

EY Tax Alert

Supreme Court rules that continuous and substantive control over operations of Indian entity establishes Fixed Place PE

Executive summary

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This Tax Alert summarizes a two-judge bench Supreme Court (SC) ruling, in the case of Hyatt International Southwest Asia Ltd.¹ (Taxpayer). The main issue under consideration before the SC was whether the activities of the Taxpayer (a Dubai-based company) under a Strategic Oversight Services Agreements (SOSA) entered into with various hotels in India led to the creation of a Fixed Place Permanent Establishment (PE) in India under Article 5(1) of India-UAE Double Taxation Avoidance Agreement (DTAA). Under the SOSA, the Taxpayer provided strategic planning services and know-how to hotels in India to ensure that the hotels were developed and operated as an efficient and a high-quality international full-service hotel.

The SC acknowledged that for determination of existence of a Fixed place PE, there is no standard formula applicable to all cases, and it is a fact-specific exercise, wherein several factors must be evaluated, including the enterprise's right of disposal over the premises, the degree of control and supervision exercised, the presence of ownership, management, or operational authority.

In the facts of the case, having regard to the terms of the SOSA, coupled with the fact that the Taxpayer exercised continuous and substantive control and supervision over the day-to-day operations of the hotels and had disposal over the hotel premises through its employees in India, the SC held that the activities of the Taxpayer established a clear commercial nexus with the hotel's core functions, thereby, resulting in creation of a Fixed Place PE under Article 5(1) of the DTAA. Correspondingly, the SC also ruled that the profits attributable to the PE are required to be determined on the premise that the PE is an independent taxable entity and the Taxpayer will be liable to pay tax on the income attributable to its PE in India even if the overall foreign enterprise has incurred losses.

¹ [TS-954-SC-2025], ruling dated 25 July 2025



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Background

- ▶ The concept of PE is a pivotal concept in international tax law. Under the DTAA, the taxing rights of the source state over the business profits of a foreign enterprise are contingent upon the existence of a PE in the source country. The concept of PE is well defined under Article 5 of the DTAA.
- ▶ In the context of Article 5(1) of India-UAE DTAA, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on. As generally understood, the phrase "fixed place of business" implies a physical location with a certain degree of permanence and geographic nexus, from which business activities of foreign enterprises are conducted.
- ▶ Further, Article 7 of the India-UAE DTAA provides that business profits earned by a UAE resident as is attributable to a PE in India, may be taxed in India.
- ▶ Furthermore, Article 12 of India-UAE DTAA, which deals with royalty taxation, defines royalty to include payment for use or right to use any copyright of a literary, artistic or scientific work, any patent, trademark, design or model, plan, secret formula or process, any industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience etc. It may be noted that income in the nature of fees for technical services (FTS) is not covered by any Article of India-UAE DTAA.

Facts of the case:

- ▶ The Taxpayer, a tax resident of UAE, is engaged in the business of rendering consultancy and advisory services to hotels located across India under the SOSA entered with each hotel owner individually.
- ▶ With respect to the SOSA entered into with hotels located in Delhi and Mumbai, the Taxpayer agreed to provide strategic planning services from Dubai and know-how to ensure that the hotels were developed and operated as efficient and high-quality international full-service hotels.
- ▶ Below were the terms of SOSA:
 - The SOSA was valid for 20 years (extendible by another 10 years through mutual agreement).
 - Hotel shall be operated in accordance with the standards comparable to those prevailing in international hotels operated by the Taxpayer and its subsidiaries. In this

regard, the Taxpayer is required to provide strategic plans, policies, procedures, and guidelines to hotels to ensure adherence to the Hyatt Operating Standards (HOS).

- The Taxpayer is required to formulate policies relating to human resources (aligned with HOS), procurement, guest admittance, use of premises, pricing, sales and marketing, reservations and operating hotel's bank accounts.
- The Taxpayer is required to formulate and establish strategic plans for all aspects of hotel operations, including branding, marketing, product development and daily operations.
- The Taxpayer was vested with powers to identify, recruit and assist in appointing the General Manager and other key personnel as well as temporarily assign (its own or affiliate) employees as full-time executive staff at the hotel without requiring prior approval from the hotel.
- The Taxpayer's executives and employees were entitled to make frequent and regular visits to India to oversee operations and implement the SOSA.
- The Taxpayer was entitled to strategic fees, calculated as a percentage of room revenues, other revenues and income derived from the hotel operations.
- If the hotel owner desires to obtain financial assistance for the construction or refinancing of the hotel, or hotel is to be used as collateral for any borrowing, owner must secure from the lender a non-disturbance and attornment agreement, which must be acceptable to the Taxpayer.

- ▶ Hyatt India Consultancy Pvt. Ltd., an Indian company (I Co), is affiliated to the Taxpayer. Having regard to the Taxpayer's activities in India, Tax Authority held that the payments received by the Taxpayer from Indian hotels under the SOSA were in the nature of royalty under the ITL as well as under Article 12 of the DTAA, as it was related to provision of know-how, skill, experience, commercial information and other intangibles. Further, it held that the Taxpayer constituted a business connection in India under ITL and created a Fixed Place PE under Article 5(1) of the DTAA, as it carried on its business through a fixed place of business - the Hotel. Accordingly, the Tax Authority attributed the service fees received under the SOSA to PE despite the fact that at overall global enterprise level, the Taxpayer had incurred losses during the concerned tax years.
- ▶ Further, the Tribunal confirmed Tax Authority's order by placing reliance on the SC decision in case of Formula One World Championship Ltd.²

² (2017) 15 SCC 602

(FOWC) and held that the Taxpayer had Fixed Place PE in India.

- ▶ Aggrieved by the order of Tribunal, the Taxpayer filed an appeal before the Delhi High Court (HC) wherein the HC ruled that the said payment was not in the nature of royalty. However, the HC upheld the Tribunal's decision that Taxpayer constituted a Fixed Place PE in India. Further, with regard to attribution, the HC referred the matter to a larger bench.
- ▶ Aggrieved by the order passed by the HC with regard to existence of Fixed Place PE under Article 5(1), the Taxpayer filed further appeal before the SC.
- ▶ Thus, the issue before the SC was whether Taxpayer's activities under the SOSA created a Fixed Place PE in India under Article 5(1) of the DTAA?

Taxpayer's contentions:

- ▶ The Taxpayer's role was limited to strategic guidance, brand compliance and long-term planning and it was not involved in the daily management of hotels, which was taken care by I Co under a separate Hotel Operating Services Agreement (HOSA) entered with the Hotel. SOSA and HOSA were entirely independent of each other.
- ▶ For a place of business to be constituted as PE, there must be an affirmative grant of a right to use of a specific physical location to carry on the Taxpayer's own business. There was no designated space or office at the hotel premises which were specifically reserved or placed at the Taxpayer's disposal. Mere involvement of the Taxpayer in policy decisions or enforcement of brand standards will not constitute Fixed Place PE.
- ▶ The SOSA explicitly stipulated that the Taxpayer shall render its services from Dubai and its employees may visit India occasionally and temporarily, merely for ensuring brand uniformity and quality compliance.
- ▶ Further, the service fee earned from hotels is not taxable as FTS as well, as there is no specific article in the DTAA enabling taxation of FTS.

Tax Authority's contentions:

- ▶ The SOSA enabled the Taxpayer to unconditionally access and have full and effective control over the hotel premises.
- ▶ The Taxpayer's role extended beyond high-level policy formulation into the actual implementation. The Taxpayer had pervasive

control owing to its continuous nature of involvement in the management and functional activities of the hotel, particularly through the General Manager (reporting to the Taxpayer), such as appointment and training of staff, monitoring daily operations, exercising financial oversight, and influencing procurement and operational decisions.

- ▶ The Taxpayer had operational presence at the Hotel as some of the Taxpayer's employees visiting the hotel remained in India for up to nine months and were involved in substantial hotel operations.
- ▶ Further, reliance was placed on SC's decision in case of FOWC (*supra*) to contend that the long-term agreement vested the Taxpayer with the right to have broad and continued control over the hotel's key functions, including staffing, operations, strategic policy, and financial oversight, which also reflects the three core characteristics of a PE: stability (20-year term), productivity (fee linked to business outcomes), and dependence (reliance on hotel infrastructure and staff to carry out its business).
- ▶ Further, the SC decision of E-Funds IT Solutions Inc³ is factually distinguishable and hence not applicable to the facts of the present case.

SC ruling:

- ▶ In the facts of this case, the SC upheld HC's decision that the Taxpayer constitutes a Fixed Place PE in India as per Article 5(1) of the DTAA and thus, the income attributable to such PE is taxable in India.
- ▶ The SC highlighted that determination of existence of a Fixed place PE is a fact-specific exercise, wherein several factors must be evaluated, including the enterprise's right of disposal over the premises, the degree of control and supervision exercised, the presence of ownership, management, or operational authority. There is no straight-jacket formula applicable to all cases.
- ▶ In this regard, SC noted that in terms of SOSA, the Taxpayer is vested with powers to:
 - Appoint and supervise the General Manager and other key personnel,
 - Implement human resource and procurement policies
 - Control pricing, branding and marketing strategies
 - Manage operational bank accounts
 - Assign personnel to the hotel without requiring the owner's consent

The above functions suggests that the Taxpayer's role was not confined to mere policy formulation or high-level decision making but

³ (2018) 13 SCC 294

extended to substantive control through implementation of its policies, ensuring compliance and active commercial involvement in all operational and financial aspects of the hotel.

- ▶ Further, the extent of control and supervision exercised by the Taxpayer was not just in advisory/consultancy capacity, rather it extended to various other administrative roles. In other words, the Taxpayer was an active participant in the core operational activities of the hotel and exercised pervasive and enforceable control over the hotel's strategic, operational and financial dimensions.
- ▶ The SC placed reliance on its decision in the case of FOWC (*supra*), wherein the SC held that the circuit where the Formula One (F1) event was held in India was a fixed place and was at the disposal of FOWC through which its business was carried on. Having regard to its decision in FOWC, the SC made following specific observations with regard to the disposal test:
 - Fixed Place PE entails two requirements to be fulfilled: (a) a fixed place of business which is at the "disposal" of the enterprise and (b) the business of the enterprise must be carried on through that place.
 - "Disposal" test means the enterprise must have a right to use the premises in such a way that enables it to carry on its business activities. To satisfy disposal test, possession of exclusive or designated physical space is not essential. A temporary or shared use of space is enough, if business is carried on through that space having regard to the commercial and operational realities of the arrangement.
 - The determination of disposal test may vary based on the nature of business and cannot be applied uniformly to all cases. For instance, to constitute a PE, trading operations may require the existence of a continuous use of fixed place, whereas service-oriented business may not.
 - One should determine in substance whether the place is at the disposal of the enterprise and is used for conducting its core business functions rather than grant of a formal right of use a particular space.
 - Further, SC upheld principles of its decision in FOWC (*supra*) that a PE must demonstrate three key characteristics:
 - (a) Stability;
 - (b) Productivity; and
 - (c) Dependence
- ▶ The SC noted that in the facts of this case, the 20-year duration of the SOSA, coupled with the Taxpayer's continuous and functional presence,

satisfies the tests of stability, productivity and dependence.

- ▶ Further, it held that the length of stay of each individual employee is immaterial for determining PE where there is continuity in the business operations. Once it is found that there is continuity in business operations, presence of employees becomes immaterial.
- ▶ Functions performed by the Taxpayer, through its staff operating from the hotel premises, were not merely "auxiliary" functions as the functions were not limited to setting up a pattern of activities for the hotel but were the core and essential functions which established control over the day-to-day operations of the hotel in India. Moreover, such functions were to be performed for a period of 20 years under a revenue-sharing arrangement.
- ▶ Further, the SC distinguished the following decisions and held that in the Taxpayer's case, hotel itself was the place where core business operations of the Taxpayer were being carried out under its direct supervision in alignment with its commercial interests -
 - In the case of Union of India & Anr. v. U.A.E Exchange Centre⁴, activities carried out in India by a liaison office (LO) were merely in the nature of aid or support to the main activity and were hence preparatory or auxiliary in nature. Accordingly, such presence did not trigger PE.
 - In the case of E-Funds IT Solutions (*supra*), the subsidiary was merely providing back-office support services which enabled parent, in turn, to render services to their customers abroad and no part of the core/main business functions or revenue earning activity of the parent were carried on through a fixed place of business in India. Further, the subsidiary was compensated basis arm's length price.
- ▶ The fact that daily operations of the hotels in India were managed by I Co, which is a separate legal entity, does not decisively support that the Taxpayer does not have a PE in India as one will need to look at the economic substance over legal form. In the given case, the extent of control, strategic decision-making and influence of the Taxpayer indicates that the business of Taxpayer was carried on through the hotel premises.
- ▶ In its concluding remarks, the SC held that the Taxpayer's ability to enforce compliance, have supervision over operations and derive revenue-linked fees established a clear, continuous commercial nexus and control over the hotel's core functions for constitution of a PE.
- ▶ Correspondingly, the SC upheld Delhi HC's decision in Taxpayer's own case⁵ with regard to profit attribution and held that the profits

⁴ (2020) 9 SCC 329

⁵ [2024] 166 taxmann.com 466 (Delhi)

attributable to the PE in India are required to be determined on the premise that the PE is an independent taxable entity and that the Taxpayer will be liable to pay tax on the income attributable to its PE in India even if the overall foreign enterprise has incurred losses.

Comments

The SC has reaffirmed that determination of PE requires functional and fact specific analysis wherein several factors must be evaluated, such as foreign entity's de facto right of disposal as against presence or absence of legal right, the degree of control, supervision and operational authority exercised on the core operational and functional activities. The decision reinforces that PE analysis remains fact specific which is done taking into account the economic substance, commercial and operational realities.

In the present case, various facts on record, such as the Taxpayer's continuous and coordinated presence through its employees, coupled with (i) its steering role in formulating policies related to human resources, (ii) appointment and training of hotel personnel, (iii) marketing strategies, (iv) managing the hotel's bank accounts and (v) direct linkage of taxpayer's income to financial and operational performance of the hotel etc. pursuant to the 20 year-long arrangement, demonstrated satisfaction of the core characteristics of a PE, i.e., stability, productivity and dependence.

Further, noting its earlier rulings, the SC reiterated that merely preparatory or auxiliary functions do not establish a PE. Similarly, an Indian subsidiary providing back-office support on an arm's length basis, without the foreign entity's involvement in core functions, does not trigger a PE for such foreign entity. The SC also noted with approval or upheld the full bench decision in the Taxpayer's case (*supra*), affirming that profit attribution to a PE is determined based on the business presence within the source state, independent of the global profitability of the foreign enterprise.

Businesses may closely evaluate the principles outlined in the SC decision including the earlier SC decisions^[6] while evaluating various business scenarios such as outsourcing activities, presence for preparatory or auxiliary functions etc.

⁶ E-Funds IT Solutions (*supra*) and Morgan Stanley and Co. Inc. [(2007) 292 ITR 416 (SC)]

Our offices

Ahmedabad

22nd Floor, B Wing, Privilon
Ambli BRT Road, Behind Iskcon Temple
Off SG Highway
Ahmedabad - 380 059
Tel: + 91 79 6608 3800

8th Floor, Building No. 14A
Block 14, Zone 1
Brigade International Financial Centre
GIFT City SEZ
Gandhinagar - 382355, Gujarat
Tel +91 79 6608 3800

Bengaluru

12th & 13th Floor
"UB City", Canberra Block
No.24 Vittal Malliya Road
Bengaluru - 560 001
Tel: + 91 80 6727 5000

Ground & 1st Floor
11, 'A' wing
Divyasree Chambers
Langford Town
Bengaluru - 560 025
Tel: + 91 80 6727 5000

3rd & 4th Floor
MARKSQUARE
#61, St. Mark's Road
Shantala Nagar
Bengaluru - 560 001
Tel: + 91 80 6727 5000

1st & 8th Floor, Tower A
Prestige Shantiniketan
Mahadevapura Post
Whitefield,
Bengaluru - 560 048
Tel: + 91 80 6727 5000

Bhubaneswar

8th Floor, O-Hub, Tower A
Chandaka SEZ, Bhubaneswar
Odisha - 751024
Tel: + 91 674 274 4490

Chandigarh

Elante offices, Unit No. B-613 & 614
6th Floor, Plot No- 178-178A
Industrial & Business Park, Phase-I
Chandigarh - 160 002
Tel: + 91 172 6717800

Chennai

6th & 7th Floor, A Block,
Tidel Park, No.4, Rajiv Gandhi Salai
Taramani, Chennai - 600 113
Tel: + 91 44 6654 8100

Delhi NCR

Aikyam
Ground Floor
67, Institutional Area
Sector 44, Gurugram - 122 003
Haryana
Tel: +91 124 443 4000

3rd & 6th Floor, Worldmark-1
IGI Airport Hospitality District
Aerocity, New Delhi - 110 037
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B
Tower 2, Sector 126
Gautam Budh Nagar, U.P.
Noida - 201 304
Tel: + 91 120 671 7000

Hyderabad

THE SKYVIEW 10
18th Floor, "SOUTH LOBBY"
Survey No 83/1, Raidurgam
Hyderabad - 500 032
Tel: + 91 40 6736 2000

Jaipur

9th floor, Jewel of India
Horizon Tower, JLN Marg
Opp Jaipur Stock Exchange
Jaipur, Rajasthan - 302018

Kochi

9th Floor, ABAD Nucleus
NH-49, Maradu PO
Kochi - 682 304
Tel: + 91 484 433 4000

Kolkata

22 Camac Street
3rd Floor, Block 'C'
Kolkata - 700 016
Tel: + 91 33 6615 3400

Mumbai

14th Floor, The Ruby
29 Senapati Bapat Marg
Dadar (W), Mumbai - 400 028
Tel: + 91 22 6192 0000

5th Floor, Block B-2
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E)
Mumbai - 400 063
Tel: + 91 22 6192 0000

3rd Floor, Unit No 301
Building No. 1
MindSpace Airoli West (Gigaplex)
Located at Plot No. IT-5
MIDC Knowledge Corridor
Airoli (West)
Navi Mumbai - 400708
Tel: + 91 22 6192 0003

Altimus, 18th Floor
Pandurang Budhkar Marg
Worli, Mumbai - 400 018
Tel: +91 22 6192 0503

Pune

C-401, 4th Floor
Panchshil Tech Park, Yerwada
(Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 4912 6000

10th Floor, Smartworks
M-Agile, Pan Card Club Road
Baner, Taluka Haveli
Pune - 411 045
Tel: + 91 20 4912 6800

Ernst & Young LLP

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