

Kluwer International Tax Blog

What Does the MLI Actually Do for PEs?

Johann Müller (International tax professional) · Tuesday, June 30th, 2020

Denmark accepted all MLI articles dealing with PEs, but what does that actually mean? Reading the MLI itself leaves one somewhat bewildered, being thrown back and forth between a variety of articles and options. Reading the instrument of ratification, does not necessarily help: it tends to be a collection of long list of countries with treaty articles, interspersed by texts typically starting with “Pursuant to article x of the Convention, Denmark considers that the following agreements contain a provision described in article y”.

So, to bring this closer to the ground, I shall go through those articles in the MLI specifically mentioning PEs and elaborate on what it is that they do. Denmark has as part of the ratification of the MLI decided to opt into all parts of the MLI also all non-compulsory provisions. This is a significant change from when Denmark originally signed the MLI.

Art. 10 – Triangular PEs

Art. 10.1 MLI is an anti-abuse rule for PEs in third countries. It is the equivalent of Art. 29.8 of the 2017 OECD Model Convention (“MC”). Paragraph 163 of the OECD commentary to it gives this example. DKCo sets up a PE in a 3rd jurisdiction (Singapore – SGPE) that imposes no or low tax on SGPE’s profits. Say SGPE’s profits are exempt from tax in Denmark either under Art. 23 of the Danish-Singapore treaty or Danish law AND are not taxable in Denmark under Denmark’s CFC rules. SGPE derives interest arising in Italy. Under article 11 of the Danish-Italian treaty, Italy would normally be obliged to grant the benefits of Art. 11.2 of the Italian-Danish treaty and limit the Italian withholding tax on interest, despite the interest being exempt from tax in Denmark and subject to little tax in Singapore. Art. 29.8 of the Danish-Italian treaty denies the benefits, and Italy can levy interest withholding tax, unless:

- the interest income comes from the active conduct of a business by SGPE, or
- the interest income is subject to at least 60% of the tax that would be due in Denmark (Art. 10.2 MLI), or
- the benefits are granted by the Italian competent authority under the discretionary relief provision if it determines that such would be justified in view of the reasons why DKCo did not satisfy the requirements of 10.1 and 10.2, after consultation and agreement with the Danish competent authority (article 10.3 MLI).

The anti-abuse rule also applies to dividends and royalties.

Denmark listed no treaties under article 10 MLI. This implies that there are no Danish Covered

Tax Agreements which include provisions regarding third country PEs. The MLI itself is unclear on what happens in a situation like this (other than to say the rules will apply), but presumably the MLI imposes an article 29.8 OECD MC like text on all Danish Covered Tax Agreements to the extent the other treaty partner does not choose to limit the application of Article 10 MLI.

The consequence of this is that Denmark generally does not apply this rule for outbound PEs, since dividends, interest and royalties will generally be subject to a tax credit, not an exemption.

With regard to inbound PEs the Covered Tax Agreements will allow Denmark to apply third country PE anti-abuse measures to the extent Danish law allows this. E.g. if an Italian company has a Singapore PE deriving interest from Denmark, then Denmark will only have to apply article 11.1 of the Danish-Italian tax treaty (eliminating Danish withholding tax on interest) IF the interest income:

- comes from the active conduct of a business, or
- is taxed in Singapore at least 60% of the tax it would have been in Italy, or
- the Danish competent authority decides to do so.

Art. 11 – Savings clauses

Art. 11.1 MLI imposes “tax savings” clauses onto Covered Tax Agreements (CTAs), meaning that such a tax treaty shall not limit the right of taxation of a country to tax its residents, except for a limited list of instances. For PEs these limitations include specifically:

- treaty benefits which require Denmark to grant a resident a correlative or corresponding adjustment, following an initial adjustment on the profits of an outbound PE; and
- treaty benefits which require Denmark to provide double tax relief with respect to profits that are attributable to an outbound PE in the other treaty jurisdiction.

Under Art. 11.2 MLI, Art. 11.1 replaces existing saving clauses in CTAs and is added to CTAs with no savings clauses, unless a country chooses to exclude this under Art. 11.3 MLI.

Denmark applies article 11.1 to all CTAs and notes that its treaties with Canada, Egypt, Indonesia, Kuwait, Malaysia, Sri Lanka, Thailand and the US already have tax saving clauses that will be replaced by Art. 11.1 if those countries also agree. For all its other CTAs, Art. 11.1 will likewise apply if the other country agrees as well.

Art. 12 – Commissionaire type arrangements

Art. 12.1 is like the new article 5.5 of the 2017 OECD MC, i.e. it qualifies commissionaires as PEs.

Art. 12.3.a determines that article 12.1 shall replace the dependent agent paragraphs of CTAs, to the extent that paragraph addresses a person that habitually exercises an authority to conclude contracts in the name of the enterprise; it does not replace the dependent agent paragraph where it e.g. defines a PE where that person secures orders for the enterprise or maintains a stock from which he regularly delivers goods. I.e. if the dependent agent paragraph in CTAs already went beyond the conclusion of contracts in the name of the enterprise, those add-ons remain. The above applies on condition that the other treaty country also applies Art. 12.3.a MLI.

Denmark notes that all 64 of its CTAs have a dependent agent paragraph which will be extended to

include Commissionaires, as described above.

Art. 12.2 MLI. Art. 12.2 is like the new Art. 5.6 of the 2017 OECD MC, meaning that article 12.1 does not apply to an independent agent acting in the ordinary course of its business. However, a person that acts (almost) exclusively on behalf of several closely related enterprises is not considered to be an independent agent.

Art. 12.3.b determines that article 12.2 shall apply in place of the independent paragraphs of CTAs, but only where both partners of those CTAs choose to do so (Art. 12.6 MLI).

Denmark notes that all of its CTAs have an independent agent paragraph which will be limited to exclude agents which (almost) exclusively act on behalf of closely related enterprises.

Art. 13 – Specific activity exemptions

Art. 13.2 determines that all the PE exemptions under Art. 5.4 of CTAs will be subject to the condition that those activities must be of a preparatory or auxiliary character (but only where both partners of the CTAs chooses to do so – Art. 13.7).

Denmark notes that all of its CTAs have PE exemptions which will be subject to the condition that those activities must be preparatory or auxiliary.

Art. 13.4 MLI. Art. 13.4 is similar to the new anti fragmentation rule of article 5.4.1 of the 2017 OECD MC, meaning that the PE exemptions paragraph does not apply if the same or a closely related enterprise carries on business activities from a place in the same country and that place constitutes a PE or the combination of both enterprises' activities are not of a preparatory or auxiliary character, IF those activities constitute complementary functions of a cohesive business operation.

Denmark's ratification also implies that the new article 5.4.1 anti-fragmentation rule will apply to its CTAs if the other country chooses to do the same.

Art. 14 MLI – Splitting-up contracts

Art. 14.1 MLI applies the revised anti-abuse commentary of paragraph 18.1 of the 2017 OECD Commentary to article 5 of the MC. It determines that where an enterprise carries on activities at a building site in Denmark for more than 30 days and connected activities are carried on at the same building site by one or more closely related enterprises, each for more than 30 days, then those closely related enterprises' time will be added to the time of the first enterprise to determine its total time at the building site.

Art. 14.2 MLI determines that 14.1 will apply in place of or in the absence of an anti-splitting of contracts clauses in CTAs if both treaty partners choose so. Otherwise, it will only apply to the extent that existing anti-splitting paragraphs are incompatible with Art. 14.1 MLI. Whilst Art. 14.3.a. allows countries to opt out of the anti-splitting of contracts completely, Art. 14.3.b allows the to opt in for general PEs, but to carve out carve out the anti-splitting rules for the exploration or exploitation of mineral resources only.

Art. 14.4 requires MLI signatories to notify the OECD if its CTAs contain anti-contract splitting provisions that are not subject to the reservation under article 14.3.b.

Denmark adopted article 14.1 without any reservation under 14.3.b.

Art. 15 MLI – Closely related persons

Art. 15.1. This article imports the 2017 OECD MC article 5.8 definition of closely related persons into CTAs for the purposes of articles 12, 13 and 14 MLI. So closely related parties are controlled parties and parties possessing more than 50 percent of the beneficial interest or the aggregate vote and value in a company or person.

Under Art. 15.2 MLI only parties that opted out under any of the rules under articles 12-14 can opt out of article 15.

Since Denmark did not opt out of articles 12 – 14 MLI, it has adopted article 15 MLI, meaning that the article 5.8 2017 OECD definition of closely related parties will apply to Denmark's relevant CTAs (where the other treaty partner made the same choices as Denmark regarding articles 12 – 14 MLI).

Art. 16 MLI – Mutual agreement procedures

Art. 16 MLI deals with mutual agreement procedures and is a minimum standard under BEPS Action 14. This means that countries must include Art. 25(1) through (3) of the 2017 OECD MC in their tax treaties, as interpreted in the Commentary to the OECD MC.

With regard to PEs specifically

Under article 16.2, second sentence, any mutual agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting Jurisdictions. However, under article 16.5 a party may reserve the right for article 16.2 second sentence not to apply on the basis that:

1. any agreement reached shall be implemented notwithstanding domestic time limits, or
2. the Contracting Jurisdictions shall make no adjustment to the profit attributable to a PE after a mutually agreed time (except in case of fraud, gross negligence or wilful default).

Where a party has not made the above article 16.5.c reservation, Art. 16.6.c.ii MLI determines that each party shall notify the OECD of its CTAs which do not contain a provision stating that a mutual agreement reached will be implemented notwithstanding domestic time limits.

With respect to article 16.6.c.ii MLI, Denmark notified the OECD that a number of its CTAs do not contain a provision setting aside domestic time limits for mutual agreements. Therefore, the MLI will impose the setting aside of domestic limits for the implementation of mutual agreement procedures regarding profits attributable to PEs onto these treaties.

Conclusion

Hopefully the above gives some clarity on what the MLI means for Danish tax treaties and the PE articles in them. However, as is shown above, the process of getting to the new meaning of treaty articles is not a simple or straightforward one. It would be of a great help if there others that actually were to work these changes into their existing treaties as one see it done elsewhere with treaties and subsequent treaty protocols.

Denmark deposited its instrument of ratification on 30 September 2019. In accordance with article 34.2 MLI, the MLI entered into force for Denmark on 2020-01-01. The deposit is available here (<http://www.oecd.org/tax/treaties/beps-mli-position-denmark-instrument-deposit.pdf>).

Finally, I would express my appreciation to Troel Kjølby Nielsen and Søren Jesper Hansen from PwC Denmark for reviewing the above and giving me their comments.

This blog post is based on a country analysis of PEs in Denmark in WoltersKluwer's PE+ database.

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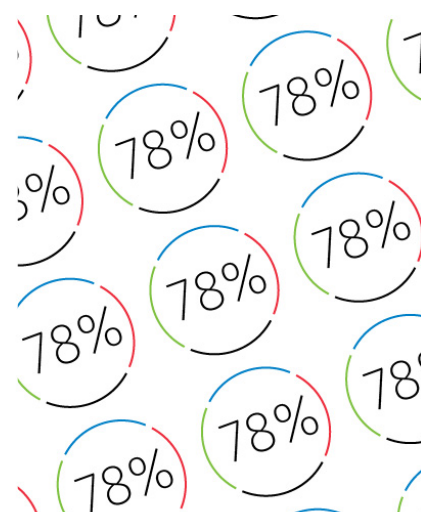
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