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The great hypocrisy - the "beneficial owner" cases

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These days the Ministry of Taxation is leading a crusade against Danish companies that have omitted to withhold tax at source in connection with the payment of dividend or interest to intermediary holding companies abroad. It is claimed that the companies are liable for the tax that has not been withheld. The purpose of this article is to demonstrate that the Ministry of Taxation has previously been of the opinion that there was no basis for claiming that tax be withheld and that the legislature concurred in this opinion. Today the Ministry of Taxation interprets the concept of "beneficial owner" differently than previously. The legal consequence is that the claims relating to tax at source cannot be asserted towards the Danish companies. The author is conducting the two first legal actions in this extensive group of cases.

During recent years the tax authorities have instituted a large number of cases against Danish companies that have either distributed dividend or paid interest to their parent companies resident in other EU Member States or countries with which Denmark has entered into double taxation treaties.

The tax authorities claim that the relevant parent companies are so-called "conduit companies" because the amounts received are channelled to affiliated companies in tax havens. Accordingly, the parent companies are not the "beneficial owners" of the dividends or interest received and therefore the Danish companies ought to have withheld tax in connection with the payment. Since that is not the case, the Danish companies are liable for payment of the tax.

This is a very extensive group of cases and the values involved are considerable.[1]

So far, only three cases have been determined by the National Tax Tribunal. In the two first cases - a case concerning dividend tax[2] and a case concerning tax on interest[3] - the taxpayers were successful, but the Ministry of Taxation has brought the cases before the courts. In the third case - a case concerning tax on interest[4] - the tax authorities were successful.

The cases have been the subject of much media attention. At appropriate intervals the newspapers have published confidential information about the individual cases - also cases that are still pending in the administrative system. In that connection it has turned out that cases have also been raised against companies owned by foreign private equity funds.

The Opposition is in a rage. The Government has let things slide for far too long as far as the multinational groups are concerned. The legislation has to be tightened. New life is breathed into the campaign of a former prime minister who has made it his favourite cause to fight private equity funds.

The rhetoric is raised. It is no longer only "tax cases" but "tax fiddle" or directly "tax evasion" and a hard-pressed Minister of Taxation has to guarantee that the fight against private equity funds is high on the agenda.[5]

When it turns out that a case has also been raised against an enterprise which is partially privatised/co-owned by the Danish State, the Opposition demands consultations with both the Minister of Finance

and the Minster of Taxation. There are no limits to the indignation.

During the entire process large sections of the press have acted as microphones for the politicians and the tax authorities, even if there are plenty of interesting questions to consider, such as, for example:

- What is the background?
- Why are so many cases raised at once in an area where cases have never previously been raised?
- Is there any basis at all for raising these cases?

The purpose of this article is to demonstrate that the Ministry of Taxation has previously been of the opinion that there was no basis for claiming that tax be withheld at source in this type of cases. Today the Ministry of Taxation interprets the concept of "beneficial owner" differently than it used to do. This means that the Ministry of Taxation has changed its practices.

The relevant previous history starts in 1998, when Minister of Taxation Ole Stavad had dividend tax for *all* foreign parent companies abolished to the effect that Denmark in reality became an attractive *tax haven* for so-called intermediary holding companies.

Following criticism from the EU for unfair tax competition the Minister, however, in 2001 reluctantly had to cause the rules to be changed to the effect that the tax exemption was limited to apply only to parent companies in EU Member States or countries with which Denmark had entered into double taxation treaties (DTC countries).

In the interpretative notes to the amending act the Minister of Taxation directed that the reintroduced dividend tax could be avoided by inserting an intermediary holding company in another EU Member State or a DTC country above the Danish subsidiary.

The business community has, of course, adapted to the announcements made by the Ministry of Taxation.

When the tax authorities a few years ago changed their practice *retroactively* (to the income year 2005), the Danish Tax and Customs Administration (SKAT) could at the same time raise a considerable number of cases against all the enterprises that had merely followed the Ministry's interpretation of "beneficial owner".

It goes without saying that this course of events gives rise to serious concerns in terms of legal certainty.

At a time when SKAT is focusing on making the tax payers "loyal partners", its conduct in this area ought to give rise to some soul-searching - and this also applies to the politicians.

However, it is even more interesting that the demonstration of the tax authorities' change of practice is also of legal importance. It applies in particular to the following three relations:

First, it is an indisputable fact that the Ministry of Taxation's change of its interpretation of the concept of "beneficial owner" is directly caused by the extension of the comments to the Model Tax Convention that was made in 2003 (on "conduit companies"). This extension implies a significant *change* - and not merely a clarification - of the concept and therefore cannot be included when interpreting previously concluded double taxation treaties.

Second, it is a fundamental administrative law principle that a tightening change of administrative practices can only have effect *for the future* to the effect that the tax payers are able to adapt to the changed practices.

Third, a Danish subsidiary is only liable for the payment of the tax not withheld at source if the company has acted "*negligently*". It goes without saying that an enterprise that has acted in accordance with the Ministry of Taxation's announcements

cannot be considered to have acted *"negligently"*.

It is my opinion that the Ministry of Taxation's changed interpretation of "beneficial owner" is incorrect, but that is not the subject of this article. The point of the article is on the other hand that even if the Ministry of Taxation's new interpretation should be correct, the claim concerning tax at source cannot, for the mentioned reasons, be raised against the Danish companies.

Limited tax liability on dividends and interest - withholding of tax at source

Under section 2(1)(c) of the Danish Corporation Tax Act a foreign company has limited tax liability in respect of any *dividends* from a Danish company. The dividend-paying company is to withhold 28% tax on the dividends.

The limited tax liability does, however, not apply to a foreign *parent company* (that owns at least 10% of the share capital of the dividend-paying company) if the taxation of the dividend is to be exempt or relieved according to a double taxation treaty or the Parent-Subsidiary Directive (90/435/EEC).

Under section 2(1)(d) of the Danish Corporation Tax Act a foreign company has limited tax liability in respect of *intra-group interest*. The interest-paying company is to withhold 25% tax (previously 30%) on the interest.

The limited tax liability does, however, not apply if the taxation is to be exempt or relieved according to a double taxation treaty or according to the Interest and Royalty Directive (2003/49/EC).

Accordingly, it applies to both the dividend tax and the tax on interest that if the tax is merely to be subject to relief according to one of the two legal precepts - the double taxation treaty or the relevant Directive - Danish taxation no longer applies.

The *double taxation treaties* entered into by Denmark generally include provisions that dividend and interest from Danish companies are to be subject to tax relief if the recipient is the *"beneficial owner"*.[6]

If the parent company is the "beneficial owner" no limited tax liability applies and the dividend-paying or interest-paying company is therefore not to withhold tax.

As opposed to the Parent-Subsidiary Directive, the Interest and Royalty Directive also includes a requirement that the receiving company must be the "beneficial owner".

Delimitation of the issue

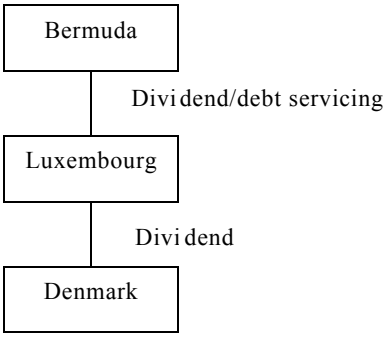
As mentioned, the tax authorities have in recent years raised a number of cases concerning omission to withhold tax at source in relation to dividends and interest.

It has been done with reference to the criteria for interpretation of the concept of "beneficial owner" that in 2003 was added to paragraph 12 in OECD's comments to the Model Tax Convention, Article 10 (dividend)[7] and which states as follows (in respect of "conduit companies"):

> "It would be equally inconsistent with the object and the purpose of the Convention for the State of source to grant relief or exemption where a resident of a Contracting State, otherwise than through an agency or nominee relationship, simply acts as a conduit for another person who in fact receives the benefit of the income concerned. For these reasons, the report from the Committee on Fiscal Affairs entitled "Double Taxation Conventions and the Use of Conduit Companies" concludes that a conduit company cannot normally be regarded as the beneficial owner if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties."

The actual circumstances in the cases raised by SKAT differ very much.

One of the typical examples can be illustrated as follows:



In this example the Danish company distributes dividend to its Luxembourg parent that either redistributes the dividend or uses it to service its debt to its parent company in Bermuda.

In this case the tax authorities claim that the intermediary company in Luxembourg is a "conduit company" and therefore not the "beneficial owner".

The tax authorities' point of view, however, goes far beyond this typical example. In the cases raised against companies owned by private equity funds, the ultimate investors (the owners) are typically resident in EU Member States or DTC countries.

Furthermore SKAT has in certain cases deprived the intermediary holding company of its status as "beneficial owner", even if the dividends or the interest has not been paid on to the owners of the intermediary holding company and consequently there has been no actual flow through or channelling of funds.[8]

In the following the typical example is used as a simple reference to the issue - also because it corresponds to the examples which the Ministry of Taxation has previously considered in interpretative notes to legislation etc.

The change of the Ministry of Taxation's interpretation of "beneficial owner" is examined below. As will appear, the Ministry has not finally developed its points of view yet.

Abolition of limited tax liability on dividends in 1998 - "the holding regime"

By Act No 1026 of 23 December 1998 the limited tax liability on *dividends* from Danish companies to foreign parent companies (with an ownership share of more than 25%) applicable till then[9] was abolished. At the same time Danish parent companies became tax-exempt in relation to dividends from foreign subsidiaries.

By these rules Denmark became a veritable tax haven for intermediary holding companies. International groups that were unable to obtain tax-free dividends from their directly owned foreign subsidiaries were now able to establish a Danish intermediary holding company and channel dividends through that without paying tax.

It was emphasised in the comments to the bill[10] that the dividend tax for foreign parent companies was already subject to significant exemptions due to the Parent-Subsidiary Directive (90/435/EEC) and the double taxation treaties entered into by Denmark. At the same time it was emphasised that the abolition of the dividend tax would give equal status to EU parent companies and non-EU parent companies and at the same time give equal status to foreign parent companies and Danish parent companies which were not already taxed on dividends from Danish subsidiaries.

It further appears that the applicable tax at source could be avoided by inserting intermediary holding companies in countries in relation to which Denmark was completely or partially prevented from withholding tax at source.

For the same reason the revenue loss was expected to be modest. Accordingly the following is stated:

> "On the other hand, it should be included in the assessment that the applicable taxation may be avoided by diverting the dividends to companies

in third countries to the effect that the dividends are not taxed in Denmark."

The legislation had the expected effect. During the following years a substantial number of intermediary holding companies were established in Denmark and an entire industry for the servicing of these companies emerged.

Accordingly, it can so far be concluded that in 1998 it was the clear opinion of the Ministry of Taxation - and the legislature - that the applicable tax at source could be avoided or subject to relief by insertion of an intermediary holding company above the Danish company in another EU country or a DTC country. Such an intermediary holding company was considered the "beneficial owner" according to the double taxation treaties, and it had an unconditional right to exemption from tax according to the Parent-Subsidiary Directive.

Criticism by the EU

The Danish holding regime was criticised by the EU. The Danish rules were, for example, in a working group report prepared for the EU ECOFIN Council[11] included in a list of harmful rules that were found to be contrary to the ECOFIN Council's code of conduct relating to business taxation.[12] The criticism was in particular due to the fact that the Danish intermediary holding companies could be used to avoid other EU Member States' taxation of dividends distributed to parent companies in tax havens.

As appears, the ECOFIN Council agreed with the Danish Government's understanding of "beneficial owner" and the Parent-Subsidiary Directive.

Partial reintroduction of limited tax liability on dividends in 2001

EU's criticism resulted in the Danish exemption of foreign parent companies for dividend tax was reduced to apply only to companies in the EU Member States and DTT countries. By Act No 282 of 25 April 2001 a third sentence was introduced in section 2(1)(c) of the Danish Corporation Tax Act as follows:

"It is a condition that taxation of the dividend is to be exempt or relieved under the provisions of Directive 90/435/EEC or under the double taxation treaty with the Faroe Islands, Greenland or the state in which the company is resident."

This fundamental condition for exemption from tax at source still applies.

In the general comments to the bill[13] the Ministry of Taxation emphasised that Denmark did not agree that the Danish rules were contrary to the EU code of conduct because they were general rules. In spite of that the Danish Government was prepared to respond favourably to the criticism:

"As mentioned, this implies that the Danish rules can be used to erode other countries' taxation. Other countries which tax dividends from companies in such countries to parent companies in tax havens are therefore dissatisfied with the fact that their taxation may be avoided by means of the Danish holding rules.

It is therefore proposed, as a contribution from Denmark for counteracting the use of tax havens and in order to comply with criticism from other countries, to reintroduce the 25% tax on dividend payments from a Danish subsidiary to its foreign parent company, but only in situations where the parent company is resident in a country outside the EU or in a country that does not have a double taxation treaty with Denmark."

In connection with the hearing of the bill several parties raised the question whether it would not still be possible to channel income from the EU without dividend taxation to tax havens by redistributing the dividend from Denmark to other EU Member States or countries with which Denmark had concluded double taxation treaties and which had less strict taxation or no taxation on dividend distributions to tax havens.

The Tax Commission of the Danish Parliament asked by question 16 the Minister of Taxation to comment on an article about an expected increase in the use of Cypriot intermediary holding companies if the Danish amendment to the act was implemented. The Minister of Taxation stated in his answer:[14]

"I agree that it is possible to avoid the proposed taxation of dividends to parent companies in non-EU Member States without double taxation treaties.
…
It is correct that the parent company in the Virgin Islands can still avoid the Danish taxation of the dividends from the Irish company by transferring the shares in the Danish company to an intermediary holding company in Cyprus. If that is the case, Denmark will not tax the dividend as the parent company in Cyprus is comprised by the Denmark/Cyprus double taxation treaty.
But, as mentioned in the article, the parent company in the Virgin Islands may also avoid taxation by replacing the Danish holding company with a holding company in Cyprus to the effect that the Irish subsidiary distributes the dividends to the company in Cyprus.
Thus, the example shows that the avoidance of the Irish dividend taxation of the parent company in the Virgin Islands no longer depends on the Danish rules but on the favourable rules in Cyprus."

In his subsequent answer[15] to question 3 submitted by the Tax Commission concerning a clarification as to why the proposal was merely expected to get *limited revenue* the Minister of Taxation stated:

"However, the companies will be able to reorganise to the effect that the shares in the Danish subsidiary are transferred to a subsidiary in a country that is not subject to Danish tax on dividend payments. This is advantageous if such dividend may be redistributed to the actual parent company at taxation that is lower than the Danish taxation, possibly without any taxation at all.
The revenue from such companies is therefore expected to be limited."

Finally the Minister of Taxation stated in his answer[16] to question 15 submitted by the Tax Commission in relation to a statement by Professor Ole Bjørn:

"It is noted that the rules proposed are not particularly efficient, as they may be avoided by an intermediary holding company in another country that is a member of the EU or has a double taxation treaty with Denmark and has favourable tax rules.
In that connection I point out that in that case the parent company in the tax haven is avoiding the taxation by means of the favourable rules in the other country."

On this background the conclusion is that it is plain from the interpretative notes to the current legislation on limited tax liability on dividends that an intermediary holding company can be inserted above a Danish subsidiary with the effect that the tax that would otherwise be released is avoided.

It is clear that the Minister of Taxation refers to mere *conduit companies* and the Minister's answers do not include any reservations.

For the same reason the *revenue* related to the amendment of the act is expected to be *"limited"*.

This is the legislation to which reference is now – following the Ministry of Taxation's change of position – made in support of SKAT's collection of *billions* in dividend tax from the taxpayers that have acted in reliance on the interpretative notes.

Introduction of limited tax liability on interest in 2004

By Act No 221 of 31 March 2004 Denmark introduced limited tax liability on *intra-group interest*. The tax liability did not, however, comprise interest if the taxation of the interest was to be exempt or relieved according to the Interest and Royalty Directive (2003/49/EC) or according to a double taxation treaty.

In connection with the hearing of the bill[17] the Minister of Taxation answered[18] an inquiry from The Institute of State-Authorised Accountants which doubted that the interest tax would have the desired effect as not all EU Member States had similar legislation.

"There is certainly a risk that, for example, a Danish company can seek to avoid tax at source on interest payments to a financial company in a low tax country by paying the interest to a company in another country comprised by the EU Interest and Royalty Directive or a Danish double taxation treaty and which does not withhold tax a source on interest payments to foreign receivers of interest, following which that company repays the interest to the company in the low tax country.

In such situations the Danish tax authorities will, however, based on a substance over form approach be able to take into account that the beneficial owner of the interest is not the company in the other country but the financial company in the low tax country to the effect that the interest payment is neither comprised by the EU Interest and Royalty Directive nor by the double taxation treaty."

As appears, the Ministry of Taxation states in this answer that is made following the extension of the comments to the Model Tax Convention in 2003 (with "*conduit companies*") that a substance over form approach can be applied to determine who is the "beneficial owner".

This was not new or surprising. According to established case law the courts can apply a substance over form approach for the purpose of establishing who is the *"rightful income recipient"* (in Danish: "rette indkomstmodtager"). It is, however, also a fact that there must be a completely extraordinary situation - pro forma or the like - in order for a dividend or interest recipient not to be the "rightful income recipient".[19]

Therefore, the Minister of Taxation also stated in his reply[20] to questions 46 and 47 submitted by the Tax Commission that *"there are not many adjustments to be made as a result of an assessment or an audit of the conduit companies"*.

For the same reasons, the Minister of Taxation did not in his answer[21] to question 52 find that conduit companies constituted a "special risk group" and therefore there was no reason to enter this subject in the tax authorities' annual tax assessment plan.

The revenue comments in the bill are in line with that. The introduction of limited tax liability on intra-group interest was not expected to result in any revenue.

Subsequent statements by the Minister of Taxation

In the interpretative notes to Act No 308 of 19 April 2006 relating to the adjustment of section 2(1)(d) of the Danish Corporation Tax Act the Minister of Taxation clarified his understanding of the concept of "beneficial owner".

The following is stated in the Minister's answer[22] to questions submitted by The Institute of State-Authorised Accountants:

"In that connection it should be remembered that as far as section 2(1)(d) of the Danish Corporation Tax Act is concerned, it should be decided on the basis of the principle of rightful income recipient who is to be deemed to be receiving the interest.

The taxation at source of the interest is only to be waived according to the treaties if the beneficial owner of the interest is resident in another state. …

If the private equity funds make share and loan investments through holding companies, it will have to be assessed whether the holding company is the rightful income recipient/beneficial owner of the interest income. In my opinion a mere conduit company in, for example, Luxembourg is not likely to be the rightful income recipient/beneficial owner of the interest income. … "

The Minister's reply contains two messages. *First*, that Danish case law relating to "*rightful income recipient"* determines who is "beneficial owner". Accordingly, there is nothing new under the sun.

Second, that the Minister now conservatively estimates that a mere conduit company is "not likely" to be the "rightful income recipient". This reservation is understandable, as the existing case law on the "rightful income recipient" does not form any basis for disregarding an intermediary holding company in terms of tax.

In late 2006 the Minister of Taxation again confirmed that *the principle of "rightful income recipient"* was decisive when determining who was the "beneficial owner".

This was done in an answer to the following section 20-question submitted by Morten Homann of SF (the Socialist People's Party):

"Can the Minister confirm that if the equity share exceeds 20% dividends from Danish companies can be paid tax-exempt to a parent company in, for example, Luxembourg and then be transferred to an actual tax haven?"

The following is stated in the Minister's answer:[23]

"The principle of rightful income recipient has to be applied to establish who "receives" the interest. The term "rightful income recipient" must be considered very much like the term "beneficial owner" used in the double taxation treaties. In the double taxation treaties the taxation at source is only to be waived or reduced if the beneficial owner of the dividends is resident in the other state.

…

It is decisive who is the rightful income recipient/beneficial owner.

…

A mere conduit company in, for example, Luxembourg will not be the rightful income recipient/beneficial owner of the dividends, see the comments to article 10 in the OECD Model Tax Convention (paragraph12.2)."

With this, the Minister for the first time since 2001 addressed foreign companies' limited tax liability on *dividends* in case of conduit.

As can be seen, the Minister maintains that the interpretation of "beneficial owner" is to be based on *"the principle of rightful income recipient"*, but the Minister now - in view of the extended comments to the Model Tax Convention (on "conduit companies") from 2003 - reaches the completely opposite result, ie that the company in the tax haven is the "rightful income recipient".

Likewise, in late 2006 the Danish Parliament acceded - by Act No 1574 of 20 December 2006 - to a protocol on amendment of the double taxation treaty between Denmark and the US.

In connection with the hearing of the bill[24] the Minister of Taxation answered a number of questions.

In the answer[25] to question 5 submitted by the Tax Committee the Minister of Taxation answered:

"A mere conduit company that is resident abroad, for example in Luxembourg, will not be the beneficial owner of the dividend, see the comments to article 10 in the OECD Model Tax Convention (paragraph 12.1)."

In his answer[26] to question 6 the Minister, however, had to recognise that the tax authorities had never taken the consequences of this position:

"I cannot report any examples of foreign conduit companies which the Danish tax authorities have not accepted as the beneficial owners of dividends from Danish companies."

In March 2007 the Minister of Taxation again confirmed that *the principle of "rightful income recipient"* was decisive when determining who was the "beneficial owner". This was done in connection with the Minister of Taxation's submission of a memorandum on "Status of the Danish Tax and Customs Administration's audit in relation to private equity funds' acquisition of seven Danish groups"[27] to the Tax Commission of the Danish Parliament. The following is stated in the memorandum:

"However, the flow of money most frequently leaves Denmark for recipients in countries with which Denmark has concluded double taxation treaties - DTC countries. This means that there is not limited tax liability to Denmark and that tax is not to be withheld at source. However, if the first recipient of the payments is not the final recipient - the "rightful income recipient" - of the payments, but a mere conduit company, the final ("rightful") recipient may still have limited tax liability."

As appears, the memorandum also confirms that the "rightful income recipient" (and accordingly the "beneficial owner") is the subject of the limited tax liability.

The interpretative notes for Act No 540 of 6 June 2007 on CFC (Controlled Foreign Company) taxation and measures against private equity funds also include

statements on the concept of "beneficial owner".

Merely the comments to article 1(vi) of the bill[28] on taxation of inbound dividend displayed a strong focus on intermediary holding companies in relation to money flows:

"It is noted that inbound dividend will not be tax exempt even if the dividend is distributed by a company in the EU/EEA or a country that has a double taxation treaty with Denmark, if this company is a conduit company between the Danish parent company and the subsidiary that is resident outside the EU/EEA in a country that does not have a double taxation treaty with Denmark."

During the hearing of the bill, the Minister of Taxation stated in this answer[29] to questions submitted by The Institute of State-Authorised Accountants:

"The principle of beneficial owner is a protection against a normally taxed company being inserted as a conduit company between the dividend paying company and the final receiving foreign tax haven company. The protection applies even if several intermediary normally taxed companies are inserted.

It is decisive who the beneficial owner is. Conduit companies comprise, for example, companies that in spite of being the formal owners have actually very narrow powers in relation to the relevant income. The company is a mere fiduciary or administrator in relation to the dividend acting on account of other parties, see the comments to article 10 in the OECD Model Tax Convention (paragraph 12.1).

Therefore, a mere conduit company in, for example, an EU Member State, will not be the beneficial owner of the dividends. It should be mentioned in this connection that the Parent-Subsidiary Directive does not imply that dividend payments through conduit companies must be approved."

In the same answer the Minister again addressed foreign companies' limited tax liability on dividend income from Denmark in case of conduit. It was done by a comment to the following example:

"Cayman Islands owns all the shares in EU Member State 1 that owns all shares in Denmark that owns all shares in EU Member State 2. EU Member State 1 may distribute dividend tax-exempt to Cayman Islands. EU Member State 1 is registered in EU Member State 1 and is subject to normal company tax in the relevant country but has de facto no income liable to tax. The address of EU Member State 1 is *care of* a law firm. The company has no employees and the company's only asset is the shares in Denmark."

The Minister of Taxation stated:

"In the mentioned situation the Cayman Islands company will be subject to limited tax liability on dividends from Denmark, as this company must be considered the beneficial owner of the dividends - the company in EU Member State 1 is a mere conduit company. This taxation of the Cayman Islands company is in accordance with the Parent-Subsidiary Directive that does not prevent taxation at source when the beneficial owner is resident outside the EU."

As appears, the Minister of Taxation takes the natural consequence of the position that the Cayman Islands company is considered the "rightful income recipient" (and accordingly the "beneficial owner") that the Cayman Islands company is subject to limited liability on the dividends in Denmark.

In his answer to question 86 submitted by the Tax Commission the Minister of Taxation had to explain the absence of examples of the Danish authorities having overruled conduit companies:

"A conduit company (holding company) can, however, not be compared with an agent or a nominee. Such company is registered and fully liable to pay tax in the country where it resides and the starting point is clearly that a holding company is entitled to treaty protection.

In connection with the updating of the OECD Model Tax Convention in 2005 [should be 2003] an OECD report according to which a holding company under specific circumstances should not be considered the beneficial owner of dividend was mentioned in a new paragraph 12.1 in the comments to Article 10 (dividend). The holding company must in reality have very narrow powers which in relation to the income concerned makes it a mere fiduciary or administrator acting on account of other parties.

Accordingly, there are very narrow limits as to when Danish tax authorities can disregard a duly registered and fully taxable foreign company, and as stated in the answer to question 6 relating to bill L 30 there are no examples of Danish tax authorities having refused to recognise a foreign holding com-

pany and accordingly having considered it a mere fiduciary."

Summary - the Ministry of Taxation's interpretation of "beneficial owner"

Based on the review above the Ministry of Taxation's interpretation of the concept of "beneficial owner" can be summarised as follows:

In 1998 the limited tax liability on *dividends* that had been introduced in 1968 was abolished in relation to all foreign parent companies. It appears from the interpretative notes that the expected loss of revenue was modest because the tax at source could already be avoided by inserting intermediary holding companies in countries in relation to which Denmark was completely or partially prevented from withholding tax at source. Accordingly, the intermediary holding companies were considered "beneficial owners".

In 2001 dividend tax was reintroduced in relation to parent companies resident in non-EU Member States without double taxation treaties with Denmark. The Minister of Taxation confirmed in the interpretative notes that it was (still) possible to avoid the reintroduced dividend tax by inserting an intermediary holding company in another EU Member State or a DTC country and channel the dividend through that. For the same reason the revenue was expected to be "limited".

In 2004 limited tax liability on *intra-group interest* was introduced. Prior to that the comments to the Model Tax Convention relating to "beneficial owner" had in 2003 been extended by "conduit companies". During the hearing of the bill the Minister of Taxation stated that a substance over form approach could be applied in order to determine the "beneficial owner". Accordingly, it was the opinion of the Ministry that the extension of the comments in 2003 did not add anything new in relation to that which already applied according to Danish law, ie *the principle of "rightful income recipient"*.

It was decisive who was the *"rightful income recipient"* and if the company in the tax haven was considered the "rightful income recipient" (and accordingly the "beneficial owner"), this company was subject to the limited tax liability.

From the end of 2006 the Ministry of Taxation has increased the rhetoric in relation to mere conduit companies not being the "rightful income recipient".

This is the basis on which the "beneficial owner" cases were originally instituted.[30]

During the subsequent proceedings it has, however, become clear to the Ministry of Taxation that the interpretation of "beneficial owner" asserted so far could not lead to the desired result because the intermediary holding company clearly has to be considered the "rightful income recipient". Therefore, the Ministry of Taxation has changed its interpretation of "beneficial owner".

The Ministry of Taxation no longer equates "beneficial owner" with "rightful income recipient". On the contrary, they are two different concepts that are not related.

Most recently the Ministry of Taxation has taken the full consequence of this changed position and has agreed that the intermediary holding company (the (alleged) conduit company) is the "rightful income recipient" and accordingly the subject of the limited tax liability. [31] The Ministry, however, maintains that the company in the tax haven is the "beneficial owner" and in support of that reference is *merely* made to the extended comments to the 2003 Model Tax Convention.

These comments are interpreted as widely as possible, for example to the effect that dividend tax is imposed even if there has been no actual flow through or channelling of funds, which is in direct contravention of the wording of the comments - and also of the interpretative notes for later legislation.[32]

In the opinion of the Ministry of Taxation it is merely decisive whether the owners behind have made the overall decision

on use of the dividends or the interest *in advance* and accordingly have limited the intermediary holding company's right of disposition of the amount received. If that is the case, the intermediary company is not the "beneficial owner".

Based on this interpretation it is difficult to point to any intermediary holding company that fulfils the Ministry's criteria for being "beneficial owner". It is absolutely normal that major decisions in a group are first made by the top management of the group, following which they are implemented by the relevant company bodies in the respective subsidiaries. Accordingly, the interpretation is in reality meaningless.

The Ministry of Taxation's new interpretation of "beneficial owner" is, however, not fully developed yet.

The Ministry still needs to explain why the company in the tax haven - and not the ultimate owners (normally resident in EU Member States or DTC countries) - is the "beneficial owner". The requirements which the Ministry is only now outlining for recognition of the ultimate owners as "beneficial owners" so far seem so restrictive that it will be difficult to fulfil them.

And so it has come to pass that the Ministry of Taxation - based on two acts from 2001 (dividend tax) and 2004 (interest tax) respectively which both imply that the introduction of limited tax liability will not bring in any notable revenue - in, so far, 16 cases have collected tax on dividend and interest payments in the amount of DKK 19bn, and according to the Ministry of Taxation more is in store.[33]

The extended comments from 2003 cannot be included when interpreting previously concluded treaties

It is a fact that the Ministry of Taxation's change of the interpretation of "beneficial owner" is directly caused by - and exclusively supported on - the extended comments to the 2003 Model Tax Convention (on "conduit companies").

That raises questions on the value of these comments as a source of law.

A detailed review of this question, including of Danish and international literature and case law, is outside the scope of this article.[34] Only a few principal findings are indicated in the following.

It is generally assumed that OECD's comments to the Model Tax Convention can be included in the interpretation of double taxation treaties.

As a starting point the interpretation is to be based on the version of the Model Tax Convention with comments that was applicable at the time of the conclusion of the treaty in question.

If new comments indicate a *change* compared to previous versions - and not merely a *clarification* - the new comments to the Model Tax Convention cannot be applied.

This is because the new comments are not approved by the parliaments of the Member States and accordingly they lack democratic legitimacy.

In a legal system like the Danish in which a double taxation treaty does not become part of Danish law till the Danish Parliament has adopted an act to that effect this is particularly obvious. It would simply be in contravention of the prohibition against delegation in section 43 of the Danish Constitution to leave legislative competence to OECD officials.

The fact that the interpretation of the double taxation treaty is decisive as to whether limited tax liability according to section 2(1)(c) and (d) of the Danish Corporation Tax Act applies at all further contributes to emphasising that the clear interpretative notes to these provisions cannot be disregarded by a change of OECD's comments.

It cannot be claimed with any right that the extended comments from 2003 - as interpreted by the Ministry of Taxation - should indicate a clarification of the concept of "beneficial owner". The Ministry of

Taxation's interpretation leads to the opposite result of that on which the Ministry has based the interpretative notes for the 2001 Act and the 2004 Act. Accordingly, it is a significant *change*.

In that connection it should be noted that the OECD countries do not agree as to the meaning of the extended comments from 2003, which seems to be a minimum requirement for accepting that a clarification has been made.

Thus, the extended comments have caused widely different interpretations with courts and tax administrations in the individual countries.

Therefore, OECD on 29 April 2011 published a discussion draft for "Clarification of the Meaning of "Beneficial Owner" in the OECD Model Tax Convention" and has requested that all interested parties (the public) submit comments to the draft. The mere appearance of this new discussion paper emphasises the impossibility of attributing any importance at all to the extended comments from 2003.

Accordingly, the conclusion is that the extended comments from 2003 do not constitute a relevant contribution to the interpretation of previously concluded treaties. The intermediary holding companies are therefore - merely for this reason - "beneficial owners" and there is no limited tax liability.

Tightening of an administrative practice only affects the future

It is a general administrative law principle that an - otherwise legal - tightening of an administrative practice cannot be implemented without the authorities' prior notification of the new opinions which they will consider decisive to this new practice. A tightening can therefore only be implemented *with effect for the future*. This is clear from the Legal Guidelines:[35]

"**Notification of change with future effect**
It is a fundamental administrative law principle that it is only possible to implement a tightening change of an administrative practice with effect for the future and following announcement of a suitable notice enabling the public to adapt to the changed state of the law."

This issue only becomes relevant if the courts should agree with the Ministry of Taxation that the extended comments from 2003 may be applied for the interpretation of "beneficial owner" and the courts further agree with the Ministry's interpretation thereof and that limited tax liability therefore applies.

Under these circumstances it is obvious that the administrative practice has been tightened *with retroactive effect*. This is also true with respect to the Parent-Subsidiary Directive and the Interest and Royalty Directive.

The Ministry of Taxation disputes that this is the case and submits in support of this that no established administrative tax practice has existed because no tax cases documenting such practices are available.

However, when express statements are available from the Ministry of Taxation as to how the rules of law are to be understood and when the tax authorities have administered in accordance with that, it is fully satisfactory documentation of an established administrative tax practice which the taxpayers can rely on.

The fact that such tax claims have not been raised until recently is not due to incomplete control by SKAT, but is due to an opinion that there was no reason to raise such claims.

In his answer to the Tax Commission of the Danish Parliament of 27 November 2006 the Minister of Taxation has confirmed that *"the administrative tax assessment procedures include making sure that the provisions for not withholding dividend tax are fulfilled, including whether a foreign company is the beneficial owner of the dividend"*.[36]

In his answer of the same date the Minister could at the same time report that there were no *"examples of foreign conduit*

companies which the Danish tax authorities have not accepted as the beneficial owners of dividends from Danish companies".[37]

The latter statement was repeated in an answer to the Tax Commission on 22 May 2007.[38]

As appears from the above, the Ministry of Taxation has not developed its interpretation of "beneficial owner" till after the institution of the legal proceedings.

Accordingly, the enterprises have not had the slightest reason to believe that exemption from tax on the payments of dividends and interest made could be denied and it is obvious that the enterprises would not have made such payments in case of any doubt that they were exempt.

In addition, it is a simple matter of "admission of guilt". The official speaking to the newspapers on behalf of SKAT in these cases stated as follows to Jyllands-Posten on 14 September 2010:

> "Even if the money has not flown through at once in all cases, the same reasons apply, ie that a company in Luxembourg without any power and right to dispose of the means is not the beneficial owner. The owners behind are the beneficial owners and therefore tax is to be withheld at source. We do not know if we will be successful. Our point of view is fairly new in administrative tax practice and we will have to await the decision of the Supreme Court at some point."

No negligence

In these cases SKAT has collected the tax at source from the Danish companies with reference to the provision in section 69 of the Taxation at Source Act under which a company that omits complying with its obligation to withhold tax is liable for payment of the outstanding amount, unless the company proves that it has not acted "negligently".

Taking into consideration that the companies' understanding of the relevant rules is in accordance with the Minister of Taxation's statements in 2001 and 2004 and therefore with the administrative tax practice continuously followed by the Ministry of Taxation for more than 30 years, there can be no doubt that the companies *have not acted negligently.*

Accordingly, it is - also for this reason - out of the question to collect the tax at source with the Danish companies.

Concluding remarks

In the late 1990s the new Danish holding rules enticed international groups to set up intermediary holding companies - often with significant values - in Denmark. When the rules were amended in 2001, the Minister of Taxation directed how tax at source could still be avoided by inserting intermediary holding companies above the Danish companies. The tax authorities have subsequently collected tax at source from enterprises that have followed the procedure directed by the Minister of Taxation. As a "thank you for coming", tax at source has been collected with intermediary holding companies in relation to values which were never intended to be taxed in Denmark and which in many cases do not come from Denmark at all.

This is just one of many examples of the consequences of SKAT's changed interpretation of the concept of "beneficial owner".

As appears from the above, SKAT is, however, not entitled to change its interpretation with retroactive effect and therefore the claims raised are - merely for that reason - groundless.

The "beneficial owner" cases have created such uncertainty as to the due process of law that not even experienced tax advisers dare make a safe bid as to whether a certain dividend distribution or interest payment will be subject to a claim from SKAT for withholding of tax - and this applies even if it is not possible to see why such distribution should be subject to tax.

For the same reason international investors bypass Denmark.

There is no prospect of the state of the law in this area being finally clarified before the courts for many years.

Accordingly, it is important that the Ministry of Taxation sets out specific guidelines for the administrative tax practice that will be followed in the future in order for the legal right to certainty to be fulfilled.

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[1] According to the Ministry of Taxation's press release of 1 April 2011 ("Skattekontrol af kapitalfonde har høj prioritet"/"Tax control of private equity funds are a high priority") the Danish Tax and Customs Administration has raised a total of 31 cases. In 16 of these cases withholding tax has been levied on dividend distributions and interest payments of a total of DKK 19bn, while the remaining 15 cases have not been completed yet.

[2] TfS 2010.502 LSR

[3] TfS 2010.974 LSR

[4] TfS 2011.277 LSR

[5] See note 1

[6] The concept of "beneficial owner" was first inserted in OECD's Model Tax Convention in connection with the revision in 1977.

[7] The same comments were added in paragraph 8 in the comments to Article 11 (interest).

[8] See TfS 2010.502 LSR and TfS 2010.974 LSR

[9] The limited tax liability on dividends was introduced by Act No 370 of 13 November 1968.

[10] L 53 of 21 October 1998

[11] Working Group Report SN 4901 99 of 23 November 1999 from ECOFIN's Code of Conduct Group

[12] The ECOFIN Council's Code of Conduct relating to business taxation (98/c 2/01) of 1 December 1997

[13] L 99 of 10 November 2000

[14] L 99 of 10 November 2000, appendix 22

[15] L 99 of 10 November 2000, appendix 24

[16] L 99 of 10 November 2000, appendix 25

[17] L 119 of 17 December 2003

[18] L 119 of 17 December 2003, appendix 21

[19] See Aage Michelsen, International Skatteret/*International Tax Law, 3rd edition, 2003, p 426:* "Most Danish double taxation treaties include provisions in articles 10-12 on "beneficial owner" as a condition for the limitations in the taxation at source of dividends, interest and royalties. As mentioned in the reference to the corresponding provisions in the OECD Convention such provisions probably do not have any important function as most intermediary companies subject to the necessary legal formalities will have no trouble complying with the requirement of being beneficial owner. The provisions will only affect actual pro forma situations. And in that case they are unnecessary, as the same result could be reached by using basic principles of law."

[20] L 119 of 17 December 2003, appendix 56

[21] L 119 of 17 December 2003, appendix 74

[22] L 116 of 14 December 2005, appendix 9

[23] Answer of 6 November 2006 to question S 474

[24] L 30 of 4 October 2006

[25] L 30 of 4 October 2006, answer of 27 November 2006 to questions 2-10

[26] L 30 of 4 October 2006, answer of 27 November 2006 to questions 2-10

[27] The Tax Commission 2006-2007, SAU general part - Appendix 115

[28] L 213 of 18 April 2007

[29] L 213 of 18 April 2007, appendix 26

[30] The Danish Tax and Customs Administration's decisions in the two first "beneficial owner" cases are dated 15 May 2009.

[31] In the first dividend tax case this was not done till during the exchange of pleadings in the Eastern High Court in 2011.

[32] See SKM 2008.728 DEP: "The Ministry of Taxation has some difficulty understanding how it can be demonstrated in the mentioned example that the Cayman Islands company is a conduit company, as money - as opposed to the example mentioned in appendix 26 to L 213 - has not actually been channelled through the Cayman Islands company."

[33] See note 1

[34] See Aage Michelsen, Commemorative Publication to Ole Bjørn, p 357

[35] The Legal Guidelines 2011-1, A.A.7.1.5, published by the Danish Tax and Customs Administration.

[36] L 30 (2006/2007), answer to question 10

[37] L 30 (2006/07), answer to question 6

[38] L 213 (2006/07), answer to question 86