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Danish High Court Decision on International Holding Structure

The author provides a summary of a recent decision of the Eastern High Court on taxation of dividends at source in the context of an international holding structure. The scope of the summary focusses on the international tax aspect of the case only.

1. Facts of the Case

In 2005 a Danish company launched a public offer to buy the shares in a Danish listed company, and succeeded. The shares in the Danish company (holding company) were transferred in connection with the establishment of another Danish holding company as a contribution in kind against the issuance of shares. Cash contribution and credit facilities were established in respect of the Danish holding companies. The shares in the ultimate Danish holding company (DHC) were contributed to a Luxembourg company against the issuance of shares, and the Luxembourg company established a new Luxembourg subsidiary through a drop-down including the shares in DHC. DHC decided to pay a dividend to its parent company in Luxembourg (LHC), which in turn issued two loans to DHC, namely a convertible loan and a non-convertible loan. The payments were effected on the same day. On 31 December 2005 the convertible loan was converted into shares. The companies had no employees, as the administration of the companies was carried out by a separate administration company.

The transactions and holding structure can be illustrated as in Figure 1.

Figure 1

(1) Danish acquiring company
|
Danish listed company

(2) Danish holding company
|
Danish acquiring company
|
Danish listed company

(3) Luxembourg company
|
Danish holding company
|
Danish acquiring company
|
Danish listed company

(4) Luxembourg company
|
Luxembourg subsidiary (LHC)
Two loans to DHC | Dividend to LHC
Danish holding company (DHC)
|
Danish acquiring company
|
Danish listed company

In 2008 the Danish tax authorities submitted two memoranda to DHC in the context of a tax audit, the first concerning the two loans to DHC and the second concerning a possible obligation to withhold dividend tax. The case summarized in this article concerns only the payment of the dividend by DHC to LHC. On 15 May 2009 the Danish tax authorities (as party in this case "the Tax Authorities") decided that DHC was obliged to withhold tax equal to DKK 1,552,376,000 of a dividend of DKK 5,544,200,000 paid to LHC.

The National Tax Tribunal ruled on the case in 2010,[1] followed by a ruling on appeal to the Eastern High Court on 20 December 2011.[2]

2. Pleadings before the National Tax Tribunal

2.1. The OECD Model Convention

The Tax Authorities argued that the requirement for a tax-exempt dividend under section 2.1.c of the Danish Corporation Tax Act, namely that the dividend withholding tax to be reduced according to the Parent-Subsidiary Directive (90/435) or a tax treaty (in this case, the Denmark-Luxembourg Income and Capital Tax Treaty (1980)), was not fulfilled to the extent that investors that were the beneficial owners were resident in non-treaty jurisdictions. This is because LHC was not considered the beneficial owner of the dividend due to LHC having no activities and no independent right to dispose of the dividend, and due to the absence of a commercial purpose for the insertion of LHC into the structure. Reference was made to the Commentary on Article 10 of the OECD Model and a 2005 decision of the Swiss Supreme Court.[3] Specifically, the Tax Authorities argued that the situations where payments were made through a conduit company in paragraph 12.1 of the Commentary on article 10 of the OECD Model were mere examples of instances where the formal recipient will not be considered the beneficial owner. In addition, it likewise contravenes the purpose and intention underlying the rules of the OECD Model to grant relief in these situations, and it is sufficient that the lack of an independent right to dispose of the dividend is related to the channelling of the dividend. The payment back to DHC was ultimately made by the conversion into shares. Thus, LHC did not receive any amount that the company at any time in fact had disposed of.

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1. SKM2010.268.LSR, *Indeholdelse af udbytteskat vedrørende udbytte til udenlandsk moderselskab*, www.skat.dk.
2. SKM2012.121.ØLR, *Retmæssig ejer – kildeskat på udbytte*, www.skat.dk.
3. 2A.239/2005 (28 Nov. 2005), Sammlung der Entscheidungen des Schweizerischen Bundegerichts, II. Öffentlich-rechtliche Abteilung.

It was argued that that the notion in paragraph 12.1. of the Commentary on Article 10 of the OECD Model that the concept of beneficial owner must be interpreted in light of, and in accordance with, the purpose of tax treaties, which includes the desire to counter tax evasion.[4] It is therefore relevant whether the dispositions had a real commercial purpose or had the purpose of obtaining treaty benefits. The Tax Authorities concluded that the purpose had been to utilize the tax treaty. Reference was made to paragraph 9.4 of the Commentary on Article 1 of the OECD Model, under which it is agreed that states are not obliged to grant benefits with regard to arrangements that imply an abuse of the provisions of the applicable treaty.

The Tax Authorities also argued that LHC was not the beneficial owner under the Denmark–Luxembourg Income and Capital Tax Treaty (1980).

DHC argued that it is explicitly stated in the 2003 Commentary on Article 10 of the OECD Model that in order for a company to be regarded as a conduit company, another person in fact must receive the income concerned. This position is also supported by paragraph 22 of the Commentary on Article 10 of the OECD Model.[5] DHC further argued that the Commentary on Article 10 of the OECD Model indicates that the lack of an independent right to dispose of the dividend is related to the channelling of the dividend to the owners of DHC. In addition, all major decisions in large groups are made by the top management of the group and thereafter carried through by the relevant companies, and a usual decision-making procedure in groups cannot be regarded as to automatically disqualify the subsidiaries of the group from being considered the beneficial owners of the dividends received.

DHC referred to the proposals for anti-abuse provisions in paragraph 11 of the Commentary on Article 1 of the OECD Model, namely the look-through approach, the subject-to-tax approach, the channel approach and the exclusion approach, and argued that the proposals must be based on the assumption that a conduit company normally cannot be deprived of treaty benefits on the grounds that the company is not the beneficial owner.[6] On these grounds, DHC argued that the provision concerning beneficial ownership cannot be applied as a general anti-abuse provision and that denial of treaty benefits with regard to general anti-abuse may be effected only under very extraordinary circumstances. It was added that the argument pleaded for by the Tax Authorities in fact is the look-through view.

DHC countered the comment of the Tax Authorities on the use of the word "likewise" in paragraph 12.1 of the Commentary on Article 10, by arguing that it clearly transpires from the context that paragraph 12.1 lists three situations where the recipient is not the beneficial owner, i.e. an agent, an intermediary or a conduit company that in fact receives the income in question. As regards the latter situation, there is a further requirement that the conduit company have "very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties".

2.2. International tax cases

The Tax Authorities referred to the 2005 Swiss Supreme Court decision regarding a Danish holding company[7] as an example of a country's denial of application of a tax treaty based on the OECD Model. The Tax Authorities also referred to the *Bank of Scotland* case decided on 29 December 2006 by the French *Conseil d'Etat*.[8] The Tax Authorities noted that the French Court concluded that the US parent company was the beneficial owner, as it had disposed of the dividend and directed the dividend to the bank to which the loan was to be repaid.

Furthermore, the Tax Authorities referred to the *Prévost Car* case decided on 26 February 2009 by the Canadian Court of Appeal[9] and the *Indofood* case decided on 2 March 2006 by the England and Wales Court of Appeal (Civil Division).[10]

Regarding the *Indofood* case the Tax Authorities noted that the UK Court found that the Dutch intermediary company could not be regarded the beneficial owner, as it was sufficient that the income was in fact disposed of in such way that the income in substance would never be under the authority of the Dutch intermediary company. The Tax Authorities specifically cited paragraph 42 of the decision, which stated that "the concept of beneficial ownership is incompatible with that of the formal owner who does not have the full privilege to directly benefit from the income".

With regard to the *Prévost Car* case, the Tax Authorities pointed out that it appeared that the Canadian Federal Court of Appeal found that the formal recipient is the beneficial owner unless the formal recipient is legally

4. *See also OECD Model Tax Convention on Income and on Capital: Commentary on Article 1* para. 7, Models IBFD.
5. Paragraph 22 reads as follows: "Attention is drawn generally to the following case: the beneficial owner of the dividends arising in a Contracting State is a company resident of the other Contracting State; all or part of its capital is held by shareholders resident outside that other State; its practice is not to distribute its profits in the form of dividends; and it enjoys preferential taxation treatment (private investment company, base company). The question may arise whether in the case of such company it is justifiable to allow in the State of source of the dividends the limitation of tax which is provided in paragraph 2. It may be appropriate, when bilateral negotiations are being conducted, to agree upon special exceptions to the taxing rule laid down in the Article, in order to define the treatment applicable to such companies."
6. DHC also referred to the report of P. Baker, *Progress Report of Subcommittee on Improper Use of Tax Treaties: Beneficial Ownership* (17 Oct. 2008), para. 14, at 9-10.
7. 2A.239/2005, Sammlung der Entscheidungen des Schweizerischen Bundesgerichts, *supra* n. 3.
8. No. 283314, www.conseil-etat.fr. The case concerned a US Corporation selling usufruct on shares issued by its French subsidiary to Bank of Scotland against payment from Bank of Scotland. The Court found that Bank of Scotland was not the beneficial owner and that the transactions in substance constituted a loan that was repaid by the French subsidiary.
9. 2009 FCA 57, http://decisions.fca-caf.gc.ca/en/2009/2009fca57/2009fca57.html.
10. [2006] EWCA Civ 158, http://www.bailii.org/ew/cases/EWCA/Civ/2006/158.html. The case concerned whether a Dutch SPV were to be regarded the beneficial owner of interest received from Indonesia according to the tax treaty between Holland and Indonesia, the tax treaty between Mauritius and Indonesia having been repealed. The Court found that the inserted Dutch SPV was not the beneficial owner of the interest.

obliged to dispose of the dividend in a certain way. The Tax Authorities rejected this principle. It was added that the concept of beneficial ownership is supported by a substance-over-form approach, and it is not in accordance with such approach to establish a requirement that there be a legal obligation to pay to the entity that is regarded as the beneficial owner. It was further added by the Tax Authorities that there were good reasons to establish the holding structure in the *Prévost Car* case and that the Court explicitly based its decision on the fact that the relevant money transfers were not predetermined.

DHC argued that the facts in the *Bank of Scotland* case substantially differed from the present case, and that the decision in the 2005 Swiss Supreme Court decision went too far by applying a general anti-abuse principle in respect of a tax treaty context, although there was no provision regarding beneficial ownership nor a special anti-abuse provision under the applicable treaty.

With regard to the *Prévost Car* decision, DHC argued that the Canadian Federal Court of Appeal found that it was of no importance for the determination of the beneficial ownership that the ultimate owners had decided that dividend was to be channelled up through the companies and that the intermediary company did not have any activity or physical presence other than that which follows from being a pure holding company in a situation where the dividend was in fact channelled to the ultimate owners.[11]

DHC also noted that the *Indofood* case concerned a back-to-back loan with no income arising in the Dutch intermediary company, and that as such the factual circumstances substantially differed from those in the present case, in which the dividend remained in DHC.

2.3. EU law

The Tax Authorities argued that it is the position of the European Court of Justice (ECJ) that EU law does not prevent a Member State from denying a company benefits deriving from EU law in a situation where the establishment of a holding company in another Member State is aimed at avoiding taxation at source on payments to non-European entities, if such structure does not have a commercial purpose.[12] The Tax Authorities argued that these conditions were fulfilled in the present case.

The Tax Authorities argued that it is not a condition for denying benefits following from the Parent-Subsidiary Directive (90/435) that concrete national authority to use article 1(2) of the directive have been implemented, and referred to *Kofoed* (Case C-321/05)[13] concerning a share exchange (involving the Merger Directive (2009/133)). In the present case, however, the Tax Authorities argued that such national authority was included in the Danish Corporation Tax Act, specifically referring to the preliminary work of the relevant bill.

In this context, DHC argued that:
- the Parent-Subsidiary Directive (90/435) (as opposed to the Interest and Royalties Directive (2003/49)) does not require that the parent company be the beneficial owner of the received dividend;
- the Tax Authorities have confused the question of beneficial owner and the question of abuse;
- incidents of abuse cannot be countered by solely referring to article 1(2) of the Parent-Subsidiary Directive (90/435);
- article 1(2) of the Parent-Subsidiary Directive (90/435) authorizes the Member States to implement and maintain national rules on abuse;
- Denmark only has case law on abuse (and not legislation);
- the Tax Authorities referred only to a part of the Commission notification14 not including the part concerning how to counter such incidents of abuse; and
- Member States should implement national rules to counter tax evasion.

DHC further argued that:
- the owners of DHC had not established DHC for the purpose of obtaining unintended benefits through the Parent-Subsidiary Directive (90/435);
- the tax benefits deriving from the differing national tax law of the two countries have nothing to do with EU law;
- article 1(2) of the Parent-Subsidiary Directive (90/435) is not an applicable rule on abuse, but rather an authorization for Member States to implement or maintain national rules on abuse; and
- Danish case law on abuse is not applicable; this argument has not been contested by the Tax Authorities. The ECJ decision in Case C-321/0515 states that the application of general anti-abuse provisions in direc-

11. DHC referred to paragraph 100 of the decision appealed to the Canadian Federal Court of Appeal in the *Prévost Car* case and paragraphs 15 and 16 of the decision of the Canadian Federal Court of Appeal, *supra* n. 9. The Court agreed to the understanding of beneficial ownership in paragraph 100 from which DHC cited: "In my view the 'beneficial owner' of dividends is the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received. The person who is the beneficial owner of the dividend is the person who enjoys and assumes all the attributes of ownership. In short the dividend is for the owner's own benefit and this person is not accountable to anyone for how he or she deals with the dividend income ... When corporate entities are concerned, one does not pierce the corporate veil unless the corporation is a conduit for another person and has absolutely no discretion as to the use or application of funds put through it as conduit, or has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs, for example, a stockbroker who is the registered owner of the shares it holds for clients. This is not the relationship between G1 Holding and its shareholders."

12. *See* Commission notification in EUT 2008, C 116/13; UK: ECJ, 12 Sep. 2006, Case C-196/04, *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue*, ECJ Case Law IBFD and UK: ECJ, 21 Feb. 2006, Case C-255/02, *Halifax plc, Leeds Permanent Development Services Ltd, County Wide Property Investments Ltd v. Commissioners of Customs & Excise, BUPA Hospitals Ltd, Goldsborough Developments Ltd v. Commissioners of Customs and Excise* and *University of Huddersfield Higher Education Corporation v. Commissioners of Customs and Excise*, ECJ Case Law IBFD.
13. DK: ECJ, 5 July 2007, Case C-321/05, *Hans Markus Kofoed v. Skatteministeriet*, ECJ Case Law IBFD.
14. *Supra* n. 12.
15. *Supra* n. 13.

tives presupposes national anti-abuse provisions.16 DHC rejected the argument of the Tax Authorities that national authority is included in the Danish Corporation Tax Act, and argued that the arguments of the Tax Authorities are circular because the Tax Authorities presuppose the result that is argued to be the result.

DHC argued that the taxation at source constitutes an infringement of the EU freedoms because the taxation results from an application of a more extensive anti-abuse rule than the anti-abuse rules than can be applied to Danish holding companies.

3. Decision of the National Tax Tribunal

The majority of the members of the National Tax Tribunal referred to the paragraphs 12, 12.1 and 22 of the Commentary on Article 10 of the OECD Model, and stated that the fact that the recipient of a dividend has very limited powers with respect to the dividend, cannot solely imply that the recipient is not the beneficial owner. The majority found that LHC should be regarded as the beneficial owner of the dividend because LHC had not distributed the dividend up to its parent company, but instead used the dividend in a downward direction, ultimately as remuneration for the acquisition of a company.

As regards EU law, the majority stated that there are no provisions under national law that have been included with respect to article 1(2) of the Parent-Subsidiary Directive (90/435) and that authority to counter fraud and abuse follows from case law. As such, the majority found that the benefits of the directive could not be denied on the basis of Danish case law.

One member of the National Tax Tribunal found that the Commentary on the OECD Model should be understood in such way that it is not decisive that the dividend had not been distributed on to the owners, as it is decisive that the formal recipient does not have powers with respect to the dividend. LHC had been inserted without having the real right to dispose of the dividend other than as predetermined by the back-end ownership structure. Therefore, the applicable tax treaty between Denmark and Luxembourg did not hinder Danish taxation at source.

As regards EU law, this one member of the National Tax Tribunal found that it is not a condition for denying benefits under the Parent-Subsidiary Directive (90/435) that concrete authority has been enacted in order to make use of article 1(2) of that directive, and that the structure could be set aside according to general EU principles under which EU law cannot be invoked for the purpose of pursuing fraud or abuse.

16. DHC specifically cited paragraphs 37-48 of Case C-321/05, *supra* n. 13, with emphasis on paragraphs 46, 47 and 48; as well as the proposal of the General Advocate in ECJ, Case C-325/08, 16 Mar. 2010, *Olympique Lyonnais SASP*, especially paragraphs 38, 47, 59, 62 and 69 thereof.

4. Pleadings before the Eastern High Court

4.1. The OECD Model Convention

Before the High Court, the Tax Authorities argued that the concept of beneficial ownership must be assessed on the basis of an independent international understanding, and that the decisive issue is the recipient's real powers with regard to the dividend. It was further argued that the arrangement (which was not commercially justified) could not imply tax exemption because LHC was not the beneficial owner.[17]

DHC[18] claimed that it had the same powers that any other intermediary holding company in any other group normally would have, and that the Tax Authorities have attempted to eliminate the requirement in paragraph 12.1 of the Commentary on Article 10 of the OECD Model that there be a flow-through to a recipient in a third country who in fact receives the dividend. There is no basis in theory or international practice to justify the very broad interpretation of the Tax Authorities.

4.2. EU law

Noting that article 1(2) of the Parent-Subsidiary Directive (90/435) allows the Member States to use "conventions" that are necessary to counter fraud or abuse, the Tax Authorities argued that the term "conventions" must be a reference to tax treaties entered into by the Member States and that the concept of "beneficial ownership" is included in tax treaties for the purpose of reducing fraud or abuse as referred to in the Parent-Subsidiary Directive. It was claimed that section 2.1.c. of the Danish Corporation Tax Act included authority to deny the benefits of the directive on the basis of the general EU principle of abuse created by case law and on the basis of the anti-abuse provision in article 1(2) of the Parent-Subsidiary Directive (90/435).

The Tax Authorities also argued that taxation at source under section 2.1.c. of the Danish Corporation Tax Act did not constitute an infringement of the EU right of freedom of establishment, as this concrete restriction had the purpose of combating tax abuse.[19]

DHC disagreed that the EU concept of "purely artificial arrangements" could be considered violated in this case and that the concept of "beneficial owner" could be regarded as a provision that is necessary to combat fraud and abuse as understood in article 1(2) of the Parent-Subsidiary Directive (90/435). There is no basis for the assumption that it is due to an omission that the Parent-Subsidiary Directive (90/435) does not require that the recipient be the beneficial owner. DHC noted that:

– the term "beneficial owner" has been included in OECD Model since 1977; that the expansion of the

17. *See* article 10(2) of the Denmark-Luxembourg Income and Capital Tax Treaty.
18. It is noted that LHC became the defendant due to a merger between DHC and LHC. For clarity purposes, in this article only "DHC" is referred to as party in this case.
19. The Tax Authorities specifically cited Case C-196/04, *supra* n. 12, para. 55; and EU Commission press release of 18 Mar. 2010 concerning a request from Germany regarding change of internal anti-abuse rules.

OECD Commentary in this regard came in the beginning of 2003;
- the Interest and Royalties Directive (2003/49) that includes the term "beneficial owner" was passed by the EU Council on 3 June 2003; and
- the Parent-Subsidiary Directive (90/435) was amended by the EU Council on 22 December 2003 and does not include the term "beneficial owner".

4.3. Decision of the Eastern High Court

The Eastern High Court (EHC) stated that the concept of "beneficial owner" is not known in Danish law. Nor is the concept defined in the OECD Model Conventions of 1977 and 2003, or in the Denmark-Luxembourg Income and Capital Tax Treaty (1980). However, guidance can be found in the OECD Commentary, and the EHC found that the amendments in the 2003 Commentary clarified the understanding of the concept (rather than amending it). Furthermore, the EHC found that, to the extent possible, the concept of "beneficial owner" should be interpreted in accordance with the international understanding that has been expressed in the OECD Commentary and with respect to the application of an independent international interpretation as found, for example in the international tax case, *Indofood*.[20]

The EHC referred to:
- the introductory comments to the OECD Model (1977);
- paragraph 22 of the Commentary on Article 10 of the OECD Model;
- the 1986 report from the OECD Committee on Fiscal Affairs;[21] and
- the Commentary on the OECD Model (2003).

The EHC concluded that the concept of "beneficial owner" cannot be used to counter any kind of abuse (which the Member States are requested to regulate bilaterally), and that it cannot be anticipated that intermediary holding companies will not normally be regarded as beneficial owners – including in situations where the ultimate owners are resident in a third country without an applicable tax treaty. In order for such an intermediary holding company not to be regarded as the beneficial owner, the owner must exercise control over the company that is beyond the planning and management in the group that is typical in international groups.[22] The EHC found that in the present case it was not necessary to determine whether the back-end owners had exercised such control over LHC, as it is a requirement that the tax-exempt payment be paid to the controlling person in a third country without an applicable tax treaty – or at least be destined to be paid to such person. This requirement was not fulfilled in here, as the dividend was returned as a loan and there was no information regarding decision on payment of the returned dividend to the back-end investors at a later time. Consequently, LHC was regarded as the beneficial owner the dividend received.

5. Outlook

In February 2012, the Ministry of Taxation announced that the decision will not be appealed to the Supreme Court.[23] This announcement indicates that the Ministry of Taxation will focus on other cases where dividends are not returned, as in this case, and that such cases will be brought before the courts in order to obtain a final clarification with regard to the legal issues concerned.

20. *Supra* n. 10.
21. The name of the report is *Double Taxation Conventions and the Use of Conduit Companies*.
22. *See* the report from the OECD Committee on Fiscal Affairs (1986), at section II.B.b., 7th sentence, *supra* n. 19.
23. SKM2012.100.SKAT, www.skat.dk.