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TECHNICAL

Direct Taxation

TAX CASE UPDATE

Whether "congress expenses" incurred under S33(1) of the ITA should be disallowed as "entertainment" expenses under S39(1)(l) of that Act.

KPHDN v ELI LILI (MALAYSIA) SDN. BHD.

High Court of Malaya at Kuala Lumpur
Civil Appeal No: R1-14-02-2009
Date of Judgment: 29 April 2010

Facts and Issues:

This is an appeal by the Director General of Inland Revenue, (the Appellant) against the decision of the Special Commissioners of Income Tax (SCIT) who upheld an appeal by the respondent (the Taxpayer) against assessments raised by the Appellant for the years of assessment (YA) 2001 and 2002, both dated 22.11.2005, for tax in the amounts of RM419,512 and RM667,975 respectively.

In the Deciding Order of the SCIT, it was held that "congress expenses" incurred for YA 2001 and YA 2002 are not expenses on "entertainment" as defined in S18 of the ITA, and therefore are allowable under S33(1) of the same Act. It was also held that penalty imposed under S113 of the ITA should not have been imposed. (All sections cited hereafter refer to sections in the ITA unless otherwise stated.)

Among the facts found by the SCIT are the following:

- The Taxpayer is a company incorporated in Malaysia and a wholly owned subsidiary of Eli Lilly (Netherland B.V.). It carries on the business of trading in human pharmaceutical and animal health products.
- Promotion of the Taxpayer's products is achieved through identifying hospitals, physicians, pharmacists and other health care professionals and making them aware of the Taxpayer's products by providing them with information (including clinical data) relating to these products. The products thus promoted through information to these medical and health care professionals are those approved for marketing by the Ministry of Health.
- The Taxpayer is prohibited from directly promoting and/or selling drugs to end consumers (i.e. patients) by statutory rules and regulations. Only doctors are allowed to prescribe the drugs and therefore, the sponsorship of doctors and speakers are vital in the marketing chain in respect of promotion of sales, to ensure that they are aware of the clinical data relating to the products, thus enabling them to make informed decisions in making prescriptions. Advertisements of the Taxpayer's products in the local newspapers are not allowed, but it may advertise in medical journals. Effectively, this means that the Taxpayer's products must be promoted through doctors, pharmacists and health care professionals.
- On a professional basis a doctor or pharmacist under the employment of a member company

is allowed to attend scientific meetings under the umbrella of a professional Society or Organization of which he is a member (e.g. MMA, MPS). Sponsorship is limited to travel, meals, registration fee and accommodation. Expenses on entertainment or recreational activities, e.g. tickets to the cinemas or other performances, paid games of golf and such, are not allowed.

- Various sums were added back in the tax computations for each of the years of assessment 2001 and 2002, the most significant of which were in respect of the following expenses:
  - (i) entertainment
  - (ii) contribution
  - (iii) gifts
- Outside speakers are engaged because the Taxpayer does not have staff who are experts in all fields of medicine. Speakers are paid a fee/ honorarium ranging from RM500 to RM1000. The Taxpayer did not have any influence on the speakers who were sponsored to give talks on its products, nor on the doctors whose attendance was sponsored, to purchase the products.
- The tax returns for YA 2001 and YA 2002 were both submitted on time, on 30.8.2002 and 14.8.2003 respectively.
- The Taxpayer incurred "congress expenses" as shown below:

YA	Amount of expenses (RM)	Amount of tax (RM)
2001	776,282	419,521
2002	1,131,419	667,975

- The Appellant disallowed the congress expenses incurred for YA 2001 and YA 2002 and raised additional assessment for both years dated 22.11.2005, with a penalty of 60% for each YA.

The Taxpayer appealed against the above assessments to the SCIT who decided in favour of the Taxpayer. Hence, the present appeal to the High Court.

Decision:

Appeal allowed. The grounds of decision are summarized below:

1. **Submissions**

1.1 The appellant submitted that:

- The SCIT erred in law in not construing that the congress expenses incurred by the Taxpayer in the form of provision of food, accommodation and travel for doctors who were speakers/ attendees at the congress, are "entertainment" expenses as defined under S18 (therefore disallowed under S39(1)(l)), even though they were incurred for the purpose of the business. (*Syarikat Jasa Bumi (Woods) Sdn Bhd v KPHDN [2000] 2 CLJ 481; Margaret Luping & Ors v KPHDN [2000] 3 CLJ 409)*
- The issue of 'bargain' or 'consideration' is crucial to determine whether or not the expense in question is "entertainment". (*United Detergent Industries Sdn Bhd v DGIR*

[1999] 1 AMR 462; Aspac Lubricants (M) Sdn Bhd v KPHDN [2007] 6 M;J 65) It was submitted that consideration moved from the Taxpayer to the speakers in the form of honorarium, but the provision of food, travel and accommodation was not part of the consideration, but was hospitality. However, there was no consideration from the attendees as these doctors were not obliged to purchase the Taxpayer's products. There was no direct benefit to the Taxpayer, and the expenses were gratuitous with no consideration.

- The SCIT erred when it found that the fact that the doctors attended the meetings amounts to consideration. It was submitted that time spent by the doctors in attending the seminars cannot amount to consideration, and the SCIT's (opposite) view is unsupported by authority.

1.2 It was submitted for the Taxpayer that:

- Being prohibited by law from advertising about its products directly to the consumer, the Taxpayer managed its sales through the holding of congresses and seminars specific to its products. These seminars were aimed at increasing sales of the Taxpayer's products and therefore they were not entertainment under S18.
- It was not sufficient to only pay an honorarium to speakers (in return for their services), the cost of travel and lodging must also be sponsored. In respect of doctors attending the congress, they gave their time and energy to participate in the congress, in return for which Taxpayer sponsored their cost of travel and lodging. It was submitted that there was a contractual obligation on both the speakers and sponsored doctors to attend the seminars.
- With reference to *Aspac*'s case, it was submitted that a practical advantage can also be consideration and when there is a material gain by either party, there is also consideration. The Taxpayer received the practical advantage of having these doctors who were potential customers to attend the seminars. Citing *Sabah Berjaya Sdn Bhd v KPHDN [1999] 3 AMR 3264,* it was submitted that where there is a material advantage gained, it is no more a gift. To be "entertainment" there must be no material advantage to the Taxpayer. However, the Taxpayer had gained a material advantage "*because it has its market assembled beforehand".* Therefore it was consideration in law and the congress expenses was not entertainment.

2. **Decision of the Court**

2.1 The Court noted the submission of the Appellant that the expenses disallowed come within the meaning of "entertainment' in S18. Citing the *United Detergent Industries* case, it noted that the SCIT had found in that case, that the expenses incurred by the taxpayer for the premium consumer items were for the purpose of promoting sales which is "*entertainment as defined under S18 and entertainment being prohibited under S39(1)(l) of the Act, it is immaterial that there was a cost element borne by the purchasers.*" The meaning of "entertainment" proffered by the learned Judge in the same case was quoted – "*One of the meaning(s) of 'entertainment' given by the concise Oxford Dictionary, 9th Ed. is hospitality, and "hospitality" according to the Dictionary means the friendly and generous reception and entertainment of guests or strangers*."

2.2 The Court also noted the submission by the Appellant that since congress expenses are entertainment, they are not deductible under S39(1)(l). Referring to the *Aspac* case and the *United Detergent Industries* case, the Court commented that "*these 2 authorities show that for expenses incurred by the taxpayer in the promotion of its business to be*

deductible under S39(1), the expenses incurred has to be for consideration and not gratuitous."

2.3 The Court referred to the SCIT's finding that time given in return for knowledge and tickets etc. must be considerations and the acquisition of new and updated knowledge is a 'practical advantage' which is 'consideration', thus leading to the SCIT's conclusion that congress expenses cannot be entertainment.

2.4. However, the Court was of the view that –

- Although the predominant purpose in the Taxpayer's mind was to promote its business, the sponsored doctors were not required to make any purchases in return for the hospitality accorded by the Taxpayer.
- Mere attendance and participation and acquisition of knowledge alone is not sufficient to amount to a practical advantage. There was no valuable consideration moving to the Taxpayer from the doctors who attended.
- Although the Taxpayer had submitted that there was a contractual obligation on both the speakers and sponsored doctors to attend the seminars, there was no evidence of any liability to be borne by a doctor who failed to attend the congress.

2.5 Referring again to the SCIT's finding stated in paragraph 2.3 (above), the Court agreed with the Appellant's submission that the conclusion by the SCIT was unsupported by authority. The Court held the view that the expenses of providing food, travel and accommodation were gratuitous, and that the congress expenses came within the definition of 'entertainment' in S18, hence not allowable under *S39(1)(l)*.

2.6 Based on the reasons given (summarized above) the appeal was allowed, and in the circumstances, the penalty imposed was held to be correct.

Members may read the full Grounds of Judgment at the Institute website and the LHDNM website.

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