Denmark adopts new rules for mandatory submission of transfer pricing documentation

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In brief

The Danish Parliament has adopted amendments that further tighten its comprehensive transfer pricing documentation regulations. The amendments introduce a mandatory submission requirement of the Master file and Local files (of all Danish entities) to the Danish Tax Authority within 60 days after the income tax return due date. The new rules are effective for income years starting from January 1, 2021.

The Danish Tax Authority also has established an office tasked with analyzing the new data it receives, which likely will result in increased transfer pricing audit risk. Taxpayers need to initiate steps to meet new requirements for contemporaneous documentation in seeking protection from significant penalties and shifts in the burden of proof in tax disputes in Denmark.

In detail

Background

Since January 1, 2019, the Danish Tax Authority has made efforts in conjunction with its tax audits to enforce the law that transfer pricing documentation must be prepared contemporaneously and finalized no later than the tax return due date. Historically, documentation was only to be submitted upon request from the Danish Tax Authority, and the taxpayer had 60 days to submit the documentation. Consequently, the Danish Tax Authority faced challenges in confirming the contemporaneous nature of taxpayers' documentation.

With taxpayers permitted 60 days post-request to submit their transfer pricing documentation, the Danish Tax Authority observed that some companies had used this time to prepare transfer pricing documentation, rather than preparing documentation contemporaneously. The latest amendments are intended to encourage all companies required to prepare transfer pricing documentation to do so contemporaneously every year, and not to postpone preparation of such documentation until receiving a notice of audit.

Impact of new requirements

Observation: The requirements can be burdensome, as documentation files, including Master and Local files, must be submitted to the revenue authority. The documentation includes, e.g., intercompany agreements, which typically do not change from year-to-year, and results in the Danish Tax Authority receiving materials that may not be important for its risk assessment and selection of taxpayers for audit.

Another consequence of the Danish Tax Authority's increased focus on the contemporaneous transfer pricing documentation requirement has been significant penalties for some taxpayers. Penalties for non-contemporaneous or generally non-compliant transfer pricing documentation are up to DKK 250,000 (USD 40,900) per entity (company or permanent establishment (PE)) per year, plus 10% of a potential income adjustment. In addition to penalties, the burden of proof shifts to the taxpayer if the transfer pricing documentation is deemed inadequate.

Observation: In addition to per-entity penalties, the Danish Tax Authority typically requests transfer pricing documentation for five years at a time, so penalties can be substantial. Further, the party having the burden of proof in litigation in Denmark typically is at substantial risk of loss.

New enforcement office

Alongside adoption of the amendments, the Danish Tax Authority established a new office tasked with analyzing the data received. This office will utilize new technology to search audit candidates systematically. It also will draw on other data such as DAC6 (potential aggressive tax planning), DAC4 (CbCR) and DAC3 (EOI of tax rulings).

Observation: A dedicated, technology-enabled office focused on analyzing a range of company transactional data likely will increase transfer pricing audit risk for many Danish taxpayers.

Application of documentation requirements

A company must prepare transfer pricing documentation if the Danish taxpayer belongs to a group that employs 250 or more employees or has both revenue exceeding DKK 250 million (USD 41 million) and total assets above DKK 125 million (USD 20 million). Also, documentation must be prepared no matter the thresholds if the Danish entity has transactions with an affiliate that is a tax resident outside the EU with which Denmark does not have a double tax treaty.

The Danish documentation rules also apply to domestic transactions. There is no objective materiality threshold on the size of transactions that must be documented. Finally, a local documentation file must be prepared for each legal entity; if there are multiple entities, the taxpayer cannot make a country file that includes all entities.

The takeaway

The latest transfer pricing documentation submission requirement has made compliant transfer pricing documentation and submission thereof (within 60 days from the tax return due date) essential in seeking protection from significant penalties and shifts in the burden of proof in tax disputes in Denmark.

As the amendments will be effective for income years starting on or after January 1, 2021, there still is some time before the first submissions must be made. However, taxpayers should take action now to align their FY20 documentation with the new requirements (and prepare documentation contemporaneously) so that they will be ready for submission of the financial year 2021 transfer pricing documentation by June 30, 2022 (which is the tax return due date for calendar year 2021). Taking timely actions also is important given the Danish Tax Authority's establishment of a new office focused on data analysis as a means of identifying audit candidates.

As a wider consequence, other countries might evaluate Denmark's new stringent transfer pricing documentation rules and follow suit, potentially turning transfer pricing into a dash between governments in a scramble for tax revenues. Meanwhile, multinational enterprises are caught in the middle, with tax disputes expected to increase going forward.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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