

**PQMD***The Partnership for Quality Medical Donations*

James B. Russo, Executive Director

### **Drug Donations: What Drives Them? Should They Be Driven? Policy Implications of a Debated Practice**

In recent years there has been a good deal of discussion in the medical and health policy literature over various aspects of drug donations — much of it focusing on a disturbing volume of reports on inappropriate donations, blame for which is, at least by inference, laid at the doors of multinational pharmaceutical firms. It is generally accepted that the firms make donations for anything but altruistic reasons, *e.g.*, it is cheaper to donate and ship unwanted drugs (needed or not) to a developing nation than to dispose of them properly, and U.S. tax laws make it possible to make money out of worthless drugs.

In fact, although the literature abounds with reports of inappropriate drug donations, sometimes by the ton, there are no documented examples of “drug dumping” by multinational firms. Until completion of the World Bank/WHO study of drug donations following four major emergencies in four nations, little or no effort has been made to go beyond discovery of inappropriate donations and actually pinpoint the donor. That study found that while many poor donations had been made, multinational corporations played a role in none of them.

At this juncture, it appears that the most that can be said about poor drug donations is that although they persist, their genesis is poorly understood. Further, it appears that the factors that *motivate* drug donations are poorly understood as well.

The purpose of this paper is to clarify two points: (1) the US tax rules that provide an incentive to donate drugs, and (2) factors that seem to influence decisions to donate.

#### **1) How Tax Deductibility for a Charitable Donation is Determined**

Donation of a medication or other medical product under current US tax regulations require the following criteria to be satisfied.

- a) The donation must be for the use of the “ill, needy or infants.” The Internal Revenue Code regulations define these terms.
- b) The drug must be sellable, *i.e.*, it must have a “fair market value,” because the deduction will be a fraction of that value, as explained in ¶ 5 below. Therefore, drug samples do not qualify for the deduction, since their selling price is zero. Drugs nearing expiration also have little or no market value, since pharmacies and hospitals won’t accept them, so they, too, earn no charitable tax deduction.

- c) The organization receiving the donation must acknowledge it with specificity, and must state that the donation was received unconditionally. Once the donation is made, the donor cannot control how or where it will be used, nor can the donor request or receive any form of compensation.
- d) The donated product must meet all FDA requirements.
- e) The deduction is determined under an Internal Revenue Service formula, as follows: The donor may deduct "the basis of the contributed property" (not the cost of goods) plus half the difference between the "basis" cost and the fair market value (not the gross profit) — OR twice the "basis" cost — whichever is lower. The "basis" as defined in the regulation is the "the inventoriable carrying cost assigned" to the product. It is determined by the way the firm normally accounts for inventory for tax purposes and depends on how it takes account of various overheads and other costs. These calculations are of course subject to review by the Internal Revenue Service.

**For example:** Assume that 30 tablets of a donated drug could have been sold to the donor company's wholesale distributors for \$50. Assume further that the basis cost under the firm's normal inventory accounting practice is \$15. The calculation would be:

- ◆ \$15 (the basis) plus half the difference between basis and fair market value, *i.e.*, [ $\$15 + \frac{1}{2} (\$50 - \$15)$ ], or \$32.50.
- ◆ However, as noted earlier, the regulations do not allow the deduction to exceed twice the basis, as it would in this illustration. The deduction would therefore fall to \$30.00.
- ◆ Assuming a corporate tax rate of 35%, the firm's taxes would be reduced by \$10.50.

## 2) Motivations for Donations Vary

It is sometimes contended that the tax deductibility of a drug donation can *make* money for the donors and that donation of excess inventory is cheaper than incinerating it. Neither assertion has been documented. If it were valid, it would seem likely that much more donating would be going on, by more firms. Yet in practice, relatively few firms account for the great majority of medicines donated to humanitarian organizations around the globe.

Indeed, it is not clear that tax deductibility is the most important motivating factor.

This was learned in connection with legislation introduced by Congressman Lloyd Doggett (D, TX) to disallow the charitable tax deduction on donations unless they meet the WHO Guidelines on Drug Donations. When Mr. Doggett asked the Congressional General Accounting Office to estimate the savings to the US Treasury his bill would bring, GAO reported that so few drug firms take the deduction that no

estimate was feasible. Moreover, were the donors' primary motives to center on maximizing profits, they would not supplement their product donations with cash and managerial assistance, as they often do. Nor would they expend resources needed to expand plant capacity — as at least two firms have done — to ensure adequate donations of products needed for large-scale disease control donation programs.

In summary, it seems apparent that the deductibility of a donation is conducive to, but not determinative of, the decision to donate. Additional factors appear to be at least as important determinants of a firm's decision to donate its products:

- ◆ The firm's sense of community;
- ◆ Employee pride in being part of a socially accountable organization;
- ◆ Encouragement and support from stockholders;
- ◆ A tradition of collaborating with humanitarian agencies;
- ◆ Knowledge that the medicines the company makes could meet a particular need

### **Conclusion and Policy Implications**

It seems clear that a mix of factors affects drug donations and those individual prospective donors respond to them differently. The interplay of the social, tax and economic factors, and the relative importance of each, remain worthy of further study.

The over-arching policy question remains: do drug donation programs merit incentives? The answer to that question requires assessment of whether or not they play useful roles in advancing health objectives.

A recent report jointly prepared by the World Health Organization (WHO) and the Secretariat of the World Trade Organization (WTO) suggests, at least with regard to disease control donation initiatives against onchocerciasis, trachoma and lymphatic filariasis, the answer may be yes. Furthermore, "The prospects of such contributions providing a sustainable solution may be enhanced where they are accompanied by measures by developed country governments, such as tax incentives."