

Danish Tax Board Rules on Treaty Protection of Hybrid Entities

by Jakob Bundgaard and Morten Reinholdt Nielsen

In a binding ruling issued on May 20, the Danish Tax Assessment Board found that a company viewed as a transparent partnership (hybrid entity) from a Danish tax perspective was not taxable in Denmark on dividends received from a Danish subsidiary due to provisions in the Nordic tax treaty.

Date: Jun. 18, 2008

Summary Published by **taxanalysts**

In a binding ruling (SKM2008.491.SR) issued on May 20, the Danish Tax Assessment Board found that a company viewed as a transparent partnership (hybrid entity) from a Danish tax perspective was not taxable in Denmark on dividends received from a Danish subsidiary due to provisions in the Nordic tax treaty (Nordic treaty).

The board's analysis was mainly based on the commentary to the OECD model. The board concluded that if a partnership is treated as a company or taxed as such in the state of residence (Iceland), then Denmark is obligated to accept the other country's qualification of the partnership as a company for tax purposes.

The published binding ruling confirms that hybrid entities from a Danish tax perspective can obtain tax treaty benefits even though a domestic classification of the entity does not recognize the entity as a company.

Full Text Published by **taxanalysts**

In a binding ruling (SKM2008.491.SR) issued on May 20, the Danish Tax Assessment Board found that a company viewed as a transparent partnership (hybrid entity) from a Danish tax perspective was not taxable in Denmark on dividends received from a Danish subsidiary due to provisions in the Nordic tax treaty (Nordic treaty). (For prior coverage of the taxation of Danish hybrid entities, see *Doc 2008-13095 [PDF]* or *2008 WTD 116-2*.)

Background

An Icelandic consulting company established a business in Denmark with local Danish consultants as partners. The legal structure of the business was set up through a new Danish legal entity (ApS) that is fully owned by the Icelandic parent company. The Icelandic company is organized in a special corporate form (Smeignarfélag, or SF) that can be characterized as a general partnership. An SF is a taxable entity in Iceland, but is considered transparent in Denmark.

From an Icelandic perspective, SFs are separate legal entities subject to corporate taxation at a rate of 26 percent on operating income and 10 percent on dividends received. An Icelandic SF would, as such, constitute a transparent entity (an I/S or K/S) under Danish law.

Danish Treatment of Dividends

The taxpayer requested a binding ruling regarding the Danish tax treatment of the dividends from the ApS to the SF. Under section 2(1)(C) of the Danish Corporation Tax Act, dividends distributed by a Danish company to a foreign company generally are subject to a

28 percent withholding tax. However, dividends distributed to a company that owns more than 15 percent (10 percent from 2009) of the share capital in the subsidiary for a period of at least 12 months are exempt from withholding tax, provided the recipient is resident in another EU member state or resident in a country that has concluded a tax treaty with Denmark.

Tax Treaty Interpretation

The taxpayer's argument in the binding ruling request was based on an interpretation of the dividends article (article 10(1) and (3)) in the Nordic treaty. According to this article, Denmark may not levy withholding tax on dividends distributed to a "person" resident in the other treaty states if the person is a "company" that owns at least 10 percent of the share capital in the distributing company. Consequently, the key element in the ruling was to determine whether an SF could be considered a person resident in the other treaty state and whether an SF constitutes a company for purposes of the Nordic treaty.

According to article 1 of the Nordic treaty, the qualification of a person in a treaty state, and therefore the right to be entitled to benefits in the Nordic treaty, is made in accordance with the wording in article 3. Article 3(1)(b) defines a person as an individual, a company, or any other body of persons. Company is defined as any corporate body or entity that is treated as a body for tax purposes (cf. article 3(1)(c)), while a body of persons means a body that is not treated as a separate taxable entity.

Article 4 of the Nordic treaty defines the term "resident of a contracting state" as a person who, under the laws of that state, is liable to tax therein by reason of his domicile, residence, place of management, or any other criterion of similar nature (the state itself and lesser subdivisions are included in the definition). According to article 4, the qualification is to be made in accordance with Icelandic domestic law.

Based on the above definitions, the taxpayer argued that an SF should qualify as a company resident in Iceland because the SF corporate form is treated as a company for tax purposes according to domestic Icelandic law. Thus, under the Nordic treaty, Denmark would not be entitled to tax the dividends distributed by the Danish legal entity to the SF.

Furthermore, in support of its argument, the taxpayer pointed out that the OECD commentary to model treaty article 1(5) (implemented on April 29, 2000, as a part of the 2000 update to the model treaty based on Annex I of the report, "The Application of the OECD Model Tax Convention to Partnerships," adopted by the OECD Committee on Fiscal Affairs on January 20, 1999), directly states:

Where a partnership is treated as a company or taxed in the same way, it is a resident of the Contracting state that taxes the partnerships on the grounds mentioned in paragraph 1 of Article 4 and, therefore, it is entitled to the benefits of the Convention.

Ruling

As a preliminary matter, the Danish Tax Assessment Board rejected the status of an SF company as a company under section 1(1)(2) of the Danish Corporate Tax Act. The key element in the further assessment was the extent to which an SF could be perceived as a company in accordance with the Nordic treaty and therefore be entitled to benefits under the dividends article.

The board's analysis was mainly based on the commentary to the OECD model. The board concluded that if a partnership is treated as a company or taxed as such in the state of residence (Iceland), then Denmark is obligated to accept the other country's qualification of the partnership as a company for tax purposes. In reaching its conclusion, the board confirmed that no withholding taxes would be levied on possible dividend distributions from the ApS to the SF.

Comments

The published binding ruling confirms that hybrid entities from a Danish tax perspective can obtain tax treaty benefits even though a domestic classification of the entity does not recognize the entity as a company.

Jakob Bundgaard and Morten Reinholdt Nielsen, Deloitte, Copenhagen

Copyright © 2008, Deloitte Touche Tohmatsu. All rights reserved.

 Comment on this story

Tax Analysts Information

Jurisdiction: Denmark

Subject Area: Corporate taxation

Entity characterization

Legislative tax issues


Tax policy issues

Treaties

Author: Bundgaard, Jakob; Reinholdt Nielsen, Morten

Tax Analysts Document Number: Doc 2008-13323

Tax Analysts Electronic Citation: 2008 WTD 118-3

Cross Reference: For prior coverage of the taxation of Danish hybrid entities, see *Doc 2008-13095 [PDF]* or *2008 WTD 116-2* .

 Use this link to bookmark or link to this document