

# Independent Personal Services & Dependent Personal Services

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# Article 14 – Independent Personal Services

# Article 14 of the UN Convention

- 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 Contracting State except in one of the following circumstances, when such income may also be taxed in the other Contracting State:
  - (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;
  - (b) if his stay in the other Contracting State is for a period or periods exceeding in the aggregate 183 days in the taxable year concerned ; in that case, only so much of the income as is derived from his activities performed in that other Contracting State may be taxed in that other Contracting State.
- 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

OECD Deleted this article w e f the year 2000

# General Overview - IPS

## Inclusions

- Article covers independent activities involving skills – most commonly, Professional skills
- Normally covers services rendered by individuals - in case of DTAAAs like Australia, UK, USA etc. firms also covered

## Exclusions

- Industrial and commercial activities – covered in Article on Business Profits”
- Professional services while in employment – covered in article on Dependent Personal Services
- Income of Artistes, Athletes and Sportsman etc. not covered. Fee for Technical Services also not covered

# Key conditions for taxing income under Article 14

Criteria	Conditions
Right of Source country to tax the income if the following conditions are satisfied	<ul style="list-style-type: none"><li>• The fixed base is regularly available in the source country to the recipient of income for the purpose of performing his activity</li><li>• So much of the Income that is attributable to fixed base</li></ul>
Physical stay criteria	<ul style="list-style-type: none"><li>• If the recipient of the Income is present in source country for more than 183 days in the period of 12 months</li><li>• Period of 12 month is rolling period (earlier Fiscal Year) – most Indian DTAA do not have rolling period concept</li><li>• Different criteria for no. of days stay in different DTAAs</li></ul>
Any other criterion	<ul style="list-style-type: none"><li>• Remuneration exceeding certain specified amount</li><li>• Exists in very few Indian treaties – Canada, Jordan, Malaysia</li></ul>

# Article 14- Understanding of Key Terms

Key terms	Understanding
Derived From	The words “derived from” have to be understood in their ordinary meaning which is “get or trace from a source; arise from, originate in; so the origin or formation of”
Professional	General attributes of “Professional” <ul style="list-style-type: none"><li data-bbox="730 824 1850 927">• An advanced level of knowledge acquired through formal training in the chosen practice area</li><li data-bbox="730 938 1766 1040">• Specialized skill sets and experience acquired through dedicated practice in the chosen and</li><li data-bbox="730 1052 1871 1154">• Accreditation to a certificate of practice issued by a relevant professional body</li></ul>

# Article 14- Understanding of Key Terms

Key terms	Understanding
Professional Services and other services of independent character	<ul style="list-style-type: none"><li>• The definition is an inclusive definition</li><li>• The term includes especially:<ul style="list-style-type: none"><li>- Independent scientific, literary, artistic, educational or teaching activities; as well as</li><li>- The independent activities of physicians, lawyers, engineers, architects, dentists and accountants</li></ul></li></ul> <p>The said term excludes;</p> <ul style="list-style-type: none"><li>• Industrial or commercial activities</li><li>• Services performed by an employee, who is covered by Art 15 (Dependent Personal Services)</li><li>• Independent activities which are covered by more specific provisions of Art 16 and 17 (eg non-employee director, artistes and sportsmen, etc)</li><li>• Payments to an enterprise in respect of services of employees or other personnel</li></ul> <p>What can be covered under “other services of independent character”</p> <ul style="list-style-type: none"><li>• Distinguishable from business profits</li><li>• Should be service</li><li>• Be similar to professional services</li></ul>

# Article 14- Understanding of Key Terms

Key terms	Understanding
Fixed Base	It denotes a center of activity (place) having a fixed or permanent character and in broad terms, implies a place from where a person can conduct his independent professional activities
Fixed Base vis-a-vis PE	<p>Distinction from PE</p> <ul style="list-style-type: none"><li>• While the term “permanent establishment” is elaborately defined under Art 5, the term “fixed base” is not defined.</li><li>• Sometimes, a PE might require a greater degree of permanence as compared to a fixed base</li><li>• The expression “base” is narrower than a “place of business”</li><li>• As against a PE, the place from where the profession is performed (in order to constitute a “fixed base”) does not need to be especially equipped for the performance of the activity</li><li>• A PE under Art 5(1) is constituted only if a business is actually carried on in a fixed place of business; however, there is no such stipulation in relation to a “fixed base”</li></ul>



# Fixed Base - Illustrations

Fixed Base	No Fixed Base
Office of an Architect/Lawyer.	Auditor provided room at client's place to perform Audit.
Physician provided consulting room twice a week by polyclinic.	Random desk made available to the manager.
Definite space in office of an associate.	Temporary camping by a researcher at base camp in Himalayas.
A Lawyer exercising profession from second home in another state.	

# Case Study

A Ltd was engaged in development and sale of software. It paid certain amount to one of its director 'B', a resident of Switzerland, as export commission on sale of software. B was not only responsible for sale of software but he had to ensure that necessary modifications were carried out in software to make it suitable to requirements of customers. B was operating from the premises of A Ltd. Whether the remuneration paid to B would fall within the purview of 'Independent Personal Services'.

Yes – Since the office of A Ltd i.e. fixed base was available to B to carry on the activities.

(ITO v. Device Driven (india) Prrivate Ltd (159 TTJ 1)(Cochin tribunal)

# Key Issues

- **Does the word “he” suggests only individual are covered?**
  - No – unless specific restriction exists
- **Can non – individuals render professional services ?**
  - Yes, DTAA with Australia, UK, USA covers firms
  - MSEB v/s DCIT – 90 ITD 793 – Article 14 can apply to non-individuals including companies
- **Company / Other forms of corporate bodies**
  - Cannot render services which can be regarded as “Personal”. Fees received by corporate are industrial and commercial profit – 39 ITD 355
- **How to count number of days presence?**
  - Man-days; and no multiple counting of same day if more than one person is present ( Clifford Chance ruling)

# Comparison of Articles

## **Article 14 v Article 12 (Professional fees versus FTS)**

- In case treaties exclude income covered under Article 14 from the purview of Article 12
- In such cases, if at all the amount is chargeable to tax in State S, it can only be under Article 14 and hence to that extent provisions of Article 12 (FTS) and Article 14 are non-competing and mutually exclusive
- In case wherein Article 12 does not expressly exclude from its purview income covered under Article 14
- In such cases, it has been held that Article 14 overrides Article 12 by applying the principle that if a case falls under more beneficial provisions of a treaty (Article 14) then it would be futile to stretch the interpretation to bring it under some other provisions of the treaty (Article 12)

# Comparison of Articles

## **Article 14 v Article 17**

- Article 17(1) starts with the words “Notwithstanding the provisions of Articles 14 and 15”. Hence, Article 17(1) overrides Article 14 and 15. Consequently, foreign artistes and sportspersons who are otherwise exempt in State S under Article 14/15 may be taxed under Article 17(1) in State S. However, income which is not attributable to performances or appearances is obviously taxable under Article 14 or Article 15, as appropriate.

## **Article 14 v Article 21**

- If Article 14 is not attracted, then there is no question of applicability of the residuary article (Article 21)

# Other Issues- 183 days test

- Physical presence irrespective of time spent on activities
- Include : Day of arrival; day of departure; holidays; vacations in India; voluntary or involuntary interruptions, short breaks, etc.
- Exclude : Days outside India even while on duty; training outside India in connection with Indian duty; off period leave etc.

# Questions

Question 1:

5 partners of a partnership firm visit State S at the same time for 40 days, presence in State S is considered for;

A)40 days

B)200 days

C)Any other

Answer – 40 days

# Questions

## Question 2

Whether a fixed base as contemplated under Article 14 would be deemed to exist in the following cases:

A) An independent consultant provides independent professional services to a company from State R and also visits State S to attend board meetings of the company as its non whole time additional director.

B) A foreign consultant merely visits client's premises in connection with some other contractual arrangements and not in connection with "professional services"

## Answer

No fixed base in both cases – Consultant is acting in independent capacity



# Judicial Precedents

- MSEB v/s DCIT – 90 ITD 793 (Mum) – elaborate explanation of professional services
- Graphite India v. Dy.CIT: 86 ITD 384
  - A profession will imply any vocation carried on by an individual, or group of individual, requiring predominantly intellectual skills, dependent on individual characteristics of the person (s) pursuing that vocation, requiring specialized and advanced education or expertise
- It is possible that characterization of income would encompass IPS as well as FTS
  - Same under the Act – Ess Vee Intellectual Property Bureau (supra)
  - Specific would override the general

# Article 15 – Dependent Personal Services

# Dependent Personal Services [Article 15(1)]

## Article 15(1)

*"Any salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived there from may be taxed in that other State."*

Salaries, wages and other similar remuneration includes benefits in kind received in respect of an employment (e.g. the use of a residence or automobile, health or life insurance coverage and club membership).

Employment exercised is the place where the employee is physically present when performing the activities for which the employment income is paid.

# Dependent Personal Services [Article 15(1)]

Income from dependent personal services is taxable exclusively in the state of residence.

If an employment is exercised in the other contacting state, however, the state of employment has the primary right to tax income (place of work principle) - only exception is in case the conditions under **Article 15(2)** are met.

The question of taxation in the country of residence is left open. Whether that state should exempt or allow the credit of taxes paid in the state of source depends on Article 23A or 23B.

# Dependent Personal Services [Article 15(2)]

*Remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State, if :*

*(a) the recipient is present in the other State for a **period or periods not exceeding in the aggregate 183 days** in the relevant taxable year ;*

*(b) the remuneration is **paid by, or on behalf of, an employer who is not a resident** of the other State ; and*

*(c) the remuneration is **not borne by a permanent establishment or a fixed base or a trade or business** which the employer has in the other State*

# Income-tax Act, 1961 (“the Act”) Section 10(6)(vi)

*The remuneration received by him as an **employee\*** of a foreign enterprise for services rendered by him during his stay in India, provided the following conditions are fulfilled—*

*(a) the foreign enterprise is **not engaged in any trade or business in India**;*

*(b) his stay in India does not exceed in the aggregate a period of **ninety days in such previous year ; and***

*(c) such **remuneration is not liable to be deducted from the income of the employer chargeable under this Act***

*\*Employee should not be a citizen of India*

# Article 15 - Dependent Personal Services – UN Model

Article 15 of the UN Model states as follows:

- 1) “subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State”.
- 2) “Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:
  - a) The recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned, and
  - b) The remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and
  - c) The remuneration is not borne by a permanent establishment which the employer has in the other State.”

# Short stay exemption (Treaty v Act) – Important Points

- Physical presence in India should not exceed the stipulated number of days during the stipulated period (definition of "period" vary from Treaty to Treaty). However, the Act specifically states the previous year.
- Citizenship is not a criteria in treaty as compared to 10(6)(vi) of the Act.
- To claim exemption under treaty one has to be a resident in home country.
- Period 183 days vis-a-vis 90 days under the Act.
- Conditions for claiming exemption vary from Treaty to Treaty.



# Short stay exemption

The conditions to be fulfilled for claiming short-stay exemption under the Treaty vary from Treaty to Treaty. Few examples:

## Indo-US:

- 183 days in the **relevant tax year**
- Salary paid by employer who is NR in India
- Remuneration not borne by PE

## Indo-Australia:

- 183 days in the **year of earning** income in India
- Salary paid by employer who is NR in India
- Remuneration not **tax deductible** while computing profits of PE/fixed base in India ion **not borne by PE**

## Indo-Swiss:

- 183 days in any 12 month period commencing or ending in the **fiscal year concerned**
- Salary paid by employer who is NR in India Remuneration **not borne by PE/fixed base**

# Short stay exemption: Analysis of first condition

***Time period may not be exceeded “in any twelve month period commencing or ending in the fiscal year concerned”.***

A formulation that creates difficulty when the fiscal years of contracting states do not coincide and which opened opportunities in the sense that, for example, worker stayed in the state concerned for last 5-1/2 months in one year and the first 5-1/2 months of the following year. The present wording of subparagraph a) does away with such opportunities for tax avoidance.

In applying that wording, all possible periods of twelve consecutive months must be considered ,even periods which overlap others to certain extent.

Question:

Mr X is present in state A for 150 days during the period 1st April 2009-2010, but present for 200 days during the period 1st August 2009 till 31st July 2010.

*Answer*

*Since the employee is present in state A for more than 183 days – short stay exemption not available for FY 2009-2010*

# Question

PQR Co. a US Company sends Mr. X to India on deputation to meet its clients. X would be in India from 20 October 2010 to 1 September 2011. X is expected to stay in India all along during this time.

Analyze the possibility of short stay for X considering that-

- a. Mr. X is a US resident
- b. Mr. X is a Swedish resident
- c. Mr. X is not a resident of any state

Answer

- a. Short stay exemption is available since presence is less than 183 days during fiscal year concerned.
- b. Short stay exemption not available since presence is more than 183 days during 12 months period.
- c. DTAA not applied and hence short stay not available

# Short stay exemption – Analysis of first condition

A Corp sends its employee John to its Indian subsidiary for 4 months to analyze the research results conducted by the subsidiary. John is required to submit his report within 5 months to A Corp. His remuneration would be paid by A Corp. In India, the Indian subsidiary provides John with accommodation and car during his India tenure.

Can Short stay exemption be availed?

Answer

Short stay exemption not available since the accommodation cost and car expenses are borne by A Corp

# Short stay exemption: Non Resident employer

## Economic Employer:

- Responsibility or risk for the results produced by the individual,s work;
- Authority to instruct the individual;
- Control and responsibility for the place at which work is performed;
- The cost of the remuneration paid to an individual;
- Provision of Tools and materials necessary for the work;
- Determination of the number and qualifications of the individuals performing the work

# Short stay exemption: Non Resident employer

## Question

XYZ & Co. is a tax resident of USA. The project office in UK sends Philip to India for a period of one month for business meetings with suppliers. Philip is a tax resident of UK while the project office is not treated as a resident of UK.

Would this jeopardize the short stay exemption in India for Philip?

## Answer

Short stay will be available under UK treaty.

# Short stay Exemption: Analysis of Third condition

*The phrase “**borne by**” must be interpreted in the light of the underlying purpose of subparagraph c) of the Article, which is to ensure that the exception provided for in paragraph 2 does not apply to remuneration that could give rise to a deduction, having regard to the principles of Article 7 and the nature of the remuneration, in computing the profits of a permanent establishment situated in the State in which the employment is exercised.*

Employer has, or has not, actually claimed a deduction for the remuneration is not necessarily conclusive.

# Judicial Precedents (borne by PE)

## **Ensco Maritime Ltd v DCIT [91 ITD 459]**

- PE was taxed on presumptive basis.
- Remuneration paid to employee who have rendered services have direct and proximate connection with business receipts of the PE.
- The third condition under article 16(2)(c) of India – USA treaty has not been fulfilled.

## **CIT v. Elitos S.P.A [280 ITR 495]**

- The funds available in India were very meager and were not sufficient to meet the remuneration of employee.
- The third condition under article 16(2)(c) of India – USA treaty was fulfilled.



# Judicial Precedents (borne by PE)

## **Lloyd Helicopters International P Ltd(2001)249ITR162(AAR)]**

- Employer has been assessed on a presumptive basis (i.e., where taxable profits are determined at a fixed percentage of gross receipts ) PE is deemed to be taxed on presumptive basis.

## **DHV Consultants BV(2005) 277 ITR 97(AAR)**

- Employer is assessed on a gross basis at concessional tax rate for fees for technical services/royalties
- In both these situation it was held that Test of “deductibility“ is met and remuneration is regarded as “borne” by a PE.

# ESOP

- ESOP given by foreign holding companies to employees of Indian subsidiary are taxable
- Indian employee receives ESOPs – migrates abroad – exercises/encashes after he becomes NR
- Reverse case – Foreign employees who come to India and then sale the shares
- Article 15 permits taxation in the country of source – to the extent of appreciation till exercise of ESOPs

# Case Study

GM Co. a US Company sent X to India to meet customers for its fertilizer exports to India. X would be in India for around 5 months. During this time he would be primarily meeting the fertilizer importers in India, addressing their concerns and obtaining feedback on the products. However he may also for a few times visit the branch office of GM Co. which deals in imports of engineering equipments to India. Many of his meetings may also be scheduled in the premises of the branch. The branch may also be required to arrange for his travels in India and stay at some places.

During this time, X would be an employee of GM Co. USA and his remuneration would be borne by USA.

GM has requested your opinion on whether X would be eligible for a short stay in India?

Answer

Short stay exemption is available. Travel expenses may not be regarded as remuneration income.

# Case Study

Mr Y was a permanent resident of Japan. He was employed with a Japanese company 'S'. By virtue of a collaboration agreement dated 14-12-1992 entered into between 'S' and an Indian company Mr. Y was deputed to India to offer guidance and technical assistance to the Indian company.

During the relevant previous year, Mr. Y worked in India for 273 days. For that period, Mr. Y received salary from 'S' in Japan. Mr. Y was in addition provided rent free accommodation by the Indian company.

Whether the salary earned by My Y is subject to tax in India

Answer

No. In this case, the provisions of the Act (he is not ordinarily resident) are more favourable than the provisions of the India-Japan tax treaty.

(CIT v. Sakakibara Yutaka) (210 Taxman 286)

# Case Study

ORR Co. is an Indian multinational company dealing with a wide range of products. It has a US branch dealing in hardware equipment. This branch sends Y to India to develop a new customer base for its new hardware equipment. Y needs to meet up with customers and explain the use and benefits of this new design. Orders would be required to be placed directly with the US branch office on the internet by the customers.

The cost of remuneration of Y would be borne by ORR USA. There would not be cross charge of costs to India. Further all stay and travel arrangements for Y would be arranged through USA though the Indian company may need to help if there is an inadvertent contingency. Y would be in India for around three months-

ORR USA has requested your opinion on whether Y would be eligible for a short stay in India?

Answer

Short stay exemption is available.

# Do's and Don'ts

Always	Never
Determine the residency of the assignee in India based on factual stay information	Work and conclude on assumptions
Obtain work profile of the employee on deputation	Proceed without first examining the relevant treaty provisions
Ascertain what are the costs borne by the local company	Confirm short stay without checking facts thoroughly
Obtain written confirmation from the overseas company on the short stay conditions	
Obtain written confirmation on- <ul style="list-style-type: none"> <li>• Residency of the individual in that state</li> <li>• Whether he would be charged to tax on global income</li> <li>• Whether he would be regarded as a tax and treaty resident of that State</li> </ul>	

# Short stay confirmations

- Stay Details – Copy of Passport
- Visa – A business visa is ideal
- Work Profile – Assignment letter and work order
- Residency confirmation
- Overseas Tax return
- Certificate for short stay conditions met - Overseas company as well as Indian Company

# Q & A



Thank you