

Tax Avoidance and Capital Gains on Securities: Lessons from Recent Danish Supreme Court Cases

1. Introduction

Tax avoidance and active tax planning are global phenomena. The structures that are utilized are frequently the same across the tax world and it is, therefore, interesting to compare how such structures are evaluated in the relevant national courts. This article reviews recent Danish Supreme court cases that have considered tax avoidance or planning techniques in relation to the capital gains taxation of securities.

2. Background

Danish corporate investors are taxable on capital gains on shares and similar securities. Under Danish tax law, however, capital gains on shares are tax exempt for corporate investors if the shares have been held for at least three years when sold.¹ Over the years, several tax avoidance techniques have been commonly applied in order to avoid the three-year ownership requirement. In the last few years, some of these techniques have been set aside by the Danish tax authorities, but upheld by the Danish lower instance courts. The Danish Supreme Court has allowed one technique while setting aside another.

This article presents recent Supreme Court cases that provide an important contribution to the examination of the anatomy of Danish tax avoidance. The article describes each of the techniques used and the courts' rulings on these techniques. Subsequently, the consistency and implications of the cases are addressed.

3. The Elevator Technique – The *Finwill* Case

In 2003, the Danish National Tax Tribunal (the Tribunal)² gave its judgment³ in the first of a series of cases in which the tax authorities successfully argued that shares sold using the “elevator technique” could qualify as a sale to a third party instead of a sale to the issuing company.⁴ Since then, the Tribunal has reached the same conclusion in a number of other cases, most recently in Case No. 798.⁵ Other cases have been held in abeyance pending this decision. In the *Finwill* case⁶ the Western Division of the Danish High Court affirmed the order of the Tribunal. In another case, the Eastern Division of the Danish High Court arrived at the same conclusion, although its reasoning differed in some respects.⁷

“Elevator cases” are characterized by a repurchase of the retiring shareholder's shares by the issuing company and a subsequent reduction of its capital, immediately

followed by a capital increase along with the issuance of shares to a new shareholder. Consequently, the repurchase by the issuing company triggers dividend tax pursuant to Sec. 16 B(1) of the Danish Tax Assessment Act (the Act),⁸ since capital gains taxation requires an exemption under Sec. 16 B(2) of the Act, which the selling shareholder has not applied for. Accordingly, the repurchase by an issuing company may result in a tax exemption on the part of the retiring shareholder if the requirements for receiving tax-exempt dividends from subsidiaries are met under Sec. 13(1)(ii) of the Danish Corporation Tax Act.⁹ Any gain on an alternative direct sale of short-term shares to a third party would be taxable, which is why the repurchase may place the retiring shareholder in a much more favourable tax position. The model has also served as an alternative to a direct sale to a third party.

The first High Court judgment in this group of cases¹⁰ has now been reviewed by the Danish Supreme Court.¹¹ In the *Finwill* case, a pension fund owned 50% of a company and the company's managing director owned the other 50% through a holding company. In connection with considerations relating to the future of the business, negotiations were started concerning collaboration with another large enterprise, which had

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1. See Sec. 9 of the Danish Act on Taxation of Capital Gains on Sale of Shares (*aktieavancebeskatningsloven*).

2. *Landsskatteretten*.

3. Tribunal, 24 October 2003, SKM2003.528.LSR, Case No. 985, *Finwill*, *Journal of Danish Tax Law (Tidsskrift for Skatteret)* (2003).

4. See Jakob Bundgaard's critical comments in “Hvad er realiteterne? – bemærkninger til den første landsskatteretskendelse i tilbagesalgskomplekset”, *Journal of Danish Tax Law* (2004), p. 68 and Morten Jappe and Lars Bo Nielsen's support of the decision in “Salg af aktier til udstedende selskab eller bare salg?”, *Journal of Danish Tax Law* (2004), p. 315. See also “Realitetsgrundsætningen i relation til samtidig kapitalnedsættelse og kapitalforhøjelse”, *SR-Skat* (2004), p.127 et seq., where Ole Bjørn, without taking any position, states that an affirmation of the order of the Tribunal would imply an increase in the scope of the substance-over-form doctrine.

5. Tribunal, 2 June 2006, SKM2006.460.LSR, Case No. 798, *Journal of Danish Tax Law* (2006).

6. Western Division of the Danish High Court, 25 May 2005, SKM2005.235.VLR, Case No. 490, *Journal of Danish Tax Law* (2005).

7. Eastern Division of the Danish High Court, 13 February 2006, SKM2006.91.ØLR, Case No. 199, *Journal of Danish Tax Law* (2006).

8. *Ligningsloven*.

9. *Selskabsskatteloven*.

10. See note 6.

11. Danish Supreme Court, SKM2006.749.H, Case No. 1062, *Finwill*, *Journal of Danish Tax Law* (2006).

more or less the same financial strength as the pension fund. It was agreed that the shares held by the managing director through a holding company were to be sold as he was not financially viable enough to take part in the future development of the company. The managing director's holding company had held the shares for less than three years. During this period, there had been discussions regarding a possible sale of the shares after expiry of the three-year period, possibly to the other existing shareholder. A repurchase by the issuing company and a subsequent capital reduction had also been considered. The latter option was chosen, and only one of the two existing shareholders was replaced. The repurchase and the capital increase were adopted at the same general meeting and without any statutory notice. As a result of the capital reduction, the share capital was reduced by a nominal amount of DKK 750,000, leading to a distribution of DKK 17.46 million by way of a dividend. The capital increase was effected by a nominal increase of DKK 750,000, which was paid by way of a cash contribution.

The Tribunal set aside the repurchase on the basis of an assessment of the specific facts and circumstances of the case. Thus, based on an "overall assessment" the Tribunal found that there was such a correlation between the transactions relating to the change in the company's shareholders that, for tax purposes, the retiring shareholder was deemed to have sold the shares to the new shareholder. In this respect, the Tribunal took, in particular, two circumstances into account: (1) the fact that the subscription amount was predetermined for payment to the retiring shareholder; and (2) the fact that the transactions were not based on commercial reasons, but on avoidance (circumvention) of the three-year rule.¹²

Similar to the Tribunal, the Western Division of the Danish High Court initially limited the issue to who the shares had been sold to. Had they been sold to the issuing company, the transaction would be subject to Sec. 16 B(1) of the Act and would be tax exempt under Sec. 13(1)(ii) of the Danish Corporation Tax Act. Had they been sold directly to the new shareholder, any gain on such sale would be taxable under Sec. 2(1) of the Danish Act on Taxation of Capital Gains on Sale of Shares.

Based on the facts of the case, the High Court found that the seller had made it a condition that the shares be transferred to the company for the sole purpose of obtaining a tax exemption: "... Thus, the model was preferred, because it was assumed to lead to tax exemption ...". The High Court further stated that the company didn't have sufficient funds of its own to repurchase the shares, and that these funds were therefore raised by a capital increase:

... The transfer implied a capital reduction, which was conditional on a simultaneous capital increase in the same amount, equal to the purchase price. Consequently, the transfer did not involve any change of the share capital or of the amount of equity ... (All quotes originally in Danish have been translated by the authors.)

The High Court then assessed the legal impact of the two alternative methods on the purchasing company and assumed that the legal consequences to the purchasing company would essentially have been the same, whether the shares had been sold immediately to the purchasing company or to the target company.

In these circumstances, the High Court found that the shares had, in reality, been transferred to the purchasing company, which, after the transfer, owned 100% of the target company. The Court deemed the transfer to have been made only for tax avoidance purposes. Accordingly, the transfer was found not to be in the nature of a repurchase by the issuing company, notwithstanding that the corporate transactions had been validly implemented, and the transfer was therefore taxable under the Act on Taxation of Capital Gains on Sale of Shares.

In conclusion, the High Court stated that the application of the provision on distribution of tax-exempt dividends in Sec. 13(1)(ii) of the Corporation Tax Act (as it then read) to a transfer of shares to the issuing company should be interpreted narrowly, also in cases where the transfer is in reality a transfer to a third party.

In Case No. 199¹³ a company had held some of its shares in a subsidiary for more than three years and some for less than three years. For the purpose of spinning off the subsidiary, the shares were sold through a combination of a direct sale to a third party and a repurchase by the issuing company. The facts relating to the repurchase were largely comparable to the facts of the *Finwill* case. Not surprisingly, the Eastern Division of the High Court arrived at the same conclusion as the Western Division, although its reasoning differed in some respects.

The Eastern Division of the High Court started where the Western Division left off: with the interaction between Sec. 16 B of the Act and Sec. 13 of the Corporation Tax Act. The Eastern Division of the High Court subsequently found that the repurchase by the issuing company was exempt from taxation if viewed separately – but then asked the question whether the circumstances of the sale were nevertheless such as to impose capital gains tax. In its decision, the High Court attached importance, inter alia, to the following:

- the issuing company did not have sufficient distributable funds (according to the wording of the reasoning – not that the company had no

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12. See note 1. See also Anne-Marie Olsen and Johannes Grove Nielsen, *Tax Notes International* (2005), p. 1141 et seq. and Niels Josephsen in *Revision & Regnskabsvæsen* (2005), p. SM 238 et seq. The latter does not, however, dismiss the judgment, but states that the transactions are mutually conditional. Tommy V. Christiansen also commented on the judgment in *Juridisk Ugebrev Skat* (2005), p. 25, stating that it was decisive for the outcome of the case that the transaction was in the nature of a share transfer, including, in particular, the fact that the issuing company did not have sufficient funds to purchase the shares. Based on the reasoning, however, the judgment should probably not be construed to the effect that the tax considerations were a prerequisite for arriving at this conclusion. It can hardly be inferred from the judgment that the High Court would have reached the same decision if the issuing company had had the funds required for financing the share purchase.

13. See note 7.

- distributable reserves) to conduct the repurchase transaction, and for this reason the “transfer was subject to ... contribution of funds by a third party”;
- the seller stipulated that the transaction was to be completed using the elevator technique;
 - the transfer agreements concluded with the third party and the issuing company, respectively, contained the same terms, were mutually conditional and subject to the simultaneous implementation of a capital reduction and a capital increase in the same nominal amount; and
 - “[the seller’s] sole purpose was to obtain a tax exemption”.

The court also emphasized that the capital reduction and the capital increase were adopted at the same general meeting, and that the funds for the capital increase were contributed in cash by the buyer who thus became owner of the whole subsidiary. Since the legal consequences of the two transfers were held to be essentially the same, whether the shares were sold to a third party or to the issuing company, the Court found that there seemed to be no commercial motive for the sale to take place through a repurchase by the issuing company and not directly to the purchaser other than tax exemption. Therefore, the Court found that the shares were in reality transferred to the purchaser for tax purposes.

When the *Finwill* case reached the Supreme Court,¹⁴ the parties repeated the allegations made before the High Court. The Supreme Court panel was composed of seven judges, which emphasizes the general importance of the case. The Supreme Court’s ruling was diametrically opposed to the High Court’s decision. A majority of five judges gave judgment in favour of the company on the following grounds:¹⁵

... The concept of dividends within the meaning of Sec. 13(1)(ii) of the Corporation Tax Act also includes consideration that, under Sec. 16 B(1) of the Act, is treated as dividends (see Notices from the Inland Revenue Department 1982, decision No. 2).¹⁶ According to the wording of the provisions, *Finwill ApS*, which at the time of the sale on 9 April 1999 had held 25% of the shares in *Circuit Electric A/S* for more than a year, was entitled to sell all its shares in *Circuit Electric* to this company without incurring tax liability.

The issue in the case is whether the sale is also tax exempt in the present situation where *Circuit Electric* did not finance the repurchase by distributable reserves accumulated in the company, but where the repurchase – as part of a replacement of the company’s shareholders – was financed by a simultaneous capital contribution by way of new shares in the company issued to a new shareholder, *Hedeselskabet Miljø og Energi A/S*.

The ownership structure in a limited liability company may be changed by a shareholder selling its shares directly to another or a new shareholder. Pursuant to Sec. 44(a)(1)(ii) and Sec. 48(b)(i) of the Danish Companies Act (*aktieselskabsloven*), however, the ownership structure may also be changed by a capital reduction, which may be implemented together with a simultaneous capital increase (see Sec. 46 of the Act). It is assumed that the transactions relating to *Finwill*’s withdrawal as a shareholder and *Hedeselskabet Miljø og Energi*’s purchase of shares were made in accordance with the rules of the Companies Act.

It appears from the legislative history of Sec. 16 B of the Act that this provision is drafted in accordance with Sec. 16 A in order to

ensure that cases where a shareholder sells shares to the issuing company and cases where a company redeems part of its share capital by distribution to the shareholders (see the Official Report of Danish Parliamentary Proceedings 1960-61, schedule B, column 852) are treated equally for tax purposes. According to the legislative history of Sec. 16 A, this provision includes any distribution by the company, whether resulting from profit earned, income tax-exempt capital appreciation or – as in this case – from capital contributed to the company. Such disposal is therefore tax exempt, provided that the requirements in Sec. 13(1)(ii) of the Corporation Tax Act are met.

Based on the above, the fact that the issuing company, *Circuit Electric*, financed the repurchase of the shares from *Finwill* with capital contributed by *Hedeselskabet Miljø og Energi* to *Circuit Electric* cannot, in our opinion lead to the conclusion that the consideration does not fall within Sec. 16 B(1) of the Act, thus giving rise to a tax exemption pursuant to Sec. 13(1)(ii) of the Corporation Tax Act.

The fact that *Circuit Electric* did not, before the capital increase, have sufficient funds available to finance the repurchase does not, in our view, change this conclusion as it is assumed that *Hedeselskabet Miljø og Energi*’s subscription for new shares in the amount of DKK 17,460,000 was offset by real values in *Circuit Electric*.

Accordingly, we believe that there is no basis for refusing to accept that the consideration paid in connection with *Finwill*’s transfer of shares to *Circuit Electric* is a dividend within the meaning of Sec. 16 B(1) of the Tax Assessment Act and thus exempt from taxation pursuant to Sec. 13(1)(ii) of the Corporation Tax Act. Based on the above, we therefore allow *Finwill*’s claim ...

The two dissenting judges would have affirmed the judgment of the Western Division of the High Court.

The Supreme Court judgment was eagerly awaited, both in relation to the remaining “elevator cases”, but also because it would serve as a general and important indication of the Danish tax authorities’ ability to recharacterize a fact recognized under company law to a fundamentally different point of fact for the purposes of tax law.

Specifically, the judgment has resolved most of the other “elevator cases”, despite the differing facts of the individual cases. The reasoning applied by the majority of the Supreme Court judges is clear and attaches decisive importance to the wording and legislative history of the relevant tax rules. Thus, the majority accepts that the interaction between different tax rules may result in tax advantages, and that the rules should not be interpreted restrictively only because of these advantages.

14. See note 11.

15. The Supreme Court judgment was commented on by Aage Michelsen in *Revision & Regnskabsvæsen* (2007) 1, p. SM 5, by Ole Bjørn in *SR-Skat* (2007) 1, p. 15 et seq. and by Jakob Bundgaard and Arne Møllin Ottosen in *Revision & Regnskabsvæsen* (2007) 4, p. 32 et seq.

16. SKDM1982.2.DEP: “The Tax Department has indicated to the Tax Directorate that consideration received by a parent company from a sale of shares to the issuing company within the meaning of Sec. 16 B(1) of the Danish Tax Assessment Act may be considered as tax-exempt dividends within the meaning of Sec. 13(1)(ii) of the Danish Corporation Tax Act, to the effect that such consideration is not to be included in the parent company’s taxable income if the parent company has held at least 25% of the shares in the subsidiary throughout the year of assessment”.

The entire avoidance idea and the tax-saving motive were considered irrelevant. It was, therefore, up to the majority of the Supreme Court judges to assess whether the statutory tax rules in Sec. 16 B of the Act and Sec. 13(1)(ii) of the Corporation Tax Act should be set aside solely because the repurchase was financed by capital contributed by a third party.

The Supreme Court decision focuses on the purpose of Sec. 16 B of the Act, which is to equate repurchases of shares with actual distributions of dividends. The Supreme Court takes into account that the concept of a dividend, as defined in Sec. 16 A of the Act, includes any distribution by the company, however it originates. In these circumstances, and based on a general construction of the law, the Supreme Court was not concerned with whether the amount results from profit earned, income tax-exempt capital appreciation or the capital contributed. This being the case, the dividend should, without doubt, be interpreted within the meaning of Sec. 13(1)(ii) of the Corporation Tax Act.

4. The Exercise of Options – The *Newpond* Case

In practice, put and call options are often part of a share transfer. Attention should, therefore, be paid to the tax risks involved in such options. Put and call options may, however, also be used for tax planning purposes.

Generally, the tax authorities focus on the private law agreement and recognize that shares and other assets are not transferred until a final and binding agreement exists. This will typically be the time when the put or call option is exercised. Under contract law, the option represents an offer until it is accepted. As a general rule, the granting of a put or call option has no tax implications; it represents a grant of third party rights to the shares and thus a partial assignment, which is not likely to be subject to taxation under the Act on Taxation of Capital Gains on Sale of Shares.

It may, however, trigger certain risks if a shareholder accepts considerable restrictions or changes in his ownership rights, since this may lead to the share being deemed to have been transferred in full, for example when put and call options are granted simultaneously.

Until recently, there haven't been any Danish cases where a simultaneous granting of put and call options for shares has been found to result in a full disposal of such shares. The question has, however, recently been considered by the Supreme Court.

The leading case is *Allan Andersen*.¹⁷ In this case, a shareholder granted a call option on his shares in a company and, at the same time, sold some of the shares and obtained a loan from the purchaser. The remaining shares in the company were pledged to the creditor (purchaser). It appeared from the letter of pledge that the pledgee had the voting rights carried by the pledged shares. Further, it was separately agreed that the creditor could exercise the voting rights to vote for a merger with the creditor company. Finally, the creditor had a pre-emptive right with respect to a capital increase. Any

dividend on the shares would be payable to the debtor. A shareholders' agreement was concluded that limited the annual distribution of dividends on the shares to which the purchasing company had a pre-emptive right to the amount of the interest on the loan.

The case is interesting in that the tax authorities stated that the shareholder, by granting the call option, had waived his full right of ownership of the shares. The tax authorities submitted that the characterization of the transaction for civil law purposes does not necessarily bind the characterization for tax law purposes. The tax authorities further submitted that it is unusual for a shareholder to waive his voting rights in connection with a pledge of shares. Based on the current state of the law, the voting rights usually remain with the pledgor, unless otherwise agreed. The fact that the balance of the purchase price of the shares was paid immediately out of the loan illustrates, according to the tax authorities, that the ownership right was assigned on the pledging of the shares. The agreement was indisputably made for tax reasons; the purpose was to ensure that the shares could be sold after seven years of ownership without incurring tax liability.

During the court hearing, it was submitted that a disposal had taken place, because the taxpayer's legal position would, in reality, have been the same, had he sold his entire shareholding. Thus, he actually received payment for the shares by way of the loan and at the same time gave up all ownership rights, except the right to dividends, by waiving the voting rights and the pre-emptive rights. Furthermore, since there was no strain on the taxpayer's liquidity as a result of the dividend agreement, the tax authorities found, based on an overall assessment, that there was no actual risk, and that both parties were, in reality, in the same position as if the shares had been transferred. Consequently, the arrangement was set aside for tax purposes, notwithstanding the civil law issues.

A majority of Supreme Court judges (three) found it unlikely that the call option would not be exercised, and that for tax purposes the shares had therefore been disposed of pursuant to Sec. 2(1) of the Act on Taxation of Capital Gains on Sale of Shares. A minority of Supreme Court judges (two) found, however, that as of the date of the agreement, the future contracts were subject to such uncertainty that there were no grounds for finding that ownership of the shareholding had been assigned at the time when the call option was granted and the loan agreement made. Similar wording was used in the *Peter Charles Andreassen* case.¹⁸

In *Peter Charles Andreassen*, relief related to the period of ownership of real property was denied because it was held that, despite the granting of a simultaneous put and

17. Danish Supreme Court, 11 February 1999, Case No. 214 H, *Allan Andersen*, *Journal of Danish Tax Law* (1999).

18. Danish Supreme Court, 22 May 1996, Case No. 469 H, *Peter Charles Andreassen*, *Journal of Danish Tax Law* (1996).

call option in 1979, the future contracts were subject to such uncertainty that the property was not deemed acquired until it was purchased in 1984. Thus, for seven years, Mr *Andreasen* could postpone the exercise of the call option at his own discretion, and it was doubtful whether by that time – if he was still owner of the undertaking – he would be able to meet the terms of the property transfer agreement. In addition, the consequences of a breach of the lease agreement or of enforcement proceedings in relation to the property were uncertain.

This issue was specifically considered in the *Newpond ApS* case.¹⁹ This case dealt with the timing of a disposal of a shareholding, to which a call option was granted in May 1999. In the case, the company had disposed of its shares in another company. In connection with the purchase of approximately 75% of the share capital, the purchaser received a call option on the remaining shares at a price of approximately DKK 92 million. The call option could be exercised from 1 August 2001 and would lapse if it had not been exercised by 30 April 2002. If the purchaser failed to exercise the call option, the company and the other shareholders were entitled to sell the stake at a price of approximately DKK 121 million. The Tribunal found that the shares had been disposed of on the granting of the call option for the purpose of circumventing the three-year rule provided for in the Act on Taxation of Capital Gains on Sale of Shares. Considering the drafting of the agreements, the Eastern Division of the High Court and the Supreme Court found that the parties were likely to have realized in May 1999 that the right to purchase the shares would be exercised by the purchaser as contemplated. Importance was attached to the fact that it was a combined put and call option, and that the price of the two options differed significantly. Further, it was taken into account that the company could not deal with the shares contrary to the call option as a transfer was, *inter alia*, subject to the consent of the board of directors. No importance was attached to the fact that the right to vote and to receive dividends on the shares was not assigned to the purchase, since the purchaser held 75% of the shares. Both the Eastern Division of the High Court and the Supreme Court, therefore, found that the shares were deemed to have been transferred for tax purposes at the time when the agreement was made in May 1999. Since the shares had been held for less than three years, the gain was taxable.

The judgment is the result of a specific assessment as to whether the parties realized, based on the evidence, that a transfer would take place, leaving no uncertainty as to whether the shares would be disposed of. At the same time, the case serves as an example of a tax planning strategy to obtain a more favourable tax position as a result of the timing of a share transfer. One tax scholar, Jan Pedersen,²⁰ commented that the judgment makes the state of the law more rigorous, because the exercise of the call option was warranted for economic reasons only. In Pedersen's view the simultaneous granting of put and call options for tax planning purposes may imply a

disposal if it is likely that the options will be exercised. The authors agree with this assessment.

5. Artificial Losses on the Sale of Securities – The *Kame* Case

In the *Kame* case²¹ a Danish company purchased access to an artificially created tax loss for the purpose of reducing its tax liability. The plan was to exploit the interaction between the Danish rules relating to taxation of gains and losses on shares (as set out in the Act on Taxation of Capital Gains on Sale of Shares), which also apply to investment fund units, as well as foreign national rules and a tax treaty.

In 1994, a Danish company, A, set up a German subsidiary, B. B was jointly taxed with A from 1994 onward. B obtained a loan of DKK 111 million from a Luxembourg bank and in December 1994 acquired units in a Luxembourg dividend-paying investment fund based on bonds. The units were pledged as security for the loan. Shortly after the acquisition, the investment fund repurchased units from B representing a value of DKK 100 million (repurchased by the issuing company). The sale did not trigger any tax liability in Germany. At the beginning of 1995, B sold the remaining units to a third party. As gains and losses on units are assessed according to the average cost formula, B retained the full purchase price of DKK 111 million in connection with the sale to the issuing company in 1994. Thus, B suffered a loss of more than DKK 100 million on the sale of the remaining units in 1995. At that time, Denmark's tax treaty with Germany provided relief from double taxation based on the exemption method.²² Accordingly, A was not liable to pay tax in connection with the sale to the issuing company in 1994, but was entitled to deduct the loss suffered in 1995 from its taxable income in Denmark. The tax authorities disallowed A's deduction of the loss. The tax authorities' decision was upheld by the Tribunal, taking the tax-saving motive and the merits of the case into account, as well as other arguments used by the tax authorities before the superior courts.

The case was decided in the High Court by three judges. Two of the judges stated that:

It is assumed that the units were purchased and sold as part of a carefully planned arrangement, the purpose of which was only to gain a tax advantage. Based on an overall assessment of the relevant transactions, the plaintiff is, however, deemed not to have suffered a real loss in the amount of DKK 107 million, which may justify a deduction as claimed. In the present circumstances, there is no reason to assess the amount of any deductible loss if the approximately DKK 100 million generated by the sale on 28 December 1994 is included in the assessment.

19. Danish Supreme Court, 11 November 2005, Case No. 933 H, *Newpond ApS*, *Journal of Danish Tax Law* (2005).

20. *Revision & Regnskabsvæsen* (2005), p. SM 24 et seq.

21. Danish Supreme Court, 8 January 2007, Case No. 201 H, *Kame*, *Journal of Danish Tax Law* (2007).

22. Shortly after, the legislature prohibited the use of the exemption method in tax treaties. See Sec. 33(6) of the Act, which provides for a switch-over principle from the exemption to the credit method for jointly taxed companies.

Thus, the majority of the judges concluded that A was not entitled to deduct the loss. The third judge found that A was entitled to an allowance. This judge found that it was a matter of a carefully planned tax arrangement, but stated that since it also involved a certain risk to A, A was also to be granted the allowance.

The decision is interesting, not so much because of the tax arrangement, but because of the reasoning of the majority. As a reason for their decision, the judges state that the arrangement was implemented for tax reasons only. The Western Division of the High Court, in stating this, is close to finding that the existence of a tax avoidance motive may be decisive.

The authors do not agree with the reasoning in the High Court judgment. There are no Danish tax rules or cases that allow transactions to be disregarded merely because they are motivated by tax reasons. The dissenting judge agreed with the judgment of the Supreme Court, taking into account that the arrangement involved an actual economic risk. For example, B would have to repay the loan to the bank, regardless of whether the value of the units declined, etc.

In the Supreme Court case, additional information was presented, and reference was made to the 1993 assessment guidelines, S.G.3.3., which state the following in relation to the remaining shareholding (and thus also the units) in connection with a repurchase by the issuing company, which is taxed as dividends pursuant to Sec. 16 B(1) of the Act:

... For tax purposes, the consideration is comparable to dividends. The taxation does not reduce the acquisition cost pertaining to the principal shareholders' shares in the company as the acquisition cost of the remaining shares stays the same as before the disposal to the company...

The panel consisted of nine judges, which indicates the general importance of the case. The Supreme Court arrived at the same conclusion as the High Court, but based its decision on different reasons, which may be directly related to the supplementary statement of claim produced in the Supreme Court. The Supreme Court stated as follows:

... The German subsidiary's estimated loss of DKK 106,934,134, which H1 ApS (formerly HIX A/S) considers it is entitled to deduct from the statement of its jointly taxed income for 1995, is primarily a result of the fact that the acquisition cost of approximately DKK 111 million for all units has been deducted from the consideration of approximately DKK 11 million resulting from the sale of the remaining 10% of the units in 1995. Thus, the company has not only deducted the acquisition cost of the 10% of the units that were sold in 1995, but also the acquisition cost of the 90% of the units that were sold in 1994 to the issuing investment fund. In this respect, H1 refers to the administrative practice indicated in the assessment guidelines, according to which the taxpayer, notwithstanding any disposal of part of its shareholding or other securities to the issuing company/the issuing investment fund, may deduct the acquisition cost of all securities upon a subsequent sale of the remaining part of the securities to a third party.

The purpose of this administrative practice is probably to compensate for the fact that a repurchase by the issuing company/the issuing investment fund pursuant to Sec. 16 B(1) of the Tax Assessment Act results in the whole consideration being

taxed as dividends without any ability to deduct the acquisition cost. In these circumstances, i.e. that the repurchase in 1994 by the issuing investment fund was not subject to taxation due to the exemption principle provided for in the tax treaty between Denmark and Germany and the tax exemption provided for under German law, the rule that has developed in practice will not be considered applicable. As stated by the High Court, no actual loss has been suffered in this situation. On the other hand, the loss has been invented for the purpose of obtaining a tax deduction ...

Thus, the Supreme Court reasoned that the administrative practice referred to by the taxpayer requires that taxation be imposed on repurchase of the shares, which, based on practical arguments, should be mitigated when further sales of shares take place. Therefore, instead of referring to abstract tax avoidance or tax abuse considerations, the Supreme Court chose a factual analysis based on an interpretation of the relevant tax rules. Accordingly, the judgment cannot be cited in support of the existence of a general anti-avoidance rule that can be invoked to set aside transactions motivated by a taxpayer's desire to reduce its tax liability. Consequently, the Supreme Court has once again determined the state of the law in this area, and overruled the tendency of the High Courts to adopt a tax avoidance line of reasoning.

6. Are the Supreme Court Cases Consistent?

6.1. Introductory remarks

Given the different outcomes of the recent Supreme Court judgments on tax planning, it is questionable whether the cases are consistent. In the authors' view they are. They fit into an overall legal framework applicable to tax planning in general and capital gains in particular.

6.2. The existence of an anti-avoidance rule

Avoidance implies arranging a transaction so as to keep it consistent with the letter or form of the law, but not with the substance or intention of the law.²³ It is commonly agreed that in tax law matters an interpretation based on the purpose of a tax provision cannot override an interpretation based on the strict wording of the law.²⁴ This poses a problem for the tax authorities as it effectively prevents the application of a purposive construction, as such construction would be contrary to a literal interpretation. Thus, the problem of avoidance arises when the possibilities for interpreting a statute are exhausted²⁵ and, because a purposive interpretation is not possible, the tax authorities' only option is to set aside the transaction based on tax avoidance.

It is consistently accepted in the tax law literature that no such avoidance rule exists. This was confirmed in the Supreme Court's judgment in the *Finwill* case. Neverthe-

23. See Jan Pedersen's 1989 doctoral thesis, *Skatteudnyttelse (Tax Exploitation)* (Copenhagen: Gad, 1989), p. 264 and same in *Skatteorientering* Ø.5, p. 19.

24. See Jan Pedersen, *Skatteorientering* Ø.5, note 23, p. 18.

25. *Id.*, p. 292.

less, there are Supreme Court judgments in which avoidance-like deliberations play a part.²⁶

One of these cases²⁷ concerned a taxpayer with a number of non-interest bearing claims against companies owned by him. The tax authorities wanted to tax him on his fixed interest income, but the Supreme Court found that a lender cannot be taxed on fixed interest income unless the transactions were intended to circumvent tax law.²⁸

There are two additional Supreme Court judgments where the court's reasoning includes the words "abuse" and "tax speculation". Case No. 99 H²⁹ involved a taxpayer who used the special Business Taxation Regime. He contributed personal debts into the business at the start of the year only to withdraw them at the end of the year, 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 judgment later affirmed by the Supreme Court, the Western Division of the Danish High Court held the following:

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

Case No. 460 H,³⁰ concerned two taxpayers who converted a loan-financed investment into bonds to obtain tax-exempt capital gains and a deduction for interest payable on the loan. New rules had, however, been introduced, which made capital gains on investments acquired with borrowed funds taxable. The rules provided, however, that capital gains would not be taxable if the taxpayer could prove that the total after tax result of the loans and the claims combined was negative. The taxpayers, having learned about the bill, rearranged their loan-financed bond investments to make the total after-tax result negative in order to claim the capital gains exemption. The Supreme Court ruled against the taxpayers, stating that the exemption is only intended to include cases where there is no tax speculation involved.

The wording of these three cases seems to suggest that the Supreme Court acknowledges the existence of an anti-avoidance rule. One cannot assume, however, that this is so. Both judgments concern attempts to circumvent a protective rule, i.e. the rules on adjustment of interest and the protective rules on loan-financed bond investments. The taxpayers tried to obtain a tax advantage that the legislators had specifically wanted to eliminate and which was characterized as "abusive" in the legislative material. In circumstances where the legislators paid particular attention to specific situations of abuse when drafting the statute, the Supreme Court finds that a strict literal interpretation may be set aside by a purposive construction.

The above cases support the conclusion that there is no general anti-avoidance rule in Danish tax law. This has been established in numerous Supreme Court cases, including the *Finwill* case. The legal adviser to the government had argued that the transactions could be set aside on grounds of avoidance, but a Supreme Court majority did not concur. It is worth noting, however, that in the *Finwill* case the Supreme Court thoroughly interpreted the rules on dividends and repurchases by the issuer, probably in order to examine whether the wording of and the legislative material behind the provisions were so clear as to rule out a purposive interpretation.

It is clear from the Supreme Court's review of the legislative material that the legislators did not foresee all steps of the elevator technique. It is evident, however, from the sources of law produced that certain steps of the elevator technique had been foreseen, for example, the fact that dividend rules allow shares to be sold tax free to the issuing company after only one year of ownership and the fact that dividends may arise from a capital increase. In the *Finwill* case, there was no proof that the Ministry of Taxation and the legislators had had specific knowledge of the elevator technique, let alone accepted its application as a matter of practice. The Ministry was aware, however, that taxpayers could freely choose between tax exemption and tax liability in certain dividend situations; it had even addressed the existing asymmetry in a bill – but had taken no specific steps to intervene.

The *Finwill* judgment supports the conclusion that the tax authorities cannot set aside "step-by-step" transactions – at least in respect of company law transactions – simply by stating that not all steps had been anticipated by the legislators.

It is fair to conclude, therefore, that in circumstances where a taxpayer, who is accused of avoiding tax rules in respect of step-by-step transactions, invokes a literal interpretation of the law, and such interpretation is clearly contrary to the presumed purpose of the law, there must be clear evidence in the legislative material before a literal interpretation can be extended to the individual steps of the transaction. If that is not the case, it may be possible to characterize the transaction on some other basis.

.....
26. Danish Supreme Court, 11 February 1998, Case No. 199 H, *Journal of Danish Tax Law* (1998); Supreme Court, 15 December 1997, Case No. 99 H, *Journal of Danish Tax Law* (1998); and Danish Supreme Court, 4 April 2002, Case No. 460 H, *Journal of Danish Tax Law* (2002). These cases were produced by the Legal Adviser to the Danish government in the *Finwill* case in support of the existence of an anti-avoidance clause.

27. Case No. 199 H, see note 26.

28. In "Hjemmel eller mangel heraf til rentefiksering", *Journal of Danish Tax Law* (1998), p. 207, Erik Overgaard refers to this judgment, claiming that "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 for the taxation of a fixed interest rate. It is, presumably, the first time the High Court has ever used the term "avoidance" separately in any judgment to provide a legal basis for taxation."

29. Case No. 99 H, see note 26.

30. Case No. 460 H, see note 26.

In fact, there have been cases where the Supreme Court has countered tax exploitation and tax abuse by applying a concrete interpretation of the sources of law involved. For instance, in the *Kame* case, the Supreme Court employed a purposive construction of administrative practice to prevent the practice from being exploited in order to obtain tax advantages. Such a procedure has been seen in other contexts as well.

6.3. The substance-over-form doctrine

It is clear that the substance-over-form doctrine applies under Danish tax law, despite fierce arguments to the contrary in some Danish tax law literature. In the authors' view, the *Newpond*³¹ case fits into the substance-over-form mindset, which held that a formal deferral of the time of sale of shares, etc. may be set aside if the parties to a transaction are found, on a balance of probabilities, to have arranged matters financially so that the sale is finalized at the granting of put and call options, provided, however, that the purpose was to obtain tax benefits.

The Supreme Court has laid down that there are clear restrictions on the use of such a substance-over-form approach. It is a precondition for its application that there is a significant inconsistency between the form and substance of a given transaction. There is no such conflict to be found if the form of a transaction is also presumed to be the substance of it, which is the case where a transaction results from the rules of company law. That connection was evident in the *Finwill* case, where the Supreme Court drew a clear line in the sand in relation to the applicability of the substance-over-form mindset.

Therefore, in *Finwill*, the Supreme Court clearly delineated the application of the substance-over-form doctrine under Danish tax law (if such a principle could be said to apply at all), by laying down that it will not apply to transactions made in accordance with formal non-tax rules, for example company law rules. To fully appreciate the significance of this delineation, it may be useful to examine the substance-over-form doctrine.

Pursuant to the "point of fact principle"³² fictitious or artificial transactions may be set aside for tax purposes if the actual substance of the transaction conflicts 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 an overall assessment. For tax law purposes, therefore, the transaction is 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 point-of-fact principle.³³ According to leading commentators it is important to bear in mind that the point-of-fact principle cannot be applied to all transactions with an element of fiction. It is a further condition that there

is a clear conflict between form and substance. For example, the formation of companies and the conclusion of marriages and divorces for tax purposes only, although by their very nature only of formal significance, cannot be set aside. The *Finwill* judgment is an example of such a delimitation of the point of fact principle as indicated in the following excerpt from the court's reasons:

The ownership structure in a limited liability company may be changed by a shareholder selling its shares directly to another or a new shareholder. Pursuant to Sec. 44(a)(1)(ii) and Sec. 48(b)(i) of the Companies Act, however, the ownership structure may also be changed by a capital reduction, which may be carried out simultaneously with a capital increase (see Sec. 46 of the Act). It is assumed that the transactions relating to Finwill's withdrawal as a shareholder and Hedeselskabet Miljø og Energi's purchase of shares were made in accordance with the rules of the Companies Act.

So far, therefore, there is little – if anything – in the case law to support the setting aside of transactions resulting from company law rules enforced by the Commerce and Companies Agency.³⁴ Distributions of dividends and reclassification of such distributions do not fall into this category. In Case No. 234,³⁵ (concerning 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 was 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 minor accounting discrepancy, etc. was not enough, said the High Court, to "deprive the limited partnership structure of tax relevance".

The closest a court has come to setting aside legal company law transactions was in the *Over-hold ApS* case³⁶ where the High Court – but not the Supreme Court – came very close to reclassifying a company law transaction.³⁷ In this case a company was denied an interest deduction in respect of a financing transaction, which was undertaken partly to exploit losses, based on a specific assessment of the facts of the case. Because of the close connection between the raising of the loan, a capital increase and a subsequent capital reduction, the

31. See note 19.

32. The principle was first described by Jan Pedersen in *Skatteudnyttelse*, see note 23, particularly p. 435 et seq. and in *Skatteorientering* Ø.5, see note 23, p. 23.

33. See Jan Pedersen in *Skatteorientering* Ø.5, see note 23, p. 24.

34. See Hans Severin Hansen, "Kommentar til en Højesteretsdom om realitet og legalitet", *Journal of Danish Tax Law* (2004), p. 88 and Jakob Bundgaard, note 4, p. 68. For an opposing opinion see Morten Jappe and Lars Bo Nielsen, note 4, p. 315, who argues that the use of company law rules can become so unusual that company law transactions and the financial reality begin to clash.

35. Eastern Division of the Danish High Court, 26 January 2006, SKM2006.69.ØLR, Case No. 234, *Journal of Danish Tax Law* (2006).

36. Danish Supreme Court, 30 October 2003, SKM 482.2003, Case No. 889 H, *Journal of Danish Tax Law* (2003).

37. The judgment was commented on by Aage Michelsen in "Kommentar til udvalgte afgørelser: Lovlig udnyttelse af undtagelsesbestemmelser 1 skatteretlige værnsregler", *Revision & Regnskabsvæsen* (2004), p. SM 9; Hans Severin Hansen, see note 34 and Jan Guldmand Hansen in "Skattemæssig omkvalifikation af selskabsretlige dispositioner – seneste praksis", *SR-Skat* (2004), p. 50 et seq.

High Court was not satisfied that the borrowed funds were at the free disposal of the company. 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 loaned to the consolidated company. Further, the High Court did not find that the inter-company loans represented any real risk for the companies. Lastly, because the information submitted by the company indicated that it earned no profit on the arrangement, the High Court found that the loan was not a usual business transaction for the company and consequently was not relevant for tax purposes.

The setting aside of company law transactions in this case was only an indirect consequence of disallowing the deductibility of interest costs. The High Court must have assessed that there was no capital increase, or that the capital increase had been carried out by the foreign parent company directly, despite the fact that for company law purposes it was the company itself subscribing for shares as part of the capital increase. The Supreme Court later overruled the High Court's judgment, stating that the company had legally applied the then express exemption applicable to financial loss-making companies in Sec. 15(7), No. 3, of the Act.

One can only welcome this respect for de facto company law transactions. Had the High Court judgment in the *Finwill* case stood, for example, it would have caused immeasurable uncertainty in predicting the tax law consequences of company law transactions.³⁸ This uncertainty has been reduced but will, of course, never be completely eliminated.³⁹

Despite the clear signal of the Supreme Court in the *Finwill* case, Danish tax authorities seem to maintain the view that certain company law matters in connection with tax-neutral restructurings may be reclassified. For example, the National Tax Board⁴⁰ recharacterized a number of dividend distributions, which were to be made prior to a tax-neutral merger, as either dividends or cash payments. The Board found that dividend distributions prior to the merger did not qualify as such, given the uncertainty of the evidence, including a lack of annual reports for the relevant years of assessment.

This discussion, however, cannot ignore the underlying Merger Directive (90/434/EEC), which governs the right to make tax-neutral restructurings within the European Union. The European Court of Justice (ECJ) recently gave its ruling in a Danish case concerning the tax authorities' reclassification, in relation to tax-exempt restructurings, of subsequent distributions of dividends into cash payments. In *Hans Markus Kofoed*,⁴¹ the ECJ interpreted the Merger Directive with regard to the notion of an exchange of shares in Arts. 2(d) and 8(1). More specifically the question was whether a dividend payment paid just after the exchange of shares could be included in the calculation of cash payment provided for in Art. 2(d). The Danish tax authorities had reclassified the dividend payments as cash. The ECJ did not accept the reclassification, stating the following:

28. The Court finds in this regard, as noted by the Advocate General in points 44 to 47 and points 52 and 53 of her Opinion, that the concept of "cash payment" within the meaning of Article 2(d) of Directive 90/434 covers monetary payments having the characteristics of genuine consideration for the acquisition, namely payments agreed upon in a binding manner in addition to the allotment of securities representing the share capital of the acquiring company, irrespective of any reasons underlying the acquisition.

See also Para. 31 of the decision:

31. Consequently, a monetary payment made by an acquiring company to the shareholders of the acquired company cannot be classified as a "cash payment" for the purposes of Article 2(d) of Directive 90/434 merely because of a certain temporal or other type of link to the acquisition, or possible fraudulent intent. On the contrary, it is necessary to ascertain in each case, having regard to the circumstances as a whole, whether the payment in question has the characteristics of binding consideration for the acquisition.

Moreover it was stated in Paras. 46-48 that:

46. As noted by the Advocate General in point 63 of her Opinion, in the main proceedings it is therefore for the national court to ascertain whether there is, in Danish law, a provision or general principle prohibiting abuse of rights or other provisions on tax evasion or tax avoidance which

.....
38. There seemed to be considerable reluctance to recommend different corporate structures in light of the High Courts' elevator judgments. For an illustration of this see SKM2006.529 SR.

39. With respect to the resistance of corporate transactions to the point-of-fact principle, however, the basis of the Supreme Court's reasoning may be relevant, i.e. that the financing of the repurchase came from the capital increase, and that the company itself did not have the means to make the repurchase. While the Supreme Court attached no particular importance to the financing in deciding the case, its reasoning on this particular point seems to contain a (possible) reservation: "The fact that Circuit Electric did not, before the capital increase, have sufficient funds available to finance the repurchase will, in our view, not change this conclusion as it is assumed that Hedeselskabet Miljø og Energi's subscription for new shares in the amount of DKK 17,460,000 was supported by real values in Circuit Electric". The basis for this statement cannot be deduced from the reasoning, but it is possible that the Supreme Court wanted to prevent the transfer of funds between parties by means of capital contributions to companies with no real value, subsequently making a tax-exempt distribution of the capital to the recipient through a capital reduction. This is interesting as Sec.13(1), No. 1 of the Danish Corporation Tax Act provides that any premium obtained by a company through the issuance of shares or a capital increase is tax exempt. One would think that a capital increase at a premium – if in compliance with the formalities of company law – will always be tax exempt, provided the form follows the substance of the transaction. See also National Assessment Council, 8 January 2004, Case No. 126 LR, SKM2003.10.TSS, *Journal of Danish Tax Law* (2004), where the Council found that a premium significantly exceeding book value was a taxable contribution to the issuing company. The Council had been asked if the subscription by a company (D) for new shares in a new parent company (M2) at a premium significantly exceeding M2's book value would trigger taxation for D, M2, M2's new parent company, or the shareholders of the latter. Subscription would take place through a non-cash contribution of the shares in D's subsidiaries and the commercial value of these shares would correspond to the nominal value of M2 shares plus a premium. The Council stated that for tax purposes the difference between the market value of the shares in the subsidiaries and the remuneration received (DKK 10,000) would be considered a non-deductible contribution by D to M2, on which M2 would be taxed. The proposed transaction would trigger no taxation for the three sole shareholders. If the Supreme Court intended to make reservations, it might well be for situations such as this. The Supreme Court's reasoning does not say, though, whether it will be the issuing company or its shareholders who will have to pay tax on the premium (if any is imposed) if the issuing company has no real value to balance the newly subscribed shares.

40. National Tax Board, 19 December 2006, SKM2006.799 SR, Case No. 223 SR, *Journal of Danish Tax Law* (2007).

41. ECJ, 5 July 2007, Case C-321/05, *Hans Markus Kofoed v. Skatteministeriet*.

might be interpreted in accordance with Article 11(1)(a) of Directive 90/434 and thereby justify taxation of the exchange of shares in question (see also Case 8/81 Becker [1982] ECR 53, paragraph 34).

47. If so, it will be for the national court to determine whether the conditions for the application of those provisions are satisfied in the main proceedings.
48. In the light of all the foregoing, the answer to the question referred must be that, in circumstances such as those in the main proceedings, a dividend, such as that paid, is not to be included in the calculation of the “cash payment” provided for in Article 2(d) of Directive 90/434 and that, accordingly, an exchange of shares such as that in issue constitutes an “exchange of shares” within the meaning of Article 2(d) of that directive.

Consequently, Art. 8(1) of the Merger Directive precludes, in principle, the taxation of such an exchange of shares, unless national rules on abuse of rights, tax evasion or tax avoidance may be interpreted in accordance with Art. 11(1)(a) of the Merger Directive and, therefore, justify the taxation of that exchange.

Thus, the ECJ referred the matter to the Danish courts to assess whether any domestic anti-abuse provision exists that supports a reclassification of paid out dividends as cash payments in a tax-free restructuring. In the authors’ opinion, the Danish Supreme Court most likely rejected such an approach in its *Finwill* decision even though the connection to company law is less direct with regard to dividend payments given that the tax law notion of dividends is not directly tied to the company law notion of dividends and the fact that dividends can be said to exist for tax law purposes irrespective of the company law provisions.⁴²

Case No. 449 SR⁴³ concerned the question of whether a distribution of dividends could be recharacterized as a cash payment in connection with a subsequent sale of shares. Under Sec. 13(1), No. 2, of the Corporation Tax Act, the dividend would be tax-free for the recipient. The applicant cited the *Finwill* judgment. The National Tax Board did not find the facts of the case comparable to those of the *Finwill* case. It stated that it would still be possible, the *Finwill* case notwithstanding, to have a different classification for tax purposes of dividend distributions, but found no grounds to reclassify distributions in the particular case.

6.4. Are courts helping legislators?

The Supreme Court’s *Finwill* judgment sends a message to the legislators not to expect the courts to assist when legislators do not act against asymmetries and shortcomings of tax law. In the words of Aage Michelsen, the judgment provides important directions on how the spheres of authority are and ought to be divided between courts and legislators.⁴⁴

In its account of the rules, the judgment offers a thorough run-through of Secs. 16A and 16B of the Act, the background and legislative history of those rules, as well as relevant rules of company law. The judgment also includes a detailed account of Bill L 87 of 13 November 1998, the significance of which was specifically rejected

by the Eastern Division of the Danish High Court. L 87 proposed an amendment to Sec. 16 B of the Act to the effect that Sec. 16 B(1) would not apply to, inter alia, the “sale of all the transferor’s shares etc. in the issuing company as part of a total transfer to the issuing company and any other buyers”. Instead, there would be capital gains taxation. During the hearing of the bill in Parliament (*the Folketing*), the Minister of Taxation answered a request,⁴⁵ stating, inter alia, that:

... for parent companies, there will be – for the first three years of ownership – a tax advantage in having the sales price taxed as dividends – dividends from subsidiaries are tax-free, whereas capital gains are not tax free until after three years of ownership. This is made possible in the previous rules, as in this situation the parent company could simply omit to apply for exemption ...

Before the passing of L 87, the Minister withdrew the proposed amendment to Sec. 16 B of the Act, explaining that:⁴⁶

As a result of the proposed amendments I withdraw the proposal to objectify Secs. 16 A and 16 B of the Tax Assessment Act. Secs. 16 A and 16 B are used in connection with succession, and I find it appropriate to await the results of the Succession Committee before proceeding.

The Supreme Court sent a strong signal in the *Finwill* case. All other things being equal, the Court was not satisfied in the *Finwill* case that the Ministry and the legislators had had specific knowledge of the elevator technique, let alone accepted it as a practice – but the Ministry was clearly aware (and yet did not act on it) that there was freedom of choice between tax exemption and tax liability in certain dividend situations; it had even addressed the asymmetry in a bill.

A week after the Supreme Court delivered its judgment, the Minister of Taxation presented a bill aimed at stopping the use of the elevator technique.⁴⁷ This was hardly surprising as the Supreme Court’s judgment in the *Finwill* case had, in effect, eliminated tax liability on companies’ sales of short-term shares. The Bill to amend Secs. 16 A and 16 B of the Act treats distributions, obtained through repurchases by the issuing company, as capital gains if the receiving company fulfils the conditions for receiving tax-exempt dividends.⁴⁸ The same is proposed in relation to liquidation proceeds distributed prior to the calendar year in which the company is finally dissolved, and in relation to distributions in connection with capital write-downs.⁴⁹ The objective of the Bill was to do away with the asymmetry in the treatment of capital gains and dividends, which could lead to a situation where the repurchasing of short-term shares by the issuing company is tax exempt or a situation where

42. See also Ole Bjørn, note 15, p. 85 for a similar conclusion.

43. National Tax Board, 20 February 2007, SKM.2007.199 SR, Case No. 449 SR, *Journal of Danish Tax Law* (2007).

44. See note 15, SM 7.

45. Bill No. 87 – Appendix 26, item 3.

46. Official Report of Danish Parliamentary Proceedings 1998-99, p. 418.

47. See Bill No. 110 of 13 December 2006, which was later changed to L 110 B and enacted as act No. 344 of 18 April 2007.

48. See Sec. 13(1), No. 2, or Sec. 2(1), Para. c of the Corporation Tax Act.

49. Secs. 16(2) and 16(3) of the Act.

occupational taxpayers can convert taxable capital gains to tax-exempt dividends. The rules apply only to Danish and foreign companies that fulfil the criteria for receiving tax-exempt dividends. Others will still have to treat sales to the issuing company as dividends. In order for foreign parent companies to receive dividends without the imposition of Danish withholding tax, the withholding tax must have been waived or reduced in accordance with the Parent-Subsidiary Directive or a tax treaty. Payments to companies located in countries that have not entered into a tax treaty with Denmark will still be treated as dividends; otherwise it would be possible to transfer dividends from low-tax countries without Danish withholding tax in the absence of statutory authority to tax capital gains.

In the judgment in the *Kame* case, however, the Supreme Court did help the legislators in the specific interpretation. In the *Newpond* case, this particular question did

not play a part as the tax classification was based on a specific interpretation of the facts.

7. Conclusions

In conclusion, it may be noted that as long as a tax system maintains, inter alia, an artificially different treatment of capital gains (the three-year rule) and dividends (the one-year rule), taxpayers will try to allocate income to the most favourable category. Examples of similar discrepancies are countless and the analysis presented in this article illustrates some of the techniques that taxpayers have tried to apply in order to obtain the tax optimal income allocation. Undoubtedly, more examples will be evident in future cases, encouraging legislators to provide for tax neutrality in the tax treatment of dividends and capital gains on shares.

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