

## Corporate Bonds in Denmark

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*Corporate financing is the choice between capital generated by the corporation and capital from external investors. However, since the financial crisis shook the markets in 2007–2008, financing opportunities through the classical means of financing have decreased. As a result, corporations have to think in alternative ways such as issuing corporate bonds.*

*A market for corporate bonds exists in countries such as Norway, Germany, France, the United Kingdom and the United States, while Denmark is still behind in this trend. Some large Danish corporations have instead used foreign corporate bonds markets. However, NASDAQ OMX has introduced the First North Bond Market in December 2012 and new regulatory framework came into place in 2014, which may contribute to a Danish based corporate bond market.*

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### I INTRODUCTION

Corporate financing is the choice between capital generated by the corporation and capital from external investors. External investors can either be lenders (debt) or shareholders (equity). However, since the financial crisis shook the markets in 2007–2008, financing opportunities through the classical means of financing have decreased.<sup>1</sup> As a result, corporations have to think in alternative ways in order to obtain the needed capital for their investments at the right price.

In Denmark debt financing has historically been dominated by mortgages secured in real estate and bank debt. However, due to the financial crisis and stricter bank regulations focus has shifted towards corporate bonds. Consequently, this has also led NASDAQ OMX to introduce the *First North Bond Market* in December 2012. The aim is to build a market for corporate bonds in Denmark as a market based alternative to traditional debt financing, similar to those already existing in Norway, Germany, France, the United Kingdom and the United States. Some large Danish corporations have historically used foreign corporate bonds markets. The new regulatory

framework from 2014 may contribute to a Danish based corporate bond market that will benefit all Danish corporations and investors as new alternative financing opportunities arises.<sup>2</sup>

The purpose of this article is to present the regulatory changes in Denmark in relation to corporate bonds. The purpose is further to analyse the tax consequences of issuing bonds in both a direct issue of bonds and through securitization.

### 2 CORPORATE BONDS

The corporate bond market is one of the largest over-the-counter (OTC) financial markets in the world.<sup>3</sup> Corporate bonds constitute an alternative, or a supplement, to bank and mortgage loans secured in real estate, and can be defined as a debt security issued by a corporation. By issuing corporate bonds companies can obtain a diversified capital structure with fewer constraints on the business and become less dependent on banks.

The prerequisite for a successful issuing of corporate bonds is, of course, a reasonable price and consistency with

#### Notes

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<sup>1</sup> See Münther: Nye danske regler om sekuritiserings og repræsentanter ved udstedelse af erhvervsobligationer, *Erhvervsjuridisk Tidsskrift* 2014, ET 2014, 57.

<sup>2</sup> See, Khang and King, *Capital Market Access and Corporate Loan Structure*, 47 *Appl. Econ.* 374–397 (2015) on correlation between access to capital and corporate loan structure.

<sup>3</sup> See, Asquith, *The Market for Borrowing Corporate Bonds*, 107 *J. Fin. Econ.* 155–182 (2013).

risk, e.g., coherence between the risk and the expected return (effective interest rate) from the corporate bond.<sup>4</sup> The terms of the corporate bonds are agreed on in each term sheet connected to the issue and therefore vary from issue to issue depending on the market and the issuing corporation. Corporate bonds usually have a medium-term range between one and seven years, and involve fewer covenants than bank loans.<sup>5</sup> However, no market standard or template exists in Denmark, even though Danish corporations have issued corporate bonds since the 1980s.<sup>6</sup>

A corporate bond basically consists of a nominal interest rate and is traded at a certain market price. The basis for the interest rate is the risk-free interest rate (i.e., a government bond with the same maturity), plus a margin that reflects the issuer's creditworthiness and the maturity of the bond (risk premium). A low creditworthiness or a long maturity leads to higher interest rates, due to the higher risk.<sup>7</sup> Further, an investor will also take into account the liquidity of the market and the currency in which the corporate bond is denominated, and this therefore also affects the market price of the corporate bond. In summary, the overall return of the corporate bond is the effective interest rate, which depends on the nominal interest rate, and the market price of the corporate bond (gains and losses).

The issuing of corporate bonds would usually, but not necessarily, require an ongoing rating from an international credit rating agency, which is an expensive process (due diligence, etc.).<sup>8</sup> A credit rating is important due to a large number of investors that are only allowed to invest in bonds with an 'official' credit rating. The initial and ongoing credit rating will affect the effective interest rate through the market price. An issuer of corporate bonds is therefore less dependent on banks, but more dependent on international credit rating agencies.<sup>9</sup> Analysis also shows that corporate bond borrowing costs are related to the bond's credit rating, but also loan size, and the lender's inventory.<sup>10</sup>

Corporate bonds will often be listed on a stock exchange, historically in the United States, Luxembourg

or the United Kingdom. However, most of the trading is not done on the stock exchange, but instead OTC by various investment banks.<sup>11</sup> Nevertheless, the listing is still important in order to make the corporate bond attractive for institutional investors, who are only allowed to invest in listed securities.<sup>12</sup>

The market for corporate bonds has been modest in Denmark and only some of the larger Danish corporations such as AP Møller-Maersk, Carlsberg, DFDS, Dong Energy, ISS, TDC, Vestas and Welltec have issued corporate bonds on foreign markets. However, the market is growing in Europe and maybe the market in Denmark will also grow significantly after the regulatory issues and limitations have been eased in 2014.<sup>13</sup>

### 3 REGULATORY ISSUES

The main issue in relation to issuing corporate bonds has been the requirement for the issuing corporation to be authorized as a financial institution (bank) set forth by the Financial Services Authority (FSA). However, in 2012 the FSA eased their interpretation of the regulation and issued new guidelines on corporate bonds without such need to be authorized as a financial institution, specifically affecting issues to a selected few investors (less than 150 investors) with an investment of at least EUR 100,000 per bond.<sup>14</sup>

The new interpretation eased the process of issuing bonds and was made in connection with a committee working on a special report on corporate bonds. The main output of the report was recommendations on how to create a well-functioning corporate bond market to benefit all Danish corporations.

#### 3.1 Report on Corporate Bonds

In November 2012, the committee presented the final report on *Corporate Bonds as a Source of Financing for Small and Midsized Corporations*.<sup>15</sup> The committee concluded that

#### Notes

- <sup>4</sup> For valuation of corporate bonds, see *Mortensen: Essays on Pricing of Corporate Bonds and Credit Derivatives*, Samfundslitteratur 2005, pp. 11–66 and *Jarrow, Li and Liu: Reduced-Form Valuation of Callable Corporate Bonds: Theory and Evidence*, 95 J. Fin. Econ. 227–248.
- <sup>5</sup> See, *Galbo and Rosenbaum: Revision & Regnskabsvæsen*, no. 5, 2013, p. 36; and *Kielland and Schaumburg-Müller: Udstedelse af virksomhedsobligationer*, Erhvervsjuridisk Tidsskrift 2012, ET 2012, 19.
- <sup>6</sup> See, *Kielland and Schaumburg-Müller: Udstedelse af virksomhedsobligationer*, Erhvervsjuridisk Tidsskrift 2012, ET 2012, 19.
- <sup>7</sup> See, *Kielland and Schaumburg-Müller: Udstedelse af virksomhedsobligationer*, Erhvervsjuridisk Tidsskrift 2012, ET 2012, 19.
- <sup>8</sup> See, also *Müntber: Nye danske regler om sekuritiserings og repræsentanter ved udstedelse af erhvervsobligationer*, Erhvervsjuridisk Tidsskrift 2014, ET 2014, 57.
- <sup>9</sup> See, *Kielland and Schaumburg-Müller: Udstedelse af virksomhedsobligationer*, Erhvervsjuridisk Tidsskrift 2012, ET 2012, 19.
- <sup>10</sup> See, *Asquith: The Market for Borrowing Corporate Bonds*, 107 J. Fin. Econ. 155–182.
- <sup>11</sup> *Ibid.*
- <sup>12</sup> See, *Kielland and Schaumburg-Müller: Udstedelse af virksomhedsobligationer*, Erhvervsjuridisk Tidsskrift 2012, ET 2012, 19.
- <sup>13</sup> See, also *Andersen and Schaumburg-Müller: Repræsentater ved obligationsudstedelse – Et nyt fuldmagtsinstitut I dansk ret*, Erhvervsjuridisk Tidsskrift 2014, ET 2014, 257.
- <sup>14</sup> See, guidelines from FSA, dated Jul. 4 2012.
- <sup>15</sup> See, Report from 'Udvalget om erhvervsobligationer som finansieringskilde for små og mellemstore virksomheder', dated November 2012.

the financial crisis and the tightening of the credit policy in banks had permanently reduced small and mid-sized corporations' access to capital. As a result the committee recommended establishing a market for corporate bonds in Denmark. The overall aim is to create a proper sized market, enabling spread and liquidity in the market. The general recommendation for establishing such a market was followed by five specific recommendations:

- (1) Establishing the legal framework for a trustee.
- (2) Establishing the legal framework for securitization.
- (3) Establishing an effective process of issuing corporate bonds.
- (4) The Ministry of Business and Growth contributing on market based terms to a well-functioning market of corporate bonds.
- (5) The Ministry of Business and Growth's initiatives only target market failures and are phased out when the financial situation is normalized.

The committee found that a well-functioning corporate bond market would benefit small, mid-sized and large corporations. Large corporations were already able to issue corporate bonds, but the introduction of a legal framework for a trustee would benefit both the issuing corporation and investors. Corporate bonds are, due to the high fixed cost for both the issuing corporation and investors (rating, etc.), not attractive for small and mid-sized corporations. However, the establishment of securitization through banks, etc. made it possible to issue bonds secured in a large pool of commercial loans to small and mid-sized corporations (SMEs) to the benefit of SMEs and investors. The report laid the groundwork for the new legislation on corporate bonds enacted with bill L 46 2013–14.

### 3.2 Legislation

Bill L 46 2013–14 was adopted in December 2013 to stimulate a corporate bonds market. The most significant changes were the introduction of a trustee model in Denmark and the possibility of securitization from 1 January 2014.

#### 3.2.1 Trustee Model

A trustee is usually a financial institution, such as a commercial bank or trust company that is given powers by a bond issuer to enforce the terms of a bond issue. A trustee is to protect the interests of the bondholders, acts on behalf of the bondholders if the issuer violates the bond terms and responsible for the registration, transfer and payment of bonds.<sup>16</sup> Bill L 46 enables the issuing corporation to appoint one or more trustees to represent the investors (bondholders) by adopted a new chapter to the Danish Securities Act on trustees and corporate bonds inspired by the model used in Norway.<sup>17</sup> However, certain requirements must be met to use the trustee model in Denmark.

To use the trustee model the trustee must be registered by the FSA and on each specific issuing of corporate bonds, which are marketed to Danish investors, issued by a Danish corporation or in other ways connected to Denmark.<sup>18</sup> The trustee must also appear in the terms of the issued bonds or in an associated agreement.<sup>19</sup> Furthermore, the trustee must be a limited liability corporation resident in Denmark, the EU, a country with an agreement with the EU on financial matters, Switzerland, Australia, Canada, Hong Kong, Japan, South Korea, New Zealand, Singapore, Taiwan or the United States.<sup>20</sup>

The trustee represents all the investors.<sup>21</sup> The terms of the representation must be stated in the terms of the bonds or an associated agreement. Such terms can state that the trustee:<sup>22</sup>

- (1) Must enforce and execute bondholders' claims against the issuer as stated in the terms.
- (2) Must manage the bondholders' assets as stated in the terms.
- (3) Can take legal action on behalf of the bondholders in relation to the bonds.
- (4) Represents the bondholders if the issuer goes bankrupt or is reconstructed.
- (5) Can convene bondholder meetings.

### Notes

<sup>16</sup> See, also *Andersen and Schaumburg-Müller*: *Repræsentater ved obligationsudstedelse – Et nyt fuldmagtsinstitut i dansk ret*, *Erhvervsjuridisk Tidsskrift* 2014, ET 2014, 257.

<sup>17</sup> See, s. 4c.

<sup>18</sup> See, s. 4a and 4b.

<sup>19</sup> See, s. 4c.

<sup>20</sup> See, s. 4b.

<sup>21</sup> Section 4d.

<sup>22</sup> See, s. 4d, para. 4.

In all cases the trustee must act in the best interest of the bondholders.<sup>23</sup> Furthermore, the bondholders can, according to the terms, be prevented from autonomously enforcing rights that are transferred to the trustee (no-action clause).<sup>24</sup> Lastly, it should be noted that the trustee agreement is also legally enforceable in regard to the bondholders' creditors, bankruptcy estate and subsequent owners (investors) of the bonds.<sup>25</sup>

### 3.2.2 Securitization

Securitization is a financial practice of pooling various types of assets for example commercial loans and selling the consolidated loans to various investors. Usually a large portfolio of assets such as commercial loans are pooled and transferred to a Special Purpose Vehicle (SPV), which will then issue bonds on the basis of the transferred commercial loans. The basic idea of securitization is that for example a bank can by selling commercial loans meet capital requirements, lower risk or obtain earlier 'repayment' in the form of selling the commercial loans. Transferring a large pool of commercial loans can be resource intensive, due to legal restraints such as denunciation. However, bill L 46 adopts a register based securitization model in the Danish Financial Business Act, which enables bonds to be issued on the basis of a large pool of commercial loans.<sup>26</sup> The register model is inspired by the model used in Germany and works in two steps: First a sale of commercial loans from a bank to a SPV<sup>27</sup> i.e., the SPV is registered as the owner of the loans in a refinancing register. Second, the SPV issues bonds secured in the registered commercial loans. Securitization can also be made through another bank, insurance corporations, pension fund, etc. instead of a SPV.<sup>28</sup>

The register model improves the balance sheets of banks, due to the sale of the loans, and unlike a true-sale securitization can sell the loans without the administrative burden of denunciation. The introduction of the register model in Denmark makes it easier to obtain commercial loans due to the possibility of issuing bonds on the basis of

a large pool of commercial loans, especially benefiting small and mid-sized corporations.

The *first* requirement is that the bank is authorized by the FSA to establish a refinancing register. Authorization requires that the bank's organization and resources are adequate to fulfil the task of keeping and maintaining a refinancing register.<sup>29</sup> Authorized banks can be found in the public register held by the FSA. The SPV must also appoint an independent supervisor, who must register with the FSA. The independent supervisor is to supervise every refinancing transaction.<sup>30</sup>

The *second* requirement is that the bank registers the assets sold to the SPV on each transaction. The register must clearly and fully identify the registered assets, including security ranking, identification of the SPV, entry date of the asset and, if possible, the expected exit date of the asset.<sup>31</sup> The refinancing register can only include loans and lease agreements relating to commercial activities and securities, derivatives, etc. connected to such loans.<sup>32</sup>

The *third* requirement is that the bank does not control the SPV, i.e., the bank or any other group corporation do not own more than 20% of the voting rights in the SPV, the bank or any other group corporation cannot replace the majority of the members of the top management in the SPV and no members of the management of the SPV are also part of the management in the bank or any other group corporation.<sup>33</sup>

The *fourth* requirement is that the SPV must issue bonds of a denomination of at least EUR 100,000.<sup>34</sup> The idea behind this requirement is to only make corporate bonds attractive for investors who understand the complexity and risk involved.

If the above-mentioned requirements are fulfilled a bank can use the securitization model as implemented in the Danish legislation as of 1 January 2014. The assets are considered to be transferred to the SPV from the moment the assets are registered in the refinancing register and with effect from that date in regard to creditors of the bank, etc. However, the assets must be clearly identified in the register – otherwise the assets are not considered to be

## Notes

<sup>23</sup> See, s. 4d, para. 2.

<sup>24</sup> See, s. 4, para. 5.

<sup>25</sup> See, s. 4 c.

<sup>26</sup> See, s. 152 n.

<sup>27</sup> As defined in s. 5, para. 1, no. 25. See, also *Müntber*: Nye danske regler om sekuritiserings og repræsentanter ved udstedelse af erhvervsobligationer, *Erhvervsjuridisk Tidsskrift* 2014, ET 2014, 57.

<sup>28</sup> See, also *Müntber*: Nye danske regler om sekuritiserings og repræsentanter ved udstedelse af erhvervsobligationer, *Erhvervsjuridisk Tidsskrift* 2014, ET 2014, 57.

<sup>29</sup> See, s. 152 l, para. 2.

<sup>30</sup> See, s. 152 r and 152 s.

<sup>31</sup> See, s. 152 j, para. 2.

<sup>32</sup> See, s. 152 p.

<sup>33</sup> See, s. 152 k, para. 2.

<sup>34</sup> See, s. 152 k, para. 5.

sold.<sup>35</sup> The bank is still responsible for administration of the assets in relation to the debtor (payments and offsetting)<sup>36</sup> and tax authorities.<sup>37</sup>

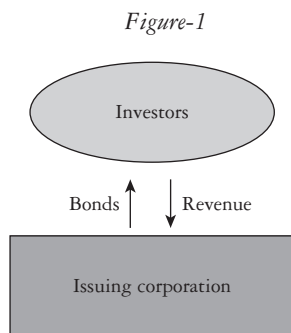
The bank is also responsible for the part of the prospectus and other material from the SPV related to assets in the refinancing register.<sup>38</sup> Furthermore, the bank is obliged to disclose information in relation to the asset in the refinancing register to the SPV, if the issued bonds are traded on a regulated market and the information is of significant value, and can do so without consent from the debtor.<sup>39</sup>

## 4 TAX CONSEQUENCES

A corporate bond is for tax purposes considered debt for the issuing corporation and a claim for the investor. However, the process of issuing the bonds ranges from a 'simple' direct issue of corporate bonds to securitization with a trustee to represent the investor. The tax consequences are analysed in the following sections.

### 4.1 Direct Issuing of Corporate Bonds

In a direct issuing of corporate bonds the corporation in need of external capital directly issues the bonds to the investors and in return receives revenue from the investors. This can be illustrated as follows:



The tax consequences for a Danish issuing corporation are the revenue received and repaid, as well as interest paid and capital gains/losses on the corporate bonds. The revenue received is tax exempt and the repayment of the revenue is not deductible. Interests paid on the corporate bonds are deductible, unless the corporation is affected by the interest limitation rules in Denmark.<sup>40</sup> Further capital losses on the bond are deductible, but can be denied according to the interest limitation rules in Denmark.<sup>41</sup> Should the issuing corporation obtain a capital gain on the bonds, such a gain is taxed in Denmark. However, a capital gain is tax exempt if the investor and the issuing corporation are group companies or the gain arises as part of a debt relief.<sup>42</sup> Capital gains and losses on the bonds are taxed/deducted when realized. The corporation can elect to use the *mark to market* principle on listed bonds and bonds issued in a currency other than Danish kroner.<sup>43</sup> Lastly, it should be noted that expenses *directly* associated with the issuing of the bonds can indirectly be deducted by adding these costs when determining a gain or loss. However, this does not include cost related to the overall structuring, assessments of the market, due diligence, etc.<sup>44</sup>

The tax consequences for the investor are more complex. The following table sums up the tax consequences in Denmark for investors:

	Status	Interests	Capital gains	Capital losses
Individual	Resident	Taxable	Taxable if trading professionally or net gains exceed 2,000 DKK	Deductible unless claim against a controlled corporation
	Non-resident	Tax exempt	Tax exempt	Not deductible

## Notes

<sup>35</sup> See, S. 152 n, para. 7.

<sup>36</sup> Offsetting can be waived by agreement.

<sup>37</sup> See, s. 152 n, para. 4–6.

<sup>38</sup> See, s. 152 l.

<sup>39</sup> See, s. 152 m.

<sup>40</sup> Cf. s. 6 of the State Tax Act and s. 6 of the Claim and Debt Tax Act. For an overview of the Danish interest limitation rules; see *Tell*, Nordic Tax J. 271 (2013).

<sup>41</sup> *Ibid.*

<sup>42</sup> Cf. ss 6, 8 and 24 of the Claim and Debt Tax Act.

<sup>43</sup> Cf. s. 25 of the Claim and Debt Tax Act.

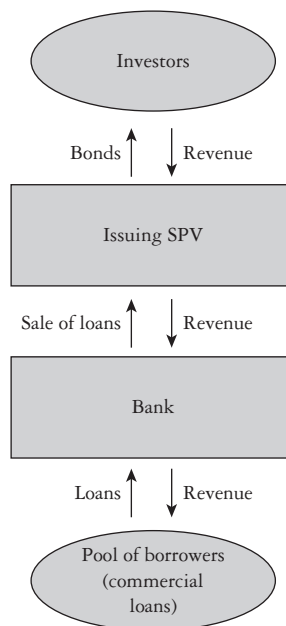
<sup>44</sup> Cf. the Danish Supreme Court in SKM2014.87.HR.

	<i>Status</i>	<i>Interests</i>	<i>Capital gains</i>	<i>Capital losses</i>
<b>Corporation</b>	Resident	Taxable	Taxable	Deductible unless claim toward group corporation
	Non-resident	Tax exempt	Tax exempt Specific exemptions do apply to group companies	Not deductible

## 4.2 Securitization

The adoption of a register based securitization model in Denmark in 1 January 2014 enabled banks to sell commercial loans to a SPV, etc., which can then issue corporate bonds secured in the pool of commercial loans, as described in section 3.2.2. Securitization involves at least three steps: (1) issuing of commercial loans from a bank, (2) sale of the commercial loans, and (3) the issuing of corporate bonds. This can be illustrated as follows:

Figure-2



First, the commercial loans involve an individual or corporation as the borrower (debtor) and a Danish bank as the lender (creditor). The tax consequences for the borrower depend on whether the borrower is an individual or a corporation.

An individual can deduct interest, while capital losses on the debt are only deductible if the loan is issued in a currency other than Danish kroner.<sup>45</sup> A capital gain on the debt is, as a main rule, tax exempt, but exceptions do apply.<sup>46</sup> A corporation can deduct both interest and capital

losses as a main rule.<sup>47</sup> A capital gain on the debt is taxed, unless the investor and the issuing corporation are group companies or the capital gain arises as part of a debt relief.<sup>48</sup>

The bank as the lender will be taxed on the received interest and capital gains on the claim. A capital loss is deductible, unless the borrower is a group corporation or a tax treaty precludes taxation of interests/gains.<sup>49</sup>

Second, the sale of the commercial loans involves a bank as the seller and a SPV as the buyer. The sale of the loans

### Notes

<sup>45</sup> Cf. s. 6 of the State Tax Act and ss 20 and 23 of the Claim and Debt Tax Act.

<sup>46</sup> Cf. ss 20–24 of the Claim and Debt Tax Act.

<sup>47</sup> Cf. s. 6 of the State Tax Act and s. 6 of the Claim and Debt Tax Act.

<sup>48</sup> Cf. ss 6, 8 and 24 of the Claim and Debt Tax Act.

<sup>49</sup> Cf. s. 6 of the State Tax Act and ss 3–5 of the Claim and Debt Tax Act.

may cause a capital gain or loss on the loans for the bank. As mentioned above a capital gain is taxable while a capital loss is deductible, unless there is a claim toward a group corporation or a tax treaty precludes taxation of interests/gains.<sup>50</sup> The SPV as the buyer of the loans would obtain a new purchase price including expenses *directly* associated with purchase of the loans if the SPV is residing in Denmark. If the SPV is resident outside of Denmark, e.g., a limited liability corporation, a collective investment scheme for professional investors, a SIKAV or securities fund, the tax consequences would need to be analysed in terms of the specific situation of the SPV in that country.

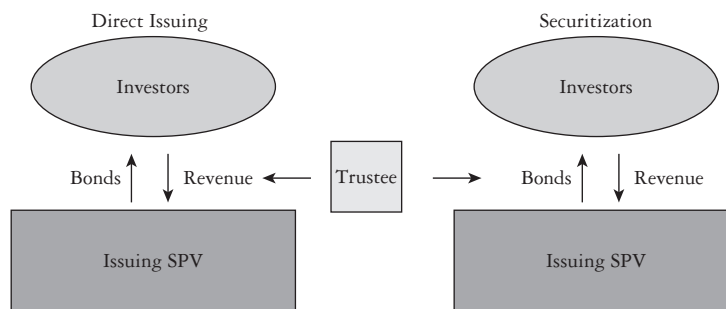
*Third*, the issuing of bonds involves a SPV as the issuing corporation and investors, such as individuals or corporations. The specific organization of the SPV will determine the subsequent tax consequences. If the SPV is a resident in Denmark the tax consequences are closely

analysed in section 4.1. In summary, a Danish SPV is tax exempt in relation to the revenue received from the issuing of the bonds, while interests paid on the corporate bonds, as well as capital losses on the bond, are deductible.<sup>51</sup> If the SPV obtains a capital gain on the bonds such a gain is taxable, unless the investor and the SPV are group companies or the capital gain arises as part of a debt relief.<sup>52</sup> The tax consequences in Denmark for the investors are also analysed in section 4.1.

### 4.3 The Use of a Trustee

The trustee model enables the use of a trustee in Denmark to represent the investors in relation to the issued bonds, both in a direct issuing and in securitizations. This can be illustrated as follows:

Figure-3



The trustee must be a limited liability corporation and act as a representative for the investors<sup>53</sup> to the mutual benefit of both the investors and the issuing corporation/SPV. The trustee is to act in accordance with the terms agreed upon, which usually would include the trustee to be a single point of contact for both the investors and the issuer, monitor the loan, hold security on behalf of the investors, coordinate meetings, represent the investor in default situations, etc. The trustee is usually paid an annual fee from the issuer (issuing corporation/SPV) and not by the investors. The use of a trustee therefore raises at least two issues: (i) the tax treatment of the fee and (ii) whether the trustee constitutes a permanent establishment for the investors.

#### 4.3.1 Tax Treatment of the Fee

If the trustee is residing in Denmark the fee is taxed in Denmark.<sup>54</sup> A fee to a non-resident trustee is only taxed in Denmark if the trustee has a permanent establishment in Denmark to which the fee is allocated. The deductibility of the fee is less obvious and several considerations should be made.

*First*, the fee may be considered a deductible operating expense. However, this requires that the fee paid to the trustee is related to acquiring, ensuring and maintaining taxable income.<sup>55</sup> In other words, the fee must be closely related to the business of the issuing corporation. Case law on financing costs as a deductible operating expense has

## Notes

<sup>50</sup> Cf. s. 6 of the State Tax Act and ss 3–5 of the Claim and Debt Tax Act.

<sup>51</sup> Cf. s. 6 of the State Tax Act and s. 6 of the Claim and Debt Tax Act.

<sup>52</sup> Cf. ss 6, 8 and 24 of the Claim and Debt Tax Act.

<sup>53</sup> Cf. s. 4b and 4d of the Danish Securities Act.

<sup>54</sup> Cf. s. 4 of the State Tax Act.

<sup>55</sup> Cf. s. 6 a and SKM2012.13HR.

traditionally been very strict, since borrowing is typically considered an establishment cost.<sup>56</sup> Only if it can be directly and unambiguously identified, that the borrowed money is used in the core business, has a corporation been granted the right to deduct such cost as an operating expense. In TfS 1987.198 LSR the National Tax Tribunal stated that only finance corporations and similar corporations can claim a deduction as an operating expense – the case related to a 1.5% credit commission. On the basis hereof an issuing corporation in a direct issuing, as described in section 3.3.1, cannot deduct a fee paid to a trustee, since the issuing of bonds is not the core business of the corporation. On the other hand, when using a SPV as described in section 3.3.2, the SPV's main purpose is to issue securities and it could therefore be argued that the fee paid to the trustee can constitute a deductible operating expense.

*Second*, the fee may be considered a deductible interest payment.<sup>57</sup> Interest is defined as a periodic payment to the lender for providing capital, which is calculated as a percentage of the remaining outstanding debt.<sup>58</sup> However, even if the fee is calculated as a percentage of the remaining outstanding debt, the payment is to the trustee and not the lender and the payment is made for the monitoring of the bonds and representation of the investors and not for providing capital, thereby disqualifying the fee as a deductible interest payment.

*Thirdly*, the fee may be considered an ongoing interest-like payment, which can be deducted according to section 8, paragraph 3, point a or b of the Tax Assessment Act. The idea behind the rule is that these ongoing interest-like payments, such as ongoing premiums for loans or securities related to debt, are so similar to interests that they are also deductible.<sup>59</sup> In SKM2007.47SR the National Tax Board confirmed that a borrower's ongoing payment to the lender (premium for mortgage security equal to the payment made by the lender to an insurance corporation), which is calculated on the basis of the outstanding debt, maturity and mortgage ratio, constituted a deductible interest-like payment. However, unlike a trustee fee, it was a payment between the lender and the borrower and further the security was related to the debt. A trustee fee is therefore most likely not deductible according to section 8, paragraph 3, point a or b of the Tax Assessment Act.

*Lastly*, the fee may be considered a transaction expense (cost of borrowing), which can be added when determining a capital gain/loss. Such costs include costs associated with acquiring of claims and incurring of debt, for example charges, brokerage fees, upfront fees and stamp duties and similarly costs incurred when selling the claim or repaying the debt.<sup>60</sup> From the examples given it is not possible to make any accurate determination of the relevant borrowing costs, however the examples are typical borrowing costs closely related to the borrowing. Given the nature of the examples of borrowing costs, that are mentioned the Supreme Court found in SKM2012.2H and SKM2014.87.HR, costs must be attributable to the debt creation or repayment. This has recently been confirmed by the High Court of Eastern Denmark in SKM2014.576.ØLR, which concerned fees to investment banks in connection with the issuing of corporate bonds. The High Court of Eastern Denmark found that the fee to the investment bank without a doubt included services related directly to debt creation, but also services of a more general nature (structuring, etc.). The High Court of Eastern Denmark then found that the corporation had not established what part of the costs that could be included, and the Court could therefore not determine or estimate the cost that could be included. In regard to the fee paid to a trustee these do not seem to be closely attributable to the debt creation, but instead the following and ongoing monitoring of the debt – not the debt creation – and hence cannot be added when determining a capital gain or loss.

In conclusion the fee paid to the trustee by the issuer only seems deductible if the issuing corporation is a financing corporation such as a SPV.

#### 4.3.2 Permanent Establishment

A permanent establishment is according to the general definition in Danish law a fixed place of business through which the business of an enterprise is wholly or partly carried on.<sup>61</sup> This definition contains three conditions; (i) the existence of 'a place of business', i.e., a facility such as premises or, in certain instances, machinery or equipment, (ii) the place of business must be 'fixed', i.e., it must be established at a distinct place with a certain degree of

#### Notes

<sup>56</sup> See, *Bolander* in SR.2010.166.

<sup>57</sup> Cf. s. 6e.

<sup>58</sup> See, *Jeppesen* in SPO 2007.331.

<sup>59</sup> Cf. Folketingstidende 1969–70, Appendix A, column 328 and *Bolander* in SR.2010.166.

<sup>60</sup> Cf. Bill L 194 1996–97.

<sup>61</sup> For more on permanent establishments, see *Skaar*: Permanent Establishment – erosion of a tax treaty principle, Kluwer Law and Taxation Publishers 1991, *Cabiers de Droit Fiscal International*: Is there a permanent establishment, International Fiscal Association 2009, Vol. 94a., *Reimer, Urban and Schmid*: Permanent Establishments, Wolters Kluwer Law & Business 2011 and *Laurson*: Fast driftssted, Jurist- og Økonomforbundets forlag 2011.



permanence and (iii) the carrying on of the business of the enterprise through the fixed place of business.<sup>62</sup>

The term permanent establishment has been addressed several times in relation to private equity structures, where a management corporation administrates the investor's investment, for example equity investment through partnerships. Lately in SKM2013.899.SR the National Tax Board found the investors to have a permanent establishment at the place of the management corporation, which contradicts former case law.<sup>63</sup> Controversially the National Tax Board found the offices of the management corporation to be at the disposal of the investors, due to the management of the partnership being identical to the management of the management corporation and that the yearly general meeting where held at the offices of the management corporation.

However, even if the decision of the National Tax Board is correct it does not seem to have any implications for the use of a trustee to represent the investors in relation to corporate bonds. The trustee model differs significantly from a private equity structure, since the private equity structure involves an assessment of whether or not the partnership constitutes a permanent establishment for the investors, while no such partnership is involved in the trustee model (a limited liability corporation). It is merely a passive investment involving independent representation. The use of the trustee model therefore does not cause a permanent establishment according to the general definition, since there is no fixed place of business at the disposal of the investors (bondholders).

Instead a trustee might constitute a permanent establishment due to the trustee being a person (agent) acting on behalf of an enterprise and who habitually exercises the authority to conclude contracts in the name of the enterprise.<sup>64</sup> Such a deemed permanent establishment, due to a so called dependent agent, might cause taxation in Denmark for non-resident investors. A dependent agent includes both individuals and corporations and the agent does not need to be a resident in Denmark or have a place of business in Denmark to constitute a permanent establishment for the investors. However, an enterprise is not deemed to have a permanent establishment merely because it carries out business through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. A person will therefore not constitute a permanent establishment if the person is independent of the enterprise both legally and economically and the person

acts in the ordinary course of his business when acting on behalf of the enterprise.<sup>65</sup>

An independent agent is responsible to his principal for the result of his work, but not subject to significant control with respect to the manner in which that work is carried out. The fact that a principal is relying on special skill and knowledge of the agent is an indication of independence. Furthermore, in determining (in)dependent status it is relevant to analyse whether the agent represents one or numerous principals. In regard to whether or not the agent acts in the ordinary course of his business it must be examined which business activities are customarily carried out within the agent's trade as an independent agent.<sup>66</sup> A trustee would usually represent numerous principals (investors) and would not be subject to significant control with respect to the manner in which that work is carried out. Furthermore, the trustee is usually specialized in monitoring, coordinating and facilitating the bonds, etc. in the ordinary course of business as an agent. In conclusion it is therefore very unlikely that a trustee constitutes a permanent establishment for the investors.

## 5 CONCLUSION

The report from November 2012 on *Corporate Bonds as a Source of Financing for Small and Midsized Corporations* has resulted in significant regulatory changes with the adoption of bill 46 2013–2014. The goal is to create a proper sized bond market, which enables spread and liquidity in the market by introducing a trustee model to benefit small, midsized and larger corporations.

Furthermore, the introduction of a trustee and securitization through a registered model enables corporate bonds to be issued on the basis of a large pool of commercial loans, which can be resold to adjust to the tightened bank regulations. It is thereby easier for banks to issue commercial loans, which benefits both small and midsized corporations. Only the future will tell if the bond market in Denmark will be as successful as in other countries, such as Norway and Sweden.

The tax consequences of the issuing of corporate bonds depend on the specific situations of the participants in the transactions. This article has analysed the tax consequences from a general point of view in section 4.1 in relation to a direct issuing of corporate bonds, section 4.2 in relation to securitization and section 4.3 in relation to the use of a trustee.

### Notes

<sup>62</sup> Cf. s. 2 of the Act on Taxation at the Source and the Corporation Tax Act.

<sup>63</sup> See, Wittendorff: Fast driftssted for investorer i private equity funds – vidtrækkende praksisændring, SR Skat, 2014, SR 2014, 112.

<sup>64</sup> Cf. s. 2 of the Act on Taxation at the Source and the Corporation Tax Act. See, also Laurson: Fast driftssted, Jurist-og Økonomiforbundets forlag 2011, Chs 4 and 5.

<sup>65</sup> See, comments to the OECD MC 2014 Art. 5 and Reimer, Urban and Schmid: *Permanent Establishments* 95–108 (Wolters Kluwer Law & Business 2011)

<sup>66</sup> See, comments to the OECD MC 2014 Art. 5.