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Galileo International Vs. DCIT

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FACTS OF THE CASE

1. Galileo International Inc. (the 'Appellant'), a resident of USA, is in the business of maintaining and operating the system for providing electronic global distribution services to airlines, hotels, tour and cab operators by connecting to travel agents ('the TAs') utilising a Computerised Reservation System ('CRS'), which may, inter alia, include a system which receives, processes, stores and disseminates data about flight schedules, seat/room availability, fare information and provision for booking capabilities etc.
2. The services provided by it are as follows:

- Display of schedules and fares
- Building of connections
- Display of flight availability status
- Provision of booking capability

3. For this purpose, it maintains and operates a huge master computer system (MCS) consisting of 18 mainframe computers with its main server located in USA. This main computer is connected to the airline servers' to/from which data is continuously sent and obtained. All the input processing and output is managed, processed and stored by the appellant through the MCS in USA.
4. In aforesaid connection, the appellant has entered into agreements (referred as participating carrier agreements or PCA) with various airlines etc. (referred to as 'participants' in the ruling) to provide them with the CRS services. The appellant earns booking fees from Airlines for services listed in relevant agreement.
5. The appellant in order to market and distribute the CRS services to the TAs appoints distributors and pays a distribution fees to them for their services. In India the appellant has entered into a distribution agreement (DA) dated 25th February 1995 with Interglobe Enterprises Pvt. Ltd., an unrelated party to market and distribute exclusively the CRS services to the TAs in India.

6. All computer hardware in the Market region which is required by Interglobe during the first two years for the TAs to use the Galileo system is provided by Galileo.
7. The appellant is also responsible for securing the telecommunication network ("SITA") at its own cost to enable the TAs to access the CRS.
8. Without integration of either in the CRS, the system would be of no business use and no income would accrue to the assessee as its income from the airlines etc. is generated from the bookings made by the subscribers.
9. Booking constituted important limb of assessee's overall operations and without the same, no income could have accrued to assessee.
10. Under the Participation Agreement, the vendor is contractually bound to honour the booking made by a subscriber.

11. Income accrues to the assessee in India from the bookings because of assets provided to the subscribers in India and the tele communications infrastructure set up by the assessee in India at its own cost as also from the operations of Galileo India.

BUSINESS CONNECTION

Section 5(2) of Income Tax Act 1961 " Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which

(*a*) is received or is deemed to be received in India in such year by or on behalf of such person ; or

(*b*) accrues or arises or is deemed to accrue or arise to him in India during such year.

Section 9 of Income Tax Act 1961, "(1) The following incomes shall be deemed to accrue or arise in India :

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, [* * *] or through the transfer of a capital asset situate in India.

[Explanation 1].For the purposes of this clause

(a) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India ;

[Explanation 2.For the removal of doubts, it is hereby declared that business connection shall include any business activity carried out through a person who, acting on behalf of the non-resident,

(a) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or

Provided *that such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having an independent status, if such broker, general commission agent or any other agent having an independent status is acting in the ordinary course of his business :*

Provided further *that where such broker, general commission agent or any other agent works mainly or wholly on behalf of a non-resident (hereafter in this proviso referred to as the principal non-resident) or on behalf of such non-resident and other non-residents which are controlled by the principal non-resident or have a controlling interest in the principal non-resident or are subject to the same common control as the principal non-resident, he shall not be deemed to be a broker, general commission agent or an agent of an independent status*.

As per distribution agreement entered between Galileo USA and Distributors, it is clear that distributors can enter into agreement with TA's on behalf of the Galileo USA. It is clear that Galileo USA fall under the explanation 2(a) of section 9 of the ITA which is laid down to decide the business connection.

Further, Inter Globe/Galileo India provides services only to Galileo USA hence it is covered under second proviso to explanation 2 of the section 9 of the Income tax Act 1961. For the question independent status, the word "mainly or wholly on behalf of non-resident" in the explanation 2 covered the Inter Globe/Galileo India hence we conclude that Inter Globe/Galileo India is not an independent agent and Galileo USA having a business connection in India.

Hon'ble Supreme Court in the case of CIT v. R.D. Agarwal & Co. [1965] 56 ITR 20 held thus :

"The expression 'business connection' undoubtedly means something more than business. A business connection in section 42 involves a relation between a business carried on by a nonresident which yields profits or gains and some activity in the taxable territories which contributes directly or indirectly to the earning of those profits or gains. It predicated an element of continuity between the business of the non-resident and the activity in the taxable territories, a stray or isolated transaction is normally not to be regarded as a business connection. Business connection may take several forms. It may include carrying on a part of the main business or activity incidental to the main business of the non-resident though an agent or it may merely be a relation between the business of the non-resident and the activity in the taxable territories, which facilitates or assists the carrying on of that business. In each case, the question whether there is a business connection from or through which income, profits or gains arise or accrue to a non-resident must be determined upon the facts and circumstances of the case."

*"**A relation to be a business connection must be real and intimate, and through or from which income must accrue or arise whether directly or indirectly to the non-resident**. But it must in all cases be remembered that by section 42, income, profit or gain which accrues or arises to a non-resident outside the taxable territories is sought to be brought within the net of the income-tax law, and not income, profit or gain which accrues or arises or is deemed to accrue or arise within the taxable territories. Income received or deemed to be received, or accruing or arising or deemed to be accruing or arising within the taxable territories in the previous year is taxable by section 4(1)(a) and (c) of the Act, whether the person earning is a resident or non-resident. If the agent of a non-resident receives that income or is entitled to receive that income, it may be taxed in the hands of the agent by the machinery provision enacted in section 40(2). Income not taxable under section 4 of the Act of a non-resident becomes taxable under section 42(1) if there subsists a connection between the activity in the taxable territories."*

FIXED PLACE PERMANENT ESTABLISHMENT

The term **‘place of business’** covers any premises, facility or installation used for carrying on the business of the enterprise, whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is immaterial whether the premises, facilities or installations are owned or rented or are otherwise at the disposal of the enterprise. A place of business may thus be constituted by a pitch in a market place or by a certain permanently used area. The place of business can be situated in the business vicinity of another enterprise.

The place of business must be fixed, i.e., it must be established at a distinct place where a certain degree of permanence can be attached.

No formal legal right to use that place is visualized or required. A PE could exist even where an enterprise occupies certain locations where it carried on its business. For a place of business to constitute a PE, the enterprise using it must be carrying on its business wholly or partly through it.

As observed by Klaus Vogel (3rd Edition page 286), "In the same vein, para 4 OECD MC Comm. Article 5 states that it was immaterial whether the premises, facilities of installations were owned or rented by, or were otherwise at the disposal of, the enterprise. A similar view was held earlier by FC Munster which stated that it was not necessary for the power of disposition to be legally confirmed by ownership or a lease. All that was required to satisfy the power of disposition test was actual disposition which did not need to go any further than necessary for allowing the permanent establishment to function."

Since part of the function is operated in India which directly contributes to the earning of revenue, the activities as narrated above carried out in India is in no way of 'preparatory or auxiliary' character. Thus the exception provided in Paragraph 3 of Article 5 will not apply and hence as stated above, the assessee shall be deemed to have a permanent establishment in India.

The assessee satisfies the following four conditions, which have come to signify the expression "fixed places of business" employed in Article 5(1) of the Treaty.

- There must be a place of business in India - Place of business test;
- The place of business should be at the disposal of the applicant - Disposition test;
- The activities performed through the place of business must constitute a business activity of the applicant - Business Activity Test
- The place of business must be fixed and the activity should last for a certain period of time - Permanence test.

The Nodes in India and hired by the assessee is clearly fixed place of business so are the premises of the travel agents who use the computers and network provided by the assessee for making the bookings. The Network and Nodes are always at the disposal of the assessee from where assessee's business activities are carried out. Since these activities are continuous over past several years, it also satisfies the permanence test.

"As per Para 4.2 of the Distribution Agreement between Galileo International and Interglobe Enterprises, Interglobe shall at its own cost and responsibility provide Galileo International's CRS Services form the Node or Router to the travel agents and shall either provide equipment to subscribers or facilitate the connection of equipment to access Galileo International's CRS Services.

As per Para 4.3 of the Distribution Agreement Galileo International shall supply to Interglobe licences for all such software products developed by Galileo International for use by the travel agents in conjunction with Galileo International's CRS Services.

Therefore, the equipment for facilitating access to the CRS Services is provided by Interglobe and software to be used by the subscriber is owned by Galileo International and licensed to Interglobe.

Para 6.5 and Para 6.6 of the Distribution Agreement enables Interglobe to request Galileo International to provide computer hardware for use by the travel agent at no cost to Interglobe for the fist two years."

Further, submitted that the Computers belonging to the assessee were supplied to the travel agents free of charge for distribution to the travel agents. The assessee has claimed depreciation on such equipment for all these years and it has been allowed by the Assessing Officer being assets owned by the assessee and used in its business in India of earning revenue from the Airlines on the basis of bookings made by Travel Agents. Hence, the assessee had a fixed place of business where assets either leased or owned by the assessee in India in all the years under appeal.

As per para 42.4 of OECD commentary, "Computer equipment at a given location may only constitute a PE if it meets the requirement of being fixed."

As per para 42.4 of OECD commentary, "Another issue is whether the business of an enterprise may be said to be wholly or partly carried on at a location where the enterprise has equipment such as server at its disposal. The question of whether the business of an enterprise is wholly or partly carried on through such equipment needs to be examined on a case by case basis, having regards to whether it can be said that, because of such equipment, the enterprise has a facilities at its disposal where business function of the enterprise are performed."

Hence, the network in India together with the equipment and software provided to the travel agents in India constitute fixed place of assessee's own business in India without which it could not have carried on its business.

As per para 42.8 of OECD commentary, "Computer equipment is to be taken as a permanent establishment if it performs the activities which are the core function of the enterprise where sales functions are performed through the computer equipment. Whether the product is delivered online or by traditional method, the equipment would constitute a "place of business" and may a permanent establishment.

As observed by Klaus Vogel (Pg 205), A place of business means all the intangible assets used for carrying on the business; in marginal cases, one such tangible assets would be sufficient. The term covers both premises and other tangible assets used by the enterprise.

The requirement of place of business to be fixed postulates a link between the place of business and a definite area pr location. It envisaged the possibility of locating, identifying or pointing out a definite place as the place from which the business is carried on. It is not the requirement that the place of business should be stationery and not moving. (**104 Taxman 377(AAR – New Delhi), Pg no 24of 1996 [1999]**)

AGENCY PERMANENT ESTABLISHMENT

The next question arises is whether the assessee has a PE in India in the form of a dependent agent. It is commonly accepted principle that an enterprise should be treated as having a PE in a State if there is under it a person acting for it, even though the enterprise may not have a fixed place of business. Thus there can be two forms of permanent establishment, (i) fixed place or (ii) through the dependent agent. An agent is a person employed to do any act for another or to represent another in dealing with third person. What an enterprise can do directly but if not so done directly but done through an agent appointed for the purpose, it will be deemed to have been done indirectly. Even in such a situation it can be said that the enterprise carrying on the business through the efforts of such agent and hence can be said to have established a PE. In the present case the appellant avails the services of Interglobe to promote the use or CRS in India and for that purpose to appoint subscribers in India. Interglobe is authorized to enter into contract with the subscribers in terms of authority generated under Distribution Agreement (DA). The appellant binds itself in respect of booking made by subscriber using the CRS. Thus what could have been done directly by appellant is achieved through the service of Interglobe. Hence, Interglobe is to be treated as agent of appellant in India.

However, all the persons other than agent of an independent status cannot be deemed to be a PE of the enterprise. The agents can be considered as PE only and only if when a person other than agent of an independent status, (i) has and habitually exercise in that State an authority to conclude contract or (ii) though he has no such authority but habitually maintains stock of goods from which he regularly delivers goods on behalf of the enterprise.

The assessee have a 'dependent agent' in India under Article 5 (4) read with (5) of the DTAA. He invited our attention to Article 5(5) of the Indo-US DTAA extracted herein :—

"An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise and the transactions between the agent and the enterprise are not made under arm's length conditions, he shall not be considered an agent of independent status within the meaning of this paragraph." **(pg. 332)**

An "Agency" does not require physical presence. It however, requires a relationship with the agent on whom contract-making authority is bestowed.

The PE will nevertheless exist if the business of the enterprise is carried on mainly through automatic equipment and the activities of the personnel being restricted to setting up and operating such equipment. A PE will still exist if the enterprise which sets up machine also operates and maintains them for its own account and whether operated by itself or by a dependent agent.

Interglobe is a PE of the Appellant within the meaning of Article 5(4) of the Appellant as, according to him Interglobe was economically dependent on the Appellant for its source of business and its activities were devoted wholly and exclusively for the Appellant and as, according to the AO, it enters into and concludes contracts on behalf of the Appellant. On page 11 of his order, he observed as follows:

"In view of the above, it is clear that Galileo India ltd. (another name of Interglobe) is nothing but a dependent agent permanent establishment of Galileo International, and therefore, the income of Galileo International is taxable in India as per Article 7 read with Article 5 of the Double Taxation Avoidance Agreement between India and USA."

In addition to above, the AO observed that Interglobe was an agent covered under Article 5(5) of the Treaty as the transactions between the two were not at arm's length as:

- there was close business connection
- hardware and software were provided by the Appellant
- training and help desk were provided by the Appellant

SUMMING OF THE ARGUMENTS

(A) The assessee's income is taxable in terms of section 9 read with section 5(2) of the Act as it has assets in India, source of income in India as also business connection in India.

(B) The assessee has a PE in India on account of:

i) having 'fixed place of business' through which its business is carried on in India as per article 5(1) of the Indo-US DTAA.

ii) It also has an agency PE in terms of the proviso to the first sentence of article 5(5).

iii) Without prejudice, it also has an agency PE in terms of second sentence of article 5(5).

iv) The activities of the assessee do not fall under any of the negative items mentioned in article 5(3).

v) The fees payable to the dependent Indian agent is not an arm's length price.

(vi) Conditions laid down in articles 4(a), 4(b) & 4(c) are also satisfied.

(vii) The assessee is taxable under the Income Tax Act. 1961, and not exempted under the Indo- US DTAA.

thank you