The Indian Income Tax Appellate Tribunal (Mumbai Bench) has allowed deduction under section 37 of the Indian Income Tax Act to a pharmaceutical company (the taxpayer) in respect of freebies given to doctors during the fiscal year ending on 31 March 2010. The Tribunal rejected the stand of Revenue authorities that, since the payments were made in violation of Medical Council of India (MCI) regulations, they were illegal and hence do not qualify for deduction in view of the Explanation to Section 37(1) of the Act.

PHL Pharma P Ltd is a pharmaceutical company engaged in the business of providing pharma marketing consultancy and detailing services to develop a mass market for pharma products. During audit for the fiscal year ended 31 March 2010, the tax officer noted that the taxpayer had claimed deduction for advertising and sales promotion expenses which included the following:

- Customer relationship management (CRM) expenses
- Key account management (KAM) expenses
- Gift articles
- Cost of samples

The tax officer believed that such expenses were in the nature of freebies given to medical practitioners disallowable in terms of the Explanation to Section 37(1) of the Income Tax Act, as clarified by the Indian IRS, vide its Circular No.5/2012 dated 1 August 2012 (the Circular). The IRS referred to an amendment to the Indian Medical Council Regulations 2002 (IMC Regulations), dated 10 December 2009, prohibiting medical practitioners and their professional associations from taking any gift, travel facility, hospitality, cash or monetary grant from the pharmaceutical and allied health sector industries (the amendment).

Expenditure, if it is an offence or prohibited by law, is not to be allowed as a deduction under section 37(1) of the Indian Income Tax Act by virtue of the Explanation to Section 37. The IMC Regulations deal with the professional conduct, etiquette and ethics of registered medical practitioners only.

The Tribunal observed that the IMC Regulations have jurisdiction to take action only against medical practitioners and not the health sector industry, i.e. the class of the taxpayer. The Tribunal noted that the code of conduct enshrined in the IMC Regulations is meant to be followed and adhered to by medical practitioners/doctors alone. In consonance, the Tribunal noted that, "[s]o once the Indian Medical Council Regulation does not have any jurisdiction nor has any authority under law upon the pharmaceutical company or any allied health sector industry, then such a regulation cannot have any prohibitory effect on the pharmaceutical company like the assessee".

Regarding the applicability of the Explanation to Section 37 of the Indian Income Tax Act, the Tribunal noted that it provides an embargo upon allowing any expenditure incurred by the taxpayer for any purpose which is an offence, which means that there should be an offence by the taxpayer who is claiming the expenditure or there is some kind of prohibition by law which is applicable to the taxpayer. However, in the present case, no such offence of law had been established which prohibits the
Further, the Tribunal noted that the maxim “expressio unius est exclusio alterius” was applicable; that is, if a particular expression in the statute is expressly stated for a particular class of taxpayers, then, by implication, what has not been stated or expressed in the statute has to be excluded for other classes of taxpayers, i.e. “[a]ny impairment or prohibition by any law/regulation on a different class of person/assessee will not impinge upon the assessee claiming the expenditure under this section”.

The Revenue authorities contended that the Circular, while clarifying the applicability of the Explanation to Section 37(1) on medical practitioners and pharmaceutical companies, interpreted IMC Regulations as applicable to pharmaceutical companies also. The Tribunal noted that circulars issued by the Indian IRS act as “contemporanea expositio” in interpreting statutory provisions and ascertaining the true meaning enunciated at the time a statute was enacted. However, the IRS, in its power, cannot create a new impairment adverse to a taxpayer or to a class of taxpayers without any sanction of law.

The Tribunal noted that the taxpayer incurred expenditure for arranging lectures and sponsoring knowledge upgrade courses which spread awareness of the products and medicines manufactured and launched by it, and for research work carried out by it for bringing medicines to the market. These results are based on several levels of tests and approvals. Thus, the Tribunal held that such expenditure incurred by a pharmaceutical company is purely for business purposes, which has to be allowed as business expenditure and is not covered by the Explanation to Section 37(1).