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EXCISE EXEMPTION

MINISTERS' PHARMA ROW RAGES ON

*Finance Minister P. Chidambaram shoots down the PM's directive on relief to small-scale pharma industry, reports **Vikram Jit Singh***

The face-off between two Union ministries on the issue of relief to small-scale industry (SSI) after the levying of excise duty based on the maximum retail price (MRP) on medicines has beaten a resolution despite the intervention of Prime Minister Manmohan Singh. The PM had accepted in total the recommendations of the Economic Advisory Council (EAC) to "increase the abatement" for small-scale pharma industries from the existing 40 percent to 60 percent and forwarded these to the Department of Revenue for implementation. However, Union Finance Minister P. Chidambaram in his response through a letter to the PM expressed his "difficulty in providing a separate rate of abatement for SSI as none of the 103 other commodities covered under MRP-based excise have two rates of abatement." This objection has been made by Chidambaram despite the fact that a separate rate of abatement of 60 percent was arrived at after a consensus among Union Revenue Secretary KM Chandrashekar, EAC Chairman C. Rangarajan and Union Secretary, Chemicals and Petro-chemicals (CPC), Satwant Reddy, in November 2006.

The other reasons cited by Chidambaram in his December 2006 letter for rejecting the PM's directive were that the EAC had circumvented the abatement committee headed by Member, Excise, Central Board of Excise and Customs PC Jha, and also on the plea that the "rate of abatement is not discretionary". The fm's obdurate stand is also made clear when he states that he would personally "come over" and elaborate on the issue to the PM. After the fm's letter derailed the process, a meeting under the chairmanship of the PM's principal secretary was held in Delhi on December 24, 2006 with the EAC, revenue department and CPC department to find a way out. But the meeting only ended up putting a stamp on the roadblock created by the fm using the pretext of the coming Assembly polls.

MRP-based excise introduced by the finance ministry in January 2005 had led to stiff opposition from the chemicals and fertilisers (CF) ministry on the



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grounds that it had failed to realise its twin objectives of checking profiteering and evasion of excise duty on contract manufacturing. The twin objectives of MRP-based excise got defeated primarily because it led to a flight of the pharma industry to tax-holiday hill states. After a series of missives from Chemicals and Fertilisers Minister Ram Vilas Paswan to Chidambaram went unheeded, Paswan shot off a letter to the PM bringing to his notice the adverse effect on prices, which went against the upa's Common Minimum Programme (CMP) of providing quality drugs at reasonable prices.

What is most surprising about the fm's letter to the PM is that the issue of circumventing the abatement committee was cited despite the fact that it held two meetings, on November 14, 2006 and December 5, 2006, on the question. Overruling the CF ministry's proposal of providing 80 percent abatement to SSI, the committee had found from available data that under 70 percent abatement was acceptable, which was consistent with the EAC's recommendation of a 60 percent abatement.

Another contradictory vein in Chidambaram's letter is on the issue of abatement about not being "discretionary". This was exposed by the fact that while levying MRP-based excise the CF ministry, which regulates the pharma sector, was not even consulted when the abatement was fixed initially at 35 percent and subsequently increased to 40 percent by the finance ministry.

Another contention in the letter, that two rates of abatement aren't prevalent for any of the other commodities covered under MRP-based excise, is invalid as no other industry is adversely affected by it.

In his earlier letter to the PM on July 19, 2006, Paswan had written that MRP-based excise coupled with excise exemption in the hilly states had "rendered pharma manufacturing uncompetitive in areas outside tax-exempt states." The letter was explicit on the excise policy's negative impact, which the finance ministry's revenue department has stuck to despite representations against it from at least 10 chief ministers and 75 mps. It said: "It may be mentioned here that while on the one hand government would be losing excise revenue, on the other hand prices of some of the medicines being produced in tax-exempt states are higher than those in the rest of the country (due to non-charging of excise duty on MRP)." Paswan also dashed off a strongly-worded missive to Chidambaram bringing to his notice the resentment amongst state health ministers.

Reflecting the angst of the health ministers at the Pharma Advisory Forum meeting held in Delhi on 23 September, 2006, Paswan wrote to the fm that the states were charging only 4 percent value added tax on medicines, which was a lower rate considering the importance of medicines. However, the excise at 16 percent, which was earlier levied on the ex-factory price of drugs, has got aggravated due to the new modality of levying it on MRP, Paswan wrote. Citing the recommendations of the Dr Pronob Sen-led Task Force set up by the PM as per the CMP, Paswan sought a reduction in excise duty to 8 percent that would not only allow a level playing field but also provide a reasonable advantage to tax-holiday states.

As brought out earlier by Tehelka (May 6, 2006), it was shown how precisely MRP-based excise had not only led to a rise in drug prices but also spawned

huge profiteering by pharma majors migrating or outsourcing from tax-holiday states. Except for select pharma majors, who wield marketing muscle, other units have to sell their products at almost a quarter of the MRP in taxable states. They also have to keep their MRP low in view of the fact that the moment they increase it, the incidence of excise rises which makes their product more expensive for the trader to pick up. On the other hand, units in tax-holiday states have no restriction to keep their MRPs low as they do not face a rising tax incidence. This allows these units to mark their retail prices high and build a huge margin for the retailer. This factor severely disadvantages the units in non-tax-exempt states as retailers do not prefer to stock their products and because customers consider these as fake because of their low pricing.

The finance ministry's controversial stand on the MRP-based excise in the face of stiff opposition is weakened by the contradictions that riddle its rationale. In its reply to Karnal Pharma Manufacturers' Association under the rti Act on June 14, 2006, the Department of Revenue said that the revenue loss under the ex-factory price-based excise regime owing to the "wide variations between ex-factory prices and the assessable value of drugs for excise duty purposes resulting in disputes and litigations." In the same letter the revenue department contradicts itself by stating that the "MRP-based levy of excise duty on pharmaceuticals is a method of determination of assessable value and hence the question of revenue gain/loss is not an issue."

The Department of Revenue's objections to implement Dr Sen's recommendations are premised on inverted duty structure and credit accumulations, loss of revenue, SSI sector-specific solutions not being possible, and the SSI definition limit of Rs 4 crore worth of clearances (ex-factory sales).

The excise duty paid by a unit on raw materials purchased for producing medicines is deducted from the excise duty payable on the finished product. This deduction is called central value added tax (cenvat). The finance ministry is apprehensive that 16 percent being the excise rate on raw materials, the cenvat will exceed the duty payable in the event excise on finished goods is halved to 8 percent as per Dr Sen's recommendations. However, the Confederation of Indian Pharmaceutical Industry (CIPi) has allayed these apprehensions by its commitment not to avail of more than 50 percent rebate under cenvat compared to the excise payable on MRP.

Every SSI unit across all manufacturing sectors is allowed annual sales of Rs 1 crore free of excise levies. This is known as 'SSI exemption limit'. After the regime of MRP-based excise was introduced, this available relief, under the same limit of Rs 1 crore, got truncated as it was calculated according to the MRP. The finance ministry is averse to increasing this limit to Rs 5 crore as per Dr Sen's recommendations on the plea that it cannot be sector-specific, implying it would lead to similar demands from non-pharma SSI sectors. However, CIPi has emphasised that since the MRP-based excise has created a sector-specific problem peculiar to pharma SSIs, it was crucial to increase the exemption limit to ensure that the excise burden was restored to its pre-MRP levels.

The revenue department has also contended that the exemption limit can't be

raised to Rs 5 crore as units with annual sales of above Rs 4 crore are not considered SSIs and aren't eligible for availing the SSI exemption. However, SSI pharma unit-owners reiterate that the department makes all calculations on an MRP basis, so even this Rs 4 crore limit in actuality works out to about one-third under the new excise regime. The problem being peculiar to the pharma SSI sector, the Rs 4 crore limit also needs to be increased to make it equivalent in terms of ex-factory value. The revenue loss cited by the finance ministry when the issue relates to essential commodities like medicines seems illogical in considering that less essential commodities like toothbrushes, bakery items and textiles are taxed at a lower rate of 8 percent. The issue becomes more unsustainable considering the Centre's decision extending the sunset of tax holiday in hill states by three years.

The cornerstone of the finance ministry's MRP-based excise regime was to end evaluation disputes. Nearly two years of MRP-based excise has seen an upheaval in the pharma manufacturing sector and its retail markets. Despite several infirmities vis-a-vis the gains, it is not understood why the excise regime is being protected with such fervour by the finance ministry.

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