2 October 2020
Global Tax Alert

Danish Tax Board rules Danish data center does not create a permanent establishment for nonresident company

EY Tax News Update: Global Edition

EY's Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration here.

Also available is our EY Global Tax Alert Library on ey.com.

Executive summary

The Danish Tax Board has ruled that a data center in Denmark, owned and operated under a hosting agreement by a Danish company, does not constitute a permanent establishment (PE) of a nonresident group company for Danish corporate tax or value-added tax (VAT) purposes.[1] The ruling confirms similar rulings of the Tax Board from 2015[2] and 2016.[3]

Detailed discussion

Facts submitted for the ruling

A nonresident company is the regional headquarters of an international group and a Danish company owns and operates a data center in Denmark. The Danish company will enter into a hosting agreement with the regional headquarters company on market conditions regarding hosting services. The Danish company will own, lease and operate servers and other equipment. The servers and equipment will be used by the company for hosting the website and related activity for the headquarters company (sole customer).

Building a better working world

The Danish company will not be permitted to use or analyze data controlled by the headquarters company and stored in the data center. The Danish company will not be authorized to conclude binding contracts on behalf of the headquarters company or assume or create any obligations for the headquarters company.

The Danish company's employees (hardware team and operational team) will be responsible for installation, operation, maintenance, and repair of the data center and will work under the instruction and control of the management of the Danish company. The hosting services provided to the headquarters company will include ownership and maintenance of the data center; installation of hardware; server connection; data storing; cataloging; processing and transmission; repair and maintenance work; and plant management (security, air condition, etc.). The Danish company will not perform any sales, marketing, or development activities.

Access to the data center will be limited to the Danish company's employees and external service providers. However, employees of the headquarters company may from time to time be granted access to the data center if data authorities have requested access to the data of a customer. The Danish company will be entitled to grant or refuse access to the data center for the headquarters company.

The headquarters company's software team will handle the software in the data center through remote access. The remote access will allow the headquarters company to survey the efficiency of the software, to install and uninstall applications, to maintain applications, and handle software and data in the data center.

The headquarters company will not have any direct activities in Denmark although the company will conclude agreements with Danish customers regarding the group's products and services.

Decision

Corporate tax

The Tax Board held that the headquarters company would not create a PE in Denmark under article 5(1) or 5(5) of the relevant tax treaty (corresponding to article 5(1) and 5(5) of the Organisation for Economic Co-operation and Development (OECD) Model Tax Convention).

In relation to article 5(1), reference was made to paragraph 122-124 of the Commentary on Article 5 of the OECD Model (2017) according to which an internet website does not constitute tangible property for which reason it cannot constitute a "place of business." On the other hand, a server on which the website is stored may constitute a "place of business" of the enterprise that operates that server according to the OECD. In the present case, the servers would be owned and operated by the Danish company. Reference was made to paragraph 124 of the Commentary according to which a hosting agreement typically does not result in the server and its location being at the disposal of the enterprise that carries on business through the website. Against this backdrop the headquarters company would only create a PE if it exercised control over the servers in a manner as if it, in fact, owned or operated the servers. The headquarters company was not considered to exercise such control over the servers. Reference was also made to the earlier rulings of the Tax Board in 2015 and 2016. On this basis, the headquarters company was held not to carry out business in Denmark through a fixed place of business. It was thus not necessary to consider whether the activity in Denmark was of a preparatory or auxiliary character.

In relation to article 5(5), it was held that the headquarters company would not create a PE because the employees of the Danish company would not be authorized to conclude binding contracts on behalf of the headquarters company.

VAT

The Tax Board also determined that the Danish company did not give rise to a PE (fixed establishment) for VAT purposes based on the following:

1. A subsidiary is as a main rule not seen as a PE
2. The headquarters company did not have the required human and technical resources present in Denmark

Reference was made to the decision of the Court of Justice of the European Union (CJEU) Case C-318/11, *Daimler*, and Case C-319/11, *Widex*, where it was held that a parent company and subsidiary were to be treated as two independent legal units and the subsidiary could therefore not be treated as a PE of the parent company.

An exception to this main rule follows from the CJEU Case C-260/95, *DFDS*, where a subsidiary was treated as a PE as it was contractually obliged to act solely as the parent company's subcontractor. The subsidiary could therefore not be treated as an independent subcontractor acting between the parent company and its customers. The services provided by the subsidiary were considered services delivered by a dependent agent. As the parent company had a commercial interest in the VAT-liable transactions, it was immaterial that the subsidiary was an independent legal entity.

Furthermore, according to the CJEU in certain rare cases a company can be considered to have a PE from which services are provided by purchasing the permanent structure in terms of human and technical means from a subcontractor. However, the Tax Board found that the Danish data center could not be viewed as such a dependent agent. The reasoning was that the Danish company had not performed any sales or marketing activities or any research and development activities on behalf of the headquarters company. Also, the headquarters company did not have any staff in Denmark performing software work, and it did not own, lease, operate, or control the servers.

Because of the above the Tax Board concluded that the Danish company did not give rise to a PE for VAT purposes.

Implications

The ruling of the Tax Board is in line with the general position of the OECD Model that a subsidiary does not create a PE for its parent company even though the only business of the subsidiary is to carry out services for the parent company assuming that the premises of the subsidiary is not at the disposal of the parent company. The remote access to a data center did not give rise to a PE in the three cited cases. From a Danish perspective, remote access that allows a nonresident taxpayer to control websites stored at servers in Denmark which are operated by another entity, and that to a limited extent also allows the taxpayer to control the servers, should generally not result in a PE in Denmark.

From a VAT perspective the case demonstrates that considering a Danish company as a PE for a nonresident group company requires a very dependent and close relation between the two companies.

Endnotes

1. See SKM2020.390.SR.
2. See SKM2015.369.SR where the Tax Board ruled that a resident company did not have a PE in a foreign country where it stored its website on a server.
3. See SKM2016.188.SR where the Tax Board ruled that a nonresident company did not have a PE in Denmark under a hosting arrangement with a resident subsidiary that operated a data center.

For additional information with respect to this Alert, please contact the following:

Ernst & Young P/S, Copenhagen
- Jens Wittendorff, *ITTS* jens.wittendorff@dk.ey.com
- Mick Jørgensen, *VAT* mick.joergensen@dk.ey.com

Ernst & Young LLP (United States), Nordic Tax Desk, New York
- Malte Soegaard malte.soegaard1@ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EYG no. 006785-20Gbl

1508-1600216 NY
ED None

ey.com