



ADVISORY[®]

INDEPENDENT TAX CONSULTING

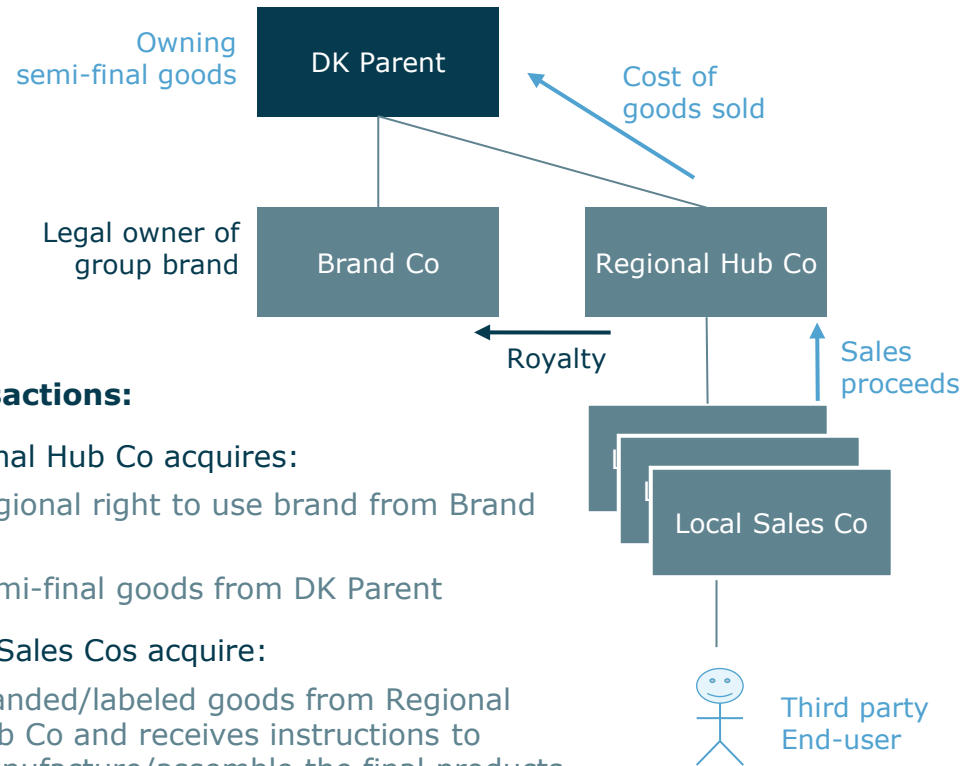


The Increasing Importance of IP in International Tax



2022 CORIT

Base case (I)



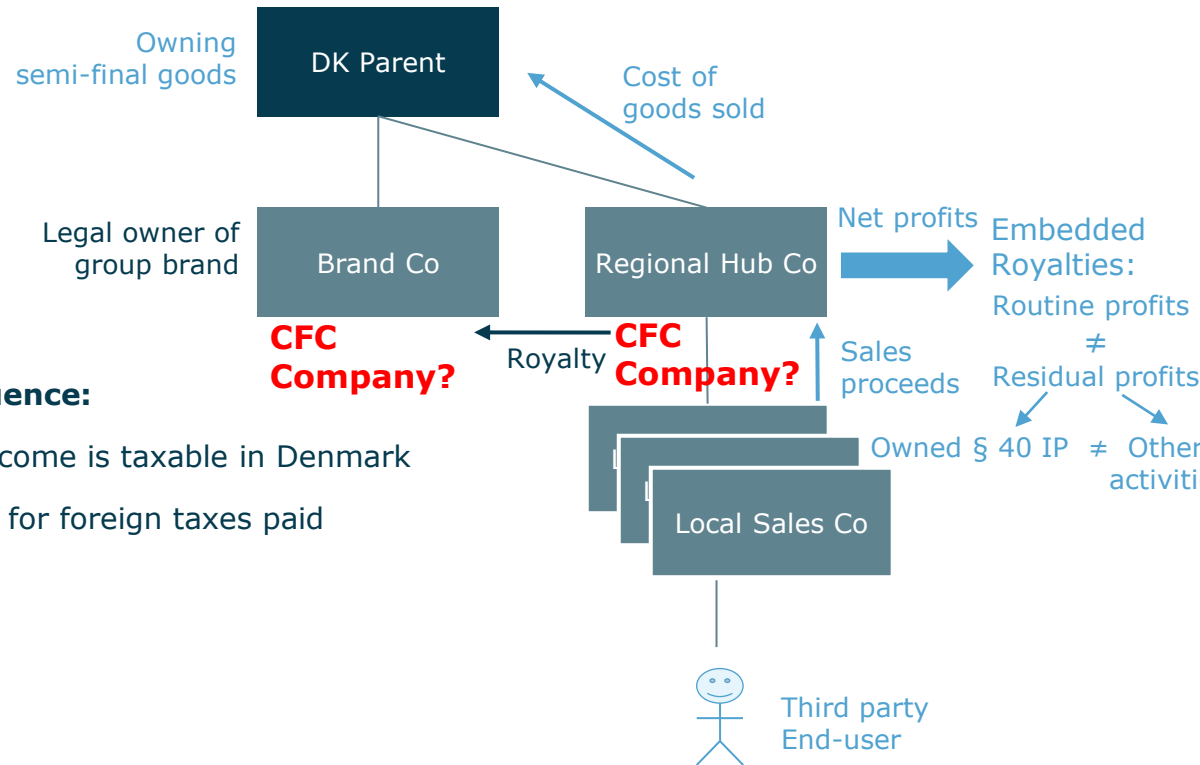
IC Transactions:

- Regional Hub Co acquires:
 - Regional right to use brand from Brand Co
 - Semi-final goods from DK Parent
- Local Sales Cos acquire:
 - Branded/labeled goods from Regional Hub Co and receives instructions to manufacture/assemble the final products

Tax considerations - WHT

- Relevant for royalties
- Depends on domestic tax law in the source state, any applicable DTT, and whether the IRD applies
- Beneficial ownership is often required
- If the proposed ATA III Directive applies, MSs should disregard any DTT and the IRD

Base case (II)



Consequence:

- Net income is taxable in Denmark
- Credit for foreign taxes paid

Tax considerations - CFC

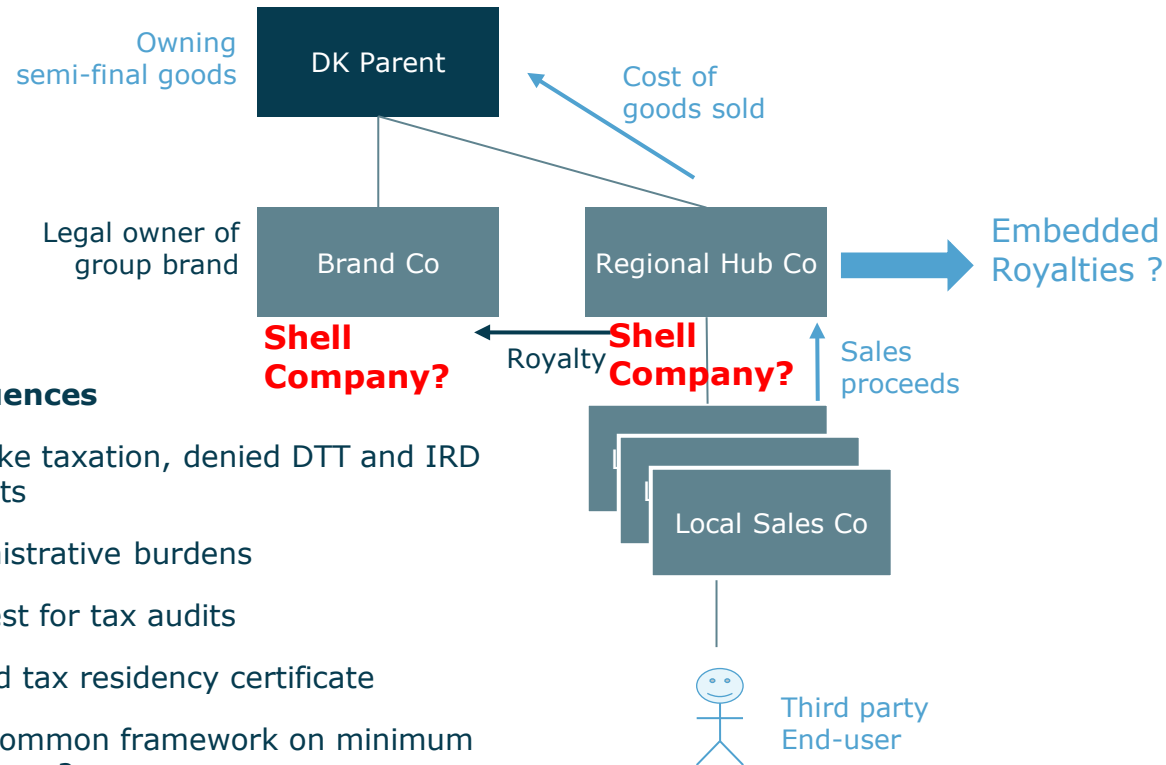
Brand Co: Royalties

- No substance carve-out

Regional Hub Co: Embedded royalties

- Existence of embedded royalties seems to be based on economic analysis with outset in TP
 - Functions performed, assets used and risks assumed in the absence of owned/available IP
- Size of embedded royalties
 - Assess which part of the residual profits that relates to own IP
- (Partial) substance carve-out
 - Carries out substantive economic activity supported by staff, equipment, assets, and premises
 - IF the company manages and performs the ownership and distribution/sales functions related to its IP, while other significant functions related to the asset only to a limited extent is performed by the company (or in the same state) -> CFC

Base case (III)



Consequences

- CFC-like taxation, denied DTT and IRD benefits
- Administrative burdens
- Request for tax audits
- Denied tax residency certificate
- New common framework on minimum substance?

Tax considerations – Shell Companies

Minimum substance test (in this case)

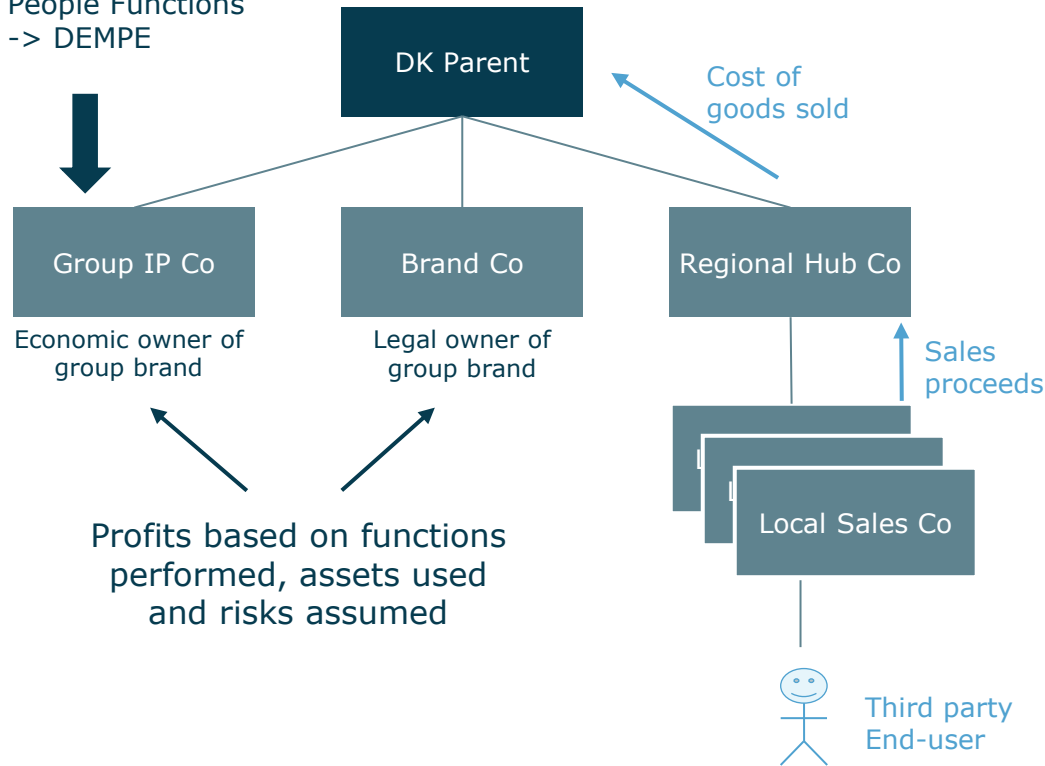
- More than 75% of the revenue is relevant income, incl. royalties and embedded royalties;
- At least 60% of the relevant income is earned or paid out vis cross-border transactions; *and*
- Administration of day-to-day operations and decision-making on significant functions are outsourced
- Carve-out (in this case): number of employees

If minimum substance is not met (declare)

- Own premises (or premises for its exclusive use);
- One own bank account within the union; *and*
- One or more “exclusive” directors / majority of equivalent full-time employees
 - Tax residency requirements
 - Qualified to carry out the activities that generates the relevant income

(Re)location or transfer of DEMPE (I)

All Significant
People Functions
-> DEMPE



Tax considerations – Transfer Pricing

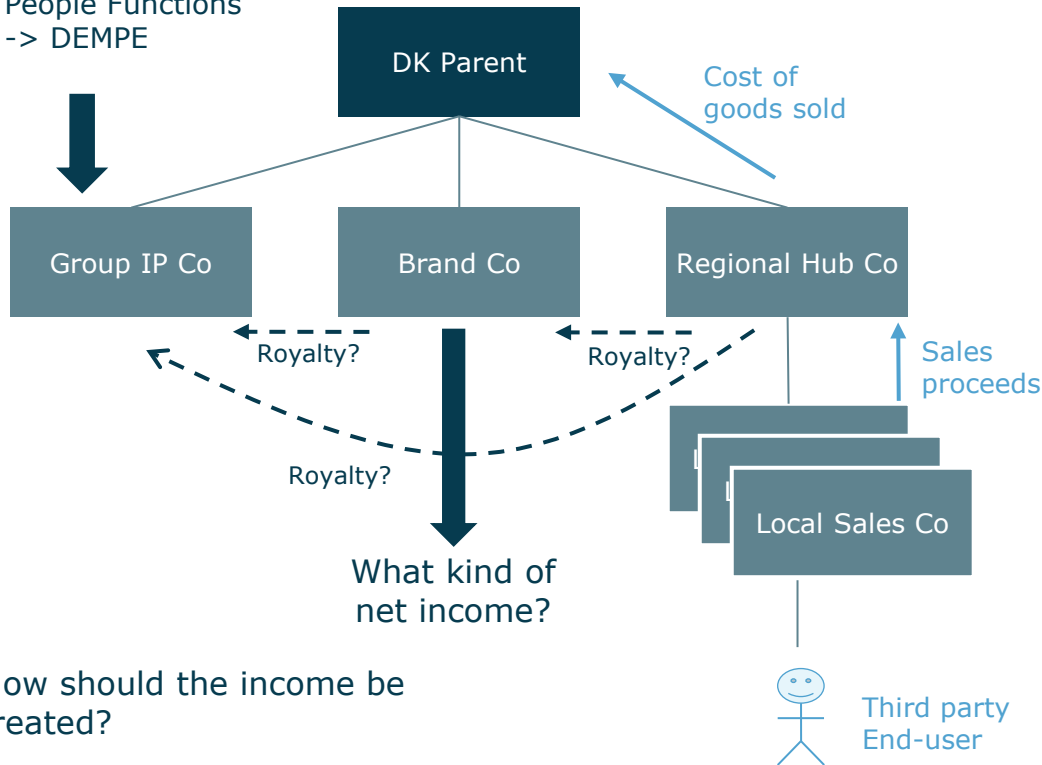
- Accurate delineation
 - Assumption: The amendments on delineation applies in this case
- In the most extreme case
 - Brand Co receives routine profits based on the simple functions etc. related to IP left
 - Group IP Co receives all residual profits related to the IP (legally owned by Brand Co)

What is the impact on other domestic and international tax laws in this situation, where Group IP Co is considered economic owner of IP or at least owner of income from IP for transfer pricing purposes?

- How should the income be treated and qualified?
- Has any IP/assets been transferred?

(Re)location or transfer of DEMPE (II)

All Significant People Functions
-> DEMPE



How should the income be treated?

Tax considerations

WHT

- Relevant DTT and any holding period?

CFC

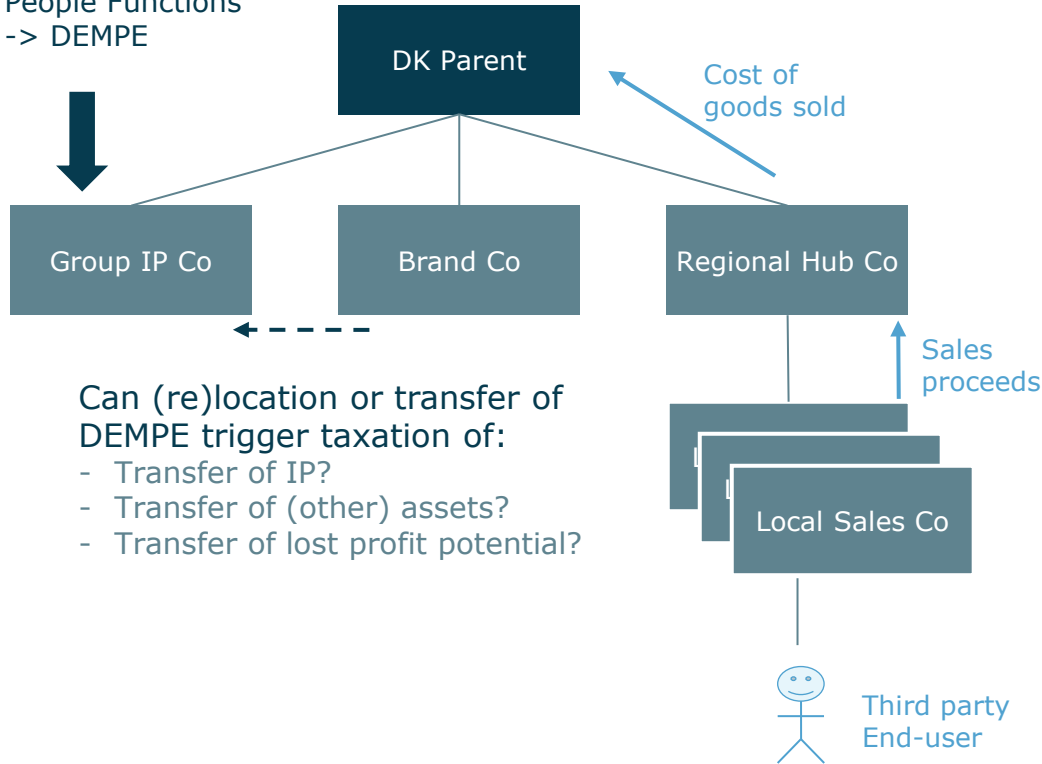
- Is it recognized that Group IP Co has full (economic) ownership of the group brand and subsequently right to receive all IP related income?
- Is the net income in Brand Co (lower) royalties or fee/remuneration for simple functions provided?
 - If not royalties, will the income be embedded royalties by nature?
 - Hard to see how the (partial) substance carve-out can be met

Shell Companies

- Is the net income of Brand Co relevant income, e.g. royalties or embedded royalties?
 - Hard to see how the minimum substance indicators can be met

(Re)location or transfer of DEMPE (III)

All Significant
People Functions
-> DEMPE



Can (re)location or transfer of DEMPE trigger taxation of:

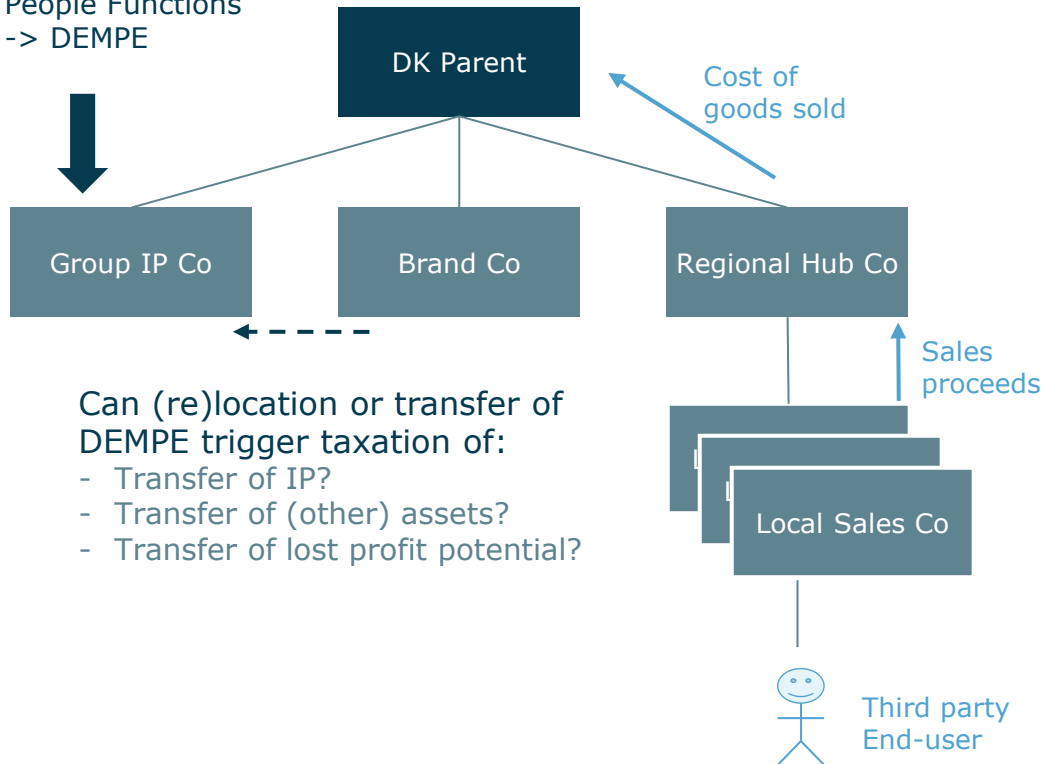
- Transfer of IP?
- Transfer of (other) assets?
- Transfer of lost profit potential?

Tax considerations - CFC

- *IF* transfer of DEMPE triggers tax of transfer of an asset covered by AFL § 40, the gain is subject to CFC taxation
- *IF* transfer of DEMPE triggers tax of "lost profit potential" not covered by AFL § 40 –then?
 - The income relates to covered IP, however, can "lost" profit be considered (i) "payment for the use of IP" or (ii) "any other income generated from IP"?
 - If Group IP Co is a CFC Company, this will impose a situation of CFC taxation of the same income twice
- Only credit for local taxes paid, as the special rules on "matching credit" on fictitious gains/sales only applies in relation to divestment of shares in the sub

(Re)location or transfer of DEMPE (IV)

All Significant People Functions
-> DEMPE



Can (re)location or transfer of DEMPE trigger taxation of:

- Transfer of IP?
- Transfer of (other) assets?
- Transfer of lost profit potential?

Tax considerations – Shell Companies

Minimum substance test

- Becomes circular and non-intuitive if transfer of people/functions triggers a “relevant income”
- How should (transferred) DEMPE functions be included?
 - Administration of day-to-day operations and decision-making on significant functions are outsourced. Are they outsourced?
 - Carve-out on employees: Does Brand Co have at least five own full-time equivalent employees carrying out the activities generating the relevant (*lost*) income?

Material tax consequences

- “..the shareholders of the undertaking shall tax the **relevant income** of the undertaking in accordance with its national law as if had it directly **accrued** to the undertaking shareholders” if “**the relevant income accrues** to an undertaking that is presumed not to have minimum substance (...)”
- Denied DTT and IRD benefits



ADVISORY®

INDEPENDENT TAX CONSULTING

Main take-away

Increasing importance on *identifying and understanding* the international tax consequences of *the existence, non-existence and transfer* of **significant people function(s) and sufficient substance** related to intellectual property.





ADVISORY®

INDEPENDENT TAX CONSULTING

KATJA DYPPEL WEBER

PARTNER, M.SC., PH.D.

CORIT ADVISORY P/S
LYNGBY HOVEDGADE 17, 2. SAL
2800 KONGENS LYNGBY
DENMARK

WWW.CORIT-ADVISORY.COM

P: +45 40 42 22 95
E: KDW@CORIT.DK



2022 CORIT