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TAX FLASH NEWS

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Expenditure on Freebies are allowed as Business expenditure since MCI Regulations are not applicable to Pharma Companies

Background

The Mumbai Tribunal in the case of PHL Pharma P Ltd.[1] (the taxpayer) held that the expenditure incurred on holding seminars, sponsoring lectures on updates, sponsoring travel and accommodation for conferences, small gifts with logo and brand names and cost of samples given to medical practitioners are in the nature of sales promotion expenditure incurred for the business of the taxpayer. Since the Indian Medical Council Regulations[2] (MCI Regulations) are not applicable to pharmaceutical companies, no violation of any law is committed and therefore the expenditure is not impaired by Explanation 1 to Section 37(1) of the Income-tax Act, 1961 (the Act).

Facts of the case

- The taxpayer is engaged in the business of pharmaceutical (pharma) marketing consultancy and detailing services to develop a mass market for pharma products.

- During the year under consideration, the taxpayer company had incurred expenditure in relation to customer relationship & management (CRM), key account management (KAM), gifting small articles and provision of samples to medical professionals.

- The CRM expenditure included activities like holding national level seminars on new medical researches and drugs for the discussion panels of doctors, sponsoring knowledge upgrade courses, subscription of costly journals, information books, sponsoring travel and accommodation of doctors for conferences etc. Under KAM, the taxpayer promoted ICCU range of products normally focusing on a brand in a particular therapy area. The Gifts included small value items like pens, diaries, calendars, table weights, stationary items etc having the logo of the taxpayer company and the name of the medicine advertised. The sample drugs were given to doctors to prove the efficacy of the drug and to establish the trust of doctors on the quality of drugs.

- The Assessing Officer (AO) held that since the MCI Regulations forbids the medical practitioners to receive any kind of gift, travel facilities, hospitality and any kind of monetary grants from any pharmaceutical or healthcare industry, the same was considered in violation of law and disallowed the expenditure in terms of Explanation to Section 37(1) of the Act in view of CBDT Circular No.5/2012[3].

- Upon appeal, the Commissioner of Income tax (Appeals) (CIT-A) held that the expenditure incurred by the assessee does not fall within the ambit of gift, travel facility, hospitality, cash or monetary grant classified as freebies and is not in violation of MCI Regulation. The CIT-A held that the expenditure is merely in connection with the advertisement of product and brand recognition. Explanation 1 to Section 37(1) cannot be said to be applicable and accordingly reversed the disallowance.

[1] DCIT v. PHL Pharma P Ltd. (ITA No. 4605/Mum/2014) order dated 12 January 2017 – Taxsutra.com

[2] Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations

[3] Circular No. 5/2012 [F. No. 225/142/2012-ITA.II], dated 1-8-2012

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- The Tax Department filed an appeal before the Income Tax Appellate Tribunal, Mumbai (the Tribunal).

Tribunal observations and ruling

- Placing reliance on the decision of the Delhi High Court in the case of Max Hospital[4], the Tribunal held that the Indian Medical Council has no jurisdiction to pass any order or regulation against any hospital or any healthcare sector and can exercise jurisdiction only on the medical practitioners.

- The maxim "*Expressio Unius Est Exclusio Alterius*" is clearly applicable. That is if a particular expression in the statute is expressly stated for a particular class of assessee then by implication what has not been stated or expressed in the statute has to be excluded for other class of assessee. The MCI regulations thus cannot be extended to Pharma or allied healthcare companies in absence of any specific legislative provisions to this effect.

- MCI regulations thus cannot have any prohibitory effect on the pharma companies including the taxpayer.

- CBDT circular No.5/2012, which was relied on by the tax department, has while clarifying, enlarged the scope and applicability of MCI Regulation by making it applicable to pharma companies. CBDT cannot provide *causus omissus* to a statute or regulation which has not been expressly provided therein.

- Also, it is a trite law that CBDT circular which creates a burden or liability or imposes new kind of imparity cannot be applied retrospectively. Following co-ordinate bench decision in the case of Syncom Formulations (I) Ltd[5], held that CBDT circular dated 1 August 2012 cannot be made applicable for AY 2010-11.

- In dealing with the decision of the Himachal Pradesh High Court in the case of Confederation of Indian pharmaceutical Industry[6], which had upheld the validity of Circular No. 5/2012, the Tribunal observed that the High Court had set a rider that if the taxpayer satisfies the AO that expenditure is not in violation of the regulation framed then it may legitimately claim the deduction. Thus if the taxpayer brings out that MCI Regulation is not applicable to it, then the AO cannot apply the same blindly.

- What has not been provided in MCI regulation cannot be either supplied by the court or by CBDT.

- The Tribunal distinguished various decisions[7] relied by the tax department based on its facts and observed that in none of the case, the non-applicability of the MCI regulations to the taxpayer was examined.

- In view of the above, no disallowance of such expenditure could be maintained.

Our comments

Expenditures incurred on freebies like free samples of medicines, gifts and sponsorship of seminars, travel and stay provided to medical practitioners have been often challenged by the tax department by treating the same in violation of MCI regulations and thus sought to be disallowed under the provisions of Explanation 1 to Section 37(1) of the Act.
The Supreme Court in the case of Eskayef Pharmaceuticals (India) Limited observed that free samples given to physicians is in the nature of sales promotion and development and it would be covered under the provisions of Section 37 (3A) of the Act. This decision has been distinguished by the Mumbai Tribunal by observing that the Supreme Court decision does not prohibit the nature of expenditure which has been incurred in the instant case.

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[4] Max Hospital v. MCI (WP 1334/2013) dated 10.1 2014
[5] Syncom Formulations (I) Ltd v. DCIT [ITA No.6429&6428/Mum/2012] dated 23/12/2015

[6] Confederation of Indian Pharmaceutical Industry v. CBDT [CWP No. 10793 of 2012-J] – itatonline.org
[7] Eskayef (Now Known as Smithkline Beecham) Pharmaceuticals (India) Limited v. CIT [2000] 111 Taxman 561(SC), Kap Scan and Diagnostic Centre (P.) Ltd. [2012] 25 taxmann.com 92 (P&H), Liva Healthcare Limited ITA Nos. 904 & 945/Mum/2013

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Further, this decision has adopted a view different from the Himachal Pradesh High Court in the case of Confederation of Indian Pharmaceutical Industry. However, the issue with respect to application of MCI Regulations to pharma companies was not challenged in the said case.

The Panaji Tribunal in the case of Geno Pharmaceuticals Ltd[8] had rejected the tax department's reliance on CBDT Circular No. 5/2012, while allowing deduction of sales promotion expenditure paid to the doctors towards traveling, conveyance, conference expenditure, etc. under Section 37 of the Act. The Tribunal observed that the tax department was unable to point out any expenditure directly incurred by the taxpayer were in violation of the CBDT circular, and thus prohibited by law.

Given that the MCI regulations govern the practices to be followed by the medical practitioners to safeguard the society from probable malpractices and promote public good, it may be interesting to see whether the contention with respect to non-applicability of MCI regulations to pharma sector will stand the test of time if challenged before the Supreme Court.

[8] ACIT v. Geno Pharmaceuticals Ltd. [ITA No. 12/PNJ/2014] AY2010-11

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