



# Union Budget 2010-11

## Pharmaceutical Industry

The Indian Pharmaceutical industry is now the third largest producer of drugs and pharmaceutical in the world.

This sector has outperformed itself and moved India up the ladder from being the fifth largest producer in the previous year to now being the third largest producer. The primary catalyst for this augmented growth is the surge in exports which was around 25% in 2008-09.

Exports typically constitute drug intermediaries, active pharmaceutical ingredients and finished dosage formulations. It is expected that these pharma exports largely to USA, Germany, Russia, UK and China will reach US\$20 billion by 2015.

The Indian pharma industry is also increasingly being seen as a global platform for clinical trial.

The key parameters which influence this sector in India are:

- R&D costs
- Regulated pricing
- Cut-throat competition
- Lack of stringent product patenting
- Varied size of entrepreneurs



# Key Expectations

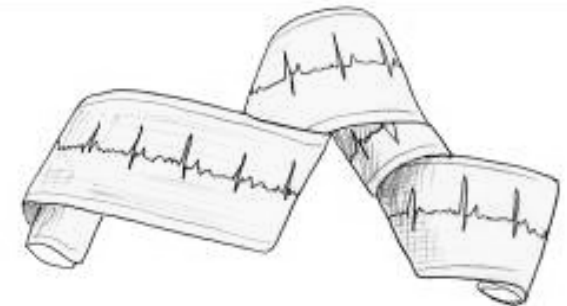
- In order to keep up the pace of R&D within the industry , **the weighted deduction on incurring R&D cost of 150% needs to be at least doubled** and 10A/10B extended for another 10 years
- Scope of expenses covered under R&D needs to be broadened to include **expenses incurred outside India for high end research**
- **Minimum Alternate Tax (MAT) rates need to be consistently lowered** because of huge gestation period in the industry
- **Removal of excise duties across the board for all essential drugs considering the span of such drugs and its importance**
- Expenses incurred on environment, health and safety norms need to be subsidised keeping in mind the low margins in the industry

## Key Expectations

**Incentives for undertaking R& D activities**

**Benefit of 10A/10B for exports**

**Customs/Excise duty exemption for life saving drugs**



# Direct Tax Proposals

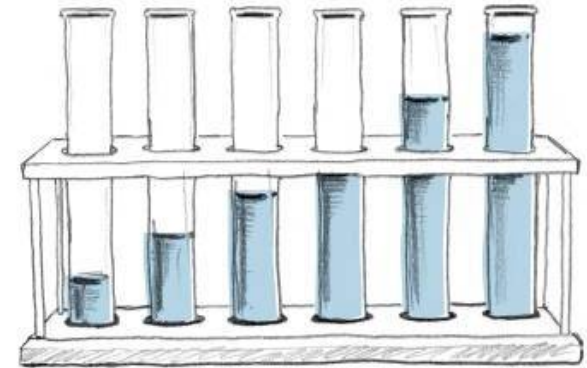
- MAT rates increased from **15% to 18%**
- Retrospective amendment made in section 10AA i.e. units in SEZs. The tax benefit under the said section to be computed taking "**total turnover of the undertaking**" as the denominator instead of "total turnover of the business of the assessee" **with effect from 01 April 2005**, i.e. the year in which SEZ Act was introduced and not from the last financial year, when the Finance bill had brought in this clarification
- **Benefit of weighted deduction for expenditure on in-house R&D is proposed to be increased to 200% from existing 150%**
- **Weighted deduction** on payments made to specified entities for **use in approved scientific research programmes** is proposed to be **enhanced from 125% to 175%**

## Amendments

**MAT rate increased to 18%**

**Retrospective amendment with effect from 01 April 2005 in section 10AA**

**Weighted deduction on R&D expenses incurred by pharma companies increased to 200%**



# Indirect Tax Proposals

The following changes in duty rate have been introduced in the Budget 2010:

## Medical, surgical, dental and veterinary equipment rationalised across different products instead of different rates earlier

1. 5% basic customs duty
2. 4% CVD/ excise duty
3. Nil special additional customs duty

**Effective duty of 9.2%**

## Parts and accessories required for the manufacture of medical equipment

1. 5% concessional basic customs duty introduced
2. Nil special CVD

## Spares for the maintenance of medical equipment

Concessional customs duty exemption withdrawn

## Clinical diapers / Napkins

Excise duty increased from Nil to 10%

## Specified medical devices, assistive devices, rehabilitation aids and other goods for disabled

1. Full exemption from basic customs duty retained
2. Full exemption from and CVD/excise duty retained

## Orthopedic implants

1. Cobalt-chrome alloys special grade stainless steel etc. for the manufacture of orthopedic implants exempted from basic customs duty
2. Subject to actual user condition

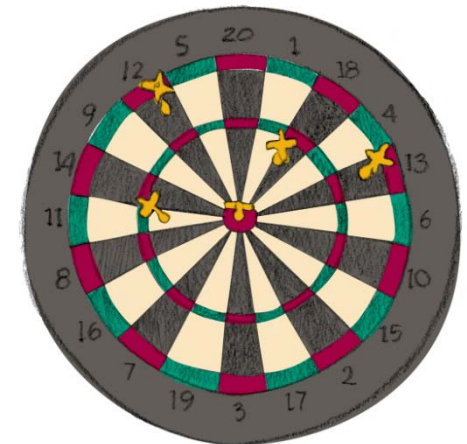
## Service tax on Corporate health check up schemes

1. Service tax now leviable on payment made by the business entity to hospitals or medical establishments
2. Service tax is also imposed on the medical charges paid by the insurance companies to the hospitals on behalf of business entities for their employees.
3. Service tax not leviable on amount paid by the individuals to hospitals or medical establishment



# Expert Viewpoint

- Increase in weighted deduction on expenses incurred on in house R&D demonstrates government's firm dedication to boost investment in this sector. **Increase in the scope of research organisation and increase in the weighted deduction on expenses incurred on outsourced research would surely act as a catalyst to the industry's growth.** Due to globalization and sophistication, there are huge expenses which are incurred by this industry in foreign countries. The budget 2010 did not provide any relief in connection with such expenditure, which was eagerly awaited
- If one would have to analyse the impact of Budget 2010 on this sector it can be considered as **Neutral**. While with one hand the government threw open the card of a **higher weighted deduction on expenses incurred on in house R&D**, with the other hand the government **grabbed the benefit by increasing MAT**. The increase in MAT rate by 80% over the past 2 years (i.e. from 10% in 2008 to 18% as proposed) will definitely affect the industry and the allied sectors since in generics and formulations this is a low margin business and molecular development requires a considerably long gestation period.
- **Companies not under MAT**, have benefited due to reduction on the **corporate income-tax surcharge from 10% to 7.5%**, on the other hand these companies would also get impacted due to the **increase in the peak rate of excise duty from 8% to 10%**, which increases the input cost of their formulations.
- From an industry perspective, although there is **an increase in the effective tax rate (Refer table next slide) by a marginal 10%**, the same would get offset by an overall boost to the **pharmaceutical industry due to the encouragement given by the government through a higher weighted deduction on inhouse R&D expenditure**, which will effectively move India higher on the scale of being a global R&D hub.

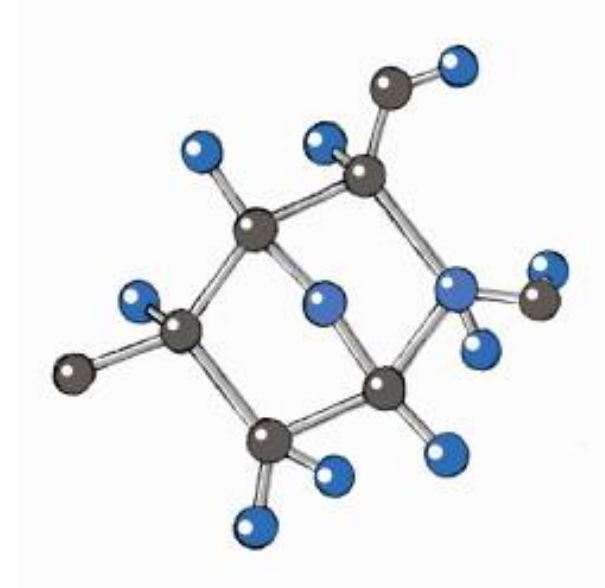


# Expert Viewpoint

## Hypothetical impact on effective tax rate of pharma companies (under MAT):

		Pre-budget	Post-budget
Turnover	(A)	1000	1000
Profits before Weighted deduction on R&D	(B)	100	100
R&D Expenditure	(C)	10	10
Weighted deduction	(D)	15	20
Profits post weighted deduction	(E)=(B)-(D)	85	80
MAT%	(F)	15%	18%
Surcharge%	(G)	10%	7.50%
MAT	(H) = (E)*(F)	12.75	14.4
Surcharge	(I) = (H)*(G)	1.28	1.08
Total Tax	(J) = (H) + (I)	14.03	15.48
<b>Effective Tax Rate</b>	<b>(K) = (J)*A</b>	<b>1.40%</b>	<b>1.55%</b>

Increase in effective rate =  $(1.55-1.4)/1.4 = 10.71\%$



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