

# TAX FLASH NEWS

1 May 2020



## Payment of non-compete fee is capital expenditure. However, depreciation is not allowed on such expenditure

The Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Hindustan Coca Cola Beverages<sup>1</sup> (the taxpayer) held that non-compete fees paid for not disclosing the confidential information relating to the business and for not competing in a similar line of business in their respective territories for a period of five years are capital expenditure. Further the taxpayer is not entitled to claim depreciation on such capital expenditure.

### Facts of the case

The taxpayer<sup>2</sup> had acquired running business of various bottlers directly or through amalgamation. The non-compete fees were paid to the bottlers for not disclosing the confidential information relating to the business and for not competing in a similar line of business in their respective territories for a period of five years. The taxpayer followed practice of charging amounts to profit and loss account on a pro-rata basis to be fully written-off over the period of benefit. The Assessing Officer (AO) disallowed the claim of the taxpayer on the ground that it was an item of capital expenditure. The AO observed that the taxpayer by virtue of non-compete fees together with consideration for the purchase of the business, had acquired new business and the said payments were thus for the purpose of acquiring income generating business undertaking. Further the depreciation claimed on the such expenditure was also denied by the AO.

### Tribunal's decision

The Tribunal relied on the taxpayer's own case for the AY 2003-04 wherein reliance was placed on the decision of the High Court in the case of Sharp Business System<sup>3</sup>. The High Court had held that the non-compete fees paid by the taxpayer to its partner as a consideration for not setting up or undertaking or assisting in the setting up or undertaking any business in India, of selling, marketing and trade of electronic office products for seven years were not revenue expenditure. Accordingly, the Tribunal in the present case held that the payment of non-compete fees were capital expenditure, on which the taxpayer is not entitled to claim depreciation<sup>4</sup>.

### Our comments

There are divergent decisions on the issue of allowability of non-compete fees. The Madras High Court in the case of Asianet Communications Ltd.<sup>5</sup> held that the payment of non-compete fees did not entail any enduring benefits to the taxpayer in its business and therefore it was allowed as revenue expenditure. The taxpayer had not acquired any new business, profit making apparatus had remained the same, the assets used to run the business remained the same and there was no new business or no new source of income, which accrue to the taxpayer on account of the payment of non-compete fees.

<sup>1</sup> Hindustan Coca-Cola Beverages- [ITA No. 2699/Del/2015]

<sup>2</sup> During the Assessment Year (AY) 2001-02

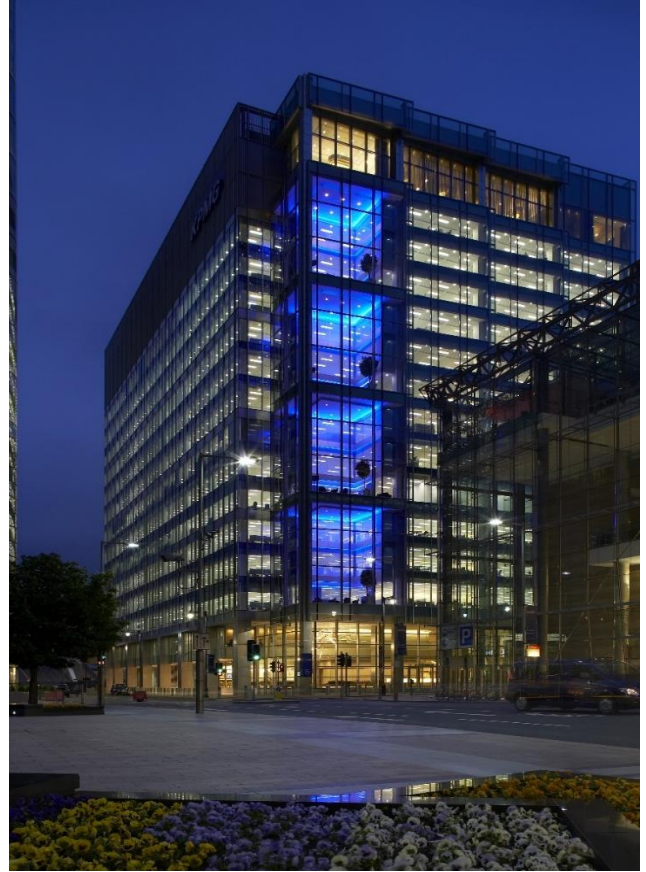
<sup>3</sup> Sharp Business System v. CIT [2012] 211 taxman 576 (Del.).

<sup>4</sup> Under Section 32 of the Act

<sup>5</sup> Asianet Communications Ltd v. CIT- [2018] 407 ITR 706 (Mad)

The Delhi High Court in the case of GKN Driveline India Ltd.<sup>6</sup> observed that the non-compete fees were paid towards all the obligations and covenants i.e. obtaining permissions from financial institutions, obtaining approvals from governmental authorities, income tax authorities, indemnity towards other losses, if any, maintenance of confidentiality about the agreement as also all the intellectual property and other data and information. Therefore, the said payment was clearly for an enduring benefit and not just towards the non-compete obligation and hence capital in nature.

The Delhi Tribunal in the present case has held that non-compete fees paid for not disclosing the confidential information relating to the business and for not competing in a similar line of business in their respective territories for a period of five years, are capital expenditure. Further on such capital expenditure depreciation is not allowed



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<sup>6</sup> GKN driveline India Ltd. v. CIT- [2017] 88 taxmann.com 208 (Del)

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