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ARTICLE

Taxation of Income in Foreign Trusts: Denmark Introduces a New Anti-avoidance Rule Targeting the Use of Foreign Trusts*

Peter Koerver Schmidt**

Denmark has introduced a new provision that states that Danish settlors of foreign trusts, under certain circumstances, must include the trust's income in their own taxable income. The provision forms part of the Danish legislator's recent attempts to prevent international tax evasion/avoidance, and the underlying aim of the provision is to make the rules concerning foreign trusts easier to administrate and enforce by the Danish tax authorities. Based on an analysis of the provision's area of application and legal effects, it is concluded that the new provision seems to be effective in mitigating the use of foreign (family) trusts for tax evasion/avoidance purposes. However, it is also concluded that there is reason to question whether the new provision is sufficiently precise and whether the aim could have been reached in a more expedient way.

1 Introduction

The use of foreign trusts has posed challenges in Danish tax law and has caused debate in the literature as well as in the general media. The reason is partly that a trust is not an acknowledged legal form in Danish law,[1] and partly that the use of trusts is often linked to tax planning, tax avoidance and tax evasion.

The debate concerning the use of foreign trusts has recently resulted in the passing of a bill introducing a new provision – Section 16 K of the Danish Tax Assessment Act – according to which settlors of foreign trusts under certain conditions must include the trust's income in their own taxable income. The purpose of the new provision is to fight aggressive tax planning, tax avoidance and tax evasion by making the rules regarding the tax treatment of trusts easier to administer and enforce by the Danish tax authorities.[2] The bill is the result of an 'anti tax heaven package' agreed upon in November 2014 by a majority vote in the Danish Parliament, and the bill is based on the recommendations made by an interdisciplinary departmental task force.[3] This task force was established in 2013 in the wake of a number of critical television programs on the use of tax havens by Danish tax payers. Its purpose was to go through the existing legislation and case law and to come up with possible initiatives to fight tax evasion and avoidance with respect to the use of foreign tax havens.[4]

In this article, the content and the consequences of the new provision are analyzed. However, before this analysis is initiated, some overall remarks about the concept of a trust will be made. In this regard, how foreign trusts thus far have been qualified and treated in Danish tax law will also be explained.

2 The definition of a trust

The trust is a well-known concept in common law jurisdictions and can be seen as one of the creations of the so-called equity system.[5] The trust developed in the end of the Middle Ages, and its primary purpose was to facilitate the transfer of freehold land within a family.[6] As the trust has an agreement-based and flexible structure it comes in

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* This article is based on an earlier version written in Danish that has been published by Copenhagen Business School in Peter Arnt Nielsen et al. (eds), *Erhvervsretlige emner*, (Djøfs Forlag 2015).

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1 For more on trusts in a Danish perspective see Rasmus Kristian Feldthusen, in *Principles of European Trust Law* 173 et seq. (D.J. Hayton et al. eds, Kluwer Law International 1999) and same author in *Trusts* (Thomson 2002).

2 Cf. the preparatory remarks to Bill L 167 (2014/2015), para. 3.1 and annex 1.

3 Cf. the Danish Government:'Styrket indsats mod skattely', November 2014.

4 Cf. the Danish Ministry of Taxation: 'Afrapportering fra den tværministerielle task force mod skattely', 6 Nov. 2014. For an overview of all the anti tax heaven measures included in bill L 167 (2014/2015) see Lars Kjærgård Terkilsen in Nordic Tax Journal, 2015, vol. 2, p. 67 et seq.

5 The term common law is in this regard used as a generic term for the legal systems belonging to the Anglo-American legal tradition.

6 Cf. John H. Langbein, *The Contractarian Basis of the Law of Trusts*, Yale L.J. 627 et seq. (1995).

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many forms across the different jurisdictions that acknowledge the trust as a legal form.[7] For the same reason, there is no general or universally accepted definition of a trust. However, in trying to identify the concept of a trust, the definition from the Hague Trust Convention seems to be an appropriate starting point.[8] Article 2 in the Convention states:

> *For the purpose of this Convention, the 'trust' refers to the legal relationships created – inter vivos or on death – by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose. A trust has the following characteristics – a) the assets constitute a separate fund and are not a part of the trustee's own estate; b) title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee; c) the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law. The reservation by the settlor of certain rights and powers, and the fact that the trustee may himself have rights as a beneficiary, are not necessarily inconsistent with the existence of a trust.*

It should be emphasized that a trust is not a separate legal entity, which is one of the things that distinguishes a trust from *inter alia* a foundation. However, there are also similarities between trusts and foundations, including that the creation of both must occur by a transfer of assets, so that the assets are separated from the settlor's private property. Furthermore, in both cases, the settlor will determine one or more specified purposes for the trust or the foundation.

3 The General Treatment of Foreign Trusts in Danish Tax Law

In the context of Danish tax law it is significant to examine whether a Danish settlor of a foreign trust should be taxed of the yield from the trust's assets. According to Danish case law, the decisive factor is whether the trust's assets definitively and effectively have been separated from the settlor's assets. If this is not the case the trust's assets will still be seen as a part of the settlor's assets, which entails that the settlor continuously should include the yield from the trust's assets in his own taxable income.[9]

By 'definitively' is meant that the settlor should not have the option to revoke the trust's assets. In other words, it must be certain that the trust's assets cannot become part of the settlor's assets again. The word 'effectively' means that the settlor may not continue to have disposal over the separated assets. If it is possible for the settlor to dismiss the trustee, the trust's assets will not be considered to be effectively separated.[10]

In the Danish literature there has been some criticism of the fact that the assessment of the trust for tax purposes has placed so much emphasis on whether the trust's assets have been definitively and effectively separated from the settlor's assets, and thereby implicitly questioning whether the trust to a sufficient degree resembles a foundation (which is a well known legal entity in Danish law and a separate taxable entity) or a tied up capital that generates interest (which is also a well known legal concept in Danish law). This has been seen as a too simplified way to look at the relationship between the trustee and the beneficiary.[11] Against this criticism, it has been argued that the critique does not in a sufficient way recognize that Danish international tax law – not foreign law – should decide whether a trust should be seen as a separate taxable entity or not.[12] This discussion will not be pursued further given the purpose of this article. However, the discussion and the relatively comprehensive case law clearly indicate the ongoing difficulties that the use of foreign trusts has caused in Danish tax law.[13]

Additionally, it should be mentioned that the new provision in Section 16 K of the Danish Tax Assessment Act is not the first initiative that the legislator has taken to address the issue of using foreign trusts for tax avoidance purposes. Accordingly, it already follows from Section 3 A of the Act on Taxation of Foundations that taxpayers who contribute means into a foreign foundation or trust – which has been established in a state where foundations or trusts are taxed significantly lower than in Denmark – have to pay a tax amounting to 20% of the contributed means. This, however, only applies to the part of the annual injection exceeding DKK 10.000. Furthermore, the provision does not apply if the settlor/

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7 Cf. D.J. Hayton et al. (eds), *Principles of European Trust Law* 13 (Kluwer Law International 1999). The authors correctly note on p. 29 that the word 'trust' is versatile and chameleon-like, taking its meaning from its context, which has to be closely examined to reveal the full ramifications of the concept.

8 Cf. Convention on the Law Applicable to Trusts and on their Recognition, as of 1 Jul. 1985. Denmark has not ratified the convention.

9 Cf. the preparatory remarks to Bill L 167 (2014/2015), para. 3.1.1.

10 Cf. The Danish Tax Assessment Council: 'Årsberetning', 2014, pp. 26–39 that provides an overview of more recent Danish administrative case law on this matter.

11 Cf. Rasmus Kristian Feldthusen in Skattepolitisk Oversigt, 2009, p. 179 et seq. and the same author in Skattepolitisk Oversigt, 2013, p. 511 et seq.

12 Cf. Aage Michelsen in Niels Fenger et al. (eds), Festskrift til Erik Werlauff, 2012, Djøfs Forlag, p. 321. For more on the qualification of foreign trusts for Danish tax purposes see Jakob Bundgaard, *Skatteret & Civilret* 638–640 (Thomson 2006) and same author in Skat Udland, 2002, no. 298, Erik Werlauff in Ugeskrift for Retsvæsen, 1997B, p. 96 et seq. and Thøger Nielsen in Tidsskrift for skatter og afgifter, 1989, no. 213.

13 The case law mainly consists of administrative decisions, but a few judgements from the courts also exist, cf. the following cases from the Supreme Court: SKM2012.95.HR and SKM2015.9.HR. The first judgment has been dealt with by Jørn Qviste & Rasmus Vang in Tidsskrift for skatter og afgifter, 2012, no. 206 and in European Taxation, 2012, pp. 372–373. Moreover, a number of (tax) criminal law judgments concerning the use of foreign trusts exist. See e,g. Jan Pedersen in SR-Skat, 2015, pp. 129 et seq.

founder can document that the means of the foreign foundation or trust are used for charity purposes for a greater amount of people. Finally, the provision includes passages meant to secure that the provision cannot be circumvented by conducting the injection of means through controlled foreign companies or by conducting the contribution of the means before moving back to Denmark.

The question whether the income in a foreign foundation or trust should be taxed significantly lower than according to the Danish rules is determined by a comparison with the Danish rules regarding taxation of foundations. Concerning foreign trusts, a comparison must be made between the taxation of the trustee abroad and the Danish rules regarding taxation of foundations.[14] In addition, a foreign foundation or trust is considered taxed significantly lower if a special agreement regarding the tax rate or the tax base has been made with the tax authorities in the state where the foundation or trust is domiciled, or if the tax treatment in that state depends on where the settlor/founder is resident.

The aim of introducing the provision in Section 3 A of the Act on Taxation of Foundations was to remove the tax incentives originating from contributing means into low taxed foreign foundations and trusts instead of into Danish foundations. In this regard, it should also be taken into account that the Danish CFC rules do not apply with respect to income in foreign foundations and trusts.[15] However, in connection with the preparation of Bill L 167 (2014/2015) the legislator ascertained that the provision was not sufficiently effective as it for instance can be circumvented by establishing the trust in a high tax jurisdiction only to subsequently move it to a low tax jurisdiction.

4 The new provision in section 16 K of the Danish tax assessment act

As noted above, the new provision in Section 16 K of the Danish Tax Assessment Act aims at mitigating tax evasion and avoidance by making the rules regarding the tax treatment of trusts easier to administer and enforce by the Danish tax authorities. The aim is further explained in the preparatory remarks of the bill, in which it is stated that the most challenging problem for the Danish tax authorities so far has been to detect, and afterwards prove, that the assets in the trust have not actually been definitively and effectively separated from the settlor's capital.

According to the preparatory remarks, it has apparently been possible for the settlor to hide the fact that the capital is in effect revocable. As an example, it is mentioned that a letter of wishes may be used by the settlor to obtain this result. Even though the letter of wishes may not officially bind the trustee, it can have a similar effect if a protector is put in place with authority to replace the trustee if the trustee does not comply with the letter of wishes. In this regard, the preparatory remarks also highlight the fact that trusts are not necessarily under any kind of supervision by public authorities.[16]

It is against this background that Bill L 167 (2014/2015) has introduced the new provision in Section 16 K of the Danish Tax Assessment Act, which entails that Danish settlors of foreign trusts, under certain circumstances, must include the income of the trust in their own taxable income. The provision applies to trusts and foundations that are established (or whereto means are injected) on or after 1 July 2015.

4.1 *Field of Application*

The new provision applies to individuals and estates of deceased persons if the individual or the estate has established and injected means into a trust while being fully liable to Danish tax.[17] Furthermore, the provision also applies if the individual or estate has injected means into the trust without being the settlor.[18]

Neither the wording of the provision nor the preparatory remarks provide a definition of what should be considered a trust. The lack of a definition was heavily criticized during the preparation of the bill. However, in answering the critique the Danish Minister of Taxation stated that it was not possible to come up with a definition that would be sufficiently robust to hinder circumvention of the provision.[19] The lack of a definition probably entails that the determination of whether the new provision will apply to a given setup must be made in accordance with the characteristics of a trust as laid out in the literature.[20]

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14 Cf. the preparatory remarks to Bill L 118 (1995/1996). For more on this bill see Otto Johnsen & Birgitte Tabbert in Skat Udland, 1996, no. 193.

15 Cf. Sec. 16 H of the Tax Assessment Act and Sec. 32 of the Corporate Tax Act. See Peter Koerver Schmidt: Dansk CFC-beskatning, 2013, Karnov Group, p. 152.

16 Cf. the preparatory remarks to Bill L 167 (2014/2015), para. 3.1.2.

17 The individual or the estate should be fully liable to Danish tax, cf. Sec. 1 of the Danish Act on Taxation at Source or Sec. 1(2) of the Estate Tax Act.

18 Taxable persons according to the Sec. 1(2) of the Estate Tax Act take over the position of the deceased person for tax purposes.

19 Cf. the preparatory remarks to Bill L 167 (2014/2015), annex 1.

20 Actually, in the preparatory remarks to the bill the Minister of Taxation referred directly the leading Danish book on trusts by Rasmus Kristian Feldthusen: Trusts, 2002, Thomson.

According to the preparatory remarks, it is, however, clear that the new provision is not applicable in situations in which the capital in the trust has not been finally and irrevocably separated from the settlor's assets. In these situations, the capital in the trust should still be seen as a part of the settlor's own capital and therefore the trust income remains taxable in the hands of the settlor. In other words, the new provision does not change anything concerning trusts where the trust capital has not been finally and irrevocably separated from the settlor's assets. However, in most situations the provision do away with the need of the tax authorities to carefully assess whether or not the funds have been finally and irrevocably separated from the settlor's assets as the trust's income in any case should end up being taxed in the hands of the settlor (unless any of the specific exceptions analysed below apply).

Besides being applicable to trusts, the provision is also applicable to foreign foundations and other similar legal forms, if it is not an indispensable condition that the injected capital has to be finally and irrevocably separated from the settlor's assets.[21] Also in this regard, the provision lacks clarification of which legal forms are comprised. The preparatory remarks, however, mention *stiftungs*, *treuhands* and *anstalten* as examples.

4.2 *Expansions of the Scope*

The scope of the provision has been expanded in order to prevent a person from avoiding being taxed according to the provision by establishing the trust while the person has temporarily moved out of Denmark.[22] More precisely, the provision states that it also applies to persons that become fully liable to Danish tax, even though they were not fully liable to Danish tax at the time of the creation of the trust or at the time the means where injected into the trust. However, this expansion of the provision only applies if the person previously has been fully liable to Danish tax, and if the creation of the trust or the injection of the means took place within the last ten years prior to the point in time at which the person again became fully liable to Danish tax.

Furthermore, the scope has been expanded in order to secure that the provision cannot be circumvented by making the injection of means into the trust through a company controlled by the tax payer.[23] Accordingly, the wording states that the tax payer has to include income from a trust in his taxable income if the trust has been established by controlled companies or means have been injected into the trust by controlled companies, and the tax payer would have been taxable if the taxpayer himself had created the trust or had injected the means into the trust. Under such circumstances, the taxpayer has to include a portion of the trust income equal to his direct or indirect ownership share of the controlled company. The assessment of whether the company should be considered 'controlled' has to be made in accordance with the definition of control in the Danish CFC rules for individuals. According to the CFC rules, the tax payer is considered to have control if he – directly, indirectly or together with close relatives – owns more than 50% of the share capital, or controls more than 50% of the votes.[24]

4.3 *Exceptions*

A number of exceptions apply to the new provision.[25] The first exception states that the provision does not apply if the tax payer documents that it is an indispensable condition for the existence of the trust that the injected capital has to be finally and irrevocably separated from the settlor's assets. This exception is key to understanding the overall scope of the provision. The wording entails that the scope of the provision is narrowed down to only being applicable if the injected means actually have been finally and irrevocably separated from the settlor's assets, but the separation is not an indispensable condition.[26]

The wording 'finally and irrevocably' should most likely be interpreted to mean that the trust capital has to be definitively and effectively separated from the settlor's assets, even though the provision and the preparatory remarks are not entirely clear on this matter.[27] However, it is stated in the preparatory remarks that the interpretation of the wording 'finally and irrevocably' should be interpreted in accordance with the existing case law, which has placed emphasis on whether trust capital has been definitively and effectively separated from the settlor's assets.[28]

Notes

21 Cf. Sec. 16 K (8) of the Tax Assessment Act.

22 Cf. Sec. 16 K (2) of the Tax Assessment Act.

23 Cf. Sec. 16 K (5) of the Tax Assessment Act.

24 Cf. Sec. 16 H (6) of the Tax Assessment Act.

25 Cf. Sec. 16 K (4) of the Tax Assessment Act.

26 As mentioned in section 4.1 above it is stated in the preparatory remarks that the provision is not applicable in situations where the capital in the trust has not been finally and irrevocably separated from the settlor's assets, since the trust income in such situations remains to be taxable in the hands of the settlor.

27 Cf. the preparatory remarks to Bill L 167 (2014/2015), para. 3.1.1.

28 Cf. the preparatory remarks to Bill L 167 (2014/2015), annex 1. See s. 3 above concerning the existing case law.

It has to follow from legislation, case law or administrative case law in the jurisdiction of the trust that it is an indispensable condition for the existence of the trust that the injected capital has to be finally and irrevocably separated from the settlor's assets. Accordingly, the condition will not be fulfilled if the settlor can undermine the actual separation by entering into agreements with the trustee on these matters. Furthermore, the condition will not be fulfilled if it is possible to relocate the trust to another jurisdiction, where no such indispensable condition exists.[29] It must be assumed that this exception rarely can be applied, as the creation of a trust rests on a contract. In other words, in the jurisdictions where trusts are set up, it does normally not follow from legislation or case law that it is an indispensable condition for the existence of the trust that the injected capital has to be finally and irrevocably separated from the settlor's assets.

The second exception states that the provision does not apply if the tax payer documents that the trust's means are only to be used for charitable purposes for a large group of people. The term 'charitable purposes' is not defined in the provision, but it follows from the preparatory remarks that the term should be interpreted in line with the other provisions in Danish tax law that use this expression.[30] In general, an entity is considered to have a charitable purpose (provide a public benefit) if the assets of the entity is used to further the interest of persons or groups of persons in economic need, provided that the beneficiaries are defined objectively in the by-laws of the entity. Among such charitable purposes social, cultural, scientific, environmental, humanitarian, religious and educational purposes can be mentioned.[31]

The third exception states that the provision does not apply if the tax payer documents that the trust's means are only to be used for pension purposes for a larger group of people,[32] and the fourth and final exception sets out that the provision is not applicable if the taxpayer documents that the trust fulfils the conditions for being an investment company.[33] The term 'investment company' comprises (1) investment institutions as defined in the so-called UCITS-directive (2009/65/EC); (2) companies whose business consists of investment in securities etc. and where shares in the company at the bearers request must be bought back or redeemed by the company's funds; and (3) companies that invest in securities, if the company's business consists of collective investment. The reason behind the fourth exception is that the owners of the investment company are already liable to tax according to a mark-to-market principle.

4.4 *Legal Effects*

The fundamental legal effect of the new provision is that the tax payer has to include the income of the trust or foundation in his or her own taxable income, provided that the income is positive. The income of the trust or foundation should be calculated according to the rules applicable to the tax payer personally.[34] This entails that the income can fall into the normal income categories for individuals, i.e. personal income, capital income and income from shares depending on the character of the trust or foundation's income.

It is worth noting that the application of the new provision on a given trust or foundation does not influence how the trust or foundation should be qualified for Danish tax purposes. The trust or foundation will in other words still be considered a separate entity for Danish tax purposes. Instead, the application of the new provision entails that the settlor becomes subject to an additional tax levied on the amount of income generated in the trust or foundation. Accordingly, the way the new provision works is somewhat similar to how the Danish rules on CFC taxation of individuals work.[35] Moreover, as the new provision does not change the qualification of the trust or foundation, it neither changes how the trust, the trustee or the beneficiaries are taxed, if these are subject to Danish tax.[36] Transactions with the trust or foundation should therefore be treated just as before the introduction of the new provision, and beneficiaries subject to Danish tax would still be taxable of distributions received from the trust or foundation.[37]

If there are more than one settlor, or more than one person have contributed funds to the trust or foundation, it is necessary to allocate adequate portions of the income

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29 Cf. the preparatory remarks to Bill L 167 (2014/2015). See also the Minister of Taxation's answer to a question from Kromann Reumert Law Firm (SAU – spm. 3), in which the minister stated that it is not sufficient if the separation only follows from the trust deed.

30 In particular, the relevant provisions are to be found in the Act on Taxation of Foundations and in the general provisions dealing with deductions for donations to charities in the Tax Assessment Act.

31 See Søren Friis Hansen & Jacob Graff Nielsen, in *Taxation of Charities*, EATLP International Tax Series, vol. 11, 211 et seq. (Frans Vanistendael ed., IBFD 2015).

32 It is a condition that the people receiving the benefits are not related to a deceased settlor, cf. Sec. 1 (2) of the Estate Tax Act.

33 As defined in Sec. 19 in the Act on Taxation of Capital Gains on shares.

34 Cf. Sec. 16 K (6) of the Tax Assessment Act.

35 However, the CFC rules only apply if a number of specific conditions – e.g. concerning control and passive/mobile income – apply.

36 Cf. the preparatory remarks to Bill L 167 (2014/2015).

37 Cf. Sec. 4 of the State Tax Act.

to the settlors and contributors in question. According to the new provision, the income should in such situations be allocated in proportion to the fair market value of the injected assets at the time of the establishment of the trust.[38] In this regard, the term 'assets' refer to all kinds of assets contributed to the trust or foundation, including cash, other financial assets, tangible property and intellectual property. In addition, it should be noted that the allocation should be made as described above no matter whether the other settlors or contributors are actually comprised by the new provision.[39]

If additional contributions are made at a later stage a new allocation key has to be determined. The new allocation should be determined according to the settlors' and contributors' shares of the fair market value of the assets before the new contribution was made and the fair market value of the assets at the new contribution. In the income year in which the additional contribution is made only a share – proportional to the period running from the time of the contribution to the end of the income year – should be included in the calculation. The following three examples illustrate the allocation principles:[40]

Example 1: Two individuals establish a trust. One of the settlors is fully liable to Danish tax whereas the other is not. The Danish settlor grants assets with a fair market value of DKK 1 million, and the foreign settlor grants assets with a fair market value of DKK 0.5 million. The Danish settlor has to include 2/3 of the income in the trust.

Example 2: After 5 years the fair market value of the trust's assets has increased to DKK 2.1 million (the trust is the same as the one in example 1). The foreign settlor makes an additional contribution of assets with a fair market value of DKK 0.7 million. The Danish settlor's share of the fair market value of the original assets is DKK 1.4 million, whereas the foreign settlor's share is DKK 0.7 million to which the additional contribution of DKK 0.7 million should be added. The Danish settlor has to include 50 percent (1.4/2.8) of the income in the trust.

Example 3: It is assumed that the additional contribution of DKK 0.7 million was made right in the middle of the income year (1 July if the income year is assumed to follow the calendar year). When making the calculation only DKK 0.35 million should be included. The Danish settlor's share of the fair market value of the original assets is DKK 1.4 million, whereas the foreign settlor's share is DKK 0.7 million to which half of the additional contribution should be added, i.e. DKK 0.35 million. The Danish settlor has to include 57 percent (1.4/2.45) of the income in the trust.

New acquisition prices (entry values) have to be determined if the trust or foundation's assets were acquired before the new provision became applicable to a given set-up. This could be the case when a trust was established before the tax payer moved back to Denmark. In such situations, the assets should, as a main rule, be considered acquired at fair market value at the time of the relocation to Denmark.[41]

As mentioned above, the income from the trust or foundation should only be included if the income is positive. If the income is negative, it is possible to carry forward the loss and offset the loss against positive income in subsequent income years.[42] A loss can only be carried forward if it cannot be contained in positive income in previous income years. It should be noted that the rules on utilization of losses according to the new provision are less beneficial for the settlor compared to a situation in which the new provision does not apply (i.e. where the trust's assets have not been finally and irrevocably separated from the settlor's assets), as the settlor in the latter situation may benefit immediately by offsetting the trust's loss against other income.

Credit relief is granted with respect to taxes paid by the trust or foundation in Denmark or abroad. In addition, credit relief is granted for Danish and foreign taxes paid by the trustee on the income from the trust. However, the relief cannot exceed a share of the total taxes equal to the proportion of the tax payers' share of the income and the total income.[43]

Finally, it should be mentioned that the anti-avoidance rule set out in Section 3 A of the Act on Taxation of Foundations, does not apply if the settlor or contributor is subject to tax according to the new provision in Section 16 K of the Tax Assessment Act. In other words, the new provision would then take precedence.[44]

Notes

38 Cf. Sec. 16 K (3) of the Tax Assessment Act.

39 Cf. the preparatory remarks to Bill L 167 (2014/2015).

40 The examples are provided in the preparatory remarks to Bill L 167 (2014/2015).

41 The preparatory remarks to Bill L 167 (2014/2015) state that the entry values should be determined in accordance with Sec. 9 of the Act on Taxation at Source, which constitutes the general rule on determination of entry values for individuals in Danish tax law.

42 Certain restrictions may apply depending on the type of loss, as losses from some sources may only be offset against gains from the same sources, cf. the preparatory remarks to Bill L 167 (2014/2015).

43 Cf. Sec. 16 K (7) of the Tax Assessment Act.

44 Cf. Sec. 3 A (2) of the Act on Taxation of Foundations. See also s. 3 above.

5 Final remarks

When introducing new legislation – including tax legislation – it indeed seems expedient to take into account whether the relevant authorities are in a good position to enforce the legislation. Accordingly, it is hard to criticize the Danish legislator for the underlying purpose behind the new anti-avoidance provision in Section 16 K of the Tax Assessment Act, which according to the preparatory remarks, was to make the rules concerning foreign trusts easier to administrate and enforce by the Danish tax authorities.

However, it seems appropriate to question whether the new provision is sufficiently precise in its scope. As shown above, the provision's field of application is very broad, and neither the wording nor the preparatory remarks contain a precise definition of the setups targeted by the new provision. Moreover, even though the new provision sets out a number of exceptions that to some degree limit the field of application, these exceptions do not change the fact that some uncertainty about the scope remains. In this regard, however, the legislator has stated that the provision would not be sufficiently robust against circumvention if a precise definition had been inserted in the provision. This argument seems neither particularly convincing nor appropriate, but merely illustrates the political commitment to effectively mitigate tax evasion and avoidance related to the use of foreign trusts at all costs. However, by adopting the new provision the legislator does seem to have reached its goal, as the settlors will rarely be in a position to benefit from the exception stating that the provision does not apply if it is an indispensable condition for the existence of the trust that the injected capital has been finally and irrevocably separated from the settlor's assets. In other words, Danish tax payers' use of foreign (family) trusts in wealth and succession planning must be expected to stop or significantly decrease.

On a more technical note it is worth noting that Danish settlor's of foreign trusts may end up in a situation where they become subject to a tax according to the new provision, even though the contractual basis of the trust prevents that the trust's assets are transferred back to the settlor. Such a scenario may be the case when the trust's means actually have been finally and irrevocably separated from the settlor's assets, but the separation is not an indispensable condition according to the legislation or case law in the jurisdiction of the trust. Thus, in this scenario the settlor seems to be in a deadlock.[45]

Another relevant question is whether the new provision should be considered to be in conflict with EU law, more precisely the freedom of establishment. During the consultation process, the Minister of Taxation was asked this question, and he answered that no such conflict exists. The argument was that Danish foundations and the foreign trusts and foundations comprised by the provision are not in the same situation as a Danish foundation is a separate taxable entity that is under public supervision, and since the means of a Danish foundation have to be finally and irrevocably separated from the settlor's assets. Whether this argumentation is in fact correct should be subject to further analysis.[46]

As a final remark it seems appropriate to consider whether the aim behind the new provision could have been reached in a more expedient way. In this regard, a different option could have been to expand the field of application of the CFC rules already in place. Examples of the use of 'true' CFC legislation to pick up income in foreign trusts actually can be found in other jurisdictions.[47] For instance, this is the case according to the Norwegian CFC rules (NOKUS rules), where income in foreign trusts or the like under certain circumstances is subject to Norwegian CFC taxation.[48] Accordingly, expanding the scope of the current CFC legislation to counter tax avoidance with respect to the use of foreign trusts could possibly have paved the way for a more precise intervention by the Danish legislator.

Notes

45 In the same vein see Jan Pedersen in SR-Skat, 2015, pp. 129 et seq. who argues that Danish tax law has demonized the use of trusts.

46 See also Lars Kjærgård Terkilsen in Nordic Tax Journal, 2015, pp. 67 et seq. In this regard it seems interesting that the German rules on add-back taxation (Zurechnungsbesteurung) with respect to foreign trusts contain an exception for trusts established in the EU/EEA, cf. Sec 15 of the Foreign Tax Act. See Bernd Noll, in *Cross-Border Investments with Germany* 363 (Thomas Rödder et al. eds, Verlag Otto Schmidt 2014). See also Till Moser & Sven Hentschel, *European Taxation* 476–479 (2015).

47 Cf. Mattias Dahlberg & Bertil Wiman in *Cahiers de droit fiscal international* 29 (Sdu Publishers 2013), and Brian Arnold & Patrick Dibout, *Cahiers de droit fiscal international* 41 (Kluwer 2001).

48 Cf. Henning Naas et al., *Norsk International Skatteret* 596–598 (Universitetsforlaget 2011).

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