2025 INSC 1481

REPORTABLE

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 4072 OF 2014

SHARP BUSINESS SYSTEM THR. FINANCE DIRECTOR MR. YOSHIHISA MIZUNO **APPELLANT(S)**

VERSUS

COMMISSIONER OF INCOME TAX-III N.D. **RESPONDENT(S)**

With

CIVIL APPEAL NO. 15048 of 2025
(Arising out of SLP(C) NO. 16277/2014

CIVIL APPEAL NO. 15049 of 2025
(Arising out of SLP(C) NO. 719/2020

CIVIL APPEAL NO. 15050 of 2025
(Arising out of SLP(C) NO. 38046/2025
(Arising out of DIARY NO. 22308/2022

CIVIL APPEAL NO. 15051 of 2025
(Arising out of SLP(C) NO. 24756/2014

J U D G M E N T

UJJAL BHUYAN, J.

Delay in filing SLP(C) Diary No. 22308/2022 is condoned.

2. I.A. No. 114870/2022 is allowed.

3. Leave granted in SLP(C) No. 16277/2014, SLP(C) No. 24756/2014, SLP(C) No. 719/2020 and SLP(C) No.__/2025 (arising out of Diary No. 22308/2022).

4. Civil Appeal No. 4072/2014 is directed against the judgment and order dated 05.11.2012 passed by the High Court of Delhi (briefly 'the Delhi High Court' hereinafter) dismissing Income Tax Appeal No. 492/2012 (Sharp Business System Vs. Commissioner of Income Tax – III) filed by the assessee for the assessment year 2001-02.

4.1. SLP(C) No. 16277/2014 takes exception to the judgment and order dated 20.11.2013 passed by the High Court of Judicature at Madras (briefly 'the Madras High Court' hereinafter) in Tax Case (Appeal) No. 1134 of 2008 (M/s. Pentasoft Technology Limited Vs. DCIT) for the assessment year 2001-02 allowing the appeal of the assessee.

4.2. The judgment and order dated 29.10.2013 passed by the Madras High Court allowing Tax Case (Appeal) No. 1195 of 2008 (M/s. Pentasoft Technologies Limited Vs. DCIT) of the

assessee for the assessment year 2002-03 is under impugnment in SLP(C) No. 24756/2014.

4.3. In SLP(C) No. 719/2020, the challenge is to the judgment and order dated 11.06.2019 passed by the High Court of Judicature at Bombay (briefly 'the Bombay High Court' hereinafter) dismissing Income Tax (Appeal) No. 556 of 2017 (Principal Commissioner of Income Tax – VII Vs. Piramal Glass Limited) of the revenue for the assessment year 2001-02.

4.4. SLP(C) D. No. 22308/2022 has been filed by the revenue against the judgment and order dated 11.01.2022 passed by the Madras High Court dismissing Tax Case (Appeal) No. 600 of 2010 (CIT, Chennai Vs. M/s. Pentasoft Technologies Limited) of the revenue for the assessment year 2001-02.

5. The perennial question of whether an expenditure incurred by an assessee is capital or revenue again confronts us in this batch of appeals. The core issue which arises for consideration in the facts of this batch of appeals is whether non-compete fee paid by the assessee is a revenue expenditure or capital expenditure?

5.1. Corollary to the above question is whether such expenditure, if considered to be an expenditure of capital nature, is entitled to depreciation under Section 32(1)(ii) of the Income Tax Act, 1961 (briefly 'the Act' hereinafter)?

5.2. In SLP(C) No. 719/2020, another issue involved is the treatment of interest on borrowed funds invested by the assessee in its sister concern and also provided as interest free advances to the sister concern and its directors; whether such interest is an allowable business expenditure?

6. Before we proceed to answer the above questions, it would be appropriate to have a brief narration of essential facts in each of the appeals relevant to the issues which have arisen for our consideration.

Non-compete fee

Civil Appeal No. 4072/2014

7. Assessee is the appellant here. It is a company which is engaged in the business of importing, marketing and selling electronic office products and equipments in India. It was incorporated on 29.02.2000 as a joint venture of M/s. Sharp Corporation, Japan and M/s. Larsen and Toubro Limited ('L&T'

for short). L&T is in the business of developing, manufacturing, marketing, distributing and selling, amongst other things, electronic equipments in India. In this connection, it has a well established country-wide sales network. M/s. Sharp Corporation was engaged in the business of designing, developing, manufacturing, marketing, distributing and selling various audio/visual products, household electronic appliances, electronic office products, computers, etc. and other related products on a worldwide basis.

7.1. During the assessment year 2001-02, assessee paid a sum of Rs. 3 crores to L&T 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 of Rs. 3 crores was claimed as a deductible revenue expenditure in the return of income filed by the assessee on 31.10.2001 for the assessment year 2001-02 as non-compete fee paid to L&T. Initially, the return was processed under Section 143(1) of the Act. Thereafter, the case was selected for scrutiny whereafter notice under Section 143(2) of the Act was issued to the assessee.

7.2. Following assessment proceedings, assessing officer passed assessment order dated 19.03.2004 wherein it was noted that by making payment of Rs. 3 crores to L&T, assessee could ward of competition in business. The object of making such payment to L&T was to derive an advantage by eliminating competition for a period of 7 years. According to the assessing officer, such an expenditure had brought into existence an advantage of enduring nature and hence treated the payment of Rs. 3 crores as capital expenditure. Therefore, the said amount was added to the income of the assessee. There were other aspects in the assessment order with which we are not concerned in the present proceeding.

7.3. Aggrieved by the order of assessment, assessee preferred an appeal before the Commissioner of Income Tax (Appeals), 'CIT(A)' for short. In the appeal, assessee contended that non-compete fee should be treated as an allowable revenue expenditure. However, in the course of the appellate proceedings, an alternative ground was put forth by the assessee that if the amount of non-compete fee paid to L&T was treated as capital expenditure, then the benefit of depreciation allowance should be extended to the assessee under Section 32(1)(ii) of the Act.

7.4. CIT(A) *vide* the order dated 02.09.2004 held that such expenditure was not in the nature of revenue expenditure. In so far the alternative ground was concerned, CIT(A) held that there was no apparent justification for the assessee to enter into a non-compete agreement with L&T for a sum of Rs. 3 crores since L&T was not a competitor of the assessee and that the business interest of the assessee would not have suffered for want of such an agreement. Since the true purport of the expenditure remained unproved, the same was disallowed being regarded as non-revenue expenditure, not for the purpose of business of the assessee. Accordingly, the assessee was held to be not entitled to depreciation. Consequently, appeal of the assessee was dismissed by CIT(A).

7.5. Assessee preferred further appeal before the Income Tax Appellate Tribunal, New Delhi (ITAT) against the order of the CIT(A) dated 02.09.2004.

7.6. ITAT *vide* the order dated 30.06.2011 noted that the assessee by paying a non-compete fee of Rs. 3 crores to L&T had eliminated competition for a period of 7 years which is a duration long enough to establish its reputation and a reasonable market

share would have been acquired by the assessee. Payment made by the assessee to L&T was not to increase its profitability. Thus, the non-compete fee could not be treated as revenue expenditure but it was in the nature of a capital expenditure. Further, ITAT held that the non-compete fee would not create intangible asset eligible for depreciation under the provisions of Section 32(1)(ii) of the Act. Thus, depreciation was not allowable on the expenditure made by the assessee as non-compete fee. ITAT held that just as the right to trade freely or to compete in the market is not an asset, similarly a right arising out of a non-compete agreement would not constitute a commercial right falling within the ambit of intangible asset under Section 32(1)(ii) of the Act. ITAT found no infirmity in the order passed by the CIT(A) and dismissed the appeal of the assessee.

7.7. It was thereafter that assessee filed Income Tax Appeal No. 492/2012 before the Delhi High Court. *Vide* the judgment and order dated 05.11.2012, Delhi High Court dismissed the appeal of the assessee as being devoid of any merit. Delhi High Court opined that expenditure incurred by the assessee by way of non-compete fee paid to L&T could not be claimed as a revenue expenditure as it was clearly a capital

expenditure. Despite holding the expenditure to be capital in nature, Delhi High Court was of the further view that the non-compete right of the kind acquired by the assessee against L&T for 7 years did not result in depreciable intangible asset. It was held that the right acquired by the assessee by payment of non-compete fee was a right *in personam* only against L&T for a period of 7 years. It was not a right *in rem*. Adverting to the expression 'similar business or commercial rights' appearing in Section 32(1)(ii) of the Act, Delhi High Court opined that it has to necessarily result in an intangible asset against the entire world to qualify for depreciation under the said provision. Delhi High Court therefore dismissed the appeal of the assessee.

Civil Appeal No. of 2025
(Arising out of SLP(C) No. 16277/2014)

8. This appeal is by the revenue assailing the judgment and order dated 20.11.2013 passed by the Madras High Court allowing Tax Case (Appeal) No. 1134 of 2008 filed by the assessee for the assessment year 2001-02.

8.1. As noted above, respondent is the assessee which is a public limited company carrying on the business of software development, hardware sales, technical training and engineering

services. Assessee exports software from its industrial units set up in software technology parks and makes domestic sales from its industrial units situated outside software technology parks.

8.2. Assessee filed its return of income for the assessment year 2001-02 on 29.10.2001 claiming various exemptions. Assessing officer passed assessment order dated 31.03.2004 under Section 143(3) of the Act raising a demand of Rs. 55,25,86,888.00 besides initiating penalty proceedings.

8.3. Aggrieved by the aforesaid order of assessment, assessee preferred appeal before CIT(A). During the appellate proceedings, assessee raised additional grounds of appeal, one of which related to depreciation on intangible assets like intellectual property rights and non-compete fee. Assessee contended that assessing officer had not granted depreciation on intangible assets as well as on non-compete fee. It may be mentioned that assessee had paid Rs. 180 crores as non-compete fee during acquisition of software development and training division of M/s. Pentamedia Graphics Limited. In these proceedings, we are not concerned with the claim of depreciation on intangible assets like intellectual property rights.

8.4. CIT(A) in the order dated 30.11.2006 held that non-compete fee is nothing but a license. Non-compete fee paid to M/s. Pentamedia Graphics Limited restrained it from using the brand name 'Pentasoft', further restraining it from undertaking any development of software. Assessee could therefore exclusively carry on the business of software development, training and export of such technologies by restraining M/s. Pentamedia Graphics Limited from carrying out the same activities. This commercial right acquired by payment of non-compete fee was held to be an intangible asset entitled to depreciation under Section 32(1)(ii) of the Act. Accordingly, direction was issued to the assessing officer.

8.5. Aggrieved by the aforesaid order of CIT(A), revenue preferred appeal before the ITAT, Chennai particularly the finding of CIT(A) that non-compete fee is eligible for depreciation under Section 32(1)(ii) of the Act.

8.6. ITAT *vide* the order dated 14.03.2008 relied on its previous decision in the assessee's own case and held that non-compete fee was not an intangible asset and, therefore, depreciation could not be allowed on non-compete fee.

8.7. Assessee preferred appeal before the Madras High Court. Madras High Court noted in the judgment and order dated 20.11.2013 that the issue as to whether non-compete fee was an intangible asset and hence entitled to depreciation was already decided by it in the assessee's own case dated 29.10.2013 for the assessment year 2002-03. Accordingly, Madras High Court decided the appeal in favour of the assessee by holding that assessee was entitled to depreciation on non-compete fee, it being an intangible asset, under Section 32(1)(ii) of the Act.

Civil Appeal No. of 2025
(Arising out of SLP(C) No. 24756 of 2014)

9. This appeal is by the revenue. Respondent is the assessee, details of which have already been mentioned in the previous appeal.

9.1. For the assessment year 2002-03, respondent filed its return of income on 31.10.2001 declaring net loss of Rs. 37,12,20,853.00. Initially the return was processed under Section 143(1) of the Act but subsequently the case was selected for scrutiny during which proceedings, assessee filed a revised

return increasing its loss. It also submitted a note on the admissibility of depreciation on intellectual property rights and on non-compete fee on 23.02.2000. Assessee stated that it had entered into an agreement with M/s. Pentamedia Graphics Limited for acquisition of the software development and training division. In the agreement dated 23.02.2000, there was a clause relating to non-competition by virtue of which M/s. Pentamedia Graphics Limited agreed that it would not enter into the business of the assessee either directly or indirectly in any country for a period of 10 years. Assessee paid Rs. 180 crores as non-compete fee to M/s. Pentamedia Graphics Limited.

9.2. Assessing officer *vide* the assessment order dated 30.03.2005 rejected capitalisation of non-compete fee as well as disallowed the claim of depreciation.

9.3. Assessee preferred appeal before CIT(A), Chennai. CIT(A) *vide* the order dated 27.02.2006 held that the assessee could carry on the business in software development export and training by restraining M/s. Pentamedia Graphics Limited from carrying out the same activities. Assessee had acquired commercial right to conduct training programmes with the use

of the trademark 'Pentasoft' and engaged in software development and export of various software products. According to CIT(A), accounting standard 26 of the Institute of Chartered Accountants of India, non-compete fee is classifiable as intangible asset since it satisfies the criteria of being: (i) identifiable, (ii) controllable, and (iii) economic benefits flowed out to the enterprise. Since the three criteria were satisfied and the assets were unconditionally transferred by M/s. Pentamedia Graphics Limited, CIT(A) held that the assessee had acquired the absolute right to enjoy, utilize and exploit such commercial right. Therefore, it was an intangible asset entitled to depreciation under Section 32(1)(ii) of the Act.

9.4. Both revenue and assessee preferred separate appeals before the ITAT, Chennai. In the order dated 06.02.2008, ITAT held that non-compete fee was not an asset which the assessee could use like a license or franchise in its business. Non-compete fee was a payment made to ward off a competitor for a specified number of years. It only conferred a right to sue in case of breach by the person to whom the amount was paid. It could only be enforced when a default occurred. As such, ITAT held that depreciation could not be allowed on non-compete fee.

9.5. Aggrieved by the order of ITAT, assessee preferred appeal before the Madras High Court, being Tax Case (Appeal) No. 1195 of 2008. Madras High Court held that non-compete agreement between parties was a composite agreement. Under the agreement, the transferor had transferred all its rights including copyrights and trade marks as well as the training and development division to the assessee. In the composite agreement, there was a non-compete clause by virtue of which the transferor was restrained from doing the same business as that of the assessee. High Court held such a right to be a commercial right. Thus, High Court was of the view that non-compete agreement and the various terms and conditions contained therein, binds the parties. Non-compete fee was, therefore, held to be an intangible asset and in terms of Section 32(1)(ii) of the Act, it would be a capital asset entitled to depreciation.

Civil Appeal No. of 2025
(Arising out of SLP(C) No. 719/2020)

10. This appeal is at the instance of the revenue assailing the judgment and order dated 11.06.2019 passed by the Bombay High Court in Income Tax Appeal No. 556 of 2017 (Principal

Commissioner of Income Tax Vs. Piramal Glass Limited) preferred by the revenue. The assessment year under consideration is 2001-2002.

10.1. Assessee, which is the respondent, is a subsidiary company of Nicholas Piramal India Limited which holds 53.76 percent of equity shares of the assessee. The rest of the equity shares have been subscribed by foreign parties. Assessee has two manufacturing divisions, both in Gujarat.

10.2. Assessee had filed its return of income for the assessment year under consideration on 30.10.2001 declaring total income of Rs. 17,11,64,492.00 under Section 115JA of the Act and a loss of Rs. 20,52,26,552.00. Though initially the return was processed under Section 143(1) of the Act, subsequently, assessment proceedings were initiated under Section 143 thereof.

10.3. During the assessment year 1999-2000, assessee had acquired the glass division from Nicholas Piramal India Limited for which a non-compete fee of Rs. 18,00,00,000.00 was paid.

10.4. In the assessment order dated 19.02.2004 passed by the assessing officer under Section 143(3) of the Act the claim of

depreciation on non-compete fee was disallowed by following the earlier order of assessment in the case of the assessee itself for the assessment year 1999-2000 holding that the expenditure was in no way connected with the acquisition of various assets. The disallowance in this regard was worked out at Rs. 12,18,37,337.00.

10.5. Assessee preferred appeal before CIT(A) who, however, in his appellate order dated 02.09.2004 upheld the decision of the assessing officer disallowing depreciation on non-compete fee.

10.6. Aggrieved thereby, assessee preferred further appeal before ITAT, 'B' Bench, Mumbai. Cross appeal was also filed by the revenue in respect of other issues. *Vide* its order dated 02.03.2016, ITAT held that so long as non-compete fee in question is capital expenditure, the same would be entitled for depreciation. ITAT, therefore, directed the assessing officer to allow the claim of depreciation on the amount of non-compete fee paid treating the same as intangible asset.

10.7. Assailing the aforesaid finding of the ITAT, revenue preferred appeal before the Bombay High Court being Income

Tax Appeal No.556 of 2017. It was noted by the Bombay High Court that on the question of grant of depreciation on non-compete fee paid, various High Courts have held in favour of the assessee. A non-compete fee provides an enduring benefit and protects the assessee against competition. The expression 'or any other business or commercial rights of similar nature' appearing in Section 32(1)(ii) is wide enough to include non-compete fee. Therefore, Bombay High Court was of the view that no question of law arose in this regard.

Civil Appeal No. of 2025
(Arising out of SLP(C) No. of 2025)
(Arising out of Diary No. 22308 of 2022)

11. This appeal by the revenue is directed against the judgment and order dated 11.01.2022 passed by the Madras High Court dismissing Tax Case (Appeal) No. 600 of 2010 of the revenue. Assessment year under consideration is 2001-02.

11.1. Assessee is the respondent. It is a public limited company carrying on the business in software development, hardware sales and technical training and engineering services. It has software export unit situated in a software technology park in India.

11.2. Assessee filed return of income for the assessment year under consideration on 29.10.2001 declaring a net loss of Rs. 66,59,04,421.00. Initially the return was processed under Section 143(1) of the Act but subsequently, assessment proceedings were initiated under Section 143 of the Act.

11.3. In the assessment order dated 31.03.2004, total income of the assessee was computed at Rs. 96,25,86,888.00 which resulted in net demand of Rs. 55,25,86,888.00 including interest under Section 234B of the Act. Consequently, penalty proceedings under Section 271(1)(c) of the Act were also initiated by the assessing officer against the assessee. In the assessment order, assessing officer made several disallowances which are not the subject matter of the appeal.

11.4. Assessee preferred appeal before the CIT(A), Chennai. During the appellate proceedings, assessee raised additional grounds of appeal which according to it were ignored by the assessing officer in the assessment proceedings. One of the additional grounds raised by the assessee related to claim of depreciation of intangible assets like intellectual property rights and non-compete fee. It was stated that assessee had paid Rs.

180 crores as non-compete fee to M/s. Pentamedia Graphics Limited for acquisition of its software development and training division.

11.5. CIT(A) in its order dated 30.11.2006 held that non-compete fee is nothing but a license. Assessee could exclusively carry on the business of software development, training and export of technologies by restraining M/s. Pentamedia Graphics Limited from carrying out the same activities. Thus, payment of non-compete fee was held to be an intangible asset entitled to depreciation under Section 32(1)(ii) of the Act.

11.6. Revenue preferred appeal before ITAT, Chennai challenging the decision of the CIT(A) holding that non-compete fee is an intangible asset eligible for depreciation. Cross appeal was also filed by the assessee on other grounds.

11.7. ITAT *vide* the order dated 14.03.2008 held that non-compete fee is an intangible asset entitled to depreciation under Section 32(1)(ii) of the Act.

11.8. This finding of the ITAT came to be challenged before the Madras High Court by the revenue in Tax Case (Appeal) No. 600 of 2010. Madras High Court followed its earlier decision in

the case of the assessee itself for the assessment year 2002-03 and dismissed the appeal filed by the revenue upholding the decision of the ITAT on this point.

Submissions

12. Mr. Ajay Vohra, learned senior counsel appearing for Sharp Business System (assessee) (appellant in Civil Appeal No. 4072/2014), at the outset submits that the expenditure incurred on account of non-compete fee is a revenue expenditure and is, therefore, an allowable deduction. He has referred to Section 37 of the Act, more particularly to sub-section (1) thereof, and submits that any expenditure of an assessee may be allowed as a deduction while computing the income chargeable under the head 'profits and gains of business or profession' subject to fulfillment of the following conditions:

(i) if the expenditure does not fall within the ambit of Sections 30 to 36 of the Act;

(ii) if the expenditure has been incurred in the accounting year relevant to the assessment year under consideration;

(iii) it should be expended wholly and exclusively for the purpose of the business or profession carried on by the assessee; and

(iv) it should not be in the nature of capital expenditure or personal expenses of the assessee.

12.1. Adverting to the above, Mr. Vohra submits that the expenditure incurred by the assessee in the form of non-compete fee is certainly not a personal expense of the assessee; the expenditure was wholly and exclusively incurred for the purpose of its business, for the purpose of establishing and enlarging the business of the assessee. There is no doubt it was expended during the relevant accounting year.

12.2. Mr. Vohra asserts that such expenditure incurred by the assessee is on revenue account since it was expended wholly and exclusively for the purpose of business. Therefore, such an expenditure should be allowed as a deduction.

12.3. He has referred to the decision of this Court in *Empire Jute Company Limited Vs. Commissioner of Income Tax*[1] where it has been held that in certain situations or circumstances, the

[1] (1980) 124 ITR 1

test of enduring benefit may fail. In fact, learned senior counsel submits that the test of enduring benefit may not be applicable universally to determine the character of the expenditure. Even when such an expenditure results in a benefit of enduring nature, that by itself would not be conclusive to regard or treat the expenditure as capital expenditure, if the benefit merely facilitates in carrying on the business more profitably and efficiently.

12.4. Applying the tests laid down by this Court in the case of *Empire Jute* (supra), learned senior counsel submits that non-compete fee only seeks to protect and enhance the business of the assessee thereby facilitating the carrying on of the business more efficiently and profitably. According to him, such payment does not result in creation of a new asset or any accretion to the business apparatus. The benefit, though of enduring advantage, is due to restriction of a competitor or potential competitor in business. Therefore, such a benefit even if of an enduring nature is not in the capital field.

12.5. Continuing with his submissions, Mr. Vohra has alluded to a judgment of this Court in *Commissioner of Income*

Tax Vs. Madras Auto Services (P) Limited[2]. Relying on the aforesaid decision, Mr. Vohra submits that the period or length of time over which the enduring advantage may spread over is not determinative of the nature of expenditure where the advantage merely facilitates in carrying on the business more efficiently and profitably, leaving the fixed assets untouched.

12.6. Mr. Vohra next refers to another decision of this Court in *CIT, West Bengal II, Calcutta Vs. Coal Shipments (P) Limited*[3] and submitted that this Court considered its decision in *Assam Bengal Cement Company Limited Vs. CIT*[4] and held that if payment is made to ward off competition in business or with an object of deriving an advantage by eliminating competition over a period of time, the same would be in the nature of capital expenditure. On the other hand, where there is no certainty of the duration of the advantage and the same could be put to an end at any time, such an expenditure would be a revenue expenditure.

[2] (1998) 233 ITR 468
[3] (1971) 82 ITR 902
[4] (1955) 27 ITR 34

12.7. It is the submission of Mr. Vohra that if the aforesaid decisions of this Court in *Coal Shipments* (supra) and *Empire Jute* (supra) are read conjointly, the only legal inference that can be drawn is that when the expenditure incurred by the assessee brings into existence a benefit of enduring nature in the capital field such payment of non-compete fee would be treated as capital expenditure and not otherwise. If the expenditure so incurred is for carrying on the business more efficiently or profitably without any addition to the profit earning apparatus, the same would be an allowable revenue deduction, irrespective of the fact whether the benefit is enduring or ephemeral.

12.8. Applying the ratio of the aforesaid decisions to the facts of the appeal, he submits that as a matter of fact there is no elimination of competition; nor does the payment create any monopoly over the business of electronic products etc. by making the non-compete fee payment to L&T. Payment was made to L&T not to eliminate competition or create a monopoly but only to run the business more efficiently and profitably. Such consideration paid to L&T cannot therefore be said to be for the acquisition of any capital asset or towards bringing into existence a new profit earning apparatus. Delhi High Court failed

to appreciate that payment of non-compete fee does not bring into existence any capital asset or advantage of enduring benefit in the capital field. Therefore, such an expenditure cannot be treated as capital expenditure. Such expenditure only helps in enhancing the profitability of business. Therefore, it is an allowable expenditure under Section 37(1) of the Act.

12.9. He thereafter makes an alternative submission. Referring to Section 32 of the Act, he submits that even if such an expenditure is construed to be a capital expenditure, depreciation cannot be denied. Section 32(1)(ii) of the Act provides that in respect of depreciation of know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature being intangible assets acquired on or after the first day of April, 1998, not being goodwill of a business or profession, owned wholly or partly by the assessee, and used for the purposes of the business or profession, the deductions as provided thereunder shall be allowed. Explanation 3 to sub-section (1) of Section 32 explains the meaning of the word 'assets' to mean (a) tangible assets, being buildings, machinery, plant or furniture; and (b) intangible assets, being know-how, patents, copyrights, trade marks,

licences, franchises or any other business or commercial rights of similar nature, not being goodwill of a business or profession. Mr. Vohra submits that the crucial expression to be noticed in this provision is 'any other business or commercial rights of similar nature'. According to him, it would be too simplistic to apply the doctrine of *ejusdem generis* to say that the aforesaid expression would mean business or commercial rights of similar nature like intellectual property rights, such as, know-how, patents, copyrights, trade marks etc. Once the High Court held that payment of non-compete fee gave the appellant an advantage of enduring benefit, then the High Court could not have denied depreciation thereon by taking the view that no asset was brought into existence.

12.10. He then refers to the decision of this Court in the case of *Techno Shares & Stocks Limited Vs. CIT*[5] which has held that membership card of Bombay Stock Exchange is in the nature of license to trade. Hence, it is an intangible asset entitled to depreciation under Section 32(1)(ii) of the Act. Based on the aforesaid decision, he submits that depreciation is allowable on

[5] (2010) 327 ITR 323

payment of non-compete fee as such payment results in acquisition of an intangible asset within the meaning of Explanation 3 to Section 32(1) of the Act.

12.11. Learned senior counsel therefore submits that firstly the expenses incurred by the assessee by way of non-compete fee is a revenue expenditure and therefore is an allowable deduction. Alternatively, he submits that if the same is construed to be a capital expenditure, then depreciation would be allowable thereon in terms of Section 32(1)(ii) of the Act.

13. Mr. Arvind P. Datar, learned senior counsel representing M/s. Piramal Glass Private Limited (formerly known as Piramal Glass Limited) submits that his client acknowledges that non-compete fee paid is not a revenue expenditure but a capital expenditure. However, the further contention is that as a capital expenditure, it is entitled to depreciation under Section 32 of the Act. Therefore, the question which arises for consideration is whether the right which accrues to the assessee on account of the non-compete agreement can be said to be an 'intangible asset' qualifying for depreciation under Section 32 of the Act.

13.1. Mr. Datar then refers to Section 32(1)(ii) of the Act and submits that the said provision clearly provides for depreciation on intangible assets owned and used for the purpose of business and profession. Intangibles include know-how, patents, copyrights, trade marks, licences, franchises or any other business or commercial rights of similar nature. Explanation 3 to Section 32 defines the term 'assets' and clause(b) of the Explanation defining 'intangible assets' is in similar terms as is referred to in Section 32(1)(ii) of the Act. He then refers to the definition of 'block of assets' as provided in Section 2(11) of the Act, clearly bifurcating assets into tangible assets and intangible assets. Intangible assets include 'or any other business or commercial rights of similar nature'. In this connection, Mr. Datar has also referred to the old Appendix I of the Income Tax Rules, 1962 (briefly 'the Rules' hereinafter) and submits that the said provision would be applicable in the present appeal since the assessment year under consideration is 2001-02. The said Appendix I has two parts: Part A dealing with tangible assets and Part B dealing with intangible assets.

13.2. Mr. Datar submits that the expression 'any other business or commercial rights of similar nature' appearing in

Section 32(1)(ii) of the Act should take the meaning of or refer to intangible assets and not the species of intangible assets, such as, know-how, patents, copyrights, trade marks, licences and franchises. Thus, the submission is that under intangible assets the abovestated intellectual property rights are the first category; and 'other business or commercial rights' fall within the second category. According to him, in 1998 when this provision came to be substituted, the legislature could not have envisaged any other rights emanating from commercial arrangements and hence deemed it fit to allow depreciation on 'any other business or commercial rights of similar nature'. The principle of *ejusdem generis* requires a commonality; and in the present case, the commonality is neither positive nor negative rights or either rights in *rem* or rights in *personam*. The commonality is that all are species of the genus 'intangible assets'.

13.3. Adverting to the distinction made by the Delhi High Court as regards rights in *rem* and rights in *personam,* Mr. Datar submits that law does not require any such distinction for allowability of depreciation: as to whether such rights are rights in *rem* or rights in *personam.* While generally patents, copyrights and trade marks confer rights in *rem,* other categories like

technical know-how, licences or franchises generally confer rights in *personam.* Even under The Patents Act, 1970, The Copyrights Act, 1957 and The Trade Marks Act, 1999, certain rights can be in *rem* and certain in *personam.* Similar is the case of a license being a privilege may be right in *rem* for some people and right in *personam* for some other people. However, Mr. Datar emphatically submits that such a debate *qua* rights in *rem* or rights in *personam* should be avoided as it is not necessary for determining the issue at hand.

13.4. Taking exception to the decision of the Delhi High Court in *Sharp Business System,* Mr. Datar submits that such a line of reasoning is against the uniform view taken by different high courts of the country. In fact, on non-compete fee, the Gujarat, Bombay, Madras and Karnataka High Courts have taken a view favorable to the assessee.

13.5. In any view of the matter, the plea regarding positive and negative rights was not taken by the revenue at any stage: from the assessing officer to the High Court. Therefore, such a plea cannot be entertained for the first time before the Supreme Court under Article 136 of the Constitution.

13.6. Without prejudice to the above, it is the further submission of Mr. Datar that the expression 'any other business or commercial rights of similar nature' is intended to cover all intangible assets other than know-how, patents, trade marks etc. which are specifically enumerated. The scope of this expression cannot be restricted or read down by carving out an exception for so-called negative rights.

13.7. Positive or negative rights are just one of the nine species of rights. As set out in Chapter VII of *Salmond on Jurisprudence,* the classification of rights into positive or negative rights, vested or tangible rights etc. is only for the purpose of characterization of such rights in the context of co-related duties. Such classification cannot be relied upon to interpret the scope of the expression 'any other business or commercial rights of similar nature' appearing in Section 32(1)(ii) of the Act. That apart, emphasis on such a classification may lead to absurd consequences because rights are not only divided into positive and negative rights. Rights can also be partially positive and partially negative. In such a case, it will be absurd to suggest that depreciation will be granted only on *prorata* basis by the assessing officer.

13.8. Mr. Datar submits that by the Finance Act, 2002, legislature has inserted clause (va) to Section 28 of the Act to tax such receipts. There is no distinction or test stating that only if it is a receipt on account of positive rights, it would be taxable. Irrespective of whether it is a positive right or a negative right, such receipts from the assessment year 2003-04 onwards is taxable. Based on this, Mr. Datar submits that for taxing such receipts on account of non-compete fee, there is no distinction for allowing depreciation. Therefore, revenue cannot approbate or reprobate to contend that only positive rights are eligible for claiming depreciation on intangible asset.

13.9. *Dehors* the aforesaid submission, Mr. Datar further contends that the amount paid for non-compete fee gives a positive advantage to the assessee who acquires such right. It enables the assessee to expand its business because of reduced competition. Thus in the hands of the acquirer, it has a positive advantage; however in the hands of the recipient of non-compete fee, the negative convenant results in a negative application or duty. Therefore, there is no negative right at play here.

13.10. Adverting to Section 2(14) of the Act, Mr. Datar submits that 'capital asset' has been defined to include property of any kind held by an assessee. The word 'property' is defined in the Explanation to sub-section (14) of Section 2 to include and always be deemed to have included rights of management or control or any other rights whatsoever. Based on such an analogy, rights acquired on payment of non-compete fee are property and hence assumes the character of a capital asset. Such an asset is an intangible asset and thus will be entitled for depreciation.

13.11. Mr. Datar then referred to the word 'used' appearing in Section 32(1) of the Act. He submits that for claiming depreciation, the assets whether tangible or intangible must be owned by the assessee and used for the purpose of business or profession. In any intangible asset, a physical or active demonstrating user test cannot be satisfied as compared to tangible asset. Therefore, the word 'used' has to be read in a broader context. A passive use or latent use would also satisfy the word 'used'. In case of a non-compete covenant, the user is using such a covenant the day he enters into the agreement for keeping a dominant or established player out of the same

business, thereby earning better profits. Thus, there cannot be any dispute that by a non-compete covenant, an intangible asset is being used. No prudent businessman will pay non-compete fee if he is not going to get a return.

13.12. Summing up his arguments, Mr. Datar, learned senior counsel, submits that the view taken by the Delhi High Court is wholly erroneous. Non-compete fee is a capital expenditure and is entitled to depreciation in terms of Section 32(1)(ii) of the Act.

14. Appearing on behalf of the revenue, Mr. S. Dwarakanath, learned Additional Solicitor General of India, at the outset, submits that the issue which arises for adjudication in the present matters is whether payment of non-compete fee is in the nature of revenue expenditure or capital expenditure? Corollary to the above is, if such payment is construed to be of capital nature, then whether depreciation under Section 32(1) of the Act is allowable on such payment?

14.1. Supporting the judgment of the Delhi High Court in *Sharp Business System*, Mr. Dwarakanath submits that payment of non-compete fee is not in the nature of revenue

expenditure. Delhi High Court has rightly held that such payment constitutes capital expenditure in the hands of the payer, having been incurred for acquiring an enduring benefit of an ephemeral nature. In this connection, learned counsel has placed reliance on the following decisions:

(i) *Empire Jute Co. Ltd.* (supra);

(ii) *Guffic Chem (P.) Ltd. Vs. CIT*[6];

(iii) *CIT Vs. Bharti Hexacom Ltd.*[7];

(iv) *Pitney Bowes India (P) Ltd. Vs. CIT*[8]

14.2. From an analysis of the aforesaid decisions, it is evident that by expending non-compete fee, assessee had acquired an enduring benefit of an ephemeral nature. Therefore, the question which follows is whether such payment would be eligible for depreciation under Section 32(1) of the Act?

14.3. In this connection, Mr. Dwarakanath submits that Section 32(1) allowing depreciation on tangible and intangible assets must be read holistically. Insofar payment of non-compete

[6] (2011) 332 ITR 602
[7] (2023) 458 ITR 593
[8] 2011 SCC OnLine Del 5114

fee is concerned, it certainly results in creation of an intangible asset. There are two aspects of allowance of depreciation in respect of intangible assets. Firstly, it should fall within one of the enumerated categories i.e. know-how, patents, copyrights, trade marks, licenses, franchises or 'any other business or commercial rights of similar nature'; secondly, it should be 'owned', either wholly or partly, by the assessee and should be 'used' for the purpose of its business or profession.

14.4. Elaborating on the above aspect, learned Additional Solicitor General submits that the issues to be adjudicated are twofold: one, whether the right acquired on payment of non-compete fee falls within the expression 'any other business or commercial rights of similar nature'; and two, whether such right is 'owned' (wholly or partly) by the assessee and 'used' for the purpose of its business or profession, business in this case.

14.5. In this regard, he submits that applying the principles of statutory interpretation and *ejusdem generis*, the appropriate construction of the expression 'any other business or commercial rights of similar nature', appearing in Section 32(1) (ii) of the Act would be to follow the preceding words i.e. know-how, patents,

copyrights, trade marks, licenses and franchises. In this connection, reliance has been placed on the following decisions of this Court:

(i) *Siddeshwari Cotton Mills (P) Ltd. Vs. Union of India*[9];

(ii) *CIT Vs. McDowell & Co. Ltd.*[10]

14.6. Explaining the above, Mr. Dwarakanath submits that the concept of *ejusdem generis* signifies a principle of construction whereby the words in a statute which are otherwise wide but are associated in the text with more limited words are, by implication, given a restricted operation and are limited to matters of the same class or genus as preceding them. That apart, in the absence of a comma, after the word franchises, either in Section 32(1)(ii) of the Act or in the Explanation thereto or in Section 2(11) of the same defining block of assets, the legislative intent becomes quite clear: the expression 'any other business or commercial rights of similar nature' does not constitute a separate category but is to be read alongwith the preceding categories. In support of this contention, learned

[9] (1989) 2 SCC 458
[10] (2009) 314 ITR 167

Additional Solicitor General has placed reliance on the following decisions:

(i) *Sree Durga Distributors Vs. State of Karnataka*[11];

(ii) *Mohd. Shabir Vs. State of Maharashtra*[12];

14.7. Applying the above principle to the issue in hand, it is submitted that the specific words 'know-how, patents, copyrights, trade marks, licenses and franchises' constitute a distinct class or category of positive rights that are capable of being used or put to use. Referring to the judgment of the Delhi High Court in *CIT Vs. Hindustan Coca Cola Beverages (P) Ltd.* [13], learned Additional Solicitor General submits that whether owned, wholly or partially, either in *rem* or in *personam*, the common underlying feature of the above set of intellectual property rights is that these are positive rights, brought into existence by experience and/or reputation, granted either under a statute or under a contract and capable of being used or put to use for the purpose of business.

[11] (2007) 4 SCC 476
[12] (1979) 1 SCC 568
[13] (2011) 331 ITR 192

14.8. He further submits that the right acquired by the payer on payment of non-compete fee does not fall in this category. It is a negative covenant that imposes an obligation on the recipient of the fee to desist from doing something and as such, it cannot be 'used' by the payer for the purpose of its business. Such a negative covenant on the part of the recipient only 'exists' and it is vital to draw a distinction between a positive right being 'owned' and 'used', whether actively or passively *vis-a-vis* a negative obligation merely 'existing'. The only 'right' obtained by the payer of non-compete fee is the right to pursue legal remedies in the event of breach of contract on the part of the payee. As such, there is no ownership or usage of any intangible asset in the manner envisaged in case of other specified items.

14.9. Positive rights can only be owned and/or used. Negative covenants only exists - those cannot be owned and/or used, whether actively or passively. The statute does not envisage allowance of depreciation on such rights/assets that are not inherently capable of being put to use for the purpose of business.

14.10. Hence, the expression 'any other business or commercial rights of similar nature' must be read as being limited to rights/assets specified by the preceding words i.e. know-how, patents, copyrights, trade marks, licenses and franchises which are positive rights conferred by the statute or by a contract and capable of being 'owned' and put to use for the purpose of business. As to the interpretation of the words 'owned' and 'used' in the context of Section 32(1), learned counsel has placed reliance on the following two decisions of this Court:

(i) *Liquidators of Pursa Ltd. Vs. CIT*[14];

(ii) *Mysore Minerals Ltd. Vs. CIT*[15];

14.11. By way of analogy, learned Additional Solicitor General has referred to Section 66E(e) of the Finance Act, 1994 which deals with the concept of negative covenant/non-compete fee *qua* declared services, relevant portion of which reads thus:

> S.66E. Declared Services:
> …
> Explanation (II)
> …
> (e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act;
> …

[14] (1954) 25 ITR 265
[15] (1999) 239 ITR 775

14.12. In the context of the Act, more particularly Section 32 thereof, there is no similar provision which specifically lays down that a right which is not capable of being put to use like the right acquired on payment of non-compete fee is nonetheless eligible for depreciation.

14.13. Summing up his arguments, Mr. Dwarakanath asserts that firstly, non-compete fee is not a revenue expenditure but a capital expenditure. Secondly, even though it is a capital expenditure leading to accrual of intangible asset, it is not eligible for deduction because it is not 'owned' and 'used' by the assessee for the purpose of its business.

15. Submissions made by learned counsel for the parties have received the due consideration of the Court.

Analysis

16. Let us advert to Section 37 of the Act at the outset. It is a residuary provision. Sub-section (1) of Section 37 reads as follows:

> (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'.

16.1. This provision contemplates that any expenditure incurred wholly and exclusively for the purposes of the business shall be allowed in computing the income chargeable under the head 'profits and gains of business or profession.' For such an expenditure to be allowed, it should fulfill the following criteria:

i) it should not be an expenditure described in Sections 30 to 36;

ii) it should not be in the nature of capital expenditure or personal expenses of the assessee.

16.2. It is axiomatic that such expenditure should be incurred during the previous year relevant to the assessment year under consideration.

17. This provision was examined by this Court in *Alembic Chemical Works Co. Ltd.* (supra). It has been explained that in computing the income chargeable under the head 'profits and gains of business or profession', Section 37 of the Act enables

the deduction of any expenditure laid out or expended wholly and exclusively for the purposes of business or profession, as the case may be. 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. In the infinite variety of situational diversities in which the concept of what is capital expenditure and what is revenue expenditure arises, it is well nigh impossible to formulate any general rule, even in the generality of cases, sufficiently accurate and reasonably comprehensive, to draw any clear line of demarcation. However, some broad and general tests have been suggested from time to time to ascertain on which side of the line the outlay in any particular case might reasonably be held to fall. These tests are generally efficacious and serve as useful servants but as masters they tend to be over-exacting.

18. There is a classical test laid down by Lord Cave L.C. in *Atherton Vs. British Insulated and Helsby Cables Ltd.*[16], where it was held:

[16] (1925) 10 TC 155

> When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.

19. There is another test of contemporary vintage. This test is based on the distinction between fixed and circulating capital and was propounded by Lord Haldane in *John Smith and Son Vs. Moore*[17]. This test was explained in the following manner:

> Fixed capital is what the owner turns to profit by keeping it in his own possession; circulating capital is what he makes profit of by parting with it and letting it change masters.

20. In *Assam Bengal Cement Company Ltd.* (supra), this Court opined that 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

[17] (1921) 12 TC 266

with a view to produce the profits, it is revenue expenditure. The ratio laid down in this judgment was summed up by this Court in the recent decision, *Bharti Hexacom Ltd.* (supra). This Court explained that where the expenditure is made for the initial outlay or for 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. Expenditure which relates to the very framework or structure or edifice of the taxpayer's business is capital expenditure.

21. *Coal Shipments Pvt. Ltd.* (supra) is a case which dealt with export of coal from India to Burma. Shipment of coal to Burma got disrupted because of the second world war, which was resumed after the cessation of hostilities. In order to overcome the difficulties in the conduct of the trade following the war, members of the coal trade in Bengal formed an association. Coal Shipments Pvt. Ltd. and M/S HV Low & Co. Ltd. were two of the major members of the association. The two companies came to an understanding and arrived at an agreement whereby it was decided that M/S HV Low & Co. Ltd. would not export coal

to Burma during the subsistence of the agreement and that it would assist Coal Shipments Pvt. Ltd. in procuring coal for shipment to Burma. For this, Coal Shipments Pvt. Ltd. made certain payments to M/S HV Low & Co. Ltd. which were taxed in the hand of M/S HV Low & Co. Ltd.

21.1. Coal Shipments Pvt. Ltd. claimed the payment of the above amounts as admissible business expenditure for the relevant assessment year. Income Tax Officer was of the view such expenditure could not be allowed as there was no written agreement in proof of such arrangement. It was not possible to say that the payments were made for the purpose of the assessee's business. It was further held that even if the payments were held to have been made to keep off M/S HV Low & Co. Ltd. from the Burma trade, those were payments made to secure a monopoly and thus were not allowable as revenue expenditure.

21.2. On appeal, the appellate authority i.e. Appellate Assistant Commissioner upheld the order of the Income Tax Officer.

21.3. On further appeal before the ITAT, it was held that the impugned payments were made to carry on the trade in a more facile and profitable manner. According to the ITAT, the arrangement that was arrived at verbally between the parties was a temporary measure liable to be terminated at will. Coal Shipments Pvt. Ltd. did not derive any advantage of an enduring character by such payments. The expenditure in question were attributable to revenue and not to capital. Accordingly, those were held to be permissible expenditure under Section 10(2)(xv) of the Indian Income Tax Act, 1922 (corresponding to Section 37 of the Act).

21.4. On reference before the High Court, it was held that such expenditure did not create any monopoly or bring about any capital advantage to the assessee. Such arrangement was not likely to have an enduring beneficial effect. It was held that Coal Shipments Pvt. Ltd. was entitled to claim deduction of such expenditure.

21.5. This Court after adverting to the facts noted that the controversy between the parties was centered on the point as to whether that part of the payment which was made because of

M/S HV Low & Co. Ltd. having agreed not to export coal to Burma during the subsistence of the agreement constituted capital expenditure or revenue expenditure. This Court thereafter referred to several judicial decisions laying down broad principles in order to determine whether an expenditure is of a capital nature or revenue nature, such as, enduring benefit and fixed capital *vis-a-vis* circulating capital. This Court rejected the contention of the revenue that as the object of making the payments in question was to eliminate competition of a rival exporter, the benefit which enured to the respondent was of an enduring nature and as such, the payment should be treated as capital expenditure. Further it was noted that the arrangement between the two parties was not for any fixed term but could be terminated at any time at the volition of any of the parties. This Court held that 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. That apart, this Court was of the view that payments made to M/S HV Low & Co. Ltd. were related to actual shipment of coal in the course of the trading activities of Coal Shipments Pvt. Ltd. and had no relation

to the capital value of the assets. Accordingly, the appeal of the revenue was dismissed.

22. In *Empire Jute Company Ltd.* (supra), this Court was concerned with an agreement between members of the Indian Jute Mills Association of which the assessee was also a member. Clause 4 of the agreement provided that no signatory shall work for more than 45 hours per week. As per Clause 6(b), the signatories were entitled to transfer, either wholly or partly, their allotment of hours of work per week to any one or more of the signatories. Under this clause, the assessee had purchased 'loom hours' from four other mills for the aggregate sum of Rs. 2,03,255.00 during the previous year relevant to the assessment year 1960-61 and claimed deduction of the said amount as revenue expenditure. When the matter came before the High Court, it was held that the amount paid by the assessee for purchase of loom hours was in the nature of capital expenditure and was, therefore, not deductable under Section 10(2)(xv) of the Indian Income Tax Act, 1922.

22.1. Reversing the decision of the High Court, this Court opined that whether it is capital expenditure or revenue

expenditure would have to be determined having regard to the nature of the transaction and other relevant factors. This Court observed that there may be cases where expenditure even if incurred for obtaining an advantage of enduring benefit, may nonetheless be on revenue account and the test of enduring benefit may break down. It is not every advantage of enduring nature acquired by an assessee 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 assessee's trading operations or enabling the management and conduct of the assessee'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.

22.2. Applying the above test to the facts of that case, this Court held that by purchase of loom hours, no new asset was created. There was no addition to or expansion of the profit

making apparatus of the assessee. The income earning machine remained what it was prior to the purchase of loom hours. The assessee was merely enabled to operate the profit making structure for a longer number of hours. That apart, the advantage was clearly not of an enduring nature. It was limited in its duration to six months; moreover, the additional working hours per week transferred to the assessee had to be utilised during the week and could not be carried forward to the next week. This Court was, therefore, of the opinion that it was not possible to say that any advantage of enduring benefit in the capital field was acquired by the assessee in purchasing the loom hours.

22.3. Even applying the test of fixed and circulating capital, this Court was of the view that it would not be possible to characterize the amount paid for purchase of loom hours as capital expenditure because acquisition of additional loom hours did not add at all to the fixed capital of the assessee. The permanent structure remained the same; it was not enlarged. Thus loom hours were not part of fixed capital on the basis of

which, it could be said that payment for purchase of loom hours was in the nature of capital expenditure.

22.4. This Court opined that the question as to whether an expenditure is capital or revenue must be viewed in the larger context of business necessity or expediency. 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. Thus, this Court concluded that the payment of Rs. 2,03,255.00 made by the assessee for purchase of loom hours represented revenue expenditure and was allowable as a deduction under Section 10(2)(xv) of the Indian Income Tax Act, 1922.

23. In *Alembic Chemical Works Co. Ltd.* (supra), the assessee was the manufacture of the antibiotic penicillin. In its initial years, it could produce only about 5000 units of penicillin per milli-liter of the culture-medium. With a view to increase the yield of penicillin, assessee negotiated with M/S Meiji Seika

Kaisha Ltd. of Japan. The negotiations ended in an agreement whereby and whereunder, M/S Meiji agreed to supply the technical know-how to increase production of penicillin to more than 10000 units for a consideration of 'once for all' payment of 50,000 US dollars. In the assessment proceedings, assessee claimed this expenditure as revenue expenditure. The Income Tax Officer, on the other hand, took the view that the expenditure was incurred for the acquisition of an asset or advantage of an enduring benefit. Holding such expenditure to be capital in nature, the Income Tax Officer declined the deduction. This view of the Income Tax Officer was affirmed by the first appellate authority i.e. Appellate Assistant Commissioner. The further appeal of the assessee was also dismissed by the ITAT. At the instance of the assessee, a reference was made to the High Court which was, however, decided in the negative against the assessee. It was thereafter that the matter travelled to this Court.

23.1. This Court after alluding to the judicial pronouncements on this point, observed that the idea of 'once for all' payment and 'enduring benefit' are not to be treated as

something akin to statutory conditions. These concepts require flexibility and not a rigid approach. There is no single definitive criterion which by itself is determinative as to whether a particular outlay is capital or revenue. The 'once for all' payment test is also inconclusive. What is relevant is the purpose of the outlay and its intended object and effect considered in a common sense way having regard to the business realities.

23.2. In the facts of that case, this Court held that the financial outlay under the agreement was for the better conduct and improvement of the existing business and should therefore be treated as revenue expenditure. Consequently, the appeal by the assessee was allowed and the question of law answered in the affirmative and against the revenue.

24. The next case that we may advert to is the case of *Madras Auto Services (P) Ltd.* (supra). In this case, the respondent assessee, a tenant, had incurred expenditure on demolition and construction of a new building which was to vest in the landlord. Assessee in lieu of incurring the actual cost of construction was entitled to use the premises for a period of 39 years at a reduced rent. The entire capital cost of construction was claimed by the

assessee as revenue expenditure on the ground that the assessee had not acquired any new asset or such expenditure did not result in any enduring advantage to the assessee in the capital field. The above stand of the assessee was accepted by the ITAT and the High Court. When revenue came up in appeal before this Court, it was held as under:

> In order to decide whether this expenditure is revenue expenditure or capital expenditure, one has to look at the expenditure from a commercial point of view. What advantage did the assessee get by constructing a building which belonged to somebody else and spending money for such construction? The assessee got a long lease of a newly constructed building suitable to its own business at a very concessional rent. The expenditure, therefore, was made in order to secure a long lease of new and more suitable business premises at a lower rent. In other words, the assessee made substantial savings in monthly rent for a period of 39 years by expending these amounts. The saving in expenditure was a saving in revenue expenditure in the form of rent. Whatever substitutes for revenue expenditure should normally be considered as revenue expenditure. Moreover, the assessee in the present case did not get any capital asset by spending the said amounts. The assessee, therefore, could not have claimed any depreciation. Looking to the nature of the advantage

which the assessee obtained in a commercial sense, the expenditure appears to be revenue expenditure.

* * * * *

Right from inception, the building was of the ownership of the lessor. Therefore, by spending this money, the assessee did not acquire any capital asset. The only advantage which the assessee derived by spending the money was that it got the lease of a new building at a low rent. From the business point of view, therefore, the assessee got the benefit of reduced rent. The High Court has, therefore, rightly considered this as obtaining a business advantage. The expenditure is, therefore, to be treated as revenue expenditure.

* * * * *

All these cases have looked upon expenditure which did bring about some kind of an enduring benefit to the company as a revenue expenditure when the expenditure did not bring into existence any capital asset for the company. The asset which was created belonged to somebody else and the company derived an enduring business advantage by expending the amount. In all these cases, the expenses have been looked upon as having been made for the purpose of conducting the business of the assessee more profitably or more successfully. In the present case also, since the asset created by spending the said amounts did not belong to the assessee but the assessee got the business advantage of using modern premises at a low rent, thus saving considerable revenue expenditure for the next 39 years, both the Tribunal as well as the High Court have rightly come to the conclusion

that the expenditure should be looked upon as revenue expenditure.

25. Having adverted to the relevant case laws, we may now examine the nature and character of non-compete fee; whether payment of non-compete fee is revenue expenditure or capital 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.

26. 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.

27. Following the judicial trend, it can be safely inferred that the length of time over which the enduring advantage may enure 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 payer (assessee) by incurring of such expenditure.

28. The non-compete compensation from the stand point of the payer of such 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 (assesee) may still not achieve the desired result. In so far the present case is concerned, on account of payment of non-compete fee, the assessee had not

acquired any new business and there is no addition to the profit making apparatus of the assessee. The assets remained the same. The expenditure incurred was essentially to keep a potential competitor out of the same business. Further, there is no complete elimination of competition. Such payment made by the appellant to L&T did not create a monopoly of the appellant over the business of electronic products/ equipments. Payment was made to L&T only to ensure that the appellant operated the business more efficiently and profitably. Such payment made to L&T cannot, therefore, be considered to be for acquisition of any capital asset or towards bringing into existence a new profit earning apparatus.

Conclusion

29. That being the position, we are of the considered opinion that payment made by the appellant to L&T as non-compete fee is an allowable revenue expenditure under Section 37(1) of the Act.

30. Consequently, the impugned judgment and order of the Delhi High Court dated 05.11.2012 passed in Income Tax Appeal No. 492/2012 is hereby set aside. The question framed

in paragraph 5 of this judgment is thus answered in favour of the assessee and against the revenue. Civil Appeal No. 4072/2014 is accordingly allowed.

31. In view of what we have held above, the supplementary question framed in paragraph 5.1 of this judgment has been rendered redundant. Therefore, consideration of the submissions made in this regard is not necessary.

32. As regards the remaining appeals, we are of the view that it would be appropriate if the matters are remanded back to the respective ITATs, all appeals/ cross-appeals filed are revived and heard afresh having regard to the ratio laid down in this judgment.

33. Ordered accordingly.

34. Since the appeals/ cross-appeals before the ITATs have been revived, parties would be at liberty to raise additional ground(s) based on the present judgment.

Interest on borrowed funds.

Civil Appeal No. _/2025
(Arising out of SLP(C) No. 719/2020,
PCIT Vs. Piramal Glass Ltd).

35. During the assessment proceedings for the assessment year 2001-2002, the Assessing Officer noted the claim of the assessee regarding interest on investments made in subsidiary company as well as interest on borrowings for payment of interest-free loan to sister concern and its directors. *Vide* the assessment order dated 09.02.2004 passed under Section 143(3) of the Act, the Assessing Officer noted from the balance sheet of the assessee that it had invested Rs. 2,587.10 lakhs in the shares of the subsidiary company M/S Ceylon Glass Company Ltd., Sri Lanka. At the same time, he found that there were interest bearing borrowings of Rs. 3267.41 crores and interest of 38.22 crores was debited to the profit and loss account. This claim of deduction of the assessee under Section 36(1)(iii) of the Act to the extent of Rs. 3,36,32,300.00 was disallowed by the Assessing Officer. According to the Assessing Officer, interest on money borrowed for investment can be allowed against income from investment. But if the shares are acquired, not as an investment for earning income but to acquire

controlling interest in a company, it would not be entitled to deduction of interest on borrowing. If the dominant purpose of expenditure was not for earning profit but to acquire controlling interest, it could not be allowed as a deduction. As a result, interest @ 13% in investment made in the subsidiary company was not allowed as a deduction. The total disallowance out of interest payment was worked out at Rs. 3,36,32,300.00.

35.1. The Assessing Officer also noted that an amount of Rs. 3,00,000.00 was outstanding from a director of the assessee company and an amount of Rs. 346.43 lakhs was due from companies where directors of the assessee were interested as directors. After considering the explanation of the assessee, the Assessing Officer made disallowance of an amount of Rs.99,49,264.00. Assessing Officer held that assessee's claim for deduction of interest paid on loan, utilized for giving interest free loan/ advances to sister concern, was not in accordance with law. The assessee also could not establish the nexus with the funds from which the advances were made to the subsidiary company. In the absence of such details, the interest was worked out to 13% per annum on account of the advances made to the

sister concern. It was disallowed on the ground that borrowed funds were used for non-business purposes. Thus the amount of disallowance at the interest rate of 13% per annum was worked out at Rs.99,49,264.00.

35.2. The first appellate authority i.e. CIT(A) agreed with the reasonings given by the Assessing Officer and disallowed the interest payment on borrowed fund claimed under Section 36(1)(iii) of the Act and upheld the order of assessment.

35.3 On further appeal, ITAT observed that since the investment was made for controlling interest in the sister concern, assessee was entitled to the claim of allowance of the interest. Investment was made in the shares of the sister company with a similar line of business and for commercial expediency. Thus no disallowance was warranted under Section 36(1)(iii) of the Act. ITAT following the decision of this Court in *SA Builders Ltd. Vs. CIT*[18], directed the Assessing Officer to allow the claim of the assessee in respect of interest on borrowed fund

[18] 288 ITR 1

since the advances were made for the purposes of commercial expediency.

35.4. Revenue challenged the aforesaid decision of the ITAT before the Bombay High Court. Adverting to one of its previous decisions, High Court held that the assessee was entitled to deduction of interest under Section 36(1)(iii) of the Act when the investment was made by the assessee in a subsidiary company to have control over the said company. With respect to interest free advances made by the assessee to the sister concern out of borrowed funds, High Court was of the view that this question had become infructuous.

Submissions

36. Mr. Dwarakanath, learned Additional Solicitor General of India appearing for the revenue, though made extensive submissions on the issue of non-compete fee, did not, however, advance any argument on the point of investment in shares of the sister concern or on interest on borrowed funds given to sister concern and its directors. However, Mr. Ajay Vohra, learned senior counsel for the respondent assessee, submitted that revenue was incorrect in contending that the

assessee had not established that the investment was made for acquiring the controlling interest in the associate concern. In fact, it was clearly mentioned by the assessee that it had made investment of Rs. 2587.10 lakhs in the subsidiary company viz, M/S Ceylon Glass Company Ltd. Dividend income from a foreign company like the subsidiary company is taxable and not exempt under Section 10(33) of the Act.

36.1. Assessing Officer had recorded that shares of the subsidiary company were acquired not for earning profit but for acquiring controlling assets. Where the Assessing Officer himself recorded the finding that investment in the subsidiary company was made for acquiring controlling interest, revenue was not justified in contending that assessee had not established that the investment was made for earning income. The fact that the assessee had made investment for acquiring controlling interest in the subsidiary company is itself sufficient for claiming deduction of interest under Section 36(1)(iii) of the Act. Investment made in the subsidiary company was in the line of the existing business of the assessee and was for the business of the assessee. In such circumstances, deduction is allowable under Section 36(1)(iii) of the Act.

36.2. In this connection, Mr. Vohra, learned senior counsel, relied upon the decision of this Court in *SA Builders Ltd.* (supra). He submits that the assessee had duly established that the debit balance in the account of the sister concern was for the purpose of business, and therefore, on these facts, the decision of this Court in *SA Builders Ltd.* (supra) would be squarely applicable to the facts of the present case.

Analysis

37. Section 36 of the Act deals with other deductions that may be allowed while computing the total income under the heading 'profits and gains of business or profession' referred to in Section 28 of the Act. Section 36(1)(iii) says that the deductions provided for the amount of interest paid in respect of capital borrowed for the purposes of the business or profession shall be allowed in computing the income referred to in Section 28.

38. In *SA Builders Ltd.* (supra), this Court considered the question regarding allowability of interest on borrowed funds. This Court referred to the provisions of Section 36(1)(iii) of the Act and to the facts of that case. It was noted that the borrowed

amount in question was not utilized by the assessee in its own business but was advanced as interest free loan to its sister concern. This Court opined that this factum was not really relevant. What was relevant was whether the assessee had advanced such amount to its sister concern as a measure of commercial expediency. Once it is established that there was nexus between the expenditure and the purpose of the business, which need not necessarily be the business of the assesee itself, revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the board of directors and then decide how much would be the reasonable expenditure. Income tax authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. We have to see the transfer of the borrowed funds to a sister concern from the point of view of commercial expediency and not from the point of view of whether the amount was advanced for earning profits. No businessman can be compelled to maximize his profits. However, this Court put in a caveat that it is not in every case interest on borrowed fund has to be allowed if the assessee advances it to a sister concern. It all depends upon the facts and circumstances of the case. This Court held thus:

34. We agree with the view taken by the Delhi High Court in CIT v. Dalmia Cement (Bharat) Ltd. [2002] 254 ITR 377 that once it is established that there was nexus between the expenditure and the purpose of the business (which need not necessarily be the business of the assessee itself), the revenue cannot justifiably claim to put itself in the arm-chair of the businessman or in the position of the board of directors and assume the role to decide how much is reasonable expenditure having regard to the circumstances of the case. No businessman can be compelled to maximize its profit. The income tax authorities must put themselves in the shoes of the assessee and see how a prudent businessman would act. The authorities must not look at the matter from their own view point but that of a prudent businessman. As already stated above, we have to see the transfer of the borrowed funds to a sister concern from the point of view of commercial expediency and not from the point of view whether the amount was advanced for earning profits.

35. We wish to make it clear that it is not our opinion that in every case interest on borrowed loan has to be allowed if the assessee advances it to a sister concern. It all depends on the facts and circumstances of the respective case. For instance, if the Directors of the sister concern utilize the amount advanced to it by the assessee for their personal benefit, obviously it cannot be said that such money was advanced as a measure of commercial expediency. However, money can be

said to be advanced to a sister concern for commercial expediency in many other circumstances (which need not be enumerated here). However, where it is obvious that a holding company has a deep interest in its subsidiary, and hence if the holding company advances borrowed money to a subsidiary and the same is used by the subsidiary for some business purposes, the assessee would, in our opinion, ordinarily be entitled to deduction of interest on its borrowed loans.

Conclusions

39. Adverting to the facts of this case, we find that the respondent assessee had claimed interest on borrowed funds under Section 36(1)(iii) of the Act which was utilized for investment in M/S Ceylon Glass Company Ltd., a subsidiary company of the assessee. The investment was made for controlling the interest in the associate concern by purchase of shares. Thus the investment was clearly for commercial expediency. We agree with the finding recorded by the ITAT and affirmed by the High Court that assessee is entitled to claim allowance of interest on the funds invested in sister concern for acquiring of controlling interest.

40. Following the decision of this Court in *SA Builders Ltd.* (supra), we find that the purpose for which the advances were made to the sister concern and its directors would also be covered by the principle of commercial expediency.

41. Accordingly, the decision of the ITAT on this point, which was not interfered with by the High Court, is hereby affirmed. Consequently, the appeal filed by the revenue on this issue is dismissed. The question framed in paragraph 5.2 of this judgment is thus answered in favour of the assessee and against the revenue.

42. All the appeals are hereby disposed of in terms of paragraphs 29 to 34 and 39 to 41 supra.

.....J.
[MANOJ MISRA]

.....J.
[UJJAL BHUYAN]

NEW DELHI;
DECEMBER 19, 2025.