STATE OF NEW YORK

TAX APPEALS TRIBUNAL

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| In the Matter of the Petition | : | |
| of | : | |
| **INFOSYS TECHNOLOGIES LIMITED** | : | DECISION<br>DTA NO. 820669 |
| for Redetermination of a Deficiency or for Refund of Corporation Franchise Tax under Article 9-A of the Tax Law for the Fiscal Years Ended March 31, 2001 and March 31, 2002. | : | |
| | : | |

Petitioner, Infosys Technologies Limited, filed an exception to the determination of the Administrative Law Judge issued on February 15, 2007. Petitioner appeared by Ernst & Young LLP (Kenneth T. Zemsky, Esq., of counsel). The Division of Taxation appeared by Daniel Smirlock, Esq. (Jennifer L. Baldwin, Esq., of counsel).

Petitioner filed a brief in support of the exception and a reply brief. The Division of Taxation filed a brief in opposition. Oral argument, at petitioner's request, was heard on September 17, 2007 in New York, New York.

After reviewing the entire record in this matter, the Tax Appeals Tribunal renders the following decision.

## *ISSUES*

I. Whether petitioner was correct in using a bookkeeping method of its own design for the purpose of allocating income to New York rather than the allocation formula set forth in the Tax Law.

II. Whether petitioner should have computed its entire net income allocable to New York based on its taxable income effectively connected with its United States trade or business as reported on its Federal income tax return or instead based on its worldwide income.

III. Whether petitioner's receipts factor should be based on actual amounts billed to clients for work done within and without the state or instead be based on a head-count ratio or days-worked ratio.

## *FINDINGS OF FACT*

We find the facts as determined by the Administrative Law Judge except for finding of fact "17" which has been restated. The Administrative Law Judge's findings of fact and the restated finding of fact are set forth below.

1. Petitioner, Infosys Technologies Limited ("Infosys"), is a software development and consulting firm; it provides software development and maintenance services to a wide variety of companies around the world. It was incorporated and is headquartered in Bangalore, India. While it provides managed software solutions to clients worldwide, Infosys utilizes an extensive infrastructure based in India to provide these solutions.

2. During the years at issue, Infosys earned approximately 71% of its total revenue from clients located in the United States. For the years at issue, Infosys did not have an office in the State of New York,[1] did not maintain a stock of goods, employ capital or own or lease property within the State. Inofosys earned revenue in New York based upon the software development activities carried out by its employees at client locations in the State.[2] In the three years

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[1] During the audit period, Infosys had United States offices in California, Illinois, New Jersey and Massachusetts.

[2] Infosys concedes that "[w]hile small, this presence did create nexus for Article 9-A purposes."

preceding the audit period, Infosys had some property in the State, primarily office space, which it rented during these years.

3. Infosys provides services in New York and elsewhere through its "Global Delivery Model" that it described in a July 8, 2003 letter to the Division of Taxation ("Division") as follows:

> The Global Delivery Model involves small teams of in-country engineers teamed with much larger "off-shore development centers." When a contract is entered into with a client, a small team of engineers will arrive at the client's site. They will conduct fact-finding regarding the needs of the client, then communicate the results to the much larger team of engineers located at an off-shore development center.
>
> The engineers sited at the client's workplace will coordinate the work on the project at a very high level and liaise with the client as needed. Most work on the project actually happens at an offshore development center. When development is complete, the taxpayer deploys an augmented team of engineers to the client's workplace for a short time to facilitate installation and implementation of the software solution.
>
> The Global Delivery Model allows the taxpayer to take advantage of time-zone differences to produce software significantly faster than would otherwise be possible. The vast majority of the offshore development centers are located in various cities in India. The time zone difference between India and the United States and most of Europe is such that, while client personnel are sleeping in the United States, the taxpayer's engineers are working on the project in India. The presence of small teams of engineers at the client site allows the client and the taxpayer's personnel to constantly monitor the progress of the project, and allows for adjustments of the specifications and timing while the project is ongoing.

4. The Infosys employees who spend time on-site at a client's location are sent from offices in India and they report to the project manager in India on a regular basis. A typical project can take from six to fifteen months to complete and these Infosys employees stay with the client during the entire time. While the skills required to understand the client's needs and

requirements are different from those required to develop the applications, Infosys's employees working at the clients' locations are similarly skilled to those in India.

Each of Infosys's applications is custom developed for the particular client and it must "start from scratch" with every client. Design work cannot be carried over from one client to another.

5. Because of the comparative costs of living between the United States and India, wages paid to the Indian professionals are considerably lower (approximately one-tenth) than the wages paid to its employees who are sent to the United States.

6. For the fiscal years ended March 31, 2001 ("the 2000 tax year") and March 31, 2002 ("the 2001 tax year"), Infosys computed its New York State corporation franchise tax liability based upon separate accounting. Included as "Statement No. 5" in its 2000 tax year franchise tax return (form CT-3) was the following statement:

> The Taxpayer is an information technology services company which was incorporated under India law and is headquartered in India. The Taxpayer conducts business activities in numerous worldwide locations, several of which are in the United States, including New York. For purposes of filing its U.S. federal corporate income tax return, the Taxpayer files a form 1120F, U.S. Return of a Foreign Corporation. Form 1120F reports only its U.S. operational income and balance sheet. The Taxpayer has determined that its New York corporate income tax liability would be out of proportion to its New York activities if the Taxpayer were to compute its New York tax liability based on worldwide income, worldwide balance sheet information, and worldwide apportionment figures. In accordance with 20 NYCRR Section 4-6.1(b) and the case of British Land (Maryland), Inc. v. Tax Appeals Tribunal of the State of New York (85 NY2d 139 [1995]), the Taxpayer has determined that its New York corporate income tax liability would be more properly reflected by using the so-called "separate accounting method." Accordingly, the Taxpayer has used this method in computing its New York corporate income tax liability reported on this tax return for the year ending March 31, 2001.

7. For the 2000 tax year, Infosys determined its total revenue from services performed in New York ($9,404,973.00) and then deducted its New York costs ($5,784,178.00) or those costs directly attributable to employees who provided services in New York which included manpower, travel, legal and professional and rates and taxes. Next, Infosys deducted its allocated direct U.S. expenses ($327,844.00), expenses (branch expenses, salary cost, legal and professional and data communication expenses) which were incurred as a result of its U.S. operations, but not directly attributable to services provided in New York. Finally, Infosys deducted its allocated indirect expenses, overhead ($2,172,841.00) and depreciation ($174,572.00) not directly attributable to services performed in New York, but resulting from its global operations, which were determined by a ratio of Infosys's New York revenue to its global revenue. The overhead expenses allocated to New York represented 47.5% of Infosys's total overhead expenses allocated to the U.S. ($2,172,841.00/$4,574,710.00) while its New York revenue ($9,404,973.00) equaled only 5.14% of its U.S. revenue for the year ($9,404,973.00/$183,031,870.00). Pursuant to Infosys's calculations, the balance, $945,538.00, was its New York entire net income, which was reported on its franchise tax return.

8. A similar formula was utilized by Infosys for the 2001 tax year wherein it calculated its New York entire net income for the year to be $1,926,406.00. Per its 2001 Federal income tax return, Infosys's gross receipts earned in the U.S. were approximately $225.2 million. Since its revenues from services performed in New York were approximately $13.7 million, only about 6 percent of its U.S. revenue was from New York.

On its Federal return, listed under "other deductions" was approximately $5.2 million in overhead expenses. On its New York franchise tax return, overhead expenses of approximately $2.1 million, or about 40% of total U.S. overhead expenses, were allocated against Infosys's

New York revenue despite the fact that its New York revenue represented only about 6% of its total U.S. revenue for the year.

9. In April 2003, the Division commenced an audit of Infosys for the 2000 and 2001 tax years. By letter dated April 18, 2003, the Division asked Infosys for information and documentation including Infosys's business activity inside New York, the U.S. and on a worldwide basis. The letter also sought a detailed explanation as to why a worldwide basis for the computation of the corporation's business allocation percentage and alternative business allocation would not be appropriate and why it would be more properly reflected using a separate accounting method. By a letter dated July 8, 2003, Infosys's representative, Ernst & Young (Kenneth T. Zemsky, Esq.) replied to the Division's request for information.

10. After reviewing Infosys's response, the Division determined that the proper filing for Infosys was on a worldwide basis and, therefore, computed its franchise tax liability using the standard apportionment formula. Accordingly, on May 9, 2005, the Division issued a Notice of Deficiency to Infosys asserting the following deficiencies[3]:

| Period Ended | Tax/MTA Surcharge | Interest | Total Due |
|---|---|---|---|
| 03-31-01 | $139,775.00 | $40,289.23 | $180,264.23 |
| 03-31-01 | $25,159.00 | $7,287.40 | $32,446.40 |
| 03-31-02 | $144,787.00 | $30,029.54 | $174,816.54 |
| 03-31-02 | $27,690.00 | $5,743.42 | $33,433.42 |
| TOTALS | $337,411.00 | $83,549.59 | $420,960.59 |

Prior to the issuance of the Notice of Deficiency, on or about November 9, 2004, Infosys, by its representative, executed a consent extending the period of limitation for assessment of

[3] The first amount listed as "Tax /MTA Surcharge" for each of the years at issue represents corporation franchise tax imposed pursuant to Tax Law § 209 while the second amount for each year represents the temporary metropolitan transportation business tax surcharge imposed pursuant to Tax Law § 209-B.

franchise taxes whereby it was agreed that such taxes due from Infosys for the period April 1, 2000 through March 31, 2001 could be determined or assessed at any time on or before June 15, 2005.

11. In recomputing Infosys's franchise tax liabilities for 2000 and 2001, the Division rejected Infosys's separate accounting methodology. It accepted Infosys's computation of the apportionment or allocation percentage on a worldwide basis. Since Infosys allocated its receipts based on where the services were performed, the Division made no adjustments to the numerator of Infosys's receipts factor. Therefore, Infosys's New York receipts were accepted as filed. While, subsequent to the issuance of the Notice of Deficiency, Infosys contended that its receipts should be determined based upon the location of its employees or by a head count of the number of employees located in New York, the Division rejected this contention because it believed that a head count would not properly reflect a receipts factor since in most companies, there are cost centers with employees who do not generate any revenue.

Infosys also contended to the Division that its New York receipts should be determined based upon time spent in and out of New York. This, too, was rejected by the Division because, in its opinion, the receipts factor is intended to represent the marketplace and looking at manhours or the number of people in the State erroneously places the same value on every employee and every service and thereby leaves out what a customer is willing to pay for the service. It must be noted that the Division's auditor admitted that no analysis was performed that would value Infosys's services within or without New York.

12. For years prior to the audit period, Infosys filed its returns on a worldwide basis. For tax years ended March 31, 1998, March 31, 1999 and March 31, 2000, Infosys's receipts factor

was 7.2294%, 3.9311% and 4.0806%, respectively. For these years, the Division accepted these receipts factors as filed.

13. For the 2000 tax year (fiscal year ended March 31, 2001), the Division computed Infosys's New York State factors and Business Allocation Percentage ("BAP") as follows:

| | WORLDWIDE[4] | NEW YORK STATE[5] | NYS FACTOR |
|---|---|---|---|
| PROPERTY | $131,338,468.00 | -0- | 0.0% |
| SALES/RECEIPTS | $428,214,414.00 | $9,404,973.00 | 2.1963% |
| PAYROLL | $154,974,846.00 | $3,620,936.00 | 2.3365% |

By adding together the property factor, the receipts factor twice[6] and the payroll factor (0.0% + 2.1963% + 2.1963% + 2.3365% = 6.7291%) and dividing the sum by four, a BAP of 1.6823% was computed by the Division.

For the 2001 tax year (fiscal year ended March 31, 2002), the Division, again utilizing "worldwide" figures from information supplied by Infosys and "New York State" figures from its franchise tax returns, computed Infosys's New York State factors and BAP as follows:

| | WORLDWIDE | NEW YORK STATE | NYS FACTOR |
|---|---|---|---|
| PROPERTY | $210,419,233.00 | -0- | 0.0% |
| SALES/RECEIPTS | $559,162,083.00 | $13,736,028.00 | 2.4565% |
| PAYROLL | $226,728,796.00 | $7,123,346.00 | 3.1418% |

[4] These amounts were derived from annual financial statements provided to the Division by Infosys.

[5] These amounts were taken from Infosys's New York State franchise tax return (lines 151 and 158).

[6] Pursuant to Tax Law § 210(3)(a) and 20 NYCRR 4-2.2(b), the receipts factor is to be added twice, and to calculate the BAP, the sum of the property, receipts (twice) and payroll factors are divided by four.

By adding together the property factor, the receipts factor twice and the payroll factor (0.0% + 2.4565% + 2.4565% + 3.1418% = 8.549%) and dividing the sum by four, a BAP of 2.0137% was computed.

14. V. Balakrishnan, who joined Infosys in 1991, is its senior vice president and secretary. Because of its global delivery model, Infosys has a competitive advantage over most of its competitors in the U.S. market.[7] Pursuant to the global delivery model, most of Infosys's software development takes place in India. Infosys operates globally through branch operations. It has marketing offices in the U.S., Europe and parts of Asia.

Whenever Infosys is hired on a project, some team members travel from India, go to the client's location to take the specifications, get the sign-off and do the knowledge transfer. Some of the team members return to India. At least 70% to 75% of the actual development of the software takes place in India. By means of dedicated data communications lines, software is downloaded to the client's location. A project typically involves 20 to 25 people, five or six of whom travel to the client's location to service the client. After obtaining the specifications of the project, three (of the five or six who traveled to the client's location) will then travel back to India to develop the applications. After the application development is complete, three or four people from the Indian development center who were part of the project travel back to the client's location, hand over the application, get the sign-off and return to India. Out of the total of 25 to 30 people who are involved in the project, two or three will stay at the client's location until the project is completed.

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[7] Mr. Balakrishnan stated that the global delivery model is not unique to Infosys but is utilized by many of its competitors in India.

There are two kinds of services performed by Infosys, to wit, one is time and material while the other is fixed priced. These are specified in the contract with the client. For time and material, Infosys bills the client based on effort spent on a monthly basis. The fixed price billed to the client is based on milestones achieved for any software development. There may be three or four milestones during the project period. Higher rates are charged by Infosys for work performed in the U.S.

A "core team" is placed at the client's location to coordinate the job, talk to the client, get the correct specifications and transfer this knowledge to a development team in India. The people in India are highly skilled; they are recruited from the top engineering colleges in India.

The cost of an employee who works outside India is approximately $80,000.00 per year while the cost of an employee located in India is approximately $7,800.00 per year, which is due to the considerable difference in the cost of living.

According to Mr. Balakrishnan, all of the risk is taken by the corporate headquarters in India. Outside India, Infosys operates on a branch operation basis where the branch takes no risk. All of the project managers are in India. During the years at issue, there were no project managers in New York. While sales personnel are sometimes located outside India on a permanent basis, they do only sales, no development.

During the audit period, Infosys allocated revenue to its U.S. branches based on services rendered. Income is sourced based on the actual efforts spent with the client, i.e., revenues are treated as U.S. source income if work is performed in the U.S.

15. Murali Krishna is Infosys's vice president of systems integration practice and is based in Lisle, Illinois, a suburb of Chicago. He supervises people worldwide and described himself as "the executive face for Infosys in the U.S." Infosys does no advertising; most of its leads are

through "cold calling." During the years at issue, sales personnel working out of the New Jersey office covered New York.

For a new client, a master services agreement is entered into whereby everything including rates is worked into a contract that then goes through a cycle of approval with Infosys personnel in India. Sales personnel cannot bind the company; all orders must be approved in India. Once that documentation is completed, employees from India come to the client's location to do requirements gathering. Then the high level design begins. While the detail design is being worked on in India, the on-site team works at the client's location in a coordination role. A typical project for Infosys would last from six to 15 months.

For a typical project, the fact-gathering, which is the first step, occurs both at the client's place of business and in India, often by means of audio or video conferencing. The next step, the design activity, takes place entirely at the development centers in India. The prototype phase also takes place in India. The development, testing and integration happens at the development centers in India. Finally, the implementation stage takes place both at the client's location and with a supporting team located in India.

The person who has direct responsibility for a particular project is the project manager who is located in the development center in India. Mr. Krishna described the people in India as the creative minds, while those at the client's site were described as client liaisons.

During the years at issue, Infosys did not have an office in New York but it now has an office in Manhattan. During the audit period, Infosys had at least 15 projects in New York. Infosys's New York clients include companies such as Ralph Lauren and J.P. Morgan.

16. S. Krishnan is the head of global taxation for Infosys and is based in Bangalore, India. He is responsible for all tax plans around the world, operating in 30 jurisdictions. While Mr.

Krishnan does not prepare the New York State tax returns for Infosys, he has a team that is responsible for the preparation of the returns. Mr. Krishnan's job is to ensure that the team properly allocated revenue and paid the correct amount of tax to the various jurisdictions.

Infosys tracks its employees to determine where services are provided. Infosys has an on-site and an offshore rate and thereby knows what to charge its customers.

Employees of Infosys are primarily based in India so they receive salaries based on their work in India. When they travel outside India, they are compensated for the costs incurred in those locations, which is referred to as a "minimum overseas allowance." The compensation received by employees while in the U.S. is almost ten times what is paid to the employees in India. Mr. Krishnan prepared the following chart, which compared wages, by salary grade, paid to an employee in India and to an employee while on assignment to New York:

| Grade | India Salary + NY allowance | Salary in India |
|---|---|---|
| I | $10,618 | $2,132 |
| II | $9,435 | $1,839 |
| III | $8,728 | $1,455 |
| IV | $7,760 | $1,158 |
| V | $6,427 | $778 |
| VI | $5,872 | $574 |
| VII | $5,575 | $491 |

Pursuant to Infosys's annual report for the 2000 tax year, a total of 94,419 "person-months"[8] were billed by Infosys, which represents the amount of time, on a per month basis, that its employees worked for clients of Infosys. This amount included on-site, offshore, nonbillable and training. Of the 57,101 billable person-months, 19,425 or 34% were on-site and 37,676 or

[8] By multiplying person-months by 30, the number of "person-days" may be calculated.

66% were offshore. In the following year (the 2001 tax year), of a total of 124,532 person-months, a total of 78,645 person-months were billed for the year. Of the 78,645 billable person-months, 54,472 person-months or 69.30% of Infosys's work was done offshore (in India) and 24,173 or 30.70% was performed on-site (at the clients' locations). Despite these figures, more income was derived by Infosys from on-site work during the audit period. Because rates charged to clients for work done in India were considerably lower than for work done on-site and because more work was done in India than on-site, clients paid less and were, therefore, happy with the global delivery model of Infosys.

In order better to reflect the record, finding of fact "17" is restated as follows:

17. Petitioner introduced in evidence a report prepared by PricewaterhouseCoopers ("PWC") entitled "Infosys–US Branch, Reporting of US Branch profits–Analysis of Arm's Length Approach, Fiscal year ended March 31, 2003" (Petitioner's Exhibit 4, ***see*** Hearing Tr. pp 169 *et seq.*). It states that its objectives are to demonstrate that it is appropriate for Infosys to adopt a method of allocating income to its United States branch based on "the international arm's length standard" and to propose an arm's-length profit allocation method. The report finds that the current method of allocating income based on the place where the work is performed and the invoiced rates per hour for that work "does not well reflect the underlying economic conditions or capture the relative contributions of the Indian headquarters and the U.S. branch in producing the revenue" (***Id***. at p. 16). Instead, the report recommends the adoption of an allocation method based on the arm's-length pricing methods of the Federal Income Tax Regulations under section 482 of the Internal Revenue Code. The report finds a legal basis for this approach in the Federal branch profits tax imposed by section 884 of the Internal Revenue Code, which generally provides a parity of tax treatment for subsidiaries and branches of foreign corporations, and in the

income tax treaty between India and the United States, which generally treats a "permanent establishment" as a "distinct and independent enterprise" in its relationship with a foreign head office. The report then reviews various alternative methods of determining arm's-length profits for the United States operations and concludes that the best method would be what it calls a "Comparable Profit Method (CPM)/ Transactional Net Margin Method (TNMM)." Applying this method to information on comparable companies found in public databases, the report concludes that a mark-up of total U.S. costs within the range of 3% to 8% would comply with arm's-length standard under the section 482 regulations. In other words, it would be appropriate in the view of the authors to allocate gross income to petitioner's United States operations in an amount between 103% and 108% of its United States costs.

One of petitioner's witnesses, Mr. Balakrishnan, testified that its gross margin on employee costs for work done in the United States was 42% or 43% and that its gross margin for work done in India was 87% (Hearing Tr., p 81).

18. For the years at issue (tax years 2000 and 2001), Infosys filed its Federal tax returns based on a net income method. In simplistic terms, for Federal purposes, revenues from work performed in the U.S. were listed on the Federal returns as taxable revenues. Thereafter, it filed its Federal returns utilizing the cost plus 7% method. However, for purposes of its New York franchise tax returns, it filed using a separate accounting methodology. The decision to utilize this separate accounting methodology was made by Mr. Krishnan and his management team after seeking and receiving advice from Ernst & Young, the accounting firm that prepared Infosys's New York State franchise tax returns for the years at issue.

19. Sunil Dhareshwar's duties with Infosys are to ensure that Infosys is complying with tax regulations in the U.S., Canada and countries in the Asia Pacific region. During the 2000 tax

year (ended March 31, 2001), Infosys had 9,831 employees (8,656 were software professionals with 1,175 support personnel); for the 2001 tax year (ended March 31, 2002), Infosys had 10,738 employees (9,405 software professionals and 1,333 support). The number of employees has increased sharply each year. In the tax year ended March 31, 2005, Infosys employed 32,178 people, 30,147 of whom were software professionals.

Infosys prepared a summary of its employees, on a month-by-month basis, in New York for the period April 2001 to March 2002. This summary was derived from Infosys's payroll records. Based upon this summary, it was determined that for this period, Infosys had "total person days" of employees in New York of 34,325. On average, Infosys had approximately 100 employees per month in New York during this period. Mr. Dhareshwar indicated that the figures for the previous year were comparable.

20. Mr. Dhareshwar analyzed the Division's audit results and reached the following conclusions:

a. The Division's results attribute Infosys's profits from India to New York. Since the amount of profit in India is significantly higher than that in New York, the audit results are skewed; and

b. The Division's results translate into a profit percentage of nearly 25%. Mr. Dhareshwar indicated that based upon Infosys's own economic evaluation, the profit percentage should be in the range of between three to eight percent.

21. The PwC report indicated to Infosys that New York State taxes seemed to be significantly higher when compared to the rest of the states to which Infosys was paying taxes and that the taxable income computed for each state should, when added together, equal taxable income for Federal purposes.

## *THE DETERMINATION OF THE ADMINISTRATIVE LAW JUDGE*

The Administrative Law Judge determined that petitioner was required pursuant to Tax Law § 208.9(c) and 20 NYCRR 3-2.3(a) to include its worldwide income, including income from sources outside the United States, in the computation of its entire net income subject to the corporation franchise tax under Article 9-A of the Tax Law. The determination rejected petitioner's assertion that it was entitled to use a "separate accounting method" in computing its income allocable to New York rather than the formulas prescribed by the Tax Law and regulations. The determination also rejected petitioner's argument that the allocation should be based on a head-count ratio or a ratio of days worked in New York to all work days without reference to the differences in billing and wage rates for work done in New York and work done in India.

In allocating petitioner's income to New York, the Administrative Law Judge determined, however, that the payroll factor should be adjusted downward in light of the wide disparity of wages in New York and in India and the fact that most of the work performed for New York customers was performed in India. The Administrative Law Judge determined that it was appropriate to reduce the payroll factor for 2000 from 2.3365% as asserted by the Division to 1.45%, which had the effect of reducing the business allocation percentage from 1.6823% to 1.4607%. Similarly, the payroll factor for 2001 was reduced from 3.1418% to 1.45%, which resulted in a reduction in the business allocation percentage from 2.0137% to 1.5908%. The Division has not taken exception to these adjustments.

## *ARGUMENTS ON EXCEPTION*

In support of its exception, petitioner asserts that the starting point for calculation of its entire net income was its Federal taxable income without the addition of its income from sources

outside the United States. Section 208.9(c) of the Tax Law should not be read as providing otherwise because that section "is present solely to provide emphasis or clarification" (Brief in support, pp.7-21). In other words, "it exists to affirm that items already included in" entire net income "are not excluded merely because they are foreign in nature" (Brief in support, p. 26). The Division's regulation, 20 NYCRR 3-2.3(a)(9), to the extent requiring the addition to the computation of income not taken into account in calculating Federal taxable income, is accordingly invalid.

Petitioner also argues that if section 208.9(c) is read as a modification of the amount of entire net income, it would place an unconstitutional burden on foreign commerce because it includes only net income from foreign sources but not net losses (Brief in support, pp. 20-21; Reply brief, pp. 12-13).

Finally, petitioner claims that in calculating the receipts factor, income from services should be apportioned based on the ratio of time worked within the state to total working time without regard to differences in billing rates or wage rates applicable to different work places (Brief in support, pp. 35-38).

The Division asserts that petitioner's income should be allocated to New York based on an application of the normal statutory formula to petitioner's worldwide income. The Division claims that this is a correct reading of the Tax Law and that its regulation section 3-2.3(a)(9) has the force and effect of law since it represents a reasonable interpretation of the statute (Brief in opposition, pp. 10-21). The Division also argues that the receipts factor should be based on the amounts shown on petitioner's returns as filed, which reflected actual charges to petitioner's clients rather than a head-count or days-worked ratio (Brief in opposition, pp. 24-28).

***OPINION***

One of the bases on which the corporation franchise tax is imposed is the entire net income base, which includes the portion of the entire net income of the corporation allocated within New York. In general, the business income of a taxpayer is allocated to the state on the basis of the taxpayer's business allocation percentage. For the years involved in this case, the business allocation percentage was equal to the average of four ratios–*viz.* the property factor, the double weighted receipts factor, and the payroll factor. The property factor is the ratio of the average value of the taxpayer's real and tangible personal property located in the state to the average value of all such property wherever located. The receipts factor is the ratio of the sum of income from (A) sales of tangible personal property to points within the state, (B) services performed within the state, and (C) rentals and other business receipts within the state to all such income. The payroll factor is the ratio of salaries and other compensation for personal services within the state to all such amounts.

In determining the receipts factor attributable to services, the Division's regulations state in pertinent part, as follows:

> The receipts from services performed in New York State are allocable to New York State. All receipts from such services are allocated to New York State, whether the services were performed by employees, agents or subcontractors of the taxpayer, or by any other persons (20 NYCRR 4-4.3[a]).

The Tax Law also provides authority for the Division to adjust the allocation formula where it is found that it fails properly to reflect the activity, business, income or capital of the taxpayer within the state (Tax Law § 210.8). The provision reads as follows:

> If it shall appear to the tax commission that any business or investment allocation percentage or alternative business allocation percentage determined as hereinabove provided does not properly reflect the activity,

> business, income or capital of a taxpayer within the state, the tax commission shall be authorized in its discretion, in the case of a business allocation percentage or alternative business allocation percentage, to adjust it by (a) excluding one or more of the factors therein, (b) including one or more other factors, such as expenses, purchases, contract values (minus subcontract values), (c) excluding one or more assets in computing such allocation percentage, provided the income therefrom is also excluded in determining entire net income or minimum taxable income, or (d) any other similar or different method calculated to effect a fair and proper allocation of the income and capital reasonably attributable to the state, and in the case of an investment allocation percentage, to adjust it by excluding one or more assets in computing such percentage provided the income therefrom is also excluded in determining entire net income or minimum taxable income.

The regulations contemplate that a taxpayer may request the Division to exercise its authority to adjust the allocation percentage (20 NYCRR 4-6.1[c]). The regulations state in pertinent part, as follows:

> A taxpayer may not vary the statutory business allocation percentage or alternative business allocation percentage formulas . . . without the prior consent of the commissioner. A taxpayer making a request for an adjustment of its business allocation percentage or alternative business allocation percentage must file its report and compute its tax in accordance with the statutory formulas. A request to vary the statutory formulas must be attached to the report setting forth full information on which the request is based, together with a computation of the amount of tax which would be due under the proposed method.

In the present case, petitioner did not follow the statutory allocation formula in preparing its tax returns and did not request the Division's permission to vary the formula. Instead it allocated income to New York based on the amounts it invoiced its customers for services rendered in New York, which were billed at a higher rate than services performed in India, and deducted certain expenses purportedly attributable to that income in calculating entire net income. Petitioner refers to this as "separate accounting," although its New York activities are clearly not a separate enterprise with its own books and records.

At the hearing, petitioner presented four witnesses who described in considerable detail petitioner's business methods, which are referred to as a "global delivery model." While much of this information seems breathtakingly contemporary from the perspective of technological engineering and business management, no reason is found in the record for distinguishing these arrangements from traditional professional services in applying the allocation rules. For example, if a client engaged a firm of French architects to send a group of employees to New York by steamship to design a new building and the group then returned to Paris to work with other architects in completing the plans with pens and pencils, the issues of allocation now before us would seem to be the same. We conclude that petitioner was not justified in failing to follow the statutory formula in allocating income to New York State. To whatever extent the wide disparity in billing and wage rates between India and the United States is a distinguishing feature of the present facts, it has been addressed by the adjustments in the formula made by the Administrative Law Judge.

The calculation of entire net income generally begins with taxable income as determined for Federal income tax purposes. The Tax Law states in this regard as follows:

> The term "entire net income" means total net income from all sources, which shall be presumably the same as the entire taxable income . . . which the taxpayer is required to report to the United States treasury department . . . (Tax Law § 208.9).

The statute then provides numerous adjustments and modifications that are to be made in arriving at entire net income for purposes of the franchise tax. One of these states, "Entire net income shall include income within and without the United States" (Tax Law § 208.9[c]).

The Division's regulations interpreting these provisions include the following:

> In computing entire net income, Federal taxable income must be adjusted by adding to it . . . in the case of a taxpayer organized outside the United

> States, all income from sources within and without the United States less all allowable deductions attributable thereto, which were not taken into account in computing Federal taxable income . . . (20 NYCRR 3-2.3 [a][9]).

The statute's use of the word "presumably" appears to indicate that the starting place for the calculation of entire net income is not always Federal taxable income. Nevertheless, the authority of the Division to vary the Federal amount is limited. In ***Matter of Dreyfus Special Income Fund v. New York State Tax Commn.***, 72 NY2d 874 [1988], the Court of Appeals held that the Division was required to apply taxable income as specially defined in Subchapter M of the Internal Revenue Code and the Division's regulation providing otherwise was invalid. Section 3-2(a)(8) of the regulations by contrast is in our view well grounded in section 208.9(c) of the Tax Law and is not vulnerable to challenge under the rule of the ***Dreyfus*** case.

Petitioner argues that the purpose of section 208.9(c) is to make clear that foreign source income of corporations organized in the United States is not omitted from entire net income but that section 208.9(c) is not intended to add back foreign source income of non-U.S. corporations. Like the Administrative Law Judge, we find this argument unpersuasive. There is no need for the clarification of the statute. It is perfectly clear that Federal taxable income includes the worldwide income of corporations organized in the United States. Unless the statutory words are interpreted in accordance with the Division's regulations to apply to alien corporations, the words would have no substantive effect.

Petitioner's argument that section 208.9(c), if interpreted as modifying the amount of entire net income, would place an unconstitutional burden on foreign commerce depends on the questionable premise that it applies only to increase entire net income but not where the portion of worldwide income not reflected in Federal taxable income is a loss. In other words, petitioner reads the words "all income from sources within and without the United States less all allowable

deductions attributable thereto" in section 3-2(a)(8) of the regulations as having no application if the amount described is a negative number. The Division rejects that reading and points out that the regulations state, "A corporation organized under the laws of a country other than the United States which has income from sources outside the United States (worldwide) may carry back or carry forward net operating losses resulting from its worldwide operations" (20 NYCRR 3-8.3)(Brief in opposition, pp. 17-18). The constitutional difficulty posed by petitioner is thus readily avoided on a basis that is consistent with our interpretation of section 208.9(c).

Although we have not found and the parties have not cited a case in which the statutory argument advanced by petitioner was addressed directly, we note that the courts have sustained the application of the franchise tax to the worldwide income of alien corporations in the face of challenges based on other theories (***see, Matter of Reuters Limited v. Tax Appeals Tribunal***, 82 NY2d 112 [1993][Tax Law § 210 (3) (a) (1)]; ***Bass, Ratcliff & Gretton, Limited, v. State Tax Commn.***, 266 US 271 [1924], ***aff'g***, 232 NY 42 [1921][former Tax Law §§ 209, 214, 215]). For the foregoing reasons, we find that the Division was correct to include petitioner's income from all sources in the calculation of its entire net income and apply the statutory allocation formulas on a worldwide basis.

Petitioner's third witness, Mr. Krishnan, who is petitioner's head of global taxation, provided information about petitioner's business structure, including salary practices, and provided a foundation for the introduction of the PricewaterhouseCoopers report described above. The PricewaterhouseCoopers report concludes that it would be appropriate for petitioner to report its Federal taxable income in reliance on the income tax treaty between India and the United States. Under the author's interpretation of the treaty, the income of a permanent establishment in the United States should be determined as if the permanent establishment were a

separate entity dealing at arm's length with its foreign headquarters and a sound method for allocating income on such arm's-length basis is to apply the Treasury Regulations under section 482 of the Internal Revenue Code.

The income tax convention between India and the United States applies by its terms to "Federal income taxes imposed by the Internal Revenue Code . . . and the excise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations" (Art 2, paragraph 1; ***see,*** Art. 28, para. 5 [exchange of information and administrative assistance]. The accompanying Treasury Department Technical Explanation states, "State and local taxes in the United States are not covered by the Convention." The treaty accordingly does not apply directly to the New York corporation franchise tax and would be relevant to the issues before us only if its effect on the determination of Federal taxable income had a bearing on the allocation of income to New York. Since we have concluded for the reasons discussed above that entire net income subject to the corporation franchise tax is not limited to the Federal taxable income in the case of an alien corporation, the treaty is irrelevant. Moreover, the ultimate conclusion of the PricewaterhouseCoopers report appears to be at odds with a fundamental policy choice reflected in the Tax Law. By adopting an allocation formula based on property, receipts and payroll, New York, like other states, has in effect rejected the use of arm's-length methodologies as the standard for determining income subject to tax in the state.

In filing its returns, petitioner allocated income to New York based on the amounts billed to its clients for work done in New York. Those amounts reflected the higher billing rates for work done in the state. On audit, the Division applied the statutory allocation formula also reflecting in the numerator of the receipts ratio the higher invoiced amounts for New York work and reflecting in the denominator the lower rates charged for work done in India. A similar

differential in wages was reflected in the payroll factor. Petitioner now argues that it is more appropriate to use a ratio of days worked in New York to all work days as the basis for allocating worldwide receipts. Petitioner relies in part on the following provision of the Division's regulations governing the allocation of receipts that are compensation for services:

> Where a lump sum is received by the taxpayer in payment of services performed within and without New York State, the portion of the sum attributable to services performed within New York State is determined on the basis of the relative values of, or amounts of time spent in performance of, such services within and without New York State, or by some other reasonable method. Full details must be submitted with the taxpayer's report. (20 NYCRR 4-4.3[f][1]).

The difficulty with petitioner's reliance on this provision is that it was not paid a "lump sum" for work done both inside and outside the state. Instead, petitioner billed its clients at a higher rate for work done in New York and a lower rate for work done in India. The amount of its receipts for services performed in New York and outside New York has been determined by the agreed upon values in its invoices. This is the basis on which it filed its returns, although its methodology differed from the statutory formula. Petitioner's assertion of an allocation based on time alone is rebutted by the actual bargained-for amounts that it received from its clients.

Accordingly, it is ORDERED, ADJUDGED, and DECREED that:

1. The exception of Infosys Technologies Limited is denied;

2. The determination of the Administrative Law Judge is affirmed;

3. The petition of Infosys Technologies Limited is granted to the extent indicated in conclusion of law "O" of the Administrative Law Judge's determination, but in all other respects is denied; and

4. The Notice of Deficiency dated May 9, 2005 as modified in accordance with paragraph "3" above is sustained.

DATED:Troy, New York
February 21, 2008

/s/ Charles H. Nesbitt
Charles H. Nesbitt
President

/s/ Carroll R. Jenkins
Carroll R. Jenkins
Commissioner

/s/ Robert J. McDermott
Robert J. McDermott
Commissioner