



Article 13 - Capital Gains
Article 14 - Independent Personal Services

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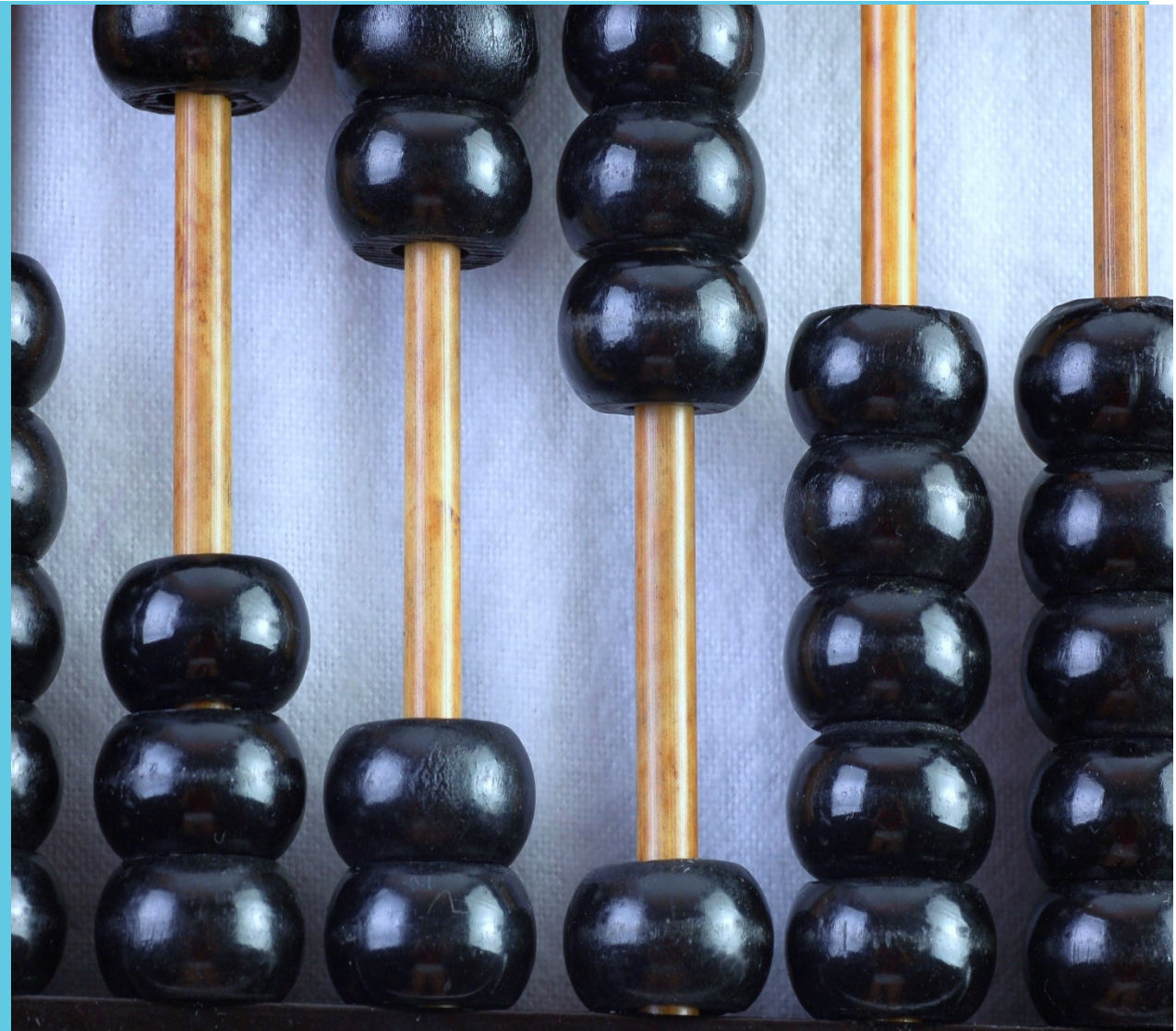
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ARTICLE 13 - CAPITAL GAINS

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WIRC of ICAI: Interpretation of Tax Treaties
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ARTICLE 13 - CAPITAL GAINS

Text of Model Conventions

	UN MODEL	OECD MODEL
1	Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.	Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 and situated in the other Contracting State may be taxed in that other State
2	Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State <u>or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services</u> , including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.	Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that other State.
3	Gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircraft or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.	Gains from the alienation of ships or aircraft operated in international traffic, boats engaged in inland waterways transport or movable property pertaining to the operation of such ships, aircraft or boats, shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

ARTICLE 13 - CAPITAL GAINS

Text of Model Conventions

	UN MODEL	OECD MODEL
4	<p>Gains from the alienation of shares of the capital stock of a company, <u>or of an interest in a partnership, trust or estate</u>, the property of which consists directly or indirectly principally of immovable property situated in a Contracting State may be taxed in that State. In particular:</p> <p><u>(a) Nothing contained in this paragraph shall apply to a company, partnership, trust or estate, other than a company, partnership, trust or estate engaged in the business of management of immovable properties, the property of which consists directly or indirectly principally of immovable property used by such company, partnership, trust or estate in its business activities.</u></p> <p>(b) For the purposes of this paragraph, "principally" in relation to ownership of immovable property means the value of such immovable property exceeding 50 per cent of the aggregate value of all assets owned by the company, partnership, trust or estate.</p>	<p>Gains derived by a resident of a Contracting State from the alienation of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.</p>

ARTICLE 13 - CAPITAL GAINS

Text of Model Conventions

	UN MODEL	OECD MODEL
5	Gains, other than those to which paragraph 4 applies, derived by a resident of a Contracting State from the alienation of shares of a company which is a resident of the other Contracting State, may be taxed in that other State if the alienator, at any time during the 12 month period preceding such alienation, held directly or indirectly at least ___per cent (the percentage is to be established through bilateral negotiations) of the capital of that company.	-
6	Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3, 4 and 5 shall be taxable only in the Contracting State of which the alienator is a resident.	Gains from the alienation of any property, other than that referred to in paragraphs 1, 2, 3 and 4, shall be taxable only in the Contracting State of which the alienator is a resident

ARTICLE 13 - CAPITAL GAINS

Basics

- Article does not define 'capital gains'
- Expression has to be interpreted as per domestic laws
- As per Indian Income Tax Act (IT Act) - Income assessable as 'capital gains' under section 45
 - Gains arising on alienation of a 'capital asset' not being 'stock in trade'
- Article 13 assigns either primary or exclusive right to the state of Residence (R) or state of Source (S)
- Taxing right cannot be invoked in absence of taxing powers under the domestic law
- Article 13 applies to
 - all capital gains, whether Short Term or Long Term
 - all taxes on capital gains whether at normal rates or special rates
- Article 13 not affected by Article 7 - 'Business Profits' and hence independent of whether the alienator has a Permanent Establishment (PE) in state S.

ARTICLE 13 - CAPITAL GAINS

Alienation

- 'Alienation' not defined in Article/Treaty or IT Act
 - Protocol to India-Canada DTAA: term 'alienation' includes 'transfer' within the meaning of IT Act
 - India - Mauritius DTAA: term "alienation" means the sale, exchange, transfer, or relinquishment of the property or the extinguishment of any rights therein or the compulsory acquisition thereof under any law in force in the respective Contracting States
- It includes:
 - Any disposition
 - Sale or Exchange
 - Partial alienation
 - Sale of a right
 - Conveyance or Assignment
 - Giving possession of property in part performance of contract
 - Settlement
 - Gift or Inheritance
- Article 13 Does not cover capital appreciation or revaluation of assets as there is no alienation
 - Commentary on OECD Model Convention (OECD commentary) provides that article applies if such appreciation taxed under domestic laws
- Whether destruction is considered as alienation?

ARTICLE 13 - CAPITAL GAINS

Para (1) - Immovable Property

- Applicable in case of alienation by a resident of state R of an immovable property situated in state S
 - Immovable property referred to in Article 6
 - Includes other assets such as property accessory to immovable property, rights to which provisions of general law respecting landed property apply, etc.
 - Immaterial whether property is commercial or residential
- Right to tax granted to state S
- State S to decide whether to tax such capital gains
- Domestic law of state S to determine how to compute and how much to tax
- Does not apply to:
 - Alienation of immovable property in state R or a third state
 - Alienation of shares of Company deriving its value principally from immovable property
- Plain reading suggests that Article 13(1) would also apply to immovable property forming part of the assets of PE and immovable property pertaining to operation of ships or aircrafts (like office premises)

ARTICLE 13 - CAPITAL GAINS

Para (2) - Movable Property of PE

- Applicable in case of alienation of:
 - Movable property forming part of the business assets of PE in state S
- Right to tax granted to state S
- Expression 'movable property' is not defined
 - Generally understood to include property which does not qualify as 'immovable property'
 - Certain specific exclusions (Eg ships) provided by Article 13(3)
- Does not apply to :
 - Alienation of Stock-in-trade
 - Movable property of establishment in India used only for preparatory and auxiliary activities
- Plain reading suggests Article 13(2) may apply to movable property of PE located in a third state
- OECD commentary states that if the whole enterprise is alienated, Article 13(2) applies only to movable property which is part of business property of PE
- UN Model additionally covers capital gains on:
 - Movable property pertaining to a fixed base available to a resident of state R in state S for performing Independent Personal Services

ARTICLE 13 - CAPITAL GAINS

Para (3) - Ships, Aircrafts or Boats

- Applicable in case of alienation of:
 - Ships or aircrafts operated in International traffic
 - Boats engaged in inland waterways transport
 - Movable property pertaining to the operation of such ships, aircrafts or boats
- Right to tax granted to state where 'place of effective management' of enterprise is situated
- No definition for 'place of effective management'
- Article 13(3) and not Article 13(2) would apply in case of alienation of movable property relating to operation of ships, aircrafts or boats

ARTICLE 13 - CAPITAL GAINS

Para (4) - Shares/Interest in Immovable Property Entity

- Applicable in case of alienation of:
 - Shares of Company deriving more than 50% of their value (directly or indirectly) from immovable property situated in state S
- Right to tax granted to state S, where the property is situated
- Does not apply to debentures, bonds or other assets
- Intended to prevent tax avoidance in situations where capital gains on alienation of immovable property is sought to be evaded through creation of structures
- Applicable on entire value on alienation of shares, etc even if part of the value is derived from assets other than immovable property
- Applicable irrespective of: Types of shares (equity, preference or otherwise), % of holding, Listing status of shares, Mode of alienation, Exemption available to alienator in state R, Status of residence of Investee (company, firm or trust)
- UN Model expressly applies to interest in Partnership, trust or estate where property consists 'principally' of immovable property situated in state S
- UN Model excludes entities using immovable property in their business activities (exclusion not applicable to property management company)

ARTICLE 13 - CAPITAL GAINS

Para (5) of UN Model - Participation Interest

- Applicable to alienation of:
 - Shares in a company (other than those covered by Para 4)
 - If participation interest exceeds specified %
- Right to tax granted to state of residence of the Investee Company whose shares are being alienated
- Applicable only to shares, other securities not covered
- State of execution of documents irrelevant

ARTICLE 13 - CAPITAL GAINS

Para (6) of UN Model & Para 5 of OECD Model - Residual Para

- Applicable to alienation of:
 - Property other than those referred to in other paragraphs of the Article
- Right to tax granted to the state where the alienator is resident (state R)
- Does not apply to:
 - Distribution on liquidation or reduction
 - Premium on redemption of bonds, debentures, etc if taxable as 'Interest'
 - Alienation of shares received on exercise of Employee stock options
- Applicable irrespective of
 - Location of property
 - Beneficial ownership of property
 - Status of taxation in state R
 - Date of acquisition/period of holding of Property
 - Source of funds used for acquiring property

ARTICLE 13 - CAPITAL GAINS

Some Salient Features of Tax Treaties Entered into by India

- India - Mauritius Tax Treaty
 - Circular No 789 dt 13.04.2000 -Tax Residency Certificate (TRC) issued by Mauritian Authorities shall be accepted by Indian Authorities for ascertaining residential status for the purpose of taxation of Capital Gains
- India - Singapore Tax Treaty
 - Capital gains arising to resident of Singapore from sale of shares/property in India are taxable only in Singapore.
 - LOB clause to prevent misuse of exemption from Indian tax by residents of third countries:
 - Primary test- No benefit of capital gains exemption if primary purpose for company's establishment is to obtain capital gains exemption
 - Secondary test - companies (referred to as 'shell' companies) that have no or negligible business operations, or with no real or continuous business activities in Singapore, would not qualify for the capital gains exemption under the treaty
 - Singapore company would not be a shell if :
 - listed on recognised stock exchanges of India or Singapore, or
 - total annual expenditure on operations in its state of residence is equal to or more than S\$ 200,000 or Rs.50,00,000, as the case may be, in the 24 months immediately before the date its capital gains arise.
- India - US & India - UK Tax Treaties
 - Each contracting state may tax capital gains in accordance with domestic tax laws

ARTICLE 13 - CAPITAL GAINS

Some Issues

- Conversion of capital asset into stock-in-trade - whether covered?
- Different classification as per Domestic Law provisions : Taxed by state R as Capital Gains and by state S as Business Income
- If transfer due to gift results in tax liability for recipient - whether covered by this Article?
- Indirect Transfer of Shares - Whether taxed as alienation of shares under Article 13(4/5) or as alienation of other property under Article 13(6)
- Should amount received subsequently (decided at a future date on happening of certain event) in excess of initial consideration be taxed as Capital Gains or Other Income?
- Transfer of intellectual property viz 'brand name' - brand value generated in India but legal documents pertaining to brand name transferred outside India
- Tax Credit - Year 1 -Resident of Country X emigrates to Country Y : tax on capital appreciation of property situated in Country X. Year 5 - Resident of Country Y - sells property in Country X. Can taxes paid in Year 1 be claimed as credit against tax liability of Year 5?
- Taxability if there is no article on Capital Gains in DTAA?
- Article 13(4) - value of assets to be seen on which date - date of sale/last audited figures/some other date?

ARTICLE 14 - INDEPENDENT PERSONAL SERVICES

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ARTICLE 14 - INDEPENDENT PERSONAL SERVICES

Text of UN Model

	UN MODEL
1	<p>Income derived by a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State except in the following circumstances, when such income may also be taxed in the other Contracting State:</p> <p>(a) If he has a fixed base regularly available to him in the other Contracting State for the purpose of performing his activities; in that case, only so much of the income as is attributable to that fixed base may be taxed in that other Contracting State; or</p> <p>(b) If his stay in the other Contracting State is for a period or periods amounting to or exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned; in that case, only so much of the income as is derived from his activities performed in that other State may be taxed in that other State.</p>
2	<p>The term "professional services" includes especially independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.</p>

ARTICLE 14 - INDEPENDENT PERSONAL SERVICES

Basics

- Covers taxability of professional services and other services of independent character
- Excludes
 - Industrial and commercial activities (covered by Article 7 - Business Profits)
 - Services performed by an Employee (Article 15 - Dependent Personal Services)
 - Independent activities covered by more specific provisions (Article 16 - Directors & Article 17 - Artists, Sportsmen, etc)
- Income from Professional Services are generally taxable in the state of Residence (R) of the service provider.
- However, these services may be taxable in the state of Source (S) in the following situations:
 - Attributable to Fixed Base: Where the service provider has a fixed base regularly available to him for the purpose of performing his activities
 - Minimum Period of Stay: Where the service provider has stayed in the Country of Source for minimum period (the period is treaty specific - varies from 183- 90 days)
- In cases of overlaps Article 14 prevails over Article 7

ARTICLE 14 - INDEPENDENT PERSONAL SERVICES

Para (1)(b) - Fixed Base

- Fixed Base not defined in Article/ Treaty of IT Act
- Analogous to Fixed Place PE defined under Article 5
 - There must be a place of business
 - Individual must have a certain right of use to the place of business
 - Use of place of business must last for a certain period of time
 - Activities performed through the place of business must be a business activity and such activities should constitute the core activities

Fixed Base	No Fixed Base
Office of an architect / lawyer	Consultant visiting another state only to attend Board Meetings
Physician provided with a consulting room twice a week in a hospital	Consultant visiting clients premises in connection with some contractual arrangement and not 'professional services'
Definite space in an office of an associate	Temporary camping by a researcher at a base camp
A lawyer exercising profession from second home in another state	

- Such Fixed Base must be regularly available for performance of services, no stipulation that Fixed Base is regularly used
- State S can tax income from professional services only to the extent of income attributable to such fixed base
- Income attributable to Fixed Base may be taxed in state S even after the fixed base is no longer available

ARTICLE 14 - INDEPENDENT PERSONAL SERVICES

Para (1)(a) - Minimum Period of Stay

- Professional Services may also be taxed in state S if:
 - Stay in state S is for a period of 183 days or more in a 12 month period; and
 - Such 12 month period commences or ends in the fiscal year concerned
- Once 183 days in 12 month period satisfied, it does not matter how small the stay is in the fiscal year concerned
- Plain reading suggests that stay for all purposes, professional or personal is to be aggregated
- Man Days v Solar Days
- Once the 183 days test is satisfied, the effect is to virtually take the taxpayer out of the Treaty, the taxability of the income to be determined under section 9(1)(i) of the IT Act
- State S can tax Professional services only to the extent derived from activities performed in state S

ARTICLE 14 - INDEPENDENT PERSONAL SERVICES

Para (2) - Professional Services

- Professional Services include:
 - Independent scientific, literary, artistic, educational or teaching activities
 - Independent activities of physicians, lawyers, engineers, architects, dentists and accountants
 - Other services of independent character
- Inclusive definition
- Services performed personal in nature and of independent character
- Income from Employment is excluded
- Vocation requiring intellectual skill dependent on individual characteristics of a person and requiring knowledge of some stream of science or education

ARTICLE 14 - INDEPENDENT PERSONAL SERVICES

Other Aspects

- Applicability to non-individuals
 - India -US Treaty: an Individual or a firm of individuals
 - India - UK treaty: an Individual whether in his own capacity or as a member of a partnership
 - India - Singapore treaty: an Individual
 - India - Netherlands / India -Japan: All residents including a company which provides professional services
- Professional Services (Article 14) vs Technical Services (Article 12)
 - Most treaties exclude Independent Personal Services from scope of Article 12 - Fees for Technical Services
 - Even in absence of specific exclusion, specific overrides general and so Independent Personal Services cannot be taxed as Fees for Technical Services
- Deduction of Expenses
 - Article 14 taxes 'net income' computed after deduction of relevant expenses
- Method of Accounting
 - In absence of specific provision, the provisions in domestic law for method of accounting (Eg Sec 145), etc would apply

RECAP

Article 13 & Article 14

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ARTICLE 13 & 14

Recap

- **Article 13 - Capital Gains arising from alienation of:**
 1. Immovable Property : Taxable in the state where the Immovable Property is situated
 2. Movable property forming part of the business property of PE in state S: Taxable in the state S
 3. Ships, Aircrafts or Boats: State where Place of Effective Management is situated
 4. Shares/Interest deriving value from Immovable Property : Taxable in the state where the Immovable Property is situated
 5. Shares exceeding specified % of Participating Interest : Taxable in the state where the Investee Company is resident
 6. Residual Property not covered above : Taxable in the state of residence of the alienator
- **Article 14 - Independent Personal Services**
 1. Professional Services or other activities of an independent character taxable in the state of residence, state of source may tax:
 - Income attributable to Fixed Base regularly available to taxpayer for the purpose of performing his activities
 - Income derived from activities performed in state S where minimum period of stay exceeds specified number of days (from 183-90 days)
 2. Professional Services include:
 - Independent scientific, literary, artistic, educational or teaching activities
 - Independent activities of physicians, lawyers, engineers, architects, dentists and accountants
 - Other services of independent character

THANK YOU

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