



Danish court rejects tax authority's proposed adjustment in MNE group restructuring

Global Transfer Pricing Alert 2018-028

The Danish National Tax Tribunal (NTT) published a ruling on 8 October regarding whether the Danish tax authorities (SKAT) were allowed to perform a discretionary assessment to deem an intercompany compensation charge in relation to the closure of a Danish company as a result of a European group restructuring.

The case - SKM2018.510.LSR - involved a Danish subsidiary of a large foreign-based multinational group. The group decided to close down the Danish subsidiary's production activities as part of a broader international turnaround plan.

SKAT took the position on audit that a compensation charge based on a discretionary assessment that resulted in an increase in the Danish company's taxable income was appropriate. SKAT justified the adjustment by arguing that only the remaining part of the group benefitted from the closure of the Danish production activities. SKAT also argued that had the closure taken place between two unrelated parties, the multinational group would have had to pay the Danish subsidiary compensation for the costs incurred in relation to the closure.

Although the Danish company was obligated to prepare transfer pricing documentation, the documentation did not include a description of a compensation charge or of the restructuring within the group. Referencing the Danish statutory order on transfer pricing documentation that was in effect from 2006, SKAT argued that it was allowed to perform a discretionary assessment because no description of a compensation charge or the restructuring was included in the

Danish company's transfer pricing documentation. SKAT performed the discretionary assessment by deeming a compensation charge to the Danish company that equaled the costs related to the closure of the production activities.

The Danish company argued that SKAT's adjustment should be rejected, because the group restructuring did not involve any controlled transactions (including any transfer of assets to related parties) with the Danish company.

Legal basis

The NTT concluded that SKAT did not have a legal basis to perform a discretionary assessment of the company's taxable income, because the formal content requirements for Danish transfer pricing documentation were not in effect for the years under audit. Hence, the Danish company was not obligated to include information on the restructuring in its transfer pricing documentation, and SKAT could not use the lack of information to justify a discretionary assessment of the Danish subsidiary's taxable income.

Transfer of assets

The NTT referred to chapter 9, part II, section D the OECD's 2010 transfer pricing guidelines to emphasize that SKAT had not proved that any transfers of assets such as machinery or customer lists had taken place between the Danish company and its related parties in relation to the closure of the production activities in Denmark.

The NTT also emphasized the fact that demand for production depended to a large extent on price, not trademarks or reputation. Furthermore, the other production subsidiaries within the group already served the same clients as the Danish subsidiary; thus, those customer relationships already existed before the closure of the Danish company.

For the NTT, both these facts supported the conclusion that no transfer of assets had taken place.

Contractual relationship

Referring to part II, section E of the OECD's 2010 transfer pricing guidelines, the NTT concluded that SKAT could not prove that the contractual relationship between the Danish company and the group should justify compensation of the costs related to the closure of the Danish production activities. After assessing the characteristics of the production and the factory, the NTT concluded that unrelated parties would not have secured their investment risk by agreeing to a compensation charge.

Territorial restriction on sale of production equipment

As a result of the closure of the Danish operation, the Danish company sold its production machinery to unrelated parties. However, the group decided that the production machinery should be sold outside of Europe to avoid a sale to direct competitors.

SKAT argued that this restriction could have a negative effect on the realized price paid for the machinery, and that such a group decision benefited other group companies and hence the Danish company should be compensated for this.

The NTT concluded that the territorial restrictions decided at group level had no effect on the actual realized price, because the Danish production capacity amounted to less than 1 percent of the total production on the European market; thus, no group companies benefited from the territorial restrictions.

Conclusion

The NTT ruling illustrates the point that SKAT's positions based on discretionary assessments should be carefully reviewed before accepting the decision, particularly if those decisions include "deemed" transactions.

The ruling also illustrates the importance of solid transfer pricing documentation. Although in this particular case SKAT was denied the ability to perform a discretionary assessment, an important factor in this result was the fact that the Danish content requirements for transfer pricing documentation were not in effect for the years under audit. However, Denmark currently has substantial content requirements for transfer pricing documentation.

Finally, it seems clear that when SKAT has deemed a transaction (for example, a transfer of assets such as customer lists or other intangibles) and the taxpayer has prepared adequate transfer pricing documentation, SKAT must document that a transfer has actually taken place.

SKAT may still appeal the NTT ruling to the Danish civil courts. The deadline to file an appeal is three months from the date of the ruling, so the ruling must be appealed by early December.

[Back to top](#)

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[Back to top](#)

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