Danish Tax Council decides against constitution of German employer's PE due to employee working from home at Denmark

H1 [TS-1195-FC-2021(DEN)]

Brief Facts

The taxpayer, a German Company was engaged in the manufacture, marketing and B2B distribution of chemical products to dealers in Germany, Austria and Switzerland. A Danish employee of the taxpayer worked from home (WFH) in Denmark due to the COVID-19 pandemic and was no longer required to appear physically at the taxpayer's offices in Germany. It was expected that in the future the employee would continue to work from home and that only 10% of his work would be performed outside Denmark. It was agreed that the taxpayer would pay an amount to cover the costs associated with working from home, but the taxpayer would not rent or otherwise make an office available to the employee in Denmark. However, the taxpayer had provided the employee with a laptop and a cell phone. The taxpayer had no other activity in Denmark apart from the employee but could register as a foreign company in Denmark for paying social security and payroll of the employee. The taxpayer had no interest in the Danish market and had no plans to expand to the Danish market.

The employee is employed as the Global Regulatory Affairs Manager in the taxpayer's department for global regulatory matters. The employee had no managerial powers and his duties included:

- registration of taxpayer's chemical products.
- preparation of regulatory data.
- preparation and submission of registration dossiers in accordance with local legislation and in collaboration with local experts.
- support for departments / offices in the individual countries.
- representation of the company in official meetings with authorities and partners in relation to the respective products.

The employee was not servicing any customers and had no authority to enter into negotiations or agreements on behalf of the taxpayer. The employee reported to the Head of Registrations in Germany and collaborated with colleagues in both Germany and third countries. The decision of the employee to continue to perform most of his work from his home office in Denmark was solely due to his personal circumstances. On the given fact pattern, the taxpayer reached out to the Danish Tax Council for obtaining a binding ruling.

Question before the Danish Tax Council

Whether the employee's work from home in Denmark result in the taxpayer constituting a Permanent Establishment (PE) in Denmark?

Taxpayer's Contentions

The OECD Commentary lays down three criteria for the creation of a PE viz existence of a place of business, fixed place of business and carrying on of the business. The taxpayer contended that the

employee's home office did not qualify as a PE under Article 5(1) of the Denmark-Germany tax treaty (tax treaty) because it did not meet these three criteria. The taxpayer referred to Danish judicial precedents wherein a home office was held not to constitute a PE under following fact patterns:

- when the taxpayer's presence in Denmark was solely due to employee's personal interests and not any business interests; and
- wherein an employee undertook internal compliances and other similar tasks which were considered as back-office functions and the employee had no customer relations.

The taxpayer also stated that registration of chemical products with local authorities was a pre-requisite before the taxpayer can sell its products in a jurisdiction and in the instant case, registrations were made only for the taxpayer's own products and not sold as a service to other companies. Accordingly, even if a PE was formed, the activities performed by the employee at the home office were in the nature of statutory compliances and as such qualified as being preparatory or auxiliary in nature when seen in light of the core business of the company. The Danish judicial precedent referred by the taxpayer, equated such work to legal compliance not having direct customer contact to be 'helpful' in nature.

Danish Tax Agency's Contentions

The Danish Tax Agency based its recommendation on applying the same three conditions for qualifying a PE under Article 5 of the tax treaty. Analysing the Commentary on Article 5 of the OECD Model Convention (2017 Update) (OECD Commentary), they explained that:

- a 'place of business' covers amongst other things, all kinds of premises which are used to carry on the company's business, regardless of whether they are used exclusively for that business or not. (Para 10 to 12)
- it does not matter if the premises is rented or owned as long as the company has a real right to use the premises and the premises are actually used for business activities to a sufficient degree. (Para 10 to 12)
- a 'place of business' can be all kinds of premises or areas used for the company's business, which depending on the circumstances also include an employee's home office. (Para 18)
- a home office is considered – available – to the company if an employee actually carries out business of the company from it. (Para 18)
- a home office used by an employee instead of the office made available to the employee cannot be considered available to the company, if the company has not required the employee to work from his own residence. (Para 19)

The Tax Agency contended that by not making an office available to the employee, it has requested the employee to use the home office to carry on business and therefore the home office could be considered to be available to the taxpayer.

The Tax Agency referred to a number of decisions:

- Creating a PE - home offices of the employees were considered permanent places of business of the taxpayers on the basis that other places of work were not made available to the employees.
- Not creating a PE – wherein the employee made a personal decision to work from home and the option to work in the offices of the taxpayer was available to him at all times.

Reference was also made to the Danish Tax Agency's control signal (Styresignal - SKM2020.298.SKTST), which inter alia relates to temporary work from home in the wake of the global outbreak of coronavirus. The control signal states that "*the fact that employees in the corona situation carry out their work from a different jurisdiction than they would normally do does not, in the opinion of the Danish Tax Agency, mean that they thereby create a PE abroad for the company, if a PE did not already exist.*" The control signal further provides factors that would effect a home office to constitute a permanent place of business for the company.

Ultimately, the Danish Tax Agency opined that the taxpayer would not constitute a PE in Denmark by emphasizing on the fact that the taxpayer did not obtain a business advantage by the employee performing the work from home office in Denmark and is based solely on the personal circumstances of the employee.

The Decision of the Danish Tax Council

The Tax Council issued a decision in terms of the taxpayer's request. The Tax Council agreed with the Danish Tax Agency's recommendation to not consider the taxpayer to have a PE in Denmark.

The decision of the employee to work from home was due to the COVID-19 pandemic and other personal circumstances, and was necessitated neither by the business interest of the taxpayer nor a requirement of the taxpayer. The taxpayer had clearly made an office available to the employee in Germany and did not require the employee to use his home for its business activities, therefore by relying on paragraph 18 and 19 of the OECD Commentary on Article 5, the home of the employee could not be said to be at the disposal of the taxpayer.

To summarise, the Council accepted the following assumptions to arrive at the decision that no PE was being created in Denmark:

- It was assumed that the employee, as a result of an agreement on a home workplace in Denmark, no longer had premises available at the taxpayer's address in Germany.
- The taxpayer had not required the employee to work from home.
- The agreement to work from home was based solely on the employee's personal circumstances and was not necessitated by the taxpayer's business interest, as the taxpayer had no activity in Denmark other than the employee's presence and no interest in the Danish market. The taxpayer had no plans to expand to Denmark.
- The taxpayer had no representative office or the like in Denmark - not even via the employee's home office.
- The employee did not service taxpayer's customers, and had no managerial powers, or authority to participate in negotiations or enter into agreements in the taxpayer's name.

Taxsutra's Comment

While the above case covers the situation of COVID 19 forced stay, the question for which ruling was requested brings out a long-term work from home situation even after travel bans are lifted. The updated OECD Guidance dated January 21, 2021 relating to COVID 19, provides that individuals teleworking from home due to an imposed public health measure, or recommended by at least one of the governments of the jurisdictions involved (as a precautionary measure to prevent the spread of the COVID-19 virus), would not create a fixed place of business PE for the business/employer. However, the final decision has been left to the respective jurisdictions.

The Danish Tax Council in another case TS-741-FC-2020(DEN), held the German taxpayer to have a PE in Denmark in a similar situation of COVID-19 work from home by the Danish national. The Danish employee was employed as Head of Sales and Business Development and his work was to market and sell the German company's products to European customers in Denmark and other Scandinavian countries through online meetings. However, this case can be distinguished on the basis that (i) the home office was listed as one of the place of employment in the employment contract, and hence home office constituted a 'fixed place of business' as employee regularly carries out business activities of the enterprise from it and the German company had no office in Denmark, and (ii) the employee performed leading and supporting functions within sales and business development, which is considered as a core task for the company rather than preparatory or auxiliary.

In the Indian context, no relief or guidance is provided by the Central Board of Direct Taxes (CBDT) with respect to creation of a PE in India due to employees being stranded in India. On petitions filed by taxpayers seeking directions for exclusion of COVID-19 induced forced/involuntary stay for financial year 2020-21, before the Supreme Court of India, on September 7, 2021, the Court decided not to entertain such petitions. Lack of clarity on this issue is likely to have ramifications for MNCs and result in creation of unintentional PE in India.:FC DEN

Taxsutra Note:

Convention between Federal Republic of Germany and the Kingdom of Denmark (*Unofficial translation*)

Article 5 – Permanent Establishment
1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
2. The term "permanent establishment" includes especially:

a) a place of management;

b) a branch;

c) an office;

d) a factory;

e) a workshop; and

f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3. A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;

e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person, other than an agent of an independent status to whom paragraph 6 applies, is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall for the purposes of Chapter II 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, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.