Danish Decision on the Agency PE Clause of the OECD Model (2017)

May 2022, the Danish Tax Council issued a decision on Danish domestic rules reflecting the agency PE clause under article 5(5) of the OECD Model (2017). This article examines the facts of the case and the reasoning of the Tax Council.

1. Introduction

On 31 May 2022, the Danish Tax Council issued a decision concerning whether a German company had a permanent establishment (PE) in Denmark. The decision seems to have gained some international attention.

The decision was based on Danish domestic law. However, effective since 1 January 2021, the Danish domestic tax law concept of PE is, in substance, generally identical to article 5 of the 2017 OECD Model Tax Convention (OECD Model (2017)). Consequently, the decision offers some guidance on the interpretation of article 5 of the OECD Model (2017), specifically article 5(5). Furthermore, the decision may even (by virtue of the corresponding domestic tax provisions) offer some guidance with respect to article 5(6) and the interplay between the basic-rule PE of article 5 (1) and the agency clause of the OECD Model (2017).

This article offers context for the decision and comments on the reasoning of the Tax Council.

2. The Facts of the Case

Decisions of the Danish Tax Council are anonymized. Consequently, the names of the companies involved and the business conducted by those companies are undisclosed.

The decision involved three companies, which were all part of the same international group. In the decision, the group is referred to as the "H Group". Furthermore, the companies were part of a sub-group within the H Group, referred to as the "Y Sub-group", which performed "Y business". These three companies were:

- H1 AG, a German company;
- H2 A/S, a Danish company; and
- H3, a company of which the state of residence was undisclosed.

H1 AG was the company responsible for research and development and production within the Y Sub-group. H2 A/S was the company hiring the employee triggering a potential PE in Denmark. H3 was the company responsible for sales in the Nordic Region for the Y Sub-group.

The request for a binding ruling on the potential PE in Denmark was caused by the hiring of a Nordic Sales Manager. The Nordic Sales Manager’s tasks included, among other things, performing market research and establishing contact with customers and presenting them with H1 AG’s products and services. Products and services were advanced and customer-specific.

The employee collected information about the customers’ requirements and needs and passed the information on to H1 AG. H1 AG would, in turn, assess the information of each potential customer and prepare a concrete, customized offer for the customer. The subsequent price negotiation and finalizing of the contract between the customer and H1 AG was performed solely by H1 AG’s German employees without the involvement of the Nordic Sales Manager. Invoices were sent to customers from H1 AG’s headquarters in Germany.

With respect to the duties of the Nordic Sales Manager, it was emphasized that he was not authorized to negotiate prices, finalize contracts or enter into legally binding contracts in any way on behalf of H1 AG or any other company within the H Group or the Y Sub-group.

Consequently, the role of the Nordic Sales Manager would be to function as a Key Account Manager for existing customers in the Nordic/Scandinavian region, to seek out new business opportunities with respect to new customers as well as existing customers and to visit (potential new as well as already existing) customers and demonstrate H1 AG’s products.

Even though the Nordic Sales Manager would act mainly for the benefit of H1 AG, he would not be formally employed by that company. Instead, he would be employed by another group company, the Danish company H2 A/S.

The reason for this setup was to ensure full compliance with Danish labour laws and regulations. He would have access to the office facilities of H2 A/S but would often be

---

1. In Danish: Skatterådet.
2. A notable deviation, although it is not relevant to the current case, is that a building site or construction or installation project constitutes a permanent establishment (PE) from day 1, as opposed to art. 5(3) of the OECD Model (2017), infra n. 3, according to which such a project only constitutes a PE if it lasts more than 12 months.
4. Even though the decision does not disclose the state of residence of H3, the company was most likely not a resident of Germany. In the decision, it is stated that the state of residence of H3 had concluded a tax treaty with Denmark, and, consequently, the state of residence of H3 is referred to as “Tax Treaty-country2”.

---
expected to work from home when he was not out visiting (potential) customers.

The Nordic Sales Manager would perform his duties as an employee of H2 A/S and for the benefit of H1 AG. Nevertheless, he would report to the CEO of H3, the reason being that sales activities and sales support was coordinated by H3. In that respect, it was emphasized, in the request for the binding ruling, that the authority to instruct the Nordic Sales Manager as the employer lay with H2 A/S.

3. The Decision of the Tax Council

3.1. Binding rulings under Danish tax law

The case concerned a request for a binding ruling by a German company from the Danish Tax Council. A binding ruling under Danish tax law entails a legal or natural person requesting the Tax Council to confirm a statement, i.e. the case must be presented to the Tax Council in the form of a question that can be answered with “yes” or “no.”

The German company, referred to only as H1 AG in the decision due to anonymization, asked the Tax Council to confirm the following: “Can the Tax Council confirm that H1 AG should not be considered having a permanent establishment in Denmark as a result of employing a Danish employee in H2 A/S?” The Tax Council answered the question with a “yes”, thereby confirming that the Danish employee did not constitute a PE in Denmark of H1 AG.

Here, it should be noted that the Tax Council explicitly emphasized that the decision only concerned H1 AG and that it had not considered whether the Nordic Sales Manager constituted a PE of the other foreign company of the Y Sub-group, H3.

3.2. The legal framework

Initially, in its decision, the Danish Tax Council explained the legal framework, namely the concept of PE under Danish domestic law and under article 5 of the tax treaty in force between Denmark and Germany. Pursuant to section 2(1)(a) of the Danish Corporation Tax Act, foreign companies conducting business in Denmark through a PE are subject to limited tax liability. Section 2(2)-(4) of that Act defines the PE concept for the purpose of Danish domestic law. The definition is, in substance, generally identical to article 5 of the OECD Model (2017).

With respect to the tax treaty, the Tax Council found that the Commentary on Article 5 of the OECD Model (2017) could only be applied to the extent that the tax treaty defined a PE the same way as the OECD Model (2017). This was the case with the basic-rule PE in articles 5(1) and 5(2). As for other parts of the definition, where the tax treaty differed from the OECD Model (2017), e.g. with regard to the agency PE clause found in articles 5(5) and 5(6), the Commentary on Article 5 of the OECD Model (2017) could not be applied. Instead, the Tax Council found that the Commentary on Article 5 of the OECD Model (2014) was applicable with respect to those parts of the tax treaty.

3.3. Basic-rule PE

After the initial statements on the legal framework, the Tax Council turned to the substantial legal analysis of the question of whether H1 AG had a PE in Denmark. The Tax Council stated that the Nordic Sales Manager was employed by a Danish company, H2 A/S, but nevertheless performed some duties for the benefit of the German company, H1 AG. Further, the Tax Council found that the Nordic Sales Manager would function primarily as a mediator of contact between the customer and H1. In that respect, the Tax Council emphasized that the Nordic Sales Manager was not authorized to enter into agreements and did not participate either directly or indirectly in contract and price negotiations with customers. However, the employee could receive a bonus of up to 10% of his base salary for reaching his individual sales targets (sales

The Danish-Germany Tax Treaty was concluded in 1995 and was in general based on the OECD Model. This also applied to the PE definition found in Article 5 of the Treaty, and consequently the PE definition was identical to the corresponding definition found in the OECD Models prior to the 2017 update. The Denmark-Germany Tax Treaty has been revised by a protocol in 2022, but the PE definition was not amended by the protocol.

The Danish-Germany Income and Capital Tax Treaty (1995) is not a “Covered Tax Agreement” pursuant to article 2(1)(a) of the OECD Multilateral Instrument (MLI), and, therefore, articles 12-15 of the MLI did not apply.

With respect to the tax treaty, the Tax Council emphasized that the PE concept in the Denmark-Germany Income and Capital Tax Treaty (1995) and in domestic law both were to be interpreted with reference to the Commentary on Article 5 of the OECD Model (2017). With respect to the Danish domestic-law definition, the Commentary on Article 5 of the OECD Model (2017) could be applied without reservations.

Exported / Printed on 3 Mar. 2023 by danny@dannykarussalam.com.
that were mediated by the employee were considered in the context of the Y Sub-group as the Nordic Sales Manager’s own sales).

Based on these findings, the Tax Council concluded that the Nordic Sales Manager acted, in their words, as a “non-independent representative” of H1 AG and, consequently, that he would constitute a PE if the requirements of the agency PE provisions under Danish domestic law and the tax treaty were satisfied.

This approach of the Tax Council is somewhat surprising. The Tax Council did not examine whether H1 AG had a basic-rule PE in Denmark pursuant to Danish domestic tax law or the tax treaty. In fact, the Tax Council failed to explain why it was not necessary to examine whether the Nordic Sales Manager constituted a basic-rule PE of H1 AG.

The approach of the Tax Council is even more surprising when considering the finding of the Nordic Sales Manager as a “non-independent representative” of H1 AG, which just seems to be another way of describing the employee as a dependent representative. By virtue of the Nordic Sales Manager being dependent on H1 AG, the latter would be deemed to conduct a business in Denmark, thereby satisfying at least one of the requirements for a basic-rule PE.\(^\text{12}\) In turn, when concluding that the Nordic Sales Manager was dependent on H1 AG, this should have left the Tax Council to consider whether H1 AG had a place of business at its disposal in Denmark by virtue the Nordic Sales Manager using the premises of H2 A/S (his formal employer) or by virtue of him working from a home office.\(^\text{13}\) Further, H1 AG, in its request for a binding ruling, had explicitly referred to the possibility of it having a basic-rule PE in Denmark.

In this context, it should be noted that a substantive amount of administrative case law exists in Denmark confirming that a home office can constitute a place of business under Danish tax law and that the threshold for a home office to constitute a PE pursuant to that case law is very low.\(^\text{14}\)

As mentioned, however, the Tax Council offered no explanation as to why it did not examine the possibility of H1 AG having a basic-rule PE in Denmark. Nevertheless, this omission of the Tax Council should, in the author’s opinion, not be overstated, as it is hardly an expression of a general relaxation of the Danish practice for when a home office to constitute a PE pursuant to that case law is very low.\(^\text{14}\)

Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are (a) in the name of the enterprise, or for the transfer of the ownership of, or (b) for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or (c) for the provision of services by that enterprise,

that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business (other than a fixed place of business to which paragraph 4.1 would apply), would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

Further, pursuant to article 5(6) of the OECD Model (2017), an agency PE is deemed not to exist if the person acting as an agent pursuant to article 5(5) is acting as an independent agent for the enterprise in the ordinary course of that business. However, an otherwise independent agent is deemed to be dependent if it acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related.\(^\text{15}\)

3.4. The agency clause and the legal framework

For the Tax Council, the question of whether H1 AG had a PE in Denmark had to be resolved by interpreting the agency clause under Danish domestic tax law and the tax treaty.

Danish domestic law applies an agency PE definition that, in substance, is identical to that of articles 5(5) and 5(6) of the OECD Model (2017).

Article 5(5) of the OECD Model (2017) holds the following:

Further, pursuant to article 5(6) of the OECD Model (2017), an agency PE is deemed not to exist if the person acting as an agent pursuant to article 5(5) is acting as an independent agent for the enterprise in the ordinary course of that business. However, an otherwise independent agent is deemed to be dependent if it acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related.\(^\text{15}\)

3.5. Independent agent

The Tax Council found that the Nordic Sales Manager was “a non-independent representative” of H1 AG. As already mentioned, the term “non-independent” seems to be a reference to the domestic law provision found in section 2(5) of the Corporation Tax Act, corresponding to article 5(6) of the OECD Model (2017), i.e. the implication seemed to be that the Nordic Sales Manager was dependent on H1 AG and could constitute a PE if the requirements of the domestic-law provision corresponding to article 5(5) of the OECD Model were met.\(^\text{16}\)

\(\text{12. See paras. 6 and 39 of OECD Model Tax Convention on Income and on Capital: Commentary on Article 5 } (22 \text{ Nov. 2017), Treaties & Models IBFD [hereinafter OECD Model: Commentary on Article 5 (2017)]. This approach is also followed in Danish case law. See DK: Danish High Court of Western Denmark, 16 May 2019, SKM2019.334.VLR.}

\(\text{13. See paras. 12 and 18-19 OECD Model: Commentary on Article 5 (2017).}

\(\text{14. In 2020, the Danish tax authority summed up its own practice in a public announcement (Styresignal), published as SKM2020.298.SKST. For an analysis of home offices constituting PEs under Danish tax law, see A.N. Laursen, Hjemmekontorer og last driftssled, 34 SR-Skat 4 (2022), pp. 136-148 (Karnov Group).}

\(\text{15. The concept of “related enterprises” is defined in art. 5(8) of the OECD Model (2017). Under Danish domestic tax law, the corresponding definition is found in sec. 2 of the Tax Assessment Act. There does not seem to be any substantial difference between the domestic-law concept and the concept under the OECD Model (2017).}

\(\text{16. See sec. 3.6.} \)
However, it is not entirely clear as to whether the term “non-independent representative” was utilized by the Tax Council, in the sense that they regarded him as “dependent” on H1 AG in the context of article 5(6) of the OECD Model (2017). Notably, the Tax Council made no explicit reference to either section 2(5) of the Corporation Tax Act or article 5(6) of the OECD Model (2017).

Further, the conclusion of Tax Council that the Nordic Sales Manager was a non-independent representative of H1 AG was based solely on the fact that the employee conducted business in Denmark on behalf of H1 AG and that the employee could receive a bonus (of up to 10% of his base salary) for reaching his sales targets. This seems to be a somewhat low threshold for finding that the Nordic Sales Manager was dependent on H1 AG within the context of section 2(5) of the Corporation Tax Act and article 5(6) of the OECD Model (2017), especially considering that the authority to instruct the employee lay with H2 A/S (the formal employer). The basis for the conclusion of the Nordic Sales Manager as “non-independent” on H1 AG could potentially also be that he acted exclusively or almost exclusively on behalf of H1 AG. However, the Tax Council did not, at any point, refer to this issue, nor did it analyse or even refer to the provisions governing this under domestic law, section 2(6) of the Corporation Tax Act or section 2 of the Tax Assessment Act (corresponding to articles 5(6) and 5(8) of the OECD Model (2017)).

Consequently, it is uncertain as to whether the Tax Council actually found the Nordic Sales Manager to be dependent on H1 AG or whether the Tax Council used the term “non-independent representative” only as a preliminary conclusion and a starting point for the analysis of whether the Nordic Sales Manager satisfied the requirements of section 2(4) of the Corporation Tax Act, corresponding to article 5(5) of the OECD Model (2017). If those requirements were satisfied, the Tax Council could then examine more thoroughly whether the Nordic Sales Manager actually was dependent on H1 AG. This explanation is further supported by the fact that the Tax Council did not make any explicit reference to the Commentary on Article 5(6) of the OECD Model (2017), which, as already stated, the Tax Council had found to be relevant to the interpretation of the domestic-law provision.

Consequently, it was not clear what the Tax Council actually meant by the term “non-independent representative”. Instead of examining the relationship between the Nordic Sales Manager and H1 AG, the Tax Council focused its substantial analysis on the requirements for the Nordic Sales Manager to be deemed a PE of H1 AG pursuant to the domestic-law provision corresponding to article 5(5) of the OECD Model (2017).

3.6. Agency PE

It was clear from the facts of the case that the Nordic Sales Manager was not authorized to conclude contracts in the name of H1 AG. Nevertheless, he could satisfy the requirements of the domestic-law provision corresponding to article 5(5) of the OECD Model (2017) if he habitually played the principal role leading to the conclusion of contracts that were routinely concluded without material modification by H1 AG for the sale of H1 AG’s products. In determining whether this was the case, the Tax Council referred to the guidance found in paragraphs 88 and 89 of the Commentary on Article 5(5) of the OECD Model (2017).

Initially, the Tax Council considered whether the Nordic Sales Manager “played the principal role leading to the conclusion of contracts” between H1 AG and its customers in Denmark. On the one hand, the Tax Council pointed out that the Nordic Sales Manager did not participate in or in any way conduct contract negotiations with the customers, and that he was not authorized to do so. Further, he did not participate in the composition of tenders to the customers. Consequently, the duties of the Nordic Sales Manager could be characterized as “marketing” rather than conducting actual sales, which the Tax Council found to be insufficient to satisfy the requirements of article 5(5) of the OECD Model (2017). On the other hand, the Tax Council emphasized that when the activities of the Nordic Sales Manager did result in a sale, the resulting bonus would befall him and not the employees of H1 AG, who would compose the tender and negotiate the contract with the customer. This implied that the Nordic Sales Manager could potentially satisfy the requirements for being deemed an agency PE of H1 AG.

This led the Tax Council to consider the requirement that contracts should be “routinely concluded without material modification by the enterprise”. In this context, the Tax Council stated that it followed from paragraphs 88–89 of the Commentary on Article 5(5) of the OECD Model (2017) that this requirement “aims at situations where the employee performs a leading role in the relevant state, even if the contracts are not formally concluded in that state, e.g., if the contracts are routinely reviewed and approved outside the state, without such a review leading to changes to important conditions in the contracts”.

The Tax Council went on to consider the facts of the case in light of this interpretation of the requirement. It emphasized that the employee did not participate in the preparation of tenders or contracts at all. As a consequence, the Nordic Sales Manager did not provide H1 AG with any contract drafts, which could be concluded by H1 AG without review. On the contrary, the only mediated contact between customers and H1 AG. The contract negotiations were performed without the involvement of the Nordic Sales Manager, and the contract would be for a customer-specific product. Consequently, the contracts would be adapted to the individual customer.

---

17. The domestic-law provision corresponding to art. 5(6) OECD Model (2017).
18. However, this does not explain why the Tax Council did not examine whether H1 AG had a place of business at its disposal in Denmark. See sec. 3.3.
Based on these considerations, the Tax Council found that the requirements of the domestic-law provision corresponding to article 5(5) of the OECD Model (2017) were not satisfied, and, thus, the Nordic Sales Manager was not deemed an agency PE of H1 AG. As there was no PE under domestic law, it was unnecessary for the Tax Council to examine whether there was a PE under the Denmark-Germany Income and Capital Tax Treaty (1995).

4. Conclusion

In its decision, the Tax Council found a Danish employee, a Nordic Sales Manager, of a Danish group company (H2 A/S) who performed sales-related activities for another group company (H1 AG) to be a “non-independent representative” of the latter company. Most likely, this description of the employee meant that the Tax Council believed the employee to be “dependent” on H1 AG in the context of Danish domestic law corresponding to article 5(6) of the OECD Model (2017). In that case, the Tax Council seems to have set a rather low threshold for deeming a person dependent on a foreign enterprise. However, it is not entirely clear from the decision as to whether that was, in fact, what the Tax Council meant by the term “non-independent representative”.

The Tax Council did not consider whether the German company, H1 AG, had a place of business at its disposal. If the Tax Council had indeed found the Nordic Sales Manager to be “dependent” on H1 AG, this omission of the Tax Council is surprising, given that H1 AG, by virtue of the activities of the Nordic Sales Manager, seemed to have satisfied one of the requirements for a basic-rule PE under Danish domestic law (the domestic law provision reflecting article 5(1) of the OECD Model (2017)).

Because the Tax Council did not consider the possibility of a basic-rule PE to exist, the decisive point was whether H1 AG was deemed to have an agency PE in Denmark (again, this assessment was based on Danish domestic law reflecting article 5(5) of the OECD Model (2017)). Ultimately, the Tax Council found no PE in Denmark.

The Nordic Sales Manager was not authorized to conclude contracts in the name of H1 AG. Further, the Tax Council emphasized that the Nordic Sales Manager did not habitually play the principal role leading to the conclusion of contracts that were routinely concluded without material modification by H1 AG. Based on an interpretation of paragraphs 88-89 of the Commentary on Article 5 of the OECD Model (2017), the Tax Council found that the requirement that a person play the principal role leading to the conclusion of contracts being concluded without material modification by a foreign enterprise was aimed at situations in which contracts were routinely reviewed and approved in another state (in this case, Germany) without such a review leading to changes to important conditions in the contracts. Because the Nordic Sales Manager did not prepare any contracts or negotiate with the customers, the requirement was not satisfied. Therefore, the Nordic Sales Manager did not constitute an agency PE of H1 AG.