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**Tax Treaties and Tax Avoidance:
Application of Anti-Avoidance
Provisions**

by

Jakob Bundgaard¹ & Peter Koerver Schmidt²

Summary and Conclusions

Under Danish tax law no statutory general anti-avoidance provision exists. However, pursuant to the doctrine of “substance over form”, fictitious or artificial transactions may be set aside for tax purposes if the actual substance of the transaction evidently conflicts with its private law form, resulting in a tax advantage. Further, no general anti-avoidance provision with international focus or effect exists in Danish tax law, which is probably the reason why Danish tax law encompasses a relatively high number of specific anti-avoidance provisions of an international nature, such as rules on transfer pricing, CFC and investment companies, captives, thin capitalization and limitation of interest deductions, exit taxation, hybrid entities and hybrid financial instruments, application of a “net principle” concerning double taxation relief and anti-double dip.

¹ Associate Professor, PhD, Copenhagen Business School, Copenhagen Research Group on International Taxation (CORIT) and partner in Deloitte.

² Tax manager in Deloitte and associated researcher at CORIT.

In general there has been very little academic discussion and case law regarding the tax treaty aspects of the vast number of anti-avoidance provisions in Danish tax law. Some of the most controversial issues regarding the relationship between specific anti-avoidance provisions in Danish tax law and tax treaties are, however, exit taxation, CFC legislation and thin capitalization rules.

It is subject to discussion whether it is possible – independently of domestic law – to integrate an interpretation of a general anti-abuse reservation in a tax treaty. However, in this regard there are no examples in Danish legal or administrative practice of a tax treaty being interpreted independently of the Danish tax law assessment to imply non-application of the treaty due to abuse. Presumably, the Danish courts will effect this with reference to Danish tax law and not with reference to an ordinary anti-abuse principle at treaty level. Further, it can be questioned whether it is possible to apply domestic anti-abuse rules, which imply that it is possible to deny treaty benefits in the source state.

Specific treaty provisions allowing application of domestic anti-avoidance provisions are not common in Denmark's treaties. Art. 45(2) in the treaty between Denmark and Germany is, however, an exception. In general Danish tax treaties do not include general anti-avoidance provisions, even though a number of tax treaties include different forms of such provisions, e.g. LOB-clauses and subject-to-tax-clauses. On the other hand, most of Denmark's tax treaties contain specific beneficial ownership clauses in arts. 10-12 regarding dividends, interest and royalties. In recent times, the Danish Minister of Taxation has attempted to broaden the meaning of the beneficial owner line of thought by using the notion conduit company as a term for a company that is not to be granted treaty relief for interest, dividends, etc. at any time. This line of interpretation has been followed by the tax authorities, and a large number of cases regarding this subject are pending. It is concluded that it must be expected that the courts will not attach great importance to the Minister's comments when assessing whether a company should be considered the rightful recipient/beneficial owner.

The Danish legislator has reformed several tax law anti-abuse provisions in order to comply with EC law, including rules on thin capitalization, CFC taxation, exit taxation, investment companies and transfer pricing documentation. Irrespective of this development it can still be questioned whether elements of the amended rules are in breach of EC law. However, there has been only little case law dealing with the relationship between domestic anti-avoidance provisions and the four fundamental freedoms under the EU treaty.

Part One

Domestic anti-avoidance provisions with an international scope

1.1 General overview

No statutory general anti-avoidance provision exists under Danish tax law. However, pursuant to the doctrine of “substance over form”, fictitious or artificial transactions may be set aside for tax purposes if the actual substance of the transaction conflicts with its private law form, resulting in a tax advantage.³ In this case tax will be imposed in accordance with the actual substance of the transaction as it appears on an overall assessment. The applicability of the doctrine of “substance over form” is, however, limited and in order for the doctrine to apply, there must be an evident conflict between form and substance. As an example the *Newpond* decision, Danish Supreme Court, Case No. 933 H, Journal of Danish Tax Law (2005) could be mentioned. The case concerned a combined put and call option on shares where the price of the two options differed significantly. The Supreme Court stated that the shares were deemed to have been transferred for tax purposes at the time when the agreement was made, since the parties at that point in time were likely to have realized that the right to purchase the shares would be exercised by the purchaser as contemplated.

The Supreme Court has stated that the doctrine will not apply to transactions made in accordance with formal non-tax rules, for example company law rules. See to this effect the *Finwell* case, Danish Supreme Court, Case No. 1062, Journal of Danish Tax Law (2006). The case concerned a situation where the taxpayer intended to take advantage of the different tax treatment of capital gains (which would be tax exempt if a three year holding requirement was satisfied) and dividends (which would be tax exempt if a one year requirement was satisfied). The Supreme Court accepted that the interaction between different tax rules may result in tax advantages and that the rules should not be interpreted restrictively only because of these advantages⁴.

In addition to the substance over form doctrine, the doctrine of “rightful recipient of income” plays a significant role. The doctrine prescribes that the subject having the (legal) right to the basis of the income – e.g. a shareholding, a claim or a business activity – should also be considered the proper recipient for tax purposes of the gain/return on the shares/claim/activity.⁵ The doctrine – it is argued –

³ The principle was originally explained by *Pedersen* in *Skatteudnyttelse* (1989), p. 435 ff. See also *Pedersen* in *Cahier de Droit Fiscal International* (2002), Vol. LXXXVIIa, p. 233-247.

⁴ The decision has been commented by *Bundgaard & Møllin Ottosen* in *European Taxation* (February 2008), p. 59 ff., *Michelsen* in *Revision & Regnskabsvæsen* (2007) 1, p. SM 5, *Bjørn* in *SR-Skat* (2007) 1, p. 15 ff. and *Bundgaard & Møllin Ottosen* in *Revision & Regnskabsvæsen* (2007) 4, p. 32 ff.

⁵ See *Michelsen* et al. in *Lærebog om Indkomstskat* (2007), vol. 12, p. 635 ff and *Dam* in *Rette indkomstmodtager: Allokering og fiksering* (2005).

can be deduced from Sec. 4 of the State Tax Act.⁶ The interaction between these doctrines is somewhat unclear, but for many practical purposes they are overlapping⁷.

1.2 General anti-avoidance provisions with international focus or effect

No general anti-avoidance provision with international focus or effect exists in Danish tax law.

1.3 Specific anti-avoidance provisions with international focus or effect

Perhaps due to the lack of a general anti-avoidance provision with international focus, Danish tax law encompasses a relatively high number of specific anti-avoidance provisions with an international scope. The extent of such specific anti-avoidance legislation has increased significantly during the last 10 years or so. The Danish legislative bodies have presented a rather broad perspective on tax avoidance including any transaction or unforeseen interplay between the tax laws of different countries which may lead to a favorable tax position of the businesses or individuals engaging in cross border activities. As a result a number of tax law provisions has been introduced with the aim of preventing tax abuse, tax planning and tax arbitrage. Tax arbitrage is considered abusive in the view of the Danish legislator.

Below the most significant anti-avoidance provisions with international focus are addressed.

Transfer pricing regime

Since 1960 Denmark has had a specific transfer pricing provision. However, this has only been an effective transfer pricing provision following a reform in 1998; cf. Sec 2 of the Tax Assessment Act.⁸ This provision sets forth the arm's length principle, which should be interpreted in line with the OECD Transfer pricing Guidelines. The provision applies in "controlled transactions"⁹.

CFC regime and investment companies

According to the Danish CFC regime, set out in Sec. 32 of the Corporation Tax Act, a company is liable to tax on the income of a Danish or foreign subsidiary or a foreign permanent establishment if:

⁶ In the tax law literature, a sometimes heated debate has taken place between proponents for the doctrine of "substance over form" and advocates of the "doctrine of the rightful recipient of the income". See *Pedersen* in *Journal of Danish Tax Law* (2001), no. 284 and *Michelsen et al.* in *Lærebog om Indkomstskat* (2007), vol. 12, p. 635 ff.

⁷ See to this effect *Bundgaard: Skatteret & civilret* (2006), p. 558 et seq.

⁸ Sec. 3 B of the Tax Control Act contains information and documentation requirements.

⁹ See *Wittendorff: Armslængdeprincippet i dansk og international skatteret* (2009) and *Bundgaard & Wittendorff: Armslængdeprincippet & Transfer pricing* (2001).

1) The subsidiary is controlled by the affiliated group of companies;¹⁰ 2) The income of the subsidiary or the permanent establishment is mainly of a financial nature; and 3) The financial assets of the subsidiary or permanent establishment exceed 10 per cent of total assets¹¹. Income is considered to be "mainly of a financial nature" if more than 50 per cent of the total taxable income consists of taxable net interest income, dividends, commissions, net capital gains on shares, royalties and capital gains with respect to intellectual property rights, or income from financial leasing or insurance activities. If the CFC rules apply, the parent company should include the total income of the subsidiary or permanent establishment in its own income. A tax credit is granted for taxes paid by the subsidiary or permanent establishment.

The CFC-rules also apply to individual shareholders controlling a foreign company; cf. Sec. 16 H of the Tax Assessment Act. However, the CFC rules only apply if the foreign income tax is less than ¾ of the Danish tax. In that case the CFC income should be included in the individual shareholder's income. Upon request to the tax authorities the individual can be exempted from CFC taxation if the company is resident in a state within the EU/EEA, provided that the taxpayer can document that the company is established in that state and is carrying out genuine economic activity regarding the CFC income.

According to Sec. 19 of the Act on Taxation of Capital Gains on Sale of Shares, the following entities should be treated as *investment companies*: 1) Investment institutes as defined in the UCITS Directive;¹² 2) companies whose business consists in investment in securities etc. and where shares in the company at the bearer's request must be bought back or redeemed by the company's funds; and 3) companies that invests in *securities*, if the company's business consists in *collective investment*.¹³ An investment company is not subject to taxation, since the taxation is instead levied directly on the shareholders, who will be taxed on gains and losses on the shares in the investment company according to a mark-to-market principle.¹⁴

¹⁰ A subsidiary or permanent establishment should be considered controlled if the parent company has *controlling influence* as defined in Sec 31C of the Corporation Tax Act, i.e. if the subsidiary or permanent establishment is subject to mandatory Danish tax consolidation or qualify for voluntary Danish international tax consolidation. Shares held by connected persons or by entities with which the parent company has an agreement about joint exercise of control should be included when measuring *controlling influence*.

¹¹ See *Bundgaard in Pedersen et al.*: Skatteretten 3 (2009), p. 303 ff.

¹² Directive 85/611/EEC.

¹³ By *collective investment* is meant that the company has at least eight participants. A company should not be considered an investment company if more than 15 per cent of its assets based on accounting principles during the financial year on average is placed in other assets than securities etc. Further, an exemption applies to so-called *employee companies*.

¹⁴ See *Bundgaard & Koerver Schmidt* in Journal of Danish Tax Law (2009), no. 567, *Nørremark & Møllin Ottosen* in Revision & Regnskabsvæsen (2009), no. 4, p. 54 and *Bergenfelt* in SR-skat (2009), p.77.

Thin capitalization and general limitations on interest deductions

The deductibility of interest expense may in general be restricted under three sets of rules for corporate taxpayers: the thin capitalisation test, the asset test and the EBIT test¹⁵. According to the Sec. 11 of the Corporation Tax Act, a company is thinly capitalized if the debt-to-equity ratio exceeds 4:1,¹⁶ provided that the *controlled debt* exceeds DKK 10 million.¹⁷ If a company is considered thinly capitalized, interest expenses and capital losses, on the part of the controlled debt that should have been converted to equity to avoid the limitation, are not deductible. However, if the company is able to substantiate that similar financing could have been obtained without security from other group companies, the company will be allowed to deduct interest expenses even though the 4:1 ratio is exceeded. As a main rule, the debt and the equity should be considered on a consolidated basis for the Danish group companies.¹⁸

As a specific measure to combat private equity funds' leveraged buyouts, Denmark has introduced two additional tests regarding the deductibility of corporate interest deductions.

Under the asset test net financing expenses may be deducted only if the expenses do not exceed a standard rate of presently 6.5 per cent (2009) of the tax base of certain qualifying assets; cf. Sec. 11 B of the Corporation Tax Act. According to the EBIT test, net financing expenses may not exceed 80 per cent of earnings before interest and tax; cf. Sec. 11 C of the Corporation Tax Act. Both the asset test and the EBIT test only apply if net financing expenses exceed DKK 21.3 million (2009). The two limitations apply to all kinds of debt – not only controlled debt.¹⁹

¹⁵ See *Bundgaard*: Tynd kapitalisering – en skatteretlig fremstilling (2000) and *Bundgaard in Pedersen et al.*: Skatteretten 3 (2009), p. 331 ff.

¹⁶ *Debt* is defined as the aggregate of controlled debt and debt owed to third parties. *Equity* is defined as the market value of the assets less the market value of the debt.

¹⁷ By *controlled debt* is meant a loan issued by a company/shareholder who controls the debtor. The definition of *control* is laid down in Sec. 2 of the Tax Assessment Act. As a starting point, control prevails if more than 50 per cent of the share capital or more than 50 per cent of the voting power directly or indirectly is held. Debt owed to independent third parties is considered controlled debt if the debt is directly or indirectly secured or guaranteed by a controlling company or a company affiliated with the controlling company.

¹⁸ However, only Danish companies which, without including foreign shareholders or a Danish ultimate parent company, should be considered part of the group, according to the definition in Sec. 4 of the Gains and Losses on Debt Claims, Debts and Financial Instruments Act, should be part of the consolidation.

¹⁹ Companies which are subject to mandatory Danish tax consolidation or subject to voluntary Danish international tax consolidation should calculate the taxable income, qualifying assets and the net financing expenses on a consolidated basis.

Hybrid entities

In order to counter tax arbitrage, possible double non-taxation and asymmetrical taxation in general, Denmark has introduced rules on hybrid and reverse hybrid entities, which entails that the domestic tax treatment in some situations depends on the tax treatment in other jurisdictions. Accordingly, if a company or association should be treated as a transparent entity according to the tax rules of a foreign state, with the effect that the company's income should be included in the income of an affiliated company in this foreign state, the company should be reclassified as a transparent entity for Danish tax purposes; cf. Sec. 2A of the Corporation Tax Act.²⁰ Further, according to Sec. 2C of the Corporation Tax Act, certain tax transparent entities should be reclassified as separate taxable entities if more than 50 per cent of the shares or voting rights are held directly by foreign investors, and the tax domicile of such foreign investors is in a country in which the Danish entity is treated as a taxable entity or which does not exchange information with the Danish authorities under an applicable income tax treaty, international agreement or any agreement concluded departmentally for assistance in tax cases.²¹

Hybrid financial instruments

Moreover, cross border tax arbitrage by way of using hybrid financial instruments has been curbed inbound and outbound; cf. Sec. 2 B of the Corporation Tax Act and Sec. 13 of the Corporation Tax Act. If a company or association etc. is indebted or similarly obligated to an individual or company resident in another country and the claim according to foreign tax rules is considered paid in capital, the debt shall also be regarded as equity with respect to the Danish tax computation; cf. Sec. 2B in the Corporation Tax Act.²² The objective of section 2B is to abolish the potential asymmetrical tax treatment of certain hybrid financial instruments. Such an asymmetrical taxation arises by way of different tax classification of an instrument in the countries involved, including the classification for Danish tax purposes as debt resulting in interest deduction for Danish tax purposes while the instrument in the country of the investor is considered equity, which depending of the legislation in that state may be considered as tax-exempt dividends. To obtain this objective, section 2B of the CTA is based on a principle according to which Danish interest deduction requires that the corresponding income is not tax exempt for the recipient. Inspired by German commentary, this principle may be called the "principle of correspondence". As already stated supra, the application of this principle is far

²⁰ This paragraph only applies if the foreign affiliated company has decisive influence over the Danish company and the foreign company is resident in the EU/EEA or in a country which has concluded a DTT with Denmark. See *Wittendorff* in *Danish Journal of International Taxation* (2004), no. 204.

²¹ See *Møllin Ottosen & Nørremark* in *Bulletin for International Taxation* (2008), p. 513 et seq. and *Ellegaard & Bundgaard* in *Journal of Derivatives and Financial Instruments* (2008), p. 246 et seq.

²² This provision only applies if the foreign individual or company has decisive influence over the Danish company or the companies are considered to be in a group of companies; cf. the principles in Sec. 2 of the Tax Assessment Act. The classification means that interest payments and capital losses are considered to be dividend payments. The provision is similarly applicable to companies that have limited tax liability in Denmark. See *Bundgaard* in *Bulletin for International Taxation* (2008), p. 33 et seq.

from a novelty in Danish tax law. The underlying tax policy rationale has been widely criticized for the fact that Denmark hereby takes on a coordinating role between different countries regarding the classification of hybrid financial instruments, while a similar effort is not laid down in the case where double taxation occurs in cross-border transactions as a result of different classifications of the same financial instrument. The Minister of Taxation responded to this criticism by stating that it is inappropriate if an interest deduction is allowed in Denmark, while the recipient is not taxed of the "interest payment" because the payment is considered dividends according to foreign legislation.²³ Further, it was stated that such asymmetries may give rise to tax arbitrage and that international tax planning aimed at obtaining a "free deduction" is prevented by the reclassification according to section 2B of the Corporation Tax Act²⁴.

Sec. 13 of the Corporation Tax Act contains the general participation regime regarding inter-company dividends. The applicability of the participation exemption has been limited to situations where the foreign paying company is not allowed under the tax laws of the country of its residence to deduct the payments, which are considered dividends under Danish tax law. The only remaining exception to this is payment of dividends that are deductible but at the same time paid by companies resident within the European Union and subject to the benefits of the Parent-Subsidiary Directive (1990/435/EEC).

Exit taxation

If a resident company ceases to be fully liable to tax in Denmark, according to Sec. 1 of the Corporation Tax Act, or if a resident company becomes resident in another state according to a double taxation treaty, the company should be considered as having disposed all assets and liabilities that no longer are subject to Danish Taxation; cf. Sec. 5(7) of the Corporation Tax Act. The assets and liabilities should be considered as sold at fair market value at the time of emigration. Likewise, the transfer of assets and liabilities within a company, e.g. from a permanent establishment in Denmark to a foreign head quarter, with the result that the assets and liabilities are no longer subject to Danish taxation, is treated as a sale at fair market value at the time of the transfer; cf. Sec. 8(4) of the Corporation Tax Act.

Shares owned by individuals should be considered as sold at fair market value when the individual ceases to be subject to full taxation in Denmark or the individual becomes a tax resident of a foreign state according to the provisions of a double taxation treaty between Denmark and the state in question; cf. Sec. 38 of the Act on Taxation of Capital Gains on Sale of Shares.²⁵ The actual payment of the exit taxation can be deferred, but in that case adequate security must be given if the individual moves outside the EU or the Nordic Countries; cf. Sec. 39 in the Act on Taxation of Capital Gains on

²³ See enclosure 10 to Bill no. L 110 B.

²⁴ Id.

²⁵ Exit taxation is only triggered if the individual's shareholding at the time of emigration has a total market value of DKK 100,000 or more.

Sale of Shares.²⁶ The deferred amount becomes due for payment when the shares comprised in the portfolio are sold if dividends are received on the shares, if the shares are sold to the issuing company or if a loan is made, by a company whose shares are included in the share portfolio statement, to the individual or related parties; cf. Sec. 39a of the Act on Taxation of Capital Gains on Sale of Shares.

Exit taxation of individuals can also be triggered on gains and losses on 1) debt claims, debt and financial contracts,²⁷ 2) employee stock options and warrants,²⁸ 3) reversed depreciations,²⁹ 4) stock, inventory, operating equipment and intangible assets,³⁰ 5) some pension payments made prior to emigration,³¹ 6) saved up surplus under the Business Taxation Scheme.³²

Other anti-avoidance provisions

Companies that are subject to full tax liability; cf. Sec. 1(1) of the Corporation Tax Act, but are domiciled in another country according to the provisions in a double taxation treaty, can only deduct expenses which concern income that can be taxed in Denmark due to the double taxation treaty; cf. Sec. 9 of the Corporation Tax Act. Likewise, an individual – who should be considered domiciled in another country according to the provisions in a double taxation treaty – can as a main rule only deduct expenses which concern income that can be taxed in Denmark due to the double taxation treaty; cf. Sec. 1(2) in the Act on Taxation at Source.

Concerning double taxation relief, unilaterally or according to a double taxation treaty, expenses which relate to the foreign-source gross income must be deducted when computing net foreign-source income; cf. the “Net principle” set out in Sec. 33 F of the Tax Assessment Act. Expenses which cannot be directly allocated to either foreign-source or Danish-source income are allocated proportionally.³³ In connection to the calculation of foreign source interest income eligible for double taxation relief,

²⁶ In order to obtain and uphold the deferral, a share portfolio statement must be filed at the time of emigration, and a tax return must be filed to the Danish tax authorities each year no later than 1 July concerning the shares included in the tax deferral. The rules on exit taxation were significantly tightened on 9 September 2008 as a result of the adoption of Bill L 187. See *Wiberg and Cederskjold Kierans* in *Danish Journal of International Taxation* (2008), no. 344, *Ravnkilde* in *Journal of Danish Tax Law* (2008), no. 917 and *Møll Pedersen* in *Bulletin for International Taxation* (2009), pp.104-106.

²⁷ cf. Sec. 37 of the Gains and Losses on Debt Claims, Debts and Financial Instruments Act

²⁸ cf. Secs. 7 H (8) and 28(4-5) of the Tax Assessment Act.

²⁹ cf. Sec. 10 of the Act on Taxation at Source.

³⁰ cf. Sec. 8 A (2) of the Act on Taxation at Source.

³¹ cf. Sec. 19 (A-E) of the Taxation of Pensions Act.

³² cf. Sec. 15 c of the Business Taxation Act.

³³ Sec. 33 F of the Tax Assessment Act applies to individuals as well as legal entities.

interest and interest expenses related to the interest income should be distributed over the period the interest and the interest expenses concern; cf. Sec. 5 D of the Tax Assessment Act.³⁴

An anti-double dip provision appears in Sec. 5 G of the Tax Assessment Act prohibiting deduction of expenses which due to foreign tax rules can be deducted from income that is not included when calculating the Danish tax.³⁵ The provision moreover prevents double dips arising from double depreciation of leasing assets; cf. par. 2 of Sec. 5 G.

Further, if a debt claim is acquired for borrowed funds, and interest or capital gains on the debt claim should not be included in the income by virtue of a double taxation treaty, interest, capital losses, commission, premiums and other expenses incurred in connection to the loan cannot be deducted; cf. Sec. 5 F of the Tax Assessment Act.³⁶ This also applies if shares are acquired for borrowed funds, provided the shares in question are shares in a company which directly or indirectly holds a significant amount of the aforementioned debt claims. Additionally, Sec. 5 C (3) of the Tax Assessment Act prohibits deduction of payments for accrued interest paid in connection to purchase of interest bearing debt claims if interest or capital gains on the debt claim by virtue of a double taxation agreement should not be included in the taxable income.

Losses on debt claims are not deductible if interest or gains related to the debt claim should not be included in the taxable income as a result of a double taxation treaty; cf. Secs. 5 and 18 in the Gains and Losses on Debt Claims, Debts and Financial Instruments Act.

According to Sec. 5 I in the Tax Assessment Act depreciations, amortizations and expenses – which can be deducted in the income year in question or in a later income year at the taxpayer's discretion – should be deducted when calculating the income from a permanent establishment or a foreign subsidiary subject to voluntary Danish tax consolidation to the extent the taxable income exceeds the

³⁴ The provision ensures that the “net principle” set out in Sec. 33 F in the Tax Assessment Act is not circumvented by placing interest in one year and interest expenses in another year. Expenses – related to capital income and dividend income eligible for double taxation relief – should be allocated to the maturity year for the income concerning individuals.

³⁵ The significance of the provision was reduced, due to an amendment of the rules on mandatory Danish tax consolidation and voluntary Danish international tax consolidation in 2005.

³⁶ The provision was introduced in order to prevent leveraged purchase of Brazilian government bonds which according to the treaty between Denmark and Brazil could only be taxed in Brazil; cf. the explanatory remarks to Bill no. L 88, 1994/1995.

tax base for the foreign tax in the country in which the permanent establishment or subsidiary is domiciled.³⁷ This rule also applies to real estate located abroad.³⁸

Finally it should be mentioned that Denmark generally does not impose withholding tax on interest paid to non-residents. However, under certain circumstances a 25 per cent withholding tax applies to interest paid to foreign related entities if the activity of the foreign related entity is subject to substantially lower taxation than if the entity had been taxable under Danish law and the activity of the foreign related entity is mainly of a financial nature; cf. Sec. 2(1) (d) and (g) in the Corporation Tax Act.³⁹

1.4 The relationship between the domestic anti-avoidance provisions and tax treaties

In general there has been very little academic discussion and case law regarding the tax treaty aspects of the vast number of anti-avoidance provisions in Danish tax law. Accordingly, there is no bulk of case law on the subject. Some of the most controversial issues regarding the relationship between specific anti-avoidance provisions in Danish tax law and tax treaties are addressed in the following.

Exit taxes and tax treaties

Danish case law has not dealt with the interpretation of tax treaties regarding capital gains in the light of domestic exit tax provisions. Article 13(4) of the Danish tax treaties is similar to the OECD model granting the exclusive taxing right to the domicile state. This issue has been widely discussed in tax literature⁴⁰. In the light of the latest development in the Case law from the European Court of Justice, this issue is still relevant. Some Danish tax treaties divide the taxing right between the contracting states whereby the new country of residence is only allowed to tax the increases in value after the move to that country and where the former country of residence is only allowed to tax capital gains arising from increases in value until the time of exit. See art. 13(6) of the following Danish tax treaties: Estonia, Italy, Latvia, Lithuania, South Africa, Ukraine. Other Danish tax treaties include a provision according to which the new country of residence should allow the taxpayer a tax credit for

³⁷ The purpose of the provision is to hinder that taxpayers, by refraining from undertaking depreciations/amortizations, can obtain a relatively higher exemption pursuant to Sec. 33 of the Tax Assessment Act or double taxation treaties; cf. the explanatory remarks to Bill no. L 188, 1995/1996.

³⁸ It should be noted that resident companies are not subject to taxation on income from foreign permanent establishments and foreign real property; cf. Sec. 8(2) of the Corporation Tax Act, unless the group has opted for Danish international voluntary tax consolidation. Accordingly, this provision contains the principle of territoriality for corporate taxpayers.

³⁹ If taxation should be waived or reduced pursuant to the Interest and Royalties Directive (2003/49/EC) or a double taxation treaty no withholding tax should be levied, provided that the companies paying and receiving the interest are affiliated for at least 1 year in which period the payment should take place.

⁴⁰ See e.g. *Michelsen* in *International skatteret* (2003), p. 344 et seq.

the part of the tax levied by the new country of residence which has already been subject to Danish exit tax. See the Danish tax treaties with the following countries: Argentina (art. 13(9)), Germany (art. 13(5)), Ireland (art. 13(8) and art. 23(4)), Mexico (art. 13(8)) and Vietnam (art. 13(8)). The Danish tax treaties with Slovenia (art. 13(6)) and Uganda (art. 14(7)) provide for double tax relief under the exemption method regarding the capital gains arising after the move of tax residence to the new country of residence.

CFC taxation

The question whether the Danish CFC regime is in conformity with double taxation treaties has been addressed by the National Tax Tribunal in Case No. 862 LSR, Journal of Danish Tax Law (2004). The case concerned a Danish company that controlled a subsidiary in Switzerland, which performed banking activities. Referring to the commentaries to the OECD Model Convention, the National Tax Tribunal stated that the CFC regime of that time was not contrary to Denmark's obligations according to the double taxation treaty with Switzerland, because the CFC rules only covered situations where a subsidiary – mainly performing activities of a financial nature – were taxed significantly lower than would be the case according to Danish rules. Subsequently the Danish CFC regime has been amended: Firstly, the CFC-test is now not dependent on the level of taxation in the foreign country in question and secondly, the parent company should include the total income – not only the financial income – of the subsidiary or permanent establishment in its own income. Accordingly, it seems appropriate to question whether the current CFC rules are within the accepted framework for CFC taxation set out in commentaries to the OECD model convention.⁴¹

Thin capitalization

No case law is available regarding the relationship between the domestic thin capitalization provision and tax treaties; possibly because the Danish thin cap regime does not imply a reclassification of interest to dividends, the issue has not been addressed in case law. In our view it can however not be excluded that the Danish thin cap provision may in some cases violate the arm's length principle in art. 9 of the tax treaties parallel to art. 9 of the OECD model. In a pending case before the Danish tax Tribunal, a taxpayer has argued that the annual thin cap test does in fact violate the nature of the arm's length principle. Moreover, in some non-published cases the Danish tax tribunal has accepted that a corresponding transfer pricing adjustment regarding an intra-group loan resulting in an additional interest deduction at the level of a Danish subsidiary may simultaneously be restricted by the thin cap provision. In such a situation it is hard to argue that the arm's length test is being taken seriously by the Danish tax authorities. The question of discrimination of companies resident in treaty states as a consequence of Danish restriction on the deductibility of interest payments has not been addressed in case law either. In the light of a reform in 2004 of the thin cap provision post, the Lankhorst-Hohorst decision from the ECJ has resulted in a country neutrality in the provision because Danish intra-group financing is also included under the scope of the legislation.

⁴¹ Cf. *Nyhegn-Eriksen* in *Revision & Regnskabsvæsen* (2007), no. 8, p. 64.

1.5 Abuse of the tax treaty itself: domestic law principles or interpretation of the treaty?

As a consequence of the fact that Danish tax treaties as a main rule do not include a general anti-abuse provision, two questions arise: (1) whether it is possible – independent of domestic law – to integrate an interpretation of a general anti-abuse reservation in the treaty and (2) whether it is possible to apply domestic anti-abuse rules, which imply that it is possible to deny treaty benefits in the source state⁴².

The first question, as to whether it is possible to adopt an anti-abuse rule at treaty level, i.e. without involving domestic tax law, appears to be subject to a certain amount of doubt in international tax law literature⁴³. There are no examples in Danish legal or administrative practice of a tax treaty being interpreted independently of the Danish tax law assessment to imply non-application of the treaty due to abuse. Presumably, the Danish courts will bring this into effect with reference to Danish tax law and not with reference to an ordinary anti-abuse principle at treaty level⁴⁴.

The fact that it is possible to arrive at an interpretation where an anti-abuse rule is adopted at treaty level, irrespective that there is no beneficial owner clause, is demonstrated by a decision from Schweizerische Bundesgericht from 2005⁴⁵. In this particular case, the Swiss tax authorities did not accept tax-free distribution of dividends from a Swiss-based company to a Danish holding company with reference to the Danish-Swiss tax treaty. The Danish holding company was owned by a Guernsey-based company, which again was owned by a company located on Bermuda. The case concerned an interpretation of the Danish-Swiss tax treaty from 1973, which as the 1963 version of OECD's Model Treaty *did not* contain a beneficial owner clause in arts. 10-12.

As far as *the second question* on domestic anti-abuse rules is concerned, it is stated in the OECD commentary that tax treaty benefits should not be granted in cases where the prime purpose of participating in certain transactions or arrangements is to ensure a more favorable tax position contrary to the purpose and intentions of the relevant provisions. In such circumstances, the commentary allows for a reclassification of who can be defined as taxpayer under domestic anti-abuse rules⁴⁶. It must be

⁴² This issue has been thoroughly analyzed by *Bundgaard & Winther-Sørensen* in *Tax Notes Int'l* (2008), p. 587 et seq. (p. 598 et seq.) regarding the notion of beneficial ownership. The following is a summary of the conclusions presented in the article.

⁴³ See *Vogel* in *Doppelbesteuerungsabkommen Kommentar* (2003), 4th edition, Vor Art. 1, margin no. 117, and *Oesterhelt & Winzap* in *European Taxation* (2006), p. 461, both with references.

⁴⁴ See *Bundgaard & Winther-Sørensen* in *Tax Notes Int'l* (2008), p. 587 et seq. (p. 598 et seq.).

⁴⁵ See decision of 28 November 2005, Schweizerische Bundesgericht, II, Öffentlichrechtliche Abteilung in the case A. Holding ApS gegen Eidgenössische Steuerverwaltung.

⁴⁶ See OECD's commentary (2005 version) on art. 1, par. 9.5 and par. 22.1 et seq.

noted, however, that the question of to which extent domestic anti-abuse rules can be applied under the treaty interpretation is subject to discussion⁴⁷.

In this regard the reasoning of the courts in the *Kame* case should be noted.⁴⁸ The case was about a Danish company, A, which in 1994 set up a German subsidiary, B. B was jointly taxed with A from 1994 onward. B obtained a loan of DKK 111 million from a Luxembourg bank and acquired units in a Luxembourg dividend-paying investment fund based on bonds in December 1994. The units were pledged as security for the loan. Shortly after the acquisition, the investment fund repurchased units from B representing a value of DKK 100 million (repurchased by the issuing company). The sale did not trigger any tax liability in Germany. At the beginning of 1995, B sold the remaining units to a third party. As gains and losses on units are assessed according to the average cost formula, B retained the full purchase price of DKK 111 million in connection with the sale to the issuing company in 1994. Thus, B suffered a loss of more than DKK 100 million on the sale of the remaining units in 1995. At that time, Denmark's tax treaty with Germany provided relief from double taxation based on the exemption method. Accordingly, A was not liable to pay tax in connection with the sale to the issuing company in 1994, but was entitled to deduct the loss suffered in 1995 from its taxable income in Denmark.

The tax authorities as well as the Tribunal and the High Court disallowed A's deduction of the loss, based on the reasoning that the arrangement was implemented for tax reasons only. In the Supreme Court case, additional information was presented, and reference was made to the administrative practice described in the 1993 assessment guidelines, S.G.3.3., which in summary stated that in connection with a repurchase by the issuing company, the consideration is comparable to dividends, therefore the acquisition cost of the remaining shares stays the same as before the disposal to the company. The Supreme Court arrived at the same conclusion as the High Court, but based its decision on different reasons. In the view of the Supreme Court, the German subsidiary's estimated loss was primarily a technical loss. Further, the Supreme Court stated that the purpose of the administrative practice, as described in the assessment guidelines, probably was to compensate for the fact that a repurchase by the issuing company/the issuing investment fund would result in the whole consideration being taxed as dividends without any ability to deduct the acquisition cost. In these circumstances, i.e. that the repurchase in 1994 by the issuing investment fund was not subject to taxation due to the exemption principle provided for in the tax treaty between Denmark and Germany and the tax exemption provided for under German law, the rule developed in practice should not be

⁴⁷ See *Zimmer* in the General report to the IFA Congress 2002, Cahiers, Vol LXXXVIIa, p. 60 et seq., and *Vogel* in *Doppelbesteuerungsabkommen Kommentar*, 4th ed., 2003, Vor Art. 1, margin no. 100 et seq. The Canadian ruling in *MIL (Investments) S.A. v. The Queen*, 2006 TCC 460, the minutes in *Tax Notes Int'l* (2006), p. 803 et seq., assumed that treaty benefits could not be denied without the existence of specific anti-abuse rules. The appeal was dismissed by the Federal Court of Appeal by ruling of 13 June 2007, see FCA 236.

⁴⁸ Case No. 201 H, *Journal of Danish Tax Law* (2007).

considered applicable. Thus, the Supreme Court reasoned that the administrative practice referred to by the taxpayer required that taxation was actually imposed on repurchase of the shares, which, based on practical arguments, should be mitigated when further sales of shares take place. Therefore, instead of referring to abstract tax avoidance or tax abuse considerations, the Supreme Court chose a factual analysis based on an interpretation of the relevant tax rules and administrative guidelines.⁴⁹

Part Two

General and specific anti-avoidance provisions in tax treaties

2.1 General overview

There is no tradition for including general anti-abuse provisions in Danish tax treaties.⁵⁰ However, a number of specific anti-abuse provisions can be found in the Danish tax treaties, including provisions regarding beneficial ownership

2.2 Specific treaty provisions allowing application of domestic anti-avoidance provisions

Specific treaty provisions allowing application of domestic anti-avoidance provisions are not common in Denmark's treaties. As an exception, however, art. 45(2) in the treaty between Denmark and Germany states that the treaty shall in no case be so construed as to imply that: a) a taxpayer may avoid his fiscal obligations in a contracting state by misusing the interpretive possibilities of the law; b) Germany should be hindered from taxing such amounts which, in accordance with Part 4 of the German Law on External Tax Relations (*Aussensteuergesetz*), may be included in the income of a resident in Germany; c) Denmark should be hindered from levying taxes in accordance with provisions similar in sense and purpose to the provisions mentioned in sub-paragraph b).⁵¹

2.3 General anti-avoidance provisions in tax treaties

In general Danish tax treaties do not include general anti-avoidance provisions. However, a number of tax treaties include different forms of such provisions.

LOB clauses

Art. 26(3) of the treaty between the Danish Trade Organization's Taipei Office and the Taipei Representative Office in Denmark contains a limitation on benefits clause (LOB clause) with a broad and general

⁴⁹ The decision has been commented by *Bundgaard & Møllin Ottosen* in *European Taxation* (February 2008), p. 59 ff.

⁵⁰ Art. 26(3) in the treaty between the Danish Trade Organization's Taipei Office and the Taipei Representative Office in Denmark constitutes an exception.

⁵¹ The German Law on External Tax Relations – *Aussensteuergesetz* – has as its objective to ensure that taxpayers cannot obtain unjustified benefits that otherwise could be obtained by exploiting differences in international tax law.

scope. The article states that a resident of a territory shall not receive the benefit of any reduction in or exemption from tax provided for in the treaty by the other territory if the main purpose or one of the main purposes of such resident or a person connected with such resident was to obtain the benefits of this agreement.

In art. 22 of the treaty between Denmark and the US, a more specific LOB clause appears.⁵² This very detailed and complex clause lists several conditions that must be met if a resident of the contracting states should be entitled to benefit from the treaty. In short the LOB clause should ensure that persons who are not resident in one of the contracting states cannot benefit from the provisions of the treaty.⁵³ Individuals resident in the US or Denmark are under all circumstances entitled to benefit from the provisions of the treaty. Also public authorities in the two states, religious and charitable organizations as well as pension funds⁵⁴ are per se entitled to the benefits. However, legal entities such as companies and trusts have to meet certain requirements regarding, among other things, ownership, cash flows and business activity.⁵⁵

Limitation of the field of application

An example can be found in article 1 of the protocol to the treaty between Denmark and Luxembourg, which states that the treaty does not apply to Luxembourg holding companies under the 1929 regime. Further, the treaty does not apply to income that a person resident in Denmark receives from 1929 holding companies or to shares in such companies.

*General "subject-to-tax provisions"*⁵⁶

⁵² Art. 22 in the treaty was amended following the ratification of the protocol which entered into force on 28 December 2007. The LOB clause is standard in US treaties.

⁵³ The LOB-clause is analyzed by *Korsgaard & Kowalski* in *Danish Journal of International Taxation* (2008), no. 130.

⁵⁴ If more than 50 per cent of the pension recipients are resident in one of the two states.

⁵⁵ Moreover, art. 4(1) (d) of the treaty states that an item income, profit or gain derived through an entity that is fiscally transparent under the laws of either contracting state shall be considered to be derived by a resident of a state to the extent that the item is treated for purposes of the taxation law of such contracting state as the income, profit or gain of a resident.

⁵⁶ In the OECD Commentary to article 1, no. 15 *general subject-to-tax provisions* are defined as provisions that provide that treaty benefits in the state of source are granted only if the income in question is subject to tax in the state of residence. However, in the following the term "general subject-to-tax provisions" will also be used to describe provisions that grant the state of residence the right to tax if the income in question is not subject to tax in the state of source.

The multilateral Nordic treaty contains a general “subject-to-tax provision” in art. 26(2).⁵⁷ Accordingly, if the right to tax income or capital is granted to a contracting state other than the state of which the person who derives income or capital is a resident, and the other contracting state according to its laws does not consider the income or the capital in its entirety as taxable, or only considers the income or capital in calculations under a progressive tax scheme, or in other tax computations, the contracting state where the person resides may tax that part of the income or capital which is not included under taxation in the other contracting state.

Likewise, the treaty between Denmark and Germany contains a general “subject to tax provision” in favor of the state of residence; cf. art. 24(3).

Specific “subject to tax provision”

Other treaties signed by Denmark contain more specific “subject to tax provisions”.⁵⁸ An example can be found in art. 29(1) of the treaty between Denmark and South Africa, which states that if one of the states introduces legislation on lower or no taxation of offshore income derived by a company,⁵⁹ the other state shall not be obliged to apply any limitation imposed under the treaty.⁶⁰ Further, pursuant to art. 29(2) it follows that if income according to the treaty should be exempt from taxation in the source state – and the state of residence in spite of this refrain from taxing the income⁶¹ – the source state can tax the income anyhow. The existence of this clause results from the fact that South Africa applies the principle of territoriality. For the same reason, art. 25 of the treaty between Denmark and Vietnam states that where any person derives income from a source situated outside Vietnam and such income

⁵⁷ The Nordic countries are Denmark, Faroe Islands, Finland, Iceland, Norway and Sweden.

⁵⁸ For a more thorough description and overview of “subject to tax provisions” in Denmark’s treaties, see *Noes* in Danish Journal of International Taxation (2003), no. 3.

⁵⁹ The company should be involved in one of the following industries: (a) shipping; (b) banking, financing, insurance, investment or similar activities; or (c) being the headquarters, co-ordination centre or similar entity providing administrative services or other support to a group of companies which carry on business primarily in other states.

⁶⁰ Art. 26(1) in the treaty between the Danish Trade Organization’s Taipei Office and the Taipei Representative Office in Denmark contains a somewhat similar provision targeted at companies that derive income primarily from outside the territory from banking, financing and insurance activities or from being a coordination center. Further, an additional subject-to-tax provision appears in art. 26(2) concerning interest, dividends and royalty paid from e.g. a company where more than 50 per cent of the capital or votes is owned or controlled directly or indirectly by a person or any other legal person not being residents of one of the territories or of the European Union or the European Economic Area.

⁶¹ In terms of any provision of the treaty other than the art. 10 on dividends.

is exempt from tax under the laws of Vietnam and also exempt from tax in Denmark under the treaty, Denmark may tax such income under its own laws.⁶²

The treaty between Denmark and Cyprus, art. 23(3), states that if income according to the treaty is relieved from tax in one of the states – e.g. Denmark – and the income pursuant to Cypriot law is subject to tax by reference to the amount which is remitted to or received in Cyprus and not by reference to the full amount, then the relief to be allowed under this convention in Denmark shall apply only to so much of the income as is remitted to or received in Cyprus. Almost similar provisions can be found in Denmark’s treaties with Malta (art. 24)⁶³, Singapore (art. 22), Jamaica (art. 24(4)) and Thailand (art. 24(4)). Art. 28(1) in the treaty between Denmark and the United Kingdom also contains a “subject to tax provision” which, however, has a more limited scope. Accordingly, the provision states that if an *individual* resident in the United Kingdom is subject to tax by reference to the amount thereof which is remitted to or received in the United Kingdom and not by reference to the full amount, then the relief to be allowed under the treaty in Denmark shall apply only to so much of the income as is taxed in the United Kingdom.⁶⁴

Finally it should be mentioned that some of Denmark’s tax treaties contain specific subject-to-tax provisions concerning among other things income from employment⁶⁵ and independent personal services.⁶⁶

2.4 Specific anti-avoidance provisions in tax treaties

Beneficial ownership clauses

Most of Denmark’s tax treaties contain specific beneficial owner clauses in arts. 10-12 regarding dividends, interest and royalties. In recent times, the Danish Minister of Taxation has attempted to broaden the meaning of the beneficial owner line of thought by using the notion conduit company as a term for a company that is not to be granted treaty relief for interest, dividends, etc⁶⁷ at any time. The tax authorities have followed this interpretation.

⁶² Art. 25 should be applied without prejudice to the participation exemption concerning dividends in art. 24(1) (f).

⁶³ Moreover, the treaty does not apply at all to certain persons that are entitled to certain tax benefits according to Maltese law; cf. the notes on 13 July 1998.

⁶⁴ Art. 28(1) was amended according to the Protocol to the Convention on Double Taxation between Denmark and the United Kingdom signed 15 October 1996. .

⁶⁵ See e.g. art. 15(2) (d) in the treaty between Denmark and Australia and art. 14(2) (d) in the treaty between Denmark and Malaysia and art. 26(3) in the Nordic treaty.

⁶⁶ See e.g. art.14 (1) (b) in the treaty between Denmark and Greece and art. 26(3) in the Nordic treaty.

⁶⁷ For an in-depth analysis of this issue with specific emphasis on interest payments, see *Bundgaard/Winther-Sørensen* in *Tax Notes Int’l 2008*, p. 587 et seq. The conclusions presented below regarding the notion of beneficial ownership are based in this article.

It is concluded that it must be expected that the courts will not attach great importance to the Minister's comments when assessing whether a company should be considered the rightful recipient/beneficial owner.

Accordingly, we are of the opinion that it is still a general principle in Danish tax law that interest is taxed with the person having the title of the claim in a civil law context. If the rightful recipient of the interest should be considered a different person than the title owner of the claim, case law requires a *special reason*. Former Danish case law has not specifically considered a similar situation where a foreign group company that is a creditor to a Danish company has itself borrowed the funds from another foreign group enterprise. When assessing whether a concrete situation gives grounds for derogating from the clear statement that interest is taxed with the person that has title of the claim in a civil law context, it seems reasonable to assume on the basis of the Supreme Court's practice in the examined neighboring areas that one criterion is not decisive, but that an overall assessment will be made on the basis of the existing facts and circumstances. The analysis has provided a number of criteria that may be important when assessing this matter.

One of the most material arguments to be presented against interpreting the notion of beneficial owner with reference to domestic law is that domestic law frequently contains no definition. In such circumstances, international literature maintains that the idea of interpreting with reference to domestic law must be dismissed in any case⁶⁸. In Danish case law, however, despite a notion in a tax treaty not being defined in Danish tax law, the Supreme Court has on some occasions interpreted in compliance with similar notions in Danish tax law. This was i.a. the case in Case No. 184 H, Journal of Danish Tax Law (1994) (concerning the interpretation of the residence requirement in the professor provision in art. 14 in the then effective Danish-US tax treaty) and the majority's decision in Case No. 222 H, Journal of Danish Tax Law (2003) (relating to hiring out of labour under the then effective tax treaty with the US and Canada.). The last mentioned decision has been widely criticized⁶⁹, but case law indicates that the Supreme Court has not abstained from interpreting with reference to domestic law when a *relatively clear* interpretation result is not arrived at by applying the international sources of law, including international tax practice and OECD's Model Treaty including commentary.

⁶⁸ See *du Toit* in *Beneficial Ownership of Royalties in Bilateral Tax Treaties* (1999), p. 177; *Helminen* in *European Taxation* (2002), 454, particularly p. 456.

⁶⁹ See *Michelsen* in *Revision & Regnskabsvæsen* (2003), SM 133, *Qviste* in *Danish Journal of International Taxation* (2003), no. 186, *Vogel* in *Bulletin for International Taxation* (2003), p. 236.

Relationship with EC law

The relationship between anti-abuse provisions and EC Law has been dealt with widely in tax law literature. However, only very little case law regarding the subject exists. Moreover, the Danish legislator has reformed several tax law anti-abuse provisions in order to comply with EC law (including thin capitalization, CFC taxation, exit taxation, investment companies and transfer pricing documentation). Irrespective of this development there has been only little case law dealing with the relationship between domestic anti-avoidance provisions and the four fundamental freedoms.

One case that should be mentioned is Case no. 199 Ø, *Journal of Danish Taxation* (2008), which dealt with the relationship between the Danish exit taxation rules and the freedom of establishment in art. 43 EC.⁷⁰ An individual who was fully liable to tax in Denmark immigrated to France in 1998 and was taxed as if all shares had been disposed at the time of the termination of full Danish tax liability. However, according to the rules at that time, respite could be obtained provided that proper security was offered by the taxpayer. With reference to the decision of the European Court of Justice in *du Saillant* (Case C-9/02), the taxpayer argued that the condition concerning security was contrary to EC law and that exit taxation accordingly could not be carried out. The High Court agreed that the part of the exit tax rules that concerned security was in breach of EC law. However, with reference to the European Court of Justice's decision in *van Dijk* (Case C-470/04) the High Court also stated, that the actual liability to pay the exit tax should not be disregarded, despite the fact that the security condition constituted a violation of the freedom of establishment, because the exit taxation rules in other aspects were not in breach of EC law. Subsequently, the rules on exit taxation of shares owned by individuals have been amended as described in paragraph 1.3. However, it has been argued that also the current rules on exit taxation are in violation of EC law.⁷¹

Even though the Danish CFC regime was amended following the European Court of Justice's decision in *Cadbury Schweppes* (Case C-196/04), it has been questioned in the tax literature whether the current CFC rules are in accordance with EC law. Concerning companies the argumentation has been – in brief – that in reality it has no effect if a Danish subsidiary should be considered a CFC company, since the subsidiary and the parent company are already subject to mandatory Danish tax consolidation, whereas it would have an actual effect if a foreign subsidiary qualify as a CFC

⁷⁰ The case has been appealed to the Supreme Court.

⁷¹ Cf. *Ravnkilde* in *Danish Journal of International Taxation* (2009), no. 158, who argues that the current rules do not meet the requirements laid down by the European Court of Justice in *Krauss* (Case C-19/92), because the rules entail that obtaining a deferral is illusory, that giving security practically is mandatory and that the rules in effect entail advance taxation. See also *Bolander* in *Danish Journal of International Taxation* (2009), no. 158, who infers that the fact that the taxpayer is not compensated for a loss on the shares incurred after the emigration could be contrary to EC Law.

company.⁷² Further, it could be argued that the objective Danish CFC rules – which do not give the parent company an opportunity to avoid CFC taxation by substantiating that the subsidiary is actually established and is carrying out genuine economic activity in the territory of the other Member State – is not in line with the premises of the Cadbury Schweppes judgment.⁷³

Also, the Cadbury Schweppes decision has been directly referred to in Sec. 16 H of the Tax Assessment Act regarding CFC taxation for individuals. The referral implies that the Cadbury Schweppes test regarding abuse is crucial for the application of the Danish CFC- regime for individuals. So far the Tax administration has – in our opinion – interpreted the test correctly⁷⁴.

Further, the thin capitalization rules in Sec. 11 in the Corporation Tax Act have been criticized for being in breach of EC law. Of particular interest is the rule according to which a Danish creditor is exempted from being taxed on interest income if the debtor cannot deduct the interest expense according to the thin capitalization rules. Firstly, it can be questioned whether the expansion of the application of the rules to purely domestic situations is necessary at all; cf. the European Court of Justice's decision in *Thin Cap Group Litigation* (Case C-524/04). Secondly, it can be questioned whether a situation in which an adjustment is made in Denmark – as a consequence of the thin capitalization rules – is in breach of EC law when the interest income is taxed in another Member State at the same time, given that a creditor in a purely Danish group would be tax exempt.⁷⁵ However, in light of recent ECJ case law, it seems appropriate to conclude that the removal of double taxation that originates from different tax treatment in other Member States should be considered a consequence of the lack of harmonization and accordingly not viewed as discrimination.

⁷² This is the case if the subsidiary or permanent establishment is not subject to but qualifies for voluntary Danish International Joint taxation. See *Rønfeldt* in *Skattepolitisk Oversigt* (2008), no. 65, who argues that this treatment of foreign subsidiaries and permanent establishments constitutes a restriction on the freedom of establishment. *Kirkegaard Nielsen* in *Danish Journal of International Taxation* (2007), no. 236 is more cautious and states that it is difficult to predict whether the ECJ would find that the Danish CFC regime is in violation of EC Law. *Michelsen* in the *Danish Journal of International Taxation* (2008), no. 85 seems to find that the Danish CFC regime is in conformity with EC Law.

⁷³ Premises 51-55 in *Cadbury Schweppes* (Case C-196/04). In the literature it has also been questioned whether the CFC regime concerning individuals is in line with EC law. However, due to the fact that individuals on request can be exempted from CFC taxation answering the question must await how the Danish tax authorities and courts will actually practice the exemption provision. See *Michelsen* in *Danish Journal of International Taxation* (2008), no. 85 and *Kirkegaard Nielsen* in *Danish Journal of International Taxation* (2007), no. 236.

⁷⁴ See contrary *Henriksen* in *Ugeskrift for Skat*, 2009, p. 3381 et seq.

⁷⁵ See *Vinther & Werlauff* in *Danish Journal of International Taxation* (2003), no. 354 and in *Journal of Danish Taxation* (2004), no. 242. The debate arose as a result of the argumentation put forward by the European Commission during *Lankhorst-Hohorst* (Case C-324/00).

Also, the rules on limitations of interest deductions in Sec. 11 B and 11 C in the Corporation Tax Act have been criticized for violating EC law. Particular elements of the asset test seem to pose problems given the fact that no part of the purchase price for shareholdings in foreign group companies can be included in the the tax base of the assets qualifying for interest deduction – unless the group has elected to be subject to voluntary Danish international tax consolidation⁷⁶ – whereas assets in Danish group companies automatically are included.⁷⁷ Further, it could be considered a problem that assets contributed from foreign group companies should only be included in the qualifying assets if the assets remain with the company for at least two years, whereas assets contributed from Danish group companies should be included from day one.

⁷⁶ If a Danish company opts for voluntary Danish international tax consolidation, all foreign group companies as well as all permanent establishments and real estate in foreign jurisdictions must be included in the consolidation (referred to as the “global pool principle”). This even applies to foreign parent and sister companies.

⁷⁷ See *Friis Hansen & Rune Stokholm* in *Cahiers de droit fiscal international*, Volume 93b, pp. 267-275 and *Rønfeldt* in *Skattepolitisk Oversigt* (2008), no. 65. Before the adoption of Bill L 202 on 28 May 2009 20 per cent of the purchase price of shares in foreign companies could be included.