



Tax alert: SC holds non-compete fees payment as revenue expenditure, deductible

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The Supreme Court (SC) has held that non-compete fees payment could not be considered for acquisition of any capital asset or towards bringing into existence a new profit earning apparatus and hence, is an allowable revenue expenditure under section 37(1) of the Income-tax Act, 1961.

In a nutshell



Non-compete fee only seeks to protect or enhance the profitability of the business, thereby facilitating the carrying on of the business more efficiently and profitably. Such payment neither results in creation of any new asset nor accretion to the profit earning apparatus of the payer. The enduring advantage, if any, by restricting a competitor in business, is not in the capital field.



The duration for which an advantage lasts, is not determinative of the nature of expenditure.

As long as the advantage is not related to the creation or acquisition of a capital asset, where the advantage merely facilitates in carrying on the business efficiently and profitably, leaving the fixed assets untouched, the payment for such advantage would be an allowable business expenditure, irrespective of the period over which the advantage may accrue to the taxpayer by the incurring of such expenditure.



By payment of non-compete fee, the taxpayer did not acquire a new business or add to its profit-making structure. The assets remained the same. The expenditure incurred was essentially to keep a potential competitor out of the same business.

Further, there was no complete elimination of competition. Such payment made by the taxpayer to B Co did not create a monopoly of the taxpayer over the business of electronic products/ equipment. Payment was made to B Co only to ensure that the taxpayer operated the business more efficiently and profitably.

Background

- The taxpayer¹ is a company which is engaged in the business of importing, marketing and selling electronic office products and equipment in India. It was incorporated in the year 2000 as a joint venture of A Co (a Japanese company) and B Co (an Indian company). B Co was in the business of developing, manufacturing, marketing, distributing and selling, amongst other things, electronic equipment in India. It had a well-established country-wide sales network.
- During the Financial Year (FY) 2000-01, corresponding to Assessment Year (AY) 2001-02, the taxpayer paid a certain amount to B Co as consideration for the latter not setting up or undertaking or assisting in the setting up of or undertaking any business in India of selling, marketing and trading in electronic office products for 7 years. The said amount was claimed as a deductible revenue expenditure [under section 37 of the Income-tax Act, 1961 (ITA)] in the return of income filed by the taxpayer for AY 2001-02 as non-compete fee paid to B Co.
- The Assessing Officer (AO) during the audit proceedings noted that by making payment to B Co, the taxpayer could ward off competition in business. The object of making such payment was to derive an advantage by eliminating competition for a period of 7 years. Hence, the AO passed an order and, *inter alia*, held the payment as capital expenditure as it had brought into existence an advantage of enduring nature.
- Aggrieved, the taxpayer filed an appeal and in the course of the appellate proceedings, the matter reached the Supreme Court (SC).

Relevant Provisions in brief

Section 37 of the ITA

(1) *Any expenditure (not being expenditure of the nature described in Sections 30 to 36 and not being in the nature of capital expenditure or personal expenses of the assessee) laid out or expended wholly and exclusively for the purposes of the business or profession shall be allowed in computing the income chargeable under the head 'profits and gains of business or profession'.*

Decision of the SC:

- The SC acknowledged that the issue for consideration, amongst others, was whether non-compete fee paid by the taxpayer was a revenue expenditure or a capital expenditure?

In this regard, the SC noted / observed as follows:

Earlier SC rulings² on capital vs revenue expenditure

- The fact that an item of expenditure is wholly and exclusively laid out for the purpose of business by itself is not sufficient to entitle its allowance in computing the income chargeable to tax. In addition, the expenditure should not be in the nature of a capital expenditure.
- If the expenditure is made for acquiring or bringing into existence an asset or advantage for the enduring benefit of the business, it is properly attributable to capital and is of the nature of capital expenditure.

If on the other hand, it is not made for the purpose of bringing into existence any such asset or advantage but for running the business or working it with a view to produce the profits, it is revenue expenditure.

¹ Sharp Business System vs. Commissioner of Income-tax [2025] 181 taxmann.com 657 (SC)

² Alembic Chemical Works Co. Ltd. vs. Commissioner of Income-tax [1989] 43 Taxman 312 (SC); Assam Bengal Cement Co. Ltd. vs. Commissioner of Income-tax [1955] 27 ITR 34 (SC); Commissioner of Income-tax vs. Bharti Hexacom Ltd. [2024] 162 taxmann.com 669 (SC); ² Commissioner of Income-tax vs. Coal Shipments (P.) Ltd. [1971] 82 ITR 902 (SC); and Empire Jute Co. Ltd. vs. Commissioner of Income-tax [1980] 3 Taxman 69 (SC)

- Where the expenditure is made for the initial outlay or extension of a business or for substantial replacement of the equipment, it is capital expenditure. If the expenditure is for running the business or working it with a view to produce profits, it is revenue expenditure.

Although an enduring benefit need not be of an ever-lasting character, it should not, at the same time, be so transitory and ephemeral that it can be terminated at any time at the volition of any of the parties.

- It is not every advantage of an enduring nature acquired by a taxpayer that brings the case within the ambit of capital expenditure. What is material to consider is the nature of the advantage in a commercial sense and it is only where the advantage is in the capital field that the expenditure would be disallowable on an application of the test of enduring benefit. If the advantage consists merely in facilitating the taxpayer's trading operations or enabling the management and conduct of the taxpayer's business to be carried on more efficiently or more profitably while leaving the fixed capital untouched, the expenditure would be on revenue account, even though the advantage may endure for an indefinite future.

If the outgoing expenditure is so related to the carrying on or the conduct of the business that it may be regarded as an integral part of the profit earning process and not for acquisition of an asset or a right of permanent character, the possession of which is a condition of the carrying on of the business, the expenditure may be regarded as revenue expenditure.

Whether non-compete fee is capital or revenue expenditure?

- Non-compete fee is paid by one party to another to restrain the latter from competing with the payer in the same line of business. It may be by way of a written agreement or by an oral understanding. The restriction may be limited to a specified territory or otherwise; similarly, it can be for a specified period or otherwise. Purpose of non-compete payment is to give a head start to the business of the payer. It can also be for the purpose of protecting the business of the payer or for enhancing the profitability of the business of the payer by insulating the payer from competition.
- **Thus, non-compete fee only seeks to protect or enhance the profitability of the business, thereby facilitating the carrying on of the business more efficiently and profitably. Such payment neither results in creation of any new asset nor accretion to the profit earning apparatus of the payer. The enduring advantage, if any, by restricting a competitor in business, is not in the capital field.**
- The length of time over which the enduring advantage may ensure to the payer is not determinative of the nature of expenditure. As long as the enduring advantage is not in the capital field, where the advantage merely facilitates in carrying on the business more efficiently and profitably, leaving the fixed assets untouched, the payment made to secure such advantage would be an allowable business expenditure, irrespective of the period over which the advantage may accrue to the taxpayer (taxpayer) by incurring of such expenditure.
- The non-compete compensation is so paid in anticipation that absence of a competition from the other party may secure a benefit to the party paying the compensation. However, there is no certainty that such benefit would accrue. Notwithstanding such an arrangement, the payer (taxpayer) may still not achieve the desired result.
- On account of payment of non-compete fee, the taxpayer had not acquired any new business and there is no addition to the profit-making apparatus of the taxpayer. The assets remained the same. The expenditure incurred was essentially to keep a potential competitor out of the same business.
- Further, there was no complete elimination of competition. Such payment made by the taxpayer to B Co did not create a monopoly of the taxpayer over the business of electronic products/ equipment. Payment was made to B Co only to ensure that the taxpayer operated the business more efficiently and profitably.
- In view of the above, the SC held that non-compete fees payment made to B Co could not be considered

for acquisition of any capital asset or towards bringing into existence a new profit earning apparatus and hence, an allowable revenue expenditure under section 37(1) of the ITA.

Comments:

In ever evolving and competitive business environment, certain entities may pay non-compete fees to its competitors (for expansion, efficiency in business, etc.). Such non-compete fees are generally paid to protect the profitability of an existing business by restraining potential competition.

Deductibility of such non-compete as deductible revenue expenditure has been a subject of litigation. In certain earlier rulings³, based on facts, courts had held that non-compete fees are in the nature of capital expenditure, particularly where the payment was linked to acquisition of a business, transfer of controlling interest, or where it was perceived to secure a long-term commercial advantage by restricting competition.

The SC, in this ruling, has now provided clarity as to the tax deductibility of such non-compete fees and held the same as revenue in nature by emphasizing the functional and commercial purpose of such payments.

The SC, in this ruling has, *inter-alia*, held the following:

- Non-compete fee only seeks to protect or enhance the profitability of the business, thereby facilitating the carrying on of the business more efficiently and profitably. Such payment neither results in creation of any new asset nor accretion to the profit earning apparatus of the payer. The enduring advantage, if any, by restricting a competitor in business, is not in the capital field.
- The duration for which an advantage lasts, is not determinative of the nature of expenditure. As long as the advantage is not related to the creation or acquisition of a capital asset, where the advantage merely facilitates in carrying on the business efficiently and profitably, leaving the fixed assets untouched, the payment for such advantage would be an allowable business expenditure, irrespective of the period over which the advantage may accrue to the taxpayer by the incurring of such expenditure.
- By payment of non-compete fee, the taxpayer did not acquire a new business or add to its profit-making structure. The assets remained the same. The expenditure incurred was essentially to keep a potential competitor out of the same business.
Further, there was no complete elimination of competition. Such payment made by the taxpayer to B Co did not create a monopoly of the taxpayer over the business of electronic products/ equipment. Payment was made to B Co only to ensure that the taxpayer operated the business more efficiently and profitably.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.

³ Tecumseh India (P.) Ltd. vs. Additional Commissioner of Income-tax, Special Range-5, New Delhi [2010]
Pitney Bowes India (P.) Ltd. v CIT (ITA No. 784 of 2011) [Delhi HC]
Sharp Business System v. Commissioner of Income Tax (IT Appeal No. 492 of 2012) [Delhi HC]



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