

Mumbai Tribunal allows expenses in the nature of “freebies” to doctors

January 19, 2017

In brief

In the case of a pharmaceutical company, the Mumbai Income-tax Appellate Tribunal (Tribunal)¹ has allowed deduction for expenses, such as holding of national level seminars for eminent doctors, product promotion before doctors, distribution of gift articles and samples, under section 37 of the Income-tax Act, 1961 (the Act).

The Tribunal held that such expenses were not in the nature of freebies to doctors and were not in violation of MCI regulations², which prohibits medical practitioners from receiving any kind of gift, travel facilities, hospitality and any kind of cash or monetary grants from the pharmaceutical or healthcare industry. In support of allowing claim for these expenses, the Tribunal held that the subject expenses were incurred to create awareness of the products and medicines manufactured and launched by the taxpayer, and stated that such expenses were definitely in the nature of sales and business promotion, which were allowable.

With respect to the Central Board of Direct Taxes (CBDT) Circular⁴ on this issue, it held that the CBDT in its clarification had enlarged the scope and applicability of MCI regulations by making it applicable to pharmaceutical companies or allied healthcare sector industries, which was not permissible. Further, it also observed that in any case, the CBDT circular could not be applied retrospectively.

In detail

Facts

- The taxpayer¹ was a pharmaceutical company engaged in the business of providing pharma marketing consultancy and detailing services to develop a mass market for pharma products.
- During assessment year (AY) 2010-11, the tax officer disallowed advertising and sales promotion expenses of INR 22,99,72,607 (incurred

post 10 December, 2009) on the ground that these expenses were in violation of MCI regulations², and accordingly, disallowable under section 37 of the Act. These expenses included expenses on distribution of free sample/ gift articles, sponsoring seminars/ conferences, subscriptions to journals, etc.

Taxpayer's contentions

Distribution of gift articles included expenses for small

value items given to doctors to maintain brand memory continuously. Further, distribution of free samples to doctors was to prove the efficacy of drugs and establish trust of the doctors in the quality of drugs. As such, these expenses were incurred for the purpose of business of the Company in the form of sales promotion expenses.

- Relying on the decision of Himachal Pradesh High

¹ ITA No. 4605/Mum/2014

² Medical Council (Professional Conduct, Etiquette and Ethics)

Regulations, 2002 (MCI Regulations) as amended by notification dated 10 December 2009 issued by the MCI.

Court (HC)³, the taxpayer contended that it was for the taxpayer to satisfy the tax officer that the expenditure was not in violation of the MCI regulations, which the taxpayer had done in the present case. In this context, it submitted that the MCI regulations were applicable to medical practitioners and hence, such expenses could not be regarded as unlawful or illegal from the viewpoint of the taxpayer.

- The CBDT circular⁴ was not retrospective, and could not be applied to AY 2010-11.

Tax officer's observations

- Allowability of such expense was prohibited by the CBDT circular read with the MCI Regulations.
- The MCI regulations were binding because the MCI was a statutory body having been set up under an Act of Parliament.
- The amended MCI notification dated 10 December 2009 clearly forbade medical practitioners from receiving any kind of gift, travel facilities, hospitality, and any kind of cash or monetary grants from the pharmaceutical or healthcare industries.
- Thus, such expenses were disallowable in terms of Explanation to section 37(1) of the Act.

Commissioner of Income-tax (Appeal)'s observations

- All the distributed products bear the name of the taxpayer company and product name, and therefore, these were purely promotional materials

distributed to doctors for brand recognition, and not as a gift for inducement of doctors.

- There was no prohibition on pharma companies under any law to distribute such promotional materials, i.e., the MCI regulations did not apply to pharmaceutical companies, and therefore Explanation 1 to section 37(1) could not be said to be applicable.

Tribunal's ruling

The Tribunal upheld the order of the Commissioner of Income-tax (Appeal) for reasons provided below.

- The MCI regulations were meant to be followed and adhered to by medical practitioners/ doctors alone, and did not cover pharmaceutical companies or the healthcare sector in any manner. Reliance in this regard was placed on the decision of Delhi HC.⁵
- The CBDT circular, in its clarification, has enlarged the scope and applicability of the MCI regulations by making it applicable to pharmaceutical companies or allied healthcare sector industries. Such an enlargement by the CBDT was without any enabling provisions either under the Income-tax law or by any provisions under the MCI regulations.
- In any case, the CBDT circular, which created a burden or liability or imposed a new kind of imparity, could not be applied retrospectively.⁶
- In relation to expenses for holding seminars, conferences,

doctors' meetings, etc., the Tribunal noted that the said activities by the taxpayer were to create awareness among doctors of its products and its research work for a successful launch. Such type of expenditure was definitely in the nature of sales and business promotion, which had to be allowed.

- In relation to gift articles and free samples, the Tribunal noted that all the gift articles under consideration were very cheap and low-cost articles that bore the name of the taxpayer, and they were purely for promotion of its products, brand reminder, etc. These articles could not be reckoned as freebies given to doctors.
- Even the free samples of medicine were only to prove efficacy, and to establish the trust of the doctors in the quality of its drugs. This too could not be reckoned as freebies given to doctors.
- The decision of the coordinate bench in the case of Liva Healthcare⁷ was distinguished on facts, as in that case, there was material on record to show that doctors and their spouses were given foreign tours, cruise travel, etc., in lieu of expected favours. It was also observed that this decision did not consider the earlier decision of the coordinate bench of the Tribunal in the case of UCB India⁸, wherein it had been held that the CBDT circular could not have a retrospective effect.
- The Tribunal noted that the ratio of decision of Punjab and

³ Confederation of Indian Pharmaceutical Industry v. CBDT (CWP No. 10793 of 2012-J) (Himachal Pradesh High Court)

⁴ CBDT Circular no. 5/ 2012 [F. No. 225/ 142/ 2012-ITA.II], dated 1 August 2012

⁵ Max Hospital v. MCI in WPC 1334/2013 judgement dated 10 January 2014

⁶ Relying on the decision of Syncom Formulations India Limited v. DCIT (ITA no. 6429/ Mum/ 2012) (Mumbai Tribunal)

⁷ Liva Healthcare Ltd. v. ACIT (ITA No. 4791/ Mum/ 2014) for AY 2010-11 (Mumbai Tribunal)

⁸ UCB India Pvt Ltd. v. ITO (ITA No. 6681/ Mum/ 2013 order dated 13 May 2016 (Mumbai Tribunal)

Haryana HC⁹, wherein it had been held that the payment of commission to doctors for referring the taxpayer's products was against public policy, and hence, not allowable. In the present case, it held that there was no violation of any law or anything opposed to public policy.

- The Tribunal noted that though the Himachal Pradesh HC³ had upheld the validity of the CBDT Circular denying deduction for freebies to doctors, the HC had also provided a rider that if the taxpayer satisfied the tax officer that the expenditure was not in violation of MCI Regulation, then it may legitimately claim the

deduction.

The takeaways

Relying on the decision of Delhi HC¹⁰, the Tribunal observed that the MCI regulations are applicable only to doctors/medical practitioners and not to pharmaceutical companies. Further, it also clarifies that the CBDT circular is prospective in nature. For the reasons discussed, the Tribunal proceeded to allow the subject expenses as the same were incurred for the purpose of business.

In relation to allowability of expenses for free samples, there are a few other Tribunal decisions wherein it has been held that distribution of samples is not prohibited by the MCI regulation.

To this extent, there is reasonable clarity on the deductibility of expenses relating to samples, unlike other sales promotion expenses generally incurred by the pharmaceutical companies.

Having said the above, considering the contrary decisions of the Tribunal on the aforementioned principles, this matter continues to be litigative. Considering the importance of the issue to the pharmaceutical industry, a higher court decision may reduce the uncertainty arising out of the divergent views.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor.

⁹ CIT v. Kap Scan and Diagnostic Centre (P.) Ltd. 25 taxmann.com 92 (Punjab and Haryana High Court)

¹⁰ Max Hospital v. MCI in WPC 1334/2013 judgement dated 10 January 2014 (Delhi

High Court) – a civil appeal and not an income-tax appeal

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