Office of Chief Counsel
Internal Revenue Service
Memorandum

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subject: Reimbursement of Branded Prescription Drug Fee

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

1. Whether a taxpayer-member of a controlled group, within the meaning of Treas. Reg. § 51.2(e), who remits payment of the Branded Prescription Drug (BPD) fee (the remitting member) is *per se* entitled to exclude from gross income a reimbursement of all or a portion of the fee from other members of the controlled group who are jointly and severally liable for the fee.

2. If the existence of joint and several liability does not result in a *per se* exclusion from the remitting member's gross income, what factors should be analyzed to determine whether the remitting member must include reimbursement of all or a portion of the BPD fee in gross income?

CONCLUSIONS

1. Joint and several liability among members of a controlled group, within the meaning of Treas. Reg. § 52.1(e), does not result in a *per se* exclusion from the remitting member's gross income, of reimbursement by other members of the controlled group of all or a portion of the BPD fee.

2. Whether reimbursement of all or a portion of the BPD fee by members of the controlled group to the remitting member constitutes gross income to the remitting member generally depends on whether the remitting member benefits from the fee payment. In determining whether, and to what extent, the remitting member is the beneficiary of payment of the BPD fee, several non-dispositive factors must be evaluated.

FACTS

Taxpayer is a U.S. corporation that is a member of an affiliated group (Group) that includes both U.S. and foreign corporations. Group develops, manufactures, and distributes medical care products, including branded prescription drugs. The foreign members of Group (collectively, Foreign) manufacture the branded prescription drugs and own all the intellectual property (IP), including technology and branding/distribution rights, associated with the drugs. Foreign contracts with Taxpayer to distribute the branded prescription drugs in the United States. As part of the intercompany agreement between Foreign and Taxpayer, Foreign licenses U.S. branding and distribution rights to Taxpayer to enable Taxpayer to market and distribute the branded prescription drugs within the U.S.

Taxpayer characterizes itself in its transfer pricing documentation as a “limited risk” distributor. Under its contracts with Foreign, Taxpayer receives a fixed profit margin resulting from the sales of the branded prescription drugs within the U.S. Pursuant to Taxpayer’s transfer pricing method and as reflected in its transfer pricing documentation, any excess profits or losses beyond the specified operating profit margin are allocated by the Taxpayer to Foreign.

The Patient Protection and Affordable Care Act, Public Law 111-148 (124 Stat. 119 (2010)) (ACA), imposes a Branded Prescription Drug (BPD) Fee on entities that manufacture or import branded prescription drugs for sale to specified government programs. ACA § 9008(f)(2) and Treas. Reg. § 51.9(d) provide that the BPD Fee is treated as a nondeductible excise tax under I.R.C. § 275(a)(6). ACA § 9008(d)(2) and Treas. Reg. § 51.2(e) generally require controlled groups to be treated as a single entity for purposes of the BPD fee. Treas. Reg. § 51.2(f) requires controlled groups to select a designated entity to file reports related to the BPD fee and to pay the BPD fee to the U.S. Treasury. Under Treas. Reg. § 51.8(d), all members of a controlled group are jointly and severally liable for the BPD Fee. Group is a controlled group within the meaning of Treas. Reg. § 51.2(e). The Labeler Code of the National Drug Code identifies Taxpayer as the manufacturer or importer of Group’s branded prescription drugs. Taxpayer is also the designated entity for Group.

Taxpayer remits the payment of the BPD fee to the U.S. Treasury on behalf of the Group. Pursuant to the intercompany agreement between Foreign and Taxpayer, Foreign reimburses Taxpayer for the entire amount of the BPD fee.

Because the BPD fee is treated as a nondeductible excise tax, Taxpayer has not claimed a deduction for payment of the fee. However, Taxpayer presently excludes the full amount reimbursed by Foreign from its gross income.

You have requested advice regarding whether the existence of joint and several liability among members of Group means that the amount reimbursed to Taxpayer for payment of the BPD fee is excludable from Taxpayer's gross income. Further, if the existence of joint and several liability is not determinative as to whether the reimbursement is excludable from Taxpayer's gross income, you have requested advice on the appropriate factors to evaluate in making this determination.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code generally provides that gross income means all income from whatever source derived. The term "income" is broadly defined as "instances of undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955).

In general, the payment of the expenses of a taxpayer by another is includible in the taxpayer's gross income. *See, e.g., Old Colony Trust v. Commissioner*, 279 U.S. 716 (1929) (payment of employee's income taxes by the employer made in consideration of employee's services constituted additional taxable income of employee); *Silverman v. Commissioner*, 253 F.2d 849 (8th Cir. 1958) (payments to an employee for wife's travel expenses on business trip to Europe includible in gross income of employee). Moreover, the payments are includible in the taxpayer's gross income regardless of whether they are made directly to the taxpayer or to a third party on the taxpayer's behalf. *See Old Colony* at 729 (holding it "immaterial that the taxes were paid over directly to the government. The discharge by a third person of an obligation [of the taxpayer] is equivalent to receipt by the [taxpayer]").

However, a taxpayer generally does not have gross income when it is reimbursed for an expense paid by the taxpayer as an agent or conduit, on behalf of the reimbursing party. Instead, an agent or conduit is merely an intermediary to funnel payment between the beneficiary and recipient and does not exercise control or dominion over the amounts received and remitted. *See, e.g.*, *Seven-Up Co. v. Commissioner*, 14. T.C. 965 (1950) (soda manufacturer-taxpayer did not realize income upon receipt of funds from bottlers for use in a national advertising campaign when the manufacturer agreed to collect the money and spend it on the national campaign, but did not profit or maintain discretion in how to use the funds); *Affiliated Foods, Inc. v. Commissioner*, 154 F.3d 527 (5th Cir. 1998) (operator of a food purchasing cooperative did not realize income upon receipt of funds from vendors for use in advertising, where vendors had ultimate control over when and where to release the funds for advertising).

A corollary principle is that when a person pays the expenses of a taxpayer to advance the business interests of the payor, the payments are not included in the taxpayer's gross income, notwithstanding any incidental or indirect economic benefit to the taxpayer. For example, in *United States v. Gotcher*, 401 F.2d 118 (5th Cir. 1968), a European manufacturer paid expenses of a taxpayer-auto dealer's trip to Germany to tour facilities as required by the manufacturer. The manufacturer's payments were not included in the taxpayer's gross income because the costs for the taxpayer's trip were incurred primarily for the manufacturer's benefit.

Thus, even when a taxpayer is legally obligated to pay a certain expense, reimbursement by another party will generally not be income to the taxpayer when the expense is undertaken for the reimbursing party's own benefit and not for the benefit of the reimbursed party. In such a case, the reimbursement is not an accession to the wealth of the taxpayer.

Finally, in cases in which a taxpayer pays an expense that benefits both the taxpayer and another party, it may be appropriate to treat the reimbursement of a portion of the expense as excludable from the taxpayer's gross income notwithstanding that the taxpayer also benefitted from the overall expense. For example, in Rev. Rul. 84-138, 1984-2 C.B. 123 (1984), the Service ruled that a subsidiary's parent corporation did not have income when its subsidiary reimbursed the parent for the subsidiary's pro rata share of certain general and administrative expenses. The subsidiary's reimbursement to parent was instead treated as a repayment of an advance made by the parent to pay certain expenses on the subsidiary's behalf. The Service distinguished the reimbursement from *Jergens Co. v. Commissioner*, 40 B.T.A. 868 (1939), where certain cost-sharing reimbursements were held to be includible in the recipient's gross income because the recipient was in the business of rendering the type of services that were reimbursed. As Rev. Rul. 84-138 illustrates, partial reimbursement may be excludable where the expense benefits both the taxpayer and the reimbursing party; however, the amount of reimbursement must be commensurate with the reimbursing party's benefit and the taxpayer must not be in the business of receiving compensation for services of the type that are reimbursed.

Although joint and several liability may be relevant to identify the parties legally liable for a particular expense, existence of joint and several liability does not, by itself, determine the ultimate beneficiary of an expense. Even where the taxpayer is legally liable for the fee, reimbursement to the taxpayer generally will be excluded from the taxpayer's gross income where the reimbursing party is the entity that benefits from the payment and any benefit to the taxpayer is incidental.

Therefore, the existence of joint and several liability among members of Group does not result in a *per se* exclusion from Taxpayer's gross income of reimbursements of all or a portion of the BPD fee by Foreign.

Instead, whether reimbursement of all or a portion of the BPD Fee by Foreign to Taxpayer is includible in Taxpayer's gross income depends on multiple factors that must be evaluated to determine whether, and to what extent, Taxpayer is the beneficiary of the payment of the fee. Relevant factors include the following: (1) whether the parties intended that Foreign will bear the economic burden of the fee; (2) whether Taxpayer has an unconditional obligation to remit the amount received by Foreign as payment of the BPD Fee; (3) whether Taxpayer profits, gains, or benefits from the amount received and remitted; (4) whether Taxpayer claims the amount received as its own; and (5) whether the amount is received by Taxpayer in exchange for services provided by it.[1]

Please call Steve Toomey at (202) 317-4735 if you have any further questions.

[1] Similarly, because Foreign and Taxpayer are controlled taxpayers, within the meaning of Treas. Reg. § 1.482-1(i)(5), the evaluation of which entity receives the benefits and bears the risks of the activities associated with the BPD Fee is relevant to the Taxpayer's transfer pricing for the foreign-manufactured drugs and their U.S. branding/distribution rights under section 482.