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Global Tax Alert

Denmark publishes bill on international taxation

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Executive summary

On 6 November 2019, the Danish Minister of Taxation published bill no. L 48 on international taxation. The bill is expected to be enacted before the end of 2019.

The main rules addressed by the draft bill are:

- Controlled foreign company (CFC) taxation
- Transfer pricing documentation
- Permanent establishment
- Deduction for final losses in foreign entities

Detailed summary

CFC taxation

The bill intends to implement the CFC rules of the European Union's (EU's) Anti-Tax Avoidance directive (Council directives (EU) 2016/1164 and (EU) 2017/952) (the ATAD) into Danish law.

The ATAD provides Member States with two options for CFC taxation:

- Model A: CFC taxation of non-distributed financial income

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- Model B: CFC taxation of non-distributed income resulting from non-genuine arrangements put in place for the essential purpose of obtaining a tax advantage

Existing Danish CFC taxation is based on model A although the entire income of the CFC is subject to taxation. CFC taxation requires that more than 50% of the income is of a financial nature and that more than 10% of the assets are of a financial nature. The existing rule is applicable irrespective of the level of taxation for the CFC.

The proposal retains model A. The following main changes are proposed:

- The asset test is abolished.
- The income test is lowered from 50% to 33.3%.
- The concept of financial income is expanded to cover "other income generated from intellectual property (IP)." According to the proposal, this rule may capture profits from the sale of goods and services that are based on IP. In this context, goodwill is not treated as IP. However, royalties and other income from developed intangibles are exempt, provided that the subsidiary has developed or acquired the IP locally, or the IP has been developed by a third party in another country. Moreover, IP owned by a subsidiary at the time it is acquired by the Danish parent company from a third party would also not qualify as CFC income. However, this will require that the value of IP and other assets generating CFC income did not exceed 50% of the total value of the subsidiary at the time of the acquisition. In order to carry out the income test it will thus be necessary to divide the income of a CFC into the following categories: "ordinary income," "goodwill income," "royalties and other income from intangibles developed or acquired locally or acquired from a third party in another country," "royalties and other income from intangibles owned by a subsidiary at the time of acquisition by the Danish parent company" and "other income generated from IP." Consequently, this process will be complicated and burdensome for taxpayers. A grandfathering rule provides that if a number of requirements are satisfied, a parent company will obtain an entry value for intangibles owned by an existing CFC equal to fair market value at the beginning of the income year beginning 1 January 2020 or thereafter.
- A Danish parent company may elect only to include the CFC income of a subsidiary rather than the entire income of the subsidiary. Such an election will be binding for five years.

The proposal does not call for the introduction of the exception outlined in the ATAD under which no CFC taxation should occur where the CFC carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances.

The new rules would be applicable for income years starting 1 January 2020 and thereafter.

Transfer pricing

The bill will significantly strengthen the Danish transfer pricing rules as follows:

- The transfer pricing (TP) documentation must be submitted to the tax authorities no later than 60 days after the deadline for the filing of the annual corporate income tax return (generally due six months after year end). This will include both the master file and country specific file(s).
- The tax authorities are entitled to extend the 60-day deadline in extraordinary circumstances.
- TP penalties may be imposed if the TP documentation is not submitted within the 60-day deadline.
- Daily penalties may be imposed if the TP documentation is not submitted within the 60-day deadline.
- Penalties may also be imposed if the tax return reporting obligation regarding transfer pricing is not satisfied.
- The tax authorities will be entitled to assess a taxpayer on an estimated basis for TP purposes if the TP documentation is not contemporaneous and is not submitted within the 60-day deadline, i.e., the burden of proof is reversed.

The new rules would be applicable for income years starting 1 January 2020 and thereafter.

Permanent establishment

The permanent establishment (PE) concept under domestic Danish law is linked to the definition thereof in Article 5 of the Organisation for Economic Co-operation and Development (OECD) Model Income Tax Convention as set forth before the 2017 update. In 2017, the PE definition in Article 5 was amended to accommodate the recommendation of the Base Erosion and Profit Shifting (BEPS) work. Most of the Danish tax treaties will also be amended as Denmark has signed the OECD's Multilateral Convention. On this basis, Denmark's taxing rights under its tax treaties will be expanded compared to its taxing rights under domestic law. For this reason, it is proposed that the domestic PE definition be amended in order to align with the new definition in Article 5. However, two Danish special rules will be upheld: (1) a building site or construction or installation project work constitutes a PE from the first day, and (2) investments in shares, receivables and financial instruments only give rise to a PE if the activity amounts to a trading activity.

Deduction for final losses in foreign entities

Danish companies are taxed on a territorial basis meaning that income or loss from foreign subsidiaries, PEs and real estate is not included in taxable income.

The Court of Justice of the European Union (CJEU) on 12 June 2018 (case C-650/16, *Bevola*) held that Danish law was incompatible with EU law because a Danish company could not claim a tax deduction for a final loss in a foreign PE.

For this reason, it is proposed that a Danish company will be entitled to claim a tax deduction for a final loss suffered by a foreign subsidiary, PE or real estate subject to a number of conditions. Among other things, the following conditions must be satisfied in order for a loss to be "final":

- That it is not possible to utilize the loss under local tax rules in previous years, the loss year or future years and that the loss has actually not been utilized.
- That it is not possible to utilize the loss in other countries.
- That the loss could not be utilized in previous years, the loss year or future year if the local tax rules had been identical with the Danish rules.

The rule would be applicable for income year 2019 and onwards. The tax authorities are expected to publish a decision that will entitle taxpayers to open past years tax returns to claim a tax deduction for final losses suffered in previous years.

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