Enhanced Efforts against Perceived No-Tax Corporations

The author considers a recently enacted Danish law that imposes restrictions on the tax loss carry-forward regime; a mandatory accountant’s certificate for certain companies; penalties for insufficient transfer pricing documentation; joint and several liabilities for certain corporate income taxes and withholding taxes; transparency as regards corporate tax payments; and amendments to domestic principles for the allocation of income to a permanent establishment.

1. Introduction

On 25 April 2012, the Minister of Taxation presented bill 173 2011/2012 (bill 173).1 Enhanced Efforts Against No-Tax Corporations, Allocation of Income to a Permanent Establishment and Transparency on Corporate Tax Payments, etc.2 The bill was passed on 13 June as Law 591 of 18 June 2012. It amends various Danish tax laws, and is part of an ongoing story in Danish politics. For several years now, corporate tax payment – and especially the lack thereof – has been a hot topic in Danish politics and among the media. As a result, the Danish tax authorities (SKAT) were allocated additional funding specifically aimed at upgrading the Transfer Pricing Unit in both 2011 and 2012.3 The upgrade seems to be working, as the Danish tax authorities in 2011 had a record high number of 47 upward adjustments (2008: 27; 2009: 32; 2010: 40).4 However, even though high in numbers, the total adjusted income was only DKK 6.2 billion, which is the lowest in four years (2008: 8.7 billion; 2009: 15.3 billion; 2010: 6.3 billion). Furthermore, the Danish tax authorities also accepted the highest total downward adjustments in four years, DKK 781 million (2008: 158 million; 2009: 145 million; 2010: 547 million).4

Bill 173 had been anticipated (with some concern by the business community and tax advisors) ever since the centre-left government took office in 2011. Shortly after, the Ministry of Taxation issued a statement announcing that it would present a bill aimed at increasing corporate tax payments – especially from multinational enterprises (MNEs). The Minister of Taxation explained that the reason for the new legislative remedies was the fact that even through the years before the financial crisis, companies realized new deficits every year. Furthermore, in any given year, 40–50% of all Danish companies do not pay taxes.5

The overall framework of the bill seemed clear: “The primary objective is to ensure a robust basis for the taxation of companies and must be viewed in conjunction with the desire of the government and its supporting party that businesses – and especially MNEs – must contribute more to the public finances”. In addition, it is stated that “the bill has as its purpose to motivate companies to contribute to the public finances”.6

As part of the legislative process the bill was sent out to public hearing, where it fell subject to scathing criticism from the business community at large and various interest groups.7 In general, the bill was said to present a serious deterioration of the legal framework for doing business in Denmark, to be highly dubious from a legal rights perspective, and to generally impugn MNEs doing business in Denmark. As one commentator put it, “the amendments are characterized by negativity towards companies and riddled with mistrust towards taxpayers”.8

Despite this harsh criticism, the centre-left government along with its supporting party made only a few amendments to the final bill.

2. Scope of the Bill

Bill 173 concerns a wide range of topics. Those drawing the most attention include the following:
- restrictions on the tax loss carry-forward regime;
- mandatory accountant’s certificate for certain companies;
- penalties for insufficient transfer pricing documentation;
- joint and several liabilities for corporate income taxes/withholding taxes for corporations that are part of a group taxation scheme;
- transparency as regards corporate tax payments; and
- amendments to domestic principles for the allocation of income to a permanent establishment.

6. Explanatory note 2 to bill 173 2011/2012 (all translations are the author’s).
7. E.g. the Association of Danish Law Firms (Danske Advokater), the Association of Danish Tax Law Firms (Dansmarks Skatteadvokater) and the Association of State Authorized Public Accountants (FSR – Danske Revisorer).
3. Amendments to the Tax Loss Carry-Forward Regime

The passage of bill 173 amends the tax loss carry-forward regime in several ways.

First, as a pure formality, the tax loss carry-forward regime was moved from its position in section 15 of the Tax Assessment Act (Ligningsloven) to the Corporate Tax Act (Selskabsskatte- Loven). The tax loss carry-forward regime had originally been placed in the Tax Assessment Act because it was applicable to natural persons and legal persons alike. For several years, however, the provision had de facto been applicable only to legal persons, which is the reason for the formal repositioning.

The passage of bill 173 also imposed amendments to the general tax loss carry-forward regime. Under Danish tax law (since 2002), tax losses may be carried forward indefinitely. This still applies, but with the passage of the bill, effective for fiscal years beginning on or after 1 July 2012, tax loss carry-forwards may reduce taxable income in excess of DKK 7.5 million (approximately EUR 1 million) only by up to 60%. A similar restriction exists under German tax law.

A more specific restriction on the tax loss carry-forward regime is also imposed by the bill. Danish tax law provides for a mandatory ring-fenced group taxation regime for resident companies, and an optional international group taxation regime. If two companies participate in a tax-exempt merger, both companies lose their tax loss carry-forwards, unless both companies belong to the same group taxation scheme and losses were incurred while belonging to said scheme. In that case, the continuing company may continue to utilize tax loss carry-forwards from both companies. However, following the passage of bill 173, a new restriction applies. If the continuing company as a result of the merger is the recipient of assets transferred, directly or indirectly, from a company which has never been part of the same group taxation scheme, the continuing company loses its tax loss carry-forward.

Consider the following example: A Co, B Co and C Co belong to the same group taxation scheme, and have done so for three years. B Co and C Co have tax loss carry-forwards incurred during those years. In the fourth year, A Co merges with the non-group company X Co, with A Co as the continuing company. If A Co subsequently were to merge with C Co (with C Co as the continuing company), C Co would not lose its tax loss carry-forward under the old regime; however this will be the consequence under the new regime. This is because C Co, as a result of the merger with A Co, indirectly is the recipient of a transfer of assets and liabilities stemming from X Co.

Another specific tax loss carry-forward restriction resulting from the passage of the bill also concerns the inter-


play between the group taxation regime, tax-exempt mergers and tax loss carry-forwards. For years, the Danish tax authorities applied the so-called “unity principle” when companies within the same group taxation scheme merged. Consider the following example: A Co is the parent company of B Co, and X Co is the parent company of Y Co. A Co has a tax loss carry-forward of DKK 10 million, while B Co has a tax loss carry-forward of DKK 12 million. A Co and X Co merge, with A Co as the continuing company. Post-merger, B Co may – due to the group taxation scheme – continue to utilize A Co’s tax loss carry-forward, despite that loss being off-limits for A Co itself post-merger. Due to the application of the unity principle by the Danish tax authorities, A Co would be barred from utilizing not only its own tax loss carry-forward, but also the DKK 12 million tax loss carry-forward from B Co post-merger.

The legal basis of the unity principle, which was derived from the Danish tax authorities’ interpretation of section 8(6) of the Merger Tax Act (Fusionsskatteloven), was rendered uncertain due to two decisions from the National Tax Tribunal (Landsskatteretten). As a result, the unity principle is now explicitly set forth in section 8(6) of the Merger Tax Act and section 31(4) of the Corporate Tax Act.

4. Accountant’s Certificate

Section 3B of the Tax Control Act (Skattekontrollloven) specifies the Danish transfer pricing compliance requirements. As such, the provision lists which companies are subject to preparing transfer pricing documentation. With the passage of bill 173, effective from 1 January 2012, the Danish tax authorities may now order a company to have an accountant certify whether facts and circumstances concerning the transfer pricing documentation give rise to the conclusion that the transfer pricing documentation:

- does not reflect the arm’s length principle.

It is a prerequisite for the Danish tax authorities that an accountant’s certificate may be issued only if the taxpayer:

- has engaged in controlled transactions with either a non-EU/EEA legal or natural person resident in a state that does not have a tax treaty with Denmark; or
- had negative earnings before interest and taxes (EBIT) in each of the last four income years.

Even if these conditions are met, the tax authorities may order an accountant’s certificate only if this is an “appropriate and relevant” measure. Due to this criterion, the tax authorities may not issue an order for an accountant’s certificate if the company’s transfer pricing documentation is obviously inadequate. In such a case, the tax authorities are entitled to estimate the income of the taxpayer. An order may be issued only if the taxpayer has indeed submitted
the required transfer pricing documentation to the Danish tax authorities.

The accountant’s certificate must be submitted to the tax authorities within 90 days from the date of the order. In failing to comply, the taxpayer risks penalties as well as an income adjustment.

The accountant’s certificate must not be drawn up by the same accountant that audited the company’s annual report.

If an accountant certifies that the transfer pricing documentation does indeed present a true and fair view of the taxpayer’s business transactions and/or that the taxpayer has respected the arm’s length principle etc., this conclusion is in no way binding on the tax authorities. Even so, the order for an accountant’s certificate cannot in itself be appealed within the administrative complaint system, unless the tax authorities chose not to go through with an income adjustment. If the tax authorities indeed decide to impose an income adjustment, the order may be appealed along with the complaint regarding the adjustment within the administrative complaint system. The reason behind this somewhat peculiar rule is that the tax authorities must be able to decide fairly quickly if the submitted transfer pricing documentation gives rise to an upward adjustment. While it is self-evident that complaints prolong the process, cutting off a company’s right to appeal seems to be a serious deterioration of corporate legal rights.

5. Penalties for Insufficient Transfer Pricing Documentation

Under section 3B(6) of the Tax Control Act, only taxpayers with more than 250 employees and either a balance sheet of more than DKK 125 million or a turnover of more than DKK 250 million are required to prepare transfer pricing documentation. Taxpayers must indicate on their income tax return if these thresholds are met. If the taxpayer subsequently agrees to prepare transfer pricing documentation, the fine is reduced to DKK 250,000. If the taxpayer employs up to 50 people. An additional DKK 250,000 is added for each additional 50 employees. Fines calculated on the basis of the number of employees are capped at DKK 2 million.

If the taxpayer has wrongfully declared that it is below the thresholds for several income years, the fines are calculated for each individual year and will be further increased by 50%.

Failure to prepare mandatory transfer pricing documentation is a criminal offence in itself. So far, the penalty has been twice the costs saved by the taxpayer by not preparing the required documentation. As it has proven to be difficult to calculate a fine based on a hypothetical cost for the taxpayer, the fine will now be a fixed amount of DKK 250,000. If the taxpayer subsequently agrees to prepare transfer pricing documentation, the fine is reduced to DKK 125,000. Failure to prepare transfer pricing documentation will often be accompanied by an upward adjustment. As a result of the passage of bill 173, taxpayers now also face an additional fine amounting to 10% of the adjustment.

6. Liability To Pay Taxes

As mentioned, Danish tax law provides for a mandatory group taxation scheme applicable to all resident companies and Danish permanent establishments of foreign resident companies, and an optional international group taxation scheme.

The group taxation scheme is – as the name implies – applicable to all companies in the same ‘group’, with control being the decisive criterion. The scheme ensures that the group is de facto taxed on its group income regardless of the individual income of each separate company. Also, cash, assets etc. may be transferred both vertically and horizontally within a group without any tax consequences for the receiving company, provided that the contributing company is not allowed a corresponding deduction. Even though the group taxation scheme ensures that the group is de facto taxed as one, each participating group company is liable to pay its own share of the total taxes of the group.

With the passage of bill 173, liability to pay taxes is now joint and several for companies in the group. The joint and several liabilities cover not only corporate income taxes, but also withholding taxes on dividends, interest and royalties. However, as the decisive criterion under Danish tax law for being part of a group taxation scheme is control, the joint and several liabilities pose a problem for companies with minority shareholders. Consider the following example:

A Co, B Co and C Co all belong to the same group taxation scheme. A Co owns B Co 100% and C Co 51%. The remaining part of C Co

14. Explanatory note 3.2.2.9.2 to L 173 2011/2012.
15. J.A. Howes, supra n. 8, at 3256.
16. These thresholds are calculated on a consolidated basis.
18. Sec. 17(3) Tax Control Act.
is owned by minority shareholders. If B Co fails to pay its taxes, A Co and C Co are liable to pay on B Co’s behalf. As such, C Co would also be held liable even though 49% of its shares are held by taxpayers who are not part of the group taxation scheme and thus have no influence or insight as regards either A Co or B Co.

During the reading of the bill, the issue of joint and several liabilities was highly criticized. As a result, the final bill was amended. Although companies which have minority shareholders are still held jointly and severally liable along with the other group companies, such companies are liable only for a percentage of debt of the other companies corresponding to the majority shareholder’s stake in the company that has minority shareholders. Revisiting the example above, C Co would be held liable only for 51% of B Co’s debt, i.e. corresponding to A Co’s stake in C Co. Companies with minority shareholders will also be held liable only after the debt has unsuccessfully been claimed at other companies in the group without minority shareholders.

When a company leaves a group, that company is no longer held jointly and severally liable for the taxes of other group companies. However, the remaining companies in the group continue to be held jointly and severally liable for any unpaid taxes of the company leaving the group if the taxes concern a period when the exiting company did indeed belong to said group.

7. Transparency as Regards Corporate Tax Payments

Under Danish tax law, the tax authorities are under a strict obligation to observe secrecy concerning any matter regarding taxpayers. However, with the passage of bill 173, certain information is no longer subject to this secrecy. In an effort to further transparency as regards corporate tax payments, the tax authorities may now publish information concerning:
- taxable income;
- utilized tax loss carry-forwards;
- tax payments; and
- under which section of the Corporate Tax Act the company in question is taxed.

All companies that are liable to file a Danish income tax return, risk having information regarding their tax matters published, namely resident companies; foreign companies with a permanent establishment in Denmark; and foreign companies that own real estate in Denmark. For groups of companies under the group taxation regime, the published information will concern the group, not the individual companies of the group. Information will be published on the website of the Danish tax authorities. Only information concerning 2011 or later income years will be made public.

The reason why the tax authorities are given this legal remedy, enabling them to publish information about companies’ tax matters, is clearly that it is anticipated to have a “positive effect on corporate tax payments.” Even so, the Ministry of Taxation stated in an answer to the parliamentary Tax Committee that the amendment was not intended to directly increase tax revenue, and that the Ministry was not aware of any such increase in other countries that had implemented similar rules.

The amendment has been highly criticized, both during the reading of the bill and after it was passed. First, it seems that the amendment’s first purpose is to serve as a pillory, publicly proclaiming companies that do not (in the eyes of the tax authorities) contribute sufficiently to the public finances. The risk of being put on public display should serve as a deterrent, thereby forcing companies to be less aggressive in their tax planning or perhaps even pay more taxes than they should under the law.

Second, it is a cause for concern that the decision to publish information is left entirely to the discretion of the tax authorities. One commentator even fears that the delicate issue of having information about a company’s tax matters published could be brought up by the tax authorities during transfer pricing negotiations with a company. As such, there is clearly a need to have the tax authorities declare in advance what criteria will be decisive in determining which companies are to have their tax conditions published.

8. Allocation of Income to a Permanent Establishment

Foreign enterprises are taxed on Danish business income only if the enterprise has a permanent establishment in Denmark under Danish domestic tax law. Danish tax law does not contain a statutory permanent establishment definition. Even so, the domestic law concept of permanent establishment is defined in accordance with article 5 of the OECD Model (2010). This is due to the fact that both administrative guidelines and case law – including jurisprudence from the Danish Supreme Court – have provided that the domestic concept of permanent establishment is to be interpreted in accordance with article 5 of the OECD Model.

The principles for allocation of income to a Danish permanent establishment of a foreign enterprise (and the allocation of income to a Danish enterprise’s permanent establishment abroad) have, under domestic tax law, been in

22. The reason for this is that under Danish tax law, different types of resident companies are taxed under different rules. A cooperative society, for example, has its taxable income calculated as a percentage of its capital, while a limited liability company is taxed on its net income.
23. See www.skat.dk.
accordance with article 7 of the OECD Model.\textsuperscript{32} Similarly, it has been Danish tax treaty policy to comply with article 7 of the OECD Model in Danish tax treaties.

However, resulting from the amendment to the Commentary to the OECD Model in 2008 and the amendment to article 7 itself in 2010, the principles for allocating income to a permanent establishment under Danish tax law are no longer aligned with the principles set out in article 7 of the OECD Model. In the explanatory notes accompanying bill 173, the consequences of the different allocation principles are elaborated upon.\textsuperscript{33} A mentioned example of these differences is administrative work carried out by a head office on behalf of a permanent establishment, e.g. day-to-day management. As article 7(3) was applied prior to the 2010 amendment, the permanent establishment was allowed a deduction corresponding to the head office’s actual administration costs regarding the permanent establishment. After 2010, according to article 7(2) of the OECD Model, the cost of administration must be determined in line with the arm’s length principle, and the permanent establishment is allowed a corresponding deduction. Another example mentioned in the explanatory notes to bill 173 concerns lending between a head office and a permanent establishment. As a head office and its permanent establishment are essentially one and the same legal person, a permanent establishment is not allowed a deduction for interest paid to its head office.\textsuperscript{34} However, following the new article 7(2) of the OECD Model, if the head office performs so-called treasury functions, interest paid from a permanent establishment to its head office is now deductible.

The described differences in the principles laid out in article 7 of the former OECD Model (2008) compared to the principles in article 7 of the current OECD Model (2010), have made it necessary to alter the principles for allocating income to a permanent establishment under Danish law. As such, the principles for the allocation of income to a permanent establishment under Danish law now explicitly reflect the principles laid out in article 7(2) of the OECD Model.\textsuperscript{35} If, however, the principles laid out in an applicable tax treaty differ from the principles of article 7 of the current OECD Model, the allocation of income must be effected according to the principles of the applicable treaty. To date, no Danish tax treaties have been concluded which adhere to the principles laid out in article 7 of the 2010 OECD Model, thus making the amendments to domestic principles for the allocation of income to a permanent establishment de facto applicable only to non-tax treaty countries.

---


34. This was established in the judgment of the Supreme Court, supra n. 32, and was confirmed in administrative case law from the Danish Tax Board (SKM2007.237 SR) stating: “It is not possible to have a claim against oneself, i.e. ‘oneself’ being a head office having a claim against its permanent establishment.”

35. Secs. 2(2) and 8(6) Corporate Tax Act; secs. 2(3) and 25 Source Tax Act. Effective from 1 January 2009, Denmark terminated its tax treaties with both France and Spain,\textsuperscript{36} so that the new allocation rules as from 2013 apply to permanent establishments of enterprises resident in either of those countries (and Danish resident taxpayers’ permanent establishments in France or Spain).\textsuperscript{37} As both Spain and France are members of the European Union, an interesting question was raised by the Danish Association of State Authorized Public Accountants (FSR – Danske Revisorer) during the reading of the bill. This organization stated that it believes that the principles for allocation of income to a permanent establishment under article 4(2) of the Arbitration Convention\textsuperscript{38} were similar to those found in article 7 of the 2008 OECD Model.\textsuperscript{39} As such, the principles for income allocation to permanent establishments under domestic law – as they would now adhere to the principles of article 7 of the 2010 OECD Model – would differ from the principles found in article 4(2) of the Arbitration Convention. This discrepancy in principles would then in turn cause problems when applied to Danish permanent establishments of either Spanish or French resident enterprises. The Ministry of Taxation replied that because article 4(2) of the Arbitration Convention does not contain a provision corresponding to article 7(3) of the 2008 OECD Model, the Ministry of Taxation does not share the view of the Danish Association of State Authorized Public Accountants. The Association then asked the Ministry of Taxation to elaborate on its notion, especially as prior legislative history\textsuperscript{40} as well as legal theory\textsuperscript{41} would agree that the principles found in article 4(2) of the Arbitration Convention did indeed correspond to those found in article 7(2) of the 2008 OECD Model (and earlier versions of the model). The Ministry of Taxation replied in turn, that it had not stated that article 4(2) of the Arbitration Convention did not correspond to article 7(2) of the 2008 OECD Model, but had only wished to stress that article 4(2) of the Arbitration Convention lacked an article corresponding to article 7(3) of the 2008 OECD Model.\textsuperscript{42} True as this may be, the Ministry of Taxation seemingly overlooked the fact that article 7(3) of the 2008 OECD Model was only intended to clarify the interpretation of article 7(2),\textsuperscript{43} thus leaving the legal position of the Ministry of Taxation in the matter uncertain.

---

36. See SKM2008.530 SKAT.
37. Readers should bear in mind, that Danish companies taxed under the Danish Corporate Tax Act are not taxed on profits that can be attributed to a foreign permanent establishment; see section 8(2) of the Danish Corporate Tax Act.
39. See comments gathered from the public hearing process from the Danish Association of State Authorized Public Accountants (FSR – Danske Revisorer), Annex 1 to bill no. 173 2011/2012.
40. See explanatory notes to bill no. 21 of 3 October 1991.
42. See Annex 23 to bill no. 173 2011/2012.
43. See the 2008 OECD Model Tax Convention on Income and on Capital: Commentary on Article 7[3], para. 27.
9. Conclusion

Bill 173 was passed in order to motivate companies to contribute at a higher level to the public finances. Seemingly, the Danish government thinks the stick is a far better motivator than the carrot: increased compliance burdens, restricted access to tax loss carry-forwards, higher penalties and even the risk of being put out on public display are the order of the day. Warnings from various interest groups as regards the deterioration of the legal framework for doing business in Denmark, as well as the legal rights of taxpayers, had no impact on the final determination of the government, and the results of the passage of the bill is likely to cause headaches for tax advisors trying to ascertain what’s what.

The amendment to the principles for allocating income to a permanent establishment under domestic tax law seems essentially rational, and the way the principles in a tax treaty are given primacy ensures an effective interplay between domestic law and the tax treaties already in place based on article 7 of OECD Models prior to the 2010 amendments. The potential clash between the allocation principles found in article 4(2) of the Arbitration Convention and the principles found in article 7(2) of the OECD Model is an interesting issue to follow. This is especially so because such a clash could come about as a result of Denmark’s termination of its tax treaties with France and Spain in 2009.

The Dutch Approach
Third Revised Edition

An up-to-date description of the Dutch Tax and Customs Administration (DTCA), including its scope of social impact and the external factors influencing its strategy.

The revised book gives a detailed description of the DTCA. It outlines the organization’s transformation in the late 1980s, the further reforms around the turn of the century and the recent adjustments to these innovations, and describes in depth the structure and function of today’s modern organization. The essential role of the business, management, and compliance philosophy in the DTCA is discussed in detail, including its innovative supervision strategy. Finally, the transformation processes to improve the performance of the information supply chain and the programme of the DTCA to increase its service and efficiency, in particular by using the opportunities of e-government, are presented.

Authors: Victor van Kommer and Matthijs Alink
Published: April 2012
Pages: 288
Format: Paperback
Price: € 60 | $ 75

For further information or to order, visit www.ibfd.org or contact Customer Service via info@ibfd.org or +31-20-554 0176.