

Impact of GST on Pharmaceutical Industry

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1. Indian pharma industry is one of the most regulated industries. The prices of certain medicines are capped by the Govt, i.e, National Pharmaceutical Pricing Authority (NPPA). Further, The Drug Price Control Order 2013 (DPCO) requires the mentioning of Retail Sales Price (RSP) inclusive of all taxes on the medicaments including outer packings. Any change in the rate of tax on the medicaments as well as Active Pharmaceutical Ingredients (API) / bulk drugs will affect the manufacturer and consumers.
2. Currently, medicaments falling under chapter heading 3003 and 3004 are generally liable for excise duty at the rate of 6%. Certain medicaments are exempted from excise duty also. Area based excise exemptions are largely availed by many pharmaceutical industries. The inputs required for manufacture attracts 12.5% excise duty. Due to this invert duty structure and exports, in many cases there is accumulation of the cenvat credit which is a major concern faced by the industry. MRP based valuation is applicable to medicaments and abate is 35%. Effectively the excise duty is 3.9%.
3. Concessional rate of VAT is applicable on medicaments. In Maharashtra, VAT rate is 6% and in Karnataka, it is 5.5%. The medicaments are exempted from octroi.
4. Certain food supplements (nutraceuticals) are also manufactured by pharma companies which attracts full rate of excise duty i.e, 12.5% and VAT 13.5% in Maharashtra, 14.5% in Karnataka.
5. It is very common practice in pharmaceutical industries to get the final products manufactured under job work, here it is typically known as 'Loan License'. Import of medicines is also a very common practice. However,

certain process like, altering the MRP, relabeling, repacking for retail sales etc amounts to manufacture under central excise.

6. It is a general practice in pharmaceutical industries to distribute Physician's Samples (PS) to medical fraternity. Presently excise duty is being paid and VAT is not applicable.
7. There is no direct sale of medicaments. Generally, medicaments are sold by manufactures to Distributors (also known as Stockists), distributors sell to Chemists and Chemists sell the medicines to patients upon the prescription by the doctors. Nutraceuticals can be sold over the counter. The margin to the distributors is 10% of their sales and margin to the Chemist is 20% of their sales. Stock transfer is also generally followed. The distributors and chemists are registered under VAT laws but not under Central Excise. The medicaments have defined expiry date and expired medicaments is returned back to the manufacturer who destroys them after following the prescribed procedure.
8. Classification of the medicaments as per the Central Excise Tariff is always a subject matter of litigation due to its complexity. The ingredients or contents, the application or end use etc factors for classification.
9. Under GST, the general rate applicable to medicaments is 12% and GST applicable for API is 18%. The problem of accumulation of Input Tax Credit (ITC) on account of invert rate structure is going to continue.
10. Manufacturing units set up in certain areas of Himachal Pradesh & Uttarakhand are exempt from excise duty (area based exemption) at present. Many pharmaceutical industries have manufacturing units in such places and currently enjoying the excise duty exemption. These exemptions are unlikely to continue in GST. The state Govt. may come out with some compensatory measure till the sunset period.
11. Batch failure is very common in the manufacturing of pharma products. Since it is a process loss, no cenvat credit is required to be reversed at present. However, in GST if the input is lost or destroyed, no ITC is available.
12. Further, quality control is an integral part of manufacture. Therefore, the finished products used for quality control or kept as sample till its expiry period is not liable for excise duty unless the same is removed outside the factory. Under GST, even if the same are sent out for quality test GST may not be applicable since it does not amount to supply.

13. There are other factors which may contribute the impact under GST. The seamless credit under GST per se may not add anything to the quantum of present VAT set-off and cenvat credit. Reversal of VAT set off in case of stock transfer and CST liabilities which are required currently, add to the margin of the manufacturers under GST.
14. Distribution of physician's samples is not free from any issue in GST. As per provisions related to input tax credit, ITC is not available on goods disposed of by way of gift or free samples. As per the provisions related to supply, disposal of business asset without consideration is liable for GST. The term business asset is not defined in GST, whether it is capital assets only or current assets also included. Clarification is required about the implication of ITC or GST on this.
15. Job work can continue as before under GST with some procedural changes. No botheration about the processes which are amounting manufacture, since concept of manufacture is absent in GST. Pharma companies can import or buy in bulk quantities and do the packing or repacking the same for retail sale without any difficulties. The business operation can be restructured conveniently. Classification remains to be crucial under GST also, litigation may continue. Transportation cost is likely to come down on account of removal of check posts at state borders and octroi check posts.
16. Returning of expired goods or near expiry goods after specified period of their supply will amount to taxable supply in GST. The return of such goods can be made under the cover of Debit Note/Credit Note and included in the return before end of September or filing of the annual return, whichever is earlier. In such cases, the supplier can reduce his GST liability provided the recipient reverses the credit. The returns made after this period, would amount to supply and GST is required to be charged by the chemists/stockists. Since such goods are required to be destroyed, the manufacturer shall not be eligible to take the credit of GST paid on returned goods.
17. There are concerns of transitional issues to the stockists and chemists. They are currently not liable to be registered under central excise hence not taking the cenvat credit. They need to discharge GST at full rate on the stock sold after appointed day whereas they have taken only setoff under VAT laws. The transitional provision, Sec 140(3) of CGST Act, provides that a person who was not liable to be registered under laws passed by the

Parliament, shall be entitled to take the credit of eligible duties on stock held in his electronic credit ledger subject to the conditions that, such goods held in stock are supplied on payment of GST, duty paid documents are available with him and such documents are not older than 12 months. However, going by the strict interpretation, the above provision may not be applicable to stockists and chemists since they are presently registered under CST Act and this transitional provision is applicable only in case of un-registered persons under any laws subsumed, manufacturers of exempt goods, 1st Stage and 2nd Stage Dealers, importers, depot of Mfgrs etc. The other transitional provision which provides for 40% of the GST paid is also not available to the stockists and chemists since one of the conditions there in is that this credit needs to be passed on to the buyer, which will not happen here. The possibilities of registration of the stockists and chemist as 1st stage and 2nd stage dealer may be thought of to overcome this issue! This credit issue is bound to reduce the sales during transitional period since every stockist and chemist would like to keep the minimum stock of goods. The manufacturers may have to bear this loss of credit to maintain the sales volume.

18. Recently the National Pharmaceutical Pricing Authority (NPPA) has issued the order vide its Office Memorandum dated 09.06.2017 stating that MRP shall be exclusive of GST in case of scheduled formulations. The computation of the factor to arrive at the revised ceiling price would be as under;

a.	Ceiling price fixed before 30.06.2017 (incl. of excise duty)	100.00
b.	Add: Local Tax/VAT (@5%)	5.00
c.	MRP (Inclusive of all taxes)	105.00
d.	Less: Excise duty (6% on 65% of MRP)	4.095
e.	Less: Local Tax /VAT as applicable	5.00
f.	Revised ceiling price to be re-notified (excluding GST)	95.905
	Factor (f/a)	0.95905

In case of scheduled formulations, which are exempt from excise duty, no multiplication factor would be applicable, the existing ceiling price would be ceiling price exclusive of GST.

