25.

Denmark

Introduction

The Danish transfer pricing rules, which are based on the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines, have evolved considerably since their initial implementation in the late 1990s. The Danish transfer pricing rules can be found in Section 2 of the Danish Tax Assessment Act (DTAA), and Section 3B and Section 17 of the Danish Tax Control Act (DTCA). Section 2 of the DTAA implements the arm's-length principle and section 3B of the DTCA imposes notification requirements on the taxpayer and requires the preparation of transfer pricing documentation, while section 17 of the DTCA enacts fines and penalties for noncompliance with the documentation requirements.

In addition, the Danish Tax Authorities (DTA) issued Executive Order (no. 42) in 2006 and have issued guidelines regarding the transfer pricing documentation requirements. The latest version of the guidelines was issued on 24 January 2013. The main aim is to ensure that all the requirements in the statutory rules are observed when documenting controlled transactions, truly demonstrating the adoption of the arm's-length principle.

In August 2009, the DTA introduced a valuation guideline in relation to the valuation of businesses, parts of businesses and intangible assets. The valuation guidelines are not binding for the taxpayer, but are considered the best practice for the valuation of companies and part of companies, including valuation of goodwill and other intangible assets. Further, the guidelines offer recommendations in the application of valuation models as well as recommendations to the content of documentation in relation to a valuation. These guidelines were updated on 15 January 2013.

In 2010, the DTA issued an action plan to focus on loss making companies and companies that do not pay tax, so called 'zero tax' companies. In June 2012, the Parliament passed a new bill on 'zero-tax' companies, tightening the rules on applicable penalties for failure to submit compliant transfer pricing documentation and authorising the DTA to, under certain conditions, impose an independent auditor's statement regarding compliance with the arm's-length principle.

In 2011, the DTA issued transfer pricing adjustments in the amount of 6.2 billion Danish kroner (DKK) and in 2012 the amount increased to DKK 21.1 billion.

Statutory rules

Section 2 of the DTAA does not address only cross-border transactions, but all transactions between related parties. Section 2 of the DTAA provides that the arm's-length principle applies to taxpayers which:

- are controlled by an individual or company
- control companies (i.e. directly or indirectly own more than 50% of the share capital or control more than 50% of the votes in another company)
- are related to a company (i.e. are controlled by the same shareholders)
- have a permanent establishment situated abroad, or
- are a foreign individual or a foreign company with a permanent establishment in Denmark.

In this context the term 'control' means that a company or individual owns (directly or indirectly) more than 50% of the share capital or controls more than 50% of the votes or has an agreement regarding controlling interest in another company. Related parties are parties that are controlled by the same (group of) shareholder(s), and the term 'controlled transactions' means commercial or financial transactions between parties, where one party either controls or is controlled by the other party or between related parties.

The arm's-length principle applies to transactions with all of the above-mentioned individuals, companies and permanent establishments. Prior to 2005, the rules on documentation applied only to cross-border transactions, but to satisfy non-discrimination principles of EU law, the scope was extended to also include domestic transactions. Consequently, the arm's-length principle applies to both domestic and cross-border transactions.

A foreign legal company included in a Danish joint taxation also falls under the Danish documentation requirements with respect to controlled transactions with other foreign companies or foreign individuals.

Disclosure on the tax return

In accordance with section 3B of the DTCA, Danish companies must, in addition to preparing transfer pricing documentation, complete an appendix (form no. 05.021) to their tax return disclosing the nature and scope of transactions with related parties. Disclosure is only a requirement if the total amount of the company's controlled transactions during the income year exceeds DKK 5 million. The deadline for tax return filing for taxpayers with 31 December year-end is 30 June the following year.

Companies with related party transactions must state for a pre-defined group of transactions (e.g. purchase of goods), whether the sum of inter-company transactions amount to:

- less than DKK 10 million
- between DKK 10 million and DKK 100 million, or
- more than DKK 100 million.

The company must also state whether the controlled transactions exceed 25% of the total transactions within each pre-defined group of transactions. In addition, one off transactions, such as an inter-company sale of fixed assets, must also be disclosed.

Sections 5 and 14 of the DTCA provide that the DTA may impose penalties on companies that do not file in due time or file incorrect or misleading information, e.g. regarding their eligibility for SME status.

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Danish transfer pricing documentation
Since 1999 documentation supporting transfer prices has been required. The documentation has to be sufficient for the tax authorities to assess whether transfer prices are consistent with the arm's-length principle.

The documentation rules can be found in section 3B of the DTCA and the specific documentation requirements are listed in Executive Order no. 42 from 2006 and the latest version of the transfer pricing guidelines issued by the DTA on 24 January 2013 (Danish TP Guidelines).

Timing of transfer pricing documentation
Documentation of controlled transactions should be conducted on an on-going basis, however, in the Danish TP Guidelines it is stated that they should be completed no later than at the time of filing the company's tax return. The deadline for tax return filing for taxpayers with 31 December year-end is 30 June the following year.

Upon request by a tax inspector, the taxpayer must submit its transfer pricing documentation within 60 days. The 60-day period is the time to dispatch the material; hence, taxpayers are advised to prepare documentation in advance of an audit. Extensions to the 60-day period are not granted by DTA.

The aim of the Danish TP Guidelines regarding the documentation requirements is to ensure that all the requirements in the statutory rules are observed when documenting controlled transactions, truly demonstrating the adoption of the arm's-length principle.

Generally, transfer pricing documentation should be written in a report format and must include the following:

- Taxpayer's address and ID number.
- Legal and organisational structure.
- Summary of statutory financial results of the last three years (for each party to the controlled transactions).
- Description of group and Danish company, including history, and explanation of losses.
- Description of all controlled transactions (including value).
- Description of products or services, which are transferred in the controlled transactions.
- Analysis of functions performed, risks assumed, and assets employed by each party to the controlled transactions, i.e. description of value chain.
- Comparability analysis, including terms and conditions of controlled transactions.
- List of inter-company agreements.
- Description of price-setting methods considered.
- Selection of the most reliable price-setting method.
- Rejection of methods not selected as most reliable.
- Description of the relevant database searches, if performed (database searches are not required, unless requested by the DTA).
- Assumptions, strategies, and policies, if any, that influenced the determination of the transfer prices.

The transfer pricing documentation may be prepared in one of the following languages: English, Danish, Norwegian, or Swedish.

More than one company can be included in a single documentation report, as well as several financial years and multiple transactions can be tested and covered by the same report. However, if multiple companies or financial years are included in the same report, it is a requirement of the DTA that the report specifies for which company and for which year the specific information applies.

Small and medium sized entities
If a company is eligible for small and medium sized entities (SME) status, the transfer pricing documentation does not have to be completed. However, SME's must still transact in accordance with the arm's-length principle, and are still subject to tax return disclosure. SMEs are defined by the European Commission (Recommendation 2003/361/EC) as companies with (measured at group level):

- less than 250 employees, and
- a balance sheet sum of less than DKK 125 million, or
- an annual turnover of less than DKK 250 million.

The exemption does not apply to inter-company transactions with affiliates and permanent establishments in states outside the EU/EEC with which Denmark does not have a double tax treaty.

Independent auditor's statement
As of 1 January 2013, and upon request from the DTA, a taxpayer must also within 90 days submit an independent auditor's statement regarding compliance with the arm's-length principle.

The DTA can only request an independent auditor's statement on companies that have:

- inter-company transactions with residents in non-EU/EEA member states that do not have a double tax treaty with Denmark, or
- realised a negative operating profit (EBIT) for four consecutive years on average.

Note that the request may be given retroactively, i.e. under the statute of limitation rules, and the DTA may request an independent auditor's statement for the income year 2007 up until 1 May 2013.

Penalties for non-fulfilment
Penalties apply if a company does not submit compliant transfer pricing documentation within 60 days of a request from the DTA. Section 17 of the DTCA provides that penalties may be imposed if transfer pricing documentation has not been prepared.

From a practical perspective, the penalties regime has been tightened in 2012 and applies if the transfer pricing documentation does not exist or if the documentation is deemed inadequate. Two-tier penalties apply to the following:

- Failure to submit compliant transfer pricing documentation within 60 days of request from the DTA or failure to submit an independent auditor's statement may result in a fixed penalty of DKK 250,000 (EUR 35,000) per company, per year. The DKK 250,000 fine can be reduced by 50% if compliant transfer pricing documentation is subsequently submitted.
- In addition to the lack of documentation or inadequate documentation, if an income adjustment is issued (i.e. the arm's-length principle has not been

observed), the minimum penalty will be increased with an amount of 10% of an upward adjustment.

The above applies to years not barred by the statue of limitations, i.e. income year 2007 is open to penalties until 1 May 2013.

Statute of limitations on transfer pricing adjustments
As a general rule, the DTA is not allowed to reopen a tax assessment detrimental to the taxpayer later than the end of April in the fourth year after the income year has expired.

This general time limit is extended by two years in respect of transfer pricing adjustments. For transfer pricing, the DTA may issue a notice of an adjustment no later than 1 May in the sixth year following the income year-end (e.g. notice of adjustment for the income year 2007 must be made no later than 1 may 2013). The final adjustment must be issued no later than 1 August, also in the sixth year following the income year-end.

Surcharge and interests on upward adjustments
Following an upward adjustment of taxable income, the taxpayer is subject to a surcharge and interests on the adjustment, i.e. tax payable.

First, a surcharge is added to the adjusted taxable amount. This is onetime charge calculated on the tax payable and is based on a percentage set by the Danish Minister of Taxation for the given year that the upward adjustment relates to.

Second, an interest rate will be levied on the tax payable (including the surcharge). The interest accrues monthly from 1 November (for the calendar year-end taxpayer) after the financial year in question until the date of payment of the additional tax e.g. if an upward tax adjustment is imposed on the income year 2007, the surcharge percentage from 2007 (5.8%) will apply and the monthly interest will accrue from 1 November 2008.

	Surcharge	Interest rate
2007	5.8%	0.6%
2008	6.3%	0.6%
2009	6.1%	0.6%
2010	5.1%	0.5%
2011	4.8%	0.5%
2012	4.3%	0.5%

Tax audits
In general, the DTA are allowed to request any information of relevance for the tax assessment and has the authority to make an estimated adjustment of the taxable income if information is not provided. In addition, the conduct of the taxpayer during an audit may influence the outcome because a refusal to provide documentation can reduce or even reverse the burden of proof of the DTA. While it is possible to negotiate with the DTA before the adjustment is finalised, it is not likely that the outcome of the audit will be a result of either negotiation or litigation, but rather an assessment raised by the DTA based on its audit findings.

Selection of companies for audit
Transfer pricing continues to be an audit theme and with the continued focus on transfer pricing, the DTA frequently audits the transfer prices of companies resident in Denmark. If a Danish company is part of a multinational group, the DTA will generally always issue a request for the transfer pricing documentation in a tax audit.

In addition, the DTA's current focus is multinationals that have loss making operations in Denmark or have an apparent lack of taxes paid to Denmark ('zero tax' companies).

Companies with the following characteristics can expect to face increased risk of extensive transfer pricing audits in Denmark during 2013:

- Continuous losses, i.e. zero tax.
- Business restructurings and/or IP transfers.
- Related parties in non-treaty countries.
- Operates a branch in Denmark.
- Companies operating under the Danish Tonnage Tax Act.
- Part of one of the largest 150 international Groups operating in Denmark.
- Companies engaged in business in the oil-industry under the Danish Hydrocarbon Tax Act.
- Companies making payments in connection with an intercompany captive/ reinsurance programme.
- Companies relying on intercompany financing.

Risk transactions or industries
It is not possible to generally identify specific transactions or industries where transfer pricing adjustments are more likely than others. Transfer pricing adjustments are often not appealed and therefore not published. More straightforward cases, such as management fees and interest on inter-company loans, are still taken up during tax audits. However, the tax authorities in Denmark have become more experienced in transfer pricing matters and are not reluctant to engage in more complicated transfer pricing issues. Moreover, another trend often seen is that the DTA attempt to disregard the business model chosen by the taxpayer, e.g. by reclassifying for example a distributor to be a service provider. Resources continue to be dedicated to the transfer pricing area.

Simultaneous examinations
Denmark will cooperate with other countries in undertaking simultaneous examinations of multinational groups. Indeed, this has already been practiced within the Nordic countries, and it is conceivable that it will occur with respect to other countries as well.

Appeals procedure
A transfer pricing adjustment imposed by the DTA must in the first instance be appealed at the administrative level to the Danish National Tax Tribunal, after which it is possible to continue the appeal to the High Court and ultimately the Supreme Court.

Burden of proof
Taxpayers are under a legal obligation to maintain current transfer pricing documentation. To the extent that this requirement is not met, the burden of proof may be reversed to the taxpayer.

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In two of the most significant court cases regarding transfer pricing (Texaco and BP), the courts confirmed that the burden of proof lies with the DTA, but the taxpayer is required to disclose information relevant to the question of whether the arm's-length principle has been violated. This information would include items such as prices and profit earned by the parent company when dealing with other group companies and with unrelated customers. Where this information is not disclosed, the court concludes that the burden of proof on the DTA is reduced.

The DTA may estimate transfer pricing adjustments if the transfer pricing documentation is inadequate. This represents a significant shift in the balance of the burden of proof between the tax authorities and taxpayers. Furthermore, the conduct of the taxpayer during the investigation may influence the outcome because a refusal to provide documentation can reduce or even reverse the burden of proof of the DTA.

Legal cases

Transfer pricing disputes are rarely taken to court as most disputes are solved through compromise. There have been three significant cases on transfer pricing. The first two were the so-called 'oil cases', both from the late 1980s, and the latest, Swiss Re, was tried recently, i.e. in February 2012.

Burden of proof

The oil cases involving BP and Texaco were the first transfer pricing cases to be tried in Denmark. Both decisions were on the question of burden of proof and ruled in favour of the taxpayers. In the Texaco case, the court found that the taxpayer could be required to disclose information regarding prices and gross profit. This information was however not available to Texaco Denmark and by that not available to the DTA. The High Court ruled that, despite this lack of information, a comparison of prices with the Rotterdam Spot Market suggested that that they did not differ significantly and an adjustment could therefore not be justified.

The BP case built upon the Texaco case. A price analysis suggested that prices paid by BP Denmark were 9% higher than the Rotterdam Spot Market, thus the High Court found a minor increase in BP's taxable income justified. This decision was taken to the Supreme Court. The Supreme Court repeated that the burden of proof rested on the DTA, but that a taxpayer's failure or refusal to disclose evidence would reduce this burden. The conclusion reached by the Supreme Court was that, as BP Denmark dealt on long term contracts, a difference in the pricing could be caused by the contractual set-up. The DTA had failed to show that the difference in price was as a result of BP Denmark being a controlled company and not as a result of the contractual terms, and the Supreme Court ruled in favour of BP Denmark.

Statute of limitations

A recent judgement from the Supreme Court (Swiss Re – HD of 2/2 2012, 1. afdeling, 68/2010) expands the scope of section 2 of the DTAA to not only include pricing and terms, but also the legal qualification of a transaction.

The case concerned the DTA's adjustment of a loan agreement between a Danish company and a US holding company. The parties did not agree on the payment terms until three and a half months after they entered into the loan agreement. Thus, the DTA fixed the interest rate for the first three and a half months and disregarded the parties' agreement to remunerate in the form of capital gains. The tax-adjustment took

place in the 5th and the 6th year after the two taxable income years in question. The Danish National Tax Tribunal rejected the DTA's adjustment, due to the fact that the statute of limitations (four years) barred an adjustment.

The Ministry of Taxation took the case to High Court, who rejected the decision made by the Danish National Tax Tribunal.

Subsequently, The Supreme Court upheld the High Court's judgement by confirming that the extended statute of limitations, i.e. six years, applies to any adjustments related to inter-company transactions. The adjustment was therefore made by the DTA within the time limit. Furthermore, the Supreme Court pointed out that the possibility for transfer pricing adjustments applies to all economic issues and other conditions related to taxability (e.g. time of payment, accruals of interests, capital losses and the legal qualification of a transaction.)

Limitation of double taxation and competent authority proceedings

The DTA is, without any limitations in time, obliged to reopen a tax assessment on request by a taxpayer, if there has been a transfer pricing adjustment abroad.

It should be noted, however, that the DTA is always entitled to form its own opinion on the transfer pricing issue in question. The authorities may disagree with an adjustment made by a foreign tax authority and consequently refuse to make a corresponding adjustment.

A Danish taxpayer can avoid a secondary adjustment, if prices and terms are adjusted in accordance with a transfer pricing adjustment.

The Danish competent authority on transfer pricing matters is the central transfer pricing unit within the DTA. Danish administrative principles, while not permitting the mutual agreement procedure to become a process of litigation, grant the taxpayer the right to comment on and discuss the position taken by the authorities. If a corresponding adjustment is refused by the authorities, it is possible to appeal to the courts.

Transfer pricing disputes with the EU can be resolved in accordance with the Convention on the elimination of double taxation in connection with the adjustments of profits of associated enterprises (Convention of 23 July 1990, 90/436/EEC), which became effective in 2006.

Year-end and retroactive adjustments

Year-end and retro-active adjustments and true-ups require special attention in Denmark. They should preferably be used as a method of last resort and need to be supported by the underlying inter-company legal agreements or transfer pricing policies. Furthermore, consideration should be given to legal, accounting, VAT and customs issues depending on the type of adjustment.

Advance pricing agreements (APA) and binding rulings

It is possible to apply for bilateral APAs with countries with which Denmark has double tax treaties, by reference to the mutual agreement article. Although Denmark does not have an official APA program, APA applications are accepted and negotiated. The first

bilateral APA involving Denmark was concluded in 2002, and since then numerous bilateral APA agreements have been concluded with Denmark. The number of bilateral APA requests has increased significantly during the last five years. Denmark was the first European country to conclude a bilateral APA with China.

The DTA are planning to issue Danish APA guidelines. However, these guidelines have been under way since 2008 and it remains uncertain when the final guidelines will be released. These guidelines will largely follow the recommendations from the Joint Transfer Pricing Forum under the EU Commission issued on 26 February 2007.

It is not common for the DTA to process unilateral APAs. However, taxpayers have the possibility of applying for a binding ruling concerning the tax treatment of a given transaction. Binding rulings will be provided by the Danish Tax Assessment Committee, and the response will typically be provided within three months. However, if upon request for a binding ruling, it is found that insufficient documentation has been submitted in order to provide a response or if the request is complicated, the authorities may extend its response time or reject the response.

Comparability analysis

Comparable database search

There is no compulsory requirement to prepare comparable databases searches. However, in the case of a transfer pricing audit, the DTA can explicitly require that a comparable database search using commercial databases be completed within 60 days upon request.

The comparability analysis is to provide, primarily, a basis for assessing whether the principles used by the taxpayer's group to determine prices in respect to its controlled transactions are in conformity with the arm's-length principle and secondly, the reasoning for the benchmarks used and the method chosen.

Criteria to consider for comparability analysis

The conditions concerning an inter-company transaction must be examined in order to determine whether the transaction or the company is comparable. The criteria set out in the Danish Executive Order No. 42 (issued in 2006) and the Danish TP Guidelines (latest version issued 24 January 2013) to assess comparability analysis are:

- characteristics of the products or services
- a functional analysis
- contractual terms
- economic circumstances, and
- business strategies.

In practice, the retrieval of comparable data related directly to transactions between independent companies operating under similar conditions remain infrequent as this type of direct observation implies access to detailed information that generally is confidential. Furthermore, even if the information is available, it would still be necessary for the transactions to be comparable, which also is seldom found in practice.

Conducting a sufficiently thorough comparability analysis that produces satisfactory and reliable results requires the databases used by the taxpayers to be publicly

available and the data to be comparatively numerous and sufficient to build an argument justifying that the selected independent companies are comparable with the tested company. Practical experiences show that no two transactions are identical. It is, therefore, necessary for the taxpayers to examine the results thoroughly on whether the differences found are significant enough to affect the comparability of the selected independent companies.

Elements of the comparability analysis write-up

In addition to the preparation of the comparability analysis, the comparability analysis must be described as part of the transfer pricing documentation. The descriptions must contain the following four elements:

- Identification of the tested transaction(s) and the pricing methods.
- Detailed written descriptions of the comparability searches providing the arguments and reasons for the qualitative and quantitative search steps.
- Explanation of the justification and range.
- Materials for the documentation from the database.

Although the Danish TP Guidelines provide an example of the presentation of the elements described above, it is stated that taxpayers may prepare the descriptions of their comparability analysis differently as long as the elements above are taken into account and references to Section 10 of the Executive Order no. 42 (2006) are provided thoroughly.

The transfer pricing methods listed in the Danish legislation are in line with the OECD Guidelines. The most reliable method to evaluate an inter-company transaction must be selected and applied. When the Transactional Net Margin Method is applied, the least complex company to the inter-company transaction under review (i.e. not necessarily the Danish company) should be the tested party.

Regional comparable searches (i.e. pan-European benchmarks) are accepted, but local comparable companies are preferred (e.g. Eastern European companies may be disqualified for not being comparable within certain industries).

Quantitative and qualitative search steps

According to the Danish TP Guidelines, the following search criteria are suggested, but not compulsory, to be included in a comparability search process:

- Identify the activity of the tested company: branch code(s), keywords related to the industry, key accounting data.
- Identify the economic circumstances: geographic boundary, size of the tested company's activity, number of years with activity.
- Identify the key accounting data to justify the pricing and qualification of the arm's-length principle.
- Verify the data available through additional qualitative steps through: internet, websites of companies and other possible methods.

It is pointed out that the selection of comparable companies must, nonetheless, be consistent. This section of the Danish TP Guidelines imply the need to avoid any cherry-picking of profitable companies among the independent companies available as comparables by both the taxpayers, when preparing a comparability analysis, and by the tax authorities during tax audits.

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Like many European countries that use the OECD Guidelines as the model for the local transfer pricing guidelines, Denmark recognises the use of average data of the past few years for the purpose of comparability analysis. Furthermore, the range of data available for multiple years might disclose facts that may have influenced the determination of the transfer prices. Companies relying on comparables, i.e. benchmark studies, are advised to update these on a regularly basis. How often depends on the industry and if there has been a major change which has affected the market.

In Denmark, the use of an arm's-length range is not explicitly specified in the legislation, but it is common practice for the data from the database to be measured using median as the statistical tool to determine the representative result of a sample set. The interquartile range also is used to determine the range of acceptable transfer prices. An interquartile range is advantageous because, by excluding outlying or extreme data point, which may be unrepresentative, the range frequently provides a good indication of representative values.

Limitations on interest deductibility

Thin capitalisation

Thin capitalisation applies to Danish companies and permanent establishments that have inter-company debt (controlled debt) to a related company or individual, which:

- directly or indirectly owns more than 50% of the share capital or 50% of the votes in the Danish company, and
- the debt to equity ratio of the Danish company exceeds the ratio 4:1.

If these conditions are met, tax deductibility for the interest and debt losses on the controlled debt, which exceeds the debt equity ratio of 4:1, is disallowed. The interest is not re-characterised as a dividend and is still treated as an interest with respect to withholding tax, etc.

If the Danish taxpayer can prove that the debt is on market terms, the deductibility is not disallowed.

The term 'controlled debt' includes both debt directly provided by a related company and debt where a related party has provided a guarantee to a third party in order to obtain the loan.

It is worth noting that:

- the thin capitalisation rules only apply if the controlled debt exceeds DKK 10 million
- the limitation of interest deductibility only applies to the part of the controlled debt that would need to be converted into equity in order to meet the 4:1 debt/equity ratio
- special consolidation rules apply when assessing the assets and debt of Danish group companies
- the 4:1 ratio is calculated on the fair market value of the company's assets.

Limitation on net financial expenses
Deductibility of interest expenses is limited in the following way and in the following priority:

- The above thin capitalisation rules apply.
- It is only possible to deduct net financial expenses in a Danish jointly taxed group equal to 3% (2013) of the tax value of qualifying assets at year-end. However, it is always possible to deduct net financial expenses of DKK 21.3 million.
- In addition, the taxable income before interest deduction may not be reduced by more than 80% as a result of net financial expenses; however, it is always possible to deduct DKK 21.3 million in a given year. Any unused net financial expenses may be carried forward.

The corporate tax rate
The corporate tax rate in Denmark is 25%.

OECD issues
Denmark is a member of the OECD and applies their interpretation of the OECD Guidelines.