

Agency Permanent Establishments and the Zimmer Case

1. Introduction

Non-resident individuals and companies are subject to limited tax liability in Denmark if they carry on business in Denmark through a permanent establishment (PE).¹ On the other hand, under the Danish territorial tax system, a resident company is exempt from taxation on profits from a PE situated in a foreign jurisdiction.² Domestic law does not provide a definition of a PE, neither for inbound nor outbound cases.³ In administrative practice, the PE concept in domestic law is interpreted in accordance with Art. 5 of the OECD Model and the Commentary thereon.⁴ However, certain specific deviations from Art. 5 are laid down in domestic law, one of which concerns agency PEs (see 6.).

Danish tax treaties usually contain an article similar to Art. 5 of the OECD Model.⁵ Under Art. 5(5), an agency PE is created if the following requirements are satisfied:

- a person is authorized to conclude contracts in the name of the enterprise;
- the contracts relate to the core business of the enterprise;
- the person habitually exercises such authority; and
- the person is not an independent agent covered by Art. 5(6).

This article will analyse how the requirements underlying an agency PE are interpreted in Danish tax law (see 2.), and how the French *Zimmer* case⁶ fits into Danish tax law (see 3.). The article will also examine the special domestic agency PE rule (see 4.), address the allocation of profit to an agency PE (see 5.), examine the tax consequences of a conversion from distributor to commissionaire (see 6.) and discuss the issue of static and dynamic interpretation of the PE rules (see 7.).

2. The Agency Permanent Establishment in Danish Tax Law

2.1. Authority to conclude contracts

The term “authority” is not defined in the OECD Model or the Commentary, and should be construed on the basis of domestic law under Art. 3(2).⁷ The authority should entitle the person to conclude contracts “in the name of the enterprise”. Ever since 1963, the Commentary has emphasized that the contracts should be “binding on” the enterprise.⁸ In 1994, it was added that the scope of Art. 5(5) covers situations where a person concludes contracts that are binding on an enterprise, even if those contracts are not actually in the name of the enterprise.⁹ Hence, the essence of the requirement is that the contracts be legally binding on the enterprise.¹⁰

Under Danish law, a distinction is made between a commercial agent, a commissionaire and a distributor. “Commercial agent” is defined as a person who is authorized to (1) solicit orders on behalf of a principal or (2) sell goods in the name of a principal.¹¹ “Commissionaire” is defined as a person that concludes contracts in its own name but for the account of the principal.¹² Contracts concluded by a commissionaire are not binding on the principal.¹³ This is the case even if the customers know

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1. Sec. 2(1)(4) Withholding Tax Act; Sec. 2(1)(a) Corporate Tax Act.

2. Sec. 8(2) Corporate Tax Act.

3. However, with regard to outbound cases the PE definition under an applicable tax treaty, is decisive, provided that a PE does not exist under the treaty definition while a PE exists under domestic Danish tax law.

4. Para. 15 Circular 136 of 7 November 1988 on the Corporate Tax Act; Para. 12 Circular 135 of 4 November 1988 on the Withholding Tax Act; Tax Assessment Guidelines 2010-1 S.A.2.2; Official Report 1060 (December 1985), at 17. The convergence of the PE concept under domestic law and Art. 5 has been confirmed by the parliament. See e.g. Bill L 119 of 11 December 1996, General Comments, Sec. 2. It has also been confirmed by the National Tax Tribunal in TfS 2006.100 and TfS 2003.71; the National Tax Board in TfS 2010.556 and SKM2010.318; and the Tax Assessment Council in TfS 1992.294. See E. Møller, *Revision & Regnskabsvæsen*, No. 1 (1963), at 8, 11; id., *Cahiers de droit fiscal international*, vol. 52 (1967), at 418; B. Gimsing, *Begrænset skattepligt* (1985), at 50; Aa. Michelsen, *International Skatteret* (2003), at 234; N. Winther-Sørensen, *Skatteretten* 3 (2009), at 158; J. Ferniss, TfS 2010.414.

5. N. Josephsen, *Skat Udland* 1996.110. However, some Danish tax treaties are based on Art. 5 of the UN Model, which expands the definition of a PE.

6. Supreme Administrative Court, *Société Zimmer Limited*, 304715 and 308525 (31 March 2010). See P.-J. Douvier and X. Lordkipanidze, “Zimmer Case: The Issue of the Deemed Existence of a Permanent Establishment Based on Status as a Commissionaire”, 17 *International Transfer Pricing Journal* 4 (2010), at 266.

7. A.A. Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* (Deventer: Kluwer Law International, 1991), at 490; D.J. Piltz, “When Is There an Agency Permanent Establishment?”, 5 *Bulletin for International Fiscal Documentation* 58 (2004), at 196, 199; A. Pleijsier, “The Agency Permanent Establishment: The Current Definition – Part One”, 29 *Intertax* 5 (2001), at 167, 171.

8. Para. 32 Commentary on Art. 5.

9. Para. 32.1 Commentary on Art. 5. The 1994 amendment was adopted following a discussion on the treatment in civil law and common law of a person that concludes contracts in its own name, but for the account of an undisclosed principal. Under civil law, a principal would normally not be bound by the contracts. On the other hand, under common law, a principal is, as a general rule, bound by the contracts. See J.F. Avery Jones and D.A. Ward, “Agents as Permanent Establishments under the OECD Model Tax Convention”, 21 *European Taxation* 5 (1993), at 154. Hence, common law does not recognize the civil law institution of indirect representation. In 1992, the United Kingdom entered an observation stating that a dependent agent concluding contracts binding on the principal constituted an agency PE whether the contracts were in its own name or that of the enterprise. See Para. 45 of the 1992 Commentary on Art. 5. This observation was deleted in 1994 as a result of the amendment of the Commentary (see above).

10. A.A. Skaar, note 7, at 164 and 488.

11. Sec. 2 Danish Commercial Agent Act.

12. Sec. 4(1) of the Danish Commission Act.

13. Sec. 56(1) of the Danish Commission Act.

that the commissionaire is acting for the account of the principal. A distributor is defined as a person that carries on business in its own name and for its own account. On this basis, an agent may create an agency PE with respect to activities under category (2), whereas activities of an agent under category (1) as well as activities of a commissionaire and a distributor should normally not create an agency PE.

In Danish tax law, several cases have emphasized the requirement under Art. 5(5) for the contracts of a person to be binding on the principal. A 1987 case decided by the National Tax Tribunal concerned a UK company that had entered into a contract with a Danish customer to perform diving services in the North Sea.¹⁴ The customer required that the UK company form a Danish subsidiary to perform the contract. As a result, a Danish subsidiary was set up and the contract was transferred to the subsidiary. The services were performed under an arrangement where the UK parent company rented its staff and equipment to the Danish subsidiary, which invoiced the customer. This arrangement was extended to new contracts with the customer which were concluded by the Danish subsidiary in its own name. The tax authorities argued that the substance of the arrangement meant that the contracts concluded by the Danish subsidiary were performed by the UK parent company. The contracts were thus held to be *de facto* binding on the parent company. Hence, the Danish subsidiary was deemed to be authorized to conclude contracts on behalf of the UK parent company. The Tribunal decided that the subsidiary did not constitute an agency PE, because it was acting in its own name and for its own account, i.e. no formal authority had been granted to the subsidiary.

A 1989 case decided by the National Tax Tribunal concerned a Danish company which was to maintain a stock of goods in Denmark on behalf of an unrelated German company.¹⁵ The Danish company was to execute orders from Danish customers, print delivery notes, issue invoices based on prices determined by the German company, receive payments from the customers, administer VAT, manage debtors and inventory, and transmit payments to the German company. The orders were to be placed directly with the German company, which would forward the orders to the Danish company. The Tribunal held that the functions of the Danish company were of a preparatory and auxiliary nature and did not create a PE. Decisive importance was ascribed to the fact that the Danish company was not authorized to conclude binding contracts on behalf of the German company.

A 1991 binding ruling from the Tax Assessment Council concerned a Danish subsidiary which was to perform a limited logistic function for its US parent company.¹⁶ The US parent company was to engage a third party to store its Nordic inventory in Denmark. The parent company was to own the inventory until a sale was made to one of its Nordic subsidiaries. The Danish subsidiary was to receive orders from the Nordic subsidiaries and arrange for the goods to be delivered from the warehouse to the customers. The Council decided that a PE

would not be created because the inventory management was a preparatory and auxiliary activity, and because receipt of orders and binding contracts would be concluded outside of Denmark.

A 1992 case decided by the National Tax Tribunal concerned a Germany company which maintained an office in Denmark.¹⁷ The office would have six to seven employees who were not authorized to conclude contracts on behalf of the German company. The employees were to be building technicians and sales persons. The office was to engage in information and marketing activities in order to make potential customers aware of the quality and applications of the products of the German company. The employees were to visit potential customers. Prices and terms were determined in Germany, and order approvals and invoices were issued in Germany and sent directly to the customers. Payments were made directly to the company in Germany. The Tribunal held that the German company did not have a PE in Denmark. Decisive importance was ascribed to the fact that the employees were not authorized to conclude binding contracts, that prices were determined in Germany, that orders were approved in Germany and that invoices were issued in Germany. On this basis, the functions of the Danish employees were held to be of a preparatory and auxiliary nature.

A 1992 binding ruling from the Tax Assessment Council concerned a German company that was to employ an agent to perform sales activities in Denmark.¹⁸ The agent would visit customers, inform the customers about prices, receive orders, submit orders to the German company and prepare market reports. The German company would provide the agent with standard contracts with list prices and discount schemes that should be used. The agent would submit orders received from the customers to the German company, which would issue order confirmations to the customers. Any changes to the standard terms were to be approved by the German company. Supply of goods and payments would be made directly between the German company and the customers. The Council determined that the agent would qualify as a dependent agent of the German company. An agency PE would arise if the agent were authorized to conclude binding contracts on behalf of the German company. An agency PE would, as the starting point, also arise if the agent were authorized only to solicit orders based on standard terms, because the subsequent approval by the German company was deemed to be a mere formality. This accords with the substance-over-form approach of the Commentary.¹⁹ However, no PE would be created if the agent were to inform the customers in writing that

14. TFS 1987.50.

15. TFS 1989.165.

16. TFS 1991.38.

17. TFS 1991.309.

18. TFS 1992.294.

19. Paras. 32.1 and 33 Commentary on Art. 5. See A.A. Skaar, note 7, at 489 and 492; M. Görl, in *Doppelbesteuerungsabkommen*, ed. K. Vogel and M. Lehner (Munich: C.H. Beck, 2008), Art. 5, m.no. 118.

the German company was not bound by any orders until an order confirmation was received by the customers.²⁰

A 2006 case decided by the National Tax Tribunal concerned a Swedish pharmaceutical company which maintained an office in Denmark with seven to fourteen employees.²¹ The functions of the Danish employees were to provide information and advice to Danish doctors, nurses, hospitals, etc. regarding the products of the company. The customers were unrelated wholesalers. The end-user placed orders with the wholesalers, which in turn placed orders with the company in Sweden. The Tribunal decided that the Swedish company did not have a PE in Denmark because the activities of the Danish employees were of a preparatory and auxiliary nature. Decisive importance was ascribed to the fact that orders, approval of orders, invoicing, payments, distribution, etc. were made directly between the company in Sweden and the Danish wholesalers, and also that binding contracts were concluded by the enterprise in Sweden, and the prices were decided by the parent company in Switzerland.

To summarize, under Danish tax law, the requirement for an agent to be authorized to conclude contracts in the name of the enterprise is interpreted in a strict legal sense by the tax authorities and the National Tax Tribunal.²² Hence, an agency PE has been rejected where customers were informed in writing that orders submitted to the agent were not accepted until an order confirmation was received from the enterprise, even though the subsequent approval of the enterprise was a formality. The Danish courts have not had the opportunity to try a case regarding this requirement.

2.2. Core business activity

The nature of the contracts concluded by the agent must relate to operations which constitute the business proper of the enterprise.²³ This would normally mean that the contracts involve the sale of the products or the services of the enterprise. Furthermore, the activities of the agent may not be of a preparatory or auxiliary character under Art. 5(4).²⁴

A 1977 case concluded that the purchase of goods (made by employees working in Denmark for a non-resident oil company) did not create a PE because the contracts related to the internal operations of the enterprise.²⁵ A 1978 case held that international sales coordination activity in Denmark did not create a PE.²⁶ A 2008 case concerned a Danish partnership, owned by US and Danish partners, which entered into a toll manufacturing arrangement with its Danish subsidiary.²⁷ The subsidiary was authorized to purchase raw material for its manufacturing activity in the name of the partnership. The National Tax Board concluded that the subsidiary was a dependent agent of the partnership. However, the purchase of raw material constituted a preparatory and auxiliary activity that did not give rise to an agency PE.

2.3. Habitually exercising the authority

The authority of a person to conclude binding contracts relating to the core business of the enterprise must be exercised habitually in the source state and not merely in isolated cases.²⁸ This requirement has not been addressed in Danish case law.

2.4. Independent agent exception

An independent agent that is acting in the ordinary course of its business does not create an agency PE under Art. 5(6) of the OECD Model, even though such person concludes contracts that are binding on the enterprise. Hence, Art. 5(6) works as an exception to Art. 5(5).²⁹ An agent must be both legally and economically independent of the enterprise in order to satisfy the independence test.³⁰

In 2003, the independence test was addressed by the National Tax Tribunal.³¹ This case concerned a Danish company that would be acting as an insurance agent for an associated enterprise in Ireland (principal) and would conclude reinsurance agreements that would be binding on the principal. On a smaller scale the agent would also conclude reinsurance contracts on behalf of an independent enterprise. The agent was remunerated by a commission fee based on a percentage of the gross premiums. On this basis, it was decisive whether the Danish company qualified as a dependent or an independent agent vis-à-vis the Irish principal. The Tax Assessment Council determined that an agency PE was created because the company had only two principals, and one of the principals was predominant. Upon appeal, the National Tax Tribunal noted that the agent would not be subject to detailed instructions or comprehensive control by the principal. On the other hand, the entrepreneurial risk was considered to be borne by the principal. The Tribunal emphasized that the agency agreement was on market terms, and that the agent would be acting within the ordinary course of its business. It was not noted that the agent was acting for only two principals. The Tribunal concluded that the Danish company was to

20. See PE. Hjerrild-Nielsen, *Skat Udland* 1992.305.

21. TFS 2006.100.

22. The authority of an agent to conclude binding contracts on behalf of the enterprise has also been a decisive criterion with regard to the question of whether a Danish enterprise was carrying on business in a foreign state under the former Sec. 17(2) of the Corporate Tax Act on foreign income relief. With regard to dependent agents, this rule was interpreted in line with Art. 5(5) of the OECD Model. See TFS 1993.454; the Tax Assessment Guidelines 2010-1 D.D.2 (Art. 5). See e.g. the cases *Ugeskrift for Retsvæsen* (1971), at 187; TFS 1992.215; TFS 1993.102; TFS 1997.713; TFS 2000.15.

23. Para. 33 Commentary on Art. 5.

24. A.A. Skaar, note 7, at 468.

25. *Revision & Regnskabsvæsen*, SM (1977), at 215.

26. *Meddelelser fra Landsskatteretten* (1978) 93.

27. TFS 2008.747.

28. Paras. 32, 33 and 33.1 Commentary on Art. 5.

29. J.F. Avery Jones and D.A. Ward, note 9; B. van der Gulik, "Qualification of a Dutch Commissionaire Under the OECD Model Convention", 46 *Tax Notes International* (2007), at 85. For a contrary view, see S.I. Roberts, "The Agency Element of Permanent Establishment: The OECD Commentaries From the Civil Law View", 20 *Intertax* 9 and 10 (1993), at 396 and 488.

30. Para. 37 Commentary on Art. 5.

31. Decision of 23 September 2003, Journal 2-4-1220-0054.

be regarded as an independent agent, and that an agency PE was not created.

In 2004, the independence test was addressed by the Supreme Court.³² The case concerned a Danish individual who owned a helicopter which was rented out in Germany. The issue was whether the rental business created a PE in Germany. The taxpayer had transferred the helicopter to a German company (HCB) as a silent partner. HCB had transferred the right to use the helicopter to its German parent company (DHD). The Court held that the taxpayer was not a co-owner of HCB and was not a member of the management of HCB. With regard to the relationship between the taxpayer and HCB, the Court noted that HCB was not subject to instructions of the taxpayer, that the entrepreneurial risk was assumed by HCB which was renting the helicopter to DHD in its own name, and that HCB permanently had several helicopters at its disposal. On this basis, the Court concluded that HCB qualified as an independent agent, and that the company was acting within the ordinary course of its business. Thus, the taxpayer did not have an agency PE in Germany. The Court relied on the key criteria of the Commentary to evaluate the requirement for legal and economic independence.³³

In 2010, the independence test was addressed by the National Tax Board in two binding rulings with a similar fact pattern.³⁴ In both cases, a private equity fund would be organized under Danish law as a limited partnership, which is a transparent entity for Danish tax purposes.³⁵ The partnership would not have its own employees and would not have a fixed place of business at its disposal in Denmark. The question was whether non-resident investors in the partnership would be deemed to have a PE in Denmark. A Danish management company (A) would be authorized to conclude binding contracts on behalf of the partnership with respect to internal matters such as appointment of an auditor, filing tax returns and money transfers. A was also acting as a management company for other private equity funds. A would make recommendations on the acquisition and sale of shares to an investment board (E), which consisted of some of the partners of A. E would evaluate the recommendations from A and submit them to another investment board (D). D would consist of individuals who were unrelated to A and the partnership. D would make binding decisions regarding the acquisition and sale of shares on behalf of the partnership. The members of D would be appointed by the investors of the partnership. The Board noted that the D, E and A would not be subject to detailed instructions and control by the partnership, that they had other sources of income, that they were responsible to the partnership for the results of their work, that they were carrying out similar activities for other funds and that they assumed the entrepreneurial risk. On this basis, the Board held that D, E and A should be treated as independent agents vis-à-vis the partnership and that an agency PE would not be created.

In 1996, the ordinary course of business test was applied by the Supreme Court.³⁶ The case concerned a non-resi-

dent individual who was partner in two Danish partnerships that owned and operated a block of flats. The tax authorities argued, among other things, that the individual had an agency PE in Denmark due to the property management carried out in Denmark by two lawyers, one of whom was a partner in one of the partnerships. The decisions of the partnerships were made jointly by the partners, including decisions on renovation and lease contracts. The Eastern High Court concluded that the lawyers caused the taxpayer to have an agency PE in Denmark. The Supreme Court found that both lawyers carried on an activity that was ordinary for property managers and that the lawyers in this context were acting within the ordinary course of their business. The Court thus relied on both objective and subjective elements under the ordinary course of business test.³⁷ Furthermore, the lawyers did not qualify as dependent agents of the taxpayer. It was held to be immaterial that one of the lawyers was a partner in one of the partnerships. On this basis, no agency PE was held to exist.³⁸

3. The *Zimmer* Case

The *Zimmer* case concerned a French subsidiary that was concluding contracts as a commissionaire in its own name but for the account of its UK parent company. In 2007, the Administrative Court of Appeal of Paris ruled that an agency PE was created because the contracts were held to be de facto binding on the parent company. The Supreme Administrative Court reversed the decision because the contracts were not legally binding on the parent company.

Danish case law on agents is in line with the result of the *Zimmer* case, as the key criterion applied is whether the contracts concluded by an agent are legally binding on the enterprise. The situation of a commissionaire has not been addressed in Danish case law. This is presumably caused by the fact that the contracts of commissionaires are not legally binding on the principal. This may also explain why the Danish tax authorities, in the author's experience, are not targeting commissionaires in a PE context.

4. Distance Selling

The domestic law concept of a PE provides for certain specific deviations from Art. 5 of the OECD Model (see 1.). Under one of the deviations, distance selling by an agent that concludes contracts which are binding on a

32. TFS 2004.162.

33. Paras. 38, 38.3, and 38.6 Commentary on Art. 5.

34. TFS 2010.556 and SKM2010.318. The facts set out above are based on TFS 2010.556.

35. The risk of creating an agency PE is held to be a major tax obstacle by *Report of Expert Group on removing tax obstacles to cross-border Venture Capital Investments* (Brussels: European Commission, 2010), at 15.

36. TFS 1996.532.

37. See similarly A.A. Skaar, note 7, at 519.

38. See A.A. Skaar, note 7, at 166 (a partner is generally held not to constitute an agency PE, unless it specifically meets the conditions of Art. 5(5)). See also *Meddelelser fra Landsskatteretten* (1983), No. 60 (National Tax Tribunal determined that a resident partner constituted an agency PE for a non-resident partner).

non-resident person does not create a PE, provided that the agent is not an employee of the principal.³⁹ This rule was adopted because of the difficulties in interpreting Art. 5(5) and (6) of the OECD Model, and in order to promote Denmark as a location for international call centres. The rule does not impact the Danish interpretation of tax treaties.

The rule is applicable regardless of whether the agent is dependent or independent of the principal, and regardless of whether an independent agent is acting within the ordinary course of its business.⁴⁰ Distance selling is defined as the (passive) receipt of orders from Danish and foreign customers by telephone, telex, telefax, EDI, etc. The rule is not applicable where the agent is also carrying on other sales-related activities for the principal, such as canvassing and general sales and marketing work. On the other hand, the agent may carry out activities that are not sales-related, such as packaging, distribution, invoicing, collection and manufacturing. It is a requirement that neither the principal nor associated enterprises carry on business in Denmark which is connected to the distance selling of the agent. In this regard it is irrelevant whether the work of the principal and associated enterprises is sales related, or whether the work is of a preparatory or auxiliary character under Art. 5(4).

5. Profits of an Agency PE

Under Danish tax law, the profits of a PE are to be determined on the basis of the general tax rules.⁴¹ There are no explicit rules that deal with the fact that a PE is not legally distinct from the rest of the enterprise of which it is a part. In the absence of express domestic rules, the principles underlying Art. 7 of the OECD Model and the Commentary thereon are applied.⁴² This means that the profits of a PE hitherto have been determined on the basis of the direct method and a restricted independence fiction of the PE.⁴³

In 2008, the authorized OECD approach (AOA) introduced a new interpretation of Art. 7 relying more on an unrestricted independence fiction.⁴⁴ The AOA was implemented in the 2008 Commentary and the 2010 revision of Art. 7. The application of the AOA to an agency PE created by an enterprise (rather than an employee) is expressly addressed. Hence, the OECD rejects the single-taxpayer approach advanced by some commentators.⁴⁵ The single-taxpayer approach contends that an arm's length remuneration of an enterprise agency PE extinguishes the profits attributable to the agency PE. The reasoning behind this approach is that the compensation to the agency PE, if arm's length under Art. 9(1), is considered to adequately reward the agency PE for its functions performed, assets used and risks assumed, and because there are no other functions performed, assets used or risks assumed in the source country, there can be no further profits to attribute. While an identical attribution of functions should follow from the AOA and the single-taxpayer approach, risks and intangibles may be subject to diverging attributions under the

two approaches. Hence, risks and intangibles should be attributed on a legal (contractual) basis under the single-taxpayer approach, which is relying on Art. 9(1) and on a factual basis ("significant people functions") under the AOA.⁴⁶ Under the AOA, profits may thus be allocated to an agency PE if the contractual and factual attribution of risks and intangibles diverge. However, if an identical attribution is made under both approaches, the AOA should also result in a zero profit for an enterprise agency PE.

The AOA and the rejection of the single-taxpayer approach have received a mixed response.⁴⁷ Some authors have rejected the AOA, among other things, because it does not account for economies of integration, it attempts to establish different risk structures within a single enterprise and it is held to be contrary to the wording of Art. 5(5).⁴⁸ Others have accepted the rejection of the single-taxpayer approach.⁴⁹ A more in-depth discussion of this subject is beyond the scope of this article.

39. Sec. 2(5) Corporation Tax Act; 2(9) Withholding Tax Act.

40. Bill L 119 of 11 December 1996, General Comments, Sec. 2.

41. Sec. 8(1) Corporate Tax Act. However, domestic law contains rules addressing specific PE issues such as the transfer of assets and liabilities in and out of Denmark, transfer pricing and thin capitalization. See P. Konnerup and N. Winther-Sørensen, *Cahiers de droit fiscal international*, vol. 91b (2006), at 279, 282.

42. TFS 1993.7 and TFS 1996.715. See N. Winther-Sørensen, note 4, at 182; J.O. Engholm Jacobsen, *Selskabsskatteloven med kommentarer* (1998), at 124.

43. N. Winther-Sørensen, *Beskatning af international erhvervsindkomst* (2000), at 196; P. Konnerup and N. Winther-Sørensen, note 4, at 281.

44. P. Baker and R.S. Collier, *Cahiers de droit fiscal international*, vol. 91b (2007), at 21, 31.

45. Para. 26 2008 Commentary and 2010 Annex on Art. 7; Para. 235 of *2010 Report on the Attribution of Profits to Permanent Establishments* (Paris: OECD, 2010). On the single-taxpayer approach see e.g. C.H. Lee, "Instability of the Dependent Agency Permanent Establishment Concept", 27 *Tax Notes International* (2002), at 1325; A. Pleijsier, "The Agency Permanent Establishment, Practical Applications. Part Two", 29 *Intertax* 6/7 (2001), at 218; C. Brodersen and H. Kolczynski, "The Commissionaire: A Tax-Focused Evaluation of Germany", 25 *Intertax* 5 (1997), at 201; H-K. Kroppen and S. Huffmeier, "The German Commissionaire as a Permanent Establishment under the OECD Model Treaty", 24 *Intertax* 4 (1996), at 133.

46. Paras. 236 and 237 *2010 Report on the Attribution of Profits to Permanent Establishments* (Paris: OECD, 2010). In the Danish case TFS 2008.369, goodwill relating to the Danish market was attributed from a German head office to a PE in Denmark because the Danish customers were serviced by the PE. If the German enterprise had conducted business in Denmark through a subsidiary, the goodwill would not have been allocable to the subsidiary. The allocation of goodwill between a head office and a PE has also been made on the basis of the criterion which part of the enterprise services the customers in question by the National Tax Board in TFS 2007.567 and by the National Tax Tribunal in its decision of 30 August 2004, Journal 2-1-1867-0832, and its decision of 3 August 2005, Journal 2-1-1867-0897.

47. The 2007 IFA Branch Reports were divided on the application of the AOA to agency PEs. See P. Baker and R.S. Collier, note 44, at 50.

48. See e.g. P. Baker and R.S. Collier, note 44, at 33 and 54; P. Baker and R.S. Collier, "2008 OECD Model: Changes to the Commentary on Article 7 and the Attribution of Profits to Permanent Establishments", 63 *Bulletin for International Taxation* 5 (2009), at 199; R.J. Vann, "Tax Treaties: The Secret Agent's Secrets", *British Tax Review* 3 (2006), at 345; W. Schön, "Attribution of Profits to PEs and the OECD 2006 Report", 46 *Tax Notes International* (2007), at 1059.

49. See e.g. B.J. Arnold, "Tax Treaty News", 63 *Bulletin for International Taxation* 2 (2009), at 42, 44; K. Vogel, "Tax Treaty News", 61 *Bulletin for International Taxation* 11 (2007), at 474; H. Pijl, "The Zero-Sum Game, the Emperor's Beard and the Authorized OECD Approach", 46 *European Taxation* 1 (2006), at 29; C.E.C.M.A. Toro, "Different Methods of Attributing Profits to Agency PEs", 53 *Tax Notes International* (2009), at 421.

In 2003, the Tax Assessment Council was requested to confirm that the profits of an agency PE could be determined on the basis of the single-taxpayer approach.⁵⁰ The case involved a subsidiary which would act as a commercial agent and conclude binding contracts on behalf of its parent company. The Council determined that the profits of the agency PE would not necessarily be zero. The Council noted that it seemed incorrect that the profits of the agency PE would be zero, as that would make Art. 5(5) superfluous. If some of the functions that an independent enterprise would perform were carried out by the principal, rather than the agent, the profits attributable to the agency PE could exceed the arm's length payment to the agent. The result of the case accords with the AOA, but the reasoning deviates from the AOA. Hence, under the AOA profits may be allocated to an agency PE because of a diverging attribution of risks and intangibles, whereas the Council focused on the functions performed.

The Danish tax authorities thus followed the approach of the Australian tax authorities, which rejected the single-taxpayer approach in 2001.⁵¹ On the other hand, the result of the Danish case is contrary to the result of Indian cases which have accepted the single-taxpayer approach.⁵²

6. Conversion from Distributor to Commissionaire

A conversion from buy/sell distributor to commissionaire may potentially trigger a deemed transfer of marketing intangibles. Under Danish tax law, the ownership of intangibles is generally determined on the basis of private law.⁵³ With regard to legally protected intangibles such as trademarks, the owner is normally the supplier.⁵⁴ With regard to non-legally protected intangibles such as goodwill, case law suggests that the tax owner is the person that is in control of the intangible in question.⁵⁵ This means that the tax owner is often the supplier, assuming that it owns the underlying intangibles (e.g. patents or trademarks).

In 1998, the Danish Minister of Taxation was asked whether a conversion from distributor to commissionaire would trigger a deemed transfer of goodwill from the distributor to the principal. The minister replied that a conversion potentially could involve a taxable transfer of goodwill to the principal.⁵⁶ If a transfer of goodwill did not arise, the principal should pay an arm's length remuneration to the commissionaire for the use of its customer portfolio.

Assuming that the ownership of goodwill rests with the supplier, a deemed transfer would not arise, and no compensation would be due for the use of the customer portfolio. Even if the ownership of goodwill rests with the distributor, a conversion need not mean that the distributor has transferred its goodwill to the supplier. This is especially true if the distributor continues to do business with the customers in its own name. The compensation paid to the distributor will, all else being equal, be reduced, which, however, may accord with the arm's

length principle if the supplier has taken over functions, risks and assets from the distributor. Furthermore, under Danish tax law, goodwill is not transferable as a separate asset apart from the business to which the goodwill attaches.⁵⁷ A conversion from distributor to commissionaire thus should not in itself cause a deemed transfer of goodwill. However, depending on the facts of each case, other intangibles, inventory, receivables, etc. may be transferred, and a right to claim indemnification based on contractual terms etc. may exist.

7. Static or Dynamic Interpretation

Arts. 5 and 7 of the OECD Model and the Commentary thereon have been subject to many changes since 1963. It has been argued that the changes in the 1994 Commentary on agency PEs,⁵⁸ the changes in the 2003 Commentary on basic PEs⁵⁹ and the changes in the 2008 Commentary on Art. 7 caused fundamental changes to the articles. This gives rise to the question of whether the PE rules in domestic law and the Danish tax treaties should be subject to a static or dynamic interpretation.

With regard to domestic law, the PE rules were adopted in 1960 and 1967. The law did not provide a definition of the PE concept or the profit allocation principles. However, the PE rules were already known from Danish tax treaties, and formed the basis for the interpretation of Sec. 2(3) of the Danish State Tax Act that was the precursor for the PE rules. Arts. 5 and 7 of the 1963 OECD Model corresponded to Art. II of the 1958 OEEC report⁶⁰ and Art. XV of the 1960 OEEC report,⁶¹ respectively. The domestic PE rules must thus, as a starting point, be interpreted on the basis of Arts. 5 and 7 of the 1963 OECD Model and Commentary. Subsequent changes to Arts. 5 and 7 and the Commentary thereon that have merely clarified the interpretation of the articles should be considered in interpreting the domestic

50. Binding ruling of 23 September 2003, Journal 99/03-4317-00217.

51. Para. 5.39 ATO Taxation Ruling 2001/11 of 31 October 2001. See also ATO Discussion Paper on Attributing Profits to Commissionaire PEs of 30 July 2002.

52. See e.g. *DIT (International Taxation) v. Morgan Stanley and Co. Inc.*, (2007) 292 ITR 416 (Supreme Court); *SET Satellite (Singapore) Pte. Ltd. v. Deputy Director of Income Tax*, Income Tax Appeal 944, 2007 (High Court Bombay, 22 August 2008); *BBC Worldwide Ltd. v. Dy. Director of Income Taxes*, Delhi ITAT, ITA 1188/Del/06 (2010). In the view of H. Pijl, "Morgan Stanley: Issues regarding Permanent Establishments and Profits Attribution in Light of the OECD View", 62 *Bulletin for International Taxation* 5 (2008), at 174; C.E.C.M.A. Toro, note 49, the decision in the *Morgan Stanley* case accords with the AOA.

53. J. Wittendorff, *Cahiers de droit fiscal international*, vol. 92a (2007), at 211, 219.

54. J. Schovsbo and M. Rosenmeier, *Immaterialret* (2008), at 424.

55. Tfs 2001.231; Tfs 2002. 563; Tfs 2004.342; Tfs 2008.369. See C.H. Eriksen, *Beskatning af immaterielle aktiver* (2007), at 52; J. Wittendorff, *Revision & Regnskabsvæsen*, No. 11 (2004), at 50.

56. Bill L 84 of 14 November 1997, Annex 14, Question 6.

57. Tfs 2005.749; Tfs 2002.288; Tfs 2002.202; Tfs 1991.16; Tfs 1986.376.

58. A. Pleijsier, note 7; D.J. Piltz, note 7, at 196.

59. A.A. Skaar, *Skatterett* (2003), at 129; H. Pijl, "The Concept of Permanent Establishments and the Proposed Changes to the OECD Commentary with Special Reference to Dutch Case Law", 56 *Bulletin for International Fiscal Documentation* 11 (2002), at 554.

60. *The Elimination of Double Taxation*, First Report (Paris: OEEC, 1958).

61. *The Elimination of Double Taxation*, Third Report (Paris: OEEC, 1960).

PE rules. In contrast, where a new Commentary changes the contents of an article, it should not be considered.⁶² Hence, Sec. 43(1) of the Danish Constitution provides that no taxation may be imposed, amended or repealed in any way other than by a law enacted by the Danish parliament. Fundamental changes to the PE rules under domestic law thus must be adopted by the parliament. On this basis, the 2010 changes to Art. 7 are irrelevant, and the relevance of all of the 2008 changes to the Commentary on Art. 7 for domestic Danish tax law are questionable.⁶³ In this context, the 2010 rulings of the National Tax Board cited above (see 2.4.) may be criticized. Hence, the Board stated that the rulings were binding for a period of five years, unless the definition of a PE in the OECD Model was amended. In the latter situation the rulings would be binding only until the OECD published the amendment. This suggests that amendments of Art. 5 and the Commentary would change the domestic Danish PE concept. For the reasons stated above, this position must be rejected.

With regard to Danish tax treaties, the situation is in principle similar, so a new Commentary should not influence the interpretation of existing treaties when it is in effect amending the article.⁶⁴

8. Conclusion

In Danish tax law, an agency PE may arise if a person is authorized to conclude contracts that are binding on the principal in a strict legal sense. Thus, it will often be possible to avoid triggering an agency PE by engaging in proper tax planning. Furthermore, domestic Danish tax law provides for an agency PE exemption with regard to distance selling. The conversion from distributor to commissionaire should not trigger taxation of goodwill or other marketing intangibles, assuming that those intangibles are owned by the supplier or another group company. A commissionaire should normally not create an agency PE under Danish tax law. If the activities of a subsidiary do constitute an agency PE, the profits will be zero under the AOA, provided that the subsidiary is remunerated on an arm's length basis and that a factual and contractual attribution of functions, risks and assets are identical.

62. N. Winther-Sørensen, *SR-Skat* (1997), at 148; Aa. Michelsen, in *Festskrift til Ole Bjørn*, ed. S. Pedersen et al. (2004), at 357, 378; P. Konnerup and N. Winther-Sørensen, note 41, at 296 et seq.; N.G. Møller, in *Rettid*, No. 1 (2007), at 71. See also J.O. Engholm Jacobsen, note 42, at 100.

63. N. Winther-Sørensen, note 4, at 189. The Tax Assessment Guidelines, 2010-1 D.D.2 (Art. 7) suggest that the tax authorities rely on the 2008 Commentary with regard to interest expenses and free capital.

64. See the minority opinion in TFS 2003.222.