

## Tax risks and optimisation possibilities connected with marketing activities carried out by pharmaceutical companies

Many pharmaceutical companies have implemented 'marketing procedures', regulating, among others, the permissible ways, tools and channels for their advertising activities. Such procedures enable the company to take greater advantage of its marketing potential as well as to limit tax, legal and business risks inherent in the pharmaceutical industry. Notwithstanding the above, it is still crucial to monitor changes in tax law regulations as well as in the practice of tax courts and tax authorities, as they can result both in business opportunities and risks for pharmaceutical companies.

### Is marketing important in the pharmaceutical industry?

It is commonly known that advertising is the driving force of commerce. Currently, in the time of an intensive market struggle and omnipresent fight for the customer, advertising, along with other elements of marketing, is a fundamental feature of a product's success. This enormous role of advertising is obvious to entities operating virtually in all industries of the current economy, including the pharmaceutical sector.

General rules of pharmaceutical companies' operations do not differ from mechanisms applicable to other industries. As in

the case of other sectors, the supply and demand law, aspirations to increase the market share as well as boost profits and companies' value apply to the pharmaceutical sector. All these mechanisms have a real impact on the business strategy of pharmaceutical firms.

Still, it should be remembered that products offered by pharmaceutical companies are of a specific nature. Unlike the majority of other goods available in the market, the use of pharmaceuticals can have a direct impact on the health, well-being and sometimes even on the life of consumers. Therefore, Polish law (just like the law of many other countries) provides certain limitations as regards the marketing and advertising of medicinal

products. Namely, entities marketing and advertising medicinal products are obliged to fulfil numerous requirements stipulated in pharmaceutical regulations (related, among others, to the addressees of the advertising messages, permissible channels and tools of transferring such messages). From the pharmaceutical companies' perspective, failure to meet such conditions can result in significant negative consequences of a tax, criminal and administrative nature.

### Are accountants a nightmare for marketing departments?

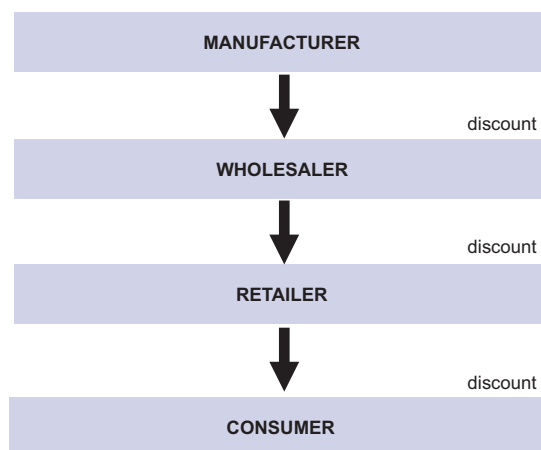
A specific kind of relationship can be observed between the marketing and financial departments of pharmaceutical firms as regards marketing activities. While the former are responsible for planning, designing and performing advertising activities, the latter are focused on their proper tax settlement. In practice, the marketing (advertising) policy of a company is very often shaped by frictions and struggles between marketing and financial teams. Thus, in the pharmaceutical industry, tax implications have frequently a significant impact on the type of marketing activities performed by companies as well as on the tools used. The major adverse effect of such a situation is that the marketing team's creativity and out-of-the-box thinking is not fully utilized (and sometimes even blocked).

Practice shows that many pharmaceutical companies have implemented 'marketing procedures', which describe permissible activities to be undertaken by the marketing department together with their operational, legal and tax implications. Such procedures are very helpful for marketing specialists as they enable the company to take greater advantage of its marketing potential on one hand, and on the other – to limit tax, legal and business risks inherent in the pharmaceutical industry.

### Is "passiveness" a good approach to marketing of medicinal products?

At the same time, strict observance of marketing instructions prepared at a certain point in time can have one major disadvantage, i.e. missing new opportunities and risks, which can have a real impact on the market position of a company. The reality, from the business, legal and tax perspective, is dynamic and subject to constant evolution. From

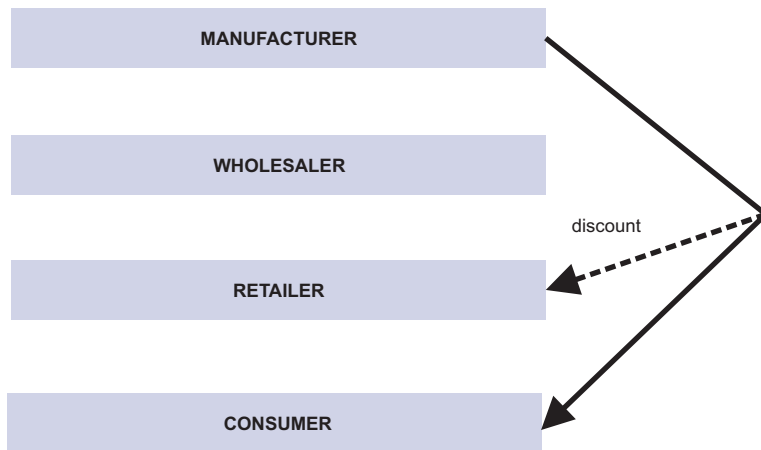
### "Traditional" flow of discounts in the pharmaceutical sector



Source: BT&A, 2010

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## “Indirect” discounts in the pharmaceutical sector



Source: BT&A, 2010

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the tax perspective (as this is the subject of this article), this evolution is based in particular on changing tax law regulations as well as on a rapidly growing body of judicial practice of tax courts and tax authorities.

### Planning opportunity

Development of judicial practice provides possibilities of planning, designing and implementing new marketing activities. For instance, offering a financial incentive (discount) to a customer (either a business partner or an end user) is usually an effective tool of boosting sales. From the tax perspective, discounts can be traditionally granted only to direct contractors (i.e. entities to which the goods or services were previously sold). Therefore, if a manufacturer of pharmaceuticals intends to offer a financial incentive to a retailer, it needs to be made through a wholesaler. Similarly, a discount to be granted to a final consumer has to go through two stages, i.e. the wholesaler and the retailer. Consequently, the procedure of offering the discount is not only time-consuming but can be also quite costly (as a part of the discount is “consumed” at each stage).

Alternatively, based on the recent case law of tax courts, another solution can be applied. Namely, in the case at hand, the discount can be granted directly by the manufacturer to a retailer or a final consumer. What is very important here is that tax courts agree that the taxable base (i.e. the amount serving as a basis for determining the tax) in this situation should be the selling price charged by the manufacturer and reduced by the dis-

count granted. Such incentives are usually called “indirect discounts”.

The solution discussed is becoming more popular in practice, also among pharmaceutical firms. For instance, some companies have introduced ‘money-off coupon’ schemes. It means that upon meeting appropriate conditions (as printed on such a coupon), the customer can receive the amount of money specified in the coupon. Still, bearing in mind the peculiarity of the pharmaceutical sector (in particular the legal limitations concerning the marketing of medicinal products), in each case implementation of this scenario in practice, should be preceded by a legal analysis.

### Risk areas

Undoubtedly, development of judicial practice can also result in certain tax, and at the same time, business risks for pharmaceutical companies. ‘Marketing procedures’ are developed at a certain point and are based on the practice prevailing at that time. A change in this practice, not followed by appropriate modifications to the procedures, may lead to adverse tax consequences for the companies that apply them.

For instance, under Polish pharmaceutical law, the advertising of medicinal products includes, among other things, the sponsoring of conferences, conventions and educational congresses for physicians (and persons trading in medicinal products). In practice, sponsorship of physicians’ participation in such events is very often included in the marketing activities of pharmaceutical companies.

Traditionally, costs related to such activities (if properly supported) have been treated as tax deductible; such an approach was usually not challenged by tax authorities.

However, the District Administrative Court in Warsaw has recently issued a worrisome decision in this respect. Namely, the Court has stated that costs incurred in connection with the sponsoring of physicians’ participation in conferences organised abroad are not directly related to the sponsor’s business activity (taxable income) and thus, are not tax deductible for it. Although this decision is not directly related to the marketing of medicinal products (but rather to the marketing of medical devices, to which the above-mentioned regulations of the pharmaceutical law do not apply), it can still be viewed by tax authorities as a specific “authority” to verify and challenge tax deductibility of such costs incurred by pharmaceutical companies. From the business perspective, recognizing such expenditure as non-tax deductible increases the total costs of marketing activities.

Consequently, in order to mitigate the discussed risk, companies performing such marketing activities could prepare themselves in advance for a potential dispute with tax authorities in this respect (e.g. by collecting documents and arguments confirming the relationship between their costs in question and their standard business activity).

### Summary

To recapitulate, changes in tax law regulations as well as in the practice of tax courts and tax authorities can result both in business opportunities and risks for pharmaceutical companies. Therefore, permanent monitoring of such changes and proper adjustment of ‘marketing procedures’ should be viewed as an integral part of continuous development of business strategy and gaining competitive edge.

Korneliusz Sawinski  
Tax Partner in BT&A Group, Head of BT&A  
Pharmaceutical Team  
korneliusz.sawinski@bttagroup.pl