Tax Avoidance Revisited: Exploring the Boundaries of Anti-Avoidance Rules in the EU BEPS Context

Denmark

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I. The Meaning of Avoidance and Aggressive Tax Planning and the BEPS Initiative

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[2]. No interpretation according to the purpose of a tax provision can set aside the wording of the law[3]. This poses a problem for tax authorities in relation to avoidance, effectively preventing the application of the desired purposive construction, as such construction would set aside the opposed literal interpretation. Thus, the problem of avoidance arises when the possibilities for interpreting a statute are exhausted.[4]

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 SAARs, which was recently 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.[5] The term tax avoidance covers acceptable/ordinary tax planning, but is also used to refer to tax planning that is considered undesirable, e.g. tax optimization manoeuvres 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

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[2] Cf. *Jan Pedersen*: Skatteudnyttelse, 1989 p. 264, and same author in Skatteorientering, 2002, Ø.5, p. 19.
[3] Cf. *Jan Pedersen* in Skatteorientering, 2002, Ø.5, p. 18.
[4] *Jan Pedersen*, Skatteudnyttelse, 1989, p. 292.
[5] See *V. Uckmar* in Cahiers de droit fiscal international, 1983, vol. LXVIIIa, p. 15 et seq. and *Julie Roger-Glabush* (ed.): IBFD International Tax Glossary (online version).

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.

It is possible to obtain tax rulings in Danish tax law, so-called binding rulings.[6] It is the subjective 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 a firm assumption 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.[7]

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 avoiding 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

[6] Cf. Sec 21-25 of the Tax Administration Act.

[7] 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."*

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. 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:

"The exemption is intended to include only cases where there is no tax speculation involved."

The wording of the TfS 1998, 99H and TfS 2002, 460 H judgments could seem to suggest that the Supreme Court acknowledges the existence of an avoidance clause. One cannot assume, however, that this is in fact the case. Both judgments concern a taxpayer's attempts at circumventing a protective ruleThe taxpayer would in this way try to obtain a tax advantage that the legislators had specifically wanted to eliminate, characterising it as "abusive" in the legislative material. In such cases where the legislators pay attention to a specific situation of abuse when drafting the statute, the Supreme Court finds that a strict literal interpretation may be set aside by purposive construction, as the very purpose of the statute is to prevent any such abuse.

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.[8] 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.

[8] The principle was originally explained by *Jan Pedersen*: Skatteudnyttelse, 1989, p. 435 et seq.

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/return on the shares/claim/activity.[9]

The interaction between these doctrines is somewhat unclear, but for many practical purposes they seem to be overlapping.[10] 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 the actual contents of it 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 applied to all transactions with an element of fiction.[11] It is a further condition that there is a clear conflict between form and substance. Therefore, although by their very nature only of formal significance, the formation of companies, the conclusion of marriages and divorces for tax purposes only, etc. cannot be set aside.

[9] The doctrine – it is argued – can be deduced from Sec. 4 of the 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.

[10] Cf. *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".

[11] Cf. *Jan Pedersen*, Skatteorientering, 2002, Ø.5, p. 24.

So far, there is very little in case law to support the setting aside of transactions resulting from company law rules[12]. Distributions of dividend and reclassification of such distributions do not fall into this category. In SKM.2006.69.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".

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*[13], 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 with the fact 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 here 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 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,

[12] Cf. *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 the financial reality begin to clash.

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

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 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.

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 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, which should be upheld for tax purposes if the transaction in question will stand a closer scrutiny. In other words, it must be considered to be current law in Denmark that no specific requirement on a business motive applies in so far the transactions are in substance what they in form appear to be. In fact, the business purpose test is to be understood as a test on economic reality. If there is no such substance, the transactions are considered empty from a substance line of thinking. 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 (e.g. 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 the transaction), 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 tax payer. Case law demonstrates some remarkable examples that show that the Supreme Court is willing to decide on tax avoidance cases in favour of the tax payer where the result is heavily supported by the legal doctrine as being correct. The former – now retired president of the Supreme Court – has publicly stated that tax payers' 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 was 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 (this provision will be discussed below) and a recent draft bill aiming at introducing country-by-country reporting based on OECD's recommendations.[14]

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 tax payers 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 advisors against cross border tax evasion and tax fraud – used the following definition of so-called "cross-border tax optimization" in its report:[15] *"The use of actions that within the limits of the law bring the tax payer in a favourable tax position or eliminate double taxation."*[16] 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

[14] Cf. Draft bill, 18 September 2015, J.nr. 15-1342223.

[15] Cf. The Danish Ministry of Taxation: "Styrket rådgiver- og branchesamarbejde mod grænseoverskridende skatteunddragelse", 6 November 2014.

[16] Certain more general observations concerning tax planning etc. can also be found in recommendation no. 1060, 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.[17]

Danish case law does not include any definition of the meaning of tax planning etc. 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 few of the BEPS proposals are expected to lead to significant changes of Danish tax law.

II. The Reaction to Avoidance and Aggressive Tax Planning in the BEPS Context

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-/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 been made yet 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 the provision to a certain extent should be interpreted in accordance with EU case law regarding abuse. Since there is no case law yet on this topic the authors cannot make the assessment as to whether the provisions will be interpreted fully in accordance with the EU/EEA concept of abuse.

The assessment of the below 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.[18]

[17] Cf. 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.

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

The Danish international GAAR does include a requirement saying 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 that the transactions are not 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.

2. EC Recommendation C-(2012) 8806 of 6 December 2012 and subject-to-tax rule

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.[19]

General "subject-to-tax provisions"[20]

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[18] 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 two provisions should be interpreted in the same way, cf. the preparatory remarks to bill L 167 (2014/2015).

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

[20] In the OECD Commentary (2014) to article 1, 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.

The multilateral Nordic treaty contains a general “subject-to-tax provision” in art. 26(2).[21] 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 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 which 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 favor of the state of residence; cf. art. 24(3).

Specific “subject to tax provision”

Other treaties signed by Denmark contain more specific “subject to tax provisions”.[22] An example can be found in art. 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,[23] the other state shall not be obliged to apply any limitation imposed under the treaty.[24] Further, pursuant to art. 29(2) it follows that if income according to the treaty should be exempt from taxation in the source state – and the state of residence in spite of this refrain from taxing the income[25] – the source state can tax the income anyhow. The existence of this clause results from the fact that South Africa applies the principle of territoriality. For the same reason, art. 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.[26]

[21] The contracting parties to the Nordic Tax Treaty are Denmark, Faroe Islands, Finland, Iceland, Norway and Sweden.
[22] For a more thorough description and overview of “subject to tax provisions” in Denmark’s treaties, see *Philip Noes* in Danish Journal of International Taxation, 2003 (SU 2003, 3).
[23] 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, co-ordination centre or similar entity providing administrative services or other support to a group of companies which carry on business primarily in other states.
[24] 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 center. 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 per cent 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.
[25] In terms of any provision of the treaty other than the art. 10 on dividends.
[26] Art. 25 should be applied without prejudice to the participation exemption concerning dividends in art. 24(1) (f).

The treaty between Denmark and Cyprus, art. 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 in Denmark's treaties with Malta (art. 24)[27], Singapore (art. 22), Jamaica (art. 24(4)) and Thailand (art. 24(4)). Art. 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 which is remitted to or received in the United Kingdom and not by reference to the full amount, then 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.[28]

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[29] and independent personal services.[30]

The authors are not aware of any plans to introduce subject-to-tax rules as proposed by the EC.

III. Transfer Pricing Rules, GAARs, Specific Anti-Avoidance Rules and Linking Rules

Danish tax law encompasses a relatively high number of specific anti-avoidance provisions (SAARs), and the extent of such legislation has increased significantly during the last two decades. In the following section, some of the most significant specific anti-avoidance rules are addressed, and the aims of the provisions are briefly explained.[31]

Transfer pricing

[27] Moreover, the treaty does not apply at all to certain persons that are entitled to certain tax benefits according to Maltese law; cf. the notes on 13 July 1998.

[28] 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. .

[29] See e.g. art. 15(2) (d) in the treaty between Denmark and Australia and art. 14(2) (d) in the treaty between Denmark and Malaysia and art. 26(3) in the Nordic treaty.

[30] See e.g. art.14 (1) (b) in the treaty between Denmark and Greece and art. 26(3) in the Nordic treaty.

[31] This section is based on *Peter Koerver Schmidt*, Nordic Tax Journal, 2014, p. 113-131, and *Jakob Bundgaard & Peter Koerver Schmidt*: Cahiers du droit fiscal international, 2010, vol. 95 a, pp. 261-279. GAARs are not dealt with in this section. See instead section II. 1 above.

The Danish transfer pricing legislation – which originally dated back to 1960 – was reformed in 1998, following a couple of judgements from the Supreme Court on "interest fixation" which the tax authorities had lost.[32] The aim of the reform was to provide a clear legal basis for transfer pricing adjustments, in order to avoid erosion of the Danish tax base and in order to ensure equal tax treatment of Danish and foreign owned companies.[33] The current regime sets forth the arm's length principle, which should be interpreted in line with the art. 9(1) of the OECD Model and the OECD Transfer Pricing Guidelines.[34] The transfer pricing rules apply to "controlled transactions" and cover cross-border transactions, as well as domestic transactions.[35]

The transfer pricing 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' transfer pricing audits have become more thorough.[36] Accordingly, transfer pricing 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 transfer pricing. The effect has been a rise in the number of cases, which has increased from 27 finalized cases in 2008 to 77 finalized cases in 2013.[37]

As a result of the increase in the number of transfer pricing cases more and more transfer pricing related litigation also seem to appear. 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.[38] 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 Sec. 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 the legal qualification of the transaction. A loan agreement on zero-coupon terms

[32] Cf. TfS 1996, 642 H, TfS 1998, 199 H and TfS 1998, 238 H.
[33] Cf. the explanatory notes to Bill L 101 (1997/1998).
[34] See *Jens Wittendorff*: Armslængdeprincippet i dansk og international skatteret, 2009, p. 262 et seq.
[35] Cf. Sec 2 of the Tax Assessment Act.
[36] Cf. *Jens Wittendorff*, International Transfer Pricing Journal, 2012, vol. 19, p. 324-329.
[37] Cf. SKAT: "Kontrolaktiviteter 2015 – Styrket regelefterlevelse på skatteområdet". In 2009 the number was 32, in 2010 it was 40, in 2011 it was 47 and in 2012 it was 67.
[38] The extended statute of limitation for controlled transactions follows from Sec. 34 (5) of the Tax Administration Act. According to this provision the deadline is 1 May of the sixth year after the end of the income year.

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 Sec. 2 of the Tax Assessment Act does not govern the legal qualification of the transaction. Accordingly, if the above mentioned statement actually should be interpreted to mean that also the legal qualification of the transaction is covered by Sec. 2 of the Tax Assessment Act, the scope of applicabilty appears significantly larger than originally expected in the litterature. However, as the reasoning of the court seems rather ambiguous, it has been argued that the precedential value of the decision may be limited.[39]

In addition to the material transfer pricing legislation, information and documentation requirements also apply.[40] Accordingly, when filing the tax return 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 transfer pricing documentation. On request, the transfer pricing 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.[41]

If sufficient transfer pricing documentation exists, it is the tax authorities who have the burden of proof concerning whether or not the transactions are at arm’s length.[42] However, if the transfer pricing 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.[43] In line with this the Supreme Court recently found – cf. 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 clearly was unreasonable.

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[39] Cf. *Jens Wittendorff*, International Transfer Pricing Journal, 2012, pp. 203-221, who is very critical towards the decision.

[40] Cf. Sec. 3 B of the Tax Control Act. For smaller corporate groups, the documentation requirements are less restrictive.

[41] Cf. Draft bill, 18 September 2015, J.nr. 15-1342223.

[42] Cf. *Jane Bolander & Jakob Graff Nielsen* in *Gerard Meussen* (ed.): The Burden of Proof in Tax Law, 2011, p. 95.

[43] Cf. 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 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).

LOB Clauses

Normally, Denmark's tax treaties do not include limitation of benefit rules (LOB rules). However, LOB rules can be found in a few of Denmark's tax treaties. Accordingly, Art. 26(3) of the treaty between the Danish Trade Organization's Taipei Office and the Taipei Representative Office in Denmark contains a limitation on benefits clause (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 resident or a person connected with such resident was to obtain the benefits of this agreement.

In art. 22 of the treaty between Denmark and the US, a more specific LOB clause appear.[44] 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.[45] Individuals resident in the US or Denmark are under all circumstances entitled to benefit from the provisions of the treaty. Also public authorities in the two states, religious and charitable organizations as well as pension funds[46] 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.[47]

CFC Legislation

Denmark introduced 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.[48] More specifically, the aim was to prevent Danish companies from establishing subsidiaries in low tax countries and moving income and assets hereto.[49]

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[44] 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.

[45] The LOB-clause is analyzed by *Carina Korsgaard & Kristoffer Kowalski*, Danish Journal of International Taxation, 2008 (SU 2008, 130).

[46] If more than 50 per cent of the pension recipients are resident in one of the two states.

[47] 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.

[48] Cf. the explanatory notes to Bill L 35 (1994/1995).

[49] 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.

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 tainted income (so-called "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.[50]

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.* 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.[51] 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.[52]

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 entail that the domestic tax treatment in some situations depends on the tax treatment in other jurisdictions.[53] Both provisions could be seen as a reaction to tax planning based on the US check-the-box rules.[54]

[50] Cf. Sec. 32 of the Corporate Tax Act. Sec. 8(2) of the Corporate Tax Act contains a "CFC-rule" for foreign permanent establishments.
[51] Cf. *Peter Koerver Schmidt*, European Taxation, 2014, vol. 54, pp. 3-9.
[52] Cf. OECD: Designing Effective Controlled Foreign Company Rules, 2015, p. 17-18.
[53] Cf. Sec. 2 A and 2 C of the Corporation Tax Act.
[54] 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.

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 foreign recipient is not taxable of the interest payments, as the interest payments should be considered internal transfers within the same entity pursuant to the tax rules in the foreign state.[55]

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 which does not have a tax treaty with Denmark.[56] Here the aim is to prevent tax payers from exploiting different entity qualification to "create" double non-taxation.[57]

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.[58] The objective of this provision is to abolish the potential asymmetrical tax treatment of certain hybrid financial instruments.[59]

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.[60] The

[55] Cf. the explanatory notes to Bill L 119 (2003/2004).
[56] Cf. Sec. 2 C of the Corporation Tax Act.
[57] Cf. the explanatory notes to Bill L 181 (2007/2008).
[58] Cf. Sec. 2 B of the Corporation Tax Act. The provision only applies if the foreign individual or company has decisive influence over the Danish company or the companies are considered to be in a group of companies; cf. the principles in Sec. 2 of the 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 investements in Danish tax law as well as is international tax law see *Jakob Bundgaard*, Intertax, 2014, vol. 42, p. 416-426.
[59] Cf. the explanatory notes to Bill L 110 B (2006/2007).
[60] Cf. Sec. 13(1)(2) of the Corporation Tax Act.

provision shall prevent Danish companies from receiving tax exempt dividends, in situations where the foreign paying company can deduct the payment.[61]

In general, the Danish linking rules described above are not entirely the same as the rules suggested by the OECD,[62] as the effect of the Danish rules often is a requalification of the entire entity or payment, and not merely deprivation of a deduction or an exemption.

Rules limiting deduction of interest

The deductibility of financing expenses may in general be restricted under three sets of rules for corporate taxpayers:[63]

- The thin capitalisation 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.
- 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.
- 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.[64] The thin capitalization rules therefore only apply to controlled debt.

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[61] Cf. 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, cf. the former Sec. 31 D(2) of the Corporate Tax Act. See Bill L 110 A (2006/2007).

[62] Cf. OECD: Neutralizing the Effects of Hybrid Mismatch Arrangements, 2014.

[63] Cf. Sec. 11, 11 B and 11 C of the Corporate Tax Act. See *Michael Tell*: Fradragsbeskæring af selskabers finansieringsudgifter, 2012.

[64] Cf. the explanatory notes to Bill L 101 (1997/1998).

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.[65] 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 criticised for being in breach of the fundamental freedoms in EU law.[66]

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 all assets and liabilities that no longer are subject to Danish Taxation. The assets and liabilities should be considered as sold at fair market value at the time of emigration.[67] Likewise, the transfer of assets and liabilities within a company to a foreign permanent establishment or a foreign head quarter, 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.[68]

Companies now have the option of deferring payment of the exit tax subject to certain conditions.[69] 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 seven 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 very briefly be mentioned:

[65] Cf. the explanatory notes to Bill L 213 (2006/2007).
[66] Cf. *Michael Tell*: Fradragsbeskæring af selskabers finansieringsudgifter, 2012, pp. 323-331.
[67] Cf. Sec. 5(7) and (8) of the Corporation Tax Act. See Bill L 35 (1994/1995).
[68] Cf. Sec. 8(4) of the Corporation Tax Act. See Bill L 121 (2004/2005).
[69] Cf. Sec. 26 and 27 of the Corporation Tax Act. See Bill L 91 (2013/2014).

- 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 which concern income that can be taxed in Denmark due to the tax treaty.[70]

- 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.[71]

- 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.[72] The provision moreover prevents double dips arising from double depreciation of leasing assets.

- 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, commission, premiums and other expenses incurred in connection to the loan cannot be deducted.[73] 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.

- 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.[74]

- 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.[75]

- 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, i.e. 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.[76]

[70] Cf. Sec. 9 of the Corporation Tax Act.
[71] Cf. Sec. 33 F of the Tax Assessment Act.
[72] Cf. Sec. 5 G of the Tax Assessment Act.
[73] Cf. Sec. 5 F of the Tax Assessment Act.
[74] Cf. Sec. 5 C(3) of the Tax Assessment Act
[75] Cf. Sec. 5 of the Act on Taxation of Gains and Losses on Debt Claims, Debts and Financial Instruments.
[76] Cf. Sec. 5(5) and 2 D of the Corporate Tax Act, Sec. 9(2), 15(4-5), 15a(10) and 15b(4) of the Merger Tax Act, Sec. 16 A(3)(1), 16 B(1) and 16 B(2)(2) of the Tax Assessment Act and Sec. 36 (1) of the 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).

III. 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 to coordinate the anti-avoidance rules introduced by law. Instead, it appears that the legislator continuously has just added new SAAR's or amended the existing SAARs whenever a (political) need has arisen to close a "loophole" or mitigate certain tax planning schemes/ideas.[77]

The lack of coordination has inter alia given rise to discussions on the interaction between the Danish transfer pricing 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 – 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 controlled foreign companies (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).[78] 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 SAAR's in Danish tax law.

In the preparatory remarks to some of Denmark's SAARs, it is explicitly stated that 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

[77] Recently an "anti tax heaven package" has been adopted, cf. 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 havens, cf. the Danish Ministry of Taxation: "Afrapportering fra den tværministerielle task force mod skattely", 6 November 2014. For an overview of the relatively few new measures included in the bill see Lars Kjærgård Terkilsen in Nordic Tax Journal, 2015, vol. 2, p. 67 et seq. From official side a broader and more systematic analysis of international tax avoidance in a Danish context has not been carried out since 1985, cf. recommendation no. 1060, 1985.

[78] See *Peter Koerver Schmidt*: Dansk CFC-beskatning, 2013, p. 338 et seq.

sake). In this regard, the decision made by the Danish Tax Assessment Council in SKM2014.577.SR is interesting.[79]

The decision concerned whether a new rule limiting the possibility of utilizing tax losses carried forward was also applicaple under the CFC rules.[80] Neither the wording of the new rule nor the preparatory remarks adressed 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 applicaple 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 are not very well coordinated.

[79] The decision has been commented by *Peter Koerver Schmidt*, SR-Skat, 2014, p. 255-260.
[80] Cf. Sec 12 (2) of the Corporate Tax Act.