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Impact Of Budget On Pharmaceutical Industry In India

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ABSTRACT

Research and development (R&D) in the pharmaceutical sector received significant impetus through the extension of 200% weighted deduction on in-house R & D expenditure. Capital expenditure on R & D for an industry such as pharmaceutical is critical for the growth of the industry and the proposal is expected to boost the active pharmaceutical ingredient (API) market in India. Implementation of advance pricing agreement is also expected to help the pharmaceutical industry to reduce its tax litigation cases. On the other hand, excise duty hike is expected to increase raw material prices for the industry.

Keywords :Major budget proposals that affected the pharma companies , Indirect tax proposals Budget scenario , Service tax

tIntroduction :

Our honourable finance minister presented the budget for the financial year 2012-2013 on 16th March 2012. For the stock markets, it turned out to be a non-event. However, few budget proposals have affected various sectors in a small way. In this article, we discuss the impact of budget proposals on Indian pharmaceutical sector.

Major budget proposals that affected the pharma companies:

1. The budget has proposed to tax all companies at the minimum alternate tax (MAT) of 18.5%. This will also include the partnerships firms based in the special economic zones (SEZ). Sun pharma will face a major hit as two of its facilities in Jammu and Sikkim enjoy benefits by avoidance of taxes as they do not pay the MAT.
2. The budget has further announced to continue the deduction of 200% for in-house R&D for another 5 years. The previous scheme was supposed to expire on 31st March 2012 which now stands extended to 31st March 2017. Large pharma players like Dr Reddy, Sun Pharma, Glenmark and Biocon will thereby continue their tax benefits on R&D expenses.
3. The budget also increased the excise duty on drug formulation and Active Pharma Ingredients (API) from 5% to 6% and 10% to 12% respectively. However, the companies have manufacturing facilities in the SEZ area will not be affected as they do not have to pay the excise duties. According to us, this will not have much impact on most of the companies in the pharmaceutical space.

Overall, the budget did not have anything encouraging for the pharmaceutical sector. However, the fact that there were no negative surprises itself has come as relief. The extension of deductions for the in-house R&D was a very good move and this will go a long way to incentivize the R&D within Indian pharmaceutical sector.

Indirect tax proposals Budget scenario

The pharmaceutical and healthcare sector is on the threshold of greatness. India is fast becoming a hub for medical tourism and facilities in India are considered at par with the best across the globe. The Finance Minister seems to share the sector's optimism and combating malnutrition and female healthcare was clearly on the agenda.

Research and development (R&D) in the pharmaceutical sector received significant impetus through the extension of 200% weighted deduction on in-house R & D expenditure. Capital expenditure on R & D for an industry such as pharmaceutical is critical for the growth of the industry and the proposal is expected to boost the active pharmaceutical ingredient (API) market in India. Implementation of advance pricing agreement is also expected to help the pharmaceutical industry to reduce its tax litigation cases. On the other hand, excise duty hike is expected to increase raw material prices for the industry.

Service tax

Rate of Service tax is proposed to be increased from 10% to 12% Introduction of the Negative list concept Specific exemption provided for healthcare services .

Item	Current rate	Proposed rate
Probiotics	10%	5%
Life saving drugs	10%	5%
Iodine	5%	2.5%
Isolated soya protein	15%	10%
Soya protein concentrate	30%	10%

Positive

- Currently in house R&D expenses are eligible for the weighed deduction at 200% of the incurred costs under section 35(2AB). This benefit is expiring by 31 March, 2012. The clause has now been extended for further period of five years i.e. up to 31st March, 2017. This will be the only announcement for the Pharma sector and we believe this could benefit all major companies like Dr Reddys laboratories, Lupin, Sun Pharma, Cipla, etc.
- The basic customs duty on Iodine is reduced from 5% to 2.5% which will benefit the healthcare segment as it has a role in the diagnostic tests.
- Custom duty on probiotics is reduced from 10% to 5%, which is of little benefit to the companies making nutritional supplements, clinical trials etc.
- Custom duty on six specific life saving drugs/vaccines and their bulk drugs is being reduced from 10% to 5%, the excise duty has also been removed. This will prove to be good for the healthcare segment due to the growth in the infectious diseases.
- Full exception from the basic custom duty and CVD is provided to certain medical products like steel tube and wire, cobalt chromium tube, Hayness alloy-25 and polypropylene mesh used for Coronary stent, artificial heart valve etc. We see positive impact of this on healthcare sector as there is growth in the lifestyle diseases and surgeries related to the same.

Negative

- The Pharma industry was seeking addition of the non in-house R&D expenses like clinical trials, land, building etc in to the section 35(AB). This has been ignored by the finance ministry and we believe it is negative to the sector as we mentioned in the opening paragraph.

- What also disappoints to the Pharma sectors is the no announcement on the tax sops to the large scale monoclonal antibody plants. The current import duty of 30% on the imported equipments required to manufacture monoclonal antibodies has also not been reduced.
- The excise duty has been increased from 10% to 12% which is negative to the Pharma sector as well. The sector is already recognized as a defensive sector and hence levy of the excise duty may reduce the profits.
- The service tax on the first year's premium on the health insurance policies has been increased from 1.5% to 3%. For the subsequent years it will be 1.5%. the healthcare policies are one of the main drivers of the healthcare sector. With the increased service tax the already slowed down insurance sector may see decreased volumes of the policies impacting the hospitals revenues.

Conclusion:

We believe that this budget has failed to deliver the long term pending demand of the Pharma sector to include non in-house R&D expenses. With the Indian Pharma companies spreading the wings on the global canvas, R&D expenses have become very crucial. Now with the Indian Pharma market also getting competitive, the growth of the domestic Pharma sector will be dependent on the innovation and hence this will not be positive on the sector. Beside the industry was expecting the reduction of the excise duty on Active Pharma Ingredients and formulations which instead has been raised to 12% increasing negative sentiment.

We believe that the status of infrastructure sector has not been awarded to healthcare sector which otherwise would have been a boaster dose for overall healthcare facilities in the country. Though healthcare has got few things in its side in this budget which we believe is good for the sector.