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Proposed amendments to the Danish Merger Tax Act

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On 23 March 2018, the Minister of Taxation presented a new bill seeking to remove unintended tax advantages associated with certain cross-border mergers.

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According to the Minister of Taxation, it is a fundamental principle of the entire Danish corporate tax system, including the exit tax rules, that income earned in Denmark must also be taxed in Denmark.

The new bill intends to amend the Danish Merger Tax Act, as it has been shown that the current rules for cross-border restructuring in certain cases unintentionally allow for income earned in Denmark not to be taxed in Denmark.

The purpose of the bill is to remove this inadvertent possibility of applying the Merger Tax Act's provisions on cross-border merger, demerger and contribution of assets to avoid taxation of income earned in Denmark.

The date from which a tax-exempt merger takes fiscal effect (the merger date) may, according to current rules, be prior to the date of the final adoption of the merger by the merging companies.

In a verdict dated 27 October 2017, the Danish Eastern High Court ruled that this was indeed the case in a situation where a Danish company in a multinational group was merged into a foreign affiliated company.

In the specific case, income of approx. DKK 140 million, which the Danish company had earned during the period from the merger date to the date of adoption of the merger by the participating parties, was not subject to taxation in Denmark.

According to the proposed bill, for cross-border mergers, where a foreign company is the recipient company, income earned in a contributing Danish company should be subject to taxation in Denmark before the merger takes place, and this should not be avoided by allowing the participating companies to carry out the merger retroactively for tax purposes.

In order to ensure this, it is proposed that the merger date of a Danish company participating in a tax-exempt cross-border merger, where a foreign company is the recipient company, cannot be prior to the date of adoption of the merger by all the merging companies.

The proposed bill will also affect the demerger of a Danish company and cross-border contribution of assets from a Danish company, when the recipient company is resident abroad.

As the possibility of avoiding Danish taxation through the implementation of cross-border corporate restructuring under the Merger Tax Act is unintended, it is proposed that the new rules shall take effect for cross-border mergers etc. that has not yet been adopted by all participating companies on 23 March 2018 or later.

EU conformity of the Danish rules on joint taxation of companies

The Advocate General of the European Court of Justice recently issued his opinion in a case concerning whether the Danish rules on joint taxation of companies comply with the EU rules on freedom of establishment.

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It is the opinion of the Advocate General, that the EU rules on freedom of establishment in principle does not preclude national legislation such as the Danish rules on joint taxation, where a loss pertaining to a permanent establishment (PE) of a foreign company can only be offset against income of Danish group companies, if the rules in the resident country of the foreign company precludes utilisation of the loss.

However, Danish legislation would not comply with EU law, if it does not permit deduction of a loss in Denmark, when the foreign company has definitively proved that the loss cannot be deducted in its country of residence. Whether this is indeed the case must be determined by the referring Danish court, according to the opinion of the Advocate General.

The ruling from the European Court of Justice is expected later this year.

Background

In Denmark, national joint taxation between all Danish entities within a group is mandatory.

International joint taxation between all entities within a group is optional.

Election of international joint taxation is binding for a period of 10 years.

Income/loss from PEs outside Denmark is excluded when calculating income of Danish companies, unless international joint taxation is elected.

A tax loss in a Danish permanent establishment can only be utilized within a joint taxation, if the loss cannot be utilized abroad.

In the case before the European Court of Justice (C-28/17), a Swedish group decided to merge its two Danish PEs.

In Sweden, the company opted to treat the situation as a tax-exempt merger while in Denmark, it was treated as a taxable asset deal.

Consequently, the continuing PE had acquired goodwill subject to depreciation in Denmark but not in Sweden (tax-exempt merger). This resulted in a Danish tax loss for the continuing PE. The continuing PE was jointly taxed with a Danish subsidiary.

In the Danish joint taxation, utilization of the loss from the PE was denied, as under Swedish legislation, utilization of such a loss was permitted.

The question presented to the EU Court of Justice was whether this is a restriction on the freedom of establishment and if so, whether it is justifiable.