GST implementation would impact the pharma industry*

Dr Milind Antani

The current indirect tax system in India is characterised by multi-stage taxation with levy of taxes not only at the central level but also at the state level. Customs duty is imposed on imports, central excise on manufacture, central sales tax (CST)/ value-added tax (VAT) at the time of sale and service tax on provision of services. Other taxes such as octroi, entry tax and cess are also levied by municipal and local authorities. It is also not possible to get credit for taxes which could have been used to offset other indirect taxes that are payable by the taxpayer viz. CST is not creditable against VAT, service tax not creditable against CST/VAT, customs duty is not creditable at all.1 This results in cost of taxes increasing significantly and also increases compliance costs as the taxpayer has to file several returns every month with different authorities.

Ashish Sodhani

With a view to simplify this tax regime, the legislature decided to bring about a comprehensive tax system which would reduce the burden on the taxpayer. The Goods and Services Tax (GST) is a single, broad-based comprehensive tax system which levies tax on manufacture, sale and consumption of goods and services at a national level. The tax has to be paid by the seller or provider of service with the right to claim input credit for the tax paid by him at the time of purchasing the goods or procuring the service. This removes credit anomalies which are present under the current indirect tax law and in turn has a favourable impact on profits and pricing of goods and services. GST is not additional tax but will subsume excise duty, service tax, additional duties of customs and CST at the central level and value-added taxes, entertainment tax, luxury tax, octroi, lottery taxes, electricity duty, state surcharges related to supply of goods and services and purchase tax at the State level.

GST system in India essentially envisages two taxes – State Level GST (SGST) and Central Level GST (CGST). Both the taxes will be levied on the taxable value of a transaction. The Government is expected to fix a combined GST which is expected to be at around 14-16 per cent. The the rates of CGST and SGST will then be fixed by the

Centre and States. CGST and SGST combined together are referred to as IGST.

If GST is implemented how it stands today, it could make various business decisions, 'tax neutral', thus, ensuring that commercial efficiencies are not compromised on account of tax constraints. Some of the key aspects of business operations that would likely be impacted by GST are as follows:

- Change in tax rate for supplies as well as purchases;
- Transactions/ supplies which are currently not taxable may become liable to GST, and vice-versa;
- Credit availability for input taxes;
- Amendment/withdrawal of tax schemes, valuation provisions.

Impact of GST on pharma industry

The Indian pharma industry, estimated turnover at Rs 450 billion, ranks fourth globally in terms of volume and is amongst the largest producer of pharma products in the world along with US, Japan, Europe and China.2 Similar to the manufacturing industry, the pharma industry also enjoys low cost of production due to economies of scale. But the levy of multiple taxes, loss of credit of tax paid, compliance and litigation cost associated with the present tax set up tend to raise prices which eventually result in causing problems to the pharma industry.

With the introduction of GST, the most visible impact appears to be the proposed discontinuance of CST. It is a cost to pharma manufacturers whenever they procure raw materials from outside their state and if sale is on inter-state basis.3 This is because of the fact that CST paid in purchases cannot be set off against the VAT liability of manufacturer /dealer. Another impact would be a review of the present warehousing strategies followed by the pharma industry. The common practice of most pharma manufacturers is that they maintain warehouses in different states to evidence movement of goods from one warehouse to another so as to save on the CST.4 Some manufacturers also went to the extent of setting up warehouses at locations like Pondicherry or Daman as the CST rate at such locations were previously lower than the rate prevalent in other states.5 Therefore, with the implementation of GST, pharma manufacturers can set up warehouses for distribution at select strategic location without looking at the same tax planning options resulting in cost of operations.

Currently, pharma goods attract excise duty at 4.12 per cent whereas the active pharmaceuticals ingredients (API), which are inputs for manufacture of pharma products, typically attract duty at 8.24 per cent. This result in accumulation of differential Cenvat Credit for the manufacturers not engaged in export of pharma goods due to the difference in duty rates of inputs vis-à-vis the finished goods. This becomes an issue because the Central Excise/ Cenvat Credit legislation does not provide any mechanism for refund of such accumulated credit. With the CGST presumed to have a single rate for both goods and services, going forward accumulation of credit may cease to be an issue for the industry.

GST is proposed to be implemented from April 1, 2016. Essentially it is the States which need to accept GST for it to be implemented in the country. With the current scheme of things, the discussions that are going on between the Finance Minister and the States it seems more likely than not that GST will become effective from the proposed dates. Further, with the new government having majority in the Centre and also starting to have majority in the States, it will not be too difficult to implement GST. The continuous effort to have discussions with the representatives of the State governments to make GST consistent with what all the States wants will also be useful for implementing it on time.