

TAXES

TAXING MATTERS

TAX ISSUES WILL PLAY A BIGGER ROLE IN GLOBAL PHARMACEUTICAL COMPANY VALUATIONS AND BUSINESS STRATEGIES.



locate IP (intellectual property), manufacturing and service delivery."

Pharma 2020: Taxing times ahead – Which path will you take? is the fifth paper in PwC's Pharma 2020 series examining key forces reshaping the pharmaceutical marketplace. Focusing on the challenges and opportunities ahead from a tax perspective, the report identifies the following market forces making tax issues more complex.

The global financial crisis, government pressure and changing market dynamics for an industry experiencing significant change and rapidly evolving healthcare reforms are likely to drive up the effective tax rate for the global pharmaceutical and life sciences industry, according to a report by PricewaterhouseCoopers (PwC) entitled Pharma 2020: Taxing Times Ahead – Which path will you take? The industry's response to these trends, including diminishing reliance on the blockbuster drug model, will make tax planning more complicated and challenging for tax executives working for pharmaceutical and life sciences companies.

A poll of 35 global senior tax executives from pharmaceutical, biotech and medical device companies, conducted by PwC, found that six in 10 tax leaders around the world agree that an increase in the effective tax rate for the pharmaceutical and life sciences industry is inevitable.

63% of the report participants agreed that the cost of increased taxes on their organisations might eventually be passed onto consumers unless they find ways to operate more efficiently and transform their approach to R&D and sales and marketing.

62% of tax executives said they are looking to maximize tax credits and other incentives for research and development and all executives polled said they believe that the demand for tax specialists will grow substantially as tax issues for the industry become more complex.

More than half of the respondents said they are now being consulted early on by senior management in strategic business decisions, and thus have influence over the direction of the company. Still, 34% said they are consulted late in the game, and 9% of tax leaders said they are informed after the fact about strategic business decisions that have tax implications for the organisation.

John Kelly heads up the pharmaceutical and life sciences practice at PwC Ireland, and says: "To continue delivering value to shareholders and society, pharmaceutical and life sciences companies must make strategic decisions about how they will drive innovation and profitability, but as they do so, each company's top tax executive needs a prominent role in that decision making. Tax planning will be a critical consideration, not an afterthought, of long-term business plans to grow, buy, merge or sell and it will be one of the most important considerations in deciding where to

ECONOMIC AND GOVERNMENT PRESSURE

The global recession has caused governments around the world to incur massive levels of expenditure. Governments are now looking for ways to cut expenditure and to identify new sources of revenue.

This is likely to result in governments moving to pay for results - managed outcomes and refusing to pay for "me too" drugs. This will mean that the power of reimbursers and insurers will likely increase and the power of pharmaceutical companies weakened as a result.

Governments will also be even more focused on generating tax revenues from global corporations. This will put a premium on ensuring that global business models are supported by the requisite levels of substance in key jurisdictions.

Payers want better value for the money they spend on healthcare and are focussing their efforts on increasing delivery of successful treatments. In response, drug and device makers are shifting from a purely product-centric focus to a service model aimed at improved patient outcomes and prevention or cure, versus ongoing treatment of disease.

As such, with other participants they are packaging traditional products with holistic services including diagnostic, wellness and compliance monitoring. In addition, with the advancement of personalised medicine and tailored approaches to prevention and care, pharmaceutical companies are developing more complex and fragile specialised therapies, many of which need to be manufactured in closer proximity to patients.

By increasing service delivery and locating manufacturing closer to patients in the end market, both the supply chain and IP will be geographically dispersed. Pharmaceutical and life sciences companies could not only face new and higher taxes as a service provider, but they will have less ability to allocate profits to lower tax-rate locations. Furthermore, a decision to locate service providers in end markets could create permanent establishments in multiple tax jurisdictions, increasing the risk of double taxation disputes involving international or intra-company allocations around pricing, royalty rates, interest, management fees, business expenses and gross revenue.

"The Irish healthcare system delivery model is currently configured and funded based upon an acute hospital model of care. The future sustainability of healthcare will be in designing a healthcare system that is based upon services designed around the ergonomics of the patient or the individual based upon disease prevention or management of disease in the community," Donal Landers, senior manager, PwC Irish Healthcare Practice explains.

"This will require the development of new services – community based diagnostics, home pharmacotherapy, telehealth, etc - all designed to be delivered to the patient in or close to their home. This is the challenge – can pharma, healthcare payers and providers align their value chains in a way that benefits them in terms of value for money and, most importantly, benefit the patient and society as a whole," he adds.



LIFE SCIENCES COMPANIES ARE INTERESTED IN LOCATING IP DEVELOPMENT IN AREAS THAT OFFER ECONOMIC AND TAX INCENTIVES AND TO EXPAND THEIR PRESENCE IN EMERGING MARKETS

COMPETITION AND INVESTMENTS

The need to fill the shrinking drug pipeline has fuelled a resurgence in mergers and acquisitions (M&A), in-licensing arrangements and formation of partnerships and joint ventures - a trend PwC expects to continue. Each of these strategies comes with significant tax implications, depending on how a company accounts for acquisition-related items, structures royalty payments, and shares profit and loss among different legal entities and locations.

Pharmaceutical and life sciences companies are interested in locating IP development in areas that offer economic and tax incentives and to expand their presence in emerging markets that promise growth potential. International competition is intensifying to attract new investment by pharmaceutical and life sciences companies, particularly from emerging markets such as China. According to PwC, this trend may further drive profit growth to the East but companies will need to balance increased income with higher tax rates and potential price controls.

"To manage effective tax rates, pharmaceutical and life sciences companies will need to develop tax planning consistent with their new business models and carefully balance risk with opportunity. Tax will need to be involved sooner and up front, a trend we are already seeing throughout the industry," Kelly concludes. ■



Why Ireland?

"To reduce tax and operating costs, international groups are increasingly seeking an onshore low-tax location in which to centralise IP and simplify corporate structures. Ireland is uniquely placed to meet these requirements."

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