# Article 14- Independent Personal Services (IPS)

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# Evolution of IPS

- Austria- Germany treaty in 1922
- Draft Model Tax Convention of OECD, 1963
- Found Place in the 1977 OECD Model Convention

| OECD MC | UN MC |
|---|---|
| Deleted in 2000 for the following reasons: *(i) there were no intended differences between the concepts of permanent establishment, as used in Article 7, and fixed base, as used in Article 14, or between how profits were computed and tax was calculated according to which of Article 7 or 14 applied. In addition, it was not always clear which activities fell within Article 14 as opposed to Article 7!“*<br><br>(ii) Article 3(1) (h)- the term ‘business‘ covers professional services | • UN Model -2011 discussed about deletion, but then majority decided against.<br>• <u>The provision contained in 14(1)(b) should be transposed into Article 5 as Article 5(3)(b)] - Period of stay criteria vs Service PE clause</u> |

# UN Model -2021 - **Article 14**

1. 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:

(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

(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. – **[UN MC Specific]**

2. 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.

# Overview of IPS

- Article covers independent activities involving skills – Exportation of Skills – most commonly known as Professional skills
- Normally covers services rendered by Individuals (Personal Services) – There are some exceptions
- Derived by – ordinary meaning to be adopted – to get a trace from a source or originate in **(Clifford Chance ruling)**
- Suggests ‘Principal to Principal’ relationship
- On a plain reading it combines the effect of Article 5 and 7
- Excludes industrial and commercial activities – covered in Article 7
- Also excludes professional services while in employment – covered in article on Article 15 (Dependent Personal Services)
- Income of Artistes, Athletes and Sportsman etc not covered – dealt in Article 17
- Example – Performance of Dance by an artist in foreign territory

  – Producer / Director – Article 7/14; Artist – Article 17; Choreographer – Article 14

# Illustrative Treaty Example

**India US Treaty – Article 15**

"Income derived by a person who is an individual or firm of individuals (other than a company) who is a resident of a Contracting State from the performance in the other Contracting State of professional services or other independent activities of a similar character shall be taxable only in the first-mentioned State except in the following circumstances when such income may also be taxed in the other Contracting State:

(a) *if such person 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 their income may also be taxed in that other State; or*

(b) *if the person's stay in the other Contracting State is for a period or periods amounting to or exceeding in the **aggregate 90 days** in the relevant taxable year. The term "professional services" includes independent scientific, literary, artistic, educational or teaching activities as well as independent activities of physicians, surgeons, lawyers, engineers, architects, dentists and accountants."*

# Interpretation

- IPS normally taxable only in the Resident State of that person

India can tax US Resident in respect of **Professional Services** rendered in India if:

- US Resident has a **Fixed Base** regularly available to him in India **(Fixed Base Test) (OR)**
- US Residents period of stay in India is more than **90 days** in the relevant financial year.

# Scope- Definition of Services

- Inclusive definition - Commentary mentions that definition is not exhaustive
- Services of personal nature – Black Law Dictionary
- Independent character – OECD Glossary
- Employment income & Industrial Commercial Activities are excluded
- Article 14(2) gives an indicative list of Professional Services.
- Professional activities also include as tax consulting, Solicitor, Painting Journalist, Teacher, Scientist, Surgeon etc.

Whether following are Professional Service -

- Running a hospital by several partners of whom one alone is a doctor
- A medical practitioner establishes an X-ray plant and machinery for augmenting his professional work i.e. he refrain from conventional function of examining patients and prescribing medicines

# Meaning of Professional Services

- Profession meaning – ***Graphite India Ltd*** Kolkata ITAT (78 TTJ 418):

*‘ An activity to be profession must be one carried on by an individual by his personal skill, intelligence & dependent on individual characteristics*

  - ✓ *Advance level of Knowledge*
  - ✓ *Specialized Skill Sets*
  - ✓ *Accreditation to a certificate of practice issued by a professional body.*

- In ***MSEB*** Mumbai ITAT (90 ITD 793) (2004) - *‘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’*

# Definition of Other Activites

- What can be covered under *'other activities of independent character'* ?
  - ✓ The expression is wider than "professional services or other independent activities of a similar character" – This was the phrase used in OECD Draft MC, 1963 – Language employed in *USA, Finland, Hungary, Indonesia, Srilanka, Mauritius etc.,*
  - ✓ Distinguishable from Business profit
  - ✓ Should be a service
  - ✓ Be similar to professional services
  - ✓ Capital is of secondary importance
  - ✓ *Real estate consultants, freelance writers, Youtube influencers etc.*

- Invocation of MAP to resolve disputes on characterization

# Persons Covered

- **Can non-individuals render professional services?**
  - ✓ Yes, if the applicable tax-treaty covers non-individuals
  - ✓ MESB vs DIT (90 ITD793) – Article 14 can apply to non-individuals.
  - ✓ DTAA with Denmark only for individuals : *Christiani & Nielsen Copenhagen 39 ITD 355 (Mum ITAT). DTAA refer only to natural person.*
  - ✓ UN Model Commentary observation i.e. it applies only to Individual.
  - ✓ Linklaters LLP [2017] 185 TTJ 525 – Applies only to Individual

- **Indian Treaties**

| DTAAs | Persons Covered |
|---|---|
| USA | Individual or firm (other than Company) |
| UK | Individual in own capacity or member of a partnership |
| Netherlands/Japan | All persons |
| Singapore | Individual |
| Australia | Individual or firm (other than Company) |

# Fixed Base Test

- No definition of Fixed Base
  - ✓ Is it Akin to PE ?
  - ✓ PE for Enterprises & FB for Individuals?
  - ✓ Erstwhile OECD compares PE with Fixed Base. (Except for Article 5 (3) to (6)
  - ✓ Divergent views as to whether PE and FB are same concepts - *[OECD Report (2000) on 'Issues related to Art 14] not identical*
  - ✓ Lower threshold helps Source Countries
  - ✓ Regularly available in FB can be equated with the disposal test in PE.

- **Protocol to India-Belarus** - *"fixed base" includes a fixed place such as an office or a room or any other place regularly available to him through which the activity of a person performing independent personal services is wholly or partly carried on.*

# Fixed Base - Illustrations

| Fixed Base | Not A Fixed Base |
|---|---|
| 1. Office of an architect/ Lawyer<br>2. Physician provided with a consulting room twice a week in a hospital.<br>3. Definite space in the office of an associate.<br>4. A lawyer exercising profession from second home in another State. | 1. Auditor provided with a room at client's place for audit<br>2. Desk made available to the manager situated in another enterprise without the presence of necessary infrastructure<br>3. Temporary camping by a researcher at a base camp in Leh, Ladakh |

# Duration Based Test

- UN Concept
  - ✓ Days criteria similar to Article 15(2)(a)
  - ✓ Almost similar to Service PE
  - ✓ India-SA deems stay base test as fixed base

  *For the purposes of this Agreement, where an individual who is a resident of a Contracting State stays in the other Contracting State for a period or periods exceeding in the aggregate 183 days in any twelve months period commencing or ending in the fiscal year concerned, he shall be* ***deemed to have a fixed base regularly available to him*** *in that other State and the income that is derived from his activities that are performed in that other State shall be attributable to that fixed base.*

- UN MC amended the language of period of stay in the year 1999 – Prior to this amendment, the language used was *'period or periods amounting to or exceeding in the aggregate 183 days in the fiscal year concerned'*.

- Impact of the above amendment – Scope for planning the presence in State S to prevent tax is remote. E.g., Person present in State S for last 5 months in year 1 and first 5 months in Year 2.

# Duration Based Test

- Purpose of stay is immaterial as the phrase used in presence – Unlike Art. 5(3)(b) where reference is made to activity. Mumbai ITAT in Clifford Chance ruling had excluded business promotional visit.

- Computing period of stay - Man days vs Solar days - **Clifford Chance (76 TTJ 725) [2002]; Worley Parsons Services (P) Ltd [2009] 312 ITR 317 (AAR)**

- How to count the days for Partnership? – Members or Partners presence is relevant or both?

| DTAAs | Language adopted |
|---|---|
| USA | Relevant taxable year |
| UK | Relevant fiscal year |
| Netherlands | Fiscal year concerned |
| Singapore | Relevant fiscal year |
| Australia | Year of income |
| Portugal | any twelve-month period commencing or ending in the fiscal year |

# DTAAs and other Criteria's

- No of days stay in Source State
  - ✓ China, Australia – 183 days
  - ✓ Germany, Bangladesh – 120 days
  - ✓ USA, UK, Singapore – 90 days
  - ✓ Indonesia – 91 days
- Only Fixed Base
  - ✓ Mauritius and Korea
- Resident or borne by PE
  - ✓ Canada, Brazil
- Additional Criterion – Specified amount (Present in UN MC 1980 removed in 1999)
  - ✓ Zambia – K 10,000
  - ✓ Canada – (C)$ 2500
  - ✓ Jordan - $ 2,000
  - ✓ T&T – INR 40,000
  - ✓ Myanmar - $16,00

# Income Attributable

- Source can tax income only to the extent of (i) attributable to fixed base or (ii) derived from activities performed in State S – The second limb is absent in India-USA DTAA. However, technical explanation address this aspect.

- E.g. Lawyer charging his fees to the client in respect of work performed in India and UK. Then so much portion of income attributable to work performed in India alone can be taxed **(Clifford Chance ruling)**

- *'Service are rendered in that other territory'* – Austrian consultant visited client factory in India and examined necessary technical aspects. He has rendered services in India even through the study of problem and background work are completed in Austria and sent his recommendation from them – ITC Limited – Kolkata ITAT (85 ITD 162) (2003).

- Net income - application of principles in Article 7 – OECD Report (2000) – Deductions for expenses to be allowed.

- Technical Memorandum of India-USA – Highlighting the subtle difference in Art 7 and Art 15 (corresponding article). Whether force of attraction is applicable?

# Interplay with other Articles

- **<u>Article 14 vs 12</u>**
  - 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 noncompeting 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)
  - *generalia specialibus non Derogant* - Specific overrides General
  - Usually, anomaly is addressed in Art 12 (For e.g. India-Singapore). Also refer India-Japan (anomaly not removed in full)

# Interplay with other Articles

**Article 14 vs 5**

- Article 5 covers furnishing of services by an enterprise through its employees or other personnel engaged by the enterprise.
- Service PE Article applies to service other than independent personal services

**Article 14 vs 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

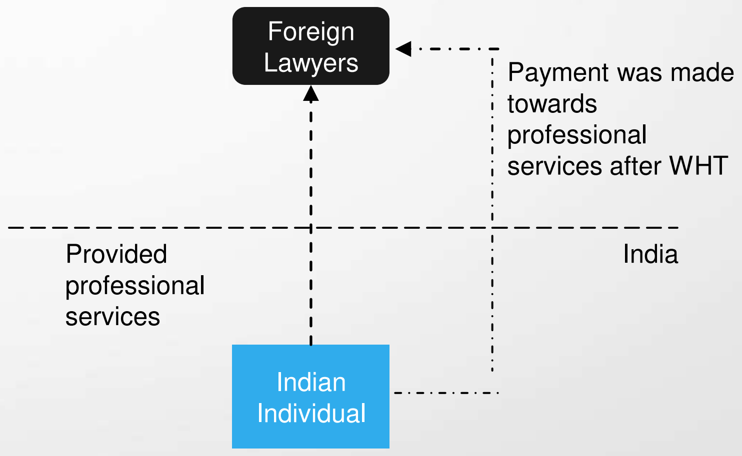
**Article 14 vs 21**

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

# Case Study – Shri Hariharan Subramanian - ITAT Delhi [TS-576-ITAT-2020(DEL)]

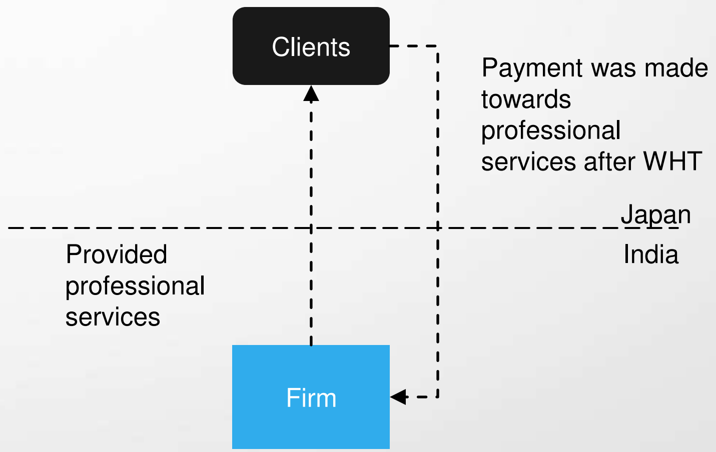
- An Indian Intellectual Property attorney had engaged various foreign IP law firms for filing patent applications, trademark registration etc on behalf of its Indian Clients.
- The assessee had not withheld tax u/s 195 for payments made to law firms situated in certain countries on the reason that these incomes are not taxable under Section 9(1)(vii) of the ITA. The Assessee relied on Section 194J where technical and professional services explicitly provided.
- Assessee had also contended that under tax treaty, the incomes fall under IPS. Wherever, the IPS article is not triggered, then the income will come under Article 7 read with Article 5 as business income not taxable on account of no PE.
- The AO and CIT (A) had disallowed the expenditure made to the non-resident entities for legal services under Section 40(a)(i) for failure to withhold taxes.

Brazil, China, Japan, Indonesia, Malaysia, Russia, Srilanka, Australia etc.



# Case Study – Amarchand & Mangaldas - ITAT Mumbai [TS-666-ITAT-2020(Mum)]

- The taxpayer is a Firm, and it is a tax resident of India. The firm has rendered professional services to its client in Japan.
- At the time making payment, the Clients have deducted taxes at source under Art 12 of India-Japan Tax Treaty (10%).
- The Firm has claimed foreign tax credit (FTC) in respect of tax deducted in Japan.
- The tax authorities has disallowed the claim of FTC on the premise that the TDS deducted by the client were not in accordance with Tax Treaty, as the income is not chargeable to tax in Japan by virtue of Art 14.



# Way forward

- New age services?
- Tele Medicines
- International Commercial Mediation
- Overseas Education

Thank You

Q & A