Denmark

Branch Reporter
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Summary and conclusions

No statutory general anti-avoidance provision exists under Danish tax law. However, the doctrines of "substance over form" and "rightful recipient of income" play a significant role. In addition Danish tax law encompasses a relatively high number of specific anti-avoidance provisions, including controlled foreign company (CFC) legislation.

CFC rules for companies were introduced in 1995. The objective was to prevent erosion of the Danish tax base caused by the increasing openness of borders to flows of capital. More specifically, the aim of the CFC rules was to prevent Danish companies from establishing subsidiaries in low-tax countries and moving income and assets there.

The CFC legislation has been amended several times since its introduction, e.g. significant changes were made in 2007 in response to the European Court of Justice's decision in case C-196/04 *Cadbury Schweppes.* First of all, the field of application of the CFC rules was widened. This means that the current CFC rules also apply with respect to subsidiaries resident in Denmark if the conditions for CFC taxation are fulfilled. Moreover, the reform of the CFC rules entailed a shift from a transactional approach towards an entity approach.

The CFC rules only apply if:

(a) the parent company directly or indirectly is a shareholder in the subsidiary, and the group has "decision-making influence" over the subsidiary;

(b) the tainted income – known as the CFC income – of the subsidiary amounts to more than 50 per cent of subsidiary's total taxable income in a given year; and

(c) the financial assets of the subsidiary exceed 10 per cent of the total assets.

The CFC income consists of (a) taxable interest income and deductible interest expenses; (b) taxable gains and deductible losses on debt claims, debt and financial contracts; (c) certain deductible fees and charges paid in connection to obtaining loans and the corresponding taxable fees etc.; (d) taxable dividends and taxable sales prices concerning shares; (e) taxable gains and deductible losses on shares; (f) payments of any kind received as compensation for the use of, or the right to use, intangible assets as well as gains and losses connected to the transfer of intangible assets; (g) deductible expenses related to the items mentioned in (a)–(f),

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(h) taxable income originating from financial leasing, including gains and losses from the sale of assets used in connection to financial leasing; and (i) taxable income originating from insurance activities, activity as a bank or mortgage credit institution and other financial activity.

CFC taxation does not take place if the group has opted for voluntary international tax consolidation. In addition, the CFC rules do not apply if the parent company's shares in the subsidiary are to be considered shares in an investment company, as defined in section 19 of the Act on Taxation of Capital Gains on Sale of Shares. Finally, CFC taxation is not a possibility if the parent company owns the shares in the subsidiary through a legal person subject to taxation according to section 13F in the Corporate Tax Act (life insurance companies).

The Danish CFC rules may also target active business performed by subsidiaries within the financial sector, as taxable income originating from insurance activities, from activity as a bank or mortgage credit institution and other financial activities is considered tainted income (CFC income). However, the National Tax Assessment Council is entitled to allow an exemption from the CFC rules with respect to subsidiaries involved in activity as an insurance company, a mortgage credit institution, an investment services company, an investment management company or a bank. The exemption will only be given if certain relatively strict conditions are fulfilled.

If all the conditions for CFC taxation are fulfilled, and no exemptions apply, the entire income of the subsidiary should be included in the taxable income of the parent company, provided that the income of the subsidiary is positive. If the parent company does not fully own the subsidiary, only a proportional part of the subsidiary's income equal to the parent company's average direct or indirect part of the subsidiary's share capital should be attributed to the parent company. The income of the subsidiary should as a general rule be calculated in accordance with ordinary Danish tax rules.

If the subsidiary has tax losses carried forward from previous income years, these losses can be set off against the income attributed to the parent company. The same applies to losses transferred to the subsidiary as a result of participation in a local tax consolidation. When a parent company is subject to CFC taxation, relief is granted for taxes paid by the subsidiary according to the ordinary credit method.

It can be questioned whether the current CFC rules are within the accepted framework for CFC taxation set out in the commentaries to the OECD model tax convention, as the Danish CFC rules also apply to income in a subsidiary that has been subject to taxation that is comparable to the level of taxation in Denmark. Further, in the tax literature it has been argued that the Danish CFC rules may be in conflict with EU law, as the application of the CFC rules only entails an additional tax burden for the Danish parent company if the subsidiary is resident in another country in which the level of taxation is lower than the Danish level of taxation.

1. Introduction

Traditionally, Danish tax law is considered to be based on a principle of worldwide taxation.[1] However, for companies a (limited) principle of territoriality was introduced in 2005.[2] Accordingly, income from permanent establishments and landed property located abroad should be excluded from the taxable income.[3] Companies incorporated in Denmark are subject to full Danish taxation.[4] Further, companies incorporated abroad are liable to full Danish taxation, if the seat of management is located in Denmark.[5] The Danish corporate tax rate has diminished over the years but has remained at 25 per cent since 2007.

All companies within a group that are liable to full Danish taxation – as well as permanent establishments and landed property located in Denmark – are subject to mandatory national tax consolidation.[6] Moreover, it is possible to opt for voluntary international tax consolidation.[7] A group exists when a (parent) company has a "decision-making influence" over one or more subsidiaries.[8]

In general dividends received by a company on "subsidiary shares" and "group shares" are tax exempt, whereas dividends on "portfolio shares" are taxable.[9] Shares are considered "subsidiary shares" when the shareholder owns at least 10 per cent of the nominal share capital of the company and the company is Danish or the company is foreign and the taxation of dividends paid by the company is to be waived or reduced under the EU Parent–Subsidiary Directive or a tax treaty. "Group shares" exist when the shareholder and the company are subject to mandatory national tax consolidation, subject to voluntary Danish international tax consolidation or at least qualify for voluntary Danish international tax consolidation.[10]

1 Cf. s. 4 of the State Tax Act.

2 Cf. bill L 121 (2004/2005). The (limited) principle of territoriality took effect from income years starting on 15 December 2004 or later.

3 Cf. s. 8(2) of the Corporate Tax Act. It is a condition that the group has not opted for voluntary Danish international tax consolidation, cf. s. 31A of the Corporate Tax Act. Certain exceptions apply to the (limited) principle of territoriality, *inter alia* concerning "CFC permanent establishments" as mentioned in section 3 below.

4 Cf. s. 1(1)(1) of the Corporate Tax Act which concerns *aktieselskaber* and *anpartsselskaber*. It has been proposed, cf. bill L 10 (2012/2013), that other types of companies and associations, etc. should also automatically be considered subject to full Danish taxation, if the company or association is registered with the Danish Central Business Register. If adopted the amendment would take effect from income years starting on 1 January 2013.

5 Cf. s. 1(6) of the Corporate Tax Act. It is to be determined by domestic Danish tax law whether a foreign entity should be considered an independent taxpayer or transparent entity. For further information concerning full Danish tax liability see Kallehauge Handberg and Svendgaard Dalgas, *Cahiers de droit fiscal international*, Danish branch report, 2011, vol. 96b, pp. 267–286.

6 Cf. s. 31 of the Corporate Tax Act.

7 Cf. s. 31A of the Corporate Tax Act. In that case also all foreign group companies as well as all permanent establishments and landed property in foreign jurisdictions must be included in the consolidation.

8 Cf. s. 31C of the Corporate Tax Act. For further explanation see section 4.3 below.

9 Cf. s. 13(1)(2) of the Corporate Tax Act.

10 "Subsidiary shares" and "group shares" are defined in s. 4 A and 4 B of the Act on Taxation of Capital Gains on Sale of Shares.

Capital gains on the sale of "subsidiary shares" and "group shares" are tax exempt whereas losses on the sale of such shares are not deductible.[11]

No generally applicable definition of passive income exists in Danish tax law. On the other hand, some of the Danish (anti-avoidance) provisions include specific definitions of "passive income" or the like relevant only to the provision in question.[12] In the Danish CFC rules an exhaustive definition of "CFC income" was inserted in 2002.[13]

In line with the directives from the general reporters, sections 2 and 3 – concerning general and specific anti-avoidance rules (GAARs and SAARs) (excluding CFC rules) – will be kept very brief, as the report will focus on the Danish CFC legislation (see sections 4, 5 and 6). Given the fact that the CFC rules are very detailed and complex, the focus will be on the main elements of the rules.

2. GAARs

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.[14] In this case, tax will be imposed in accordance with the actual substance of the transaction based on an overall assessment. The applicability of the doctrine of "substance over form" is, however, limited; in order for the doctrine to apply, there must be an evident conflict between form and substance.

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

[11] Cf. s. 8 of the Act on Taxation of Capital Gains on Sale of Shares. Pursuant to a new draft law proposal the same should apply to capital gains on portfolio shares in unlisted companies ("tax exempt portfolio shares"), cf. the definition in the proposed new s. 4C of the Act on Taxation of Capital Gains on Sale of Shares. The draft law proposal was announced on 30 August 2012 and is intended to enter into force as of 1 January 2013. According to the proposal capital gains on portfolio shares will be tax exempt if: (a) the shares are unlisted, (b) the portfolio company is a Danish limited company (A/S or ApS) or a similar foreign company, and (c) the annual value of the portfolio company's assets for accounting purposes does not consist of more than 85 per cent of listed shares. Gains and losses on "taxable portfolio shares" – e.g. shares in listed portfolio companies – are taxable/deductible according to a mark-to-market principle, cf. s. 9 of the Act on Taxation of Capital Gains on Sale of Shares.

[12] As an example it can be mentioned that the rules limiting utilisation of tax losses carried forward after a change of control uses the term "net capital income", cf. s. 12 D(3) of the Corporate Tax Act. Further, the rules on limitation of deduction of interest are focused on "net interest expenses" as defined in s. 11 B(4) of the Corporate Tax Act.

[13] Cf. s. 32(5) of the Corporate Tax Act. See bill L 99 (2001/2002 – 2. session). See also section 4.2 below.

[14] The principle was originally explained by Pedersen, *Skatteudnyttelse*, 1989, pp. 435 *et seq.* See also Pedersen in *Cahiers de droit fiscal international*, Danish branch report, 2002, vol. 87a, pp. 233–247.

of the gain/return on the shares/claim/activity.[15] The doctrine – it is argued – can be deduced from section 4 of the State Tax Act. The interaction between these doctrines is somewhat unclear, but for many practical purposes they overlap.[16] Both doctrines apply generally and do not specifically target foreign/passive income. However, the doctrines should normally not be considered a sufficient tool when it comes to preventing erosion of the Danish tax base as a result of e.g. Danish companies setting up subsidiaries in low-tax countries.[17]

3. SAARs

Danish tax law encompasses a relatively high number of SAARs, and the extent of such legislation has increased significantly during the last 15 years. For a more comprehensive description of these rules, please see Bundgaard and Koerver Schmidt, *Cahiers de droit fiscal international*, 2010, vol. 95a, Danish branch report, pp. 261–279. Below some of the most significant such provisions with relevance for passive income are briefly addressed.

Simultaneously with the introduction of the above-mentioned (limited) principle of territoriality for companies, a sort of switch-over rule – concerning "CFC permanent establishments" abroad – was introduced as an exception to the principle of territoriality.[18] Accordingly, if the CFC conditions were fulfilled, if the permanent establishment was a subsidiary/company, the income of the permanent establishment should still be included in the taxable income of the Danish company (headquarters).[19] In that case, the Danish company is entitled to relief pursuant to the domestic Danish relief provision (ordinary credit) or relief under the tax treaty (if a treaty exists) with the country in which the permanent establishment is located.[20] The income of the permanent establishment should be calculated according to the authorised OECD approach.[21] However, if it follows from the tax treaty – with the country in which the permanent establishment is located – that the income should be calculated in a different manner, the method prescribed in the treaty prevails.[22]

15 See Michelsen *et al.*, *Lærebog om indkomstskat*, 2011, pp. 649 *et seq.* and Dam, *Rette indkomstmodtager: Allokering og fiksering*, 2005.
16 See to this effect Bundgaard, *Skatteret and civilret*, 2006, pp. 558 *et seq.*
17 See section 4.1 where the reason for introducing CFC legislation is explained.
18 Cf. s. 8(2) of the Corporate Tax Act.
19 The conditions for CFC taxation are dealt with below, see sections 4.2 and 4.3.
20 Cf. the preliminary remarks, bill L 121 (2004/2005 – 2. session). As a general rule, the relief provisions in Denmark's tax treaties are based on the credit method. However, if it follows from the applicable tax treaty that relief should be given pursuant to the exemption method, this should be respected. Accordingly, in that case no Danish "CFC taxation" should take place with respect to the income in the permanent establishment. See Wittendorff, *SR-Skat*, 2006, no. 1, pp. 57–74 and Guldmand Hansen *et al.*, *Sambeskatning* 2011/2012, 2011, p. 180.
21 Cf. s. 8(6) of the Corporate Tax Act.
22 S. 8(6) of the Corporate Tax Act was introduced recently as part of bill L 173 (2011/2012).

Transfer pricing legislation applies to "controlled transactions".[23] This provision sets forth the arm's length principle, which should be interpreted in line with the OECD transfer pricing guidelines.[24] Recently, a new rule that authorises the tax authorities to require a taxpayer to submit an auditor's assurance report on its transfer pricing documentation has been approved by Parliament.[25] The new rule targets loss-making companies and companies engaging in transactions with tax havens.[26]

The deductibility of interest expenses may in general be restricted under three sets of rules for corporate taxpayers: the "thin capitalisation test", the "asset test" and the "EBIT test".[27] The "asset test" and the "EBIT test" were introduced in 2007 as the legislator found that the CFC rules and the thin capitalisation rules in force at the time did not provide sufficient protection of the Danish tax base in situations where Danish companies were acquired by private equity funds in highly leveraged buy-outs.[28]

In order to counter tax arbitrage, possible double non-taxation and asymmetrical taxation in general, Denmark introduced rules on hybrid and reverse hybrid entities, which entail that the domestic qualification for tax purposes in some situations depends on the tax treatment in other jurisdictions.[29] Moreover, cross-border tax arbitrage by way of using hybrid financial instruments was curbed inbound and outbound.[30]

The following entities should be treated as investment companies:[31] (a) investment institutions as defined in the UCITS Directive (85/611/EEC); (b) companies whose business consists of 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 (c) companies that invest in securities, if the company's business consists of collective investment.[32] An investment company is not subject to taxa-

[23] Cf. s. 2 of the Tax Assessment Act. Further, s. 3B of the Tax Control Act contains information and documentation requirements.

[24] See Wittendorff, *Armslængdeprincippet i dansk og international skatteret* (2009) and Bundgaard and Wittendorff, *Armslængdeprincippet and Transfer Pricing* (2001) and the same authors in *Cahiers de droit fiscal international*, 2007, vol. 92a, Danish branch report, pp. 211–234.

[25] Cf. s. 3B(8) of the Tax Control Act.

[26] See Wittendorff, *Tax Notes International*, 2012, vol. 67, no. 3, pp. 237–239.

[27] Cf. s. 11, 11B and 11C of the Corporate Tax Act. In short, a company is thinly capitalised if the debt-to-equity ratio exceeds 4:1. Under the asset test, net financing expenses may be deducted only to the extent the expenses do not exceed a standard rate of presently 3.5 per cent (2012) of the tax base of certain qualifying assets. According to the EBIT test, net financing expenses may not exceed 80 per cent of earnings before interest and tax. See Tell, *Fradragsbeskæring af selskabers finansieringsudgifter*, 2012 and Hansen and Stokholm in *Cahiers de droit fiscal international*, 2008, vol. 93b, pp. 267–275.

[28] Cf. the general remarks to bill L 213 (2006/2007).

[29] Cf. s. 2A and 2C of the Corporate Tax Act.

[30] Cf. ss. 2B and 13 of the Corporate Tax Act.

[31] Cf. s. 19 of the Act on Taxation of Capital Gains on Sale of Shares.

[32] 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, are placed in assets other than securities, etc. Further, an exemption applies to so-called employee companies.

tion,[33] 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.[34]

If a resident company ceases to be fully liable to tax in Denmark, according to section 1 of the Corporate 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 of all assets and liabilities so that they are no longer subject to Danish taxation.[35] The assets and liabilities should be considered sold at fair market value at the time of emigration. Likewise, the transfer of assets and liabilities within a company, e.g. from the headquarters in Denmark to a foreign permanent establishment, is treated as a sale at fair market value at the time of the transfer.[36] An infringement procedure is initiated by the European Commission regarding the rules on exit taxation of companies.[37]

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 income of the foreign related entity is subject to substantially lower taxation than if the entity had been taxable under Danish law.[38] Royalties are as a general rule subject to 25 per cent withholding tax.[39] Dividends may also be subject to Danish withholding tax, but an exemption may apply to dividends originating from "subsidiary shares" and "group shares".[40] With respect to the Danish provisions on withholding taxation, several cases are currently pending concerning the interpretation of the concept of "beneficial ownership".[41]

33 Cf. s. 3(1)(19) of the Corporate Tax Act.

34 Cf. s. 23(7) of the Act on Taxation of Capital Gains on Sale of Shares.

35 Cf. s. 5(7) of the Corporate Tax Act.

36 Cf. s. 8(4) of the Corporate Tax Act. The National Tax Assessment Council stated that exit taxation may occur even if the income of the permanent establishment subsequently is subject to "CFC taxation" pursuant to s. 8(2) of the Corporate Tax Act, cf. SKM2009.643.SR.

37 See case C-261/11 (pending).

38 Cf. s. 2(1)(d) of the Corporate Tax Act and s. 65 D of the Act on Taxation at Source. If taxation should be waived or reduced pursuant to the EC 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 interest have been affiliated for at least one year in which period the payment is made.

39 Cf. s. 2(1)(g) of the Corporate Tax Act and s. 65 C of the Act on Taxation at Source. No withholding tax should be levied if the royalty is paid to a foreign entity qualifying under the EC Interest and Royalties Directive, provided that the companies paying and receiving the royalty have been affiliated for at least one year in which period the payment is made.

40 Cf. s. 2(1)(c) of the Corporate Tax Act. See also the introduction.

41 Presently, the leading case is a decision made by the High Court (Eastern Division), which the taxpayer won, cf. SKM2012.121.ØLR. See Bundgaard, *Tax Notes International*, 2012, vol. 68, no. 1, pp. 63–74.

4. CFC legislation

4.1. General issues

CFC rules for companies were introduced in 1995 following lengthy considerations about the pros and cons of such legislation.[42] From the preliminary remarks to the bill introducing the CFC rules it followed that the objective behind the new rules was to prevent erosion of the Danish tax base caused by the increasing openness of borders to flows of capital.[43] More specifically, the aim of the CFC rules was to prevent Danish companies from establishing subsidiaries in low-tax countries and moving income and assets there. Further, it followed directly from the preliminary remarks that the CFC rules were not only targeted at passive income but also at income from active business within the financial sector.[44]

The CFC legislation has been amended several times since its introduction in 1995.[45] As mentioned above, the rules were changed in 2002 in order to make it easier to assess whether the conditions for applying the rules were fulfilled. However, the most significant amendments took place in 2007 following the European Court of Justice's decision in case C-196/04 *Cadbury Schweppes*.[46] Unlike most other Member States, the Danish legislator responded to the decision by widening the field of application of the CFC rules. Accordingly, the condition that the subsidiary should be subject to low taxation was abolished, as the amended rules also apply domestically.[47] Moreover, the 2007 reform entailed a shift from a transactional approach towards a jurisdictional approach (entity approach), as the entire income of the subsidiary – and not only the tainted income – should be attributed to the parent company according to the present rules, provided that the conditions in the CFC rules are fulfilled.[48] Only minor more technical changes have been made to the CFC rules after 2007.[49]

42 The possibility of introducing CFC rules was already discussed 10 years earlier by a committee appointed by the Minister of Taxation, cf. recommendation no. 1060, 1985. Back then the committee concluded that CFC legislation would be too hard to administer.

43 Cf. bill L 35 (1994/1995).

44 The objective of the CFC rules was described in (almost) similar ways in connection to later amendments of the rules, cf. e.g. bill L 213 (2006/2007).

45 See Michael Sørensen in *Cahiers de droit fiscal international*, 2001, vol. 86b, Danish branch report, pp. 457–478, concerning the initial CFC rules.

46 Cf. bill L 213 (2006/2007).

47 As a consequence the abbreviation "CFC" now stands for "controlled financial company", cf. the tax authorities' Legal Guidelines, 2012, para. C.D.4.1.1.

48 However, traces after the transactional approach can still be found in the rules. It is worth noting that the Danish CFC rules for individuals, as a general rule, still only apply to foreign companies subject to low taxation, cf. s. 16 H of the Tax Assessment Act. Upon application, an individual can be exempt from CFC taxation if the company is resident in the EU/EEA, provided that the company is in effect established in the Member State and that the company performs a genuine economic activity concerning the CFC income in that state.

49 Cf. e.g. bill L 23 (2008/2009).

4.2. Definition of a CFC

Pursuant to the wording, the Danish CFC rules apply to "a parent company of a company or an association ('the subsidiary')", cf. section 32(1) and (6) of the Corporate Tax Act. Accordingly, a legal entity that pursuant to Danish rules is considered a separate taxable entity could constitute a CFC. If none of the owners is liable for the entity's liabilities and the entity's profit is shared among the owners in proportion to their part of the invested capital, the entity should normally be considered a separate taxable entity.[50] A foundation or a trust cannot constitute a CFC.[51]

The CFC rules only apply if the tainted income – known as the CFC income – of the subsidiary amounts to more than 50 per cent of the subsidiary's total taxable income in a given year.[52] In other words an "income condition" applies.[53] The total income should be calculated in accordance with Danish rules.[54] The CFC income consists of certain kinds of income that presumably can easily be placed in a subsidiary abroad, cf. the exhaustive list provided in section 32(5) of the Corporate Tax Act:

(a) taxable interest income and deductible interest expenses;
(b) taxable gains and deductible losses on debt claims, debt and financial contracts;[55]
(c) certain deductible fees and charges paid in connection to obtaining loans and the corresponding taxable fees, etc.;[56]
(d) taxable dividends and taxable sales prices concerning shares;
(e) taxable gains and deductible losses on shares;
(f) payments of any kind received as compensation for the use of, or the right to use, intangible assets as well as gains and losses connected to the transfer of intangible assets;[57]
(g) deductible expenses related to the items mentioned in (a) –(f);
(h) taxable income originating from financial leasing, including gains and losses from the sale of assets used in connection to financial leasing; and
(i) taxable income originating from insurance activities, activity as a bank or mortgage credit institution and other financial activity.

50 A specific assessment based on several different criteria should be made. See the tax authorities' Legal Guidelines, 2012, para. C.D.1.1.3. Certain anti-avoidance rules apply to hybrid entities.

51 See circular letter no. 82, 25 May 1997, para. 7.2.3.

52 Cf. s. 32(1)(1) of the Corporate Tax Act.

53 The assessment of whether the "income condition" is fulfilled should be based on the income generated during the course of the subsidiary's full income year, cf. the Minister of Taxation's reply published in SKM2008.240.DEP.

54 Cf. e.g. the preliminary remarks to bill L 23 (2008/2009), annex 15. Some adjustments have to be made, e.g. concerning depreciable assets and assets received or transferred in connection to "tax exempt restructurings", cf. s. 32 (4) of the Corporate Tax Act. See section 4.5 below.

55 Gains and losses on certain contracts (forward contracts, etc.) are in some cases excluded from the CFC income if the contracts aim at protecting the subsidiary's earnings and expenditures from business operations.

56 As mentioned in s. 8(3) of the Tax Assessment Act.

57 An exception applies to payments received for the use of, or the right to use, intangible assets developed by the subsidiary itself, provided that the payment does not originate from another group company. Intangible assets are defined in accordance with art. 12(2) of the OECD model tax convention.

Besides the "income condition" an "asset condition" also applies. Thus, the CFC rules only apply if the financial assets of the subsidiary exceed 10 per cent of the total assets.[58] Financial assets are defined as assets that can generate CFC income. Assets that generate tax exempt income should not be included in the calculation. In addition, non-interest bearing receivables connected to the sale of goods, etc. should not be included either. The calculation should be based on the assets' book values. However, with respect to intangible assets that generate CFC income, the market value should be used. It is not sufficient to calculate the ratio based on the assets and their value at the beginning and at the end of the income year, as an average assessment over the entire income year should be made.[59]

A "transparency rule" applies with respect to the "income condition" as well as the "asset condition".[60] The aim of the rule is to ensure that the establishment of a foreign local holding company – owning a subsidiary resident in the same country which performs business operations – does not give rise to CFC taxation at the level of the Danish parent company. Accordingly, when assessing whether the "income condition" and the "asset condition" are fulfilled with respect to the local holding company, a consolidated calculation should be made.[61]

4.3. Control or participation

The CFC rules only apply if a company (the parent company) directly or indirectly is a shareholder in the subsidiary, and the group has "decision-making influence" over the subsidiary.[62] In the wording reference is made directly to the definition of "decision-making influence" in the rules about tax consolidation.[63] Accordingly, "decision-making influence" should be understood as the right to control the economic and operational decisions of the subsidiary. "Decision-making influence" appears, for instance, when the parent company directly or indirectly owns more than 50 per cent of the voting rights in the subsidiary, unless under special circumstances it can be clearly demonstrated that such a shareholding does not constitute a decision-making influence.[64]

58 Cf. s. 32(1)(2) of the Corporate Tax Act.

59 Cf. the preliminary remarks to bill L 213 (2006/2007) and the Minister of Taxation's reply published in SKM2008.240.DEP. The amount of measurement points necessary is determined based on a specific assessment. Focus should be on changes in the amount of financial assets that are not a result of the ordinary business of the CFC (such as e.g. sale of goods).

60 Cf. s. 32(1)(1) and (2) of the Corporate Tax Act.

61 The "transparency rule" does not only apply to "pure" holding companies. In the example at hand, a subsequent assessment of the second-tier subsidiary – with respect to the "income condition" and "asset condition" – should be made on a stand-alone basis.

62 Cf. s. 32(6) of the Corporate Tax Act. It is not a condition for the application of the CFC rules that "decision-making influence" appears on certain dates (i.e. at the beginning or at the end of an income year). If the parent company only has "decision-making influence" in part of the income year, the income generated by the CFC in this limited period is subject to CFC taxation at the level of the parent company, provided that the other CFC conditions are fulfilled. In that case, it will be necessary to calculate the CFC's taxable income for the part of the year in which the parent company had "decision-making influence", cf. s. 32(12) of the Corporate Tax Act and circular no. 82 of 29 May 1997, para. 7.3.3.2. See also section 4.5 below.

63 See s. 31C of the Corporate Tax Act.

64 Cf. s. 31C(3) of the Corporate Tax Act. Even if the parent company does not own more than 50 per cent of the voting rights, it could in some cases still be seen as having "decision-making influence",

When determining whether "decision-making influence" exists, with respect to the CFC rules, voting rights held by individual shareholders as well as their close relatives should also be taken into account.[65] According to very complex rules on "constructive ownership" also voting rights held by other shareholders with which the parent company has agreed to exercise "common decision-making influence" should be included. In addition, voting rights held by certain transparent entities in which the parent company is a participant should be included. These rules on "constructive ownership" were inserted into the CFC rules in 2006 as part of a wider intervention aimed at private equity funds.[66]

4.4. Definitions of "low taxation" and of a targeted territory

As mentioned above, the CFC rules for companies also apply with respect to subsidiaries resident in Denmark. Accordingly, no "low-tax condition" appears in the present rules. As a consequence there is no need for "white lists" or "blacklists".

4.5. Attributed income and the calculation of income

If all the conditions for CFC taxation are fulfilled, the entire income of the subsidiary should be included in the taxable income of the parent company, provided that the income of the subsidiary is positive.[67] If the parent company does not fully own the subsidiary, only a proportional part of the subsidiary's income equal to the parent company's average direct or indirect part of the subsidiary's share capital should be attributed to the parent company. Further, only income generated by the subsidiary in the period during which the parent company had "decision-making influence" should be included.[68] The income of the subsidiary that is attributable to the parent company should be calculated in accordance with Danish tax rules, including the (limited) principle of territoriality.[69] The Minister of Taxation has confirmed that the total income of the subsidiary – to be used in assessing whether the "income condition" is fulfilled and to determine the amount to be attributed to the parent company – can be calculated in foreign currency. Subsequently, the total income is then converted into Danish currency.[70]

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as a result of e.g. the contents of the articles of association, an agreement or practical majority at the annual meeting, cf. s. 31C(4) of the Corporate Tax Act. For a more thorough analysis see Guldmand Hansen *et al.*, *Sambeskatning* 2011/2012, 2011, pp. 19–32.

65 Close relatives comprise a spouse, parents, grandparents, children and grandchildren and their spouses and an estate after decease of close relatives; cf. s. 16 H(6) of the Tax Assessment Act. Also voting rights held by foundations and trusts established by close relatives, etc. should be included.

66 Cf. bill L 116 (2005/2006).

67 Cf. s. 32(1) of the Corporate Tax Act.

68 Cf. s. 32(7) of the Corporate Tax Act.

69 Cf. e.g. the preliminary remarks to bill L 23 (2008/2009), annex 15. The application of the (limited) principle of territoriality for instance entails that income from a subsidiary's permanent establishment abroad should be excluded. Instead a separate CFC assessment of the subsidiary's permanent establishment is made, cf. s. 32(3) of the Corporate Tax Act. If the CFC conditions are fulfilled with respect to the subsidiary's permanent establishment, the income of the permanent establishment should be attributed to the Danish parent company.

70 Cf. bill L 213 (2006/2007), annex 26.

Certain adjustments should be made to the subsidiary's income calculated pursuant to Danish rules.[71] For example, when the subsidiary transfers assets and liabilities acquired before the group obtained "decision-making influence" over the subsidiary, the market value at the point in time when the group obtained "decision-making influence" should be used instead of the original acquisition price. Further, special rules apply in order to determine the tax basis of the subsidiary's intangible assets and depreciable assets. Thus, no acquisition price (tax basis) should be determined for intangible assets and goodwill developed by the subsidiary itself.[72] Moreover, if the subsidiary has not fulfilled the CFC conditions in the previous year, the tax basis of other depreciable assets should be calculated as the original acquisition price less the accumulated foreign tax depreciations.[73] Finally, certain rules apply in order to secure that "tax exempt" restructuring – in which the subsidiary participates – in most situations should not give rise to CFC taxation.

4.6. Domestic taxpayers to which the income is attributed

The CFC legislation applies to companies and associations that are fully liable to Danish taxation.[74] In addition, the CFC rules apply to permanent establishments in Denmark of a company or association resident abroad. As mentioned above, the CFC rules only apply if the resident company or permanent establishment (the parent company) directly or indirectly is a shareholder in the subsidiary, and the group has "decision-making influence" over the subsidiary.[75] If a subsidiary has more than one direct/indirect Danish parent company, CFC taxation has effect at the level of the parent company owning the largest direct/indirect part of the share capital in the subsidiary. If two or more Danish parent companies directly/indirectly own an equal part of the share capital in the subsidiary, CFC taxation should take place at the level of the parent company placed highest in the corporate chain.[76]

71 Cf. s. 32(8) of the Corporate Tax Act.

72 In other words, the acquisition price (tax basis) should be considered nil, cf. the direct reference made in the provision to s. 4 A(1)(2-3) of the Corporate Tax Act. This provision was introduced in 2004. The main aim was to avoid a company – participating in tax exempt restructuring carried out before the company became fully liable to Danish taxation – getting a "free" step-up on the tax basis. See Wind Andersen, *Danish Journal of International Taxation*, 2004, no. 158, pp. 315–325.

73 However, if the subsidiary for some reason has chosen not to take full advantage of the possibility for depreciation in previous income years pursuant to foreign rules, or if the foreign tax basis cannot be assessed, the depreciable asset should be considered acquired at the actual time of the acquisition to the original acquisition price and then depreciated pursuant to Danish tax rules. This follows from s. 31 A(8) of the Corporate Tax Act, which the CFC rules directly refer to.

74 Cf. s. 32(1) of the Corporate Tax Act which refers directly s. 1 of the Corporate Tax Act. The latter provision lists the different entities subject to full Danish taxation.

75 The CFC rules also apply to foundations and associations that are subject to tax pursuant to the Act on Taxation of Foundations, cf. s. 12(1). However, foundations and associations are not subject to CFC taxation of the income in a lower-tier subsidiary if the income of that subsidiary is already subject to Danish CFC taxation in the hands of an intermediate company pursuant to s. 32 of the Corporate Tax Act.

76 Cf. s. 32(1) of the Corporate Tax Act.

4.7. Exemptions from CFC taxation

Several exemptions from the CFC rules exist. First, CFC taxation should not take place if the group has opted for voluntary international tax consolidation.[77] Secondly, the CFC rules do not apply if the parent company's shares in the subsidiary are to be considered shares in an investment company, as defined in section 19 of the Act on Taxation of Capital Gains on Sale of Shares.[78] Thirdly, pursuant to section 32(4), CFC taxation is not a possibility if the parent company owns the shares in the subsidiary through a legal person subject to taxation according to section 13F in the Corporate Tax Act (life insurance companies).[79]

As mentioned above, the Danish CFC rules may also target active business carried out by subsidiaries within the financial sector, as taxable income originating from insurance activities, activity as a bank or mortgage credit institution and other financial activities are to be considered tainted income (CFC income). Right from the beginning this fact was subject to heavy criticism.[80] As a result, an exception for certain kinds of subsidiaries operating within the financial sector was introduced in 2002, cf. section 32(2) of the Corporate Tax Act.[81] Accordingly, the National Tax Assessment Council is entitled to allow an exemption from the CFC rules with respect to subsidiaries involved in activity as an insurance company, a mortgage credit institution, an investment services company, an investment management company or a bank.[82] However, permission will only be given if all of the following conditions are fulfilled:[83]

- the subsidiary has a concession to perform the above-mentioned activities within the financial sector;
- the subsidiary is subject to surveillance of a public authority;
- the major part of the subsidiary's income originates from business with clients in the country where the subsidiary is resident. It follows from the preliminary remarks that the condition as a main rule should be considered fulfilled if the income originating from domestic clients is at least twice the amount of the income originating from foreign clients;
- the major part of the subsidiary's income originates from business with clients that are not affiliated to the subsidiary. It follows from the preliminary remarks that the condition as a general rule should be considered fulfilled if

77 Cf. s. 32(2) of the Corporate Tax Act. CFC taxation should not take place if the subsidiary is still subject to taxation of recapture of losses realized under the former tax consolidation regime. This exception does not follow from the wording of s. 32 of the Corporate Tax Act, but is mentioned in the preliminary remarks to bill L 213 (2006/2007).

78 Cf. s. 32(1)(3) of the Corporate Tax Act. For further information on investment companies see section 3.

79 This exception was introduced in 2007 – bill L 110 A (2006/2007) – in order to avoid double taxation, i.e. CFC taxation as well as taxation of gains based on a mark-to-market principle at the same time.

80 See Wittendorff, *Danish Journal of International Taxation*, 2002, no. 66, pp. 142–149.

81 Cf. bill L 99 (2001/2002 – 2. session).

82 The same exemption applies with respect to foreign permanent establishments subject to the switch-over rule mentioned above in section 3.

83 For an analysis of the many decisions from the National Tax Assessment Council concerning exemption from the CFC rules see Koerver Schmidt, *Danish Journal of International Taxation*, 2011, no. 486, pp. 903–914.

the income originating from non-affiliated clients is at least twice the amount of the income originating from affiliated companies;[84]

- the subsidiary's capital base does not exceed the amount necessary to perform its activity as an insurance company, a mortgage credit institution, an investment services company, an investment management company or a bank; and
- the subsidiary is Danish, or the taxation of dividends from the subsidiary should be eliminated or reduced pursuant to the EU Parent–Subsidiary Directive or a treaty with the country in which the subsidiary is resident.

The National Tax Assessment Council is entitled to attach certain terms/conditions when allowing an exemption from the rules. The maximum duration of the exemption is 10 years. In the tax literature it is among other things argued that the conditions for obtaining a dispensation from the National Tax Assessment Council are too strict to serve the purpose.[85]

4.8. Relief provisions (foreign taxes and losses)

As mentioned in section 4.5, the income of a subsidiary should only be attributed to the parent company, if the subsidiary's income is positive. If the subsidiary has tax losses carried forward from previous income years, these losses can be set off against the income attributed to the parent company.[86] The same applies to losses transferred to the subsidiary as a result of participation in a local tax consolidation or as a consequence of "other kind of rules concerning the transfer of losses".[87] However, the amount to be set off against the income attributed to the parent company cannot exceed an amount equal to the losses calculated in line with Danish tax rules.

When a parent company is subject to CFC taxation, relief is granted for taxes paid by the subsidiary according to the ordinary credit method.[88] Relief is given for Danish and foreign taxes paid by the subsidiary, including withholding taxes.[89] If the parent company has tax losses carried forward or has made a tax loss in the year in which CFC taxation takes place, the parent company can choose to leave out of account the losses in order to utilise the possibility of relief.[90]

If the Danish parent company owns the subsidiary indirectly – e.g. through another subsidiary resident in country B – and the income of the subsidiary is also

84 Cf. bill L 99 (2001/2002 – 2. session)

85 Cf. Nyhegn-Eriksen, RR, 2007, no. 8, pp. 60–66, Rosenlund and Reinhold Andersen, *Danish Journal of International Taxation*, 2007, no. 235, pp. 532–546 and Zahle and Steenholdt, *SR-skat*, 2007, no. 6, pp. 477–489.

86 Cf. s. 32(9) of the Corporate Tax Act. It is not a condition that the CFC conditions were fulfilled in previous years, cf. the National Tax Assessment Council in SKM2010.57.SR.

87 With respect to a subsidiary resident in the United Kingdom, the National Tax Assessment Council confirmed that losses transferred to the subsidiary, according to the UK rules about "group relief", could be set off against the income attributed to the parent company, cf. SKM2008.229.SR. Moreover, the Minister of Taxation has stated that e.g. the Finnish rules on "group contributions" are to be considered "other kinds of rules on transfer of losses", cf. SKM2008.240.DEP.

88 Cf. s. 32(11) of the Corporate Tax Act. The CFC rules refer directly to the domestic relief provision in s. 33 of the Tax Assessment Act.

89 The relief should be calculated as if the subsidiary was taxed according to the (limited) principle of territoriality. See section 1.

90 Cf. s. 32(9). The wording refers to the provision in s. 33 H of the Tax Assessment Act.

subject to CFC taxation in country B – no relief is given for the tax paid on the CFC income by the intermediate subsidiary in country B.[91] Hence, a risk of double taxation exists.

If the CFC conditions are fulfilled with respect to a subsidiary resident in Denmark, relief is granted for Danish tax paid by the Danish subsidiary. As the same corporate tax rate (25 per cent) applies to the Danish subsidiary and the Danish parent company the relief granted – for taxes paid by the Danish subsidiary – should fully absorb the parent company's additional tax on the income from the Danish subsidiary. In other words, if the CFC conditions are fulfilled with respect to a Danish subsidiary, it should not result in a higher tax burden.[92]

As CFC taxation is based on a year-by-year assessment, CFC taxation of the income in a foreign subsidiary may result in a higher tax burden for the parent company in a given year, even though the subsidiary – seen over more than one income year – locally pays taxes to an amount equal to or even higher than the Danish level of taxation. This could e.g. be the case if the Danish rules differ from the rules in the country where the subsidiary is resident with respect to when certain deductions can be made (timing differences). As a result, a quite complex rule concerning reimbursement of excess CFC tax was introduced in 2001.[93] In short, previously paid CFC tax on income from a subsidiary can be set off against the parent company's taxes in a later income year, to the extent that the sum of the Danish and foreign taxes paid on the income from the subsidiary exceeds the sum of the Danish tax calculated with respect to the subsidiary's income in the income year in question as well as in the intervening income years. If the amount calculated is too large to be set off against the parent company's taxes, the excess amount should be repaid to the parent company in cash.

Any gain on shares in a subsidiary held directly by a Danish parent company should normally not be taxable, as the shares in the subsidiary in most cases would be considered "group shares" or "subsidiary shares".[94] However, the special provision regarding "deemed surrender taxation" should be taken into account.[95] The provision was introduced in 1999 in order to ensure that CFC taxation could not be avoided by selling the shares in the subsidiary (e.g. in a situation where no CFC income had yet been generated by the subsidiary because the subsidiary had only invested in e.g. zero-coupon bonds).[96] Accordingly, if the parent company directly or indirectly reduces its ownership share in the subsidiary, the subsidiary should be seen as having transferred certain assets and liabilities at market value.[97] As a

91 Cf. bill L 213 (2006/2007), annex 31. The Danish Bankers Association had asked the Minister of Taxation to consider the example mentioned in the body text. In his answer the Minister of Taxation stressed that relief was only given for taxes paid by the CFC itself.

92 This has been confirmed by the Ministry of Taxation, cf. bill L 213 (2006/2007), annex 1. Further, it should be noted that if CFC taxation applies with respect to a subsidiary resident in Denmark, CFC taxation occurs after tax losses are apportioned among the group companies, pursuant to the rules on mandatory national tax consolidation, and after taxation of the subsidiary.

93 Cf. s. 32(13) of the Corporate Tax Act. See bill L 35 (2000/2001). Later some of the conditions for reimbursement were relaxed, cf. bill L 99 (2001/2002).

94 See section 1.

95 Cf. s. 32(10) of the Corporate Tax Act.

96 Cf. bill L 53 (1998/1999). The scope was widened in 2001, cf. bill L 35 (2000/2001).

97 The rule concerns assets and liabilities covered by the Act on Taxation of Capital Gains on Sale of Shares and by the Act on Taxation of Gains and Losses on Debt Claims, Debt and Financial

result, any deemed gains and losses on these assets and liabilities should be taken into account when assessing whether the CFC conditions are fulfilled.[98] Moreover, if all the CFC conditions are fulfilled the deemed gains and losses should be included in the income attributed to the parent company. Only a proportional amount equal to the reduction of the parent company's ownership share in the subsidiary should be included. The parent company is entitled to relief for the tax that the subsidiary should have paid in the country where it is resident if it actually had transferred the assets and liabilities at market value.[99]

Dividends distributed by the subsidiary to the parent company should normally not be taxable, as the shares in the subsidiary in most cases would be considered "group shares" or "subsidiary shares".[100] However, as a consequence of the rules on "constructive ownership", see section 4.3, it cannot be excluded that dividends distributed from a subsidiary in certain cases would be taxable, if the parent company's shareholding does not meet the requirements for being considered "group shares" or "subsidiary shares". If the income of the subsidiary had previously been subject to CFC taxation at the level of the parent company, the distribution of taxable dividends would result in double taxation.[101]

5. General tax treaty issues

Right from the introduction of CFC rules in 1995 the relationship between these rules and Denmark's tax treaties has been subject to debate in the tax literature.[102] Over the years, the Danish legislator has maintained the position that CFC legislation does not conflict with Denmark's tax treaties, as the CFC rules: "only concern the taxation of a Danish company".[103] In other words, in view of the Danish

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Instruments. It also applies to provisions made for tax purposes by the subsidiary. The rule does not apply if the shares in the subsidiary are transferred to another group company, cf. s. 31 of the Corporate Tax Act, or a close relative, cf. s. 16H of the Tax Assessment Act.

98 This was specified in 2004, cf. bill L 119 (2003/2004), in reaction to a decision made by the National Tax Tribunal, SKM2004.248.LSR, in which the tribunal had found that the "deemed transfer" should not be taken into account when assessing whether the CFC conditions were fulfilled. According to the legislator, the decision showed a loophole in the rules, cf. the tax committee's report of 17 March 2004, bill L 119 (2003/2004), annex 72. As a result, it was specified in the wording that the "deemed transfer" should also affect the assessment of whether the CFC conditions were fulfilled.

99 Cf. s. 32(11) of the Corporate Tax Act.

100 See section 1.

101 This fact has been pointed out to the Minister of Taxation. However, the Minister of Taxation answered that this limited risk of double taxation was considered tolerable for the sake of keeping the CFC rules usable, cf. bill L 23 (2008/2009), annex 15.

102 See e.g. Steenholdt, *Journal of Danish Tax Law*, 1995, no. 148, pp. 223–228, Cort Hansen, *Danish Journal of International Taxation*, 1999, no. 5, pp. 24–34, Laurbjerg Nielsen, *Danish Journal of International Taxation*, 1999, no. 191, pp. 407–416, Svendgaard, *Frivillig og tvungen sambeskatning af selskaber*, 2001, pp. 250–251, Nyhegn-Eriksen, RR, 2002, no. 9, pp. 10–21, Amby, *Danish Journal of International Taxation*, 2003, no. 219, pp. 510–511 and Rix in Aigner *et al.*, *CFC Legislation, Tax Treaties and EC Law*, 2004, pp. 152–164.

103 Cf. bill L 35 (1994/1995), annex 46 (see also annex 16 and 33). The Minister of Taxation restated his position in bill L 35 (2000/2001), annex 6.

legislator, the CFC rules should not be considered in conflict with Denmark's tax treaties (even though CFC taxation may result in economic double taxation), as tax treaties in general only concern juridical double taxation.[104] It should be noted that Denmark's tax treaties normally do not contain a provision specifically concerning CFC taxation.[105]

The question of whether the Danish CFC regime is in line with double taxation treaties was addressed by the National Tax Tribunal.[106] The case concerned a Danish company that controlled a subsidiary in Switzerland, which performed banking activities. Referring to the 2003 commentaries to the OECD model tax convention, the National Tax Tribunal stated that the CFC regime was not contrary to Denmark's obligations according to the double taxation treaty with Switzerland. It is interesting that the tribunal without further explanation referred to the 2003 commentaries when taking into account that the treaty with Switzerland was signed in 1973.[107]

Further, the reasoning of the tribunal is interesting as emphasis was put on the fact that the CFC rules (of that time) only covered situations where a subsidiary – mainly performing activities of a financial nature – was taxed at a significantly lower rate than it would have been according to Danish tax rules. As mentioned above, fundamental amendments were made to the Danish CFC regime in 2007, including the abolition of the "low-tax condition". 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 tax convention, especially since the commentaries specify that:[108] "As a general rule, these measures should not be applied where the relevant income has been subjected to taxation that is comparable to that in the country of residence of the taxpayer." On the other hand, it must be acknowledged that the various statements in the commentaries about CFC taxation and tax treaties are not particularly clear and to some extent seem self-contradictory.[109] For example it is also stated that article 7:[110] "does not

104 The relationship between Danish law and treaties can be described as dualistic, cf. Michelsen in Lang (ed.), *Tax Treaty Interpretation*, 2000, pp. 63–76. For a more thorough description of the relationship between Danish anti-avoidance provisions and tax treaties see Bundgaard and Koerver Schmidt, *Cahiers de droit fiscal international*, 2010, vol. 95a, Danish branch report, pp. 261–279.

105 Cf. Bundgaard in Winther-Sørensen *et al.*, *Skatteretten* 3, 2009, p. 330.

106 Cf. SKM2004.439.LSR.

107 Compared to earlier commentaries, the 2003 update more clearly reflects the position that CFC taxation should normally not be considered in breach of tax treaty obligations. Even though the Danish Supreme Court in certain cases (not concerning CFC legislation) has applied a dynamic method of interpretation, it has been questioned whether more recent commentaries can be applied when considering whether the Danish CFC rules are in breach of Denmark's older tax treaties, cf. Michelsen, RR, 2005, no. 1, SM, pp. 2–5.

108 Cf. the 2010 commentaries to art. 1 in the OECD model tax convention, para. 26. This fact has been pointed out to the Minister of Taxation by the Danish Auditors Association (FSR), cf. bill L 213 (2006/2007), annex 1.

109 Cf. de Broe, *International Tax Planning and Prevention of Abuse*, 2008, p. 591. Brian J. Arnold, *Bulletin for International Taxation*, 2004, pp. 244–260, has argued that: "The simplistic statements about CFC rules in the prior and current Commentary on Art. 1 do not adequately reflect the different legislative approaches used by various countries; as a result, these statements could lead to inappropriate conclusions about whether a particular country's CFC-rules conflict with its tax treaties."

110 Cf. the 2010 commentaries to art. 7 in the OECD model tax convention, para. 14.

limit the right of a Contracting State to tax its own residents under controlled foreign companies provisions found in its domestic law". Therefore, it is not easy to conclude whether the Danish CFC rules are in line with Denmark's tax treaty obligations.[111]

6. EU law issues

Whether the Danish CFC rules should be considered in line with the fundamental freedoms has also been subject to considerable debate over the years. As mentioned in section 4.1 the Danish CFC rules were amended as a consequence of the European Court of Justice's decision in case C-196/04 *Cadbury Schweppes*. Accordingly, the condition that the subsidiary should be subject to low taxation was abolished, as the amended rules should also apply domestically, i.e. to subsidiaries resident in Denmark. In the view of the legislator, this amendment entails that: "there is no different treatment, no matter whether the parent company owns a subsidiary resident in Denmark, a foreign subsidiary resident in the EU/EEA or a foreign subsidiary resident outside the EEA".[112]

The National Tax Assessment Council had the opportunity to consider whether the amended CFC rules should be considered in line with EU law. The case concerned a Danish operational company which contemplated establishing a subsidiary in Cyprus.[113] It was the intention that the subsidiary in Cyprus should invest the profits – originating from the Danish parent company's business activities – in securities. The council concluded that the current Danish CFC rules did not conflict with EU law. However, the decision was very brief regarding this matter and the council mainly repeated the point of view of the legislator that no different treatment exists, as the rules also apply with respect to Danish subsidiaries.

In the Danish tax literature several authors argue that the CFC rules might still be in conflict with the fundamental freedoms, in particular article 49 on the freedom of establishment.[114] The main argument is that different treatment still exists,

111 For a more thorough analysis see Koerver Schmidt, *SR-Skat*, 2012, no. 5, where the uncertainty is pointed out but where it is also concluded that the Danish CFC rules should probably not be considered in breach of Denmark's tax treaty obligations. See also Kirkegaard, *Danish Journal of International Taxation*, 2007, no. 236, pp. 547–555.

112 Bill L 213 (2006/2007).

113 Cf. SKM2008.450.SR. The decision also dealt with several questions related to the CFC rules for individuals, cf. s. 16H of the Tax Assessment Act, including the exception for subsidiaries which are in effect established in another EU/EEA Member State and perform a genuine economic activity concerning the CFC income in that state.

114 Cf. Oreby Hansen & Lytken, *Danish Journal of International Taxation*, 2012, no. 141, pp. 252–261, Rønfeldt, *Skatteværn og EU-frihed*, 2010, pp. 371–375, and same author in SpO, 2008, no. 2, pp. 65–85 and in *Intertax*, 2009, no. 1, pp. 40–50, Knudsen and Pham, special addendum to *Journal of Danish Taxation*, 2009, Kirkegaard, *Danish Journal of International Taxation*, 2007, no. 236, pp. 547–555, Terkilsen, *IUR-information*, 2007, no. 5/6, pp. 22–25, Nyhegn-Eriksen, RR, 2007, no. 8, pp. 60–66 and Zahle and Steenholdt, *SR-Skat*, 2007, no. 6, pp. 477–489. Michelsen, *Danish Journal of International Taxation*, 2008, no. 85, pp. 237–249 appears to be more cautious. He states that if it is correct to assume that the European Court of Justice in effect uses a discrimination test (and not a restriction test), it is not certain that the Danish CFC rules conflict with

as the application of the CFC rules only entails an additional tax burden for the Danish parent company, if the subsidiary is resident in another country in which the level of taxation is lower than the Danish level of taxation.[115] As explained in section 4.8, the relief granted for taxes paid by a Danish subsidiary should normally fully absorb the parent company's additional tax on the income from the Danish subsidiary. Moreover, if a subsidiary resident in Denmark forms part of a tax consolidation, CFC taxation should only take place after tax losses are apportioned among the group companies and after taxation of the subsidiary itself.[116]

If it is correct to assume that the Danish CFC rules still result in different treatment with respect to Danish and foreign subsidiaries – and that the CFC rules therefore constitute a restriction on the freedom of establishment – it seems fairly straightforward to conclude that the Danish CFC legislation goes beyond what is necessary to achieve its purpose. As explained in section 4.2, the Danish CFC rules have a very broad field of application and are not limited to wholly artificial arrangements. Moreover, it is of no significance for the application of the Danish CFC rules whether the taxpayer intended to escape the tax normally due.[117] Finally, as it appears from section 4.7, no exemption was introduced in the rules with respect to subsidiaries that are in effect established in another EU/EEA member state and perform a genuine economic activity there. In conclusion, it seems uncertain whether the Danish CFC rules for companies should be considered in line with EU law.

cont.
the freedom of establishment, as the rules do not discriminate because they also apply to Danish subsidiaries.

115 In this regard it is worth considering the remark made by the European Court of Justice that: "Even taking into account … that such a resident company does not pay, on the profits of a CFC within the scope of application of that legislation, more tax than that which would have been payable on those profits if they had been made by a subsidiary established in the United Kingdom, the fact remains that under such legislation the resident company is taxed on profits of another legal person. That is not the case for a resident company with a subsidiary taxed in the United Kingdom or a subsidiary established outside that Member State which is not subject to a lower level of taxation." See case C-196/04 *Cadbury Schweppes*, para. 45.

116 On the other hand, it may be argued – based on Case C-298/05 *Columbus Container Services* – that the Danish switch-over rule in s. 8(2) of the Corporate Tax Act does not conflict with the freedom of establishment, as there is no discrimination resulting from a difference in the treatment of permanent establishments abroad and "permanent establishments" in Denmark, cf. Terkilsen, *Frit valg af etableringsform*, 2010, pp. 156–168 and Bundgaard in Winther-Sørensen *et al.*, *Skatteretten* 3, 2009, p. 329. For the opposite opinion see Guldman Hansen *et al.*, *Sambeskatning* 2011/2012, 2012, pp. 312–313 and 350.

117 See Case C-196/04 Cadbury Schweppes, para. 51: "It follows that, in order for a restriction on the freedom of establishment to be justified on the ground of prevention of abusive practices, the specific objective of such a restriction must be to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory."