



TAX:WATCH

The Supreme Court rules in favor of the Subsidiary in a TP-case

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Consequently, the Royalty payments between affiliated companies were deductible as operating expenses.

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The case concerned whether royalty payments from a Danish subsidiary, arising from the use of trademarks and trade names, knowhow, international network intangibles and business concept, to its Swiss parent company, were deductible operating expenses or not.

The subsidiary paid a total of DKK 83,860,000 during the years 2006-2009 under audit. The royalty rate was 2 percent.

The case was presented in the Eastern High Court in 2019, where it was concluded that the royalty payments were non-deductible operating expenses.

Despite the fact that there was some evidence to suggest that the royalty payments were a deductible operating expense, the High Court found that the taxpayer had not met the burden of proof, and concluded that the payments of the royalties to the parent company did not constitute a deductible operating expense.

In addition, the subsidiary had to pay DKK 400,000 to the Ministry of Taxation to cover legal costs.

The High Court based its decision on multiple circumstances. It emphasized that the Danish subsidiary operated in the Danish market where the price, as opposed to brand, is the most important competitive parameter.

Moreover, the Danish subsidiary had realised a loss for most of the years in scope.

It is therefore unlikely, that an independent party would have paid for the rights to use an international trademark under the same conditions. The Danish subsidiary had also incurred significant marketing expenses.

Moreover, the High Court stated that the Swiss parent company must be assumed to have had a benefit of being represented on the Danish market to service the global clients, and that the royalty payments were a standard condition imposed by the parent company irrespective of the market.

Finally, the Danish subsidiary had also failed to answer multiple information requests from the Ministry of Taxation.

However, The Supreme Court has recently overruled the decision from The Eastern high Court with a contradictory judgement.

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Three of the judges in the Supreme Court found that the payment was acceptable and constituted a deductible operating expense. As opposite, the Supreme Court found that the tax authorities had not met the burden of proof that the payment was *not* an expression of remuneration on market terms.

Nor did the Supreme Court consider the company's transfer pricing documentation for the years concerned as deficient to such an extent, that it was a result of lack of documentation.

However, two judges considered that the Tax Authorities had met the burden of proof that the royalty payments were not on arm's length terms. Nevertheless, they ruled that the royalty payments were deductible operating expenses.

Consequently, no judge ruled in favor of the Tax Authorities.

Comments

Last year, the Danish Tax Authorities suffered a defeat in the Supreme Court in a similarly transfer pricing case against Microsoft's Danish department. Although this case against Adecco is opposite.

The Danish Tax Authorities had clearly won the case both in the National Tax Court and in the High Court.

Consequently, the outcome of the case at the Supreme Court is a big defeat to the Danish Tax Authorities.

The case is another example of the courts - especially the Supreme Court - very high demands on the documentation in which the Tax Authorities must provide, before the Court finds a transfer pricing non-acceptable.

And luckily for that. When the Danish Tax Authorities rates commercial agreements in Transfer Pricing cases, it happens without detailed insight in both the specific company and in the specific industry.

Consequently, it is very difficult - but of course not impossible - for the Danish Tax Authorities to overrule agreed business terms.

The significance of the judgment for other companies is mostly founded in this fact, since the facts assessed in transfer pricing cases, including the Adecco case, can rarely be found 1:1 in other companies.

In BDO, we have insight into the rules on transfer pricing documentation. If you want an assessment of whether the documentation in your company is sufficient, you are welcome to contact us.

We have TP experts in all regions of the country.

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