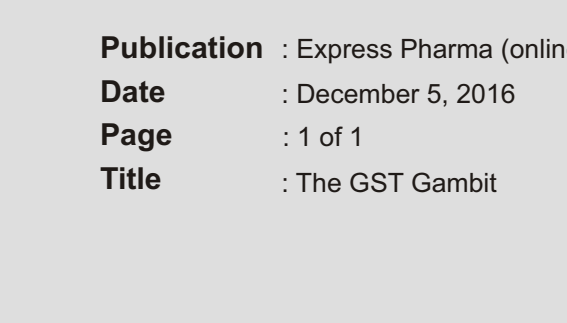




Publication : Express Pharma (online)
Date : December 5, 2016
Page : 1 of 1
Title : The GST Gambit

The GST GAMBIT

By Prathiba Raju on December 5, 2016



As the deadline for GST roll out nears, the pharma industry is cautiously optimistic about its impact
By Prathiba Raju

The roll out of GST is expected to bring in several changes in the way pharma business functions. It will have an impact on varied aspects of the business processes like product pricing, supply chain management, IT, finance and accounting, legal and compliance etc. According to industry experts, GST is likely to bring in more operational efficiencies as well as reduction in manufacturing cost.

A gateway of opportunity

The recently passed GST has opened a new gateway of opportunities for the pharma industry, as it would rid the sector of problems caused by the multiplicity of taxes. Under the current indirect tax regime, the pharma sector is burdened with numerous taxes, which are levied at various stages such as central levy (central excise duty, service tax and customs duty), state levy (sales tax, value added tax (VAT), entry tax etc.) and other municipal taxes (octroi duty, local body tax (LBT).

All these taxes will be subsumed into a single tax called the Goods and Service Tax (GST), which will reduce multiple compliance and cost of goods. Also, one can expect free flow of credit under the new GST regime.

"GST is not just a tax change but a business change. Hence, it will change the way pharma business functions and business decisions will be made on the basis of pure economic factors without taking into consideration the taxation point of view. It will help mitigate the cascading or double taxation effect on transactions. Under the current indirect tax regime, there are several transactions that fall within the ambit of two or more levies, which is finally borne by end consumers. GST will create a completely tax-neutral environment for business. The compliance-related services such as registration, returns, payment of tax, etc. will be available to the tax payer online under one single portal, thereby reducing the compliance cost. The same will eventually increase the competitiveness of Indian goods and services in the international market," shares Santosh Dalvi, Partner, KPMG.



Santosh Dalvi

Elaborating on the provisions of GST, KV Subramaniam, President, Reliance Life Sciences said, "As with most other sectors, GST is expected to be beneficial for the Indian pharma industry. In the medium-to-long run, it aims to simplify the tax structure and bring about commercial efficiency. The pharma sector is currently faced with issues of multiple taxes at central, state and municipal levels. GST promises to simplify and streamline the indirect tax structure and will mitigate the cascading effect of the taxes. It also proposes seamless credit across all value additions. All these should lead to an improvement in supply chain efficiency and reduction in manufacturing costs."



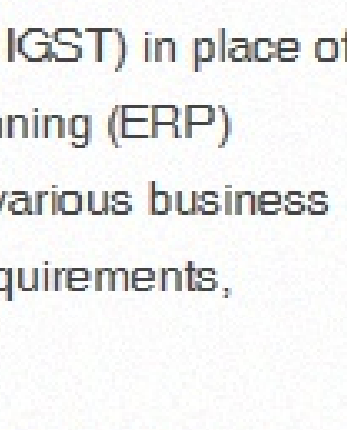
KV Subramaniam

Displaying the same optimism, Dr Amit Varma, Managing Partner, Quadria Capital, explains, "Single tax rate across all goods and services will result in redistribution of taxes across all categories. This will lead to a reduction in taxes on manufactured goods and thereby impact the pricing of the final product. The integration of tax on goods and services through GST will provide the additional benefit of credit for service tax paid by manufacturers. Both CENVAT and VAT, which are being levied at present, give tax credit to the manufacturers for the tax paid on raw materials. There are various services, including logistics, involved in getting the input material to its final customers. Service tax is paid on the cost of such services as well. With implementation of GST, the cost of services, including logistics, will be considered as value add, and the manufacturer will get tax credit for the service tax paid."



Dr Amit Varma

Informing that GST is a step towards 'One country, one tax,' KT Rama Rao, Minister for Industries and IT Minister, Telangana said, "We have supported GST in the Parliament and have also ratified GST amendment in the state legislature. From an industry perspective, it will have a positive outcome as it rationalises lots of taxes and uncomplimates them. Now, how will this work out for manufacturing state to consuming state is what we need to wait and see because the Government of India has promised to support whatever deficit might come for about the next five years. I believe that GST should ensure that the same level of support is maintained irrespective of what form or shape it will be. I do hope that GST will take our economy a notch up because a two per cent GDP growth can be expected through GST. We also believe that the new tax form will uncomplimate things and attract lot of foreign investments."



KT Rama Rao

Thus, the sector hopes that GST would increase compliance, remove complexities, ensure hassle-free functioning and pave way for more opportunities.

Role of IT

Although GST will reduce multiplicity of taxes, taxpayers need to reprogramme their entire Information Technology (IT) system by creating new codes (eg. CGST, SGST and IGST) in place of existing tax codes – Excise, VAT, CST and others. The Enterprise Resources Planning (ERP) system needs to be aligned with GST requirements and it will have an impact on various business processes like tax configuration, computation, invoicing requirements, reporting requirements, master data amendments and documentation requirements.

In a highly-regulated sector like pharma, upgradation of new IT systems could take anywhere between 12 to 15 months, informs Verma. Detailing about the issues in enhancing the ERP system, he said, "With the implementation of GST, they will have to move from their current system, where every transaction is recorded separately, to an upgraded system where there is a correlation between every entry. Under the current system, every state is treated differently. The solution won't be a one-size fit approach. All modules and business processes should be mapped as per company needs, taking in account sector-specific requirements. Implementing the new IT system could take a few months. GST will mainly impact master data management, tax computation and business process localisation."

GST: Positives and Negatives

Positives

- Taxation will have positive impact in the medium to long term.
- Traditional cost and distribution model will get replaced by supply chain efficiencies and therefore reduce cost
- GST will also have positive effect on warehousing strategy

Negatives

- Tax bracket is expected to increase and will have short term negative impacts
- Free samples given as physician's samples for promotion could attract GST. These would impact the bottom line of the pharma industries marginally in a short term but expected to be set-off for better operational efficiency in the long term

Mentioning that GST implication for ERP is multi-fold, Subramaniam opined that it is necessary to have a robust ERP system to ensure seamless business operations, compliance, tax administration and a detailed impact analysis.

"Pharma companies need to take a close review on all inward and outward processes, like stock transfers, loan-licensing etc. Subcontracting transactions must be closely evaluated as such transactions will fall under the ambit of GST. Further, credit available to the taxpayer will depend on proper filing of sales and purchase register. Invoices also need to be amended as per the GST rules and regulations. Hence, changes need to be made accordingly. A thorough review of the ERP is needed in terms of adaptability with GST," Dalvi added.

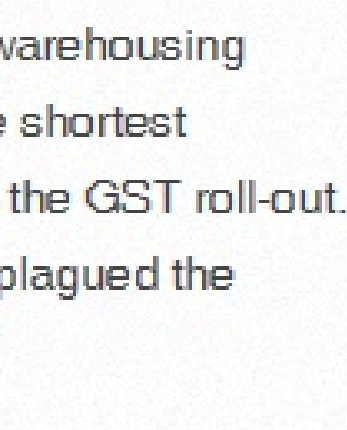
In a way, the new tax reform will streamline the Indian pharma business. It will help to consolidate the warehouse segment and rationalise supply chain networks as well as take advantage of economies of scale.

Foreseeing huge benefits

GST is set to transform the way goods are transported within the country. The pharma industry is set to enjoy the benefits of the logistics sector and bring in a more streamlined flow of goods. It will facilitate inter-state flow of goods and will help in meeting the demands of healthcare delivery systems. Obstacles in the form of check posts, way bill requirements, octroi, entry tax, cess and central sales tax during transactions within the state and interstate will be subsumed. It will be cost effective and have operational advantages.

"Most pharma manufacturers maintain warehouses in different states so as to save on Central Sales Tax (CST). Some manufacturers also went to the extent of setting up warehouses at locations like Puducherry or Daman as CST rates in those locations were previously lower than the rates prevalent in other states. Therefore, with the implementation of GST, pharma manufacturers can set up warehouses for distribution at select strategic locations resulting in reduction of cost of operations. This will enable companies to consolidate warehouses, rationalise supply chain networks and take advantage of economies of scale," states Varma.

Opining that optimal usage of warehouses will reduce inventory costs, Phanish Chandra, CEO, Docplexus, says, "With the new tax regime, a better optimised hub and spoke model in warehousing is expected. There will be a boost in demand for refrigerated, temperature-controlled warehouses and transportation solutions as the overall costs of logistics is said to be reduced."



Phanish Chandra

According to KPMG, under GST, warehousing decisions shall be based on strategic locations rather than tax requirement. GST will have an overall impact on the supply chain management of the pharma vertical. The traditional clearing and forwarding or consignment sales agency distribution model may have to be re-aligned by distribution models, which will be effective under the GST regime.

"Currently, most of the pharma companies maintain their warehouses/ C&F locations in different states primarily to cater to the demands at remote locations and also to do away with additional CST impact. GST is going to be imposed on stock transfer between manufacturing locations to C&F locations (which is not the case as of now). This may pose an issue of additional working capital blockage," viewed Subramaniam.

Ramesh Agarwal, Chairman, Agarwal Packers and Movers Ltd (APML), speaking about GST, during the foundation day of APML, informs that the new tax regime they could offer to Virtual Warehousing Solution (VWS) to big companies. He says, "Consumers will be surprised to know that the logistics cost for our customers will actually come down by eight per cent even as they are catered to a superior and more efficient service."

Hence, pharma companies are trying to upgrade their ERP systems and enhance warehousing capabilities to equip themselves to comply with the upcoming GST guidelines in the shortest possible time. Thus, a lot of advantages will come the way of pharma players after the GST roll-out. Yet, another one of them is that it may correct the inverted tax structure which has plagued the sector for a long time.

Reversing Inverted tax structure

Inverted duty structure in excise taxes, i.e., higher rate of taxes (12.5 per cent) on inputs vis-à-vis lower rate of six per cent on formulations has negatively impacted the sector. The GST law provides for a refund of accumulated credit due to an inverted tax structure. This is a welcome step for the pharma sector. However, it will be better to wait and watch, inform experts.

"The pharma sector has always been affected by an inverted tax structure. In this scenario, the tax cost of inputs is higher than the tax cost of outputs. This has affected domestic manufacturers as the inverted tax structure has resulted in blockage of accumulated input credit. Currently, the credit is merely on paper since there is no refund available for such credits. The GST will be a boon for such manufacturers as it may completely abolish the inverted tax structure or will release the blockage of credit accumulated in the form of refund as stated in the model GST law," Dalvi informs.

Explaining how the inverted tax structure discourages domestic value addition and promotes imports, Subramaniam says, "At present, APIs attract an excise duty of 12.5 per cent, while formulations are subjected to an excise duty of six per cent. This often leads to accumulation of credit which ultimately becomes cost to the manufacturer. In this context, the model GST law provides for a refund of accumulated credit on account of an inverted tax structure. However, it would be better if, in the first instance itself, the GST regime does not provide for an inverted tax structure."

Pricing concerns

Though the pharma sector finds the new tax reform a good step forward, veterans also recommend certain suggestions to plug certain gaps in the law.

The pharma sector unanimously voice their concern that if the rates exceed 12 per cent, price of various drugs may rise in the short-to-medium term. They suggest that the rates should remain at 12 per cent to keep the impact on pharma pricing neutral. They also believe that if appropriate exemptions are made by the GST council then the prices of drugs may remain stable for a long term.

Experts express concerns on the price of life-saving drugs which currently enjoy tax exemption. They hope that they continue to enjoy the benefits as this will ensure that the impact of the new tax regime on the cost of healthcare to the patients remains positive. However, if medicines are subject to a higher GST rate, regulatory restrictions in India with respect to increasing the MRP for notified drugs, may pose a challenge to the industry.

"Presently, unless exempted, pharma products attract an excise duty of six per cent computed on MRP as reduced by 35 per cent. It further attracts VAT of five to six per cent depending upon the state on the selling price, including excise duty. Moreover, for interstate transactions, two per cent CST is applicable. Going forward, GST (both Centre and State) will be applicable on transaction price with seamless credit available throughout the value chain. The cascading effect present under current tax regime is expected to get addressed under GST. Thus, a rate of up to 12 per cent is expected to keep price of drugs neutral, beyond that it may have inflationary effect," explains Subramanian.

Apart from prices, the pharma sector also insists that in public interest, all anti-cancer drugs, products made from human blood plasma, drugs covered under Drug Price Control Order (DPCO) or under Essential Commodities Act, be kept free from tax. Instead of giving exemption, these drugs should attract zero rate of tax under GST. This will enable manufacturers to take credits of inputs and input services used for manufacturing these medicines and in the true sense, make life-saving drugs available to patients at affordable prices.

Insisting that the National List of Essential Medications (NLEM) must be exempted from the GST regime, Chandra says, "The drugs used to treat epidemics such as dengue, malaria, chikungunya, diphtheria, etc. must be kept out of the GST regime. India also has a huge burden of disorders like diabetes and cardiovascular diseases (CVDs). It will be a welcome step if the common drugs used to treat these are kept out of the GST regime for a long term."

Citing that there is a proposal to keep life-saving drugs and the physician's sample out of the purview of GST, Varma says, "We have to find out what the exact rate is and what comes under exemption finally. Any form of direct or indirect GST on free supplies could have a significant impact on the sales and promotional spend of pharma companies, specifically those introducing new drugs. Medical professionals use these free samples to distribute and gain first-hand experience on the performance of the drugs. Model GST law provisions for free supply of drugs should be taxable. Hence, free samples given as physician's samples for promotion could attract GST."

A growth engine

As a whole, GST will open a vista of opportunities for the pharma sector by harnessing them to digital prowess, a positive trigger which needs to be duly supported with clear government policies, initiatives and approval mechanisms to promote pharma sector in India and achieve the target, inform experts.

According to KPMG, the Indian pharma market is expected to grow over 15 per cent per annum by 2020, which in value terms will make it a \$55 billion industry. With new GST in the pipeline, the pharma sector is expected to foster exponentially as it will lead to ease of doing business. GST will ensure to bring out tax savings in multiple levels of the supply chain.

"Many pharma companies have been working in internal silos. GST will push them to undertake steps to streamline their operations. In addition to taxation, GST also brings the opportunity to look at various business processes with a much holistic approach. Pharma companies will embrace this change and growth expectations will be achieved," says Chandra.

Subramanian sums up, "We have to wait and watch on the decisions taken by the GST Council on the simplified tax issues such as rate of tax and exemption, list to understand the full impact etc. With simplified tax structure, one country one tax rate and automated compliances, GST has given a hope that it will have an advantage over current regime."

prathiba.raju@expressindia.com