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India | Tax & Regulatory | For private circulation only | 20 June 2018

Global Business Tax Alert

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AAR holds that it has powers as well as duty to look at all aspects of the questions raised. With regard to the income, AAR held that the Applicant constitutes a PE in India and therefore the fees received is attributable to the PE and hence taxable as business income

Issue no: GBT/15/2018

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Facts

- FRS Hotel Group (Lux) S.a.r.l. (now FRHI Hotels & Resorts S.a.r.l.), [Applicant] is a Company within the FRHI Group incorporated under the laws of Luxembourg. It is the principal operator company of the FRHI Group outside North America and provides services in connection with hotel management and including all services that are necessary for hotel operation, such as establishing hotel standards and policies, sales and marketing, centralized reservations, purchasing and certain other services. The hotel properties managed by the group are operated under brand names – 'Fairmont', 'Raffles' or 'Swissotel'.
- Bengal Ambuja Housing Development Limited [BAHDL], an Indian company has developed and owns a five star deluxe hotel known as Swissotel in Kolkata. It has engaged the Applicant to provide certain services in different phases of hotel development and operation so that the hotel property can be developed and operated as per international standards similar to other Swissotel properties across the globe.
- The Applicant and BAHDL entered into a Centralized Services Agreement [CSA] for rendering the following services:
  - Global reservation services
  - Centralized services
  - Corporate design and construction services
  - Purchasing services
- The Applicant approached the Authority for Advance Rulings [AAR], for determining taxability in relation to global reservation services and purchasing services. However, at a later stage, the Applicant withdrew its question in relation to purchasing services on the plea that the Applicant does not contemplate to provide such services.
- Thus, the only question before the AAR was whether global reservation services would be chargeable to tax in India as royalty or fees for technical services [FTS] under the provisions of the Income-tax Act, 1961 [the Act] or Article 12 of India-Luxembourg tax treaty [the tax treaty].
- The Revenue contended that the CSA contains references to certain other agreements entered into between the Applicant and BAHDL; and thus in order to bring out the modus operandi of the Applicant and to determine the taxability of the given transaction, it is essential that the other agreements also be brought on record.
- The Applicant was of the view that the only question raised before the AAR was regarding the taxability of global reservation services and thus reference to any other agreement is unnecessary. However, the AAR has called for the following additional agreements:
  - Hotel management agreement
  - Centralized services agreement
  - Hotel license agreement
  - Hotel advisory agreement
  - Technical services agreement

- The Applicant has primarily made submissions as to why the income arising from providing global reservation services cannot be taxed in India as royalty or FTS.
- The Revenue has countered the submissions of the Applicant and urged that the primary issue in this case is whether the Indian hotel constituted a Permanent Establishment [PE] in India under Article 5 of the tax treaty.
- The Applicant reiterated that the question raised is only in relation to taxability of the income from global reservation services as royalty or FTS. Therefore, any arguments on the existence of PE should not be adjudicated upon or even considered.

Issue before the AAR

Whether the income from provision of global reservation services would be chargeable to tax in India as royalty or FTS under the Act or tax treaty?

Ruling of the AAR

Whether AAR can give a ruling on the question (i.e. existence of PE), which was not raised in the application

- The AAR has observed that before proceeding on the merits of the issue, it is necessary to first deal with this preliminary issue as to whether it would be justified to give a ruling on the existence of PE in the present application, when the question is limited to the taxability of one single stream of income by way of royalty or FTS.
- The AAR relying on Rule 12 of the Authority for Advance Rulings (Procedure) Rules 1996 observed that the AAR has not only the power, but duty to look at all aspects of the questions set forth, which would enable it to pronounce a ruling on the substance of the questions posed for its consideration.
- The AAR observed that the AAR was formed with the idea of providing certainty and finality to the taxation aspects of the issues raised before it. Therefore, if the ruling is given without having regard to other business operations and streams of income, then the whole exercise of getting conclusive order will become futile. The AAR held that such a compartmentalized approach would be highly unjustified as business operations by their very nature cannot be divided into one or the other sub parts.
- The AAR observed that the question posed before us proceeds on the inherent assumption that there is no PE in India. The AAR further observed that Article 12 of the tax treaty itself provides that where the right, property or information in respect of which royalty or FTS is paid is effectively connected to a PE, then the provisions of Article 7 will apply. Therefore, the AAR has held that the present application does call for an adjudication on the issue of the existence of a PE.

Constitution of PE

- The AAR observed that all the agreements entered into by the Applicant with BAHDL are integrated and cannot be split into one or the other.
- The AAR observed that in order to determine a fixed place PE, the following test laid down by the Supreme Court in the case of Formula One World Championship should be satisfied:
  - 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

Fixed place PE

- The AAR observed that there is no doubt that the Indian hotel is a fixed place. However, whether the said fixed place is at the disposal of the Applicant.

Disposal test

- On the reading of the various agreements, the AAR held that Indian hotel is completely at the disposal of the Applicant. The key observations of the AAR on the agreements, based on which it held that the disposal test is satisfied, are as under:
  - At the very stage of inception, i.e. the construction of the hotel, the Applicant is called upon to oversee the design and construction of the property to ensure that it is compliant with the brand standards of the Applicant.
  - The Applicant is exclusive operator and managing agent of Indian hotel.
  - BAHDL has undertaken that it will not interfere with the Applicant's exercise of the executive authority over the operations and management.
  - Right from the employment of the hotel staff (including the managerial personnel) to taking decisions over capital improvements, every possible operational right stands vested in the Applicant.
  - The Applicant and its contractors shall have the right to access all parts of the hotel to the extent and at the times deemed appropriate by it.
  - BAHDL itself is barred from contacting any hotel staff directly.
  - BAHDL has bound itself to the terms of hotel management agreement for a period of 10 years extendable by another 40 years.
  - Some of the core functions of the operations of the hotel has been outsourced to the Applicant. For the same, BAHDL also arrange for visas, licenses, authorisations for the Applicant, its consultants, employees etc. to carry out such services at the hotel premises.
  - All purchases shall be done through designated vendor of the Applicant.
  - The Applicant has further undertaken to advise BAHDL with all the critical aspects of the hotel operation such as training of staff, preparing of budget, carrying out capital improvements etc. The final decision making power with regard to these aspects of the hotel management are with the Applicant.

Carrying business (wholly or partly) through such fixed place

- The AAR observed that the Applicant is admittedly engaged in the business of operation and management of the hotels.
- The AAR further observed that the Applicant has, in substance, taken over all the important functions in relation to the operation and management of the

  Indian hotel. The Applicant has received fees from each of the agreements. Thus, the Applicant is carrying business through such fixed place in India.
- The AAR has accordingly held that the Indian hotel satisfies all the three tests and does constitute a fixed place PE of the Applicant with respect to these incomes.
- One of the contentions of the Applicant was that it has performed the activities in the capacity of agents of BAHDL and therefore, these activities do not constitute carrying on of the Applicant's business in India and no fixed place PE can be said to exist for the Applicant. The AAR has held that the principal-agent relationship is non-existent in the facts of the case considering the business model under which the Applicant is operating. Further, the final decision in respect of all of the important functions relating to the operation and management of the Indian hotel is in the hands of the Applicant.
- The AAR has held that as the Indian hotel is a fixed place PE of the Applicant, the income earned by the Applicant shall be attributable to the PE and taxable as business income. The AAR has accordingly held that the question of determining the income as in the nature of royalty or FTS becomes academic.

Conclusion

- The AAR based on the various agreements entered into between the Applicant and BAHDL analyzed the substance of the transaction and held that the Indian hotel constituted the PE of the Applicant. Hence, it held that the income received from the Indian hotel is attributable to the PE and therefore chargeable to tax in India as business income.

Source: AAR No. 1010 of 2010 pronounced on 24 May 2018

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