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HEALTH CARE SECTOR:

THE UNTAPPED OPPORTUNITIES FOR INVESTORS

INTRODUCTION

Healthcare is India's one of the largest growing sectors. Healthcare sector comprises of hospitals, medical devices, clinical trials, outsourcing, telemedicine, medical tourism, health insurance and medical equipment. There are several laws that govern construction and land development for medical facilities. Transactions in medical real estate are also subjected to FDI policy.

Healthcare real estate is a niche market within the real estate market. In broader sense, health care real estate or medical real estate includes buildings, offices and campuses constructed or leased for medical facilities. These buildings can be owned by hospitals, health systems or private party groups.

Recently, private equity firm Toro Finserv has begun to raise 500 million Dollars to invest in real estate for health care real estate. This is the first fund focused on putting money on infrastructure for hospitals and diagnostic companies in India.

WHAT MAKES HEALTH CARE INVESTMENTS ATTRACTIVE?

- An aging population that requires ever more medical facilities and rapid growth of population that has out stripped the supply of medical facilities.
- As of now India has only 9 hospital beds per 10000 persons. It is required to be increased to 30 per 10000 for complying with international standards. India needs around 3 million beds to achieve the target of 30 beds per 10000 people and an additional 1.54 million doctors and 2.4 million doctors.
- 70% of India's healthcare infrastructure is in the top 20 cities and there is increasing demand for infrastructural development for healthcare facilities in rural areas.
- Exponentially increasing cases of diabetic, obesity, infertility, cancer and T.B.
- Development in technology that allow increasing numbers of medical procedures to be done in medical offices outside of a hospital setting.

- Tight medical office markets in many places as negligible construction came on line for several years. Real estate in healthcare offers an untapped opportunity that has not been exploited by investors so far.
- Increasing interest of investors who are looking for taking advantage of high lease rates in some areas.
- India is cost competitive when compared to its peers. The cost of surgery in India is only one tenth of that in US or Europe.
- Increasing scope for health tourism especially that in Fertility treatments and in traditional medicines such as Ayurveda, Sidha, Yunani, Sidhha and Naturopathy.

FOREIGN DIRECT INVESTMENT

Healthcare has seen a significant increase in FDI in flow over the last three years. Value of private equity transactions has increased from 94 million USD in 2011 to 1275 million USD in 2016. A large number of investments by global healthcare players such as the Parkway group have strengthened India's image as an attractive healthcare investment destination.

A foreign investor can invest in real estate in India subject to the FDI policy in townships, housing, built up infrastructure and construction development.

In the manufacturing of medical devices and hospitals 100% FDI is permitted under the automatic route. In pharmaceutical sector, 100% FDI is allowed under the automatic route for Greenfield projects. For Brownfield project investments, up to 100 per cent FDI is permitted under the government approval route and up to 74% is permitted under the automatic route.

In 2016 the cap on insurance sector (including health insurance) has been increased from 26% percent to 49% provided that the ownership of the insurance company is retained in Indian hands.

FOREIGN VENTURE CAPITAL INVESTMENTS

Another flow of investments comes into the health care sector through venture capital investments by entities registered as foreign venture capital investors with the Securities and Exchange Board of India. It is mandatory for a private equity investor to register as foreign venture capital investor under the Foreign Venture Capital Investment regulations and it has certain significant advantages.

An FVCI is exempt from compliance with the pricing guidelines under the FDI policy for the acquisition of securities at the time of entry as well as for the transfer of securities at the time of exit.

Similarly, when the promoters intend to buy-back the shares from the foreign venture capitalists, they are not required to make an open offer under Regulation 10 of the, SEBI (substantial Acquisition of Shares and takeovers) Regulations, 2011. SEBI has been giving permission to FVCIs for investing in indentified sectors such as research and development in certain pharmaceutical sectors. The RBI has made certain amendments to Foreign Exchange Control Regulations in order to allow

FVCIs to invest in SEBI registered alternate investment funds.

Some of the benefits which are available to FVCIs are listed below:

1. They benefit from free entry and exit pricing and are not bound by pricing restrictions applicable to the FDI investment route.
2. SEBI registered FVCIs have been given Qualified Institutional Buyer status and are eligible to subscribe to shares in the Initial Public Offer through the book building route.
3. Under the SEBI (Issues of Capital and Disclosure Requirements) Regulations, 2009 the FVCIs by virtue of being Qualified Institutional Buyers are eligible to subscribe securities under the Qualified Institutional Placement route.
4. Under the above said Regulations, there is lock –in period of one year from the date of allotment in the public issue. But, Venture Capital Funds and FVCIs are exempted from this requirement, provided that shares have been held by them for a period of at least 1 year of the date of filing the draft prospectus with the SEBI.

HEALTH CARE REAL ESTATE

The SEBI in 2016 had proposed to include Hospitals under the definition of real estate. This was part of the efforts to ease norms related to Real Estate Investment Trust [REITs]. Even though according to the definition of Ministry of Finance, hospitals fall under the domain of infrastructure, large townships and commercial projects usually offer hospitals as part of the projects and therefore they are rent generating completed assets. Thus such assets must fall within the definition of real estate or property under REITs.

SEBI had issued Rules for REITs in September 2014 but these trusts haven't invoked investor confidence and the industry has been seeking effective steps to make them attractive. The government had earlier declared tax sops for REITs.

From investor's view, healthcare REITs as a group generally trade at a premium yield to other REITs categories. It is considered as one of the stable sectors because even during economic decline Healthcare real estate continues to grow.

Irrespective of the size of your real estate portfolio, you face a number of legal issues, risks and challenges including regulatory compliance, public safety, environmental issues and emergency preparedness planning. The case of medical real estate assets is not different. Indeed, medical real estate ownership, investment and leasing arrangements are governed by a complex set of rules and regulations intending to prevent financial conflicts of interest.

For instance, the conditions under which health care providers lease practice space to referring physicians must meet specific criteria to avoid violations of laws. Without sufficient expertise in health care real estate and contract making such as assessing fair market value, physicians and providers struggle to execute arms length transactions. Similarly, physicians wishing to own medical real estate are often saddled with substantial liabilities such as out of pocket cost, stringent loan terms like personal guarantee and lender indemnification. Real estate transactions in medical facilities should be dealt with great care so as to avoid regulatory missteps. Similar problems haunt providers seeking to monetise assets to unlock liquidity to fund future growth.

By associating with real estate developers and contractors who lack the know-how to comply with these rules, physicians and providers can find themselves party to ill-designed property arrangements that subject them to financial, reputational and professional risks. Third party experts such as legal advisers, Chartered accountants and engineers can provide valuable assistance in guiding physicians and providers in medical facility development and asset monetisation.

The emerging trend is that hospitals and practitioners embrace third party ownership and management of real estate. By using third party developers they can preserve their capital resources for acute care needs and focus their attention on providing services by passing on responsibility of building regulation and maintenance minutiae.

Health care facilities have to undergo a lot of technological and regulatory requirements. Therefore, building maintenance tasks such as heating, cooling, sterilisation and management tasks etc are outsourced to third parties.

In India the prevalent model is that a trust may procure land from the government or the local municipal body on a long lease and develops the land and constructs the hospitals. The challenges in this model are the restrictions imposed by the government like the restrictions on expansion.

Another model is the corporate hospital model where a company buys land and then constructs hospitals. This model requires more funding on account of the land cost. Both forms have to comply with laws relating to the respective structure of business.

TAXATION

If the healthcare institutions are run by corporate entities the following are the important taxes applicable,

1. Corporate tax: A resident company is taxed on its worldwide income whereas a non-resident company is taxed only for its income received in India. Domestic companies are taxed at the rate of thirty percent of total income and the tax applicable to non resident companies is 40%. However, as proposed in the Union Budget of 2017, from the tax year 2017-2018, tax rate for domestic companies with turnover or gross receipt not exceeding Rs.50 Crore in the previous year 2015-16 are liable to pay at the rate of 25% instead of 30%.
2. Dividend Tax: A domestic company which has declared, distributed or paid any amount as dividend is required pay a dividend distribution tax at 15%.
3. Capital Gains: Long terms gains earned by a non-resident on sale of unlisted securities are

taxable at the rate of 10%. Short term capital gains earned by a non-resident on

a. The sale of listed shares are taxable at the rate of 15% subject to the securities transaction tax

b. The sale of any other type of security and capital asset are taxable at the ordinary corporate rate.

4. Exemptions: Capital expenditure incurred in establishing a hospital with 100 beds capacity or more is fully deductible. A 5 year tax holiday is available for profits received from the operation of hospitals located in all parts of India except in certain cities. However, this is available to hospitals which are constructed prior to March 31; 2013.Certain tax exemptions are available to hospitals which are charitable or not for profit.

<u>Is Service Tax Applicable to Hospitals?</u>

Health care services by medical practitioners or paramedics and clinical establishments such as hospitals, nursing homes and clinics are exempt from service tax by virtue of Notification no.25/2012-ST dated 20.06.2012. Services by veterinary clinics in relation to healthcare of animals and birds are also exempted. Technical testing of new drugs by clinical trials also enjoys this exemption.

<u>Is Building Tax Applicable to Hospitals?</u>

The division bench of the Kerala HC has in a recent ruling held that hospital buildings are entitled to exemption from building tax subject to provisions of S.3 of the Building Tax Act, i.e, only if they are providing free services, in *Jubilee Mission Medical College and Research Institute v. Govt of Kerala.*

In a later case while setting aside the orders of the first Appellate Authority and Income Tax Appellate Tribunal, Kochi, the division bench of the Kerala HC has observed that under the Income Tax Act, the provision for depreciation is contained in S.32 and if a hospital building or a part thereof qualifies to be a plant, such as operation theatre, X-ray rooms, it would be eligible for depreciation at the rate of 25%; whereas that part of the hospital which is to be treated as a building shall be eligible for depreciation only at the rate of 10%.

Earlier in *Income Tax Commissioner v. Dr.Venkatarao* the SC considered the case of Medical Practitioner running a nursing home; in that case the SC had held the nursing home to be a plant.

Post -GST Scene

GST will be cursed in the healthcare sector more than it will be praised. Medical devices and services such as dialysis machines and fluid, pace maker, cataract surgery lenses, surgical equipment used in orthopaedic operations, cancer treatment except that of blood cancer etc will be getting costlier under GST. Therefore, in order to sustain the consumer base, the hospitals will have to reduce the hospital fee to neutralise the increased tax. This is expected to discourage small scale investors and start-up companies from investing in hospital and other health care services.

In 2016, Indian Medical Association (IMA) had demanded that the GST exemption granted to the services offered by governmental institutions should be extended to the private sector as well.

It will also have an impact on medical real estate industry. The actual GST rate on under construction properties is 18%. However, the effective tax on such properties will be 12% as under the new regime developers will be allowed in -put tax credit. However, in -put tax credit is not available on ready to occupy buildings. Earlier, a buyer would have to pay several indirect taxes, such as excise duty, value added and service tax, which are now subsumed by GST. On the other hand, stamp duty has not been subsumed by GST.

Nevertheless, GST is said to have a positive impact on the pharmaceutical sector. It will help the business by streamlining the tax structure. GST has consolidated different taxes that were imposed on the pharmaceutical industry. This will ease working together of the business. Besides, GST will bring about yielding proficiency in streamlining the store network. Further, GST will conceive a seamless stream of tax credit, represent a change in general consistency and is also anticipated that it will make a level playing field for pharmaceutical companies.

The most important advantage is the diminishing of exchange cost with the discontinuance of central sales tax. GST will result in enhanced operative effectiveness and reduced manufacturing cost in pharmaceutical industry. The warehousing methodology of pharmaceutical companies will also benefit from the new tax structure. Earlier, the companies were forced to maintain distribution centres in various states to keep a distance from sales taxes. However, now the companies can merge stock-rooms as they are required to pay only integrated GST on inter-state supply of goods and services.

In other words, the traditional cost and distribution model will get replaced by supply chain efficiencies due to discontinuance of CST and interstate transactions between two dealers will become tax neutral. Therefore, the decreased cost can be added to margins and even the customers will derive benefit from this. This will also provide more freedom to the companies to explore strategic supply chain and distribution chain.

All these are expected to boost investment including foreign investment in pharmaceutical sector.

However, there are certain negative impacts also: since GST applies on different phases of the supply chain. It will have negative impact on free drug samples, bonus/discount schemes etc.

<u>ENVIRONMENTAL NORMS</u>

1. Authorisation for the setting up of facility for generation, collection, reception and treatment of Medical waste under the rules issued under the Environmental protection Act.(Bio-Medical Waste (Management and Handling) Rules 1998)
2. Clearance from state pollution control board to operate and establish facility under the Water Prevention and Control of Pollution Act and Air Prevention and Control of Pollution Act.
3. Permission from Municipal Corporation for incinerator required to dispose of medical waste and body parts.

4. Land allotted for agriculture cannot be used for hospital construction.

Under the Bio-Medical Waste (Management and Handling) Rules 1998, It is the duty of every occupier of an institution generating bio-medical waste which includes a hospital, nursing home, clinic, dispensary, veterinary institution, animal house, pathological laboratory, blood bank by whatever name called to take all steps to ensure that such waste is handled without any adverse effect to human health and the environment.

The Rules in a schedule to it provides how to dispose of or handle each category of bio-medical waste. Every occupier/operator is required to submit an annual report to the prescribed authority in Form 11 under the Rules by 31 January every year, to include information about the categories and quantities of bio-medical wastes handled during the preceding year.

OTHER REGULATORY REQUIREMENTS AND LICENCES

Apart from these the compliance with the following are necessary

1. Municipal permission for construction.
2. Fire safety compliance; a fire licence is necessary to prove that the hospital will not cause any damage or loss of life and needs to be procured from the local municipal council.
3. Registration under shops and establishment legislation specific to the state.
4. Registration of the establishment with the state government as a private medical establishment.
5. Registration under the Prenatal Diagnostics Techniques(Regulation and Prevention of Misuse) Act,1994
6. Compliance with Medical Termination of Pregnancy Act.
7. Approval from Food and Drug Administration to obtain certain drugs and to store human blood if blood bank is present.
8. License for operating X-ray, CT scan as well as cath lab from AERB.
9. Approval for the possession and purchase of denatured spirit.
10. Narcotic license.
11. Registration under various labour laws.

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