H.R. 6392 (117th Congress) – No Tax Breaks for Drug Ads Act

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Tax Policy Analysis

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Introduction

Do you find commercials for medications are almost inevitable when watching your favorite news or TV shows? About three decades ago, the only medication advertised on TV were nonprescription drugs. In 1997, the Food and Drug Administration permitted pharmaceutical companies to publicize prescription products directly to consumers in TV commercials.[1] Since then, advertisement for prescription drugs has significantly grown, leading to such advertising expenses skyrocketing to average $6 billion annually.[2]

On January 13, 2022, Representative Elissa Slotkin (D-MI) introduced H.R.6392, No Tax Breaks for Drug Ads Act and referred it to the Ways and Means Committee. The purpose of this bill is to "prohibit a tax deduction for expenses relating to direct-to-consumer advertising of prescription drugs".[3] The bill would add new section 280I called Disallowance of deduction for direct-to-consumer advertising of prescription drugs. In the past few years, several bills have been introduced in Congress to end "tax subsidies" for prescription drugs ads, such as H.R. 8399 (116th Congress), S. 2478 (115th Congress) and S. 2623 (114th Congress).

The current tax law allows a deduction for advertising expenses as an ordinary and necessary expense that relates to the taxpayer's trade or business (§162). Such a deduction is not listed as a tax expenditure in the Tax Expenditures Report from the Office of Tax Analysis of the U.S. Department of the Treasury, since it is not a provision "attributable to provisions of Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability".[4] Advertising expenses are a normal deduction in a business income tax system.

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1 FDA. (1997, November 21). FDA backgrounder on FDAMA. U.S. Food and Drug Administration. Retrieved July 20, 2022, from https://www.fda.gov/regulatory-information/food-and-drug-administration-modernization-act-fdama-1997/fda-backgrounder-fdama.
2 U.S. Government Accountability Office. (2021, May 18). Prescription drugs: Medicare spending on drugs with direct-to-consumer advertising. Prescription Drugs: Medicare Spending on Drugs with Direct-to-Consumer Advertising | U.S. GAO. Retrieved July 20, 2022, from https://www.gao.gov/products/gao-21-380.
3 H.R.6392 - 117th Congress (2021-2022): No Tax Breaks for Drug Ads Act. Congress.gov | Congress Library. (n.d.); retrieved July 20, 2022, from https://www.congress.gov/bill/117th-congress/house-bill/6392/text?r=1846&s=5.
4 Tax expenditures. U.S. Department of the Treasury. (2022, January 19); retrieved July 21, 2022, from https://home.treasury.gov/policy-issues/tax-policy/tax-expenditures.

However, Representative Slotkin and others view the advertising expense tax deduction for pharmaceutical companies as "a tax loophole that allows these giant companies to avoid paying billions of dollars in taxes while prices on prescription drugs continually increase for consumers".[5]

Next, we apply the AICPA Tax Policy Concept Statement 1 – Guiding principles of good tax policy: A framework for evaluating tax proposals to analyze H.R. 6392.[6]

Criteria	Does the proposal satisfy the criteria? (explain)	+/-
Equity and Fairness – Are similarly situated taxpayers taxed similarly? Also consider any different effects based on an individual's income level and where they live.	Pharmaceutical companies will be taxed similarly since no tax deduction for direct-to-consumer advertising expenses would be allowed for any pharma company. However, corporations in other industries that have similar revenues would be allowed to deduct advertising expenses in calculating their taxable income. For example, Company A is a pharmaceutical company that has $50 billion of gross income and $30 billion of expenses (including $2 billion of advertising expenses), with the bill enacted, Company A's taxable income is $22 billion, of which $4.62 billion tax liability is calculated. Company B is an automobile manufacturer that has the same gross income and expenses, and with the deductibility of advertising expenses, Company B's taxable income is $20 billion, of which $4.2 billion tax liability is calculated. Both companies have the same amount of revenue and expenses per GAAP, but this bill makes Company A pay an additional $420 million in tax. A similar result is met in comparing pharma and non-pharma businesses of any size. Therefore, the bill does not meet the principle of horizontal equity. Vertical equity is met among pharma companies, but not in looking at all businesses that advertise.	-

5 Slotkin introduces bill to close tax loophole for Big Drug Companies. Representative Elissa Slotkin. (2022, January 19); retrieved July 20, 2022, from https://slotkin.house.gov/media/press-releases/slotkin-introduces-bill-close-tax-loophole-big-drug-companies.

6 American Institute of Certified Public Accountants (AICPA) Tax Division. (January 2017). Tax Policy Concept Statement No.1-Guiding Principles of Good Tax Policy: A Framework for Evaluation of Tax Proposals; https://us.aicpa.org/content/dam/aicpa/advocacy/tax/downloadabledocuments/tax-policy-concept-statement-no-1-global.pdf.

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Certainty – Does the rule clearly specify when the tax is to be paid, how it is to be paid, and how the amount to be paid is to be determined?	Prohibiting the tax deduction for expenses relating to direct-to-consumer advertising of prescription drugs will affect certainty negatively, because defining direct-to-consumer advertising can be complicated and tricky when creativity comes into play. For example, a pharmaceutical company invites a celebrity or an industry expert to a popular talk show or a YouTube channel presenting the significance of depression and adds ten seconds to the presentation mentioning the prescription drugs. How will this ten seconds be treated? How is the expense of this advertising computed? Therefore, the bill does not meet the certainty principle on how to determine the amount that is disallowed, when some business activities might include an element of direct-to-consumer advertising. In addition, what about when they run ads directed at doctors or hospitals? Since the individual viewers might also be consumers of the drug, is that advertising disallowed too? What about the cost of apparel they give to employees that has the company name on it and that causes the viewing public to think of the company's drugs?	-
Convenience of payment – is the tax due at a time that is convenient for the payor?	Prohibiting the tax deduction for expenses relating to direct-to-consumer advertising of prescription drugs will have no effect on the business tax return and payment due date. Corporations will file their tax return and pay their taxes in the same manner no matter whether this bill is enacted.	N/A
Effective Tax Administration – Are the costs to collect the tax at a minimum level for both the government and taxpayers? Also consider the time needed to implement this tax or change.	Due to the complexity of defining direct-to-consumer advertising in practice, the corporate taxpayers need to spend more time to identify advertising expenses. The IRS will likely spend more audit time to ensure the advertising cost deducted by pharmaceutical companies is not related to direct-to-consumer advertising. There is a possibility that more court cases will emerge due to noncompliance to business advertising expense deductions.	-
Information Security – Will taxpayer information be protected from both	Prohibiting the tax deduction for expenses relating to direct-to-consumer advertising of prescription drugs will have no effect on the information security, as there are no specific reporting requirements in disclosing any sensitive information.	N/A

unintended and improper disclosure?		
Simplicity - can taxpayers understand the rules and comply with them correctly and in a cost-efficient manner?	Prohibiting the tax deduction for expenses relating to direct-to-consumer advertising of prescription drugs will add another layer of complexity to the tax code, because categorizing direct-to-consumer advertising will require precise definitions such as to distinguish direct-to-wholesaler advertising that serves multiple markets. Corporate taxpayers in the pharmaceutical industry will need to spend more time and money to make sure staying in compliance with this tax nondeductible expense when nontraditional advertising is involved.	**-**
Neutrality - The effect of the tax law on a taxpayer's decisions as to how to carry out a particular transaction or whether to engage in a transaction should be kept to a minimum.	Removing the deductibility of drug advertising violates the principle of neutrality of the tax code. Additionally, it violates neutrality to treat advertising expenses as any different from normal business expenses. Current tax law allows advertising expense deduction in general. Adding a section to disallow expenses relating to direct-to-consumer advertising of prescription drugs can affect pharmaceutical companies' decisions on how to promote their products. Instead of traditional advertising, these companies may reach out to more healthcare professionals including caretakers to promote their products privately (through means other than advertising which would be disallowed by the bill), which may cause biased recommendations and unhealthy competition among healthcare professionals.	**-**
Economic growth and efficiency – will the tax unduly impede or reduce the productive capacity of the economy?	Pharmaceutical companies spend billions of dollars in advertising every year. By disallowing the tax deduction for expenses relating to direct-to-consumer advertising of prescription drugs, these companies may reduce such advertising, which will negatively affect the profitability of many businesses, including advertising agencies, television and radio stations and publishers. For example, newspapers in print or in digital versions rely on selling advertising space to make profits. Significant decrease in advertising revenue for many businesses will also negatively impact jobs, which ultimately reduces the productive capacity of the economy.	**+/-**

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	If the bill leads pharma companies to not spend as much on advertising and use the savings to reduce drug prices, customers will have more funds for other spending or for savings, which can help the economy.	
Transparency and Visibility – Will taxpayers know that the tax exists and how and when it is imposed upon them and others?	Prohibiting the tax deduction for expenses relating to direct-to-consumer advertising of prescription drugs does not affect transparency and visibility. All the pharmaceutical companies are giant businesses and have their own accounting and tax department, which allows these companies to know that the tax exists and when it is imposed upon them no matter whether this bill is enacted or not. However, the classification of various advertising activities is not easy, which may cause errors in calculation and reporting. A Treasury Regulation with examples will be needed to provide more detailed information on compliance.	**-**
Minimum tax gap – is the likelihood of intentional and unintentional non-compliance likely to be low? Is there any way people may intentionally or unintentionally avoid or evade this tax or rule?	Prohibiting the tax deduction for expenses relating to direct-to-consumer advertising of prescription drugs will likely increase intentional and unintentional non-compliance due to the complexity of defining direct-to-consumer advertising in practice when more innovative ways of promoting prescription drugs are created. The interpretation of what constitutes direct-to-consumer advertising can also be different by the IRS, the courts, and the pharmaceutical companies.	**-**
Accountability to taxpayers – Do taxpayers have access to information on tax laws and their development, modification and purpose; is the information visible?	This bill has a strong intention to reduce pharmaceutical companies' advertising expenses relating to direct-to-consumer advertising, so that more funds can go to R&D, lower prices of prescription drugs and increase the government revenue. The rationale for disallowing such advertising expenses as a tax deduction seems clear for the taxpayers because it is very specific. However, the purpose of this bill is to change the big pharmaceutical companies' behavior and lower prices for consumers. It is not clear what data was reviewed and why is it proposed to be part of the tax law rather than provided in	**+/-**

	another manner, such as via other government agencies such as FDA establishing stricter rules or banning or reducing the amount or size of direct-to-consumer advertising of prescription drugs? Therefore, the principle of accountability to taxpayers is partially met.	
Appropriate government revenues – will the government be able to determine how much tax revenue will likely be collected and when?	The government has access to the data on how much advertising expenses were deducted by pharmaceutical companies in past years and can use the data to estimate the amount of tax revenue to be generated if the bill is enacted. However, it is difficult to predict how significant that pharmaceutical companies will shift from direct-to-consumer advertising to other types of marketing. Therefore, it will be difficult to produce a reasonable estimation on the potential revenue.	**+/-**

Tax Analysis Summary

Based on the tax policy analysis, H.R. 6392 does not meet the principles of good tax policy with only mixed rating on the principle of accountability to taxpayers. Most of the key principles of good tax policy are not satisfied. Overall, this bill has more weaknesses than strengths.

Limiting tax deductions is an arbitrary way of approaching a legitimate concern. Consumer drug ads play an important role in debates about the costs of prescription drugs, the risks of misuse and overuse of some medications, the balance of authority between doctors and patients, the limits of commercial speech, and a host of other issues.

H.R. 6392 is not well crafted to address these issues. Allowing drug companies to deduct advertising costs is not a subsidy. Many other deductions are such as certain tax credits and the mortgage interest deduction. The corporate income tax is a tax on corporate income. To calculate income properly, businesses total up their revenues and deduct their expenses of producing that income. Those expenses include wages for workers, rent for office space, and the costs of advertising. Under an income tax, companies deduct those expenses because they incur them in pursuit of the profits. It is debatable how fast companies in any industry should write-off their advertising costs as some of these ads may produce long-term benefits for the company. But in an income tax, it is an allowable business expense.

The purpose of this bill is to reduce the expenses related to direct-to-consumer advertising of prescription drugs, so that more funds can go to R&D, lower prices of prescription drugs and increase the government tax revenue. However, can the goals of this bill truly be achieved by simply cutting the deduction?

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First, pharmaceutical companies can always find other types of marketing to promote their products, so the deductible advertising expense may not be reduced by this bill. Second, even if funds are saved from expenses, they may not be used to invest in R&D, but to repurchase their company stocks or to pay out more dividends to shareholders. Third, the high prices of prescription drugs are not only due to heavy advertising.[7] There are two primary factors that push prescription drugs prices high. The first one is the monopoly situation in the pharmaceutical industry, which is caused by the strict drug manufacturing rights that are protected by the U.S. government. The other reason is that pharmaceutical companies are allowed to set prices for drugs with little negotiation with buyers or consideration of affordability by the target consumer base. Without changing our healthcare system, it will be difficult to change the high price situation of prescription drugs [Note: *The Inflation Reduction Act of 2022, allows the Secretary of Health and Human Services to negotiate prices on certain drugs in Medicare Parts B and D. This provision aims to lower the cost of drugs that are at least nine years past FDA approval. The Act imposes a significant penalty on drug companies unwilling to negotiate*.[8]]

We do not believe that limiting deductibility is the right way to discourage direct-to-consumer drug advertising. Disallowing the tax deduction may not reach the purpose of reducing prescription drugs prices. Instead, it creates a financial penalty based on the corporate tax rate. Eliminating the tax deduction would have increased the effective cost of drugs by more than a third. Without deductibility, a $100,000 ad would have cost as much as a deductible $127,000 one.[9]

To conclude, our suggestion is that not all goals can be achieved through our tax system. Instead of proposing a tax bill that is not considered a good tax policy, other government agencies, such as FDA and Congress, might step in and put stricter regulations and rules on the direct-to-consumer advertising of prescription drugs. The Food and Drug Administration should weigh the pros and cons of consumer ads and how they vary across different conditions, therapies, and advertising media.

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7 "Should Congress use the income tax to discourage consumer drug ads?" Tax Policy Center. (2019, January 28); retrieved July 21, 2022, https://www.taxpolicycenter.org/taxvox/should-congress-use-income-tax-discourage-consumer-drug-ads.
8 H.R. 5376, https://www.congress.gov/bill/117th-congress/house-bill/5376/text/rh-.
9 The net after-tax cost of a $127,000 expenditure under the current system is actually only $100,000 [Deduction = $127,000 X .21 = $26,667; $127,000 - $26,667 = $100,333, or about $100,000].