Non-resident controlling operation and management of a hotel in India has a PE in India

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In brief

Recently,[1] the Authority for Advance Rulings (AAR) held that when a non-resident service provider has taken over all the essential functions relating to the operation and management of an Indian Hotel by entering into different agreements, and created a presence in India by rendering services to such Indian Hotel -

- such a presence would satisfy all the tests laid down by the Supreme Court (SC)[2]; and
- a permanent establishment (PE) of the non-resident in India would come into existence under the India-Luxembourg Double Taxation Avoidance Agreement (tax treaty).

Further, the AAR held that any income received by such non-resident from the provision of any other incidental services would be attributable to such PE.

In detail

Facts

- The taxpayer was a leading international hotel chain engaged in development, operation, and management of hotels, resorts and branded residences.
- The taxpayer had entered into five agreements with an Indian Hotel for the provision of various services in relation to the operation and management of the Indian Hotel as per international standards. The various agreements were as follows:
  - Hotel Management Agreement (HMA)
  - Centralised Services Agreement (CSA)
  - Hotel License Agreement (HLA)
  - Hotel Advisory Agreement (HAA)
  - Technical Services Agreement (TSA)
- The HMA was the "Principal Agreement" while the other four agreements constitute the "Ancillary Services Agreement." The taxpayer had approached the AAR regarding the taxability of services rendered under the CSA. Services under the CSA included global reservation services such as facilitation of reservation/ booking of rooms, banquets halls, etc., in the Indian Hotel Property.
- The Revenue at the time of admissibility of the application, urged that the CSA contained references to other agreements mentioned above and it should not have been read in isolation. The Revenue also urged that the provision of services to the Indian Hotel in India might constitute a PE in India.

Issues before the AAR

- Whether the payments received by the taxpayer from the Indian Hotel for provision of services under the CSA would be taxable in India as "fees for technical services (FTS)" or "royalty"?
- Whether the AAR would be

[1] AAR No 1010 of 2010

[2] Formula One World Championship Limited *v.* CIT [2017] 80 taxmann.com 347 (SC)

justified in ruling on the existence of PE in India, when the question raised before it was limited to the taxability of a single stream of income?

- If yes, whether the Indian Hotel constituted a PE of the taxpayer in India?

Taxpayer's contentions

- The ruling was sought only on the provision of services under the CSA and any reference to the other agreements would be inappropriate.
- All activities had been performed in the capacity of agents of the Indian Hotel. Hence, these activities did not constitute carrying business in India, and hence, no PE would exist in India.
- The services rendered under the CSA did not qualify as FTS or royalty and should have been considered as business income not liable to tax in India under the tax treaty, as these services were rendered entirely outside India and could not be attributed to any PE in India.

Revenue's contentions

- All agreements should have been read conjointly, as one agreement referred to the other.
- The taxpayer had taken over the control of the operation and management of the Indian Hotel, and thus, the Indian Hotel should have constituted the PE of the taxpayer in India. Any income earned by the taxpayer from India should have been attributable to such PE under the tax treaty.
- The Revenue also contested that all streams of income, including income from GRS was taxable under the Income-tax Act, 1961 as business income, as the taxpayer's "business connection" and "source" laid in the operation of hotels in India.

AAR's ruling

On preliminary contention of the Revenue

- The five agreements could not be viewed on a standalone basis. The activity of the taxpayer was integrated and could not be divided. All agreements formed part of a single arrangement, containing references to each other at several places and was co-terminus. The taxpayer's contention to restrict the query to only the CSA was devoid of merit.

On existence of PE

- From the judgement of the SC[2] it was well settled that a fixed place PE was constituted on fulfilment of the following three conditions:
  - Existence of a fixed place;
  - The fixed place being at the disposal of the non-resident;
  - The non-resident carrying on its business (wholly or partly) through such fixed place.
- The following key clauses of the agreements established that the Indian Hotel was the place at the disposal of the taxpayer and that it exercised significant control over such place.
- Under the HMA, the taxpayer rendered services relating to the day-to-day operation and management of the Indian Hotel. Control, discretion, authority and responsibility for the operation of the Indian Hotel, right to access all parts of the Indian Hotel were provided to the employees of the taxpayer and its affiliates. Authority in relation to hiring, termination, transfer, replacement of higher management or any staff of the Indian Hotel was granted to the taxpayer.
- Under the CSA, the core functions relating to the operation of the Indian Hotel, such as sales, marketing, reservation, etc., were outsourced to the taxpayer. As regards purchasing services, the taxpayer was given complete autonomy in vendor selection for supply of goods and services.
- Under the TSA, the taxpayer was involved—since inception—in overseeing the design and construction of the Indian Hotel to ensure compliance with the brand standard.
- Under the HAA, the taxpayer was responsible for all critical aspects of the Indian Hotel, such as training staff, preparing budgets, carrying out capital improvements, etc.
- As per the agreements, the final decision-making power with regard to hotel management laid with the taxpayer and even the Indian Hotel was completely at the disposal of the taxpayer.

  The taxpayer had, in substance, taken over all the important functions in relation to the operation and activities from a fixed place in India, i.e., the Indian Hotel.
- The taxpayer, irrespective of different nomenclature in different agreements, was engaged in the complete management of its business operations in India.
- The Indian Hotel was acting only for and on behalf of the taxpayer, as the entire risk was of the taxpayer. Thus, all the three tests were satisfied, and

the taxpayer constituted a fixed place PE with respect to incomes earned pursuant to these agreements.

- Thus, the AAR held that the payments received by the taxpayer from the Indian Hotel for the provision of services under the CSA should have been attributable to the taxpayer's PE in India.

The takeaways

- The AAR has reemphasised the need of reading all agreements together instead of isolated reading of agreements, which would lead to absurd and untenable inferences and conclusions.
- Where a non-resident service provider has autonomy over the day-to-day operations and management of the recipient, the risk of constituting fixed place PE cannot be negated. This could be relevant for analysing PE exposure in future.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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