



Supreme Court Confirms Fixed Place PE for Hyatt in India: Emphasises Substance Over Form and Operational Control

Newsflash

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*For Circulation
1 August 2025*

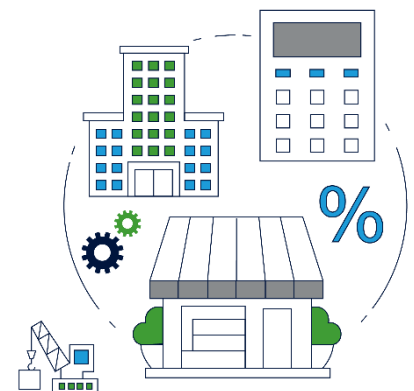
1.0 Background

In a landmark judgement passed by the Hon'ble Supreme Court (SC) in the case of **Hyatt International Southwest Asia Ltd. ('the Appellant')**, the existence of Fixed Place Permanent Establishment (PE) has been affirmed under Article 5(1) of the India UAE Double Taxation Avoidance Agreement (hereinafter referred to as 'the relevant DTAA'), leading to its income taxable in India. In addition, it has been laid that since a PE is conceived to be an independent taxable entity, attribution of profits to a PE in India is permissible even if the overall foreign enterprise has incurred losses.

The ruling emphasises the significance of the concept of 'substance over form' and of operational control, supervision and implementation. Also, it reinforces the principle that taxability is based on business presence and not merely on the basis of physical presence/global profitability of the foreign enterprise.

2.0 Facts of the Case

- 2.1 The Appellant is a company incorporated in Dubai and qualifies to be a tax resident of the UAE under Article 4 of the relevant DTAA.
- 2.2 Two independent Strategic Oversight Services Agreements ('SOSA') were entered by the Appellant with Asian Hotels Limited ('AHL'), India – one for AHL Delhi and another for AHL Mumbai. Through these agreements, the Appellant had to provide strategic planning services and "know-how" to ensure that the hotel was developed and operated as an efficient and a high-quality international full-service hotel.
- 2.3 For Assessment Year (AY) 2009-10, the Appellant filed its income tax return as 'NIL' and claimed refund. Thereafter, scrutiny proceedings were initiated under section 142(1) read with section 143(3) of the Income-tax Act, 1961 (the "Act"), wherein the AO (reaffirmed by the Dispute Resolution Panel) through the final assessment order held that the activities of the Appellant constituted –
 - (i) A business connection under section 9(1)(i) of the Act,
 - (ii) A PE under Article 5 of the relevant DTAA,



- (iii) Royalties and Fees for Technical services (FTS) under section 9(1)(vi)/(vii) of the Act, and
- (iv) Royalties under Article 12 of the relevant DTAA.

Keeping the above in mind, similar assessment orders were passed for AY 2010-11, 2011-12, 2012-13, 2013-14, 2014-15, 2016-17 and 2017-18.

- 2.4 Challenging the above assessment orders, the Appellant filed an appeal before the Tribunal. On examining the various terms of the SOSA and placing reliance on the decision of the SC in the case of **Formula One World Championship Ltd.¹**, the Tribunal held that the Appellant had a fixed place PE in India under Article 5(1) of the relevant DTAA and the amounts received by the Appellant under SOSA were in the nature of 'Royalty'. Henceforth, rejecting the contention of the Appellant that it did not have a PE in India, all appeals filed for relevant years were dismissed.
- 2.5 Aggrieved with the order of the Tribunal, the Appellant filed an appeal before the Hon'ble Delhi High Court (HC) wherein it was held that the payments received did not constitute royalty. However, it concurred with the view taken by the Tribunal that the Appellant constituted a fixed place PE in India under Article 5(1) of the DTAA.
- 2.6 Aggrieved with the above order of the Hon'ble HC, the Appellant filed an appeal before the Hon'ble SC with respect to existence of Fixed Place PE in India under Article 5(1) of the relevant DTAA and consequently, whether income derived under SOSA is taxable in India.

3.0 Contentions of the Appellant

- 3.1 Placing reliance on the SOSA, the Appellant highlighted that it was engaged in rendering hotel consultancy and advisory services from Dubai to various hotels belonging to the Hyatt Group including those located in India and its role was limited solely to strategic guidance, brand compliance and long-term planning. The day-to-day operations were not carried out by the Appellant, rather were carried out by Hyatt India Pvt Ltd (Hyatt India) under a separate Hotel Operating Services Agreement (HOSA) entered directly with the Hotel owner.
- 3.2 The SOSA explicitly stipulates that the Appellant shall render the above - mentioned services from Dubai and is not obligated to send or station any employee in India. However, as per the SOSA, as per the Appellant's sole discretion, only occasional and temporary visits by its employees to India were permitted.
- 3.3 The purpose of the visit of the six employees of the Appellant who visited and stayed at the hotel premises in India for a short duration during the relevant years, was merely for routine oversight visits to ensure brand uniformity and quality compliance. The visits were spread across various



¹ *Formula One World Championship Limited v Commissioner of Income Tax, International Taxation-3, Delhi (2017) 15 SCC 602 (SC)*

Hyatt hotels located across India and the duration of such visits did not exceed the threshold prescribed under Article 5(2)(i) of the relevant DTAA.

- 3.4 The Appellant did not maintain a fixed place of business, office or branch in India. Neither was any designated space at the hotel premises in Delhi or Mumbai specifically reserved or placed at the disposal of the Appellant nor was any control or dominion exercised by the Appellant on any part of the premises. Mere involvement in policy decisions or enforcement of brand standards does not amount to a fixed place of business PE.
- 3.5 Reference was placed on **Formula One (supra)** and **M/s. E-Funds IT Solutions Inc²** wherein it was held that for a fixed place PE to be constituted, it is essential that the two tests are met i.e.,
- There must be a specific, fixed, and identifiable physical location in India; and
 - Such location must be at the disposal of the foreign enterprise for use in carrying out its own business activities.

Thus, the Appellant contended that the absence of a prohibition on decision-making in the SOSA does not imply a right of disposal, and a Fixed Place PE cannot be presumed without an express grant of the right to use a specific physical location for conducting business.

- 3.6 The Appellant did not have a PE in India as per Article 5(1) of the relevant DTAA and accordingly its business income was not taxable under Article 7 of the relevant DTAA. Further, in the absence of a specific Article in the relevant DTAA enabling taxation of FTS, the service fees earned by the Appellant from Hyatt hotels is not taxable in India.

4.0 Contentions of the Revenue

- 4.1 On perusal of the SOSA, it was apparent that the Appellant not only had access to the hotel premises, but such premises were at the Appellant's full and unconditional disposal.
- 4.2 Business was carried out by the Appellant through its employees stationed at the hotel, thereby satisfying the requirements that constitute a fixed place PE under Article 5 of the relevant DTAA. The Appellant played crucial role which extended beyond high-level policy formulation and into the domain of actual implementation.
- 4.3 The Appellant was involved in carrying out managerial and operational functions which involved appointment and training of staff, monitoring day-to-day operations, exercising financial oversight, and influencing procurement decisions, particularly through the General Manager who reported directly to the Appellant. Thus, the Appellant did have pervasive and enforceable control over the hotel operations in India.



² Assistant Director of Income Tax -1, New Delhi v M/s E-Funds IT Solutions Inc (2018) 13 SCC 294 (SC)

4.4 Through documentary evidence which reflected the names of employees, role and duration of stay in India, it was evident that such employees were involved in substantive hotel operations, certainly indicating that through such employees the Appellant had operational presence in India. Thus, it was evidently clear that the Appellant had full and effective control over the hotel premises and such premises were indeed at its disposal for conducting business activities, thereby constituting a fixed place PE.

4.5 Reliance was placed on decision of the Hon'ble SC in the case of **Formula One (supra)** wherein it was held that for a fixed place PE to exist, two core conditions must be met-

- There must be a fixed place of business, and
- Through that place, the business of the enterprise must be wholly or partly carried on.

It was also emphasized that duration of access to the premises is not the determinative factor in itself rather it is the right of disposal and conduct of business through the premises that are the core tests.

4.6 In addition, the three core features of a PE have been met by the Appellant, which are as under-

- **Stability**- The Appellant has entered into a long-term agreement for 20 years (SOSA) through which it enjoys broad and continued control over the key functions of the hotel, including staffing, operations, strategic policy and financial oversight.
- **Productivity** - The service fees earned by the Appellant was linked to the financial performance of the hotel
- **Dependence** - The Appellant relied on the hotel infrastructure and staff in India to carry out its business operations.

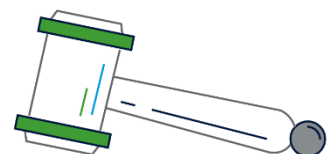
4.7 Applying the above principles and considering the moot fact that the Appellant had pervasive control and continuous nature of involvement, the Revenue alleged that the Appellant constitutes a Fixed Place PE in India as per Article 5(1) of the relevant DTAA and henceforth, profits are to be attributed to such PE to be liable to tax in India. Further, the decision of the SC in the case of **E-Funds (supra)** relied upon by the Appellant was factually distinguishable and not applicable to the present case.

5.0 Decision of the Apex Court

5.1 SOSA went above and beyond mere hotel consulting and advisory functions

Placing reference to various clauses under the SOSA, the Hon'ble SC observed that the Appellant -

- Had entered into an agreement for a period of 20 years which could be further renewed through mutual agreement.



- Is responsible for providing and formulating strategic plans for all aspects of hotel operations, including branding, marketing, product development, and daily operations; drafting policies, procedures and guidelines and align the HR policy of the hotel, to ensure adherence to 'Hyatt Operating Standards'.
- Is responsible for formulating policies relating to procurement, guest admittance, use of premises, pricing, sales and marketing, reservations and operating bank accounts of the hotel
- Has the right to assign employees to India without prior approval of the hotel owner or management.
- Has the right to identify, recruit and assist in appointing non-local hotel employees including the General Manager, key personnel and members of the Executive Committee on behalf of the hotel owner.
- Has the right to temporarily assign its own employees to serve as full-time executive staff at the hotel
- Is entitled to receive the 'Strategic Fees' for the services provided. The consideration is not a fixed fees but calculated based on the percentage of room revenue and other direct / indirect revenues, thereby reflecting an active commercial involvement.

On perusal of the above, the Hon'ble SC opined that the role of the Appellant was not merely limited to policy formulation or high-level decision making. The enforceable rights along with the various managerial and functional authority carried out by the Appellant demonstrated the degree of control and supervision being exercised, which went beyond the role of merely rendering hotel consulting and advisory services.

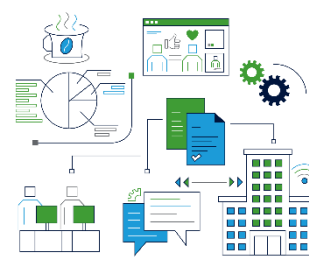
Further, it was noted that the Appellant was intensely engaged in enforcing compliances and overseeing business operations of the hotel, thereby concluding that the role extended to substantive operational control and implementation. Apart from the above, the Appellant's ability to derive profit-linked fees from the hotel's earnings also demonstrated a clear and continuous commercial nexus and control with the hotel's core functions, thereby satisfying the conditions necessary for the constitution of Fixed place PE in India under Article 5(1) of the DTAA.

5.2 Disposal Test Reaffirmed

Placing heavy reliance on its own decision in the case of **Formula One (supra)**, the Hon'ble SC reiterated that for a fixed place PE to exist, two essential elements need to be satisfied –

- place must be at the disposal of the foreign enterprise, and
- business of the enterprise must be carried on through that place.

The said conditions must also reflect the features of stability, productivity, and independence. Therefore, for a fixed place of



business to exist what essentially matters is whether the foreign enterprise has the premises “at its disposal” to carry on core business activities.

Emphasis was laid on the pivotal ‘Disposal test’ wherein the enterprise has a right to use the premises in a manner that enables it to carry on its business activities. Further, whether such premises are either owned, rented or shared has no relevance as long as the enterprise can use and exercise control over the place at its own discretion.

It was noted that exclusive possession of a designated physical space is not an essential criterion. Therefore, a certain amount of space at the disposal of the enterprise which is used for business activities is sufficient to constitute a place of business and no formal legal right to use that place is required. **It is necessary that the ‘Disposal test’ is determined in substance than in form depending on the nature of facts and business operations/ control carried out in reality.**

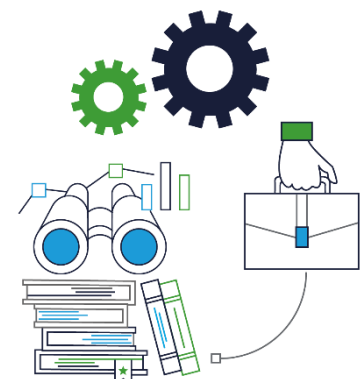
In addition, it was noted that the core attributes of a PE – stability, productivity and dependence were also met by the Appellant since, the long-term duration of the SOSA along with the Appellant’s continuous functional presence and earning Strategic fees which was linked to financial performance satisfies the above.

Keeping the above in consideration, the Hon’ble SC was of the view that the Appellant had pervasive and enforceable control over the hotel’s strategic, operational, and financial areas. The rights vested with the Appellant indicate that it was an active participant in the core operational activities of the hotel, thereby satisfying the ‘Disposal test’ and confirming the existence of a fixed place PE in India.

5.3 Core business vs Preparatory / Auxiliary functions

Considering the nature of functions performed by the Appellant which were beyond advisory functions and extended to substantive operational control and implementation, the Hon’ble SC had a divergent view with that the Appellant merely performed ‘auxiliary’ functions.

It was noted that the functions performed by the Appellant, through its staff operating from the hotel premises, were not just limited for setting up a pattern of activities for the hotel, but were core and essential functions, clearly establishing control over the day-to-day operations of the hotel. Moreover, since such core functions were to be carried out continuously for a period of twenty years and with a profit linked fee, in no manner the Hon’ble SC was in consensus with the Appellant that the hotel premises do not satisfy the criteria required to be classified as a ‘fixed place of business’ in India.



Further, the Hon’ble SC held that the Appellant’s reliance on the decision of *E-Funds (supra)* was misplaced. Unlike in *E-Funds (supra)*, where the Indian entity only provided back-office support without involvement in core functions, in the present case the hotel itself was the situs of the Appellant’s primary business operations, carried out under its direct supervision and aligned with its commercial interests. Hence, the ruling was factually distinguishable.

5.4 Substance over Form under spotlight

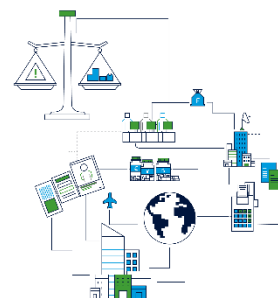
Downplaying the involvement of Hyatt India, the Hon'ble SC emphasized that legal form does not override economic substance in determining the PE status. The extent of strategic involvement, operational control, supervision, influence and decision making carried on by the Appellant together allows "Economic substance" to take the center stage thereby establishing that business of the Appellant was carried on through the hotel premises in India, thus satisfying the conditions of constituting a Fixed Place PE in India under Article 5(1) of the relevant DTAA.

5.5 Continuity of business presence in aggregate

On the basis of the travel logs, job functions and responsibilities carried out by the employees of the Appellant who visited India frequently to implement the SOSA, the Hon'ble SC noted that the length of stay of each individual did not exceed the prescribed limit of nine months as laid under Article 5(2)(i) of the relevant DTAA. However, since there existed continuity of business presence and operations, the period of stay of such individuals is to be seen in aggregate and not the individual duration of each employee's stay, thereby concluding that the intermittent or rotating presence of such employee personnel does not negate the existence of a PE.

5.6 Profit attribution despite Global losses:

The Hon'ble SC upheld the decision of the larger bench of Hon'ble Delhi HC in the Appellants own case³ and held that profits can be attributed to a PE in India even if the foreign enterprise as a whole has incurred losses. The fact that a PE is conceived to be an independent taxable entity cannot be possibly doubted or questioned. This reinforces the principle that taxability under the DTAA is determined based on the existence of a business presence in India, not the consolidated financial profitability of the enterprise.



6.0 Our Comments

- 6.1 The ruling is of paramount importance given the evolving jurisprudence on the PE. Various multinationals across the globe engaged in cross border transactions may now need to proactively reassess, re-evaluate and review not just the business model and service contracts entered but also the actual functions being performed *de hors* what is being mentioned in the paper form.
- 6.2 For PE to be constituted, right of disposal and conduct of business are the core tests. It is not essential to have a designated office space to trigger PE. What now matters is the existence of continuity, control, and business presence in the absence of any physical office setup or exclusive office.

³ *Hyatt International Southwest Asia Ltd vs. ADIT [TS-693-HC-2024(Delhi HC)]*

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This Newsflash summarizes the recent decision of the Apex Court, which affirms that Hyatt International constitutes a Permanent Establishment in India, based on the operational control exercised over its Indian hotels. It may be noted that nothing contained in this Newsflash should be regarded as our opinion and facts of each case will need to be analyzed to ascertain thereof and appropriate professional advice should be sought for applicability of legal provisions based on specific facts. We are not responsible for any liability arising from any statements or errors contained in this Newsflash.

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1 August 2025

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