Big fines for missing transfer pricing documentation

TAX:WATCH NO. 4
28-04-2017

Companies are fined if they are unable to provide adequate proof of their transfer prices at short notice - even if the Danish tax authorities find nothing to correct.

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Group-related companies are obligated to trade with each other at the same prices and on the same terms as independent parties. In many cases, transfer pricing documentation must be prepared and kept available.

In 2012, an amendment of the law resulted in more clear guidelines for the fines in transfer pricing cases. As a starting point, the fine for missing or not timely submission of documentation constitutes a fixed basic amount of DKK 250,000 per year. However, the fine may be reduced by half if documentation is submitted subsequently. Conversely, it can be raised by 10 pct. of any increase of the taxable income implemented by the Danish tax authorities.

Recently, the Danish tax authorities have published two rulings regarding this issue.

The first case concerned a Danish subsidiary of a German group. In August 2013, the company received a letter from the Danish tax authorities with a request to submit transfer pricing documentation for the years 2009-2012 within 60 days. Initially, the company submitted information that the Danish tax authorities found inadequate. Complementary documentation was not submitted until the end of February 2014, which was four months late.

Although the Danish tax authorities approved the documentation, the district court sentenced a fine of DKK 250,000 for late submission of the documentation. Normally, the fine for 4 years would amount to DKK 500,000, but the court ruled there was no basis for total accumulation of fines as the company had cooperated and contributed to the provision of the necessary information.

The second case concerned a Danish company belonging to a larger group. The company received a letter from the Danish tax authorities in September 2013 with a request to submit transfer pricing documentation for the years 2009-2012 within 60 days. However, the letter was lost internally in the company. Hence, the documentation was not submitted before the deadline expired.

The company was sentenced to a fine of DKK 250,000 at the High Court. In the ruling, the size of the fine was substantiated by the fact that the offense had to be regarded as one infringement in four years, and that a fine based on the number of years would result in an excessively high penalty.

Both cases are characterised by the companies willingly contributing to the procurement of the documentation requested by the Danish tax authorities, and that the tax authorities – at least in the latter case - did not find grounds for criticising the transfer prices.

Nevertheless, in both cases, the companies were penalised with significant fines solely for exceeding the deadline for submission of transfer pricing documentation.

The Danish tax authorities state that another trial is underway in the judicial system.

It may be tempting for companies to choose a model, where the statutory transfer pricing documentation is initially only made in a light version, because the full version is very resource-intensive to compile. However, a decision on this may prove problematic if sufficient transfer pricing documentation cannot be obtained within the 60-day time limit.

The courts are uncompromising, when it comes to forgotten tax deductions

The Supreme Court has clearly stated that the taxpayer is responsible for a proper tax assessment. The limitation period is 3 years and 4 months - even if the taxpayer ends up paying taxes on income, the taxpayer has not earned.

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In case of forgotten deductions, a reopening of old tax assessments may be requested until 1 May of the fourth year after the end of the income year. Currently, 2013 and later years can be reopened. After 1 May 2017, only 2014 and later years can be reopened.

Reopening of tax assessments subsequent to the general limitation period can be allowed in cases of "special circumstances", but this usually does not imply cases of forgotten deductions. Case law is very rigid as illustrated by a recently published ruling of the Supreme Court.

The case concerned an individual, who had paid back social security in 2004 amounting to just over DKK 300,000. There was no doubt that he was entitled to a deduction for the amount, because he had been taxed on the amount upon receiving it.

The municipality did not report the repayment to the Danish tax authorities as required by law. Consequently, the deduction did not appear on the taxpayer's tax assessment for 2004.

The general limitation period for reopening the tax assessment for 2004 expired on 1 May 2008. However, the taxpayer did not apply for resumption until 2012. At that time, however, it was too late according to the Supreme Court.

This was due, inter alia, to the fact that the rules on reopening tax assessments subsequent to the general limitation period under exceptional circumstances have a narrow scope, and that the taxpayer in all the years possessed the necessary information to detect the error. Further, the missing deduction could not be attributed to errors committed by the tax authorities. Thus, there were no "special circumstances". The taxpayer's private circumstances could not be considered important.

The verdict is a very clear indication that taxpayers are fully responsible for a proper tax assessment. This is the case regardless of the taxpayer's sense of tax law and the fact that the taxpayer - as in this instance - ended up paying tax on income not received.