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Jon Winsett
CEO, NPI

Medical device tax costly pill for some companies to swallow

by Omar Ford, *Medical Device Daily* staff writer

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A medical device excise tax that aims to raise $20 billion throughout a 10-year-period, is causing deep concerns and frustration for some parts of the med-tech industry. The tax is part of the newly adopted healthcare law, which is set to bring sweeping reform throughout the country.

Members of the medical device industry argue that the tax could cause an undue financial burden for medical device companies – especially those smaller companies who have revenue in the $60 million range.

"The tax is an absolute disaster," Albert "Ace" Edwards, president of the Southeastern Medical Device Association (SEMDA; Norcross, Georgia), told *Medical Device Daily*. "You've got to explain the logic of taking money from a healthy industry, not receiving any funding from the government, and giving it to an industry [dependent upon federal funding]. I don't see the logic in that."

Members of SEMDA include a good bit of smaller companies, who can't weather the tax storm as easily as say a Medtronic (Minneapolis) could.

"Some of our companies are at $50 million in revenue, but they aren't to the point where they turn a profit yet," Edwards said. "They're still developing their products to go to the market."

He added that this tax has the potential to harm innovation, by taking away additional dollars that these companies would have to initiate clinical work or navigate through the PMA and 510-K approval process.

In an unattributed March 21 statement, the Medical Device Manufacturers Association (MDMA; Washington) echoed similar statements and said it is "very concerned about the impact a $20 billion device tax will have on patient care, innovation and small businesses," making the case that under the tax, "many companies will owe more in taxes than they generate in profits." MDMA says that such a scenario will force firms to lay off employees and cut budgets for research and development. The statement also notes that absent an elimination of the tax, "structuring it to provide relief for smaller companies is critical," urging that Congress address the issue "before the tax takes effect in 2013." (*Medical Device Daily* , March 23, 2010).

"Minnesota is going to bear about 25% of the [medical device excise] tax," said Don Gerhardt, the chief executives of LifeScience Alley (Minnesota), a trade group that represents med-tech companies. "With it being a tax on revenue instead of profit – well, that's going to be a bit difficult. This is an enormous issue for Minnesota, with the potential to effect 300,000 jobs – at minimum."

Gerhardt told MDD that he has been in conversations with companies and they have said they're considering layoffs.

Other options include halting proposed expansions all together.

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Legislators that support the tax contend that other industries – from pharmaceutical companies to hospitals – have agreed to commit billions to help pay for expanding health insurance coverage to most Americans, and that it's only fair that device companies pitch in and contribute their fair share.

In the meantime, companies are either adopting a "wait and see attitude" – to see if the tax is scaled back a bit – or approaching lawmakers and asking for the tax to be scrapped.

According to Jon Winsett, CEO of NPI Financial (Atlanta), an enterprise spend management consulting firm, the cost of taxes could be burdensome to a small company, but there is light at the end of the tunnel.

"These taxes will cut into profit margins, and those companies that have the most narrow margins will feel a harder pinch. Theoretically, a 2%-4% increase would result in a $60 million company paying an average of $1.8 million in taxes," he told *MDD* via email. "Of course, there are other variables here that affect this number."

Winsett added that there were ways to offset this cost, with a leaner budget and a keener eye on expenses. "I think the interesting point is this. In our experience here at NPI, a $60 million company typically devotes 3%-4% of their annual revenues to shipping spend and another 2%-3% to IT spend. For the sake of math, let's say that company A spends 3% on each – amounting to a total of $3.6 million a year on shipping and technology. NPI, just through vendor contract negotiations, typically cuts 30% fat off of each of these spend areas. That translates into $1.08 million in immediate cost savings. Now, factor in other spend management tactics, like vendor portfolio consolidation, and you can see how easy it is to offset a major tax increase."

Winsett said that the main issue is that med-tech companies need more transparency when it comes to dealing with vendors.

"Most med-tech companies are grossly overpaying for two things right now – shipping and technology," Winsett said. "This is because there is little pricing transparency in these areas, which means a vendor can charge one company as much as 30% more than the next company with little rhyme or reason."

A solution for companies seeking to cut costs would be going back to the bargaining table with shipping and IT vendors and renegotiating their respective contracts to offset the tax increase.

He added that "this is just one best practice of a solid management strategy that can yield immediate and long-term savings, not to mention save companies from having to lean their staff even further or sacrifice the competitive edge they have in R&D. The problem is most companies don't even know that they're overpaying."

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