



**Court rules that no legal issue arises if the Tribunal's finding on attribution of income is based upon relevant material which cannot be disturbed.**

### Background

The Delhi High Court disposed off the appeal filed by the Tax Department against the order<sup>1</sup> passed by the Tribunal in case of *Galileo International Inc.* ('taxpayer' or 'GII'). The issue before the High Court was to decide whether legal issues arose from the order of the Tribunal regarding attribution of profits.

The High Court dismissed the appeal of the Tax Department<sup>2</sup>.

The Hon'ble High Court observed:

- The Tribunal has first apportioned the revenue generated from the operations carried out in India and thereafter determined the attribution of profits.
- While determining the taxable profit, the Tribunal has held that there is no further income taxable<sup>3</sup> in India as the commission paid to the Indian agent is more than the revenue attributed.

### Facts

The taxpayer, a resident of USA, had developed a fully automatic reservation and distribution system known as Computerised Reservation

---

<sup>1</sup> *Galileo International Inc. v. DCIT* [2008] 19 SOT 257 (Delhi)

<sup>2</sup> *Vide* order dated 25 February 2009

<sup>3</sup> Relied on Central Board of Direct Taxes ('CBDT') Circular No. 23 dated 23 July 1969

System ('CRS')<sup>4</sup> with the ability to perform comprehensive information, communication, reservation, ticketing, distribution and related functions on a worldwide basis.

The taxpayer received information from the airlines, processed this information and stored it on its database. It received requests from the Travel Agents ('the TAs') for information on bookings and forwarded the booking initiation or updated requests from the TAs to the Airline Servers. It received responses thereto from the Airline Servers and forwarded the same to the TAs. The taxpayer at its own cost had obtained connectivity services from its Data Centre in USA to, *inter alia* the nodes of SITA in India.

The taxpayer entered into a Participating Carrier Agreement ('PCA') with various participant airlines to provide CRS services. It also entered into a Distribution Agreement ('DA') with Interglobe, an unrelated company to market and distribute CRS services to the TAs in India. Interglobe was to act as sole and exclusive distributor of the taxpayer's CRS services in India.

Interglobe in turn, entered into Subscriber Agreements with various TAs to provide access codes, equipment, communication link and support services to the TAs. The TAs could either obtain access to the taxpayer's CRS through the access code provided by Interglobe or they could independently access the CRS of the taxpayer's competitor.

The taxpayer received 3 Euros per booking from the Airlines and paid commission of 1 Euro to Interglobe in India.

The revenue authorities assessed the income of the taxpayer from the bookings made by the TAs in India on the basis that the activities were completed in India through the hardwares installed in India and therefore, it had a business connection in India.

They also held that the computers were a fixed place of business and that Interglobe would constitute an agency permanent establishment ('PE') in India as per the India – USA Tax Treaty. Thus, the income of GII from the booking made in India was taxable as business income under Article 7 of the Tax Treaty.

### **Tribunal's order**

Both the taxpayer as well as the Income-tax Department went into appeal before the Tribunal. The Tribunal held that:

---

<sup>4</sup> The CRS *inter alia* included a system which received, processed, stored and disseminated data about flight schedules, seat/room availability, fare information, etc.

- GII had a business connection in India and accordingly its income in respect of the booking which takes place from the equipment in India can be deemed to accrue or arise in India.
- GII had a 'fixed place' PE as a part of the CRS system connected and configured to the computers of the TAs in India is the fixed place of business through which the business of GII is carried on in India.
- Interglobe is a dependent agent of GII and therefore it constituted agency PE of GII in India.

Further, based on analysis of the functions performed, assets used and risks undertaken by GII, the Tribunal attributed 15% of the revenue from the bookings made in India to the operations of GII in India. However, no further income is chargeable to tax in India as the payments made to Interglobe were higher than the entire income attributable to India<sup>5</sup>.

### **Miscellaneous Application Order**

The Department had also filed a Miscellaneous Application ('MA') requesting the rectification of mistake that Tribunal has inadvertently attributed revenue instead of income in its order.

The Tribunal dismissed the application filed by the Department and held<sup>6</sup> that the apportionment of revenue to the operations carried out in India is required for computing the income taxable in India. The Tribunal also held that it has consciously come to the conclusion that no income accrues in India and therefore, there is no mistake apparent on record.

### **Issues before the High Court**

Against the order of the Tribunal, the Department went into appeal before the High Court, *inter alia*, raising the following questions of law:

- The Tribunal erred in attributing only 15% of the Revenue as income accruing / arising in India
- The Tribunal committed an error by equating 15% of taxable income with gross profits and thereafter subsequently reducing it with deduction of expenses paid to Interglobe.

---

<sup>5</sup> Reliance on Morgan Stanley & Co. Inc. v Director of Income-tax, Mumbai [2007] 292 ITR 416 (SC) and CBDT Circular no. 23 dated 23 July 1969

<sup>6</sup> Miscellaneous Application Order dated 21 November 2008

### **Tax Authorities Contentions before the High Court**

- The Tribunal has committed an error in attributing revenue, as the criteria laid down in Circular No. 23<sup>7</sup> as well as the Tax Treaty enumerates the concept of attribution of “profits” and not “revenue”.
- When 15% of the revenue is attributed to India, the commission payable to Interglobe must have been taken into consideration and it could not be deducted again.
- The taxpayer’s activities in India were not wholly channelled through its agent (i.e. Interglobe) and *in fact* some of the activities were directly carried out by the taxpayer. Therefore, the conditions stipulated in Para 6<sup>8</sup> sub para (c) of Circular No. 23 (supra) were not satisfied, and as such the taxpayer cannot place reliance on the circular.

### **High Court’s Order**

- The High Court has considered the Tribunal order in detail and observed that the Tribunal has discussed the principle followed in apportioning the income accruing in India and outside India. While doing so, the Tribunal had first analysed the ‘revenue attributable’ to the operations carried out in India and thereafter, computed the profits attributable to it.
- The High Court observed that the Tribunal has held no profit is taxable in India on the basis of its fact finding as under:
  - Since, GII had a business connection and PE in India its income was chargeable to tax in India. However, only the income attributable to India could be taxed in India.
  - First step to assess the taxable profit is to determine the revenue attributable to the operations in India, thereafter, compute the taxable income.

---

<sup>7</sup> CBDT Circular No. 23 dated 23 July 1969

<sup>8</sup> Where a non-resident’s sales to Indian customers are secured through the services of an agent in India, the assessment in India of the income arising out of the transaction will be limited to the amount of profit which is attributable to the agent’s services, provided that (i) the non-resident principal’s business activities in India are wholly channelled through his agent, (ii) the contracts to sell are made outside India, and (iii) the sales are made on a principal-to-principal basis. In the assessment of the amount of profits, allowance will be made for the expenses incurred, including the agent’s commission, in making the sales. If the agent’s commission fully represents the value of the profit attributable to his service; it should prima facie extinguish the assessment.

- On the analysis of principles (Functions performed, assets used and risk undertaken) for apportionment of revenue, the Tribunal has concluded that role played by GII in India is limited to the computers at the desk which are merely connected or configured to the extent it can perform booking function but not capable of processing the data of all the airlines together at one place. Further, huge investment and capacity was required which is not available in the computers installed at the TAs desk. Therefore, major portion of the work is processed at the host computer in USA and the activities in India were only miniscule portion. Accordingly, only 15% of the revenue is attributable to the operations of GII in India.
- Thereafter, having regard to the provision of the Tax Treaty and the CBDT Circular No. 23, the Tribunal found that the commission paid to Indian agent was more than the revenue attributed to the Indian operations (3 Euros X 15% = 0.45 Euro < 1 Euro) and therefore, no further income is taxable in India. The High Court also concurred with the decision of the Hon'ble Supreme Court in the case of Morgan Stanley.

In view of the above observations, High Court held as under:

- The High Court held that while giving the finding of fact that 15% of the revenue can be attributed to the activities in India, the Tribunal had not taken into consideration the commission paid to the Indian agent.

Further, there was no dispute before the AO or the CIT (A) that entire payment made to Interglobe would not be allowed to the taxpayer.

Accordingly, the High Court having regard to CBDT Circular no. 23 rejected Department's claim that after attributing revenue, no further expenses would be deductible.

- Further, the High Court held that no legal issue arises on attribution of income if the Tribunal's finding is based upon relevant material which cannot be disturbed. Reliance in this regard was placed on the judgment of the Hon'ble Supreme Court in the case of Hukam Chand Mills<sup>9</sup> wherein it has been held that *in the absence of some statutory or other fixed formula, any finding on the question of proportion involves some element of guess work. The endeavour can only be to be approximate and there cannot in the very nature of things be great precision and exactness in the matter. As long as the proportion fixed by the Tribunal is based upon the relevant material, it should not be disturbed.*

---

<sup>9</sup> Hukam Chand Mills Ltd. v. CIT [1976] 103 ITR 548 (SC)

## **Our Comments**

The Tribunal having regard to the provisions of the Act and Tax Treaty had followed a reasoned process to attribute profits to PE in India. The Court not appreciating the contention of the tax authorities that there is a mix question of fact and law that require judgement, went at length on the process followed by the Tribunal and held that the process followed by the Tribunal is well reasoned one to attribute profits to PE in India and based on earlier Apex Court judgement held that this should not be disturbed.

This ruling sets a trend and rightly so, that when it is a matter of attribution and the Tribunal has correctly arrived at it based on relevant material, there can be no point of law before the High Court.

This could be a very helpful decision in all disputes dealing with attribution of profits to the PE in India.

## **Disclaimer**

*The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.*

**For further information about KPMG in India and our services, please contact:**

### **Bangalore**

Maruthi Infotech Centre, 11-12/1  
Inner Ring Road  
Koramangala, Bangalore 560071  
Phone: + 91 80 3980 6000 Fax: +91 80 3980 6999

### **Chennai**

KPMG House  
No.10, Mahatma Gandhi Road,  
Nungambakkam High Road,  
Chennai 600034  
Phone: +91 44 39145000 Fax: +91 44 39145999

### **Delhi**

DLF Cyber City, Building no. 10, Block B, Phase II  
Gurgaon, Haryana 122 002  
Phone: +91 124 307 4000 Fax: +91 124 254 9195

**Hyderabad**

KPMG, 8-2-618/2  
Reliance Humsafar, 4th Floor  
Road No.11, Banjara Hills  
Hyderabad - 500 034  
Phone: +91 40 66305000/23350060 Fax: + 91 40 6630 5299

**Kolkata**

KPMG Infinity Benchmark  
Plot No. G-1, 10th floor Block - EP & GP,  
Sector – V, Salt Lake City  
Kolkata - 700091  
Phone: +91 33 4403 4000 Fax: +91 33 4403 4199

**Mumbai**

KPMG House, Kamala Mills Compound, 448 Senapati Bapat Marg  
Lower Parel, Mumbai 400 013  
Phone: +91 22 39896000 Fax: + 91 22 39836000

**Pune**

703, 7th Floor Godrej Castlemaine, Next to Ruby Hall Clinic,  
Bund Garden Road, Pune 411001  
Phone: +91 20 30585764/65 Fax: +91 20 3058 5775