Issue 115
October 2014
PP 9741/10/2012 (031262)

PwC Alert

Entertainment Redefined – You Entertain When You Promote Your Business?

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The position up to the year of assessment (YA) 2013

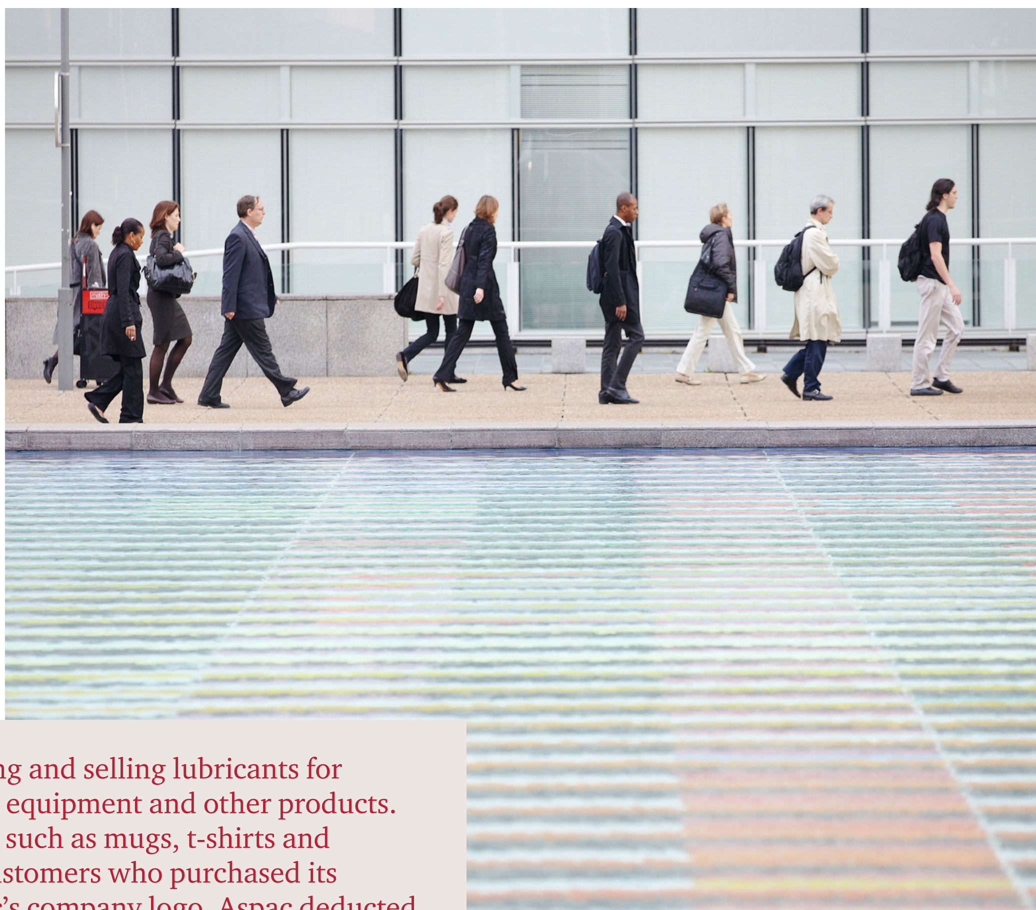
> *"Entertainment" includes –*
>
> *(a) the provision of food, drink, recreation or hospitality of any kind; or*
>
> *(b) the provision of accommodation or travel in connection with or for the purpose of facilitating entertainment of the kind mentioned in paragraph (a),*
>
> *by a person or an employee of his in connection with a trade or business carried on by that person.*

The above definition of "entertainment" within Section 18 of the Income Tax Act 1967 (the Act) prior to amendment by Act 761 of 2014, along with Section 39(1)(l) of the Act operate to limit 50% tax deduction on expenses caught within that definition notwithstanding that the expense is incurred in the production of income. This wide definition of "entertainment" has inevitably spawned a slew of litigations in the Malaysian courts.

The expenses challenged in these cases range from promotional items sold together with goods, cash incentives given to reward sales agents upon achieving set targets, and for industries which are prohibited from advertising directly to consumers, expenses incurred to promote products through other channels. The bone of contention in these litigations involves expenses which lay businesspersons would regard as promotional expenses rather than entertainment expenses. However, the Inland Revenue Board (the IRB) seems to view promotion and entertainment as synonymous, inseparable subjects.

Technically, the question is whether an expense is "food, drink, recreation or hospitality of any kind" as defined in Section 18 of the Act. In this respect, statute interpretation requires that the meaning of each of the words "food, drink, recreation and hospitality" must be imported from and cohere with each other. Where food, drink and recreation exist, it must be given hospitably and where hospitality is given it must be in the category of food, drink and recreation. Therefore what generally remains is the need to zero-in on the meaning of 'hospitality'.

In the case of *United Detergent Industries Sdn Bhd v DGIR* [1998] MLJU 138, the High Court referred to dictionaries on the ordinary meaning of the word "hospitality" which connotes the action of entertaining someone gratuitously without that someone having to subscribe *(give something, a price)* towards the cost incurred by the host. Relief was hailed in from 2007 when the Court of Appeal delivered a landmark decision in the case of *Aspac Lubricants (Malaysia) Sdn Bhd v KPHDN* (2007) MSTC 4,271 (the Aspac case). The Courts have through the Aspac case along with other cases set the law clear on the definition of entertainment - it excludes promotional expense and a bargain.



Aspac was in the business of blending and selling lubricants for motorised vehicles as well as selling equipment and other products. Aspac gave away promotional items such as mugs, t-shirts and umbrellas (customer items) to its customers who purchased its products. These items carried Aspac's company logo. Aspac deducted the expenses incurred on these customer items from its gross income on the basis that these were expenses wholly and exclusively incurred in the production of its gross income. However, the IRB disallowed these expenses on the basis that they were entertainment expenses.

The Court of Appeal held that the customer items are not entertainment and are deductible on the following grounds:

(i) where the dominant, if not sole purpose of the customer items is to promote business, it cannot be described as entertainment; and

(ii) the consumer items were part of the bargain made between Aspac and its customers in that the consumer items and the products are collectively the consideration moving from Aspac to its customer in exchange for the consideration moving from its customer, i.e. the purchase price.

Despite the Court's decision in the Aspac case and subsequent similar decisions in other cases, the IRB persisted in challenging entertainment expenses. The Government eventually amended the definition of entertainment to explicitly include promotional expense and a bargain. Effectively, the Court's position taken in the various cases has been negated when Finance Act 2014 was sanctioned. The IRB prevailed.

The amended definition of entertainment (with effect from YA 2014)

The definition of entertainment with effect from YA 2014 now reads as follows (words in bold denote the new insertion):

"Entertainment" includes –

(a) the provision of food, drink, recreation or hospitality of any kind; or

(b) the provision of accommodation or travel in connection with or for the purpose of facilitating entertainment of the kind mentioned in paragraph (a),

by a person or an employee of his, ***with or without consideration paid whether in cash or in kind, in promoting or*** *in connection with a trade or business carried on by that person.*

As promotional activities are indispensable in today's competitive business environment, the amendment is harsh, punitive, discouraging and burdensome to the business community.

The IRB's intention behind the amendment is that effective from YA 2014, all food, drink, recreation including related travel or accommodation incurred by businesses **to promote business** in the production of income is 'deemed' as entertainment. Therefore, such expenses will follow the tax treatment of entertainment, that is, 50% of such promotional expenses incurred in the production of income are not tax deductible unless they fit into the following exceptions (where 100% deduction is still allowed) as prescribed under Section 39(1)(l) of the Act:

(i) the provision of entertainment to his employees except where such provision is incidental to the provision of entertainment for others;

(ii) the provision of entertainment by a person who carries on a business which consists of or includes the provision for payment of entertainment to clients or customers of that business and that entertainment is provided for payment by the clients or customers in the ordinary course of that business;

(iii) the provision of promotional gifts at trade fairs or trade or industrial exhibitions held outside Malaysia for the promotion of exports from Malaysia;

(iv) the provision of promotional samples of products of the business of that person;

(v) the provision of entertainment for cultural or sporting events open to members of the public, wholly to promote the business of that person;

(vi) the provision of promotional gifts within Malaysia consisting of articles incorporating a conspicuous advertisement or logo of the business;

(vii) the provision of entertainment which is related wholly to sales arising from the business of that person;

(viii) the provision of a benefit or amenity to an employee consisting of a leave passage to facilitate a yearly event within Malaysia which involves the employer, the employee and the immediate family members of that employee.

‘Entertainment related wholly to sales’

The above exceptions are generally clear and straightforward to apply save for exception (vii). The phrase “related wholly to sales” is perhaps the remaining provision to be clarified. The scope of “related wholly to sales” has not been tested in the Courts as cases brought before the Courts have so far related to the period prior to the insertion of subsection (1)(l)(vii) “… related wholly to sales …” to section 39(1)(l).

The IRB has in its *Public Ruling No. 3/2008 – Entertainment Expense* (the PR) interpreted ‘entertainment related wholly to sales’ to mean ‘entertainment directly related to sales provided to customers, dealers and distributors but excluding suppliers’. In the PR, the IRB has also provided examples of types of expenses that it envisages to fall within its interpretation. The examples are as follows:

(a) *Expenses on food and drink for launching of a new product.*

(b) *Redemption vouchers given for purchases made.*

(c) *Cash vouchers, discount vouchers, shopping vouchers, meal vouchers, concert or movie tickets.*

(d) *Free gifts for purchases exceeding a certain amount.*

(e) *Redemption of gifts based on a scheme of accumulated points.*

(f) *“Free” maintenance/service charges or contribution to sinking fund by property developers.*

(g) *Lucky draw prizes given to customers for purchases made.*

(h) *Expenditure on trips given as an incentive to dealers for achieving sales target.*

(i) *Expenditure incurred on refreshment given to its customer while waiting for their cars to be serviced.*

The common threads from the above examples appear to be as follows: (i) they are incurred at point-of-sale and (ii) they are given based on actual sales, both of which have elements of business promotion. However the above is arguably not conclusive as the examples are unlikely to cover all situations.

Section 39(1)(l)(vii) "… wholly related to sales" was not simultaneously amended together with the definition of "entertainment" to also explicitly exclude promotional items given in a bargain. It would be interesting to observe how the newly amended definition of entertainment and the phrase 'related wholly to sales' would operate together. A strict interpretation would mean that so long an expense is related wholly to sales, it is fully deductible even if the expense is promotional.

Let's talk

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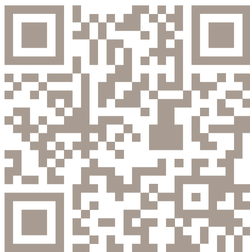

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Publisher: PricewaterhouseCoopers Associates Sdn Bhd (Company No. 464376-X) Level 15, 1 Sentral, Jalan Travers, Kuala Lumpur Sentral, P O Box 10192, 50706 Kuala Lumpur, Malaysia.
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