



# The Ohio Commercial Activity Tax: Impact on Pharmaceutical Distributors

Ohio's primary pharmaceutical distributors are uniquely positioned at the center of the healthcare supply chain, providing vital medicines and other products and services to more than 24,000 pharmacy and provider settings throughout the state. Pharmaceutical distribution is a high volume, high-value, yet very low-margin industry, disproportionately affected by gross receipts tax models such as Ohio's Commercial Activity Tax (CAT). In fact, under this construct, pharmaceutical distributors bear a tax burden **nine times** greater than the average for all industries.

A modification to the gross receipts tax model for this unique industry would help ensure a fair and equitable approach to tax policy and maintain the level of efficiency and service pharmaceutical distributors bring to Ohio.

## BACKGROUND

HDA distributor members serve as the vital link in the healthcare supply chain by protecting product integrity and providing the highest-quality medicines and services, ensuring cost management and enabling providers to deliver care more effectively to patients.

Primary pharmaceutical distributors purchase a majority of prescription medicines and other medical products directly from manufacturers and store this inventory in their networks of warehouses and distribution centers in Ohio and across the country. Pharmacies, hospitals and other healthcare providers place orders with distributors for the medicines they need in a just-in-time model. Distributors process and deliver these orders on a daily basis, enabling patients timely access to the medicines they need.

Distributors also work efficiently to bring safety and reliability to the supply chain. They provide logistics expertise and advanced information technology to streamline supply chain operations and protect product integrity, which reduces costs, saving the nation's healthcare system billions of dollars each year.

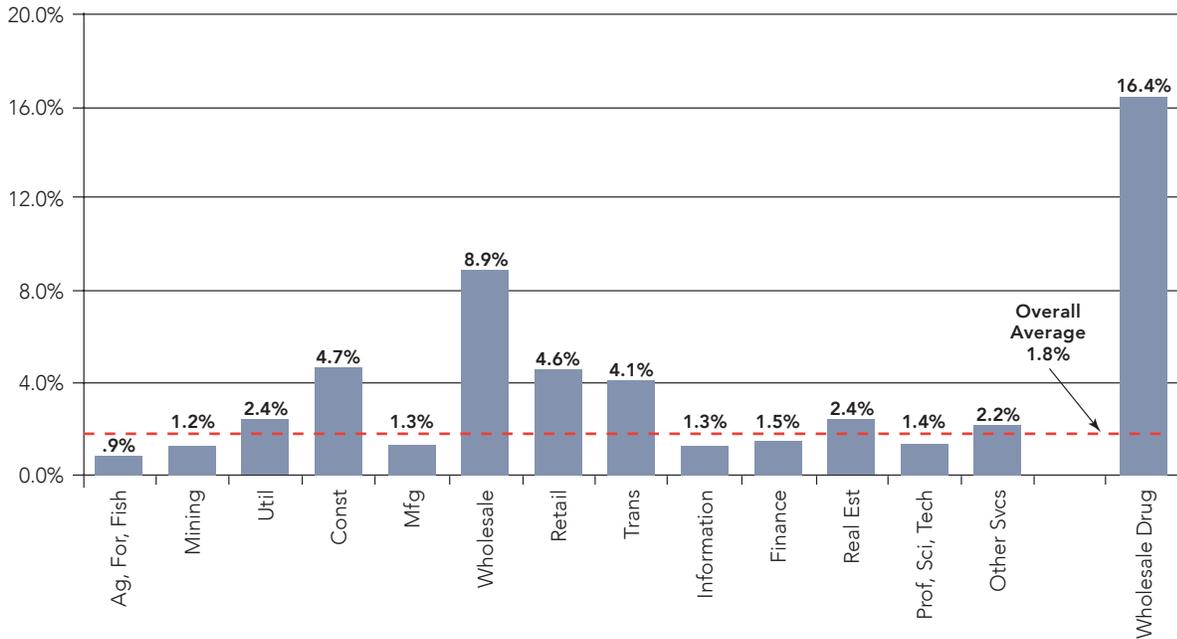
## HDA MEMBERS ARE DISPROPORTIONATELY AFFECTED BY THE CAT

When Ohio first instituted the CAT in 2005, the goal was to implement a simple, fair and equitable tax structure for Ohio businesses. However, HDA members have not seen tax benefits under this gross receipts-based tax structure. The CAT is not equitable, neutral or competitive as applied to pharmaceutical distributors.

As detailed in an independent study by the accounting firm of PricewaterhouseCoopers LLP prepared for HDA, pharmaceutical distribution is an industry that suffers disproportionately from a gross receipts tax, such as Ohio's Commercial Activity Tax. Due to extremely thin margins, the imposition of even a low-rate gross receipts tax imposes an extremely high tax burden relative to the industry's profits and net worth. For example, Ohio's 0.26 percent gross receipts tax averages 1.8 percent of pre-tax income for all industries; by contrast, for healthcare distributors, the tax burden is equivalent to 16.4 percent of pre-tax income, therefore resulting in the industry experiencing a significantly higher tax burden than the average for all other industries.

The General Assembly's intent in 2005 was to simplify business taxes and create a system that was fair, broad-based and equitable. We agree with this intention, yet we are operating under a system that disproportionately impacts one industry over all others.

## 0.26% GROSS RECEIPTS TAX AS A PERCENT OF PRE-TAX INCOME BY INDUSTRY, 2011–13



Source: Compustat, HDMA Factbook and PriceWaterhouse Coopers Calculations (2015)

### HDA RECOMMENDS A FAIR, EQUITABLE SOLUTION

We urge the General Assembly to consider a modification that would address the concerns stated above. HDA believes a viable alternative could include a modified gross receipts tax, which would be imposed on a pharmaceutical distributor's gross receipts minus the pharmaceutical distributor's cost of goods sold.

In an effort to bring policy more in line with the goal of a broad-based and fair tax structure for Ohio pharmaceutical distributors, the Legislature should consider an alternative tax policy. Moreover, Ohio lawmakers should consider solutions identified and implemented by other states that have recognized the unbalanced tax liability that comes from a gross receipts tax.

For example, the state of Texas provides a notable example of an effective tax policy that calculates tax liability based on gross receipts, and the tax structure includes a Cost of Goods Sold (COGS) deduction from gross receipts. This policy brings the tax liability of industries in much closer alignment with the goal of being broad-based and fair across all tax payers.

Given the vital nature of the products involved, Ohio's adoption of an alternate tax structure for pharmaceutical products would recognize the importance of maintaining efficiencies in the healthcare system and ensure that the costs of prescription medicines are maintained at manageable levels for Ohio consumers.