Chapter 12

Denmark

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12.1. The meaning of avoidance and aggressive tax planning and the BEPS initiative

12.1.1. The meaning of tax avoidance in national legal systems

Avoidance generally means the arrangement of a transaction so as to keep it consistent with the letter of the law, but not with the presumed contents or intention of the law.[1] No interpretation according to the purpose of a tax provision can set aside the wording of the law.[2] This poses a problem for tax authorities in relation to avoidance because it effectively prevents the application of the desired purposive construction, as such a construction would set aside the opposed literal interpretation. Thus, the problem of avoidance arises when the possibilities for interpreting a statute are exhausted.[3]

Danish tax law does not contain any general legal definition of tax avoidance. The treatment of tax avoidance is determined on the basis of case law and specific anti-avoidance rules (SAARs), which has recently been supplemented by an international GAAR.

Generally the terms tax avoidance, tax evasion and tax fraud are relatively well established in Danish legal theory and appear to follow the terminology frequently applied internationally.[4] The term tax avoidance covers acceptable or ordinary tax planning, but is also used to refer to tax planning that is considered undesirable, such as tax optimizations that are within the letter of the law, but contrary to the spirit of the law. In contrast, tax evasion may be characterized as behaviour that is not in line with the applicable tax law, and tax fraud is a form of deliberate evasion of tax that is generally punishable by law.

The above statement also holds true in terms of administrative regulations, which do not contain any clarification on the meaning of tax avoidance in Danish tax law.

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1 *See*, for comparison, Jan Pedersen, *Skatteudnyttelse*, 1989 p. 264, and same author in *Skatteorientering*, 2002, Ø.5, p. 19. This section is partly based on Jakob Bundgaard & Arne Møllin Ottosen, European Taxation, 2008, vol. 48, pp. 59-69.

2 *See*, for comparison, Jan Pedersen, *Skatteorientering*, 2002, Ø.5, p. 18.

3 Pedersen, *supra* n. 1, p. 292.

4 *See* V. Uckmar in Cahiers de droit fiscal international, 1983, vol. 68a, p. 15 et seq. and Julie Roger-Glabush (ed.), IBFD International Tax Glossary (online version).

It is possible to obtain tax rulings in Danish tax law, so-called binding rulings.[5] It is the view of the authors that the tax ruling regime does not have a significant impact on the tax avoidance carried out.

Although the tax treatment of tax avoidance is primarily handled by case law, no actual definition or meaning of the notion of tax avoidance can be derived. The legal tradition is to describe the concept of tax abuse and circumvention by identifying the contours as decided by the courts. In essence, the definition then becomes case specific. Moreover, legal theory does not agree on what is the correct interpretation of case law that deals with tax avoidance.

It is firmly assumed in tax law literature that no such general avoidance clause exists. Nevertheless, there are Supreme Court judgments in which avoidance-like deliberations play a part, *see* TfS 1998, 199 H, TfS 1998, 99 H and TfS 2002, 460 H.

TfS 1998, 199 H concerned a taxpayer with a number of non-interest-bearing claims against companies owned by him. The tax authorities wanted to tax him on a fixed-interest income, but the Supreme Court found that it must be so that a lender cannot be taxed on a fixed-interest income unless the transactions made were intended to circumvent tax law.[6]

TfS 1998, 99 H concerned a taxpayer who used the special business taxation regime and contributed personal debts into it at the start of the year, just to withdraw them again at the end of the year and thereby avoid the special rules on adjustment of interest on personal debts. It is clear from the legislative history of the business taxation regime that the legislators presupposed that a person using the business taxation regime would not be able to abuse the regime to obtain full deductibility of the interest payable on any personal debt contributed. Consequently, in a judgment later affirmed by the Supreme Court, the Western Division of the Danish High Court laid down:

> Taking into account the purpose of the Business Taxation Regime [*virksomhedsskatteloven*] and the fact that the taxpayer's transactions were clearly abusing the rules of the Act, the Court finds the assessment authorities justified in setting aside the arrangement.

The case TfS 2002, 460 H concerned two taxpayers who had made a loan-financed investment in bonds to obtain tax-exempt capital gains and deductions for interest payable on the loan. But new rules were introduced making capital gains on claims acquired on borrowed funds taxable. At the same time, however, an exemption was introduced saying that capital gains would not be taxable if the taxpayer proved that the total result after tax of the loans and the claims combined was negative.

5 *See*, for comparison, secs. 21-25 Tax Administration Act.

6 *See* Erik Overgaard, Journal of Danish Tax Law, 1998 (TfS 1998, 207), who with reference to this judgment argues the following: "It is hard to take the Supreme Court's choice of words to be anything other than an indication that reference to a general avoidance clause is made to provide statutory authority to the taxation of a fixed interest rate. It is, presumably, the first time the Supreme Court has ever used the term 'avoidance' separately in any judgment to provide legal basis for taxation."

Having learned about the bill, taxpayers rearranged their loan-financed bond investments to make the total result after tax negative, and thereby claiming exemption. But the Supreme Court ruled against the taxpayers and stated that the exemption was intended to include only cases where there was no tax speculation involved.

Pursuant to a doctrine of “substance over form”, it has been argued that fictitious or artificial transactions may be set aside for tax purposes if the actual substance of the transaction conflicts with its private law form, resulting in a tax advantage.[7] In this case, tax will be imposed in accordance with the actual substance of the transaction based on an overall assessment. The applicability of the doctrine of “substance over form” is limited, however, and in order for the doctrine to apply there must be an evident conflict between form and substance.

In addition to the substance-over-form doctrine, the doctrine of the “*rightful recipient of income*” plays a significant role. The doctrine prescribes that the subject having the (legal) right to the basis of the income – e.g. a shareholding, a claim or a business activity – should also be considered the proper recipient for tax purposes of the gain or return on the shares/claim/activity.[8]

The interaction between these doctrines is somewhat unclear, but for many practical purposes they seem to be overlapping.[9] However, the doctrines should normally not be considered to be a sufficient tool when it comes to preventing erosion of the Danish tax base.

The substance-over-form doctrine was first described by Jan Pedersen's 1989 doctoral thesis entitled Tax Exploitation, particularly p. 435 et seq. and in *Skatteorientering Ø.5*, p. 23, where it is stated that the main element of the general clause is that fictitious or artificial transactions may be set aside for tax purposes if its actual contents clashes with its external civil law form, resulting in a tax advantage. Tax will then be imposed in accordance with the actual substance of the transaction such as it appears on an overall assessment. Thus, a chain of transactions, each of them plausible enough, forming part of a larger transaction (“step-by-step transactions”), may be subject to one overall assessment. For tax law purposes, the transaction is therefore assessed not on the merits of each step individually, but on the basis of the overall impression of the transaction as a whole.

There are limits, however, to the applicability of the substance-over-form doctrine. Thus, according to leading commentators, it is important to bear in mind that the substance-over-form doctrine cannot be

7 The principle was originally explained by Jan Pedersen in *Skatteudnyttelse*, 1989, p. 435 et seq.

8 The doctrine – it is argued – can be deduced from sec. 4 State Tax Act. *See* Aage Michelsen in Aage Michelsen et al., *Lærebog om indkomstskat*, 2015, p. 675 et seq. and Henrik Dam: *Rette indkomstmodtager: Allokering og fiksering*, 2005.

9 *See*, for comparison, Jakob Bundgaard, *Skatteret & civilret*, 2006, p. 558 et seq. In the literature, a debate has taken place between proponents for the doctrine of “substance over form” and advocates of the doctrine of the “rightful recipient of income”.

applied to all transactions with an element of fiction.[10] It is a further condition that there is a clear conflict between form and substance. Therefore, although by their very nature they are only of formal significance, the formation of companies and the conclusion of marriages and divorces for tax purposes only, etc. cannot be set aside.

So far, there is very little in case law to support the setting aside of transactions resulting from company law rules.[11] In SKM2006.69.ØLR (concerning the facts of a transfer to a limited partnership) the Eastern Division of the Danish High Court ruled that the formation of the partnership could not be set aside as it had been in line with all applicable company law rules, and as the taxpayer had contributed funds and assumed a risk. The fact that it was a dormant company with a little accounting discrepancy etc. was not enough, the High Court said, to "deprive the limited partnership structure of tax relevance". Also the decision of the Supreme Court in SKM2006.749.HR *Finwell* supports the finding that transactions owing their existence to company law rules and procedures cannot be set aside.

The closest thing so far to the setting aside of legal company law transactions seems to be the judgment rendered in Journal of Danish Tax Law 2003, 889 H *Over-hold ApS,*[12] in which the High Court – but not the Supreme Court – came very close to reclassifying a company law transaction. The company was denied deduction of interest in a financing transaction involving an element of exploitation of losses, based on a specific assessment of the facts of the case. Because of the close connections between the raising of a loan, a capital increase and a subsequent capital reduction, the High Court was not satisfied that the company did actually have free disposal of the borrowed funds. Likewise, the High Court held that the loss-making company did not have free disposal of its equity as, in the High Court's opinion, the loan of DKK 120 million had been designated in advance to be lent to the consolidated company. Further, the High Court did not find that the inter-company loans represented any real risk for the companies. And lastly, because, according to the information submitted, the company earned no profit on the arrangement, the High Court found that the loan *was not a usual business transaction* for the company and consequently could not be given any tax relevance.

As can be seen, the setting aside of company law transactions is only an indirect consequence of wanting to disallow deductibility of interest costs. The High Court must have assessed that there was

[10] Pedersen, *supra* n. 2, p. 24.

[11] *See*, for comparison, Hans Severin Hansen, Journal of Danish Tax Law, 2004 (TfS 2004, 88) and Jakob Bundgaard, Journal of Danish Tax Law, 2004 (TfS 2004, 68), but contra Morten Jappe & Lars Bo Nielsen in Journal of Danish Tax Law, 2004 (TfS 2004, 315), arguing that the use of company law rules can become so unusual that company law transactions and financial reality begin to clash.

[12] The judgment is commented on by Aage Michelsen, *Revision og Regnskabsvæsen* 2004 (RR 2004 SM 9), by Hans Severin Hansen in Journal of Danish Tax Law, 2004 (TfS 2004, 88) and by Jan Guldmand Hansen, *SR-Skat*, 2004, p. 50 et seq.

no capital increase, or that the capital increase had been made by the foreign parent company directly, despite the fact that for company law purposes it was the company itself subscribing for shares as part of the capital increase. The Supreme Court later overruled the High Court's judgment, stating that the company had legally applied the then express exemption applicable to financial loss-making companies in sec. 15(7), no. 3, of the Danish Tax Assessment Act.

The recent Supreme Court decision SKM2014.422.HR *Topdanmark A/S* may have altered the above to a certain extent. Accordingly, the decision implied that certain capital increases should be disregarded with respect to finding the acquisition price for shares in a tax planning arrangement. Moreover, the Supreme Court's decision in SKM2016.16.HR *Færø-sagen* has caused additional uncertainty, as the court actually set aside a structure involving a merger of two holding companies. In our view, the decision is somewhat controversial and among other things it should be kept in mind that the case concerned the tax system in place on the Faroe Islands.

A *tax savings motivation* underlying the taxpayers' activities will not in itself lead to a reclassification of the transaction in question according to court case law. However, it seems that the Danish tax authorities as well as lower courts are of the opinion that such a motive in itself is sufficient to set aside a transaction. However, the Supreme Court has stated on several occasions that tax saving is a valid and commercial motive that should be upheld for tax purposes if the transaction in question stands up to a closer scrutiny. In other words, it must be considered to be current law in Denmark that no specific requirement for a business motive applies insofar as the transactions are in substance what they appear to be in form. In fact, the business purpose test is to be understood as a test of economic reality. If there is no such substance, the transactions are considered empty from the perspective of substance. Moreover, a tax saving motive will increase the substance test, and accordingly, is a prerequisite for reclassifications according to the substance-over-form doctrine.

In a few rare cases, where the taxpayer has acted aggressively (for example, where the tax motive is the sole motive) it has been seen that the Danish Supreme Court has set aside a transaction (rather than merely adjusting the terms and conditions of it), *see* TfS 1999, 950 H.

In the view of the authors, case law is not fully consistent among the courts and the Danish Tax Tribunal. In fact, certain leading cases demonstrate a different view from the Supreme Court in the approach to tax avoidance, although the Supreme Court generally does not rule more often in favour of the taxpayer. Case law demonstrates some remarkable examples that show that the Supreme Court is willing to decide on tax avoidance cases in favour of the taxpayer where the result is heavily supported by the legal doctrine as being correct. The former – now retired president of the Supreme Court – has stated that taxpayers' positions will gain support if they are right.

In Danish law, the legal, administrative and/or case meaning of tax avoidance does not seem to be directly influenced by its meaning in other jurisdictions, OECD, soft law or the case law of the ECJ.

The BEPS discussions generally, and to a large extent, are already included in the Danish tax system. Consequently, not many of the BEPS proposals would lead to significant changes in the Danish tax system if it were decided to follow the BEPS recommendations closely.

The only direct examples of changes caused by the BEPS agenda are the introduction of an international GAAR in Danish law (*see* section 12.2.1.) and the recent adoption of a Bill introducing country-by-country reporting based on OECD's recommendations.[13]

12.1.2. The meaning of tax planning, abusive tax planning and aggressive tax planning in national legal systems

There is no legal definition of tax planning, abusive tax planning or aggressive tax planning in Danish tax law. In the political debate, however, it seems that aggressive tax planning is defined as any tax advantage that could be achieved by taxpayers and that has not been directly legislated against previously or if the existing legislation is too narrow to include certain transactions.

The above statement also holds true in terms of administrative regulations, which do not contain any clarification on the meaning of tax planning in Danish tax law.

A committee established by the government in 2013 – in order to facilitate stronger discipline among tax advisers against cross-border tax evasion and tax fraud – used the following definition of so-called "cross-border tax optimization" in its report:[14] "The use of actions that within the limits of the law bring the tax payer in a favourable tax position or eliminate double taxation".[15] However, this definition does not hold any formal authority.

As mentioned above, it is possible to obtain tax rulings in Danish tax law, so-called binding rulings. It is the subjective view of the authors that the tax ruling regime does not have a significant impact on the tax planning carried out. In fact, it has been observed on several occasions that whenever taxpayers submit requests for tax rulings in terms of specific tax planning techniques, such rulings

13 *See* Law 1884 of 29 Dec. 2015, Bill L 46 (2015/2016).

14 *See* The Danish Ministry of Taxation, *Styrket rådgiver- og branchesamarbejde mod grænseoverskridende skatteunddragelse*, 6 November 2014.

15 Certain more general observations concerning tax planning etc. can also be found in recommendation nos. 1060 and 1985 (*Skatteflugtsbetænkningen*).

may be granted, but with the simultaneously issuance of a Bill aiming at amending the legislation in order to prevent such tax planning techniques.[16]

Danish case law does not include any definition of the meaning of tax planning. The notion of tax planning does not trigger any legal consequences. Refer to the above case law regarding circumvention and abuse.

The BEPS discussions generally, and to a large extent, are already addressed by the Danish tax system. Consequently, only a few of the BEPS proposals are expected to lead to significant changes of Danish tax law.

12.2. The reaction to avoidance and aggressive tax planning in the BEPS context

12.2.1. Domestic general anti-avoidance rules (GAARs)

A GAAR in its wide sense does not exist in Danish law. However, an international GAAR was introduced in Danish tax law in 2015. This GAAR consists of the implementation of the recent abuse provision in the Parent-Subsidiary Directive, but with a wider scope as to also be applicable to the Merger Directive and the Interest and Royalty Directive. Moreover, the provision also introduces the OECD-based principal purpose test with respect to tax treaties.

To a certain extent, the Danish international GAAR is similar to the EC Recommendation. However, from a legal perspective, the provisions are not identical.

No thorough analysis has yet been made as to the conformity of the Danish international GAAR with the EU/EEA concept of abuse. During the official hearing process, it was stated that to a certain extent the provision should be interpreted in accordance with EU case law regarding abuse. Since there is no case law yet on this topic, the authors cannot assess whether the provisions will be interpreted fully in accordance with the EU/EEA concept of abuse.

The assessment of the following elements in the Danish international GAAR are completely identical with the anti-abuse clause in the Parent-Subsidiary Directive and the OECD principal purpose test.[17]

> a) main objective test (the accrual of a tax advantage the grant of which is contrary to purpose of the legal provision);

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16 *See*, for example, Bill L 84 (2010/2011), which introduced an amendment targeting the use of cross-border vertical mergers in order to circumvent the Danish rules on withholding tax of dividends. This could be seen as a direct reaction to two decisions from the Tax Assessment Council.

17 Even though the wording of the anti-abuse clause in the Parent-Subsidiary Directive and the OECD principal purpose test are not the same, it is the view of the Danish legislator that the two provisions should be interpreted in the same way, with respect to the preparatory remarks to Bill L 167 (2014/2015).

The Danish international GAAR does include a requirement stating that the transactions should have been put in place for the main purpose, or one of the main purposes, of obtaining a tax advantage:

> b) the obtaining of a tax advantage as the essential aim of the transactions concerned;

Same as under 1):

> c) complementary business purpose test (under international tax law) or the genuine economic activity test (under EU law);

The Danish international GAAR includes a requirement for the transactions to not be genuine with regards to all relevant facts and circumstances:

> d) subjective element, consisting of the intention to obtain a tax advantage;

Subjectivity is included in the above-mentioned main objective test:

> e) the principle of proportionality.

The principle of proportionality is not, as such, included in the Danish international GAAR. However, it is assumed that the administration of the GAAR should be in accordance with the principle of proportionality. Due to the very recent introduction of the Danish international GAAR, no case law is yet available.

12.2.2. EC Recommendation C-(2012) 8806 of 6 December 2012, the subject-to-tax rule and the Proposal for an Anti-Tax Avoidance Directive of 28 January 2016

It is not common for Danish treaty policy to include subject-to-tax rules as proposed by the EC. However, a number of tax treaties do include different forms of such provisions.[18]

12.2.2.1. General subject-to-tax provisions[19]

The multilateral Nordic treaty contains a general subject-to-tax provision in article 26(2).[20] Accordingly, if the right to tax income or capital is granted to a contracting state other than the state of which the person who derives income or capital is a resident, and the other contracting state, according to its laws, does not consider the income or the capital in its entirety as taxable, or only

18 *See also* Jakob Bundgaard & Peter Koerver Schmidt in Cahiers de droit fiscal international, 2010, vol. 95a, pp. 261-279.

19 In the *2014 Commentary on Article 1 of the OECD Model*, no. 15, *general subject-to-tax provisions* are defined as provisions that provide that treaty benefits in the state of source are granted only if the income in question is subject to tax in the state of residence. However, in the following, the term "general subject-to-tax provisions" will also be used to describe provisions that grant the state of residence the right to tax if the income in question is not subject to tax in the state of source.

20 The contracting parties to the Nordic Tax Treaty are Denmark, Faroe Islands, Finland, Iceland, Norway and Sweden.

considers the income or capital in calculations under a progressive tax scheme, or in other tax computations, the contracting state where the person resides may tax that part of the income or capital that is not included under taxation in the other contracting state.

Likewise, the treaty between Denmark and Germany contains a general subject-to-tax provision in favour of the state of residence; *see* article 24(3).

12.2.2.2. Specific subject-to-tax provision

Other treaties signed by Denmark contain more specific subject-to-tax provisions.[21] An example can be found in article 29(1) of the treaty between Denmark and South Africa, which states that if one of the states introduces legislation on lower or no taxation of offshore income derived by a company,[22] the other state shall not be obliged to apply any limitation imposed under the treaty.[23] Further, pursuant to article 29(2), it follows that if income according to the treaty should be exempt from taxation in the source state – as well as in the state of residence in spite of this refrain from taxing the income[24] – the source state can tax the income anyway. The existence of this clause results from the fact that South Africa applies the principle of territoriality. For the same reason, article 25 of the treaty between Denmark and Vietnam states that where any person derives income from a source situated outside Vietnam and such income is exempt from tax under the laws of Vietnam and also exempt from tax in Denmark under the treaty, Denmark may tax such income under its own laws.[25]

The treaty between Denmark and Cyprus, article 23(3), states that if income according to the treaty is relieved from tax in one of the states – e.g. Denmark – and the income pursuant to Cypriot law is subject to tax by reference to the amount that is remitted to or received in Cyprus and not by reference to the full amount, then the relief to be allowed under this convention in Denmark shall apply only to so much of the income as is remitted to or received in Cyprus. Almost similar provisions can be found

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21 For a more thorough description and overview of subject-to-tax provisions in Denmark's treaties, *see* Philip Noes, Danish Journal of International Taxation, 2003 (SU 2003, 3).

22 The company should be involved in one of the following industries: (a) shipping; (b) banking, financing, insurance, investment or similar activities; or (c) being the headquarters, coordination centre or similar entity providing administrative services or other support to a group of companies that carry on business primarily in other states.

23 Art. 26(1) in the treaty between the Danish Trade Organization's Taipei office and the Taipei Representative Office in Denmark contains a somewhat similar provision targeted at companies that derive income primarily from outside the territory from banking, financing and insurance activities or from being a coordination centre. Further, an additional subject-to-tax provision appears in art. 26(2) concerning interest, dividends and royalty paid from e.g. a company where more than 50% of the capital or votes is owned or controlled directly or indirectly by a person or any other legal person not being residents of one of the territories or of the European Union or the European Economic Area.

24 In terms of any provision of the treaty other than art. 10 on dividends.

25 Art. 25 should be applied without prejudice to the participation exemption concerning dividends in art. 24(1)(f).

in Denmark's treaties with Malta (article 24),[26] Singapore (article 22), Jamaica (article 24(4)) and Thailand (article 24(4)). Article 28(1) in the treaty between Denmark and the United Kingdom also contains a subject-to-tax provision, which, however, has a more limited scope. Accordingly, the provision states that if an *individual* resident in the United Kingdom is subject to tax by reference to the amount thereof that is remitted to or received in the United Kingdom and not by reference to the full amount, the relief to be allowed under the treaty in Denmark shall apply only to so much of the income as is taxed in the United Kingdom.[27]

Finally, it should be mentioned that some of Denmark's tax treaties contain specific subject-to-tax provisions concerning among other things income from employment[28] and independent personal services.[29] The authors are not aware of any plans to introduce subject-to-tax rules as proposed by the EC.

12.2.2.3. The proposal for an Anti-Tax Avoidance Directive (ATAD) of 28 January 2016

As mentioned above, a GAAR in its wide sense does not exist in Danish law, but an international GAAR was introduced in Danish tax law in 2015. However, the international GAAR is only applicable with respect to transactions covered by the Parent-Subsidiary Directive, the Merger Directive, the Interest and Royalty Directive and tax treaties. Accordingly, if the ATAD proposal is adopted in its original form, it will be necessary to introduce a statutory GAAR in Danish law applicable to all corporate taxpayers.

Besides the GAAR the ATAD proposal includes an interest limitation rule, a rule on exit taxation, a switch-over clause, a CFC rule and a rule on hybrid mismatches. Except for a general switch-over rule, Denmark already has such SAARs in place.[30] However, as current Danish SAARs do not exactly match the SAARs in the ATAD proposal, certain amendments of the Danish provisions will have to be made if the ATAD proposal is adopted in its original form, to ensure that the Danish rules at least cover the situations encompassed by the SAARs in the ATAD proposal.[31]

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26 Moreover, the treaty does not apply at all to certain persons that are entitled to certain tax benefits according to Maltese law; *see* the notes on 13 July 1998.

27 Art. 28(1) was amended according to the Protocol to the Convention on Double Taxation between Denmark and the United Kingdom signed 15 October 1996.

28 *See*, for example, art. 15(2)(d) in the treaty between Denmark and Australia, art. 14(2)(d) in the treaty between Denmark and Malaysia and art. 26(3) in the Nordic Tax Treaty.

29 *See*, for example, art.14(1)(b) in the treaty between Denmark and Greece and art. 26(3) in the Nordic Tax Treaty.

30 *See* section III below.

31 *See* Jakob Bundgaard & Peter Koerver Schmidt, *SR-Skat*, 2016, pp. 151-163.

12.3. Transfer pricing rules, GAARs, SAARs and linking rules

Danish tax law encompasses a relatively high number of SAARs, and the extent of such legislation has increased significantly during the last two decades. Section 12.3.1. addresses some of the most significant SAARs, and the aims of the provisions are briefly explained.[32]

12.3.1. Transfer pricing

Danish TP legislation – which dates back to 1960 – was reformed in 1998, following a number of judgments by the Supreme Court on "interest fixation", which the tax authorities had lost.[33] The aim of the reform was to provide a clear legal basis for TP adjustments, in order to avoid erosion of the Danish tax base and to ensure equal tax treatment of Danish and foreign-owned companies.[34] The current regime sets forth the arm's length principle, which should be interpreted in line with the article 9(1) of the OECD Model and the OECD Transfer Pricing Guidelines.[35] The TP rules apply to "controlled transactions" and cover cross-border transactions, as well as domestic transactions.[36]

The TP rules have in recent years been more frequently used to prevent or combat avoidance, and in general it is the impression that the tax authorities' TP audits have become more thorough.[37] Accordingly, TP has for a number of years been a focus area for the tax authorities and more resources have been allocated to the units dealing with TP. The effect has been a rise in the number of cases, which increased from 27 finalized cases in 2008 to 77 finalized cases in 2013.[38]

As a result of the increase in the number of TP cases, more and more TP-related litigation also seems to be happening. One of the court cases that has received quite a lot of attention is the Supreme Court's decision in SKM2012.92.HR (*Swiss Re*). The case – which the tax authorities won – clarifies that the extended statute of limitation regarding controlled transactions is applicable with regard to all types of adjustments.[39] However, the most controversial aspect of the decision was the reasoning adopted by the Supreme Court regarding the scope of the arms' length principle laid out in section 2 of the Tax Assessment Act. Thus, the Supreme Court made the following statement:

> The authority to make an adjustment covers all economic elements and other terms of relevance for taxation purposes including, for example, also due date, recognition of interest and capital losses and

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32 This section is based on Peter Koerver Schmidt, Nordic Tax Journal, 2014, p. 113-131, and Bundgaard, *supra* n. 18. GAARs are not dealt with in this section. *See* instead section II. 1 above.

33 *See* TfS 1996, 642 H, TfS 1998, 199 H and TfS 1998, 238 H.

34 *See* the explanatory notes to Bill L 101 (1997/1998).

35 *See* Jens Wittendorff, *Armslængdeprincippet i dansk og international skatteret*, 2009, p. 262 et seq.

36 *See* sec. 2 Tax Assessment Act.

37 *See* Jens Wittendorff, International Transfer Pricing Journal, 2012, vol. 19, pp. 324-329.

38 *See* SKAT, *Kontrolaktiviteter 2015 – Styrket regelefterlevelse på skatteområdet*. In 2009, the number of finalized cases was 32, in 2010 it was 40, in 2011 it was 47 and in 2012 it was 67.

39 The extended statute of limitation for controlled transactions follows from sec. 34(5) Tax Administration Act. According to this provision, the deadline is 1 May of the sixth year after the end of the income year.

> the legal qualification of the transaction. A loan agreement on zero-coupon terms concluded between related parties with retroactive effect may thus be adjusted by the tax authorities on the basis of section 2(1) of the Tax Assessment Act.

This statement is troublesome, as the prevailing opinion in the Danish literature has been that section 2 of the Tax Assessment Act does not govern the legal qualification of the transaction. Accordingly, if the above-mentioned statement should be interpreted to mean that the legal qualification of the transaction is also covered by section 2 of the Tax Assessment Act, the scope of applicability appears significantly larger than originally expected in the literature. However, as the reasoning of the court seems rather ambiguous, it has been argued that the precedence value of the decision may be limited.[40]

In addition to the material TP legislation, information and documentation requirements also apply.[41] Accordingly, when taxpayers file their tax returns, the tax authorities should be informed about the nature and scale of the controlled transactions. Moreover, the taxpayer is obliged to prepare and hold written TP documentation. On request, the TP documentation must be handed over to the Danish tax authorities. Recently, the government has put forward a draft bill aiming at introducing country-by-country reporting based on OECD's recommendations.[42]

If sufficient TP documentation exists, it is the tax authorities that have the burden of proof concerning whether or not the transactions are at arm's length.[43] However, if the TP documentation is insufficient, the tax authorities are allowed to disregard the originally applied prices or rates as the burden of proof is then shifted to the taxpayer.[44] In line with this, the Supreme Court recently found – *see* SKM2015.296.HR – that the tax authorities were entitled to make a discretionary assessment of the value of the sales price concerning an intra-group transfer of shares. Moreover, the Supreme Court stated that the discretionary asssessment could only be set aside if the taxpayer could substantiate that the discretionary assessment was made on an incorrect basis or was clearly unreasonable.

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40 *See* Jens Wittendorff, International Transfer Pricing Journal, 2012, pp. 203-221, who is very critical of the decision.

41 *See* sec. 3B Tax Control Act. For smaller corporate groups, the documentation requirements are less restrictive.

42 *See* Draft bill, 18 Sept. 2015, J. nr. 15-1342223.

43 *See* Jane Bolander & Jakob Graff Nielsen in Gerard Meussen (ed.), *The Burden of Proof in Tax Law*, 2011, p. 95.

44 *See* the decision of the National Tax Tribunal in SKM2014.53.LSR. The decision constitutes the first published case concerning a cash-pooling arrangement. Among other things the Tribunal found that the interest applied to inbound and outbound loans in a cash-pooling arrangement should be the same. Moreover, the Tribunal found that the assessment should be based on the group credit rating and not on an individual credit rating of the company. *See also* Eduardo Vistisen, Danish Journal of International Tax Law, 2004 (SU 2014, 107).

12.3.2. LOB clauses

Normally, Denmark's tax treaties do not include limitation of benefit (LOB) rules. However, LOB rules can be found in a few of Denmark's tax treaties. Accordingly, article 26(3) of the treaty between the Danish Trade Organization's Taipei office and the Taipei Representative Office in Denmark contains a LOB clause with a broad and general scope. The article states that a resident of a territory shall not receive the benefit of any reduction in, or exemption from, tax provided for in the treaty by the other territory if the main purpose, or one of the main purposes, of such a resident or a person connected with such a resident was to obtain the benefits of this agreement.

In article 22 of the treaty between Denmark and the United States, a more specific LOB clause appears.[45] This very detailed and complex clause lists several conditions that must be met if a resident of the contracting states should be entitled to benefit from the treaty. In short, the LOB clause should ensure that persons who are not resident in one of the contracting states cannot benefit from the provisions of the treaty.[46] Individuals resident in the United States or Denmark are under all circumstances entitled to benefit from the provisions of the treaty. In addition, public authorities in the two states, religious and charitable organizations as well as pension funds[47] are per se entitled to the benefits. However, legal entities, such as companies and trusts, have to meet certain requirements regarding, among other things, ownership, cash flows and business activity.[48]

12.3.3. CFC legislation

Denmark introduced controlled foreign company (CFC) legislation in 1995. The objective behind the introduction of CFC legislation was to prevent erosion of the Danish tax base caused by the increasing openness of borders to flows of capital.[49] More specifically, the aim was to prevent Danish companies from establishing subsidiaries in low-tax countries and moving income and assets hereto.[50]

According to the Danish CFC regime, a Danish company is liable to tax on the income of a Danish or foreign subsidiary if: (i) the subsidiary is controlled by the affiliated group of companies; (ii) the

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45 Art. 22 in the treaty was amended following the ratification of the protocol which entered into force on 28 December 2007. The LOB clause is standard in US treaties.

46 The LOB clause is analysed by Carina Korsgaard & Kristoffer Kowalski, Danish Journal of International Taxation, 2008 (SU 2008, 130).

47 If more than 50% of the pension recipients are resident in one of the two states.

48 Moreover, art. 4(1)(d) of the treaty states that an item income, profit or gain derived through an entity that is fiscally transparent under the laws of either contracting state shall be considered to be derived by a resident of a state to the extent that the item is treated for purposes of the taxation law of such contracting state as the income, profit or gain of a resident.

49 *See* the explanatory notes to Bill L 35 (1994/1995).

50 *See* Peter Koerver Schmidt, *Dansk CFC-beskatning i et internationalt og komparativt perspektiv*, 2013, and Peter Koerver Schmidt, Cahiers de droit fiscal international, 2013, vol. 98a, pp. 259-277.

tainted income ("CFC income") of the subsidiary amounts to more than 50% of the total taxable income; and (iii) the financial assets of the subsidiary exceed 10% of the total assets.[51]

If the CFC rules apply, the Danish parent company should include the total income of the subsidiary, provided that the income of the subsidiary is positive. If the parent company does not fully own the subsidiary, only a proportional part of the subsidiary's income should be attributed to the parent company. Furthermore, only income generated by the subsidiary in the period during which the parent company had "deciding influence" should be included. A tax credit is granted for taxes paid by the subsidiary.

It should be noted that the scope of the Danish CFC regime for companies was expanded in 2007 in order to bring the rules in line with EU law following the European Court of Justice's decision in case C-196/04 *Cadbury Schweppes*, namely in Bill L 213 (2006/2007). However, it has been argued that different treatment still exists, as the application of the CFC rules only entails an additional tax burden for the Danish parent company if the subsidiary is resident in another country in which the level of taxation is lower than the Danish level of taxation.[52] Despite this criticism, the OECD's BEPS recommendations suggest that Member States should consider applying CFC rules equally to both domestic subsidiaries and cross-border subsidiaries. In this context, the Danish rules are explicitly mentioned as an example.[53]

12.3.4. Linking rules

Denmark already had linking rules in place before the OECD initiated the BEPS Project. Accordingly, Denmark has introduced provisions on hybrid as well as reverse hybrid entities, which entails that the domestic tax treatment in some situations depends on the tax treatment in other jurisdictions.[54] Both provisions could be seen as a reaction to tax planning based on the US check-the-box rules.[55]

Accordingly, if a company or association should be treated as a transparent entity according to the tax rules of a foreign state, with the effect that the company's income should be included in the income of an affiliated company in this foreign state, the company should – if certain conditions apply – be reclassified as a transparent entity for Danish tax purposes. The objective of the provision is to mitigate the possibility of "creating" deductible interest expenses in Denmark in situations where the

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51 *See* sec. 32 Corporate Tax Act. Sec. 8(2) Corporate Tax Act contains a CFC rule for foreign PEs.
52 *See* Peter Koerver Schmidt, European Taxation, 2014, vol. 54, pp. 3-9.
53 *See* OECD, *BEPS Action 3: Designing Effective Controlled Foreign Company Rules*, 2015, pp. 17-18.
54 *See* secs. 2A and 2C Corporation Tax Act.
55 For more on the Danish rules on hybrid entities and hybrid financial instruments, *see* Jakob Bundgaard, Bulletin for International Taxation, 2013, vol. 67, pp. 200-204, who demonstrates the frequent Danish use of coordination rules based on a principle of correspondence.

foreign recipient is not taxable for the interest payments, as these payments should be considered internal transfers within the same entity pursuant to the tax rules in the foreign state.[56]

Conversely, certain tax transparent entities should be reclassified as separate taxable entities if more than 50% of the shares or voting rights are held directly by foreign investors and the tax domicile of such foreign investors is in a country in which the Danish entity is treated as a taxable entity or in a non-EU Member State that does not have a tax treaty with Denmark.[57] Here the aim is to prevent taxpayers from exploiting different entity qualification to "create" double non-taxation.[58]

Cross-border tax arbitrage by way of using hybrid financial instruments has been curbed inbound and outbound. Accordingly, if a company or association etc. is indebted or similarly obligated to an individual or company resident in another country and the claim according to foreign tax rules is considered paid in capital, the debt shall also be regarded as equity with respect to the Danish tax computation.[59] The objective of this provision is to abolish the potentially asymmetrical tax treatment of certain hybrid financial instruments.[60]

In addition, the applicability of the inbound dividend participation exemption has been limited to situations where the foreign paying company is not allowed under the tax laws of the country of its residence to deduct the payments that are considered dividends under Danish tax law.[61] The provision will prevent Danish companies from receiving tax exempt dividends in situations where the foreign paying company can deduct the payment.[62]

In general, the Danish linking rules described above are not entirely the same as the rules suggested by the OECD,[63] as the effect of the Danish rules often is a requalification of the entire entity or payment, and not merely the deprivation of a deduction or an exemption.

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56 *See* the explanatory notes to Bill L 119 (2003/2004).

57 *See* sec. 2C Corporation Tax Act.

58 *See* the explanatory notes to Bill L 181 (2007/2008).

59 *See* sec. 2B Corporation Tax Act. The provision only applies if the foreign individual or company has decisive influence on the Danish company or the companies that are considered to be in a group of companies; *see* the principles in sec. 2 Tax Assessment Act. The classification means that interest payments and capital losses are considered to be non-deductible dividend payments. *See* Jakob Bundgaard, Bulletin for International Taxation, 2008, vol. 62, p. 33 et seq. For a more general analysis of debt-flavoured equity investments in Danish tax law as well as in international tax law, *see* Jakob Bundgaard, Intertax, 2014, vol. 42, pp. 416-426.

60 *See* the explanatory notes to Bill L 110 B (2006/2007).

61 *See* sec. 13(1)(2) Corporation Tax Act.

62 *See* the explanatory notes to Bill L 23 (2008/2009) and to Bill L 84 (2010/2011) where the scope of the provision was expanded to cover situations where a lower-tier foreign subsidiary obtains the deduction. Originally, this rule was introduced in 2006 as part of another provision with regard to declared dividends, *see* the former sec. 31 D(2) of the Corporate Tax Act. *See* Bill L 110 A (2006/2007).

63 *See* OECD, *BEPS Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements*, 2014.

12.3.5. Rules limiting deduction of interest

The deductibility of financing expenses may in general be restricted under three sets of rules for corporate taxpayers:[64]

(1) The thin capitalization test. A company is thinly capitalized if the debt-to-equity ratio exceeds 4:1, provided that the controlled debt exceeds DKK 10 million. If a company is considered thinly capitalized, interest expenses and capital losses, on the part of the controlled debt that should have been converted to equity to avoid the limitation, are not deductible. However, if the company is able to substantiate that similar financing could have been obtained without security from other group companies, the company will be allowed to deduct interest expenses even though the 4:1 ratio is exceeded.

(2) The asset test. Net financing expenses may be deducted only to the extent the expenses do not exceed a standard rate of presently 4.1% (2015) of the tax base of certain qualifying assets.

(3) The EBIT test. Net financing expenses may not exceed 80% of earnings before interest and tax.

All three rules apply both domestically and internationally. The aim of the thin capitalization rules is to counter the shifting of tax revenue from Denmark caused by intra-group loans made from foreign group companies to Danish subsidiaries on terms that could not have been achieved between independent parties.[65] The thin capitalization rules therefore only apply to controlled debt.

The asset test and the EBIT test were introduced in 2007 as the legislator found that the CFC rules and the thin capitalization rules in force at the time did not provide sufficient protection of the Danish tax base in situations where Danish companies were acquired by private equity funds in highly leveraged buyouts.[66] Both the asset test and the EBIT test only apply to net financing expenses exceeding DKK 21.3 million (2015). The two limitations apply to all kinds of debt – not only controlled debt.

Also elements of the rules on limitation of interest deductions have been criticized for being in breach of the fundamental freedoms in EU law.[67]

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64 *See* secs. 11, 11B and 11C Corporate Tax Act. *See* Michael Tell, *Fradragsbeskæring af selskabers finansieringsudgifter*, 2012.

65 *See* the explanatory notes to Bill L 101 (1997/1998).

66 *See* the explanatory notes to Bill L 213 (2006/2007).

67 *See* Tell, *supra* n. 64, pp. 323-331.

12.3.6. Other SAARs

If a resident company ceases to be fully liable to tax in Denmark, or if a resident company becomes resident in a another state according to a tax treaty, the company should be considered as having disposed of all assets and liabilities that are no longer subject to Danish tax. The assets and liabilities should be considered as sold at fair market value at the time of emigration.[68] Likewise, the transfer of assets and liabilities within a company to a foreign PE or a foreign headquarter, with the result that the assets and liabilities are no longer subject to Danish taxation, is treated as a sale at fair market value at the time of the transfer.[69]

Companies now have the option of deferring payment of the exit tax subject to certain conditions.[70] The exit tax balance must be settled by annual installments equal to the higher of the income relating to the assets multiplied by the applicable Danish corporate tax rate, or 1/7 of the exit tax balance at the time it was established. Accordingly, deferred exit taxes will be paid within a maximum period of 7 years. An interest of minimum 3% is charged on the remaining deferred exit tax every year.

Finally, a number of other provisions protecting the Danish tax base should briefly be mentioned:

(a) Companies that are subject to full Danish tax liability, but are domiciled in another country according to the provisions in a tax treaty, can only deduct expenses that are related to income that can be taxed in Denmark due to the tax treaty.[71]

(b) A "net principle" applies concerning double taxation relief, unilaterally or according to a double taxation treaty. The principle states that expenses that relate to the foreign-source gross income must be deducted when computing net foreign-source income.[72]

(c) An anti-double dip provision prohibits deduction of expenses, which due to foreign tax rules can be deducted from income that is not included when calculating the Danish tax.[73] The provision moreover prevents double dips arising from double depreciation of leasing assets.

(d) If a debt claim is acquired for borrowed funds, and interest or capital gains on the debt claim should not be included in the income by virtue of a tax treaty, interest, capital losses,

[68] *See* secs. 5(7) and (8) Corporation Tax Act. *See* Bill L 35 (1994/1995).
[69] *See* sec. 8(4) Corporation Tax Act. *See* Bill L 121 (2004/2005).
[70] *See* secs. 26 and 27 Corporation Tax Act. *See* Bill L 91 (2013/2014).
[71] *See* sec. 9 Corporation Tax Act.
[72] *See* sec. 33F Tax Assessment Act.
[73] *See* sec. 5G Tax Assessment Act.

commission, premiums and other expenses incurred in connection to the loan cannot be deducted.[74] This also applies if shares are acquired for borrowed funds, provided the shares in question are shares in a company that directly or indirectly holds a significant amount of the aforementioned debt claims.

(e) A provision prohibits deduction of payments for accrued interest paid in connection with a purchase of interest-bearing debt claims if interest or capital gains on the debt claim by virtue of a tax treaty should not be included in the taxable income.[75]

(f) Losses on debt claims are not deductible if interest or gains related to the debt claim should not be included in the taxable income as a result of a tax treaty.[76]

(g) Recently, a number of new provisions have been enacted in order to ensure that Danish dividend withholding tax cannot be avoided by structuring the transactions differently, for example, by migration of a Danish subsidiary, a tax-exempt cross-border merger, liquidation or share redemption, and other kinds of reorganization of the ownership of a Danish subsidiary.[77]

12.4. Application of GAARs, TP rules and SAARs

The Danish GAARs and SAARs (including TP rules and linking rules) form a patchwork of anti-avoidance measures. Accordingly, there does not seem to be a distinct hierarchy and the legislator has generally not prioritized the coordination of the anti-avoidance rules introduced by law. Instead, it appears that the legislator has just continuously added new SAARs or amended the existing SAARs whenever a (political) need has arisen to close a "loophole" or mitigate certain tax planning schemes/ideas.[78]

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74 *See* sec. 5F Tax Assessment Act.

75 *See* sec. 5C(3) Tax Assessment Act.

76 *See* sec. 5 Act on Taxation of Gains and Losses on Debt Claims, Debts and Financial Instruments.

77 *See* secs. 5(5) and 2D Corporate Tax Act, secs. 9(2), 15(4-5), 15a(10) and 15b(4) of the Merger Tax Act, secs. 16 A(3)(1), 16 B(1) and 16 B(2)(2) Tax Assessment Act and sec. 36(1) Act on Taxation of Gains on Shares. *See* Bill L 202 (2008/2009), Bill L 84 (2010/2011), Bill L 10 (2012/2013) and Bill L 81 (2013/2014).

78 Recently an "anti-tax haven package" has been adopted, *see* Bill L 167 (2014/2015). The bill was based on recommendations made by an interdisciplinary departmental task force. This task force was established in 2013 and its purpose was to go through the existing legislation and case law in order to come up with possible initiatives to fight tax evasion and avoidance with respect to the use of foreign tax

The lack of coordination has inter alia given rise to discussions on the interaction between the Danish TP legislation and the specific thin capitalization rules. The question is whether the rules can be applied simultaneously with respect to the same loan. Administrative case law – which is not publicly available – suggests that this is the case.

In addition, the lack of coordination has given rise to discussions on whether specific anti-avoidance provisions under Danish law are applicable when assessing the conditions for Danish taxation of CFCs (CFC taxation) and when calculating the income to be attributed to the Danish parent company according to the CFC rules (e.g. whether the thin capitalization rules, TP rules and so on have to be applied when making the CFC taxation calculations).[79] The CFC rules do not address this issue directly, but it is clear that the calculations as main rule should be carried out based on Danish tax rules. The question then is whether this also includes all or some of the other SAARs in Danish tax law.

In the preparatory remarks to some of Denmark's SAARs, it is explicitly stated whether the SAAR in question should or should not be applicable under the CFC rules. However, in most cases, the relationship with other SAARs is not dealt with in the preparatory remarks (or the wording for that sake). In this regard, the decision made by the Danish Tax Assessment Council in SKM2014.577.SR is interesting.[80]

The decision concerned whether a new rule limiting the possibility of utilizing tax losses carried forward was also applicable under the CFC rules.[81] Neither the wording of the new rule, nor the preparatory remarks addressed this issue. However, the Council stated that the new rule should also apply under the CFC rules, as the Council argued that all Danish SAARs should be considered applicable under the CFC rules unless it follows directly from the wording of the SAAR or its preparatory remarks that the SAAR in question does not apply under the CFC rules.

The decision from the Tax Assessment Council concerned a rather specific situation and does not generally solve the problems concerning overlapping or uncoordinated SAARs in Danish tax law. However, it clearly illustrates some of the diffuculties that may arise when the continuous addition of new SAARs is not very well coordinated.

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havens, *see* the Danish Ministry of Taxation, *Afrapportering fra den tværministerielle task force mod skattely*, 6 Nov. 2014. For an overview of the relatively few new measures included in the bill, *see* Lars Kjærgård Terkilsen, Nordic Tax Journal, 2015, vol. 2, p. 67 et seq. Officially, a broader and more systematic analysis of international tax avoidance in a Danish context has not been carried out since 1985, *see* recommendation nos. 1060 and 1985.

79 *See* Peter Koerver Schmidt, *Dansk CFC-beskatning*, 2013, p. 338 et seq.

80 The decision has been commented on by Peter Koerver Schmidt, *SR-Skat*, 2014, pp. 255-260.

81 *See* sec. 12(2) Corporate Tax Act.