

28 February 2011

Budget PLUS 2011 Tax Alert

Life science industry

Foreword

The Finance Minister presented the Union Budget 2011 on 28 February 2011. With the Gross Domestic Product estimated to have grown at 8.6% in real terms in 2010-11, the Finance Minister rightly mentioned that India stands on the threshold of a decade which presents immense possibilities.

With the introduction of Direct Tax Code (DTC) on track (1 April 2012) and the framework preparation for Goods and Service Tax in full progress, the Finance Minister has restricted the Budget proposals to streamline the existing laws to the impending legislations.

Direct Tax Proposals

Weighted deduction for payments in connection with Research and Development

Continuing its efforts to promote innovation, the government has proposed an increase in weighted deduction available for payments made to National Laboratories, Universities, Indian Institute of Technology, or specified persons for scientific research undertaken under approved programs, inter alia, by pharmaceutical and bio-technology companies, from 175% to 200%.

However, no increase has been proposed for other category of weighted deductions available for specified expenditure/ payments.

Minimum Alternate Tax (MAT)

Rate of MAT

Under MAT provisions, a company whose income tax liability under normal tax provisions is less than 18% of its book profit is liable to pay MAT on its book profits.

The existing rate of MAT of 18% of book profits has been marginally increased to 18.5%.

Ambit of MAT

Currently, units operating in a Special Economic Zone (SEZ) have been specifically kept out of the purview of MAT. However, with the objective of streamlining the existing laws with the impending DTC, units operating in a SEZ are now proposed to be brought within the ambit of MAT provisions.

Typically, companies subjected to MAT could include pharmaceutical companies which are operating in SEZ units and enjoying tax concessions or holidays.

Further, Limited Liability Partnerships have also been brought under the purview of MAT.

Tax Rates

Corporate tax rates

The corporate tax rate for domestic companies remains unchanged at 30% and for foreign companies at 40%.

Surcharge on income-tax

In continuation with the initiative of the Government to phase out the surcharge levy, it is proposed to reduce the surcharge from existing 7.5% to 5% (ie for domestic companies having a turnover of more

than INR 10 million). Thus, the effective tax rates for domestic companies shall reduce from 33.22% to 32.445%.

The rate of surcharge for foreign companies is proposed to be decreased to 2% from 2.5%. Thus, the effective tax rates for foreign companies shall reduce from 42.23% to 42.024%.

Transfer Pricing

Due date for filing tax returns have been extended to 30 November in case of corporates filing transfer pricing certificates. This above amendment would be applicable for returns to be filed for financial year 2010-11 onwards.

Further, the benefit of +/-5% variation is proposed to be changed to a percentage to be notified by the Government.

Additionally, the power provided to transfer pricing officers has been proposed to be expanded to include power to conduct survey and to consider international transactions not referred to them.

Personal tax rates

While there have been no changes in the tax rates, the basic exemption limit for individuals have been raised to INR 180,000 from INR 160,000.

Further, the age threshold for senior citizens has been revised to 60 years from 65 years and the basic exemption limit raised to INR 250,000 from INR 240,000.

Additionally, the basic exemption limit for senior citizens aged 80 years or more, has been raised to INR 500,000.

Indirect Tax Proposals

Customs Duty

- ▶ Basic Customs Duty ('BCD') on specified raw material namely Polypropylene and stainless steel strip capillary tube for manufacture of syringes, needles, catheters, cannulae has been reduced from 10% to 5%. Further, Countervailing duty ('CVD') has also been reduced from 10% to 5% and an exemption from Special Additional Customs duty ('SACD') of 4% has been made on such specified raw material. However, the said concession / exemption would be subject to actual user condition.
- ▶ Patent & Propriety medicines imported for retail sale (falling under Customs and Excise Chapter heading 30) exempted from SACD of 4%.
- ▶ BCD on the following life savings drugs specified below and their bulk drugs reduced from 10% to 5% with exemption from CVD of 10%
 - ▶ Rasburicase
 - ▶ Nilotinib
 - ▶ Pneumococcal sacchride Conjugate Vaccine absorbed 13-valent suspension for injection
 - ▶ Micafungin sodium for injection
- ▶ BCD on lactose for use in manufacture of homoeopathic medicines has been reduced from 25% to 10%.

The above amendments are likely to have a mixed impact on life science industry depending on the current classification of the product and the tax rates.

Central Excise Duty

- ▶ The merit rate of excise duty (CENVAT) for non petroleum goods has been increased from 4% to 5%.

On account of this amendment, all the drugs and medical equipments hitherto attracting basic excise duty of 4% would now attract 5%. Therefore the effective duty rate would increase from 4.12% to 5.15%.

- ▶ A number of exemptions from excise duty have been withdrawn. A nominal duty of 1% ad valorem has been imposed inter alia on following items with a condition that no credit of duty paid on input and input services is taken.
 - ▶ Medicaments (including those used in Ayurvedic, Unani, Siddha, Homeopathic or Bio-chemic systems), manufactured exclusively in accordance with the formulae described in the authoritative books specified in the First Schedule to the Drugs and Cosmetics Act, 1940 (23 of 1940) or Homeopathic Pharmacopoeia of India or the United States of America or the United Kingdom or the German Homeopathic Pharmacopoeia, as the case may be, and sold under the name as specified in such books or pharmacopoeia (falling under Excise Chapter heading 30);

- ▶ Intravenous fluids, which are used for sugar, electrolyte or fluid replenishment (falling under Excise Chapter heading 30);
- ▶ Vaccines (other than those specified under the National Immunisation Program) (falling under Excise Chapter heading 3002 20 or 3002 30 00);
- ▶ Anaesthetics (falling under Excise Chapter heading 30).
- ▶ Excise duty on sanitary napkins (falling under Chapter Heading 4818 40 90), baby, and clinical diapers and adult diapers (falling under Chapter Heading 4818 40 10) reduced from 10% to 1% subject to condition that Cenvat credit on inputs / input services / capital goods would not be available.

However, in case the manufacturers of medicaments, anaesthetics, intravenous fluids, sanitary napkins, baby and clinical diapers and adult diapers intends to avail Cenvat credit, subject to conditions, then they would be required to pay excise duty at the rate of 5%.

All of the above customs and excise duty related changes are applicable from 1 March 2011.

- ▶ Definition of 'inputs' under central excise has been revised. Henceforth all goods used in the factory of manufacturer of the final product, except those specified in the negative list and goods having no relationship whatsoever with the manufacture of final product, would qualify for treatment as inputs. This would be effective from 1 April 2011.

Service Tax

- ▶ The scope of health services has been expanded to include the following:
 - ▶ All services including diagnostic services, provided by a centrally air-conditioned (wholly or partially) clinical establishment having more than 25 beds for in-patient treatment;
 - ▶ Diagnostic services being provided by a clinical establishment with the aid of laboratory or other medical equipment;
 - ▶ Services provided by a doctor not being an employee of a clinical establishment from a premises of such establishment.
- ▶ Further an exemption of 50% of the value of service has been made available for the purpose of levy of service thereof.

In view of the comprehensive coverage of health services mentioned above, the existing health services where payments are required to be made directly by the insurance companies or business entities would no longer be operational.

The changes in the health services would come into effect from a date to be notified after the enactment of Finance Bill 2011.

- ▶ The Point of Taxation Rules 2011 have been framed and made effective from 1 April 2011. These rules would determine the point in time when the services shall be deemed to be provided. The general rule will be that the time of provision of service will be the earliest of the of the following date:

- ▶ Date on which service is provided or to be provided
- ▶ Date of invoice
- ▶ Date of payment

Definition of 'input service' has also been rationalized to impart clarity and achieve congruence with the definition of inputs. This would be effective from 1 April 2011.

- ▶ Rule 6(5) allowing full credit in relation to specified 17 services deleted with effect from 1 April 2011.
- ▶ Trading activity, services with partial value exemption included in the definition of exempted services with effect from 1 April 2011.
- ▶ Amount payable under Rule 6(3)(i) (ie amount to be paid by service provider availing full credit on exempted services) reduced from 6% to 5%.

Other Amendments

- ▶ The Standards of Weights and Measures Act, 1976 has been repealed with effect from 1 March 2011 and replaced by 'The Legal Metrology Act, 2009'. Section 4A of the Central Excise Act is being amended to incorporate reference to the new Act. This change would be effective from the date of enactment of the Finance Bill 2011.
- ▶ The interest rate for delayed payment of service tax, excise and customs has been increased to 18% with effect from 1 April 2011.

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