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A: Interest deductibility: the implementation of BEPS Action 4

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Denmark

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Summery and conclusions

Interests are in general deductible in Denmark. Businesses including corporations can deduct interest throughout the period in which the interests accrue, while individuals may deduct the interest in the income year in which the interest falls due for payment.

Interest limitation rules have played a significant role in Danish anti-avoidance rules for corporations, especially since 2007. Since 2007 Denmark has applied three main interest limitation rules (i) a thin capitalisation rule, (ii) an asset-based limitation rule, and (iii) an EBIT-based limitation rule.

The thin capitalisation rule was introduced in 1998 with the purpose to deny the deductibility of excessive gross interest payments and capital losses on controlled debt, if the debt itself is not considered to be in accordance with the arm's length principle. If the debt-to-equity exceeds a ratio of 4:1 at the end of the income year, the exceeding controlled debt of the corporation will be considered to be not at arm's length, unless the corporation can provide evidence to substantiate that similar financing - including the principal amount and interest rate - could be obtained between independent parties at the end of the income year (arm's length at the end of the income year).

The purpose of the asset-based limitation rule and the EBIT-based limitation rule is to deny the deductibility of net financing expenses which are not considered to be related to the generation of taxable income in Denmark.

According to the asset-based limitation rule, net financing expenses are not related to the generation of taxable income in Denmark, if the net financing expenses exceed the tax value of the corporation's assets multiplied with a standard rate (2.7% 2019-level).

According to the EBIT-based limitation rule, the net financing expenses are not related to the generation of taxable income in Denmark if the net financing expenses exceed 80% of the corporation's taxable income before net financing expenses and taxes (EBIT).

Furthermore, certain hybrid rules may apply according to which debt can be reclassified to equity, which will subsequently result in a reclassification of the related interest payments to non-deductible distributions.

Following the OECD BEPS Action 4 report the Danish Implementation Council, which advises the Danish government in ensuring that Danish corporations are not subject to stricter requirements than corporations in other EU countries, recommended that the three Danish interest limitation rules be simplified and harmonised with OECD BEPS Action 4 report/ATAD article 4.[2]

However, Denmark did not follow the recommendation of the Implementation Council. Instead Denmark chose to retain all three interest limitation rules and only aligned the

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2 See Anbefaling fra Implementeringsrådet: Bekæmpelse af metoder til skatteundgåelse, dated 14 March 2017.

earning-based limitation rule, i.e. the EBIT-based limitation rule, to match the OECD BEPS Action 4 report/ATAD article. 4. Further the Danish hybrid rules on reclassification of corporate taxable entities to permanent establishments and on reclassification of debt to equity will be abolished and be replaced by the hybrid rules contained in OECD BEPS Action 2 report/ATAD article 9.[3]

Denmark retains the thin capitalisation rule as a targeted rule and the asset-based interest limitation rule as the general interest limitation rule without any material changes. It seems that the Danish legislator does not share the OECD BEPS Action 4 reports concerns in relation to inconsistencies or that some corporate group's most valuable assets may not be taken into account when applying the asset-based limitation rule, as the rule uses the historic, i.e. depreciated, value of the assets. The asset-based limitation rule is therefore probably still the strictest interest limitation rule in Denmark for large(r) Danish corporations.

However, following OECD BEPS Action 4 report and ATAD, Denmark has amended the EBIT-based limitation rule to comply with both OECD BEPS Action 4 report and ATAD article 4.[4] Hence, as of 1 January 2019 the taxable income before net financing expenses, taxes, depreciation and Amortisation (EBITDA) can only be reduced by a maximum of 30% by virtue of deducting net financing expenses, i.e. a change from an 80% of EBIT- (tax figure) to an 30 % of EBITDA-rule (still tax figure). Further a group ratio-rule is implemented in conjunction with the EBITDA-based rule, as the ratio of net interest to third parties divided by EBITDA of the worldwide group can replace the fixed 30% ratio in accordance with OECD BEPS Action 4 report. Lastly the new EBITDA-based interest limitation rule does not apply to financial undertakings covered by ATAD article 2(5), which is in line with OECD BEPS Action 4 report, unless the taxpayer elects to apply the rule for 10 years.

In conclusion Denmark already had quite strict interest limitation rules and Denmark chose only to align the earning-based limitation rule to the international standards in ATAD article 4 and the OECD BEPS Action 4 report.

Part One: General rules regarding interest deductibility

1.1. General overview

Interest expenses are generally deductible in Denmark, unless any of the specific interest limitation rules apply.[5] It is a prerequisite for interest deductions that there is in fact an actual loan between the parties which has to be repaid, and according to which the debtor is legally required to pay interest.[6] Thus, a guarantor, *inter alia*, can only deduct interest expenses accrued during the period after the guarantee obligation has been triggered.

Interest expenses are generally deductible regardless of the origin, purpose(s) or reason(s) of the underlying loan. However, certain exceptions apply as interest accruing on taxes, customs, duties et cetera, have not been deductible since 1975.[7]

Certain other financial expenses, such as recurring commissions and premiums on

3 See Bill no 1726 of 27 December 2018.
4 See Bill no 1726 of 27 December 2018.
5 Cf. s. 4 of the State Tax Act and for example s. 11, 11 B and 11 C of the Corporate Tax Act.
6 See TfS 1999, 571 Ø, TfS 2001, 316 V and TfS 1988, 278 H.
7 Cf. s. 17 A of the Tax Assessment Act.

loans as well as one-off premiums on loans with a maturity of less than two years, are also deductible.[8] One-off commissions and similar non-recurring commissions on such short term loans can be immediately deducted with up to 2.5% of the loans principal amount, while the excess commission(s) and/or premium(s) must be allocated throughout the remaining maturity period.[9]

The Danish rules concerning interest limitation for companies - as described below in Part Two and Part Three - encompass interest expenses, other financial expenses such as capital losses on loans and claims, and the interest expenses embedded in financial lease payments.

1.2. Definition of "interest"

The definition of "interest" for tax purposes is not statutorily defined in Danish tax law but based on case law from the Danish Supreme Court. The definition of interest is "*a periodic calculated payment to a creditor to make capital available and the payment is calculated as a certain percentage of the at any time outstanding debt*."[10] It is not imperative, that the interest be paid periodically, insofar as the interest is calculated periodically, i.e. the ongoing accrual of interests payable is the determining factor for tax purposes.

If one or more of the mentioned characteristics are not present, the payment will not qualify as an interest payment. Instead the payment may be classified as a capital loss or another type of payment.[11]

In 2016 - after a significant period of negative market interest rates - the interest definition was statutorily clarified to also include negative interest, i.e. to also include a periodic payment to a debtor from a creditor to make capital available to the creditor, when such periodic payment is computed as a certain percentage of the at any time outstanding debt.[12]

The Danish interest definition is quite narrow compared to, inter *alia*, to the interest definition contained in article 11 of the OECD Model Tax Convention. The Danish definition of interest has not been changed following the release of the OECD BEPS Action 4 report.

1.3. Interest deductibility

Generally speaking, interest expenses are deductible in the income year in which the interest falls due for payment.[13] Interest expenses relating to a period longer than six months , and due more than six months before the expiration of the period, must be allocated throughout the period in which the interests are incurred.[14] To the extent an interest payment for a prior income year has in fact not been paid, the taxpayer may not deduct any further interest expenses regarding the same loan, unless the taxpayer provides evidence that he was able to maintain the debt or provides sufficient security for such capability.[15]

8 Cf. s. 8(3) of the Tax Assessment Act.
9 Cf. s. 5 and 8(3) of the Tax Assessment Act.
10 Cf. the Danish Supreme Court in the Nakskovhus-case (UfR 1941, 563 H).
11 See also TfS 1994, 268 and TfS 1998, 77.
12 Cf. Law no. 1883 of 29 December 2015.
13 Cf. s. 4 of the State Tax Act and s. 5 of the Tax Assessment Act.
14 Cf. s. 5(2) of the Tax Assessment Act.
15 Cf. s. 5(8) of the Tax Assessment Act.

Interest expenses are also deductible for companies although companies are required to allocate the interest expenses throughout the period in which the interests accrue. Individuals engaged in business activities may choose to allocate interest expenses over the period in which the interests accrue.[16]

Part Two: limitation on interest deductibility before BEPS Action 4 report

2.1. General overview

Denmark has since 2007 applied three main interest limitation rules:
(i) a thin capitalisation rule,
(ii) an asset-based limitation rule, and
(iii) an EBIT-based limitation rule.
The purpose of the thin capitalisation rule is to deny the deductibility of excessive gross interest payments and capital losses on controlled debt if the debt itself is not considered to be in accordance with the arm's length principle. If the debt-to-equity exceeds a ratio of 4:1 at the end of the income year, the exceeding controlled debt of the corporation will be considered to not be at arm's length, unless the corporation can provide evidence to substantiate that similar financing - including the principal amount and interest rate - could be obtained between independent parties at the end of the income year (arm's length at the end of the income year).

The purpose of the asset-based limitation rule and the EBIT-based limitation rule is to deny the deductibility of net financing expenses which are not considered to be related to the generation of taxable income in Denmark.

According to the asset-based limitation rule, net financing expenses are not linked to the generation of taxable income in Denmark, if the net financing expenses exceed the tax value of the corporation's assets multiplied with a standard rate (2.7% 2019-level).

According to the EBIT-based limitation rule, the net financing expenses are not linked to the generation of taxable income in Denmark if the net financing expenses exceed 80% of the corporation's taxable income before net financing expenses and taxes (EBIT).

Furthermore, certain hybrid rules may apply according to which debt can be reclassified to equity which will subsequently result in a reclassification of the related interest payments to non-deductible distributions.

2.2. Limitations that entails a reclassification of interest payments to non-deductible distributions

A Danish resident corporation's debt to a non-resident individual or corporation exerting controlling influence is reclassified to equity if the debt is characterised as equity in the state

[16] Cf. s. 5(4) and 5(5) of the Tax Assessment Act.

of residence of the controlling individual/corporation.[17] Further, the consequence of this hybrid rule is that interest payments on the debt are reclassified to non-deductible dividend distributions. In certain situations, the hybrid rule also applies to debt even though the debt is characterised as a claim for the creditor under foreign tax rules. Such situations occur if the creditor has debt to another group company for which the debt (claim) is characterised as equity (or instead this company has debt to another group company and so on), i.e. the hybrid mismatch occurs further back in the group structure behind the intermediary or intermediaries. However, reclassification as encompassed by the intermediary anti-avoidance rule does not apply if the withholding tax on the interest from Denmark to the intermediary is to be reduced according to the Interest and Royalty Directive (2003/49/EC) or according to a tax treaty.

Lastly, if a corporation provides a loan either directly or indirectly to a controlling individual, a so-called shareholder loan, the debt is reclassified as a dividend distribution, unless the taxpayer can substantiate that the loan (i) is granted during the ordinary course of business, or (ii) constitutes an ordinary loan from a bank, or (iii) constitutes that the loan was for purposes of self-financing, as encompassed by section 206 (2) of the Danish Companies Act.[18] Any interest payment on such a shareholder loan is not deductible, as no loan exists for tax purposes.

2.3. Limitations that disallow interest deduction without reclassification

Denmark applies three main interest limitation rules, which disallow interest deduction without reclassification. The interest limitation rules apply only to corporations and apply on group level for resident corporations and permanent establishments in Denmark.[19]

The thin capitalisation rule[20] entails a disallowance of interest deduction as well as capital losses on loans in relation to loans, which are assumed not to be "arm's length". The thin capitalisation rule only applies to loans entered into between related corporations including permanent establishments, but also includes loans from third parties if the loan either directly or indirectly is guaranteed by a related corporation, as this might *de facto* create a controlled environment and thereby potentially constitute a non-arm's length (controlled) loan. The thin capitalisation rule only applies for corporate groups which have controlled debt exceeding ten million DKK at the end of the income year.

In assessing whether the controlled debts are considered arm's length, the corporation's solvency ratio is the determining factor. This necessitates that an account of all the corporation's assets and liabilities as well as an assessment of the market value hereof, be made annually which can be a very complex and costly task for taxpayers and tax authorities alike.[21]

If a corporation's debt-to-equity ratio exceeds 4:1 the corporation is considered thinly capitalised and the controlled debt, which must be reclassified accordingly as equity in order for the debt-to-equity ratio to equal 4:1, is not considered to be "arm's length". Accordingly,

17 Cf. s. 2B of the Corporate Tax Act. The hybrid rule also applies to non-resident corporations' permanent establishments and real estate in Denmark.

18 Cf. s. 16E of the Tax Assessment Act.

19 Cf. s. 11(4), 11B(8) and 11C(2) of the Corporate Tax Act.

20 Cf. s. 11 of the Corporate Tax Act.

21 Cf. s. 11(2 and 3) of the Corporate Tax Act.

gross interest payments and capital losses arising from the reclassified part of the controlled debt cannot be deducted. If the corporation can substantiate that similar funding could be obtained between independent parties at the end of the income year, deduction limitations may be reduced or completely eliminated.[22]

Danish corporations, as well as permanent establishments in Denmark, will be considered tax-exempt on interest income and capital gains if the corresponding deduction of the interest payments and/or capital losses relating to the controlled debt has been denied according to the thin capitalisation rule.[23] This tax exemption does not include interest income and capital gains relating to third party loans, guaranteed by a related corporation.

Furthermore, Danish corporations and permanent establishments in Denmark is tax exempt on interest income and capital gains if the corresponding deduction of the interest payment and/or capital losses has been denied according to the thin capitalisation rule in another EU/EEA country. This amount is however maximised to that which would have been denied according to the Danish thin capitalisation rule, had the thinly capped borrower been tax resident in Denmark.[24] This was added to the thin capitalisation rule following the ECJ's decision in the C-593/14 *Masco*-case.

The thin capitalisation rule is applied at group level for corporate groups and permanent establishment hereof although it should be noted that this assessment is not necessarily identical to being subject to Danish joint taxation. Accordingly, the solvency ratio and controlled debt are calculated on group level when assessing whether interest limitation may be imposed.[25]

The asset-based limitation rule denies interest deductions, as well as other deductions for net financing expenses, if the underlying debt obligation cannot be considered linked to the financing of assets, which generate taxable income in Denmark.[26] A minimum threshold of net financing expenses up to 21.3 million DKK applies.

The basis for the computation of any net financing deduction limitations is the tax value of the corporations' assets multiplied by a standard rate (2.7 % 2019-level). [27] These assets encompass:

– depreciable assets
– non-depreciable assets
– finance leased assets (according to their book value; tax value if group companies)
– net value of work-in-progress (at the expense of others)
– net value of work-in-progress, assets bought by a trader for trading purposes, inventory and trade debtors exceeding trade creditors is positive
– net operating losses ("NOL's)
– financial instruments entered into for purposes of hedging operating income or operating expenses

Not included in the computation are specifically:

– shares (unless trading in shares)
– receivables
– cash

22 Cf. s. 11(1) of the Corporate Tax Act.
23 Cf. s. 11(6) of the Corporate Tax Act.
24 Cf. s. 11(7) of the Corporate Tax Act.
25 Cf. s. 11(4) of the Corporate Tax Act.
26 Cf. s. 11 B of the Corporate Tax Act.
27 Cf. s. 11 B (2) of the Corporate Tax Act.

– claims
– bonds
– financial instruments, which are not entered into for purposes of hedging operating income or operating expenses.[28]

As the tax value of the above-mentioned assets are used depreciations will reduce the corporation's maximum limit for the deductibility of net financing expenses. Further, assets without a tax value or a tax value of zero will not be included in the calculation. The asset-based limitation rule is very complex and represents a fairly unique approach - only briefly mentioned in paragraphs 79 and 80 of OECD BEPS Action 4 - which seeks to identify the maximum financing needs of the assets generating taxable income and thereby the maximum net financing expenses related to loans financing these assets generating taxable income in Denmark.

The *net* financing expenses constitute:

– interest payments and deductible commissions related to loans agreements,
– capital gains and losses on claims, loans and financial instruments,
– a calculated finance cost on financial lease arrangements
– dividends as well as capital gain and losses on shares.[29]

It should be noted that if the net computation of dividends and capital gains and losses on shares is negative, the negative share expenses are not included in the net financing expenses but are instead carried forward to offset future positive (net) share income in relation to the computation of net financing expenses.

The net financing expenses which exceed the tax value of the assets multiplied with the standard rate cannot be deducted. Noticeably the asset-based limitation rule assumes a close correlation between the tax value of the assets and the financial needs of the company; so, it should be considered doubtful whether the asset-based limitation rule is targeted enough, especially in the light of the administrative inconvenience for both taxpayers and tax authorities.

Generally, net financing expenses which cannot be deducted are not eligible to be carried forward according to the asset-based limitation rule. However, net capital losses relating to debt, including foreign exchange losses, and financial instruments may be carried forward for three tax years to offset future gains on debts, including foreign exchange gains, and financial instruments.[30] Further it should be noted that unrealised losses on interest swaps related to debt secured in real estate can always be carried forward during the term of the interest swap to offset any future gains on the same interest swap.

The asset-based limitation rule applies on a consolidated basis for corporate groups and permanent establishment that are party to Danish joint taxation. Accordingly, the net financing expenses and assets are calculated jointly when assessing a potential interest limitation according to the asset-based limitation rule.[31]

The EBIT-based limitation rule denies the deduction of net finance expenses not related to the generation of taxable income in Denmark.[32] The underlying idea is that net financing expenses exceeding 80 % of the taxpayer's taxable income before net financing expenses and taxes (EBIT) are not related to the generation of taxable income in Denmark.

[28] Cf. s. 11 B (5) of the Corporate Tax Act.
[29] Cf. s. 11 B (4) of the Corporate Tax Act.
[30] Cf. s. 11 B (10) of the Corporate Tax Act.
[31] Cf. s. 11 B (8) of the Corporate Tax Act.
[32] Cf. s. 11 C of the Corporate Tax Act.

The taxable income before net financing expenses (EBIT) can only be reduced by a maximum of 80% by virtue of deductible net financing expenses. Exceeding net financing expenses can be carried forward. The net financing expenses are currently defined by referring to the definition of net financing expenses in the asset-based limitation rule and is applied following the application of the thin capitalisation rule and the asset-based interest limitation rule in that order.

Net financing expenses up to 21.3 million DKK are not affected by the EBIT-based limitation rule. The EBIT-based limitation rule is – like the asset-based limitation rule - applied on a consolidated basis for corporate groups and permanent establishment hereof parties to Danish joint taxation.[33]

2.3.1. Limitations by reference to the borrower

As stated above, Denmark applies three main interest limitation rules, which are all based on the circumstances of the borrower.[34]

However, it should also be noted that Denmark currently applies hybrid rules in relation to both taxable corporate entities[35] and transparent entities[36], according to which reclassification of the borrower may apply insofar as another country or countries, in which majority shareholder(s) are resident for tax purposes, applies a different classification of the entity.

These hybrid rules are outside the scope of this report but should be noted as such a reclassification of the borrower can also have effect in relation to the interest limitation rules.

2.3.2. Limitations by reference to the lender

Generally, Denmark does not apply interest limitation rules based on a reference to the lender, i.e. by referring to the tax treatment of the lender.[37]

However, as stated above, Denmark does apply certain hybrid rules, where the deduction of the borrower is limited due to the circumstances of the lender. A Danish resident corporation debt to a non-resident controlling entity may be reclassified to equity if the debt is characterised as equity in the state of residence of that entity, herewith making the circumstance of the lender decisive.[38] Interest payments on the debt are accordingly reclassified to dividend distributions.

[33] Cf. s. 11 C (2) of the Corporate Tax Act.

[34] As the limitation according to the thin capitalisation rule can be reduced or eliminated if the corporation can demonstrate that similar funding could be obtained between non-related parties some reference is also given to the lender.

[35] Cf. s. 2A of the Corporate Tax Act.

[36] Cf. s. 2C of the Corporate Tax Act.

[37] As the limitation according to the thin capitalisation rule can be reduced or eliminated if the corporation can demonstrate that similar funding could be obtained between non-related parties some reference is also given to the lender.

[38] Cf. s. 2B of the Corporate Tax Act. The hybrid rule also applies to non-resident corporations' permanent establishments and real estate in Denmark.

2.3.3 Limitations based on other considerations

Cons.iderations should be given to the general classification of debt and equity, as a prerequisite for interest deduction is the existence of debt.

Danish tax law does not clearly define the terms debt and equity. Debt is generally defined as a creditor having a legal claim for the repayment of money. For tax law purposes debt is traditionally defined as (i) a legal obligation (ii) which is real and (iii) which obligates the borrower to repay the amount and (iv) an exchange of promises and payments between the parties.[39]

In general, the classification is closely related to the civil law classification. However, there are instances in which “a loan” may be classified as equity even though it does not meet the civil law requirements for being equity, e.g. if “a loan” is provided and it is clear from the start that the borrower will not be able to repay the loan. It is still not entirely clear whether perpetual and super-maturity loans - meeting the civil law classification as debt - is also classified as debt for tax law purposes.[40]

Further specific Danish hybrid rules may reclassify debt to equity and thereby interest to dividends as described above in section 2.3.2.

Part Three: Implementation of the proposals in the BEPS Action 4 report

3.1. General overview

Denmark participated in the work leading to the OECD BEPS Action 4 report, and it has been greatly anticipated how Denmark would implement the content of the OECD BEPS Action 4 report, as well as Directive 2016/1164 (ATAD). In 2017 the Danish Implementation Council, which advises the Danish government in ensuring that Danish corporations are not subject to stricter requirements than corporations in other EU countries, recommended that the three Danish interest limitation rules be simplified and harmonised with OECD BEPS Action 4 report/ATAD article 4.[41] Hence, the adjustments recommended were not to tighten the interest limitation rules - as the Danish interest limitation rules are already quite strict - but rather to simplify and align the Danish interest limitation rules to the international standards.

However, as described below Denmark did not follow the recommendation of the Implementation Council. Instead Denmark retain all three interest limitation rules and only align the earning-based limitation rule, i.e. the EBIT-based limitation rule, to match the OECD BEPS Action 4 report/ATAD article 4. Further the Danish hybrid rules on reclassification of corporate taxable entities to permanent establishments and on reclassification of debt to

39 See also *Jakob Bundgaard* in Derivatives & Financial Instruments, 2008 (Vol. 10), No. 4, Perpetual and Super-Maturity Debt Instruments in International Tax Law.

40 See also Cahiers de Droit Fiscal International, vol. 97b, 2012, The debt-equity conundrum, Denmark, pp. 231-251 and *Jakob Bundgaard* in Derivatives & Financial Instruments, 2008 (Vol. 10), No. 4, Perpetual and Super-Maturity Debt Instruments in International Tax Law.

41 See Anbefaling fra Implementeringsrådet: Bekæmpelse af metoder til skatteundgåelse, dated 14 March 2017.

equity will be abolished and be replaced by the hybrid rules contained in OECD BEPS Action 2 report/ATAD article 9.[42]

3.2. Implementation of the BEPS Action 4 report

The OECD BEPS Action 4 report's recommendation on best practice to prevent base erosion and profit shifting through interest expenses, is an earning based interest limitation rule. The recommended approach is to limit the deduction of interests and payments economically equivalent to interests, to between 10-30% of EBITDA (fixed ratio), but also to apply a group ratio-rule alongside the fixed ratio. The group ratio-rule will allow deductions up to net interest payments to third parties divided by EBITDA calculated on the basis of the worldwide group accounting figures. Further, a *de minimis* (group) threshold is recommended to carve out low risk entities/groups. Lastly, a carry-forward of disallowed interest expenses and conversely a carry-forward of unused interest capacity is recommended.[43]

The OECD BEPS Action 4 report also recommends supporting the EBITDA-rule by rules aiming to prevent circumvention, as well as to consider introducing rules to tackle specific base erosion and profit shifting risks not addressed in the OECD BEPS Action 4 report, for example rules on thin capitalisation.

The earning based approach is considered a straightforward approach which ensures that the net interest deductions are directly linked to the generation of taxable income by economic activities. However, the OECD BEPS Action 4 report also considers using asset values to measure economic activity. The main benefit would be that asset values are generally more stable than earnings which would improve certainty and create a steadier and more predictable level of interest limitation.[44]

The OECD BEPS Action 4 report emphasises that the key issue in applying an assets-based approach is not only to identify those assets which drive the creation of value, but also to achieve a consistent and acceptable model for valuing each asset. The use of market values could be impractical and involve an excessive compliance burden, while amortised historic cost valuation could give rise to inconsistencies and can be influenced by management decisions such as write downs. Historic cost is also unlikely to represent the actual value of the assets contribution to the economic activity, especially in relation to intangible assets in which case the largest revenue generating assets of some groups will potentially not be taken into account in an asset-based approach.[45]

As described above in section 2.1 and 2.3 Denmark applies three main interest limitation rules:
(i) a thin capitalisation rule
(ii) an asset-based limitation rule
(iii) an EBIT-based limitation rule
Following OECD BEPS Action 4 report/ATAD, Denmark will as, of 1 January 2019, apply three main interest limitation rules:
(i) a thin capitalisation rule

[42] See Bill no 1726 of 27 December 2018.
[43] See OECD BEPS Action 4 report, cha. 1.
[44] See OECD BEPS Action 4 report, para. 79.
[45] See OECD BEPS Action 4 report, para. 80.

(ii) an asset-based limitation rule
(iii) an EBITDA-based limitation rule
Denmark thereby retain the thin capitalisation rule as a targeted rule, but also the asset-based interest limitation rule as the general interest limitation rule without any material changes. It seems that the Danish legislator does not share the OECD BEPS Action 4 reports concerns in relation to inconsistencies or that some corporate group's most valuable assets may not be taken into account when applying the asset-based limitation rule, as the rule uses the historic, i.e. depreciated, value of the assets. The asset-based limitation rule is therefore probably still the strictest interest limitation rule in Denmark for large(r) Danish corporations.

However, following OECD BEPS Action 4 report and ATAD, Denmark has amended the EBIT-based limitation rule to comply with both OECD BEPS Action 4 report and ATAD article 4.[46] Hence income starting 1 January 2019 or later the taxable income before net financing expenses, taxes, depreciation and amortisation (EBITDA) can only be reduced by a maximum of 30 % by virtue of deducting net financing expenses, i.e. from an EBIT- (tax figure) to an EBITDA-rule (still tax figure). Further, the *de minimis* threshold was increased from DKK 21,300,000 to 22,313,400 DKK (approx. 3 million EUR). Moreover, the new EBITDA-based interest limitation rule does not apply to financial undertakings covered by ATAD article 2(5), which is in line with the OECD BEPS Action 4 report, unless the taxpayer elects the rule to apply for 10 years.

As a further amendment the definition of net financing expenses in the new EBITDA-based limitation rule deviates from the definition of net financing expenses in the asset-based limitation rule, as dividends, as well as capital gains and losses on shares, is no longer included in the definition of net financing expenses.[47] The rules will apparently apply different definitions of net financing expenses as net share income is not included in calculating the net financing expenses in the EBITDA-based limitation rule.

Net share income cannot accurately be seen as *payments equivalent to interest* but was originally included in the Danish definition of net financing expenses to reduce the net financing expenses in order to compensate for shares generating taxable income that are not included in calculating the asset-base in the asset-based interest limitation rule. As of 1 January 2019, such net share income is no longer included in the definition of net financing expenses in relation to the EBITDA-based limitation rule but will instead be included in the calculation of EBITDA. The amendment seems necessary to comply with ATAD article 4, as an inclusion of net share income in the net financing expenses may in some instances lead to a higher interest deduction than allowed under ATAD article 4.

Further a group ratio-rule is enacted in conjunction with the EBITDA-based rule, as the ratio of net interest to third parties divided by EBITDA of the worldwide group can replace the fixed 30% ratio in accordance with the OECD BEPS Action 4 report. Hence, corporations subject to Danish joint taxation, or which *could* be part of Danish international joint taxation, may instead of the 30% rate rely on its group's net third party net financing expenses/EBITDA ratio based on the groups consolidated financial statement.[48]

Lastly, the exceeding net financing expenses can still be carried forward unlimitedly, while following the implementation of ATAD article 4 also unused interest capacity (EBITDA) may be carried forward for up to five years.

[46] See Bill no 1726 of 27 December 2018.
[47] See Bill no. 1726 of 27 December 2018.
[48] See Bill no. 1726 of 27 December 2018.

3.3. No implementation of the BEPS Action 4 report

While Denmark was engaged in the work on OECD BEPS Action 4, the Danish legislator still does not seem to have converted to the idea of having an earning-based limitation rule as the main interest limitation rule. Instead the Danish legislator seems committed to the asset-based limitation rule despite the concerns raised in the OECD BEPS Action 4 report, paragraph 80, on measuring economic activity based on historic costs. In this regard, Denmark has not followed the OECD recommendations but apparently considers an earnings-based limitation rule a good supplement to the asset-based limitation rule.

However, as mentioned above in section 3.2., Denmark has implemented many of the recommendations into the current earning-based limitation rule, as part of the implementation of ATAD and thereby comply with the OECD BEPS Action 4 report.

The OECD BEPS Action 4 report recommends that, as a minimum, the earning-based limitation rule is applied to all entities that are part of a multinational group, but countries may also apply it more broadly to include stand-alone entities. The Danish earning-based interest limitation rule goes further than the minimum recommendation as the rule applies to all corporations, including standalone entities, even though the risk of BEPS seems significantly lower in relation to standalone entities than in relation to multinational groups.

The new Danish earning-based interest limitation rule includes the recommend group ratio-rule. The choice of applying the group ratio-rule also entails that Denmark do not apply an equity escape-rule (assets-based ratio), as also discussed in OECD BEPS Action 4 report, paragraph 118 and possible under ATAD article 4. ATAD article 4 enables a country to apply an equity escape-rule instead of the group ratio-rule. According to the equity escape-rule a corporation may fully deduct its financing expenses if the corporation can demonstrate that the ratio of equity over total assets is equal to or higher than the equivalent ratio of the overall group. However, Denmark did not choose to introduce an equity escape-rule.

Lastly, countries may choose to exclude interest expenses incurred on specific third-party loans related to certain public-benefit assets.[49] Denmark has not chosen to introduce such an exemption for public-benefit projects.

All in all, Denmark does follow most of the recommendations contained in the OECD BEPS Action 4 report, mainly through ATAD, but still chooses to apply an asset-based main limitation rule, while the earnings-based EBITDA-rule complements the asset-based limitation rule.

3.4. European Union implementation

On 28 January 2016, the European Commission presented the proposal for ATAD I, as part of the Anti-Tax Avoidance Package, and on 20 June 2016, the Directive was adopted. On 29 May 2017, ATAD II was formally adopted amending ATAD I in relation to hybrid mismatches with third countries. The purpose is first and foremost to fight tax avoidance and aggressive tax planning and also to avoid risks associated with unilateral and subsequent divergent implementation of BEPS measures by each member state, which could fragment the single market by creating national policy clashes, distortions and tax obstacles for businesses operating within the single market.

[49] See OECD BEPS Action 4 report, para. 64-71.

On 31 May 2018, a Danish draft proposal on implementing ATAD I & II into Danish tax law was submitted for a public hearing, but with only four weeks for the public to respond.[50] The public hearing ended 28 June 2018, and no actual bill was presented before parliament until 3 October 2018.[51] The bill 28 on the Danish implementation of ATAD I & II was then separated into two bills, respectively L 28A and L 28B. The bill be in effect as of 1 January 2019, with hybrid and exit tax-rules taking effect as of 1 January 2020, while CFC rules where separate into L 28 B and are still pending before the Danish Parliament. The Danish implementation is very similar to the wording of ATAD I & II and the details of the Danish implementation of the interest limitation rule(s) in ATAD article 4 are described above in section 3.2.

Lastly, it should be noted that part of the Danish thin capitalisation rule was found incompatible with articles 49 and 54 TFEU, as it only allowed a Danish resident company a tax exemption for interest paid by a Danish resident subsidiary, but not by a non-resident subsidiary, if the Danish subsidiary is not entitled to a tax deduction for the corresponding interest expenditure due to the Danish thin capitalisation rule. A new section 11(7) of the Corporate Tax Act was added to also allow for tax exemption for interest paid by a non-resident subsidiary insofar as the Danish subsidiary is not entitled to a tax deduction for the corresponding interest expenditure due to local thin capitalisation rules, as well as the Danish thin capitalisation rule (had it applied).[52]

The (in)compatibility of the consolidated approach in relation to both the asset-based limitation rule and the earnings-based limitation rule with articles 49 and 54 TFEU has been discussed - also in the light of the ECJ decisions in C-350/11 *Argenta Spaarbank* and recently in C-650/16 *Bevola* – but it has not resulted in any changes to the Danish legislation.

Part Four: Cross-border consequences

4.1. Domestic rules addressing foreign interest-limitation rules

Denmark has been quite active with respect to anti-tax avoidance rules to avoid double deductions (double dip) as well as deduction/no-inclusion situations.

This includes hybrid rules, as described above, but also double dip rules. Individuals and corporations resident in Denmark cannot deduct expenses in Denmark if the same expenses are also deductible according to foreign rules.[53] Further, losses in a Danish permanent establishment cannot be deducted if the losses can also be deducted in the foreign state, where the headquarter is resident.[54] Foreign interest-limitation rules can prevent double dip situations by causing the Danish double dip rules not to apply.

Further, a deduction/no inclusion can be avoided by denying a tax exemption for received dividends if the dividends can be deducted by the distributing entity.[55] A denial of deductibility according to foreign interest limitation rules can thereby ensure that dividends received in Denmark remain tax exempt.

50 See the draft proposal on Implementing the Anti-Tax Avoidance Directive, dated 28 May 2018 (J.nr. 2017-1461).
51 See Bill no. 28 2018-19.
52 Cf. s. 11(7) of the Corporate Tax Act.
53 Cf. s. 5G of the Tax Assessment Act.
54 Cf. s. 31 of the Corporate Tax Act. The rule was scrutinised by the ECJ in *NN* C-28/17.
55 Cf. s. 13 of the Corporate Tax Act.

Lastly, following the C-593/14 *Masco*-case Danish corporations and permanent establishments in Denmark are tax exempt on interest income and capital gains on loans if the deduction of the corresponding interest payment and/or capital losses has been denied according to the thin capitalisation rule in another EU/EEA country; up to what would have been denied according to the Danish thin capitalisation rule had the borrower been a resident in Denmark.[56] The tax exemption provided in the Danish thin capitalisation rule is herewith directly affected by foreign thin capitalisation rules.

4.2. Mutual agreement and other mechanisms for avoiding double taxation

4.2.1. Before the BEPS Action 4 report

Firstly, proactive steps can be taken in order to avoid double taxation by requesting, via the Danish tax authorities, a binding ruling on the Danish tax consequences of a considered transaction or a transaction which has already been carried out.[57] It is also possible for corporations to request for an advance pricing agreement (APA) which is a commonly used tool by a number of multinational companies.[58] Denmark has concluded bilateral APAs with several different foreign tax administrations such as the United States, China and Japan.

Secondly, retroactive steps can be taken in order to avoid double taxation by making an administrative appeal of a tax assessment. The taxpayer cannot appeal a tax assessment directly to the courts prior to an administrative appeal before the Tax Board or Tax Tribunal.[59] A court appeal must be filed within three months after the final administrative decision has been rendered. [60]

The most common retroactive relief mechanism in relation to avoiding double taxation, is the Mutual Agreement Procedure (MAP). All of Denmark's tax treaties - besides only two- include a MAP provision. Nearly all MAP requests made in Denmark have been resolved.[61] None of the Danish tax treaties in force include an active arbitration clause. However, the arbitration clauses in the tax treaties with Japan, Switzerland and Israel will be activated if Denmark concludes a similar (active) arbitration clause with another country. Denmark is also part of the EU Arbitration Convention (transfer pricing) and has implemented Directive 2017/1852/EU on tax dispute resolution mechanisms in the European Union.

4.2.2.. After the BEPS Action 4 report

Denmark was quite active in the BEPS project and in the development of the Multilateral Instrument (MLI). Despite the active participation, Denmark has initially made nearly every

56 Cf. s. 11(7) of the Corporate Tax Act.

57 Cf. s. 21 of the Tax Administration Act.

58 See Danish Branch report in Cahiers de Droit Fiscal International Vol. 101 A: *Dispute resolution procedures in international tax matters*.

59 Cf. s. 48 of the Tax Administration Act.

60 Cf. s. 48 of the Tax Administration Act.

61 See Danish Branch report in Cahiers de Droit Fiscal International Vol. 101 A: *Dispute resolution procedures in international tax matters*.

reservation possible to the MLI.[62] However, nearly all reservations seem lifted in the draft Bill submitted for public hearing 30. November 2018, but as of yet, no bill or final reservation has been presented before the Danish Parliament.

It should be noted that none of the above-mentioned dispute resolution mechanisms specifically address disputes relating to interest limitation rules, neither prior to nor after the OECD BEPS Action 4 report.

62 See http://www.oecd.org/tax/treaties/beps-mli-position-denmark.pdf


International Fiscal Association