

# A study on embedded taxes in the healthcare sector of India

NATHEALTH - EY

March 2022





# Foreword

GST was a major indirect tax reform implemented in July 2017, which brought into significant gains across the sectors but at the same time eluded few sectors like healthcare services. Because of healthcare services being exempt from GST at the output, the taxes paid on input goods, input services and capital goods by healthcare establishments remain embedded and could not be offset against the output tax and therefore raising the healthcare costs. In this view, the healthcare services sector needs a rationalization of the current GST rate structure so that the healthcare sector could get rid of the embedded taxes problem.

The GST Council has recently created a Committee of Group of Ministers (GOMs) under the chairmanship of the Chief Minister of Karnataka, Shri Basavaraj Bommai to look at various GST rates for making suggestions on rate rationalization. In this context, NATHEALTH and EY established a collaboration and conducted a study of embedded taxes in the healthcare sector to identify the optimal GST rate for the healthcare sector which would help to pass through the embedded taxes on the inputs including pharmaceuticals, medical devices and other services flowing into the healthcare sector.

This report is a product of a detailed study by EY based on evidence collected from the hospitals and diagnostic centers subdivided into segments by size. The report provides some crucial insights about the quantum of embedded taxes in the healthcare sector. This study also establishes the template of how GST rates should be fixed. The suggestion is that sectoral rates should be finalized based on a study of the supply chain of inputs feeding into a sector and should be completely data driven.

We are grateful to Maj Gen (Prof) Atul Kotwal, SM, VSM Executive Director and Air Commodore (Dr.) Ranjan Kumar Choudhury VSM Advisor, Health Care Technology from National Health Systems Resource Centre. We are also thankful to the officials from the Ministry of Health and Family Welfare, Department of Pharmaceuticals and Department for Promotion of Industry and Internal Trade for their support and cooperation.

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# 1. Introduction

The Goods and Services Tax (GST) was a transformational tax reform which benefited the sectors across the spectrum. However, the benefits of GST have by and large eluded the healthcare services sector as majority of healthcare services are exempt under the current GST regime. One of the important objectives of GST scheme was to ensure free flow of input duty credit across the value chain. In view of this, a large number of exemption notifications were reviewed at the time of the implementation of the GST (including 299 Central exemptions and over 90 State exemptions). Thereafter, a significant number of exempted items were brought under the GST net.

However, important segments like healthcare services were kept on the exemption list. This was done on the assumption that a majority of healthcare establishments would not come under the GST regime and would be relieved of fulfilling a lot of GST related procedures like 'Registration' and 'filing of Returns'. Unfortunately, due to this, the most promising feature of the GST of facilitating smooth flow of input tax credit got restricted as most of the inputs procured by the healthcare establishments including medical equipment, consumables, labor and maintenance of medical equipment, rental services, housekeeping services, etc., bore the GST burden, but these taxes could not be set off against the output tax liability because the output healthcare services were exempt from GST. The blocked credit which remains unutilized in the value chain becomes a cost and gets passed on to the end user, raising the cost of healthcare services and thereby diluting the government objective of making India an affordable healthcare destination.

This point was also emphasized by the Former Chief Economic Advisor, Dr. Arvind Subramanian in the report on 'Revenue Neutral Rate on structure of rates on GST' released just before the implementation of GST that reducing exemptions on healthcare services under the GST regime would be more consistent with social policy objectives and therefore healthcare services should also be brought under the GST net, especially the private sector segments so that the burden of taxes on inputs could be relieved. The report mentioned that the taxes on healthcare services turn out to be quite substantial and the burden is higher for the bottom 40 per cent, as bulk of healthcare expenditure is on medicines (which are taxed at a higher rate than medical services), and particularly so for the bottom 40 percent.

In this background, it is important to revisit the existing GST rate applicable for the healthcare services in India with an aim to determine the most optimal GST rate structure for this segment which would help not only in transmitting the cost benefits of GST to this segment but would also facilitate in formalizing the healthcare segment further. However, to determine the appropriate GST rate structure for the healthcare sector, it is important to estimate the quantum of embedded taxes which remains blocked in the healthcare value chain and gets loaded in the healthcare cost, raising it significantly.

It is in this backdrop, EY had undertaken an exercise in collaboration with the Healthcare Federation of India (NATHEALTH) to study the issue of embedded taxes in the healthcare sector with a focus on two major segments - hospitals and testing labs under the healthcare establishment. This whitepaper presents a detailed analysis of the embedded taxes computed for both these segments in the subsequent section. Besides this, the whitepaper also brings out several interesting insights pertaining to pre-GST and post-GST incidence of duty comparison, key GST bearing inputs that contribute to the maximum proportion of embedded taxes, etc.

In the present scenario where the Government is thinking of conducting a large-scale GST rate rationalization exercise across sectors, this study on embedded taxes in the healthcare sector offers a great opportunity for stakeholders including the Government to relook and rationalize the GST rate structure in the healthcare sector to unlock the profound potential that India's healthcare sector possess. A stakeholder consultation on the findings of the study would certainly help to bring out plausible policy suggestions, which could be taken up for wider discussion with the government. The recommendations of the Fifteenth Finance Commission on the GST rate rationalization and the recent formation of a committee of Group of Ministers (GOM) in September 2021, headed by Karnataka Chief Minister by the GST Council to look into the GST rate rationalization issues has raised the importance of this exercise even more<sup>1</sup>.

In this whitepaper, Section 2 provides the background of this study by summarizing the current scenario of GST structure applicable for healthcare services in India, as well as laying out the issues of high cost of health in India. Section 3 outlines the approach and methodology used for conducting this study. Section 4 highlights the key findings of this study for hospitals and testing labs. Finally, Section 5 summarizes of the embedded taxes analysis and provides the way forward.

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<sup>1</sup> Outlook India: <https://www.outlookindia.com/website/story/business-news-gst-council-panel-on-rate-rationalisation-marks-the-first-steps-to-overhaul-current-tax-structure/395886>



## 2. Background

### 2.1 GST rate structure employable in healthcare sector

Under Notification No. 9/2017- Integrated Tax (Rate) dated 28 June 2017, healthcare services in India are exempt vide entry no 77 which is reproduced as under: "Healthcare services by a clinical establishment or authorized medical practitioner or para medics are exempt from goods and services tax".

The word 'clinical establishment' means a hospital, nursing home, clinic, sanatorium, or any other institution that offers services or facilities requiring diagnostics or treatment or care for illness, injury, deformity, abnormality, or pregnancy in any recognized system of medicines in India or a place established as an independent entity or a part of an establishment to carry out diagnostic or investigative services of diseases. The supply of such medicines, consumables, surgical and implants used for providing healthcare services to in-patients for diagnosis or treatment are naturally bundled and are provided in conjunction with each other, would have to be considered as "composite supply and should be made eligible for exemption under the category health care service" in terms of Notification No.12/2017 Central tax (rate) dt. 28 June 2017.

Health care services (Sec.2 of CGST Act, 2017)

| Means   | Includes   | Excludes  |
|---|--|---|
| Service by way of diagnosis or care for illness, injury, deformity, abnormality, or pregnancy in any recognized system of medicines in India. | Services by way of transportation of the patient to and from a clinical establishment. | Hair transplant or cosmetic or plastic surgery except when undertaken or restore to reconstruct anatomy or functions of body affected due to congenital. Excludes defects, developmental abnormalities. |

The table below presents the current GST rate applicable for some of the items that are used by the healthcare services sector. As can be seen from the table, a lot of inputs going into the healthcare sector is taxed heavily which remains blocked in the value chain due to the exemption at the output end.

Table 1: GST rate applicable for input items used by healthcare services providers

| HSN Code                        | Description   | Rate (%) |
|---------------------------------|---|----------|
| 3002                            | Animal blood prepared for therapeutic, prophylactic, or diagnostic uses   | 12       |
| 3701                            | Photographic plates and film for x-ray for medical use  | 12       |
| 3822                            | All diagnostic kits and reagents including COVID-19 Test kits (Diagnostic reagents based on polymerase chain reaction (PCR) nucleic acid test.)   | 12       |
| 4015                            | Surgical rubber gloves or medical examination rubber gloves   | 12       |
| 841920                          | Medical, surgical or laboratory sterilizers   | 18       |
| 9004                            | Spectacles [other than corrective]; goggles (including those for correcting vision) including Protective spectacles and goggles   | 18       |
| 9018                            | Instruments and appliances used in medical, surgical, dental veterinary sciences, including electro-medical apparatus   | 12       |
| 9019                            | Mechano-therapy appliances; massage apparatus; psychological aptitude testing apparatus; ozone therapy, or other therapeutic respiration apparatus including Medical ventilators                                      | 12       |
| 9020                            | Other breathing appliances and gas masks, excluding protective masks having neither mechanical parts nor replaceable filters masks incorporating eye protection or facial shields.                                    | 12       |
| 9021                            | Orthopaedic appliances, including crutches, surgical belts and trusses; splints and other fracture appliances; artificial parts of the body   | 12       |
| 9022                            | Apparatus based on the use of X-rays or of alpha, beta or gamma radiations, for medical, surgical, dental or veterinary uses, including radiography or radiotherapy apparatus, X-ray tubes and other X-ray generators | 12       |
| 9402                            | Medical, surgical, dental, or veterinary furniture (for example, operating tables, examination tables, hospital beds with mechanical fittings, dentists' chairs   | 18       |
| 999722                          | Cosmetic Plastic Surgery  | 18       |
| SR. 83 OF LIST 1 TO SCHEDULE IV | Blower/mister kit for beating heart surgery   | 5        |

Source: Rate of GST on goods, Central Board of Indirect Taxes and Customs

## 2.2 High cost of healthcare in India

The Economic Survey of India 2021 has reiterated the need to increase public health spending from 1% to 2.5-3% of the GDP pointing out that this could reduce out-of-pocket expenditure for healthcare in India from 60 to 65% of the total health expenditure, being one of the highest in the world to 35%<sup>2</sup>. To achieve this goal, the Indian Government is considerably raising the budget allocation for expenditure on public health and well-being. In the Budget 2021, the Government has raised the health and well-being budget by 137 percent amounting to Rs 2.23 Lakh Crores<sup>3</sup>.

The out-of-pocket expenditure (OOPE) may include payments towards doctor's fees, medicine, diagnostics, operations, charges for blood and ambulance services, while certain non-medical expenditure as well, including the money spent towards travelling expenses and attendant charges.

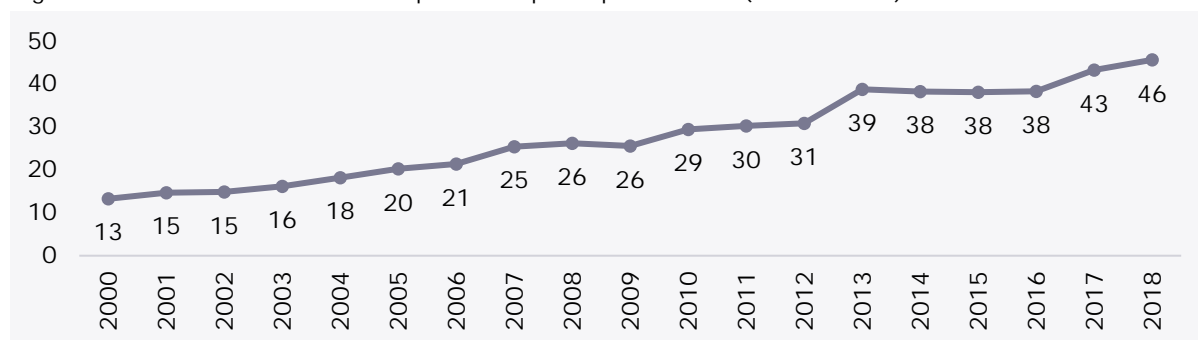
<sup>2</sup> Union Budget 2021-22: [https://www.indiabudget.gov.in/budget2021-22/economicsurvey/doc/vol1chapter/echap05\\_vol1.pdf](https://www.indiabudget.gov.in/budget2021-22/economicsurvey/doc/vol1chapter/echap05_vol1.pdf)

<sup>3</sup> Money Control: <https://www.moneycontrol.com/news/business/budget/union-budget-2021-healthcare-spending-boost-led-by-covid-19-vaccination-drinking-water-sanitation-6410561.html>



In fact, as per the report on health and family welfare statistics in India for 2019-20 published by the Ministry of Health and Family Welfare, Government of India, the majority of the expenditure faced by the end consumer in India for non-hospitalization cases pertains to cost of medicines (70.3% on average) and diagnostic tests (12.6% on average)<sup>4</sup>. Professional fees constitute only 13.3% of the total bills paid by end-consumer for procuring healthcare services<sup>5</sup>. Thus, out-of-pocket expenses in India pertain a great deal to several aspects of healthcare service provision, discussed more in detail in Section 4.

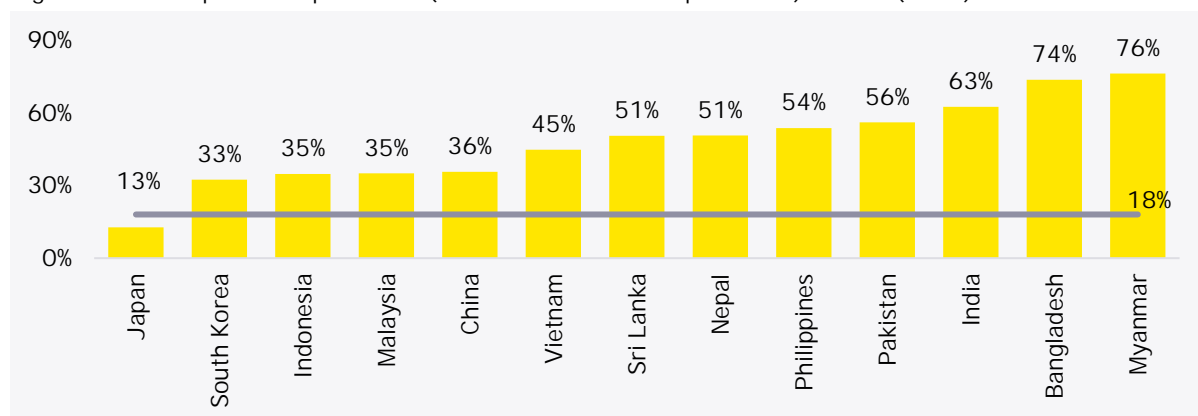
Figure 1: Trend in Out-of-Pocket expenditure per capita in India (current USD)



Source: World Bank

The out-of-pocket expenditure per capita for India has increased at a steep pace in the past two decades. As can be seen from the above Figure, these expenses in India stood at USD 13 in 2000 and increased by more than three times to USD 46 in 2018. Similarly, on comparing the out-of-pocket expenditure as a percentage of current health expenditure in Asia in 2018, shows that while this share stood at 18% for the world average, it was 63% for India, which is higher than Pakistan (56%), Sri Lanka (51%), China (36%) and Japan (13%).

Figure 2: Out-of-pocket expenditure (% of current health expenditure) in Asia (2018)



Source: World Bank

As envisaged under the National Health Policy 2017 of making India an affordable healthcare destination, it is important to explore plausible policy measures that could aid in bringing down the healthcare cost in India. One such possible area of policy intervention could rationalize the GST rate structure in the healthcare sector by phasing away the exemption at the output healthcare services. The phasing away of exemption and bringing the healthcare sector under the ambit of GST with merit rate at the output healthcare service would help in solving the problem of embedded taxes by allowing pass through of input tax credits in the healthcare value chain and thereby would slash the healthcare cost for the end consumers. However, for this merit rate to decide, it is important to estimate the quantum of embedded taxes in the healthcare sector. The next section covers the data and methodology part pertaining to computation of embedded taxes.

<sup>4</sup> Ministry of Health and Family Welfare: <https://main.mohfw.gov.in/sites/default/files/HealthandFamilyWelfarestatisticsinIndia201920.pdf>

<sup>5</sup> Ministry of Health and Family Welfare: <https://main.mohfw.gov.in/sites/default/files/HealthandFamilyWelfarestatisticsinIndia201920.pdf>



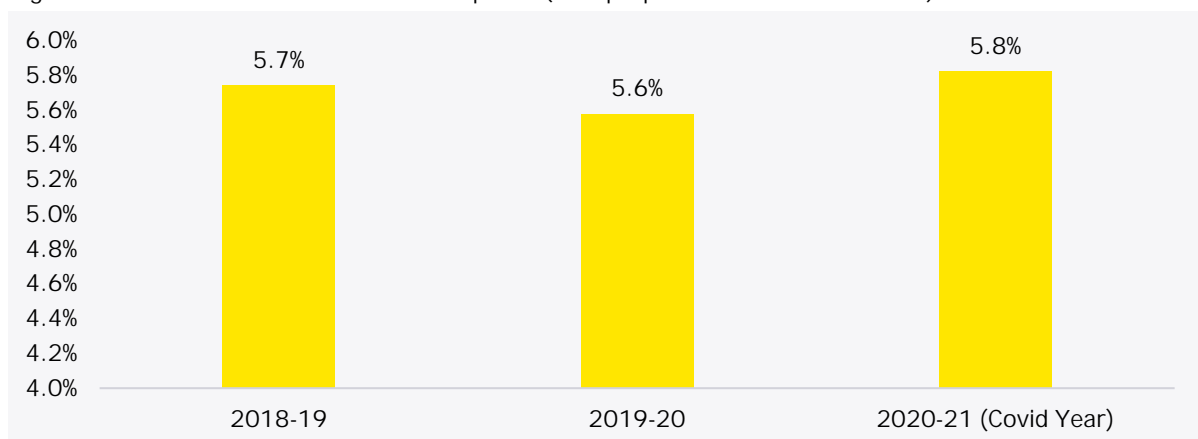
### 3. Analysis and key insights

#### 3.1 Key findings for hospitals

##### Analysis of embedded taxes

The embedded taxes encompass the total GST amount paid by hospitals for procurement of their inputs to provide the output services, which are exempt. For hospitals, these embedded taxes on an average account for nearly 6% of their total expenses in a year<sup>6</sup>. However, a more relevant parameter to consider for GST rate rationalization is the embedded taxes rate over the total revenues of the hospital. The following Figure shows the embedded taxes for hospitals during the years 2018-19, 2019-20 and 2020-21, which was also a year that saw more activity due to covid related expenditures, both at the hospital and the final consumer level. Nonetheless, across the three years, the embedded tax rate stayed at an average of 5.7%<sup>7</sup>.

Figure 3: Embedded Taxes Rates for Hospitals (as a proportion of total revenues)



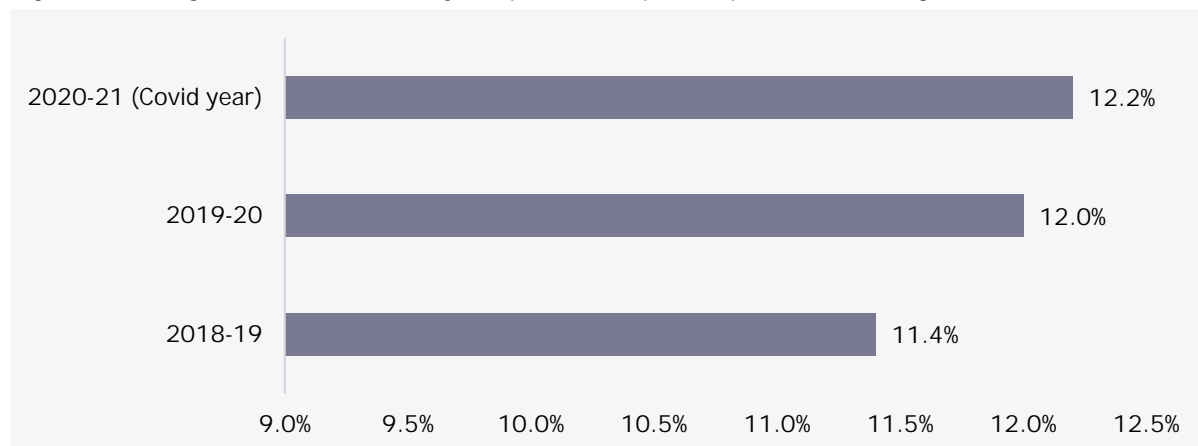
Source: EY analysis, Industry inputs

<sup>6</sup> EY analysis based on data provided by healthcare service providers. For further information, refer to Section 5.

<sup>7</sup> EY analysis based on data provided by healthcare service providers. For further information, refer to Section 5.

To better understand this burden of embedded taxes, it is noteworthy to consider the average GST rate that the hospitals face while procuring their inputs. Over the past three years, the average GST rate faced by hospitals on procuring their inputs has been about 12%. The figure below indicates that this average rate has only been rising, indicating the rising share of high-rated GST bearing inputs.

Figure 4: Average GST rate incurred by Hospitals: GST paid/Expenditure bearing GST

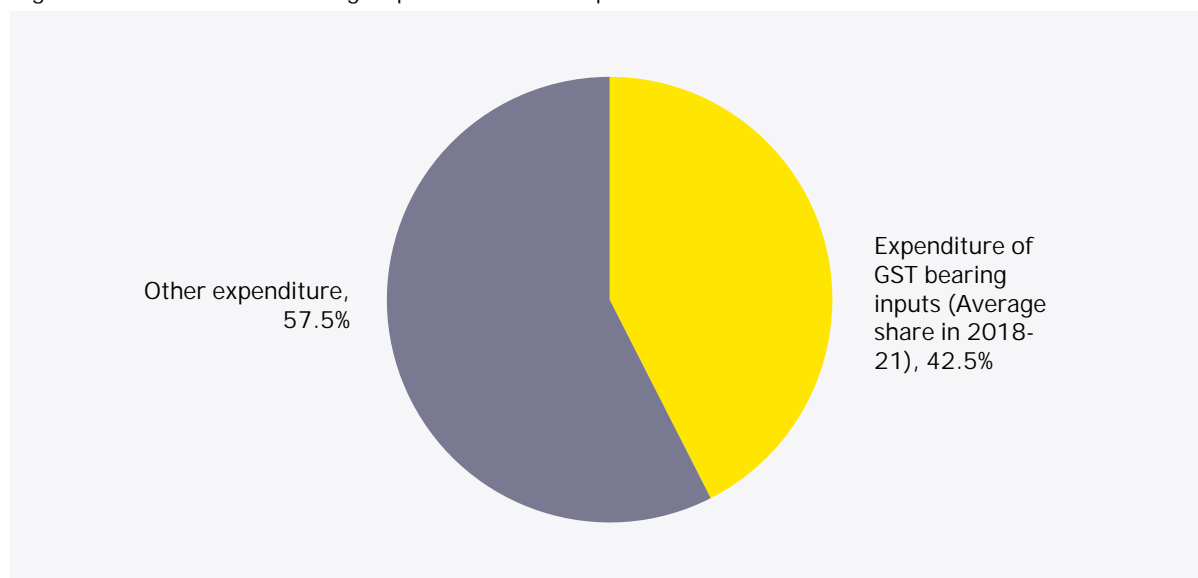


Source: EY analysis, Industry inputs

### Analysis of GST bearing inputs

For hospitals, the expenditure of GST bearing inputs in their total expenditure stood at 40.6% in 2018-19, 43.5% in 2019-20 and 43.5% in 2020-21<sup>8</sup>. On an average thus, irrespective of the size of the hospital, the expenditure for GST bearing inputs stand at least 40%.<sup>9</sup> This indicates that GST bearing items procured by the hospitals form a sizeable amount.

Figure 5: Share of GST bearing Expenditure for Hospitals



Source: EY analysis, Industry inputs

These inputs range from material consumption such as pharmacy consumption including both lifesaving and non-lifesaving medicines, food, and beverages, printing and stationary, instruments, machinery to several input services. These input services include manpower supply services, maintenance and repair services of other machinery and equipment, textile cleaning services-laundry, rental services, courier services, financial auditing services, Data transmission services, telephone expenses, IT consulting & support services, as well as other

<sup>8</sup> Based on data provided by hospitals. For further information, refer to Section 5.

<sup>9</sup> Based on data provided by hospitals. For further information, refer to Section 5.



professional, technical, and business services. Nowadays, TV, internet and radio advertising and transportation expenses also form a key part of the inputs for Hospitals. A broad summary of key GST bearing inputs as witnessed across hospitals as has been provided below.

Table 2: Key GST bearing inputs for Hospitals

| Name of Inputs  | Highest contribution observed (in the hospital's total GST bearing expense) | GST Rate Applicable |
|---|---|---------------------|
| Medicines Apart from Life Saving Drugs  | 47%   | 12%                 |
| Instruments and appliances used in medical, surgical, dental or veterinary sciences | 12%   | 12%                 |
| Contractual Labour expense  | 28%   | 18%                 |
| House Keeping Services  | 6%  | 18%                 |
| Repair and maintenance charge   | 6%  | 18%                 |
| Rents   | 2%  | 18%                 |

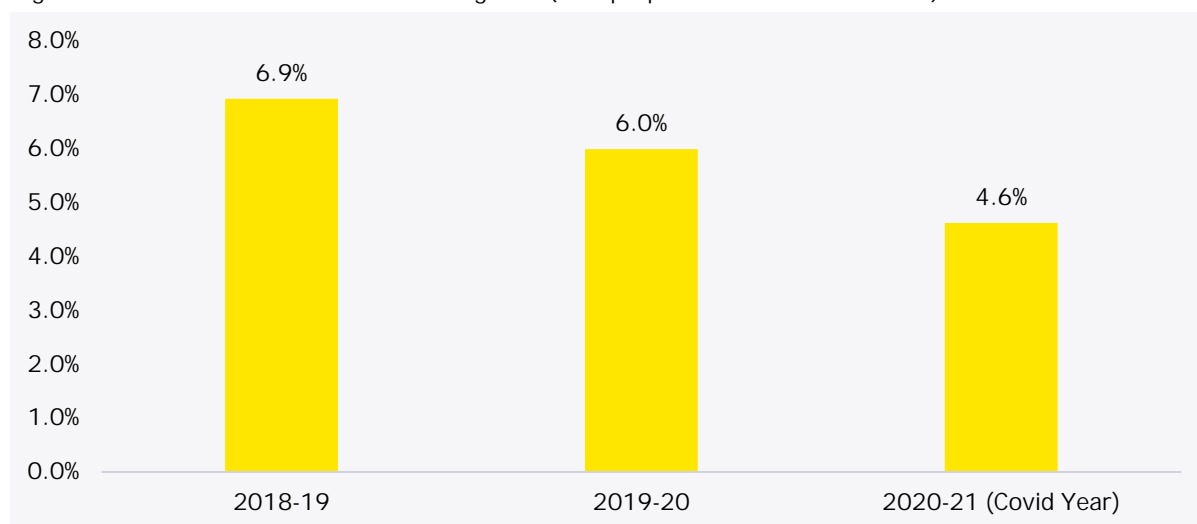
Source: EY analysis, Industry inputs

## 3.2 Key findings for testing labs

### Analysis of embedded taxes

The embedded taxes encompass the total GST amount paid by testing labs for procurement of their inputs to provide output services, which are exempt. For testing labs, these embedded taxes on an average account for nearly 5.2% of their total expenses in a year<sup>10</sup>. However, a more relevant parameter to consider for GST rationalization is the embedded taxes rate over the total revenues of the hospital. Under this parameter, the embedded taxes rate stood at nearly 6.5% (average) during 2018-19 and 2019-20<sup>11</sup>. However, as the testing labs saw an increase in demand for their services in the Covid year, the increase in revenue effect brought the embedded tax rate to 4.6% in 2020-21<sup>12</sup>. Nonetheless, across three years, the embedded tax rate stayed at an average of 5.8%<sup>13</sup>.

Figure 6: Embedded taxes rate for testing labs (as a proportion of total revenues)



Source: EY analysis, Industry inputs

<sup>10</sup> EY analysis based on data provided by healthcare service providers. For further information, refer to Section 5.

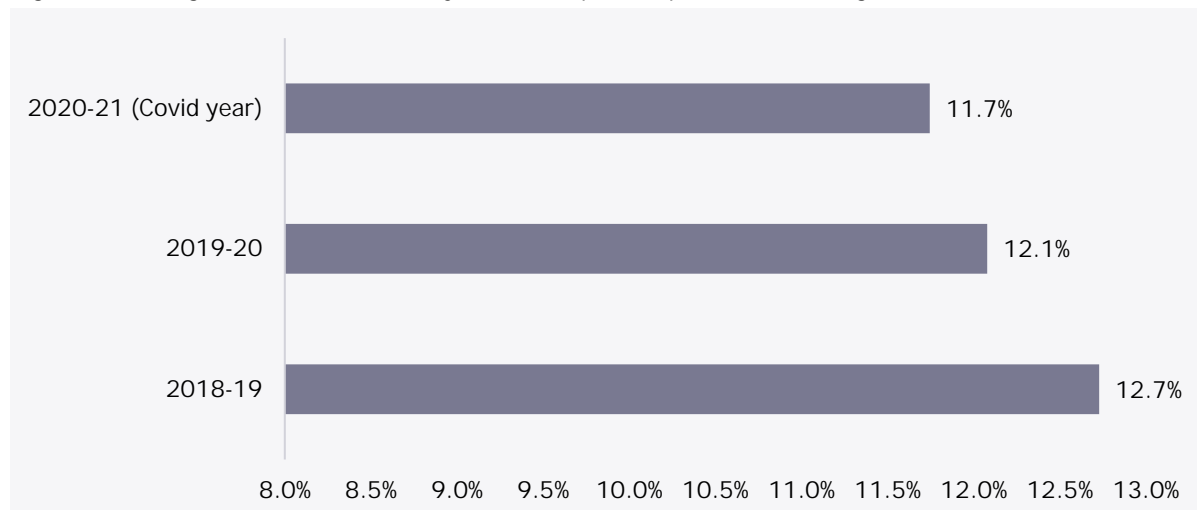
<sup>11</sup> EY analysis based on data provided by healthcare service providers. For further information, refer to Section 5.

<sup>12</sup> EY analysis based on data provided by healthcare service providers. For further information, refer to Section 5.

<sup>13</sup> EY analysis based on data provided by healthcare service providers. For further information, refer to Section 5.

It is important to recognize that only in 2020-21, when the embedded tax rate has been less than 5%, it is an isolated result. This is due to the unusually higher volume of demand for COVID-related testing services. However, as this may not be the years going forward, the rate is likely to stabilize between 5.5% to 6%. Meanwhile, the average GST rate that the testing labs or diagnostic centers face while procuring their inputs matches with that of hospitals. Over the past three years, the average GST rate faced by labs on procuring their inputs has been about 12%<sup>14</sup>. The figure below indicates that this average rate has been above 11%, indicating the burden of high-rated GST bearing inputs.

Figure 7: Average GST rate incurred by labs: GST paid/Expenditure bearing GST

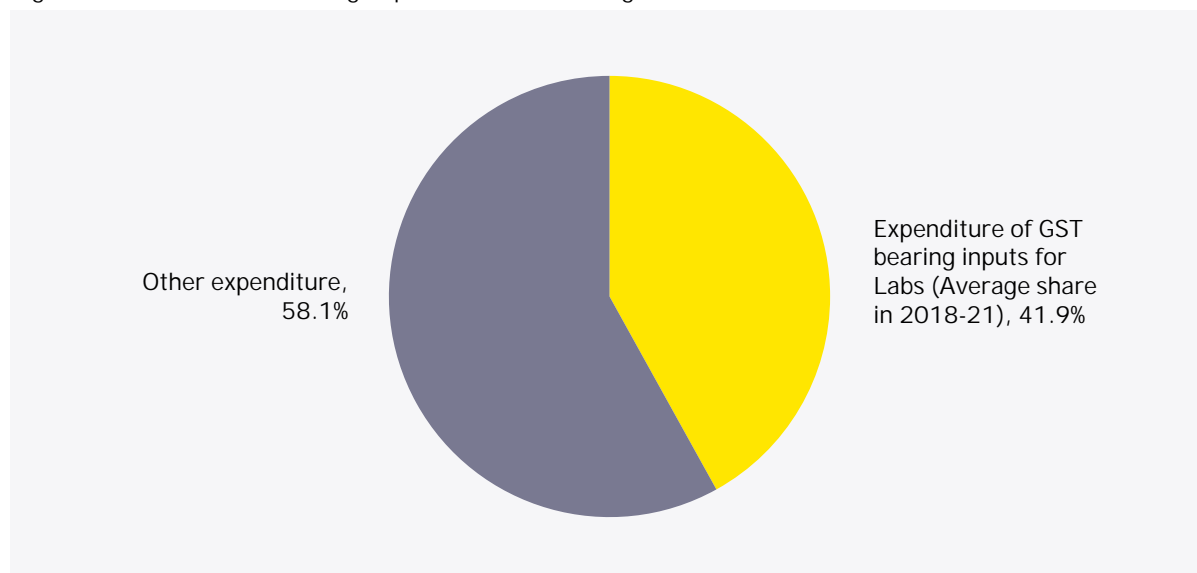


Source: EY analysis, Industry inputs

#### Analysis of GST bearing inputs

For diagnostic centers and testing labs, the expenditure of GST bearing inputs as proportion to their total expenditure stood at 40.1% in 2018-19, 41.8% in 2019-20 and 43.9% in 2020-21<sup>15</sup>. On an average thus, irrespective of the size of the testing lab, the expenditure for GST bearing inputs stand at least 40%. This indicates that similar to the hospitals, GST bearing items procured by the testing labs form a sizeable amount.

Figure 8: Share of GST bearing expenditure for Testing Labs



Source: EY analysis, Industry inputs

<sup>14</sup> EY analysis based on data provided by healthcare service providers. For further information, refer to Section 5.

<sup>15</sup> Based on data provided by Testing Labs. For further information, refer to Section 5.

Diagnostic centers and testing labs face a multitude of inputs expenditure which bears GST. These input items include consumables such as laboratory reagents, instruments and appliances, testing kits (COVID Kit), capex items like machinery, plant, or laboratory equipment; Computer hardware, such as laptops, desktops, scanners as well as furniture and fixtures. They also incur cost on purchase of input services such as computer software, courier services, rents, facility maintenance, marketing cost, IT expenses, bank charges and insurances. Expenditure on marketing items and cloud services have also seen a rise in recent years. The following table provides some of the key input items purchased by diagnostic centers and testing labs along with the GST rate faced in purchasing the said item.

Table 3: Key GST bearing inputs for Testing Labs

| Name of Inputs                | Highest contribution observed (in the Lab's total GST bearing expense) | GST Rate Applicable |
|-------------------------------|--|---------------------|
| Consumables and Reagents      | 44% - 75%  | 5%, 12%, 18%        |
| Capex                         | 6%   | 18%                 |
| Rent                          | 14%  | 18%                 |
| Computer Services             | 8%   | 18%                 |
| Repair and maintenance charge | 5%   | 18%                 |
| Marketing Costs               | 7%   | 12%, 18%            |

Source: EY analysis, Industry inputs

In this study, we have analyzed input-level data for both hospitals and testing labs and ascertained that irrespective of the year or the type of facility, the embedded taxes blocked due to GST exemption at the output level is at least 5%. We have also discussed the average GST rate borne by both types of healthcare providers and quantified the burden of GST bearing input expenditure in the provider's total expenditure. Finally, we have provided certain key input items to highlight the indispensable items to healthcare service providers, which add to their costs, as well as the blocked taxes. The next section provides the embedded taxes rates in context to the pre-GST level, as well as presents the case for GST rate rationalization in the healthcare services sector.



## 4. Summary and way forward

### 4.1 Comparison with Pre-GST taxes

To summarize, the average embedded taxes rate over the total revenues for hospitals stood at 5.7% for the period between 2018-19 and 2020-21<sup>16</sup>. Meanwhile, the average embedded taxes rate over total revenues for testing labs and diagnostic centers stood at 5.8% during the same post-GST period<sup>17</sup>. The findings have been presented in the table below. While the average rate of embedded taxes is quite similar for hospitals and testing labs, the inputs leading to blocked input taxes are different for both segments.

For instance, hospitals incur higher expenditure on medicines (both general and lifesaving) as well as contractual labor for cleaning, maintenance, and repair services of hospital facilities. Hospitals on an average hire more contractual labor compared to testing labs, on which they incur GST rate of 12%-18%<sup>18</sup> depending on the nature of the contractual labor hired. This trend was observed across hospitals. Meanwhile, testing labs incur high expenditure on chemicals, reagents, and kits to cater to the high volume of testing demand emerging in India. Testing labs also have higher marketing expenditure as compared to hospitals.

Table 4: Comparison between Pre-GST and Post-GST Embedded Taxes Rates

| Average embedded taxes rate in GST period (2018-19 to 2020-21) |                                     |
|--|-------------------------------------|
| Hospitals  | Testing Labs and Diagnostic Centers |
| 5.7%   | 5.8%                                |
| Average embedded taxes rate in Pre-GST period (2016-17)        |                                     |
| Hospitals  | Testing Labs and Diagnostic Centers |
| 4.3%   | 3.8%                                |

Source: EY analysis, Industry inputs

<sup>16</sup> EY analysis based on data provided by healthcare service providers. For further information, refer to Section 5.

<sup>17</sup> EY analysis based on data provided by healthcare service providers. For further information, refer to Section 5.

<sup>18</sup> Based on data provided by Hospitals. For further information, refer to Section 5.

Despite these variabilities, both hospitals and testing labs have been suffering from the embedded taxes problem, which has only increased in the post-GST period. For hospitals, the embedded taxes rate has increased from 4.3% in 2016-17 to 5.7% in the GST period, as per the data provided by the healthcare providers. Meanwhile, for testing labs, the embedded taxes rate has increased from 3.8% to 5.8%, during the same period. Thus, the healthcare services sector provides a unique case wherein the GST regime has not augured well for the service providers. In this context, a GST rate rationalization exercise is much needed in the sector to overcome the embedded taxes problem and provide for opportunities to healthcare service providers to invest in high-quality inputs to provide high-quality output to end-consumers.

## 4.2 Summary of key findings

The findings of this study on embedded taxes in the healthcare services sector can be summarized in the following points, encompassing both the case for hospitals and testing labs:

- ▶ The study is based on the data provided by the hospitals and testing labs and broadly shows that the embedded taxes are in the range of 5.5% to 6% of the total revenue of healthcare units.
- ▶ The hospitals and testing labs were not able to give data on the imports as they were not directly sourced and are mainly procured through third party agencies. It is also likely that this could also marginally increase the embedded tax rate to nearly 6%.
- ▶ Essential medicines and life-saving drugs account for a major proportion of embedded taxes for hospitals, and temporary solutions such as Covid-related waivers will not solve the problem.
- ▶ The other interesting findings is that unlike in other sectors, the healthcare sector has not been able to derive the benefits of GST transition. In fact, the embedded taxes in the healthcare sector have increased in the post-GST regime compared to the pre-GST scenario. This may be perhaps due to partial pass through of credits which was available in the pre-GST regime where the healthcare services was vivisected for the purposes of taxation –the material component was subject to State VAT while the services component levied by the Centre was exempted. In the post-GST scenario, even if there are partial material component the entire output services is treated as ‘Deemed Services’ (not goods).
- ▶ The other interesting finding is that the contractual labor forms an important cost component for the healthcare sector as it is subject to GST at the rate of 18 percent which is paid under the category of manpower services. The lack of pass through for these taxes disincentivizes hospitals and testing labs from hiring contractual labor. Therefore, in this sense, imposition of a marginal GST rate on healthcare services would be employment inducing.

## 4.3 The way forward

Based on our study of the embedded taxes and findings, we suggest a wider discussion to be taken up amongst stakeholders in the healthcare sector on following recommended options pertaining to the future of GST rate rationalization in the healthcare sector:

- ▶ Option 1 – In this option, status quo is maintained, and the healthcare sector continues to be exempt in the GST regime.
- ▶ Option 2 – In this option, zero rating on healthcare services is proposed. This will cause no change in price to the consumers while reducing the burden of embedded taxes on healthcare service providers.
- ▶ Option 3 – In this option, a suitable GST rate may be levied on output services for all private hospitals and an optional dual rate structure may be given for Government establishments. This will allow private hospitals to have partial passthrough of blocked input credit. Meanwhile, the consumers may not be impacted as the reduction in costs to the hospitals will offset the impact of the decided GST rate on the output level.
- ▶ Option 4 – Employing a combination of above listed options. This may be decided based on the combination that minimizes the impact on end-consumer while reducing embedded taxes burden on healthcare service providers.

As the entire exercise of GST rate structure rationalization is under examination by a commission under GST council, our request is that at least a few important items which account for a significant proportion of embedded taxes could be brought to a merit rate, providing some relief to the healthcare services segment, and at least neutralize the increase of 1.5% post covid (in GST regime). These items are specific to the Healthcare services sector and may be considered essential in reducing the embedded taxes burden for healthcare service providers. The list of the selected items identified is the following:


Table 5: List of input items having high GST burden

| HSN Code | CBIC Description   | Rationale  | GST Rate (%) | Suggested Rate (%) |
|----------|--|--|--------------|--------------------|
| 3822     | All diagnostic kits and reagents   | Covid pandemic has brought to the forefront the importance of affordable testing related kits and important reagents required for testing and treatment. Thus, items under this HSN chapter may be considered for GST rate rationalization.  | 12           | 5                  |
| 3004     | Medicaments consisting of mixed or unmixed products for therapeutic or prophylactic uses, put up in measured doses (including those in the form of transdermal administration systems)   | Intravenous (IV) Fluids and Antibiotics are used extensively in treatment of severe illnesses. Bringing about affordability in these items through rate rationalization will help in reducing out-of-pocket expenditure in healthcare of the population.   | 12           | 5                  |
| 9402     | Medical, surgical, dental, or veterinary furniture (for example, operating tables, examination tables, hospital beds with mechanical fittings, dentists' chairs), having rotating as well as both reclining and elevating movements; parts of the foregoing articles | Without proper hospital furniture such as reclining beds and chairs, operating and examination tables, hospitals and clinics can't be set up. These lists of items are essential to delivering healthcare services, thus they may be considered for rate reduction.  | 18           | 5                  |
| 9018     | Instruments and appliances used in medical, surgical, dental, or veterinary sciences, incl. scintigraphic apparatus, other electro-medical apparatus and sight-testing instruments, n.e.s. Products Include: Disposable Surgical Face Mask                           | Bringing affordable healthcare requires provision of ECG machine, Ultrasound machine, Echo Cardiograph, Syringes to tackle modern day diseases. This chapter includes several instruments considered to be basic requirements in both government and private hospitals, and therefore may be considered for rate reduction to reduce embedded taxes. | 12           | 5                  |



|      |   |   |    |   |
|------|---|---|----|---|
| 9022 | Apparatus Based On The Use Of X-Rays Or Of Alpha, Beta Or Gamma Radiations  | X-Ray (Radiology) imaging devices are basic requirements for all hospitals and diagnostic labs, whether government or private. Meanwhile, advanced imaging devices such as that for Mammography are essential to the future of female health in India. Thus, items under this HSN chapter may be considered for rate rationalization. | 12 | 5 |
| 9021 | Splints and other fracture appliances; artificial parts of the body; other appliances which are worn or carried, or implanted in the body, to compensate for a defect or disability | To bring about accessibility and affordability of implants, items in the given HSN chapter may be considered for GST rate reduction. This will reduce the embedded taxes burden of both government and private hospitals.   | 12 | 5 |

Source: EY Analysis based on inputs by Hospitals and Testing Labs



## 5. Approach & Methodology

### 5.1 Outline of the study

This study focused on computing the quantum of embedded taxes in the healthcare sector by covering two major segments including hospitals and testing labs. The identification and selection of sample healthcare units for both these segments were done in consultation with NATHEALTH. To make the sample representative, we had classified and selected the healthcare units based on the size and geography. For both hospitals and testing labs, the healthcare units are segmented under three heads – small, medium, and large. The details pertaining to the basis of segmentation is further elaborated in the subsequent section.

These healthcare units were approached with a structured questionnaire for data collection to better understand their cost structure and major inputs that bore the GST burden and are used by these healthcare units to provide the output healthcare services. Through these questionnaires, comprehensive data was collected across these categories of inputs and the actual tax incidence borne by the healthcare units was assessed.

Broadly, the inputs that flow into these healthcare units can be mapped under three heads:

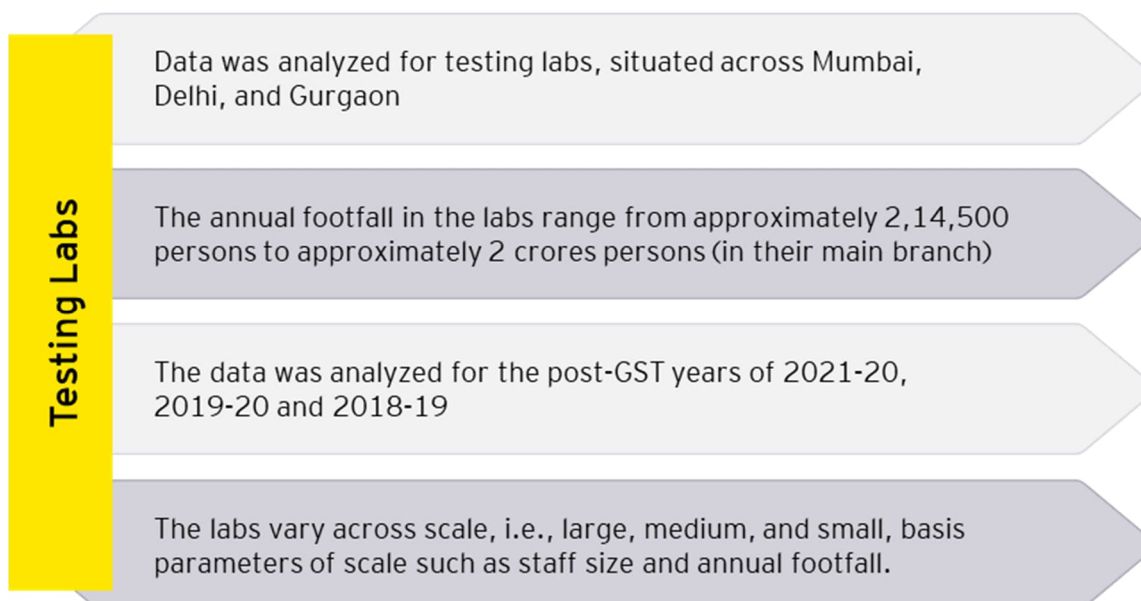
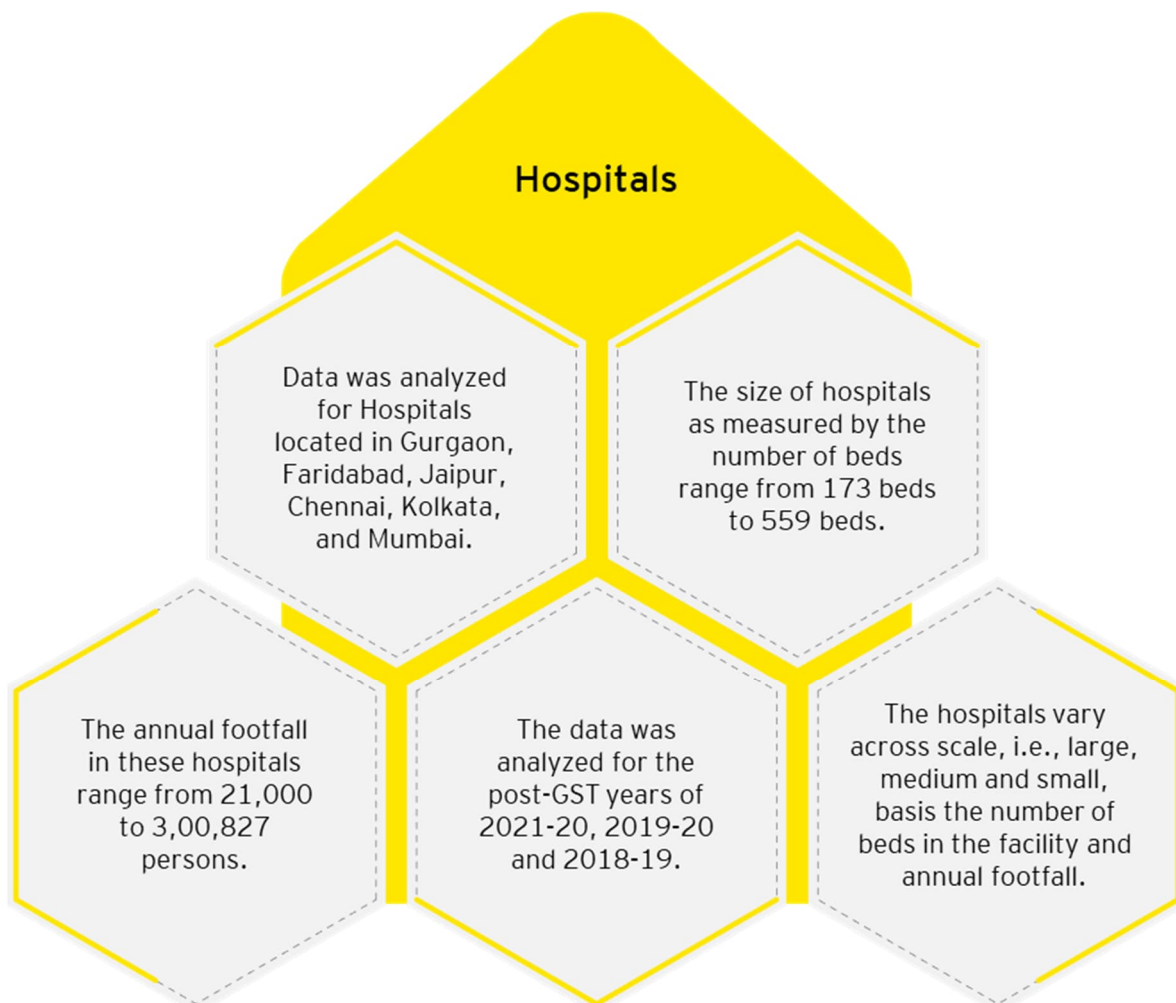
1. Capital goods – Medical, surgical furniture, electronic appliances and gadgets, storage equipment, vehicles, plant and machinery, etc.
2. Input goods – Drugs and medicines, chemicals, power and fuels, paper and machinery, etc.
3. Input services – Rent, salaries, leasing charges, IT licenses, legal fees, housekeeping services.

In the Annexure - A, we have broadly mapped the universal of the supplies falling under the three categories - input goods, input services and capital goods in the healthcare sector. This is indicative of the level of granular data received for the purpose of embedded taxes calculation.

Finally, the quantum of embedded taxes was estimated by the GST rates provided at each input level and was aggregated across the necessary inputs to compare with the total expenditure and total revenues of the healthcare unit. The unit level data across various parameters were analyzed across both segments – hospitals and testing labs. This analysis has been provided in detail in Section 4.

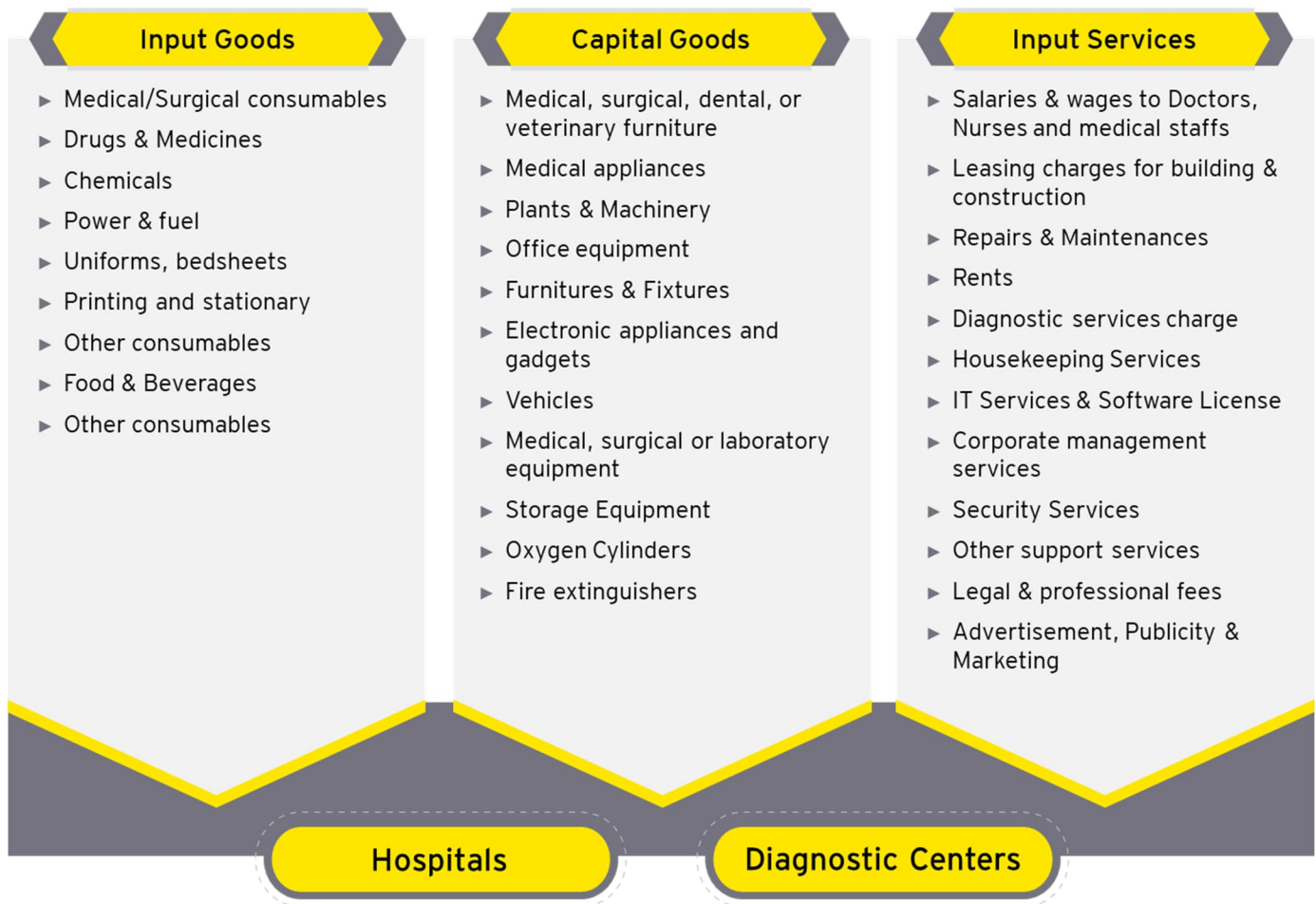
## 5.2 Description of the analyzed data

This study is based on the comprehensive financial data provided by six hospitals and six testing labs and diagnostic centers in India. These data sets provide details on total revenues, total expenditures, description of items of expenditure across the three categories of input goods, input services and capital goods as well their GST related details. The overall salient features of the data analyzed include the following:





## 6. Annexure A: Mapping inputs in the healthcare industry





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EYIN2204-013

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