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Denmark introduces general anti-abuse provision – moving from SAAR to GAAR?

On 26 January 2015, the Danish tax authorities issued a draft bill which sets out to deal with certain potential abuses recently encountered by the tax authorities as well as the enactment of the general international anti-abuse initiatives currently considered at EU and OECD level.

The new bill includes three main elements:

- Introduction of a new international anti-abuse tax rule which denies tax treaty and EU tax directive benefits in cases of deemed abuse
- Introduction of a new "CFC type" rule for trusts
- Introduction of limited duration of tax rulings on exit tax values, targeting post-exit asset or business transfers

New international anti-abuse tax rule
The bill introduces a new general anti-abuse provision (GAAR) into Danish tax law. This is an early Danish attempt to adopt the expected amendments to the EU Parent/Subsidiary Directive (2011/96) as well as the reasoning behind Action Point 6 of the BEPS initiative (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances) in Danish domestic law. The new provision marks a possible change in the traditional Danish anti-abuse tax legislation doctrine which, in the past, has targeted specific practices which have been deemed to be abusive and therefore been countered by specific anti-abuse rules (SAAR).

The new rule in s. 3 of the Danish Tax Assessment Act (ligningsloven) contains two provisions: An EU tax directive anti-abuse provision and a tax treaty anti-abuse provision. Despite differences in the wording, no specific difference in the contents is pursued between the directive anti-abuse provision and the tax treaty anti-abuse provision.

The EU tax directive anti-abuse provision mainly attempts to implement the anti-abuse or misuse amendment to the Parent/Subsidiary Directive which was agreed at the meeting of the European Council held on 27 January 2015. The Danish anti-abuse provision more or less mirrors the wording of the amended Directive, stating that Denmark "shall not grant the benefits of this Directive to an arrangement or a series of arrangements which,

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having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances". Furthermore, "an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality".

Unlike the anti-abuse provision in the Parent/Subsidiary Directive, the Danish domestic provision is also intended – in addition to the Parent/Subsidiary Directive – to apply as an anti-abuse rule to all EU Direct Tax Directives, specifically the EU Merger Directive (2009/133) and the Interest-Royalty Directive (2003/49).

The tax treaty anti-abuse provision aims at implementing the expected outcome of the BEPS project, specifically Action Point 6 regarding Preventing the Granting of Treaty Benefits in Inappropriate Circumstances. As the final report on Action Point 6 has not yet been released, it is arguably somewhat premature to introduce a provision which incorporates the outcome of the project. However, the bill nevertheless aims at applying the new provision on both existing and new Danish tax treaties based on the alleged general agreement among the OECD countries implying that states are not obliged to grant treaty benefits from participation in arrangements that entail abuse of treaty provisions.

The new provision states that treaty benefits will not be granted if [our translation]: "it is reasonable to establish, taking into account all relevant facts and circumstances, that obtaining the benefit is one of the most significant purposes of any arrangement or transaction which directly or indirectly leads to the benefit, unless it is established that granting the benefit under such circumstances would be in accordance with the content and purpose of the tax treaty provision in question."

Since Denmark has not previously operated with a general anti-abuse provision and due to the very general nature of its wording, a level of uncertainty as to the obtaining of tax directive or tax treaty benefits will be introduced with the entering into force of the new proposed provisions. At least, uncertainty will exist pending specific administrative or court practice regarding the use of both provisions. Accordingly, caution should be shown as to the application of such provisions, and specific tax advice thereon should be obtained, in particular when implementing financial or organisational structures, even if legitimate business reasons exist to implement the structure in question, in so far as they may also be deemed to be tax-motivated.

The new anti-abuse provision is set to take effect from 1 May 2015. No grandfathering rule will apply.

"CFC taxation" of trusts

The use of foreign trusts has in recent years come to the attention of the Danish tax authorities, mainly due to the possibilities, which have turned out to exist, of retaining a de facto control of assets in a trust, although such assets have formally been irrevocably separated from the assets of the settlor.

Therefore, the draft bill also introduces a CFC type of taxation of income of trusts set up by Danish tax resident individuals or individuals who have been Danish tax residents within the past 10-year period and move back to Denmark after setting up a trust abroad. The provision will also apply to assets contributed to existing trusts after the settlor (or another contributor to the trust) becomes a Danish tax resident person.

Under the proposed provision, income generated from assets transferred to a trust by a settlor or a company controlled by one or more settlors will for Danish tax purposes be considered as income in the hands of the Danish resident settlor(s) of the trust. A tax credit will, however, be available for tax paid by the trust on the same income. Income which has been taxed in the hands of the settlor(s) pursuant to the rule will not also be taxed upon distribution from the trust.

A notable aspect of the new provision is that assets in a trust comprised by the provision will be subject to an inheritance tax of an effective percentage of 36.25, even if the heirs would have been tax-exempt or subject to a reduced inheritance tax if the same assets had been inherited from the settlor(s) directly.

It is also noteworthy that the new provision does not contain a definition of "trust", not least when considering that the trust concept does not exist in Danish law. Certain generic features are, however, set out in the travaux préparatoires to the draft bill.

If the means of the trust are used exclusively for charitable purposes or other non-profit purposes (subject to definition) to benefit a large group of persons, or if the trust is set up for pension purposes to benefit a large group of persons, the new provision does not apply.

While the current draft provision gives rise to uncertainties regarding interpretation and application in practice, it is nevertheless our expectation that if enacted, the use of traditional trusts in Danish wealth planning and succession planning will cease or be reduced significantly for all practical purposes.

The new trust rules are set to take effect as from 1 July 2015.

Tax ruling on exit values
In order to avoid unpleasant surprises when moving out of Denmark, it is common practice to obtain a binding ruling from the tax authorities on the exit tax payable on certain types of assets, including – as is often the case in practice – unlisted shares, as a result of moving out of Denmark. However, in the experience of the tax authorities, these binding rulings have, on some occasions, led to an asset valuation upon exit which is lower than the valuation subsequently determined upon a third party sale thereof.

The draft bill therefore includes a reduction of the reliance period in respect of a binding ruling to a maximum of six months (currently, the reliance period is five years provided that the circumstances remain unchanged.) Furthermore, if the tax authorities, on the basis of any subsequent sale or subsequent yield on the assets assessed in the binding ruling, may make it probable that the actual value at the time of exit exceeded the binding ruling value by at least 30% and at least DKK 1m (approx. EUR 135,000), the binding ruling will not be binding on the tax authorities.

The draft provision will, in practice, transfer the risk of unknown relevant concurrent or subsequent circumstances within at or after exit from the tax authorities to the tax payer, even when a binding ruling is obtained precisely to avoid uncertainty. From a practical perspective, it may therefore be advisable to carefully document the basis for the valuation applied at the time of exit, whether or not a binding ruling is obtained, and giving due consideration to the documentation requirements set out under Danish transfer pricing rules.
