Tax News

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Agenda

1. New Danish legislation with International Emphasis (L84).
2. The Notion of a Group for Joint Taxation and Participation Exemption purposes.
3. International Developments regarding the Notion of Permanent Establishments.
4. Common Consolidated Corporate Tax Base (CCCTB).
5. Developments in ECJ case law.

1. New Danish Legislation with International Emphasis

(L 84 - Act no. 254 dated 30 March 2011)

In general on L 84

1. Aims at adjusting and clarifying (on at least 21 different areas)

2. More robustness towards tax planning (once again!)

Follow up on the tax reform of 2009 (L 202)

- **Mostly changes regarding the existing anti-clustering rules.**
  - Deemed less relevant to big groups.

- **Losses on subsidiary shares (new ABL § 43)**
  - Deduction regarding old losses, where the shares change status from subsidiary shares into portfolio shares.
  - Conflict between the financial crisis, the previous three year rule and the rules regarding taxable change of status of shares.
  - Deduction in net gains regarding the same shares in the following years.
  - Requires deductibility at the time of the presentation of the Bill (L 202) – ie. ownership period less than three years (but more than 10%).
    - Shares acquired no later than 23 April 2006.

Tax neutral restructurings and the anti abuse legislation regarding dividends

Tax neutral restructurings……

- Strengthening the Danish WHT on dividends.
- All changes are based on the pending beneficial ownership cases.
- Prevent planning which aims at avoiding Danish WHT on dividends by way of merging a Danish holding company with a foreign parent company.
  - The Danish Tax Board has decided in a ruling dated 16 November 2010 that liquidation proceeds from a merger are not taxable as dividends in Denmark.
  - Could be arranged by having a Danish holding company ready every year for which a distribution should be made.

Tax neutral restructurings……

- **This model is prevented by several means:**

  1. **Recharacterization** of proceeds from the cancellation of shares in a contributing Danish company into dividends
     - If WHT on dividends is not reduced or eliminated under a treaty or the PSD
     - Or if the receiving company owns less than 10% of the contribution company, but has a controlling influence

  2. **Requirement to obtain an advance approval** to carry out tax neutral cross border merger
     - If a Danish company is the contributing company, if there are shareholders with controlling influence, which are not subject to the above new rules and not residents of a tax treaty state or within the EU.

  3. **Cash payments** to individuals and corporate shareholders which are normally treated as capital gains are reclassified into dividends, if the receipient is a resident outside Denmark which would be taxable from dividends received.

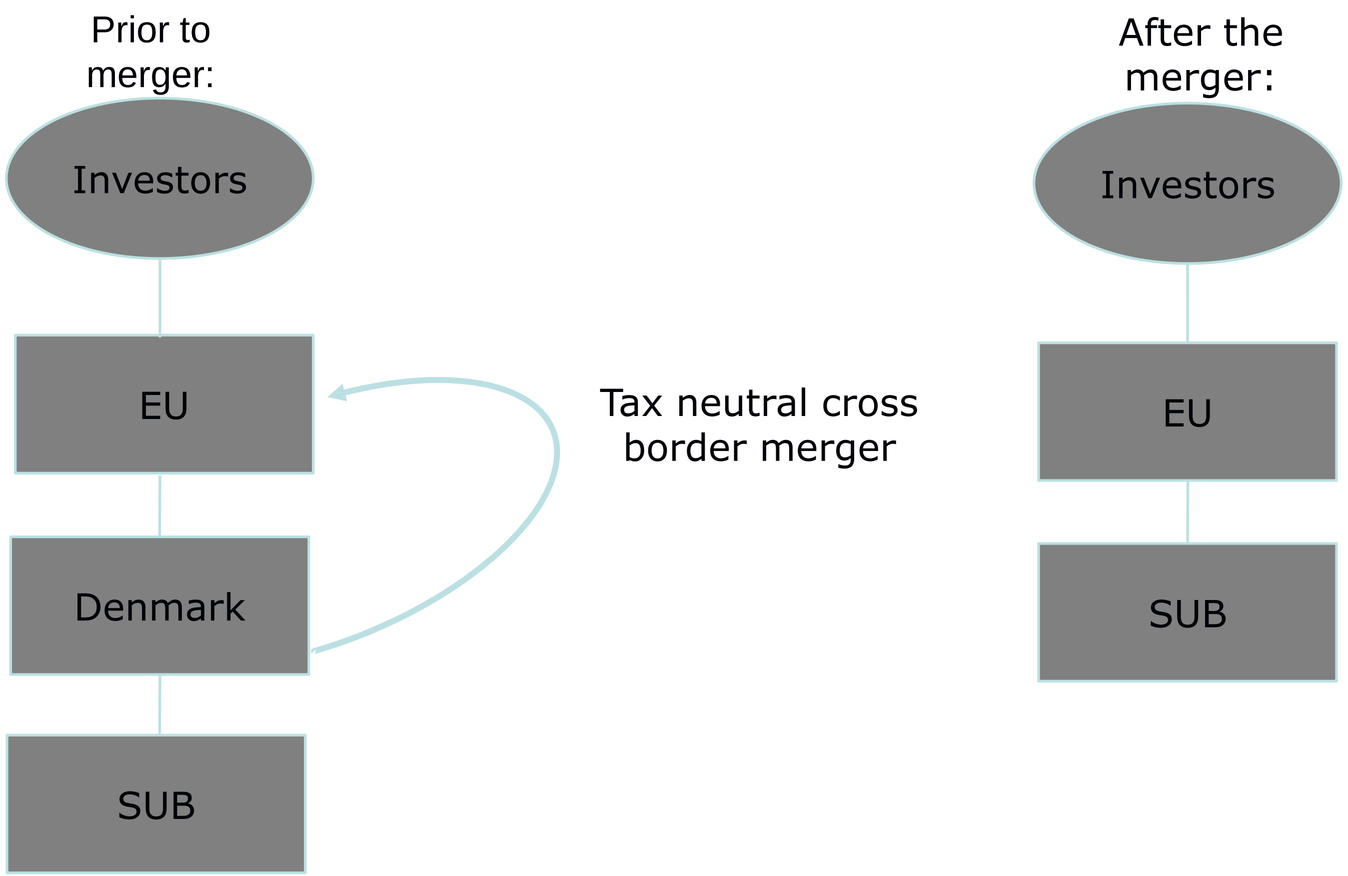
Tax neutral restructurings……

- Domestic provisions necessary to prevent fraud and abuse, cf. Article 1(2) of the PSD and article 15 of the merger directive.

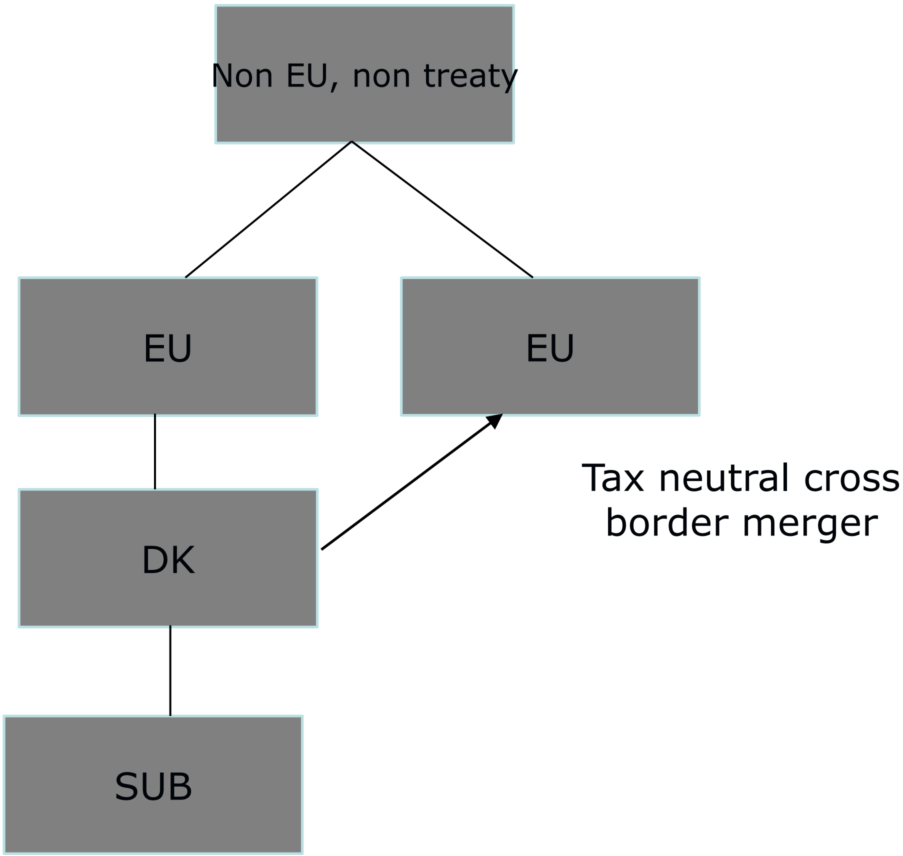
- Not an objective abuse provision since a reference is made to the general abuse provision of the PSD.

- The PSD does not include a beneficial ownership clause. Hence EU-holding companies should be tested against the generally applicable anti abuse provision.

Tax neutral restructurings……



Tax neutral restructurings……



- Advance approval by Danish tax authorities
- Relevant test: tax avoidance or evasion

Other Adjustments Regarding the Danish Legislation on Tax Netural Reorganizations

Other adjustments…..

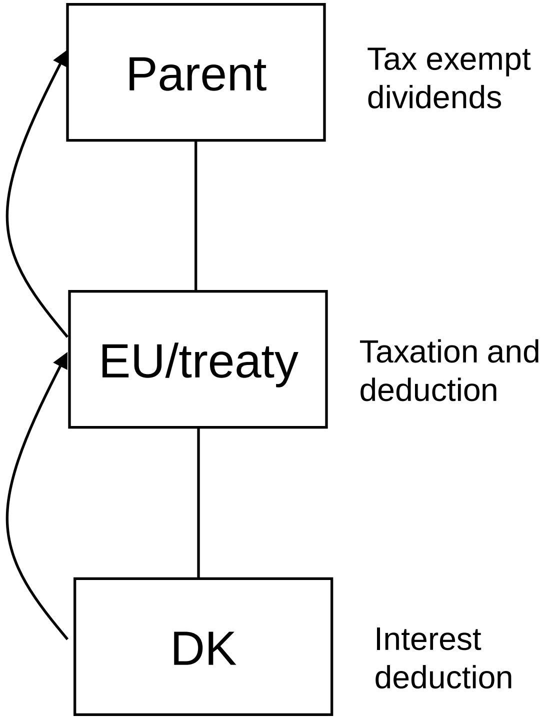
- **Approval regarding tax neutral divisions, if:**
  - An individual or corporate shareholder has controlling influence of the contributing company and is not a resident in a tax treaty state or within the EU
  - Cash payment is made to companies owning less than 10% of the share capital of the contributing company or if the shares are group shares.

- **Vertical merger – Own shares**
  - Cancellation of own shares received in a tax neutral merger is tax exempt if the contributing company owns more than 10% of the receiving company.
  - Accordingly, gains are taxable as dividends if the contributing company owns less than 10% of the shares of the receiving company (portfolio shares).

Adjustments to Existing Anti Arbitrage Legislation

Adjustments to existing anti arbitrage legislation

- Inbound hybrid financial instruments (SEL § 2 B)
- Expanded to cover situations where
  - the state of residence of the immediate creditor does not classify the instrument as equity but
  - where an instrument exist with another entity in another country where the instrument is treated as equity.
- Irrespective of number of tiers
- Not applicable if tax treaty or IRD

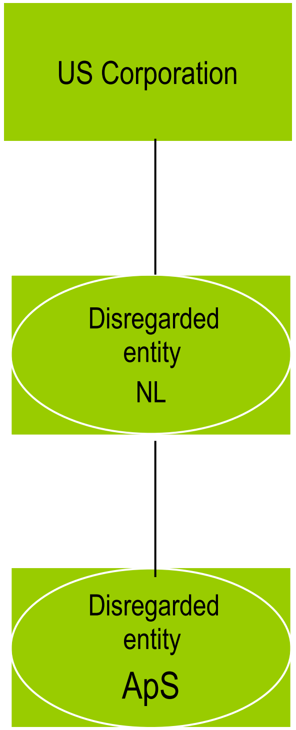


Adjustments to existing anti arbitrage legislation

- Outbound hybrid financial instruments

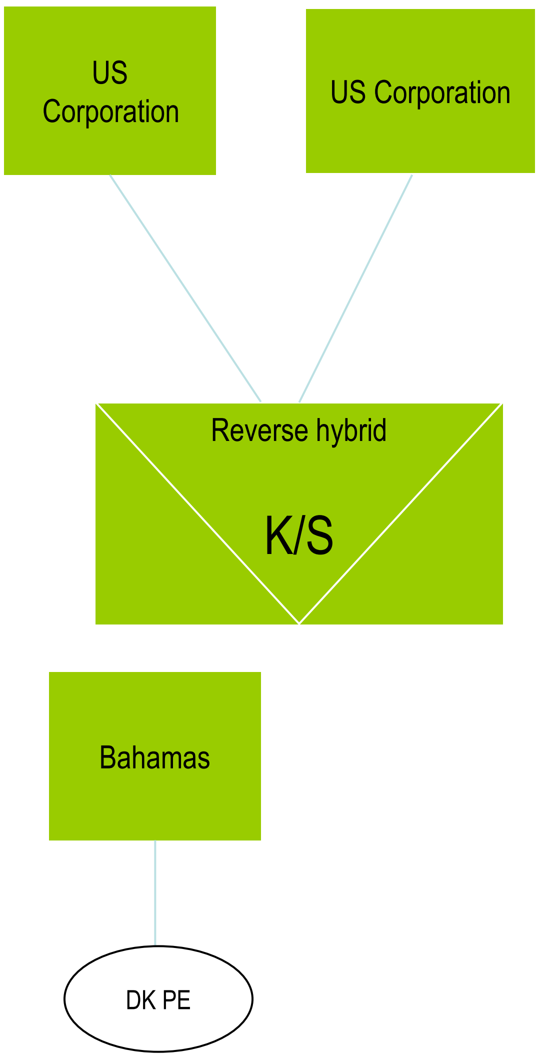
- Inbound tax exemption does no apply to dividends
  - Where a lower tier subsidiary was able to deduct the distributions and
  - Where the deduction did not result in a taxation an intermetiate tier, and
  - Where the WHT in any of the intermediate tiers should be reduced or eliminated under the PSD.

Adjustments to existing anti arbitrage legislation



- **Hybrid entities - SEL § 2 A**
  - Reclassification of Danish ApS into transparent entity, if US CTB
  - Includes reclassification of foreign entities if foregn entity is transparent in another country.
    - Interest from ApS to US: non deductible
    - Interest from ApS to NL: deductible
      - Requires NL to be a taxable entity and resident in Holland
      - Requires Holland to have a treaty with Denmark or to be EU Member State
      - **New requirement**:
        - » Only deduction in Denmark if interest- or royalty payment is included under the scope of a tax treaty or the IRD.
        - » Assumes an effecient ”subject to tax clause” – Not yet enacted COM 2003(841).
      - ”Beneficial owner” – double trouble!

Adjustments to existing anti arbitrage legislation



- **Reverse hybrid entities – SEL § 2 C**
  - Reclassification of transparent entities into taxable entities
  - Several changes:
    - Branches from non treaty states cannot avoid reclassification if an information exchange agreement is made.
    - No reclassification back into transparency due to an information exchange agreement – otherwise full exit taxation.

    - Tightening:
      - Includes all companies from non treaty states with branches in Denmark
      - Reasoning:
        - » Yield on intangibles in such branches are in fact tax exempt. Since there is no Danish tax and no foreign tax if the branch does not constitute a PE in Denmark

Follow up with Respect to Other Legislative Changes

Follow up with respect to other legislative changes

- **Credit shares – limited payment of share capital**

- Company law:
  - Only a requirement to pay 25% of the capital (at least 80.000 DKK) – effective from 1. march 2011.

- Tax law
  1. Gains and losses on claims and debt regarding credit shares are not taxable or deductible (new KGL § 24 A)
  2. Unchanged treatment of cash contributions and contributions in kind.
  3. Impaired claims on a shareholder regarding capital not paid in (New ABL § 28 A):
     - Results in a similar reduction of the acquisition price of the shares.
     - A sale prior to the calling of the claim from the company does not affect the acquisition price of the shares.
     - Example:
       - A owns the entire capital of S, a total of nom 500.000 DKK., 25% is paid in. If the remaining 375.000 DKK is impaired to 0 this will lead to a similar reduction of the acquisition price of the shares. Going forward the acquitision price is 125.000 DKK.

Follow up with respect to other legislative changes

4. Sale of shares
    - Ordinary capital gains treatment irrespective of paid in capital or not
    - Including other tax law requirements involving ownership, control etc.
    - No effect on acquisition price and acquisition time.

- Tax planning:
  - A way of contributing value between group companies?
  - Minister of Taxation:
    - Possible to tax the benefit that the non paying shareholder obtains.
    - Mitigate by agreeing an interest payment.

Adjustments to the Tonnage Tax Regime

Adjustments to the Tonnage tax regime

1. Hybrid branches subject to SEL § 2 C can be included under the tonnage tax regime.
   - Introduced to prevent the exclusion of loss making activities by placing loss making activities in a hybrid entity (SEL § 2 C)

2. Income from subleased ships can only be subject to the tonnage tax regime if the tenant uses the ships for purposes included under the tonnage tax regime
   - Ie the ”usage requirement” should also be fulfilled going forward in sublease arrangements.
   - Introduced to prevent circumvention by way of subleasing ships rather than leasing own ships.

3. The TP exemption regarding documentation and information requirements is abolished with respect to transactions subject to the tonnage tax regime.

2. The Notion of a Group for Joint Taxation and Participation Exemption Purposes.

The Notion of a Group

- A ”group” is required for the purpose of
  - Danish mandatory joint taxation
  - Participation exemption regarding dividends
  - Participation exemption regarding capital gains on shares.
  - CFC taxation

- Group shares consist of:
  - Shares where the issuing company and the share owning company can be subject to either Danish mandatory joint taxation or volountary international joint taxation
    - Includes foreign companies of a similar nature to Danish limited companies.
  - Shares, where a foundation and the issuing company are considered a group and where the company can enter into joint taxation
    - Includes single companies not actually subject to joint taxation.

- Tax treaty not required (contrary to subsidiary shares)

The Notion of a Group

- A Group is defined in SEL § 31 C.
- Changed in 2010 with the Danish Company Law reform
- The definition is closely related to IAS 27 only with minor deviations.
  - Dynamic notion of a group
  - Interpretation in accordance with IFRS (IAS 27) and SIC 12.
- The changes are:
  - Ownership of shares not required – however needed regarding capital gains taxation.
  - Only one parent company can exist
  - Broader subjective scope
  - More emphasis on substantive influence rather than formal influence

The Notion of a Group

- Together with one or more subsidiaries, a company, a trust or organisation etc. (parent company) constitutes a group of companies.

- Controlling influence is the power to control a subsidiary's financial and managerial decisions.
  - May be changed to: "the power to direct the activities", cf. Draft IFRS X

- Controlling influence
  - When parent directly or indirectly through a subsidiary owns more than half of the voting rights in a company,
  - Unless in exceptional circumstances it can clearly be shown that such ownership does not constitute a controlling influence.
  - No longer a requirement that the parent company owns shares in the subsidiary
  - Presumption of a group if control over voting majority.
  - Exceptional circumstances
    - Not easy to fulfill.
    - Voting restrictions in shareholders agreement or elsewhere.
    - Veto rights not granting the holder control does not dissolve a group, cf. Application Guidance, ED 10 Exposure Draft, B1-B2.

The Notion of a Group

- Group presumption can still be applicable even though veto rights are present.
  - See SKM 2011.42 SR
    - 51% of the voting rights of the target company
    - Major issues required unanimous decisions.
    - The veto rights concerned decisions regarding decreases or increases of the activities of the target company, sale of the assets of the company, entry into joint ventures, dividend payments, liquidation, bankruptcy.
    - Actual veto rights did not diminish the competencies of the management to manage and to make decisions regarding the company's present activities.
    - The substantive influence of the acquiring company was not reduced with respect to financial and managerial decisions.
  - SKM 2010.677 SR
    - Shows that veto rights can diminish influence through the right to appoint the chairman of the board of directors.

The Notion of a Group

- Shareholders agreements
  - Prior to 2010
    - Shareholders agreement not granting any shareholder the majority
    - Sufficient to break the group since formal possession of the voting rights existed.
    - See SKM 2009.388 LSR and SKM 2010.209 SR.
  - 2010 and onwards
    - The existence of a shareholders agreement stating that consensus has to be reached is sufficient to prove exceptional circumstances to show that such ownership does not constitute a controlling influence.
    - See SKM 2010.209 SR.
-

The Notion of a Group

- Other criteria: If a parent company does not own more than half of the voting rights in a company, controlling influence exists if the parent company has:
  1. power over more than half of the voting rights by virtue of an agreement with other investors,
  2. power to govern the financial and operational policies in a company by virtue of the bylaws or agreement,
  3. power to appoint or remove the majority of the members of the board or equivalent governing body, and the board or the governing body has controlling influence over the company, or
  4. power to cast the majority of the votes at the general meeting or at an equivalent meeting, and thereby possesses the actual controlling influence over the company.

- Potential voting rights
  - The existence and effect of potential voting rights, including warrants and options, that can at present be exercised or converted, must be taken into account in determining whether a company has controlling influence.
  - Options, warrants, convertible bonds etc. which by unilateral measures can be exercised/converted.

The Notion of a Group

- Great practical importance: subsidiaries in countries without a tax treaty in place.
- Eg. Joint venture: 50% in non treaty state entity
  - Other means of obtaining group treatment (e.g. 51% of voting rights, agreements etc.).

3. International Trends and Developments Regarding Permanent Establishments

International trends regarding Permanent Establishments

- Generally MNE’s are taxed on the basis of the PE principle
- Main rule
- Building site
- Agency Permanent establishments
- Subsidiaries

- Mail rule: Requirements
- 1. Place of business
- 2. Through which the business is carried out and which is
  - Activities of a preparatory and auxiliary character does not constitute a PE
- 3. Fixed
  - Normally 6 months

International trends regarding Permanent Establishments

- **Mexico: Service PE's**
  - Mexican Circuit Court (may 2010)
    - Services rendered in Mexico for a period exceeding 12 months
    - UsCo rendered strategic consulting services (IT systems) to a Mexican Government Institute through two US partners.
    - US individuals travelled to Mexico for an average of one week per month.
    - Access to meeting rooms and telephone.
    - Circuit Court found that there was no PE
      - UsCo did not conduct its business activities
      - Not enough permanence

- **China: Notice 75 issued on 26 July 2010**
  - Generally applicable guidelines.
  - Service PE's
  - Secondment Arrangements from foreign parent companies to Chineese subsidiaries.
    - Clarify which entity the secondee works for? (substantive control)

- **R&D Centres**
  - A research centre organized as a branch office does not normally qualify as a PE
  - Scientific research is deemed to be of a preparatory or auxiliary character under Article 5(4) of the OECD Model.
  - Requires that the activity does not qualify as quality control, and that the R&D is solely performed for the enterprise of which it is a part.
  - Par. 24: ”In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxilirary activity”.
    - Identical to the general purpose?
      - Contract research: Yes.
      - Research on own risk including the transfer of the ownership and right to use: yes.
      - Production: No

International trends regarding Permanent Establishments

- Danish case law: TfS 2007.549 SR
  - Danish company was considered not to obtain a PE in Sweden due to the creation of a R&D centre in Sweden.
  - Core business was development, production and sale of ”devices” - R&D in Sweden

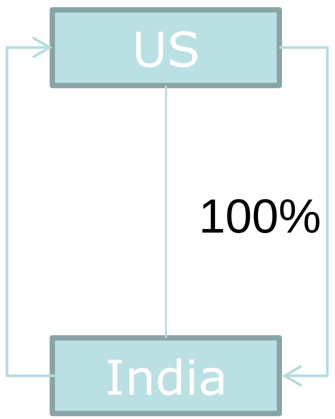
- Low-taxed subsidiary may be able to set up a research centre in a high-tax country
  - without being subject to taxation there during the development and exploitation stage,
  - even though the R&D centre may be crucial to the overall success of the company.

International trends regarding Permanent Establishments

- A **Subsidiary as a PE**
  - Moving up the international agenda
  - OECD Model art. 5(7): ”shall not of itself constitute either company a PE of the other”
  - But the subsidiary may constitute a PE based on the main rule or as an agency PE.

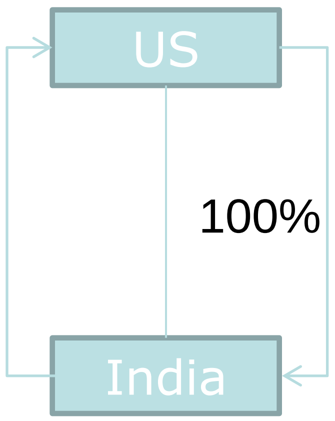
- International case law
  - Hotel Management-case (Bundesfinanzhof 1993)
    - UK sister company had a PE through the Hotel manager agreement
  - Ericsson Radio Systems AB, Motorola Inc., Nokia Networks OY (Special Bench of New Delhi Tribunal 2005)
    - Only with respect to Nokia OY.

- Morgan Stanley & Co (Supreme Court of India 2007)
  - Backoffice services carried out in India
    - IT, bookkeeping and other support functions
    - Activity considered of a preparatory and auxiliary character
    - Not considered a PE
  - Stewardship activities from parent in US
    - Parent instructs, supervises and controls the quality of the subsidiary
    - Short stays in India
    - The services were not considered a service to the subsudiary but a protection of the parent company's commercial interest
    - Not considered a PE



International trends regarding Permanent Establishments

- Morgan Stanley & Co (Supreme Court of India 2007) (cont'd)
  - Secondment activities from parent in US
  - Secondments of a duration up to 2 years where the employees take part of the daily operations
  - The right to instruct lies with subsidiary
  - The responsibility lies with parent company
  - Salary from parent company and repayment from subsidiary.
  - Considered a PE
    - Employees employeed by parent which rendered a service to the subsidiary.



International trends regarding Permanent Establishments

- Conclusion regarding the avoidance of a PE according to the main rule
  - Services rendered to and from group companies do not constitute a PE (OECD par. 42)
  - Avoid written agreement on the right to use office specific offices.
  - Avoid using specific offices with subsidiary.
  - Split salary
    - Increased risk if employed in several companies from one location
  - Written agreements on the distribution of tasks
  - Avoid transfering client contacts from parent company to subsidiary.
  - Arm's length

- **Agency Permanent Establishments**
  - 1. Agent is dependent of the enterprise
    - Legally or economically dependency, or
    - Not acting in ordinary course of their business
  - 2. Authority to conclude contracts on behalf of the enterprise regarding its ordinary business
    - Including contracts, agreed by an agent in his own name, if they commit the enterprise.
    - Can include contracts, which are routinely approved by the enterprise.
  - 3. The authority to conclude contracts is habitually excercised by the agent
  - 4. Contracts concern the core business of the enterprise

International trends regarding Permanent Establishments

- **Zimmer Ltd. (Conseil d’etat 31. March 2010 France)**
  - UK Parent and French Subsidiary
  - Production in the UK and sales and marketing in France.
  - French sub commissionary
  - Dependent and authority to conclude contracts?
    - From a purely legal standpoint the commissionaire does not have the power to legally commit the principal.
  - No Permanent establishment

International trends regarding Permanent Establishments

- **Dell Products (Court of Appeals, 4 March 2011, Norway)**
  - Dell products were sold i Norway under a commission agreement with Dell Products (Ireland) (the principal).
  - Dell AS sold and marketed the products in its own name but for the risk and account of Dell Products.
  - Agency Permanent Establishment?
    - Legally binding or sufficient that contract and actual behaviour lays down commitment?
    - Court found that Dell AS *in fact* commited Dell Products to the contracts it negotiated in Norway (all contracts were approved by Dell Products).

- **Conclusions – Avoidance of Agency PE's**
  - Case law is country specific.
  - Control and instruction right depend on the line of business conducted.
  - Economic independence of principal.
  - Several principals.
  - Fulfill arm's length principle.
  - Substantively binding contracts may increase risk.
  - Subsidiary's participation in negotiations with customers can increase risk.

4. Common Consolidated Corporate Tax Base (CCCTB)

CCCTB – The Concept

- Companies/groups with activities in several EU member states should be able to opt for a single set of rules – hence the idea Common Consolidated Corporate Tax Base.
  - Rather than 27 national systems.

- Proposal for af Directive presented 16 march 2011.

- Benefits of CCCTB
  - Lower compliance costs.
  - Elimination of transfer pricing issues within the EU.
  - Access to cross border loss utilization within the EU.
  - Reduced risk of double taxation.
  - Simplification of international restructurings.
  - Abolition of discrimination og restrictions.

CCCTB – Basic Structure

- Design of an all new EU-legislation regarding the calculation of the taxable income.
- Distribution of income for taxation in the EU-countries where there are activities.
- Maintain national Corporate Tax Rates

CCCTB – Basic Structure

- Tax based is defined on the basis of the CCCTB-rules.
  - No attachment to IAS-/IFRS
- The CCCTB is volountary.
- Rules are to be applied by the companies subject to domestic Corporate tax rules.
  - And companies established outside the EU of a similar nature to the above mentioned entities subject to taxation within the EU.
- All-in-all-out principle
- CCCTB does not require a cross border element

CCCTB – The Tax Base

- Detailed rules with a broad tax base.
- Based on a modified principle regarding the global income.
- Computed annually on the basis of the net income principle.
- Participation exemption regarding dividends and capital gains on shares.
- Specific rules regarding depriciation (based on economic ownership).
- Indefinite loss carry forward.

CCCTB - Consolidation

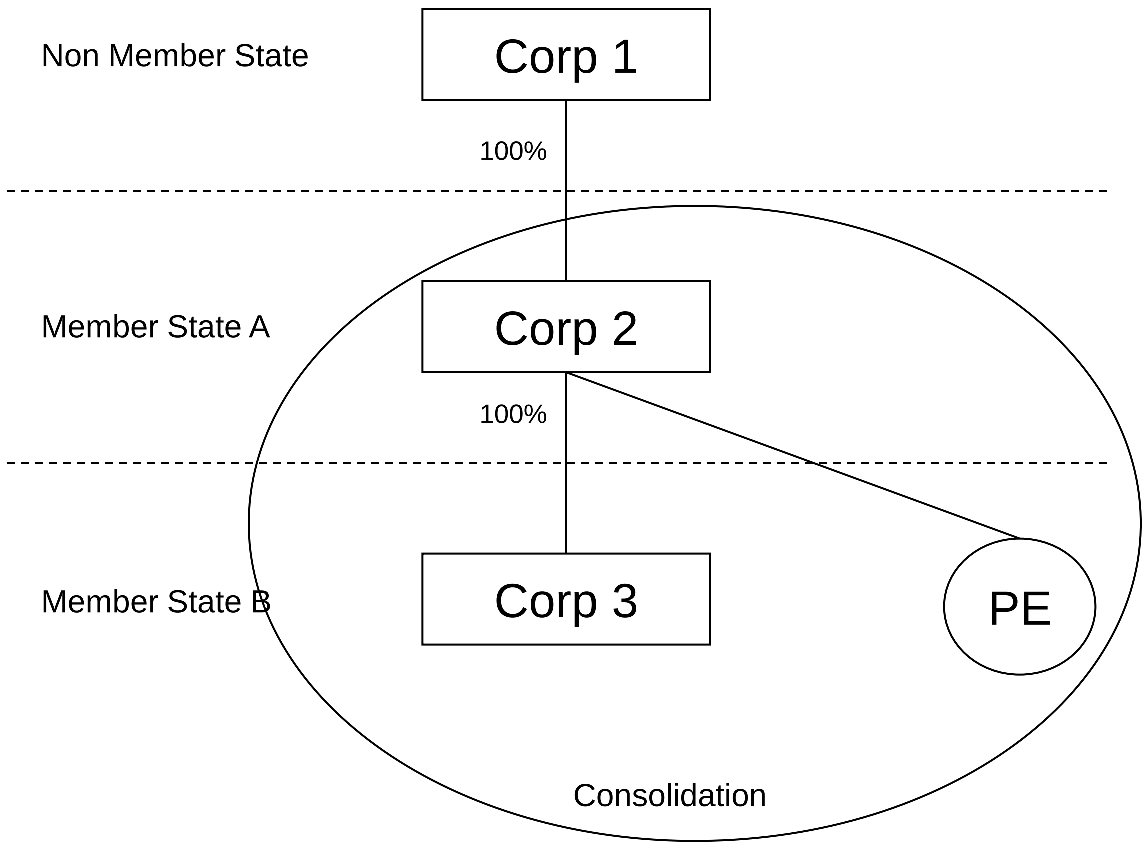
- Concolidation is an essential part of the CCCTB proposal.
  - In essence: cross border loss off-setting.
  - Tax base rules are used to define a usable tax base for the purpose of consolidating.

- Consolidation is mandatory if CCCTB is opted

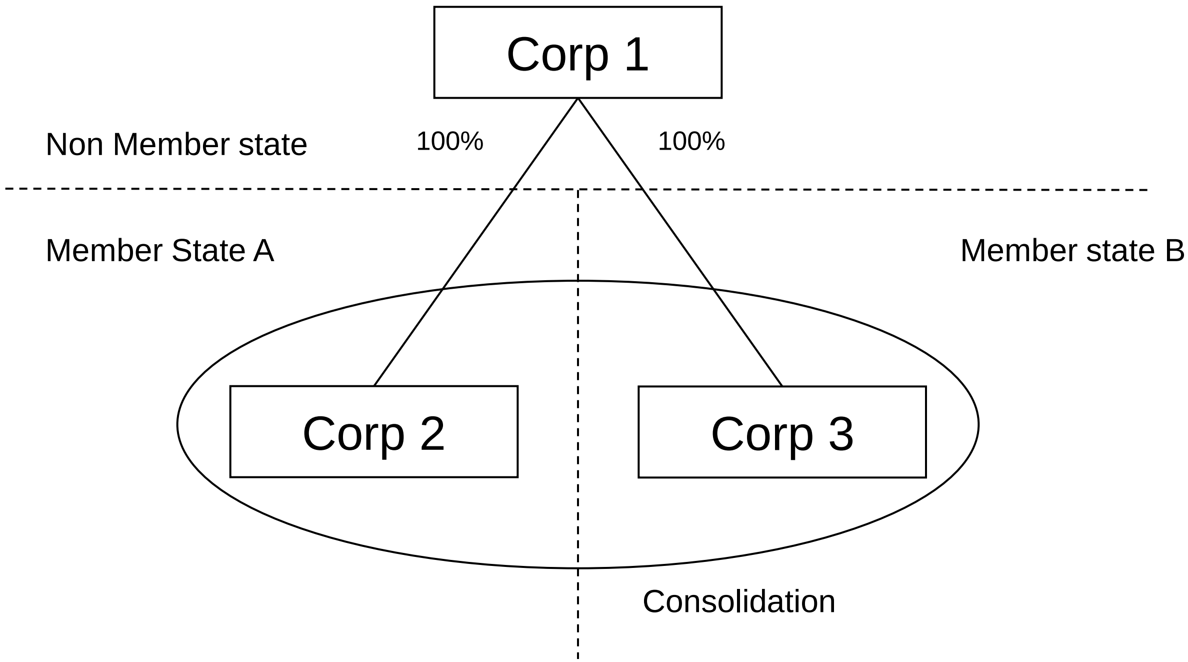
- Group defined as a resident tax payer and its:
  - PE's in other member states
  - PE's owned by qualified subisidiaries
  - Qualified subsidiaries residents in other member states
  - Other qualified tax payers, which are qualified subsidiaries of the same parent company resident in a third country.

- Qualified subsidiary:
  - (a) a right to exercise more than 50% of the voting rights;
  - (b) an ownership right amounting to more than 75% of the company's capital or more than 75% of the rights giving entitlement to profit.

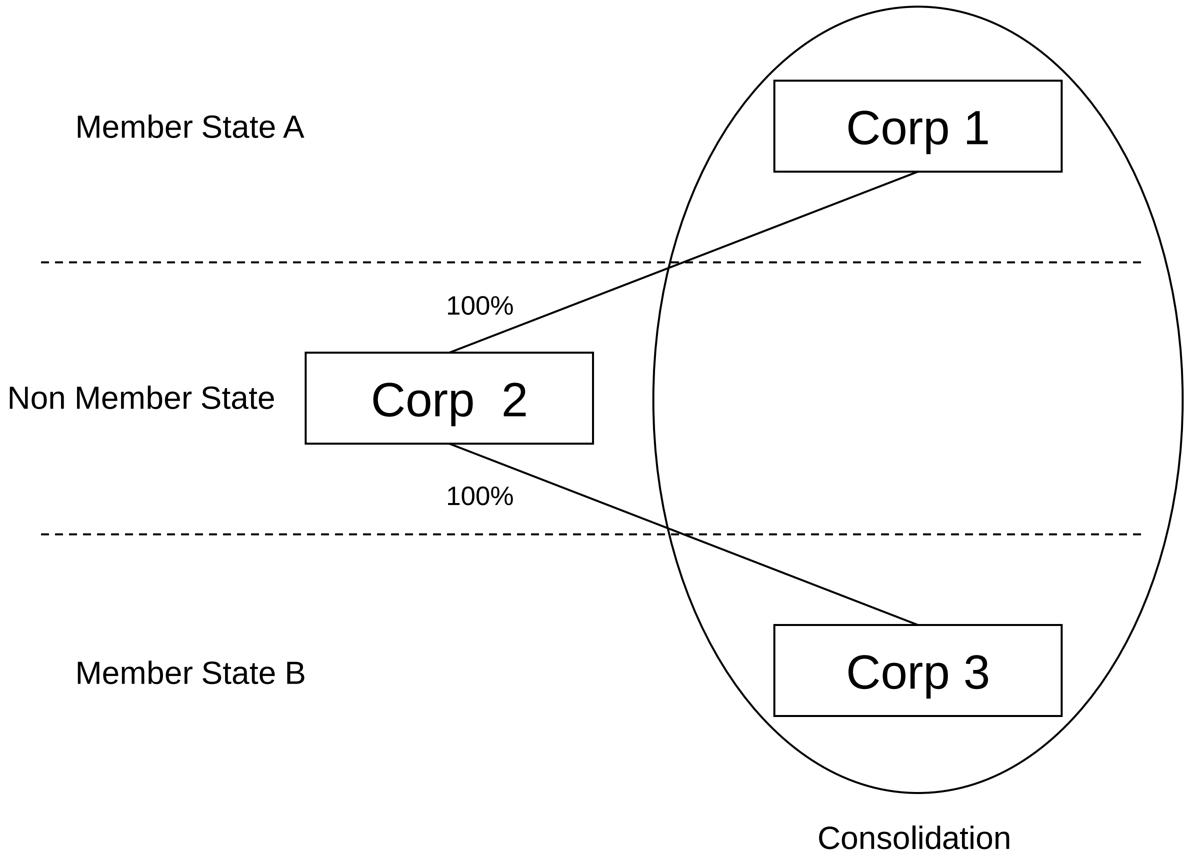
CCCTB – Consolidation



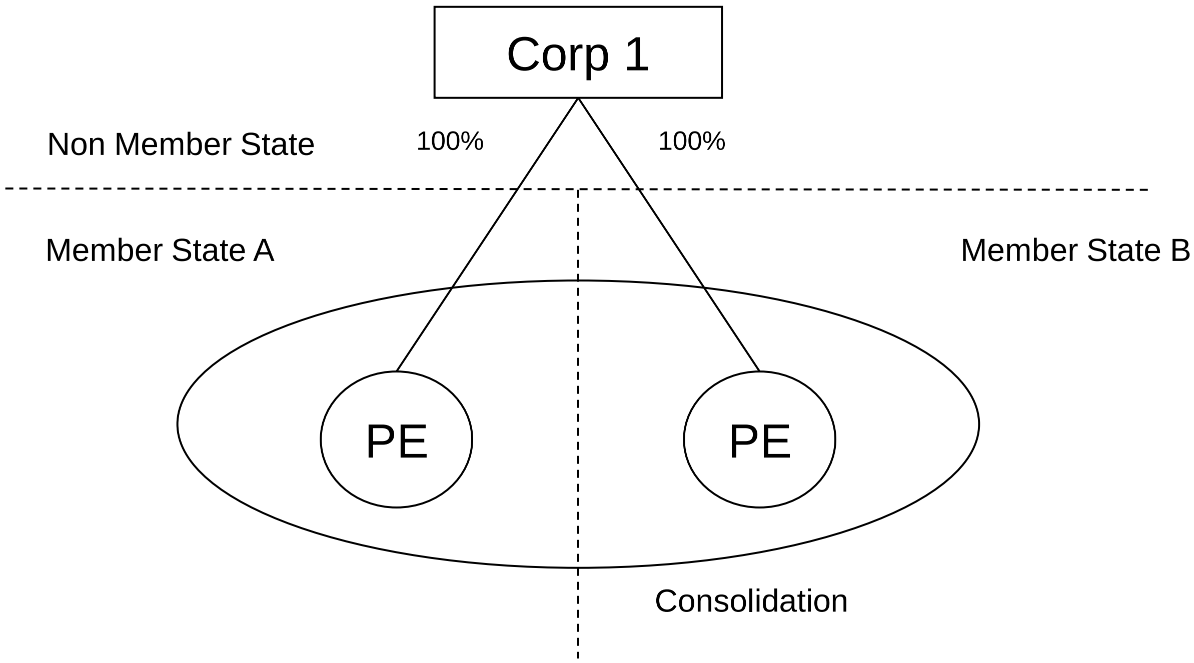
CCCTB – Consolidation



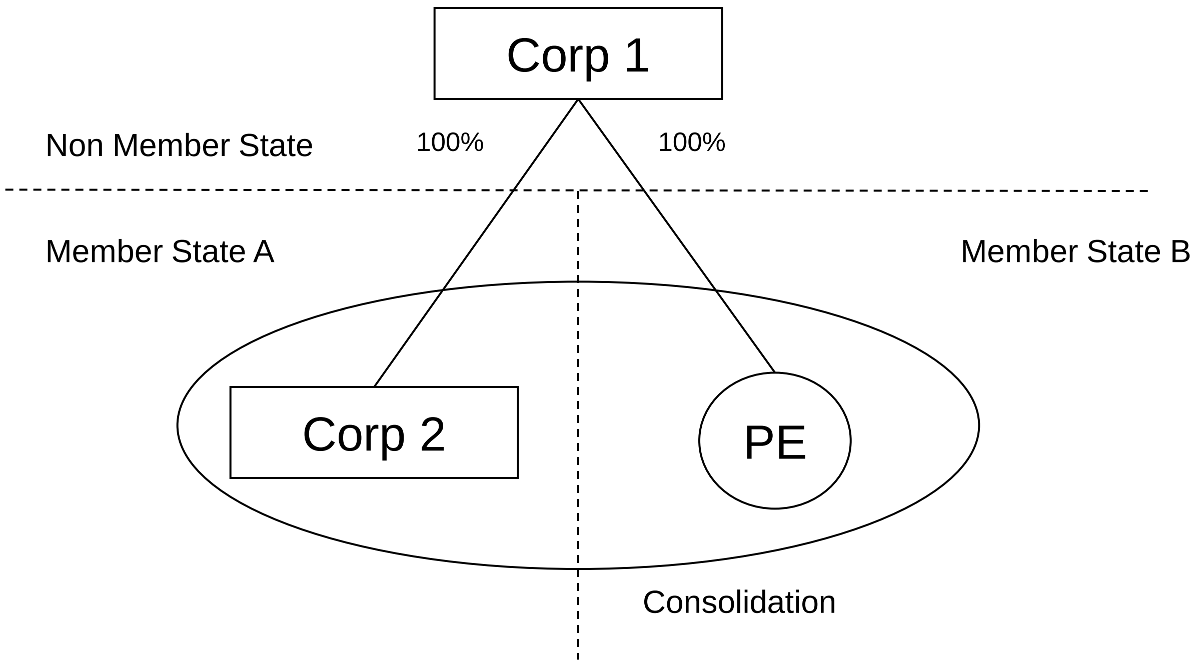
CCCTB – Consolidation



CCCTB – Consolidation



CCCTB – Consolidation



CCCTB – Allocation mechanism

- Allocation to countries where the group has its acitivites.
- EU Member States apply their national corporate tax rates.
- Formulary apportionnement
- Allocation on the basis of specific factors:
  - Sales (destination)
  - Labour (payroll and number of employees)
  - Assets (tangible assets)
- Safeguard-clause

CCCTB – Allocation mechanism

$$\text{Share A} = \left(\frac{1}{3}\frac{\text{Sales}^{A}}{\text{Sales}^{\text{Group}}} + \frac{1}{3}\left(\frac{1}{2}\frac{\text{Payroll}^{A}}{\text{Payroll}^{\text{Group}}} + \frac{1}{2}\frac{\text{No of employees}^{A}}{\text{No of employees}^{\text{Group}}} \right) + \frac{1}{3}\frac{\text{Assets}^{A}}{\text{Assets}^{\text{Group}}} \right) * \text{Con'd Tax Base}$$

CCCTB – Perspectives

- Is the CCCTB project realistic?
  - 12 in favour, 8 cautious, 7 against
- Enhanced cooperation
  - A minimum of 8 member states advance with the CCCTB-project
- Support from Businesses

5. EU Law Developments

- **Case submitted against Denmark's exit tax**
  - On 24 November 2010 the European Commission lodged a case against Belgium, Denmark and the Netherlands regarding their tax rules which impose an immediate exit tax when companies transfer their seat or assets to another EU Member State.
  - The Commission considers these provisions to be incompatible with the freedom of establishment
  - Danish tax lax provides for immediate taxation of capital gains on:
    - Assets transferred outside Denmark to a foreign PE.
    - Transfer of assets from a Danish PE to a foreign head office.
  - The Commission considers that such exit tax rules are likely to dissuade businesses and companies from exercising their right of freedom of establishment and constitute restrictions of Article 49 TFEU.

EU Law Developments

- Restrictive?
  - Different treatment of comparable situations
  - Possibility to opt for international joint taxation
    - Gielen, case C-440/08

- Justifications
  - Principle of territoriality
  - Safeguarding the allocation of the power to impose tax between the Member States
  - Coherence (taxation of built in gains)
  - Prevention of abuse
    - Lower tax rates of ongoing income
    - Deduction regarding development costs / taxation of income
  - Fiscal Control etc?

- Proportionality?

EU Law Developments

- **Modehuis A. Zwijnenburg BV, case C-352/08 (20 May 2010)**
  - Merger directive article 11(1)(a): fraud and abuse
  - Dutch authories denied a tax neutral merger, because the merger was carried out with the purpose of avoiding a Dutch duty on the acquisition of real estate.
  - ECJ:
    - Narrow interpretation of article 11(1)(a) of the directive
    - Only taxes explicitly included under the scope hereof can enjoy the benefits of the directive and hence be subject to the exception in article 11(1)(a)

- **Danish Double Dip Provision (LL § 5 G)**
  - Eastern High Court decision dated 22 November 2010
  - The Court concluded that the ECJ case law (Marks & Spencer and Lidl) result in the provision not constituting a violation of EU law and no basis for referring the case to the ECJ.
  - Reference was made to the risk of double deduction and the possibility of obtaining a deduction, if a final loss has been suffered.

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