Taxation of Intangible Property

General report at the Nordic Tax Research Council Seminar in Snekkersten, Denmark, 12 and 13 May 2011.

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Part I Introduction

1. Background

Intangibles are the major source of sustainable competitive advantages for firms. This is evidenced by the continuous increase in the market-to-book ratio (Tobin's *q*) of multinational enterprises (MNEs).[1] The gap between the market and replacement values has largely been explained by intangibles not recorded on the balance sheet.[2] Innovation is also crucial to the Nordic countries because of the resulting productivity gains, economic growth, high-quality jobs and tax revenues. The importance of innovation was recognised in the Lisbon strategy adopted by the European Council in 2000 that set the EU goal of becoming "the most competitive and dynamic knowledge based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion" by 2010. Two years later at the Barcelona European Council, it was agreed that R&D investments in the EU should be increased with the aim of approaching 3% of GDP by 2010. The Council specifically called for an increase in the level of private sector R&D funding, which should rise from a level of 56% to 80% of total R&D. In 2003, the Commission encouraged Member States to a concerted use of R&D tax incentives, to improve tax measures for R&D and to disclose data on the budgetary cost of such tax measures.[3] In 2005, the Commission called for a coordinated European approach to improve the tax environment for R&D.[4] In 2006, the Commission provided guidance to help Member States improve their R&D tax treatment.[5] It encouraged Member States to improve the use and coordination of tax incentives on specific R&D issues. An expert group was established to address the need to improve the evaluation of R&D tax incentives, and the group published its final report in 2009.[6] Another recent report indicates that several Member States are still lacking behind the 3% target.[7] By 2009, R&D investments varied considerable among the Nordic countries: (i) Finland and Sweden invested almost 4% of GDP, (ii) Denmark and Iceland around 3% of GDP and (iii) Norway 1.76% of GDP.

2. Taxation of intangibles

Taxation of intangibles may be viewed from the three traditional dimensions of tax law: (i) domestic law, (ii) treaty law and (iii) EU/EEA law. Domestic tax law may incentivise R&D in order to increase the level of R&D investments, attract foreign direct investments or to dissuade taxpayers from making investments abroad rather than domestically. Both the development and exploitation of intangibles are characterized by a great degree of mobility. This leads countries to adopt anti-avoidance rules in order to prevent an erosion of the national tax base. Among other things, transfer pricing rules, exit taxation and CFC taxation aim at ensuring that domestically developed intangibles are not artificially migrated to foreign affiliated companies.

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[1] B. Lev, Intangibles, *Management, Measurement, and Reporting* (2001), at 8.
[2] C. Hulten and J. Hao, *Intangible Capital and the "Market to Book Value" Puzzle*, Economics Program Working Paper Series 08-02 (New York: The Conference Board, June 2008).
[3] Investing in research: an action plan for Europe, COM(2003) 226 final/2.
[4] Working together for growth and jobs: A new start for the Lisbon Strategy, COM(2005) 24 final.
[5] Towards a more effective use of tax incentives in favour of R&D, COM(2006) 728 final.
[6] Design and Evaluation of Tax Incentives for Business Research and Development - Good practice and future developments (Brussels: European Commission, D-G for Research, 2009).
[7] An analysis of the development of R&D expenditure at regional level in the light of the 3% target (Brussels: European Commission, D-G for Research, 2009).

Tax treaties allocate the taxing right to intangible profits between countries. The taxing right is assigned exclusively to the residence state under the OECD Model unless an intangible forms part of the business assets of a permanent establishment (PE) in the source state.[8] Residence taxation means that an MNE may be able to influence where a substantial share of its profits are recorded and taxed. An MNE may thus be able to permanently reduce taxation under a territorial tax system or to defer taxation under a worldwide tax system. This provides an incentive for MNEs to shift intangibles to low-tax jurisdictions. Tax treaties usually embody a non-discrimination provision akin to Article 24 of the OECD Model. Such a provision may, for example, mean that R&D costs of a resident company may not be subject to a less favourable tax treatment just because the company is owned by a resident person of the other contracting state.

EU law requires Member States to exercise their competences in the area of direct taxation consistently with the fundamental freedoms and the ban on state aid of the Treaty on the Functioning of the European Union (TFEU). This is of relevance for the design of both tax incentives and anti-avoidance rules. The EEA Agreement is based on similar principles.

3. Scope of the subject

The subject for the 2011 Nordic Tax Research Council seminar is the taxation of intangible property. The scope of the legal reports is the taxation of both development and exploitation of intangibles. It is confined to taxation of companies and does neither consider the taxation of individuals nor other types of taxes which impact companies, such as the level of personal income taxes, social security contributions and VAT. Moreover, the scope does not cover direct support in the form of subsidies, indirect support or investor taxation, e.g. venture capital.

The general report is divided into five parts (Parts II-VI), in addition to the introductory Part I: Part II on R&D tax incentives, Part III on taxation of the development of intangibles, Part IV on taxation of the exploitation of intangibles, Part V on base erosion and Part VI which concludes the subject. The approach is first to introduce the specific issue and then to undertake a comparative analysis of the tax laws of the Nordic countries. The comparative analysis has primarily been prepared on the basis of the national reports.

[8] Articles 7(1), 12(1), 13(2) and (5), and 21(1) and (2) OECD Model. Article 12(2) UN Model assigns a taxing right to the source country with regard to royalties. On the allocation of the taxing right to intangibles see W. Schön, “International Tax Coordination for a Second-Best World (Part II)”, 2 *World Tax Journal* 1 (2010), at 65, 90.

Part II R&D tax incentives

The topic of R&D tax incentives prompts a number of questions. First, it may be considered whether there is shortage of private R&D investments. The standard arguments for introducing R&D tax incentives are thus based on market failures causing firms to invest less in R&D than is optimal for society. Hence, R&D is creating positive, external knowledge, whereby firms investing in R&D are not able to appropriate all returns from its investments as knowledge spillover to rivals and other third parties. Since firms are only inclined to make investments with an appropriate expected private return, R&D projects that are desirable for society may not be undertaken.[9] Subsidies may push the optimal level of R&D investments for private firms up to the optimal level for society. A Danish study estimates the total return to society of R&D investments to be approximately 28% whereof 24% are captured by the investor and 4% spills over to third-parties.[10] In addition, informational asymmetries in early-stage funding between R&D firms and investors may lead to financing constraints.[11]

Second, if shortage of R&D investments exists it must be decided whether the government should intervene or leave it to the market to regulate the level and direction of R&D investments. Third, if governmental intervention is held to be appropriate the preferred form must be determined. Direct governmental support can take the form of R&D tax incentives as well as grants, loans and equity investments. Indirect support can be given through funding of the educational system, public research institutions etc. According to the EU Commission, R&D tax incentives offer the advantage of being timely, predictable and transparent. Fourth, governmental support may target R&D investments in the private sector in general, specific industries, types of firms or technologies, different stages of development and exploitation (see below), collaboration between private and public sectors etc. If spillover effects are more pronounced in some areas it may be considered to direct support thereto. For example, spillover effects are normally higher for basic research than for applied research.[12] Support is sometimes more generous for R&D projects involving collaboration between private firms and public research institutions.[13] Aside from trying to overcome market failures, the rationale for this may be a belief that universities are producing knowledge more valuable to business than business is aware of, and that science should be more exposed to the practical needs of business.[14]

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[9] D. Czarnitzki, “Tax Incentives for industry-science R&D collaboration”, Annex 2 in Design and Evaluation of Tax Incentives for Business Research and Development - Good practice and future developments (Brussels: European Commission, D-G for Research, 2009). Økonomi og Miljø 2011 (Copenhagen: Det Økonomiske Råd, 2011), at 149.

[10] Økonomi og Miljø 2011 (Copenhagen: The Economic Councils, 2011), at 178.

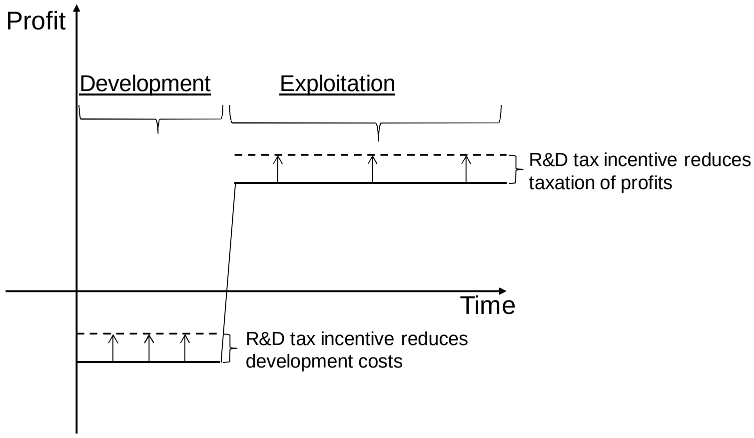
[11] D. Czarnitzki and H. Hottenrott, “Financing constraints for industrial innovation: What do we know?”, Annex 3 in Design and Evaluation of Tax Incentives for Business Research and Development - Good practice and future developments (Brussels: European Commission, D-G for Research, 2009).

[12] Økonomi og Miljø 2011 (Copenhagen: The Economic Councils, 2011), at 152.

[13] D. Czarnitzki, “Tax Incentives for industry-science R&D collaboration”, Annex 2 in Design and Evaluation of Tax Incentives for Business Research and Development - Good practice and future developments (Brussels: European Commission, D-G for Research, 2009).

[14] Design and Evaluation of Tax Incentives for Business Research and Development - Good practice and future developments (Brussels: European Commission, D-G for Research, 2009), at 20.

A R&D tax incentive may target: (i) the development stage, or (ii) the exploitation stage. In the development stage, a tax incentive will reduce R&D costs in various ways whereas in the exploitation stage, a tax incentive will reduce taxation of net profits, see the figure.



Both categories of tax incentives enhance the net present value of the expected profits from a R&D project and are thus capable of influencing the level of R&D investments. R&D tax incentives have traditionally targeted the development stage and used intangible development costs as focal point. However, a 2009 EU-report mention that directing more of governmental support for R&D to the positive outcomes – intangible profits - is an interesting approach that should be studied in more detail.[15]

The impact of the two categories of R&D tax incentive is not identical. First, incentives relating to the development stage are solely triggered by the defrayal of R&D costs. By contrast, incentives relating to the exploitation stage require both the defrayal of R&D costs and that such investment are successfully turned into marketable products. Accordingly, it is more difficult to benefit from a tax incentives relating to the exploitation stage. For a mature firm with a large R&D pipeline this may be less of a concern compared to a start-up firm with a single R&D project. Second, only tax incentives reducing development costs address the issue of constraints in early-stage financing. Third, if a taxpayer expects to exit an R&D investment by selling the shares of the R&D firm, a tax incentive reducing taxation of intangible profits may be of little value. All in all, start-up firms and small and medium-sized enterprises (SMEs) may benefit most from tax incentives targeting the development stage whereas mature firms may benefit from incentives relating to both the development and exploitation stage. If the intention is to dissuade mature firms from relocating intangibles to other countries, R&D tax incentives relating to the exploitation stage may be more efficient.

Tax incentives relating to the development stage apply third-party costs as focal point. Such rules create an incentive for taxpayers to reclassify costs as R&D costs and thus a need for tax authorities to scrutinize tax returns more closely. Tax incentives relating to the exploitation stage may apply royalties and/or royalties embedded in revenues from the sale of goods and services as focal point. Embedded royalties may be identified as total profits less an appropriate return to tangible and financial assets employed under transfer pricing methods.

[15] *Id*. footnote 9.

Part III Taxation of the development of intangibles

1. General

Part III provides a comparative analysis of the tax treatment of intangible development and acquisition in the Nordic countries: Section 2 on development of intangibles, section 3 on licensing of intangibles and section 4 on purchase of intangibles. Section 1 contains a general discussion of R&D tax incentives targeting the development stage. The common types of R&D tax incentives are summarized in table 1.

Table 1: R&D tax incentives

Tax incentive	**Content**	**Examples of EU Member States ex. Nordic countries**
Expensing of costs	A tax deduction of intangible development costs on a current basis constitutes a tax incentive because such costs normally are incurred in order to earn future income. In contrast, the tangible development costs must normally be capitalized.	Available in most Member States
R&D tax credit	A R&D tax credit is based on the value of costs and provides a reduction of tax liability. For example, a R&D tax credit of 20 % entitles taxpayers to reduce their tax liability with an amount equal to 20% of qualifying R&D costs. A non-refundable tax credit can only be set off against the tax liability. It may sometimes be carried forward or backward. A refundable tax credit may be received in cash if it exceeds the tax liability (negative company tax). A refund may be available immediately or after a period of time.	Austria, Belgium, France, Hungary, Ireland, Italy, Portugal, Spain and the United Kingdom
Super deduction	A super deduction is based on the value of costs and provides a deduction from taxable income of an amount that exceeds the actual costs. For example, taxpayers may be entitled to claim a 150 % deduction of qualifying R&D costs.	Austria, Belgium, Greece, Hungary and the United Kingdom
Accelerated capital depreciation	Accelerated capital depreciation allows taxpayers to depreciate R&D assets for tax purpose at a rate that is faster than the economic rate of depreciation.	Belgium, Ireland and the United Kingdom

The design of R&D tax incentives should, among other things, define the following factors: (i) eligible R&D projects, (ii) eligible cost base, (iii) whether fees paid to contract service providers qualify, (iv) whether the taxpayer must be the owner of the resulting intangible (and thus bear the risk of intangible development), (v) whether intangibles developed in the course of a cost contribution arrangement[16] qualify, (vi) the rate of tax credit, deduction or depreciation, (vii) whether a cap must be imposed on the amount of eligible costs, (viii) whether an incentive should be calculated on the basis of volume or incremental change and (ix) whether credits, deductions, etc. may be transferred between members of a tax group.

It must also be considered whether tax incentives should target specific: (i) taxpayers (SMEs or large enterprises), (ii) stages of intangible development (e.g. fundamental research, industrial research or

[16] Para. 8.3 OECD Guidelines.

experimental development), (iii) industries, (iv) technologies or (v) collaboration between the private and public sectors. For example, super deductions and accelerated depreciation are most valuable to mature firms generating profit, whereas a refundable tax credit may be of equal value to start-up firms with no current profit and mature firms.

In an EU and EEA context, R&D tax incentives should conform to both the fundamental freedoms and the state aid rules. A R&D tax incentive may, in particular, be incompatible with the fundamental freedoms if it imposes restrictions on where R&D is performed or where the intangible developed is used (territorial restrictions). Explicit territorial restrictions were held to infringe on the freedom to provide services (TFEU Article 56) in *Laboratoires Fournier*[17] and *Tankreederei*[18] and on both the freedom to provide services and the freedom of establishment (TFEU Article 49) in *Commission v. Spain*.[19] In a pending case the Advocate General is of the opinion that an Austrian tax rule is incompatible with the free movement of capital (TFEU Article 63), because it restricts the deductibility of donations granted to public research institutions etc. located in Austria.[20] An implicit territorial restriction could be a R&D tax incentive which is subject to administrative approval favouring resident R&D performers over non-residents wishing to provide R&D services, e.g. when such approval is needed only for R&D costs incurred abroad, or when the administrative burden is heavier for non-residents.[21] In the opinion of the Commission, it is unlikely that the European Court of Justice (ECJ) will accept a justification for a territorial restriction.[22]

R&D tax incentives must also be compatible with the state aid rules (TFEU Article 107). The Commission has clarified that tax incentives which target a specific group or sector may constitute state aid and therefore must be examined under the rules on state aid.[23] Under Article 31 of regulation 800/2008, aid for R&D projects must be compatible with the common market within the meaning of TFEU Article 107(3) and must be exempt from the notification requirement of Article 108(3) provided that a number of conditions are met.

2. Development of intangibles

2.1. General

The tax rules in the Nordic countries applicable to operating costs incurred in order to develop intangibles are summarized in table 2.

Table 2: Tax treatment of operating costs

Tax incentive	**Finland**	**Norway**	**Sweden**	**Denmark**	**Iceland**
Expensing of costs	Yes	Yes / No	Yes / No	Yes	Yes
R&D tax credit	No	Yes	No	No	Yes

[17] Case C-39/04 (*Laboratoires Fournier*)
[18] Case C-287/10 (*Tankreederei*).
[19] Case C-248/06 (*Commission v. Spain*).
[20] Opinion of Advocate General Trstenjak in Case C-10/10 (*Commission v. Austria*).
[21] Towards a more effective use of tax incentives in favour of R&D, COM(2006) 728 final, at 5.
[22] *Id*. at 6.
[23] *Id*. at 7; and Commission notice on the application of the State aid rules on measures relating to direct business taxation, OJ C 384/03 of 10 December 1998.

Super deduction	No	No	No	No[1]	No
Accelerated capital amortization	Yes	No	No	Yes	Yes

[1] Section 8 Q of the Tax Assessment Act provides for a super deduction. However, no funding is currently available for this provision.

Operating costs incurred for intangible development are tax deductible in all of the Nordic countries.[24] The right to deduct R&D costs is spelled out in the Danish, Swedish and Finnish tax legislation.

The timing of the deduction is subject to quite different rules. In Denmark, Finland and Iceland, intangible development costs may be expensed in full in the year in which they are incurred or depreciated. In Sweden and Norway, operating costs incurred in an early stage of intangible development may be deducted, whereas costs incurred in later stages must be capitalized and amortized together with the intangible. In Sweden, this follows from the fact that intangible development costs must be recognized in accordance with generally accepted accounting principles. This means that such costs may be treated differently depending, among other things, on the nature of the intangible, the nature of the industry, the development stage and the size of the company. In Norway, development costs must be capitalized from the point in time where it is likely that an intangible asset will actually materialize irrespective of the nature of the intangible. Neither Sweden nor Norway requires costs incurred to develop marketing intangibles to be capitalized. The Swedish and Norwegian approaches may easily create disputes between taxpayers and tax authorities. The subsidy associated with the expensing of R&D costs is currently relatively modest due to the low corporate tax rates and market interest rates.

A R&D tax credit is offered in Norway and Iceland. The tax credit in Norway amount to 20% of eligible costs up to NOK 5.5 M for SMEs and 18% for other companies (refundable). If R&D services are purchased from an approved university or other research institute, the cap is NOK 11m. The tax credit in Iceland amount to 20% of internal R&D costs up to ISK 100m, which is increased to ISK 150m if costs are also incurred to third-parties (refundable).

Capital costs (depreciation of property, plant and equipment) related to intangible development activities are treated like other capital costs in Norway and Sweden. By contrast, Danish tax law provides for accelerated capital amortization in three situations. First, the purchase price of machinery, equipment and ships acquired for R&D purposes may be deducted in full in the year of acquisition.[25] Second, a full deduction may be claimed in the year of acquisition of all types of intangibles acquired for R&D purpose.[26] Third, depreciation on assets acquired for R&D purposes may commence before the start-up of the business in which the result of the R&D will be used.[27] Icelandic tax law provides for a full deduction in the year of acquisition of patents

[24] The Swedish government has proposed to relax the rules on the tax deductibility of R&D costs. Thus, it will no longer be a condition that there is a direct link between the R&D and the core business of the enterprise. See Vissa skattefrågor inför budget-propositionen för 2012 (Stockholm: Ministry of Finance, 13 April 2011), at 85.
[25] Section 6(1)(3) Depreciation Act.
[26] Section 8 B(1) Tax Assessment Act.
[27] Section 51 Depreciation Act.

and trademarks purchased for R&D purposes. In Finland, research costs of a capital nature incurred in order to develop the business may be deducted in full in the year of acquisition, provided that a similar deduction is made for accounting purposes.

In relation to intangible development the Nordic countries do not normally differentiate between internal costs or fees paid to external service providers, different types of intangibles, the industry, the characteristics of the taxpayer or the owner of the taxpayer. However, technological and scientific activities undertaken in order to develop manufacturing intangible such as patents, formulas and knowhow are generally treated more favourable than artistic and creative activities to develop designs and marketing intangibles such as brands and trademarks. Hence, the scope of all of the Nordic tax incentives is confined to R&D activities.

2.2 Donations

Governments often encourage collaboration between private firms and public research institutions. Such collaboration may include the granting of a donation to a research institution which is conducting research within an area of interest for a private firm. All of the Nordic countries allow tax deduction, in certain circumstances, for donations made to qualifying R&D institutions.

2.3 Tax losses

Intangible development activities are often of a risky, costly and long-term nature. Mature firms may be in a position to utilize tax deductions on a current basis against profits from other activities. In contrast, start-up firms and SMEs may not have sufficient profits, if any, to absorb R&D costs during the development stage. For such firms the tax treatment of losses is of importance. Hence, if losses incurred during the development stage cannot be set off against profits during the exploitation stage, R&D intensive firms are discriminated against vis-á-vis other types of firms. Moreover, successful start-up firms are often acquired by larger firms. Rules that prevent the use of tax losses carried forward after a change of control may thus be detrimental to start-up firms. Since a firm may engage foreign affiliates in its development activities it is also of interest how losses incurred by foreign affiliated entities are treated domestically. Table 3 summarizes the relevant tax rules in the Nordic countries.

Table 3: Treatment of tax losses

	Finland	**Norway**	**Sweden**	**Denmark**	**Iceland**
Loss carry-forward	10 years	Indefinitely	Indefinitely	Indefinitely	10 years
Loss carry-back	No	No	No[1]	No	No
Change of ownership rules	Yes	No[2]	Yes	Yes	Yes
Loss transfer from domestic subsidiary	Yes	Yes	Yes	Yes	Yes
Loss transfer from domestic PE of an affiliated company	Yes	Yes	Yes	Yes	No
Loss transfer from foreign PE	Yes[3]	Yes[3]	Yes	No[4]	No
Loss transfer from foreign subsidiary in EU/EEA	No	No	Yes/No	No[4]	No

[1] The rules on profit periodization reserve may effectively cause a tax loss carry-back as a profit reserve established in prior income year may be released in an income year where losses are incurred.

[2] A carry-forward of losses may be denied if the main purpose of a transaction was to gain access to the losses.

[3] A tax loss is disallowed if relief for double taxation is granted under the exemption method.

[4] Losses incurred by non-resident subsidiaries and foreign PEs are non-deductible under the territorial principle. However, an election for cross-border tax consolidation may be made where all foreign group companies and PEs are subject to Danish taxation. Few companies have made such an election because the requirement to include *all* foreign entities is prohibitive. Accordingly, in practice losses incurred by foreign entities are normally not tax deductible.

The Nordic countries are quite generous when it comes to tax loss carry-forwards. In Denmark, the previous five year limit for carry-forwards was abolished, among other things, in order to encourage the creation of new innovative companies.[28] All of the Nordic countries except Norway apply change of control rules under which tax losses brought forward may be forfeited if ownership or control changes. Selling a start-up company with tax losses or allowing new investors into such a company may thus trigger adverse tax consequences. However, the rules may provide exemptions for genuine business transactions.

All of the Nordic countries allow a loss transfer (tax consolidation or group contribution) between domestic affiliated entities for which reason a taxpayer may carry out a R&D activity in a resident subsidiary without losing the ability to deduct tax losses from the activity in its own taxable income on a current basis.

Where R&D activities are performed by a foreign affiliated entity, a markedly different tax treatment exists between organizing the foreign entity as a branch office or a subsidiary. A foreign branch office which is solely engaged in R&D activities on behalf of the company which it is a part of should normally not create a PE under tax treaty provisions corresponding to Article 5(4) of the OECD Model.[29] In this case a loss (development costs) will normally be tax deductible in the residence state. If a branch office is also engaged in other types of activities, or if a R&D activity is also carried out for other taxpayers, a PE may arise. A loss incurred by a foreign PE may normally be set off against domestic profits of a resident company unless double taxation is relieved under the exemption method. In this respect Denmark stands out since losses of a foreign PE are disallowed under the territorial principle.[30] In contrast, if a R&D activity is carried out by a non-resident subsidiary, none of the Nordic countries provides for a transfer of losses on a current basis. Development costs incurred by a non-resident subsidiary may, however, in practice be claimed by a resident parent company under a contract R&D arrangement where the parent company is the owner of the result of the R&D activity. Sweden has recently amended its tax law to allow a resident parent company to deduct definitive losses incurred by a subsidiary resident in an EU/EEA country. In view of *Marks & Spencer* it is questionable whether the tax laws of the other Nordic countries are compatible with EU and EEA law with respect to definitive losses.[31] This also holds true with respect to definitive losses incurred by a foreign PE.[32]

[28] L 99 of 7 February 2002, General comments.
[29] Para. 23 Commentary on Article 5 OECD Model.
[30] Section 8(2) Corporate Tax Act.
[31] Case C-446/03 (*Marks & Spencer*).
[32] Case C-414/06 (*Lidl Belgium*).

The distinction between domestic and foreign losses of a subsidiary may make it more attractive from a tax perspective to undertake development activities domestically, or through or a foreign branch office, rather than a non-resident subsidiary in order to benefit from tax deductions on a current basis. However, the future taxation of intangible profits should also be considered. If the foreign taxation is sufficiently low, the cash flow disadvantage of not being able to claim tax deductions for development costs incurred by a non-resident subsidiary may be outweighed by the future advantage of a low taxation of intangible profits. In any case, if a non-resident subsidiary is generating profits the cash flow issue does not exist.

3. Licensing of intangibles

Licensing of intangibles is an alternative to development or acquisition of intangibles. The tax treatment of royalty payments is summarized in table 4.

Table 4: Tax treatment of royalty payments

Payment		**Finland**	**Norway**	**Sweden**	**Denmark**	**Iceland**
Ordinary royalty		Deductible	Deductible	Deductible	Deductible	Deductible
Lump sum[1]	Expensing	Economic life < 3 years	No	No	Patent and know how	No
	Depreciation	Economic life ≥ 3 years	Yes	Yes	Other IPR	Yes
Upfront payment[2]		Do.	Deduction	Amortization	Deduction	Deduction

[1] A payment covering several income years which is conditional upon the licensor's performance in later years.
[2] A payment covering the entire licensing term which is unconditional upon the licensor's performance in later years.

Royalty payments are treated like other operating costs for tax purposes in the Nordic countries (see III.2.1). In Denmark, Norway and Iceland, an up-front payment is deductible in the year of payment provided that an unconditional liability to make the payment exists.

The Nordic countries do not directly differentiate between royalty payments relating to different types of intangibles (aside from the rules explained above), the industry, the characteristics of the transferor or transferee of the intangible, or the owner of the transferee.

4. Acquisition of intangibles

Acquisition of intangibles is an alternative to development or licensing of intangibles. The tax treatment of the purchase price for an intangible in the Nordic countries is summarized in table 5.

Table 5: Tax treatment of the purchase price for an intangible

Payment	**Finland**	**Norway**	**Sweden**	**Denmark**	**Iceland**
Full deduction in year of acquisition	Economic life < 3 years	Economic life < 3 years	No	(i) Patents, (ii) knowhow and (iii) IPR acquired for R&D purposes	(i) Purchase price below ISK 250,000 and (ii) patents and trademarks acquired for R&D purposes

Ordinary amortization	(i) IPR cannot be sold separately: Economic life or 10 years, if shorter. (ii) IPR can be sold separately: 10 years or economic life, if shorter.	(i) Goodwill, 20% declining-balance basis. (ii) Other IPR with limited economic life: Legal life or economic life, if shorter. (iii) Other IPR, economic life unlimited: No depreciation.	(i) 30%, declining-balance basis, or (ii) 20%, straight-line basis.	(i) Goodwill, up to 1/7 per year. (ii) Other IPR, max. 1/7 per year or straight-line over remaining period of legal protection if the latter is less than 7 years.	(i) Goodwill, 10-20%, straight-line basis. (ii) Other IPR, 14-20%, straight-line basis, or economic life, if shorter than 5 years.

The tax laws of the Nordic countries are quite different when it comes to the treatment of the purchase price for intangibles. First, Denmark grants a full deduction in the year of acquisition of patents, know-how and all types of intangibles acquired for R&D purposes, irrespective of the economic life or the amount of purchase price. A full deduction for patents and know-how has been provided because such assets are assumed often to have a relative short technical and commercial life due to rapid product developments. Second, Sweden and Denmark base depreciation of intangibles on standard rates. By contrast, in Finland, Norway and Iceland the economic life of an intangible is the focal point (except goodwill in Norway). In Norway this means, among other things, that an intangible which does not lose value due to ongoing maintenance may not be depreciated.

Finland, Sweden and Iceland do not directly differentiate between different types of intangibles (aside from the rules explained above), the industry, the characteristics of the transferor or transferee of the intangible, or the owner of the transferee. Denmark, Norway and Iceland make a distinction between goodwill and other intangibles. Danish tax law also makes an important distinction between, on the one hand, patents and know-how, and, on the other hand, other types of intangibles. This may give rise to distortions since taxpayer may favour a qualification as patents and know-how rather than other categories of intangibles.

Part IV Taxation of the exploitation of intangibles

1. General

Part IV provides a comparative analysis of the taxation of intangible exploitation in the Nordic countries: Section 2 on domestic exploitation and section 3 on international exploitation. Section 1 contains a general discussion of relevant tax incentives.

The common types of tax incentives relating to the exploitation of intangibles are summarized in table 6.

Table 6: Tax incentives on exploitation of intangibles

Tax incentive	Content	Examples
Tax holiday	General reduced taxation.	Switzerland, ETR of 0% for max. 10 years depending on scale and type of investment; Luxembourg, ETR of 2-3%; and France, ETR of 0% for 3 years for young innovative companies.
Patent box	Reduced taxation of intangible profits. A patent box may apply only to self-developed intangibles or may also include acquired intangibles. It may cover royalties and capital gains on intangibles as well as intangible profits embedded in the price of goods and services. It may be confined to only some categories of intangibles. A transfer to and from a patent box may be treated as taxable events. A cap may be imposed on the amount of income eligible for patent box treatment.	Netherlands (ETR 5%), Belgium (ETR 6.8%), Spain (ETR, 5.0%), France (ETR 15%), Malta (ETR 0%) and Luxembourg (ETR 5.7%). U.K. proposal (ETR 10%).[33] Ireland has abolished its patent box regime.[34]

In general, tax incentives targeting the exploitation stage are primarily of benefit to mature firms. Start-up firms may thus only be able to benefit after several years and only if R&D is successfully turned into marketable products or services (see II.). The purpose of tax holidays is usually to attract foreign direct investment from high-tax jurisdictions. By contrast, patent box regimes may also be adopted in order to dissuade resident firms from migrating intangibles, retain high-value jobs and increase R&D investments. A patent box may provide a more levelled playing field for large firms and SMEs. Thus, where a large firm often has critical mass to set up a low-taxed subsidiary, this may not be the case for a SME.

2. Domestic exploitation

Intangible profits may be derived from: (i) the sale of goods and services incorporating intangibles (embedded royalties), (ii) royalties and (iii) capital gains from the sale of intangibles. The taxation of domestic exploitation of intangibles in the Nordic countries is summarized in table 7.

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[33] Budget 2011 (London: HM Treasury, March 2011), at 28; and para. 4.6 of Proposals for controlled foreign companies (CFC) reform: discussion document (London: HM Revenue & Customs, January 2010).
[34] Finance Act 2011.

Table 7: Taxation of domestic exploitation of intangibles

	Finland	Norway	Sweden	Denmark	Iceland
Tax rate	26%[1]	28%	26.3%	25%	20%
Tax holiday	No	No	No	No	No
Patent box	No	No	No	No	No
Roll-over relief	No	No	No	No	Yes
Deferral of income recognition or tax payment	No	No	No	Yes	No
Tax exempt sale of IPR by parcelling	Yes	Yes	Yes	Yes	Yes

[1] On 21 December 2010 a proposal to lower the corporate tax rate to 22 % was published. Due to the pending change of government, the destiny of the plan to introduce a R&D tax incentive is uncertain for the time being.

All of the Nordic countries subject intangible profits to the ordinary, statutory corporate tax rates. None of the countries have adopted tax holidays or patent boxes. A roll-over relief is available in Iceland whereas Denmark allows payment of capital gains taxes to be deferred, if payment for an intangible is received in the form of an earnout[35] or instalments.[36] The Nordic countries do not offer tax incentives relating to intangible exploitation and are thus, all else being equal, vulnerable to migration of intangibles to low-tax countries.[37]

The sale of an intangible may trigger a substantial tax charge because a tax basis often does not exist where the intangible is self-developed. A tax planning strategy used in some countries is to transfer the intangible in question to a resident subsidiary and then sell the shares in the subsidiary relying on participation exemption. Under such a strategy, the transferor is tax exempt whereas the transferee will usually not obtain a step-up in tax basis. It may be possible to implement such a strategy in all of the Nordic countries. Sweden and Norway are the only countries making it possible to transfer a separate intangible to a resident subsidiary or domestic PE of a group company in a tax exempt transaction. However, in Norway taxation of the transferor materializes if the transferee later on leaves the group which prevents abuse of the law. Under Danish tax law, a tax exempt sale of patents, knowhow and other intangibles acquired for R&D purposes is possible, because the purchase price of such assets may be deducted in full in the year of acquisition. Hence, prior to the sale to a third-party, an intangible may be transferred to a resident subsidiary and the capital gain of the transferor be set off against the purchase price of the transferee under tax consolidation. In Finland, Norway, Denmark and Iceland, an intangible may be transferred to a resident subsidiary as part of reorganization (transfer of assets, division, etc.) although limitations may be imposed on the ability to sell the subsidiary shortly after the reorganization. Such parcelling arrangements arguably do not mean that the national tax base is diminished since the intangible continues to be owned by a resident company and the tax basis remains the same. However, ultimate ownership of the intangible has changed hands in a cash transaction between third-parties which is not an option envisaged by the tax laws.

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[35] Section 40(7) Depreciation Act.

[36] Section 27 A Tax Assessment Act. This rule is not applicable to transaction between associated enterprises.

[37] In 2007, this caused the Danish government to propose a patent box regime which was not enacted. See proposed section 11C Danish Corporate Tax Act set out in section 1(4) of draft No 1 of 1 February 2007 (j. No 2007-411-0081). The proposal was not incorporated into the final bill L 213 of 18 April 2007 and law No 540 of 6 June 2007.

3. International exploitation

Intangibles may be exploited internationally under licensing agreements with non-residents, through a foreign PE or a non-resident subsidiary. Other alternatives are to export goods and services manufactured on the basis of an intangible and to sell the intangible itself. The latter alternatives do not normally give rise to foreign taxation and are analyzed above (see IV.2).

3.1 Royalty payments

All of the Nordic countries subject royalty payments from foreign sources to taxation at the statutory rates. Royalty payments are often also subject to taxation in the source state. Tax treaty provisions akin to Article 12(1) of the OECD Model give the residence state an exclusive taxing right to royalties, unless the intangible in respect of which the royalties are paid is effectively connected with a PE in the source state, cf. Article 12(3). The same applies under the Interest and Royalty Directive (2003/49/EC). In contrast, under Article 12(1) of the UN Model the taxing rights to royalties are shared between the contracting states. If royalties are subject to source state taxation, double taxation arises and the residence state is obliged to relieve double taxation. Table 8 summarizes the rules on relief for double taxation in the Nordic countries.

Table 8: Relief for double taxation of royalty payments

Payment	**Finland**	**Norway**	**Sweden**	**Denmark**	**Iceland**
Method	Ordinary credit	Ordinary credit	Ordinary credit	Ordinary credit	Ordinary credit
Limitation	Per country	Overall[1]	Overall	Per country	Overall
Gross or net principle	Net principle	Net principle	Net principle	Net principle	Net principle
Matching of costs and income across income years	No	No	No	No	No
Excess foreign tax credit	5 year carry-forward	5 year carry-forward; 1 year carry back	5 year carry-forward	Carry-forward if excess foreign tax credit is due to tax losses	No

[1] Basket system: (i) income from low-tax countries; (ii) income from petroleum activities and (iii) other foreign income.

All of the Nordic countries are relying on the method of ordinary credit but domestic tax laws diverge when it come to the question whether relief must be calculated per item, per country or on an overall basis. Tax treaties do not address this issue.[38] The overall approach of Norway, Sweden and Iceland reduces the risk of double taxation because high and low-taxed income from different jurisdictions is pooled.

Tax treaties usually leave the choice to domestic law whether to apply a gross or net principle.[39] All of the Nordic countries adhere to the net principle under which foreign income must be reduced with deductible

[38] Para. 64 Commentary OECD Model.
[39] Paras 42, 43 and 62 Commentary on Article 23 OECD Model.

costs relating to it for purpose of calculating relief for double taxation. This means that juridical double taxation of royalties may easily arise because source state taxation is normally made on a gross income basis. International exploitation of intangibles through licensing arrangements may thus give rise to an extra economic burden vis-á-vis domestic exploitation. That said, none of the Nordic countries have adopted rules which effectively ensure that all intangible development costs are allocated to the foreign income, since costs incurred in prior income years must not be considered.[40] For example, costs incurred to develop a patent during the years 1-10 are not set off against royalty income derived from the exploitation of the patent in the years 10-20. This means that the domestic tax base is reduced with development costs relating to profits which are subject to foreign taxation.[41]

An excess foreign tax credit may arise where: (i) the foreign tax rate exceeds the domestic tax rate, (ii) the foreign tax base exceeds the domestic tax base, or (iii) the taxpayer incurs losses from other sources which reduces or eliminates domestic taxes. Tax treaties do not normally address the issue of excess foreign tax credit which is entrusted to domestic tax laws.[42] Sweden, Norway and Finland allow taxpayers to carry forward excess foreign tax credits regardless of how it has arisen. Denmark only provides for a carry-forward if excess foreign tax credit is caused by tax losses. No carry-forward is provided by Iceland.

3.2. Permanent establishment

3.2.1 Attribution of intangible profits

An intangible may be commercially exploited by a foreign PE of a resident company. Whether economic ownership to an intangible and intangible profit must be allocated to a foreign PE is a complex and highly uncertain question which is governed by domestic tax law and tax treaty provisions corresponding to Article 7(2) of the OECD Model.[43] In 2008, the OECD adopted the Authorised OECD Approach (AOA) for purpose of the attribution of business profits to PEs under Article 7(2). The OECD acknowledged that some parts of the AOA were in conflict with Article 7 and the previous interpretation thereof, e.g. the ban on deduction for notional interest, royalties and management fees.[44] The AOA has thus been implemented in a two-step process; first the Commentary on Article 7 was amended in 2008, and then the wording of Article 7 was amended in 2010. It is thus necessary to distinguish between OECD-based tax treaties concluded: (i) prior to 17 July 2008, (ii) after 17 July 2008 and before 22 July 2010 and (iii) after 22 July 2010. Most of the tax treaties of the Nordic countries are still based on older versions of Article 7(2).[45] It remains to be seen whether the courts will accept dynamic interpretation of Article 7(2) in old tax treaties as envisaged by the

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[40] In Denmark, section 5 D Tax Assessment aims at ensuring that income and costs are matched across income years but it is not applicable to royalty income. See para. 8.5 Circular No 72 of 17. April 1996.

[41] Treas.reg. § 1.861-17 in the United States mitigates this effect by requiring R&D costs incurred in the United States to be allocated between domestic and foreign source income for purpose of calculating foreign tax credit. Hence, U.S. companies with foreign sales and income are presumed to be doing at least some of their R&D to enhance their foreign profitability. See J.R. Hines and A.B. Jaffe, “International Taxation and the Location of Inventive Activity”, in *International Taxation and Multinational Activity*, ed. J.R. Hines (Chicago: University of Chicago, 2000), at 201, 206.

[42] Paras 65 and 66 Commentary on Article 23 OECD Model.

[43] Para. 77 2010 Report on the Attribution of Profits to Permanent Establishments (Paris: OECD, 2010).

[44] Para. 8 Report on the Attribution of Profits to Permanent Establishments (Paris: OECD, 2008).

[45] The latest bilateral tax treaties concluded by Denmark are still based on the 2008 version of Article 7. See tax treaty with Kuwait of 22 June 2010, tax treaty with Cyprus of 11 October 2010 and tax treaty with Hungary of 27 April 2011.

OECD. Another key issue is to what extent the domestic tax laws of the Nordic countries are consistent with the fully-implemented AOA. For example, domestic Danish tax law is hardly in line with the AOA since internal interest payments must be disregarded for non-financial enterprises,[46] whereas internal interest payments ("treasury dealings") are, in principle, recognised under the AOA.[47]

Under the AOA, economic ownership to intangibles is allocated between head office and PE on the basis of another new concept: significant people functions. In respect of internally developed intangibles, the significant people functions relevant to the determination of economic ownership are those which require active decision-making with regard to the taking on and management of individual risk and portfolios of risks associated with the development of intangible property.[48] Hence, economic ownership cannot be allocated to a PE alone because the employees of the PE actually developed the intangible. If "sole or joint ownership" to an intangible is not allocated to a PE, it may be entitled to compensation as a contract researcher.[49] In respect of acquired intangibles, the significant people functions might include the evaluation of the acquired intangible, the performance of any required follow-on development activity, and the evaluation of and management of risks associated with deploying the intangible asset.[50] In respect of marketing intangibles, the significant people functions may include, for example, functions related to the creation of and control over branding strategies, trademark and trade name protection, and maintenance of established marketing intangibles.[51] Under the AOA, an internal dealing may have to be recognized if one part of an enterprise begins to use an intangible which hitherto has been allocated to another part of the enterprise. Such an internal dealing may, depending on the facts, be treated as a transfer of: (i) outright economic ownership, (ii) joint economic ownership, (iii) a beneficial interest in the intangible or (iv) notional right to use the intangible.[52] The application of the purely factual concepts (AOA and significant people functions) to a complex, international business organization model that is constantly changing is bound to create disputes between taxpayers and tax authorities and between competent authorities.

In summary, exploitation of intangibles through a foreign PE is associated with considerable tax uncertainty, both regarding the legal basis for the application of the AOA under domestic tax laws and tax treaties concluded before 22 July 2010, and regarding the determination of the tax consequences under the AOA.

3.2.2 Relief for double taxation

All of the Nordic countries except Denmark subject resident companies to tax on a worldwide basis. Business profits of foreign PEs are thus subject to taxation in both the resident state and source state causing juridical double taxation. By contrast, Denmark applies the territorial principle under which business profits

[46] TfS 1993, 7 H. In 2010, the Danish minister of taxation announced a bill on the attribution of profits to PEs presumably in order to implement the AOA in domestic law. However, the proposal has not yet been published.

[47] Paras 152, 153, 157 and 159-161 2010 Report on the Attribution of Profits to Permanent Establishments (Paris: OECD, 2010).

[48] *Id*. para. 85.

[49] *Id*. para. 201.

[50] *Id*. para. 94.

[51] *Id*. para. 97.

[52] *Id*. paras 207-209.

of foreign PEs are tax exempt. Juridical double taxation of business profits of a foreign PE is relieved under the credit method under domestic law of Sweden, Norway, Finland and Iceland. Hence, if intangible profits are subject to a low level of taxation in the source state, taxation will be lifted up to the level prevailing in the residence state. However, some tax treaties still rely on the exemption method, which makes it possible to maintain a permanent low level of taxation of a foreign PE assuming that CFC taxation is not triggered.

3.3 Subsidiary

An intangible may be commercially exploited by a non-resident subsidiary which has developed or acquired the intangible. Intangible profits of a non-resident subsidiary are not subject to domestic taxation at the level of the parent company on a current basis, save for CFC taxation (see V.5). Table 9 summarizes the tax treatment in the Nordic countries of dividends and capital gains from non-resident subsidiaries.

Table 9: Tax treatment of dividends and capital gains from non-resident subsidiaries

Income	**Finland**	**Norway**	**Sweden**	**Denmark**	**Iceland**
Dividends	(i) EU: Exemption. (ii) Tax treaty country: Treaty provision. (iii) Non-treaty country: Taxable, tax credit for WHT.	(i) General rule: Exemption (97%). (ii) EEA low-tax country and substance test: Exemption (97 %). (iii) Non-EEA low-tax country: Taxable, indirect tax credit.	Exemption	Exemption	Exemption
Capital gains	(i) EU or tax treaty country: Exemption. (ii) Non-treaty country: Taxable.	Do.	Exemption	Exemption	Exemption

Dividends and capital gains regarding non-resident subsidiaries are generally tax exempt in the Nordic countries. Norway is the only country which distinguishes between income from high-tax and low-tax countries. However, the Finnish taxation of income from non-treaty countries is intended to have the same effect. Otherwise, tax exemption in the Nordic countries does not depend on the level of foreign taxation or the nature of the activity of the subsidiary. If a parent company is able to steer clear of CFC taxation it may thus be able to permanently reduce taxation by exploiting intangibles in non-resident, low-taxed subsidiaries. This is a markedly difference in tax treatment compared to business activities conducted through a foreign PE where relief for double taxation normally is granted under the credit method. The tax policy reason for granting exemption relief for dividends of subsidiaries and credit relief for business profits of PEs is not obvious.

Exploitation of intangibles through a foreign subsidiary is not associated with the legal and factual uncertainties of the AOA which arise where a foreign activity is conducted through a PE (see IV.3.2.1). Hence, contractual arrangements between associated enterprises are normally decisive for the tax allocation of assets and risks, save for general anti-avoidance rules. This is another key difference between the use of subsidiaries and PEs.

Part V Base erosion

1. General

Since value creation in private firms is largely based on intangibles and the arm's length principle allocates income of MNEs between group members with market transactions as benchmark, ownership of intangibles within a MNE affects the income allocation between group members and tax jurisdictions. A MNE may thus realize significant tax savings by exploiting intangibles in low-tax jurisdictions. A recent U.S. study shows that the global effective tax rate of six U.S.-based MNEs is in the range 10-20% despite the fact that more than 50% of their revenues are derived in the U.S. and that U.S. profits are subject to federal taxation of 35%.[53] The study confirms that a large portion of the foreign profits are derived in low-tax jurisdictions. Hence, each of the MNEs has established a foreign principal in a low-tax jurisdiction. The principal owns and is responsible for the development of intangibles. In contrast, lower value functions such as contract manufacturing or limited risk distributor functions are located in jurisdictions as dictated by nontax business needs. Although tax planning of Nordic MNEs may traditionally have been less aggressive, globalization undoubtedly also has an impact in this area. The general business attitude to tax planning may thus gradually be changing and Nordic MNEs become more receptive to intangible tax planning opportunities.

Governments may counteract base erosion by an arsenal of different types of anti-avoidance rules, some of which is discussed below. In this respect two questions emerge: (i) what taxpayer behaviour should be prevented, and (ii) what means should be adopted in order to achieve the desired effect, see table 10.

Table 10: Scope of anti-avoidance rules

Anti-avoidance rules	Intangible ownership established by low-taxed subsidiary							
	Acquisition			Self-development	Outsourcing			CCA[1]
	Related-party		Third-party		Related-party		Third-party	
	Resident	Nonresident			Resident	Nonresident		
Transfer pricing and exit taxation	√				√			√
CFC and dividend taxation	√	√	√	√	√	√	√	√
Withholding tax								

[1] Cost contribution arrangement, see Chapter VIII of the OECD Guidelines.

A low-tax subsidiary may establish ownership to an intangible in various ways. It is not given that anti-avoidance rules should address all situations. There is probably widespread consensus about that a transfer of an intangible from a resident, high-taxed company to a non-resident, low-taxed subsidiary should be targeted. On the other hand it is debatable whether acquisitions from third-parties, self-development, outsourcing and cost contribution arrangements should be within the scope of anti-avoidance rules.

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[53] Present Law and Background Related to Possible Income Shifting and Transfer Pricing (Washington D.C.: Joint Committee on Taxation, JCX-37-10, 20 July 2010).

Related-party transfers of intangibles from a resident company may be targeted by two categories of rules: (i) transfer pricing and exit taxation, and (ii) CFC and dividend taxation. Third-party acquisitions of intangible and self-development of intangibles may only by targeted by CFC taxation and dividend taxation. Withholding tax on royalties is usually not an efficient means of preventing the exploitation of intangibles by low-taxed subsidiaries because a license arrangement will normally not be put in place and because tax treaties normally grant an exclusive taxing right to the residence state. CFC-taxation and dividend taxation rules are only applicable with respect to resident parent companies.

Part V provides a comparative analysis of some of the anti-avoidance rules of the Nordic countries which may address migration of intangibles: Section 2 on transfer pricing rules, section 3 on exit taxation, section 4 on domestic development and foreign exploitation of intangibles, section 5 on CFC taxation and section 6 on withholding taxes. General anti-avoidance rules are outside the scope of this report.

2. Transfer pricing

2.1 General

Transfer pricing of intangibles is a key issue in international tax law. Tax issues relevant for transfer pricing cases may be categorized as follows: (i) non-pricing issues of general tax law, (ii) transfer pricing issues and (iii) other specific transfer pricing issues. There is a discussion of these three issues below.

2.1.1 Non-pricing issues

Evaluation of a transfer pricing case requires a preliminary decision on other basic tax issues. Among other things, such non-pricing issues include the following questions: (i) does a taxable asset exist, (ii) who is owner of the asset; (iii) has a transaction relating to the asset occurred and (iv) who are the parties to the transaction. Such issues are outside of the scope of the arm's length principle of Article 9(1) of the OECD Model and normally also domestic transfer pricing provisions and they must be resolved under general tax rules of domestic law.[54] An international consensus or coordination of these basic issues is lacking and domestic laws often diverge. This means that transfer pricing cases may not always be resolved under the arm's length principle of domestic tax law, tax treaty provisions corresponding to Articles 9(1) and 25 of the OECD Model, the OECD Guidelines and the Arbitration Convention (90/436/EEC).

An example of a transfer pricing case dealing with non-pricing issues is *Cytec Norge*.[55] This case concerned a Norwegian partnership which was converted from fully-fledged manufacturer into a toll manufacturer of a Dutch affiliated company causing a significant decrease of its taxable income. This triggered a transfer pricing adjustment of NOK 374m (later reduced to NOK 300m), since the conversion was held to involve a transfer of customer base, technology, trademarks and goodwill. The taxpayer argued, among other things, that the decision was based on incorrect facts, since the partnership had not been the owner of the technology. Hence, the technology had been transferred to the partnership under license agreements with the two partners, and the license agreements had been terminated before the conversion. The Court agreed that

[54] J. Wittendorff, "The Object of Art. 9(1) of the OECD Model Convention: Commercial or Financial Relations", 17 *International Transfer Pricing Journal* 3 (2010), at 200.
[55] Utv 2007/1440 (*Cytec Norge*).

the intangibles were critical for the business of the partnership and that the partnership had the right to exploit the intangibles prior to becoming a toll manufacturer. The crucial issues were whether the rights had an intrinsic value for the partnership through ownership or license rights and, if so, whether these rights were transferred to the associated enterprise at the time of conversion. The majority of the Court upheld the decision. The majority found that, under the license agreements, the partnership had obtained royalty-free, exclusive, irrevocable and indefinite rights to exploit the technology, and that the partnership was also the owner of its own technology. The license rights to the technology were held to have an intrinsic value. In addition, the partnership was found to be the tax owner of the customer base, trademarks and goodwill. Based on the contractual terms and the actual conduct of the parties, the intangibles were held to have been transferred in connection with the conversion.

General tax rules of domestic law may be critical to the ability to protect the national tax base. This may be illustrated by a case concerning a Danish sales company of a foreign MNE which had restructured its Nordic sales organization for a specific product group.[56] Thus, there was to be only one company in the Nordic region for this product group which would establish a branch office in each Nordic country, including Denmark. A newly established Danish branch office would be given sole distributorship of the product group in Denmark. The Danish company's assets, liabilities and employees allocated to these products would be transferred to the new branch office. The rest of the group's products would continue to be distributed by the existing Danish company. The question was whether the goodwill relating to the customer base in Denmark would be transferred from the Danish company to the affiliated Nordic company. The customers would cease to trade with the Danish company as soon as it no longer had the right to sell the products in question. The ruling was based on the fact that the sole distributorship agreement could be terminated at 6 months' notice, that no intellectual property rights would be transferred, and that the distributor's transfer of rights under the agreement was subject to the group's consent. On this basis, the National Tax Board decided that the Danish sales company was not the tax owner of the goodwill. Instead, the goodwill was found to belong to the regional parent company in Europe or the ultimate parent company. Hence, under Danish tax law a business restructuring will often mean that marketing intangibles are not transferred from a Danish distributor to a foreign affiliated company.[57] In other countries, tax ownership of marketing intangibles may be deemed to belong to the local distributor and a business restructuring may trigger capital gains taxation.[58]

2.1.2 Transfer pricing issues

Where an analysis under general tax law leads to the conclusion that a controlled transaction has occurred, the scene is set for an arm's length test of the transfer price. The arm's length test of intangibles accentuates a number of general transfer pricing issues. *First*, comparable reference transactions rarely exist because valuable intangibles are often unique and are usually not transferred between independent parties. *Second*, the value of an intangible is normally its value in use (not value in exchange) which is expected to last several years, and which depends on the resources and competencies of the individual enterprise. *Third*,

[56] TfS 2004, 342 LR.

[57] The binding ruling relied on two Supreme Court decisions dealing with domestic transactions. See TfS 2001, 231 H and TfS 2002, 563 H.

[58] T. Miyatake, "Transfer pricing and intangibles", *Cahiers de droit fiscal international*, Vol. 92a (2007), at 19, 26.

these matters give rise to informational asymmetry between taxpayers and tax authorities. Hence, a proper arm's length test requires detailed knowledge of the technological features of the intangible and its profit potential, the group's strategy and opportunities for exploiting the profit potential, as well as an understanding of complex financial, legal and commercial matters. The uncertainty associated with an *ex ante* valuation of intangibles is a particular problem for the tax authorities. If the actual profits attributable to an intangible exceed the projected profits which influenced the valuation of an intangible transferred in a controlled transaction, the tax authorities may question whether this discrepancy was caused by unforeseen circumstances or by an abuse of the informational asymmetry. The valuation issues are evidenced by the significant amounts that are often at stake in transfer pricing cases dealing with intangibles.

The OECD Guidelines is still relying on the comparable uncontrolled price method (CUP) for intangibles, even though this method usually cannot be reliably applied due to the lack of comparables.[59] The OECD is thus not offering any practical guidance which is reflected in the absence of an international consensus about the methods to be used to evaluate transfer prices of intangibles.[60] A cross-border transfer of intangibles is thus particularly vulnerable to international disputes and double taxation. The new Chapter IX of the 2010 OECD Guidelines on business restructurings addresses some aspects of the migration of intangibles.[61] Moreover, the OECD has recently launched a project on transfer pricing aspects of intangibles.[62]

The lack of international guidance has caused some countries to introduce their own rules. The transfer pricing laws of the United States and Germany have recently been tightened in order to stem the migration of intangibles. The German rules address the transfer of intangibles in the course of a relocation of functions,[63] whereas the U.S. rules address intangibles in the context of buy-in transactions under cost sharing arrangements.[64] Both countries have adopted income-based methods under which intangibles are valued on the basis of the expected future cash flow thereof. The Danish[65] and U.K.[66] tax authorities have followed suit and issued guidelines on the application of income-based methods. The OECD Guidelines acknowledge such methods, but adopt a cautious attitude and provide no real guidance. The absence of international guidelines creates uncertainty about appropriate approaches which is reflected in the diverging, and sometime conflicting rules of the United States and Germany. Hence, there are no consensus on the scope, methodology, input parameters and certain other issues relating to the application of income-based

[59] J. Wittendorff, "Valuation of Intangibles under Income-Based Methods - Part I", 17 *International Transfer Pricing Journal* 5 (2010), at 323, 327.
[60] T. Miyatake, "Transfer pricing and intangibles", *Cahiers de droit fiscal international*, Vol. 92a (2007), at 19, 33.
[61] Chapter IX is based on *Transfer Pricing Aspects of Business Restructurings: Discussion Draft for Public Comment* (Paris: OECD, 2008).
[62] http://www.oecd.org/topic/0,3699,en_2649_45675105_1_1_1_1_37427,00.html.
[63] Business Tax Reform Act (*Unternehmensteuerreformgesetzes*) of 14 August 2007 (BGBl I 2007 1912)
[64] Treasury Decision 9441 (Internal Revenue Bulletin 2009-7).
[65] Transfer pricing, ; kontrollerede transaktioner; værdiansættelse (Copenhagen: SKAT, 2009).
[66] HM Revenue and Custom's International Manual, INTM467200.

methods.[67] The application of income-based methods on the basis of identical facts may thus lead to widely different results in the two countries.

Income-based methods address the issue of lack of empirical market data and the issue of the value of an intangible being its value in use. The new methods generally entail a shift from direct, empirical methods to indirect, hypothetical methods. A number of legal and factual issues are associated with the use of income-based methods in transfer pricing which do not always arise in corporate finance.

From a legal perspective, it is pivotal that valuation is made on the basis of the arm's length principle rather than fair value, which is applied in accounting and corporate finance. Although both standards focus on the transfer price that would have been agreed in a transaction between independent enterprises, they diverge from each other in certain significant respects.[68] Hence, the arm's length principle requires a subjective, entity-specific valuation, whereas fair value requires an objective, market-based valuation. A subjective, entity-specific valuation is of particular importance to specialized assets such as intangibles, where the economic value is the value in use of the property which is expected to last several years, and which depends on the resources and capabilities of the individual enterprise. This may cause the profit potentials of intangibles to differ significantly between enterprises, and the arm's length price to differ from fair value.

One of the factual issues associated with the use of income-based methods is that valuation in transfer pricing is usually confined to a single intangible or group of intangibles, whereas in corporate finance valuation is often made on a group or entity level. Thus, in transfer pricing there is a need for a refinement of income-based methods in order to reliably capture more narrowly defined cash flows of individual intangibles. For example, where an intangible relates to one component of an asset consisting of many components, such as a car, it would be difficult to calculate the present value of the profit attributable to the intangible in question reliably as the cash flow attributable to the intangible will be difficult to isolate from the overall cash flow attributable to the final asset.[69] It may thus be necessary to supplement traditional income-based methods used in corporate finance with profit-split approaches in order to allocate total profits between the intangible in question and other, existing and future production factors. This is usually a highly arbitrary exercise where historical intangible development costs may be used as proxy for arm's length values of intangibles. Another factual issue is whether the profit potential of an intangible should be confined to existing applications that do not require further development (make/sell value), or whether it should also include exploitation of the intangible as a platform for the development of new generations of the intangible (platform value). This is a hot audit issue in the United States where taxpayers often have valued intangibles contributed to cost sharing arrangements solely on the basis of their make/sell value. This may cause relative low values especially for property with a short economic life such as computer software. The IRS has lost the

[67] J. Wittendorff, "Valuation of Intangibles under Income-Based Methods - Part II", 17 *International Transfer Pricing Journal* 6 (2010), at 383, 389.
[68] J. Wittendorff, "The Arm's Length Principle and Fair Value: Identical twins or just close relatives?", 62 *Tax Notes International* 3 (18 April, 2011), at 223.
[69] Preamble, Explanation of Provisions, Sec. 1.482-4(c)(2)(ii)(B)(1), in Treasury Decision 8552 (Internal Revenue Bulletin 1994-31). See also para. 6.22 OECD Guidelines.

first case dealing with this issue because the Tax Court found no legal basis for taking the platform value into account under the 1995 cost sharing regulations.[70] However, the 2008 cost sharing regulations have been amended to expressly consider platform value.[71]

Income-based methods do not address the issue of informational asymmetry. Under income-based methods key input parameters are projected profits and risk-weighted discount rates. This gives rise to significant uncertainty and offers taxpayers the opportunity of manipulation. The uncertainty may be illustrated by the Swedish *Ferring* case concerning the transfer of intangibles from Sweden to Switzerland in the course of a business restructuring, both the taxpayer and the tax authorities applied income-based methods but arrived at values of SEK 275.5m and SEK 957m, respectively.[72] Likewise, in the Norwegian *Dynea* case concerning the valuation of a subsidiary, two expert witnesses both applied income-based methods and arrived at values of NOK 0.5bn and NOK 1-5bn, respectively.[73] Income-based methods are thus not a panacea for transfer pricing of intangibles.

2.1.3 Other transfer pricing measures

The difficulties and uncertainties associated with making arm's length tests of intangibles may cause countries to adopt transfer pricing measures which supplement or supplant the arm's length principle. Such measures may be categorized according to whether they address: (i) the allocation norm, (ii) enforcement of the allocation norm or (iii) dispute resolution under the allocation norm.

Substantive rules regarding the allocation norm may infringe on the arm's length principle of Article 9(1). Table 11 summarizes such transfer pricing measures and their compatibility with the arm's length principle.

Table 11: Transfer pricing rules on the allocation norm

Measure	**Content**	**Compatible with Article 9(1) of the OECD Model**
Realistic alternatives	Realistic alternatives to a controlled transaction may be applied in two fundamentally different capacities in a transfer pricing analysis: (i) as a criterion under the comparability analysis or (ii) as a separate means for determining transfer prices. The U.S. § 482 regulations from 1994 make use of realistic alternatives for both purposes.[74] The use of realistic alternatives as a separate means for establishing arm's length prices is illustrated by examples which show that the arm's length test of a royalty rate	No. The OECD Guidelines emphasize that the valuation of intangibles should not be made on the basis of a highest and best use principle.[77] The OECD has also stated that it is inappropriate to use realistic alternatives as a separate

[70] *Veritas Software Corp. v. Commissioner*, 133 TC 14 (2009). The IRS believes that the Court's factual findings and legal assertions were erroneous. On this basis it does not acquiesce in the result or the reasoning of the decision. See Action on Decision, Internal Revenue Bulletin 2010-49, 6 December 2010

[71] Treas.reg. § 1.482-7T(c)(1). See J. Wittendorff, *Transfer Pricing and the Arm's Length Principle in International Tax Law* (2010), at 555.

[72] District court (*länsretten*) in Malmö, decision of 3 March 2009, case No 6132-07.

[73] Court of appeal (*lagmannsretten*) in Borgarting, decision of 12 June 2009, case No 08-159542ASD-BORG/03.

[74] Treas.reg. §§. 1.482-1(d)(3)(iv)(H), 1.482-1(f)(2)(ii)(A), 1.482-3(b)(2)(B)(8), 1.482-3(e)(1), 1.482-4(d)(1), 1.482-7T(g)(2)(iii)(A), 1.482-7T(g)(4)(i)(A) and 1.482-9(h).

	may take into account the result of the taxpayer's alternative of producing and selling the goods itself.[75] If the alternative transaction would be expected to provide the taxpayer with higher profits than the actual transaction, the transfer price of the actual transaction is deemed not to be arm's length. The U.S. fiscal year 2012 budget proposals would add to Section 482 a realistic alternative approach for intangibles, which is intended to receive a similar result as the highest and best use principle of fair value.[76]	means for establishing arm's length prices.[78] Hence, this would be in breach of the following principles: (i) the recognition of the controlled transaction as actually structured, and (ii) an arm's length test from the perspectives of both parties.
Commensurate with income standard (CWI standard)	A CWI standard entails that the transfer price is evaluated on an *ex post* basis, i.e. projected profits are replaced with actual profits of the transferee realized after the transaction. A CWI standard has been adopted by the United States, Canada and Germany. By contrast, the U.K. has recently decided not to introduce a CWI standard ("earnout approach").[79]	No. However, the OECD Guidelines essentially construe the arm's length principle of Article 9(1) as incorporating a CWI standard. [80] This is in breach of the principle of the recognition of the controlled transaction as actually structured and the ban on the use of hindsight.[81]
Authorised OECD Approach (AOA)	The AOA of Article 7(2) of the OECD Model involves that risks and intangibles are allocated between head office and PE on a factual basis. Adopting the AOA for associated enterprises under Article 9(1) would prevent a contractual separation of the risks and intangibles from the functions and thereby the basis for much tax planning. The 2010 OECD Guidelines have, in essence, introduced the AOA in relation to Article 9(1).[82] Hence, the OECD argues, among other things, that the arm's length principle authorizes tax authorities to disregard actual transactions, such as the transfer of an intangible to a low-taxed subsidiary, if employees of the subsidiary do not have authority to and effectively do perform control functions in relation to the intangible.[83]	No. There is no legal basis in the arm's length principle of Article 9(1) to apply the AOA because the existence, form and content of "commercial or financial relations" should be determined under domestic law prior to the application of the arm's length principle.
Formulary	Under FA the overall profits of an MNE is calculated as a whole	No.[86]

[77] Para. 6.15 OECD Guidelines.
[75] Treas.reg. §§. 1.482-1(f)(2)(ii)(B) and 1.482-4(d)(2).
[76] General Explanations of the Administration's FY 2012 Revenue Proposals (Washington D.C.: Department of the Treasury, February 2011), at 45.
[78] Paras 3.14-3.18 OECD Task Force report on intercompany transfer pricing regulations under US section 482 temporary and proposed regulations (Paris: OECD, 1992).
[79] Corporate Tax Reform: delivering a more competitive system (London: HM Revenue and Customs, November 2010), at 34.
[80] Paras 3.72, 3.73, 6.28, 6.32, 9.87 and 9.88 and Annex to Chapter VI OECD Guidelines.
[81] J. Wittendorff, *Transfer Pricing and the Arm's Length Principle in International Tax Law* (2010), at 166 and 689.
[82] Paras 9.22-9.28 OECD Guidelines.
[83] Paras 9.190-9.192 OECD Guidelines.

apportionment (FA)	and allocated between the associated enterprises on the basis of allocation keys. This resolves the transfer pricing issues related to intangibles. The Commission has proposed that EU-based MNEs should be able to elect to apply FA within the EU.[84] The scheme for SMEs is Home State Taxation (HST) and the scheme for large companies is a Common Consolidated Corporate Tax Base (CCCTB). The Commission has published a proposal for a Council Directive which would implement the CCCTB.[85]	

The arm's length principle of Article 9(1) of the OECD Model does not address enforcement and dispute resolution. Rules of domestic tax law dealing with these issues are thus of a supplementary nature. Table 12 summarizes examples of transfer pricing measures dealing with enforcement and dispute resolution.

Table 12: Transfer pricing rules on enforcement and dispute resolution

Measure	**Content**
Reporting requirement	Reporting requirements may be imposed in order to make tax authorities aware of extraordinary transactions undertaken for tax planning purposes, such as the transfer of valuable intangibles.
Documentation requirement	Documentation requirements address the issue of informational asymmetry.
Penalties	Transfer pricing penalties imposed for noncompliance with documentation rules and/or the arm's length principle generally encourage taxpayers to comply with the relevant tax law.
Advance pricing agreement (APA)	Transfer pricing disputes may be avoided if a taxpayer and tax authorities reach an APA on an appropriate transfer price prior to the controlled transaction in question. An APA may be unilateral, bilateral or multilateral.
Burden of proof	The burden of proof in transfer pricing cases often rests with the tax authorities. It may be difficult for the tax authorities to substantiate that income projections underlying valuation of intangibles under income-based methods were unreliable on an *ex ante* basis. This issue may be addressed in various ways: (i) the burden of proof may generally be shifted to taxpayers in cases dealing with intangibles; (ii) the burden of proof may be reversed if a taxpayer does not comply with documentation requirements (iii) the burden of proof may be shifted to the taxpayer if, at a certain time after a transfer of an intangible, a test shows that critical assumptions for the valuation to a significant degree have not been satisfied; or (iv) statutory presumptions may be imposed to the benefit of the tax authorities.

[86] Paras 1.16-1.32 OECD Guidelines.

[84] Towards an Internal Market without Tax Obstacles – A Strategy for Providing Companies with a Consolidated Corporate Tax Base for the EU-wide Activities (COM(2001) 582 final of 23 October 2001), at 11 and 21.

[85] COM(2011) 121/4. Under the proposed directive a company's tax base would be shared among EU Member States in which the company is active on the basis of a formula that equally weighs the company's assets, labour and sales. According to Article 92(2), assets include not only fixed tangible assets but also, as a proxy for intangible assets for an initial five-year period, the costs of R&D, marketing, and advertising incurred in the six years prior to a company entering the CCCTB.

2.2 Nordic countries

All of the Nordic countries rely on the arm's length principle as allocation norm for associated enterprises in their domestic transfer pricing tax law and tax treaties.[87] The arm's length principle is normally interpreted on the basis of Article 9(1) of the OECD Model and the OECD Guidelines, although the legal status of the OECD material differs between the Nordic countries. Denmark is the only Nordic country which has published guidelines on the valuation intangibles. None of the Nordic countries have adopted substantive tax rules that deviate from the arm's length principle (realistic alternatives, CWI standard, AOA or FA). For example, in the *Ferring* case the Court emphasized that the arm's length test should be based on the actual transaction rather than a hypothetical transaction (rejection of realistic alternatives) and on the information available at the time of the controlled transaction rather than later information (rejection of CWI approach).[88]

Table 13 summarizes the rules on transfer pricing enforcement and dispute resolution in the Nordic countries.

Table 13: Transfer pricing rules on enforcement and dispute resolution

Measure	**Finland**	**Norway**	**Sweden**	**Denmark**	**Iceland**
Reporting requirement	Yes	Yes	No	Yes	No
Documentation requirement	Yes	Yes	Yes	Yes	No
Transfer pricing penalties	Yes	Yes	No	Yes	No
APA[1]	No	No[2]	Yes	No	No
Burden of proof	Generally, rests with the party that can best provide the required evidence. Normally,	Tax authorities. However, tax assessment on an estimated basis in	Tax authorities.	Tax authorities. However, tax assessment on an estimated basis in	Tax authorities.

[87] Swedish tax law distinguishes itself from the tax law of the other Nordic countries by the fact that the domestic transfer pricing provision is solely applicable to cross-border transactions. Certain domestic below market value transfers (*underprisöverlåtelser*) between resident companies do not trigger taxation. Thus, while cross-border transactions must be at arm's length prices, domestic transactions can be at cost-only prices. In the *Malta* case (RÅ 2008, ref. 30) the Supreme Administrative Court found the rules on below market value transfers to be in breach of Article 43 of the EC Treaty (now Article 49 TFEU). The compatibility of the Swedish transfer pricing provision with EU and EEA law must be examined on the basis of the criterion established in *Thin Cap Group Litigation* (Case C-524/04) and *SGI* (Case C-311/08). Although the Swedish transfer pricing provision constitutes a restriction on the freedom of establishment, it may be justified in the need to maintain a balanced allocation of taxing rights and to prevent tax avoidance. In order to comply with the principle of proportionality the legislation needs to meet two conditions. First, in all cases where the arm's length principle is not observed, the taxpayer must be given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that arrangement. Second, there must only be an adjustment of that part of the payment that exceeds the arm's length price. In the opinion of the general reporter, the test of commerciality is separate from the arm's length test. See J. Wittendorff, *Transfer Pricing and the Arm's Length Principle in International Tax Law* (2010), at 270.

[88] District court (*länsretten*) in Malmö, decision of 3 March 2009, case No 6132-07.

	the burden of proof rests with the taxpayer.	case of noncompliance.		case of noncompliance.	

[1] Domestic rules that are separate from general binding rulings and mutual agreement procedure APAs under tax treaty provisions corresponding to Article 25 of the OECD Model.
[2] Binding rulings are available regarding the pricing of natural gas.

All of the Nordic countries except Iceland have adopted transfer pricing enforcement and dispute resolution rules. Denmark has issued special documentation rules on intangibles.[89] However, these rules are of a non-binding nature whereas the ordinary documentation rules are binding on taxpayers. The documentation rules of the other Nordic countries are not designed to deal with the transfer of intangibles and the special issues associated with the valuation thereof. An important issue in transfer pricing cases is the burden of proof. In all of the Nordic countries except Finland, the burden of proof rests with the tax authorities as a starting point. However, if documentation requirements are not satisfied a tax assessment may be made on an estimated basis in Denmark and Norway. In addition, under the Norwegian transfer pricing provision, if an associated enterprise is resident in a country outside of the EEA and there is reason to believe that income has been shifted to the associated enterprise, such income shifting will be deemed to have resulted from the common control, unless the taxpayer can document that this is not the case.[90]

3. Exit taxation

3.1 General

Intangibles may be migrated by way of an outright sale or a license agreement. Such transactions are within the scope of transfer pricing legislation. However, an intangible may also migrate in other ways, for example, where the owner of the intangible migrates, or the intangible itself is moved out of the residence country or its tax jurisdiction.[91] Such transactions are addressed by exit taxation.

Exit taxation is a hot issue in an EU and EEA context because cross-border relocation triggers taxation of unrealized capital gains, whereas relocation within a Member State does not. Even though a national is not prevented from exercising a fundament freedom, exit taxation is of such a kind as to restrict the exercise thereof, having at the very least a dissuasive effect. In *de Lasteyrie* and the *N-case*, the ECJ ruled that exit taxation of shares held by individuals was, in principle, prohibited by the Treaty.[92] However, the territorial principle has been accepted as a valid justification for exit taxation,[93] provided that deferral of tax payment is granted without an obligation to provide guarantee,[94] and that full account is taken for a reduction in the

[89] Para. 5 Transfer Pricing; kontrollerede transaktioner; værdiansættelse (Copenhagen: SKAT, 2009).
[90] Section 13-1(2) of the Norwegian Tax Act. The same applies if the associated enterprise is resident in a country within the EEA, provided that Norway does not have the right to demand information concerning the wealth and income of such person pursuant to an international treaty.
[91] Cross-border reorganizations through mergers, divisions and transfer of assets may also cause intangibles to leave a country's tax jurisdiction.
[92] Para. 48 of Case C. 9/02 (*de Lasteyrie*); and para. 39 of Case C-470/04 (*N*).
[93] Para. 47 of Case C-470/04 (*N-case*).
[94] *Id*. para. 51.

value of the property in question capable of arising after the transfer of residence, unless such reduction is taken into account in the host country.[95] In *Daily Mail*, the ECJ ruled that the freedom of establishment could not be interpreted as conferring on companies incorporated under the law of a Member State a right to transfer their central management and control and their central administration to another Member State while retaining their status as companies incorporated under the legislation of the first Member State.[96] Nonetheless, in the opinion of the Commission the interpretation of the freedom of establishment given in *de Lasteyrie* in respect of individuals has direct implications for companies.[97] The ECJ is set to examine exit taxation of companies in the pending case *National Grid Indu* which concerns the relocation of the place of effective management of a Dutch company from the Netherlands to the United Kingdom.[98] Moreover, the Commission has referred Spain and Portugal for the ECJ because exit taxation of companies in these countries is considered to infringe on the freedom of establishment.[99]

Exit taxation may also be in breach of tax treaty provisions akin to Article 13(5) of the OECD Model under which the residence state is granted an exclusive taxing right to capital gains.[100] The Commentary on Article 13 recognizes that taxation may be imposed even if there is no alienation of an asset.[101] Taxation of the transfer of an asset from a PE to its head office is expressly recognized by the Commentary.[102] Hence, where exit taxation is triggered solely as a result of cross-border relocation, it would seem to comply with the exclusive taxing right of the residence state. However, if domestic tax law establishes additional conditions for exit taxation, and these conditions are met after the time of relocation, it may be argued that an infringement on Article 13(5) occurs since at that time the former residence state is now a source state. Accordingly, where exit taxation is triggered solely as a result of cross-border relocation, an EU / EEA tax issue may arise, and where exit taxation is triggered at a later point in time a tax treaty issue may arise.[103] The tax treaty issue may be dealt with by special provisions in tax treaties.

3.2 Nordic countries

Table 14 summarizes the exit taxation rules of the Nordic countries regarding intangibles.

Table 14: Exit tax rules regarding intangibles

	Finland	**Norway[1]**	**Sweden**	**Denmark**	**Iceland**
Migration of resident company, IPR not attributable to domestic PE	Yes	Yes	Yes	Yes	Yes
Migration of resident company, IPR attributable to domestic PE	No	No	No	No	Yes

[95] *Id*. para. 54.
[96] Para. 24 of Case C-81/87 (*Daily Mail*).
[97] Exit taxation and the need for co-ordination of Member States' tax policies, COM(2006) 825 final, at 5.
[98] Case C-371/10 (*National Grid Indu)*.
[99] Case C-269/09 (*Commission v. Spain*); and Case C-38/10 (*Commission v. Portugal*).
[100] Aa. Michelsen, *International skatteret* (2003), at 344; and F. Zimmer, *Internasjonal inntektsskatterett* (2009), at 318.
[101] Paras 5-9 of the Commentary on Article 13 OECD Model.
[102] Para. 28 of the Commentary on Article 7; and para. 10 of the Commentary on Article 13 OECD Model.
[103] F. Zimmer, *Internasjonal inntektsskatterett* (2009), at 319.

Domestic PE → foreign head office	Yes	Yes	Yes	Yes	No
Resident company → foreign PE (exemption country)	Yes	Yes	Yes	Yes	No
Resident company → foreign PE (credit country)	Yes	No	No[2]	Yes	No
CFC taxation ceases	No	Yes	No	No	No
Valuation standard	Market value	Market value	Market value	Market value	Market value
Tax deferral until realization	No	No	Yes[3]	No	No
Reverse foreign tax credit upon realization	No	No	No	No	No

[1] The Minister of Finance has proposed certain changes to the rules on exit taxation. See Prop. 78 L (2010-2011) and Prop. 116 LS (2010-2011).

[2] Existing law on this point is not quite clear.

[3] Taxpayer may obtain permission to defer payment of exit tax on intangibles. The amount of deferral must be reduced with 1/10 in each year of the initial 10 years after the migration etc.

All of the Nordic countries impose exit taxation on the migration of a resident company (e.g. change of the place of effective management) unless the assets are attributable to a domestic PE subsequently to the migration. Iceland stands out because exit taxation is also triggered in the latter situation. The allocation of an intangible from a domestic PE to the foreign head office also triggers exit taxation. Again, Iceland provides for an exception. Moreover, exit taxation occurs in all of the Nordic countries except Iceland where an intangible of a resident company is allocated to a foreign PE if relief for double taxation is based on the exemption method. This is not the case if relief is granted under the credit method because the residence state does not lose its tax jurisdiction over the assets in this situation (worldwide taxation). However, if the source state does not grant a step up in tax basis to the market value at the time of the migration, the residence state may not be able to collect any taxes from a subsequent sale because it will be obliged to grant a foreign tax credit. Denmark and Finland are imposing exit taxation on assets allocated to PEs in credit countries. In the case of Denmark this is due to the fact that companies are taxed under a territorial principle. Norway is the only country which applies exit taxation under its CFC taxation. None of the countries have adopted the arm's length principle as valuation standard in relation to exit taxation. However, the legislative history of the Norwegian rules indicates that transfer pricing principles may potentially be applied. If a market value standard requires an objective valuation it may cause results than diverge from the arm's length principle which requires a subjective valuation.[104] If different valuation standards apply under transfer pricing and exit taxation rules, taxpayers are provided with the opportunity of engaging in standard shopping.

Exit taxation in the Nordic countries (except Sweden) arguably infringe on the fundamental freedoms of EU and EEA law because deferral of the tax payment is not granted and a reduction in value of the intangible is not taken into account. The Commission has formally requested Denmark to amend its exit taxation of companies.[105] Likewise, the EFTA Surveillance Authority has presented a reasoned opinion to Norway

[104] See above V.2.1.2.

[105] Press release IP/10/299 of 18 March 2010. The Danish National Tax Board ruled in a decision from 2007, that the Danish exit taxation of companies did not infringe on the freedom of establishment (TfS 2008, 161 SR).

because its exit taxation is considered to be in breach of the EEA Agreement.[106] A similar case against Sweden was closed since Sweden complied with the Commission's request to amend its domestic tax law.[107] Sweden is thus providing taxpayers with the right to defer payment of exit taxes.[108] However, the deferred amount is reduced with 1/10 per year. Sweden is thus attempting to strike an appropriate balance between the ECJ case law on exit taxation of shares held by individuals and the fact that business assets such as intangibles are often not subject to any realization if the company is successful.[109]

4. Domestic development and foreign exploitation

Transfer pricing and exit taxation rules address the transfer of existing intangibles out of the reach of a country's tax jurisdiction. However, an intangible may be developed domestically and exploited abroad without any cross-border transfer. The domestic development may be carried out by a branch office (R&D centre) of a non-resident taxpayer, or by a resident company under a contract R&D arrangement with a non-resident taxpayer.

4.1 Branch office

A research centre organized as a branch office does normally not qualify as a PE because scientific research is deemed to be of a preparatory or auxiliary character under Article 5(4) of the OECD Model.[110] Among other things, this requires that the activity does not constitute quality control, and that the R&D is solely performed for the enterprise of which it is a part.[111] This was the outcome of a Danish binding ruling where a Danish company was held not to obtain a PE in Sweden due to the creation of a R&D centre in Sweden.[112] A low-taxed subsidiary may thus be able to set up a R&D centre in a high-tax country without being subject to taxation there, even though the R&D centre may be crucial to the overall success of the company. In this way a country may witness that valuable intangibles are developed domestically and "migrated" offshore without any taxation.

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[106] EFTA Surveillance Authority Press release (11)13 of 2 March 2011. The Norwegian government has presented a proposal the EFTA opinion. See Prop. 116 LS (2010-2011).

[107] Press release IP/08/1362 of 18 September 2008.

[108] The impetus for the Swedish law change was the decision of the Supreme Administrative Court in the *Malta* case (RÅ 2008, ref. 30) where the rules on below market value transfers (*underprisöverlåtelser*) were held to be in breach of Article 43 of the EC Treaty (now Article 49 of the TFEU). The case concerned the transfer of the place of the effective management of a Swedish company to Malta which caused the company to become tax resident in Malta under domestic Maltese law and Article 4(3) of the 1995 Swedish-Maltese tax treaty. This triggered Swedish withdrawal taxation in respect of real property in the United Kingdom held by the company, since Sweden would not be entitled to impose tax on income from the real property under the tax treaty. The Court found that the taxation caused a hindrance to the exercise of freedom of establishment, but that the legislation was justified by imperative requirements in the public interest. The legislation was held, however, not to be compatible with the principle of proportionality since the purpose of the legislation could be fulfilled by deferring the Swedish taxation until the real property was sold.

[109] B.J.M. Terra and P.J. Wattel, *European Tax Law* (2008), at 788.

[110] Para. 23 of the Commentary on Article 5 OECD Model.

[111] A.A. Skaar, *Permanent Establishment: Erosion of tax treaty principle* (1991), at 307; and M. Görl, in Vogel/Lehner, *Doppelbesteuerungsabkommen* (2008), Artikel 5, at margin No 94.

[112] TfS 2007, 549 SR.

From a tax policy point of view it would be appropriate to revisit the PE thresholds including the exception for scientific research in light of the adoption of the AOA under Article 7(2) of the OECD Model. Hence, under the functionally separate entity approach and the OECD Guidelines underlying the AOA, internal dealings are more often recognized and PEs are widely treated like subsidiaries. If the exception for scientific research was abolished a R&D centre would normally qualify as a PE under the basic rule. On this basis, a functional and factual analysis under the AOA would be decisive for the attribution of profits to the PE. This could mean that the PE was treated as a contract researcher or as a (co)owner of the intangibles.[113]

4.2 Resident company

A low-taxed subsidiary may engage a resident group company to carry out R&D on its behalf on a contractual basis. Under such an arrangement, valuable intangibles may be developed domestically and exploited abroad. Among other things, such arrangements may be subject to both a substance over form and transfer pricing examination.

4.2.1 Substance over form

General anti-avoidance rules may provide authority to disregard contractual arrangements for tax purposes. However, a R&D contract arrangement will often stand the test under such rules if it is concluded prior to the transaction in question, the parties adhere to the contractual terms, all relevant legal formalities are observed and the transfer price is reasonable.

The 2010 OECD Guidelines attempts to consolidate a conceptual change of the arm's length principle under which Article 9(1) authorizes the tax authorities to disregard or recharacterize controlled transactions.[114] The OECD states that the starting point for the arm's length test is the contractual risk allocation.[115] In other words, the controlled transaction as actually structured should be recognized for transfer pricing purposes. However, it is further stated that Article 9(1) authorizes an examination of the economic substance of controlled transactions.[116] In this view the analysis of economic substance should take into account whether the contractual terms provide for an arm's length risk allocation. If there is empirical evidence of a similar risk allocation in comparable uncontrolled transactions, the contractual risk allocation is deemed to be on an arm's length basis.[117] In the absence of third-party evidence, a hypothetical test must be made where the following factors are decisive: (i) the control over the risk, and (ii) the financial capacity to bear that risk.[118] Applying the financial capacity factor in a transfer pricing analysis accords with the arm's length principle because it simply involves reognizing the counterpart risk inherent in any transaction. This, however, is not the same as applying the factor in a substance analysis where it could cause an "all or nothing" result. The notion of control should be understood as the capacity to make decisions to take on the risk and decisions on

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[113] See above IV.3.2.1.
[114] J. Wittendorff, *Transfer Pricing and the Arm's Length Principle in International Tax Law* (2010), at 169.
[115] Para. 9.11 OECD Guidelines.
[116] *Id*. para. 9.12.
[117] *Id*. para.9.18.
[118] *Id*. para. 9.20.

whether and how to manage the risk, internally or using an external provider.[119] This would require the company to have employees who have the authority to effectively perform these control functions.

In this context, the OECD presents an example of a R&D contract arrangement.[120] According to the OECD, the principal under such an arrangement would be expected to make the following decisions in order to control the risk: (i) the decision to hire the contract researcher, (ii) the decision of the type of research, (iii) the budget allocated to the contract researcher, (iv) review reporting by the contract researcher and (v) assess the outcome of the research.[121] Where associated enterprises are able to satisfy these requirements, a R&D contract arrangement should be recognized under the new substance test of the OECD Guidelines. That said, in the opinion of the general reporter, an analysis of the substance of a risk allocation is outside the scope of Article 9(1) because the existence, form and content of "commercial or financial relations" should be determined under domestic tax law prior to the application of the arm's length principle.[122] Thus, as long as an arm's length price has been paid for a contractual assumption of risk that is recognized by domestic tax law, further consideration about which company in the group effectively controls the risk is irrelevant for the purposes of Article 9(1).[123] In essence, the OECD is attempting to impose the AOA developed in the context of Article 7(2) to associated enterprises in the context of Article 9(1).[124] The tax policy reason for this move is obvious, since a factual - rather than contractual - allocation of risk between associated enterprises would invalidate tax planning opportunities provided by the separate entity approach and the recognition of controlled transactions as actually structured.[125] Hence, applying the AOA for associated enterprises would prevent a contractual separation of risks and intangibles from functions.[126] The AOA has been adopted precisely to prevent such tax planning.[127] The OECD statements on substance over form examinations cannot normally be ascribed any value as a source of law for the interpretation and application of treaty articles corresponding to Article 9(1) because it does not reconcile with the ordinary meaning of the terms in Article 9(1) with its context and its object and purpose. This may also be the case for domestic transfer pricing rules based on the arm's length principle of Article 9(1).[128] Legal authority to disregard or recharacterize a controlled transaction must thus normally be found in general anti-avoidance rules of domestic tax law.

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[119] *Id*. para. 9.23.
[120] *Id*. para. 9.26.
[121] Note that the "old" para. 7.41 of the OECD Guidelines provide much more discretion to the R&D company.
[122] J. Wittendorff, *Transfer Pricing and the Arm's Length Principle in International Tax Law* (2010), at 151.
[123] The management of risk for an associated enterprise may, of course, in itself qualify as a commercial or financial relation according to Article 9(1), which would require the payment of an arm's length service fee.
[124] C. Dali-Ali and S. Langlois, 17 *Tax Management Transfer Pricing Report* (2008), at 543. This approach may have been inspired by para. 3 of the 2004 Dutch transfer pricing decree (IFZ 2004/680M). See D. Oosterhoff, "OECD Discussion Draft on Transfer Pricing Aspects of Business Restructurings", *International Transfer Pricing Journal* 16 (2009), at 190.
[125] R.J. Vann, "Reflections on Business Profits and the Arm's-Length Principle", in *The Taxation of Business Profits Under Tax Treaties*, ed. B.J. Arnold, J. Sasseville and E.M. Zolt (2003), 133, 153 et seq.
[126] *Id*. at 143.
[127] Para. 18 2010 Report on the Attribution of Profits to Permanent Establishments (Part I) (Paris: OECD, 2010).
[128] The Norwegian transfer pricing provision in section 13-1 of the Tax Act also authorizes a recharacterization of controlled transactions. See Rt 1940/598 (*Fornebo*).

4.2.2 Transfer pricing

If a R&D contract arrangement is recognized for tax purposes, an appropriate transfer price must be determined. The OECD Guidelines suggest that the transfer price may be determined on the basis of the cost plus method if the research company is insulated from financial risk under the contractual arrangement.[129] This has also been the traditional position under the U.S. tax law. However, in 2005 the IRS adopted a new approach under which an experienced research team may qualify as an (non-routine) intangible.[130] This may cause the profit split method to be considered the best method whereby a significant portion of the profits from the exploitation of intangibles may be attributed to the research company.

The new U.S. position was developed in relation to buy-in transactions under cost sharing arrangements where in-process R&D is made available by U.S. parent companies. In such a situation, the R&D team which has undertaken the intangible development prior to the buy-in transaction, and which may successfully have developed earlier versions of the same technology, will normally be particular suited to complete the ongoing development. Such arrangements normally involve that the U.S. parent company performs the R&D and that the low-taxed subsidiary makes capital contributions to the arrangement. A 2007 technical advice memorandum also stated that an experienced research team may qualify as an intangible because it has substantial value, independently of the services of any individual member of the team, attributable to the team's collective contracts and know-how, as no one individual or group of individuals may be able to bargain compensation sufficient to eliminate a premium. However, in *Veritas Software Corp. v. Commissioner* the Tax Court ruled in favour of the taxpayer that a R&D and marketing team of a U.S. parent company did not constitute an intangible under the 1995 cost sharing regulations because this item was not enumerated in the regulations and did not have substantial value independently of the services of any individual.[131] The new, broad definition of an intangible was incorporated into the cost sharing regulations in 2008.[132] In order to provide clarity about the proper transfer pricing definition of intangibles outside of the cost sharing regulations, the U.S. administration has proposed that the definition generally should be expanded to include workforce in place.[133] The new U.S. approach differs significantly from the traditional OECD approach although it is, in principle, merely a factual issue.

5. CFC taxation

5.1 General

The use of CFC taxation to address the difficulties of applying the arm's length principle has recently been considered by various countries. In 2007, the Danish tax authorities proposed that the definition of CFC

[129] Para. 7.41 OECD Guidelines.
[130] See, e.g., Preamble, Explanation of Provisions, § 1.482-7(b), in REG-144615-02 (IRB 2005-40).
[131] *Veritas Software Corp. v. Commissioner*, 133 TC 14 (2009).
[132] Preamble, Explanation of Provisions, § 1.482-7T(g), in TD 9441 (IRB 2009-7).
[133] General Explanations of the Administration's FY 2012 Revenue Proposals (Washington D.C.: Department of the Treasury, February 2011), at 45. See also Description of Revenue Provisions Contained in the President's Fiscal Year 2010 Budget Proposal Part Three: Provisions Related to The Taxation of Cross-Border Income and Investment (Washington D.C.: Joint Committee on Taxation, JSC-4-09, September 2009), at 40.

income be expanded to include revenue from the sale of goods manufactured on the basis of patents.[134] The aim of this proposal was to target low-taxed subsidiaries where intangible profits are embedded in trading income rather than royalty streams. The proposal was not enacted. In 2010, the U.K. tax authorities published a proposal for a new CFC regime.[135] The new rules would target the artificial diversion of U.K. profit rather than taxing profits that are genuinely earned in foreign subsidiaries. Under a revised proposal, profits of intangibles held by foreign entities would be subject to CFC taxation in any of the following situations: (i) intangibles have been transferred from the United Kingdom, (ii) intangibles are effectively managed in the United Kingdom and (iii) intangibles has been equity financed in the United Kingdom.[136] CFC taxation would only occur if "excessive profits" have arisen in the foreign entity. The U.S. administration has also proposed to address migration of intangibles to low-tax jurisdictions by expanding the definition of subpart F income to include "excess returns" from the transfer of intangibles by a U.S. person to a related low-taxed CFC.[137]

The use of CFC rules to address the transfer pricing issues of intangibles means that the residence state of the parent company will have to share the intangible profits with the residence state of the CFC, as a foreign tax credit is normally granted for income taxes paid by a CFC. Hence, the measure will normally not be as efficient as establishing an appropriate transfer price with regard to the transfer of intangibles to a CFC. On the other hand, CFC rules may capture profits of intangibles developed or acquired from third-parties by the CFC which would not be taxable under transfer pricing rules.

In an EU and EEA law context, *Cadbury Schweppes* indicates that traditional CFC regimes can be justified under the fundamental freedoms only if they are confined to wholly artificial arrangements intended to escape the national tax normally payable.[138] This test is not met if a CFC is actually established in its home country and carries on genuine economic activities there. On this basis, traditional CFC regimes will normally not be effective within the EU/EEA where the CFC is conducting an active trade in its home country. With regard to tax treaties, the OECD is of the view that CFC rules normally do not infringe on tax treaties.[139] However, the outcome of court cases addressing the issue has not been consistent.[140]

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[134] Proposed Sec. 32(5)(7) Danish Corporate Tax Act, set out in Sec. 1(24) of Draft 1 of 1 February 2007 (Journal 2007-411-0081). However, the proposal was not incorporated into the final bill L 213 of 18 April 2007 and the enacted Law 540 of 6 June 2007.

[135] Proposals for controlled foreign companies (CFC) reform: discussion document (London: HM Revenue & Customs, January 2010), Chapter 4.

[136] Corporate Tax Reform: delivering a more competitive system (London: HM Revenue and Customs, November 2010), at 33.

[137] General Explanations of the Administration's FY 2012 Revenue Proposals (Washington D.C.: Department of the Treasury, February 2011), at 45. See also Description of Revenue Provisions Contained in the President's Fiscal Year 2010 Budget Proposal Part Three: Provisions Related to the Taxation of Cross-Border Income and Investment (Washington D.C.: Joint Committee on Taxation, JSC-4-09, September 2009).

[138] Para. 75 of Case C-196/04 (*Cadbury Schweppes*).

[139] Para. 23 Commentary on Article 1, para. 13 Commentary on Article 7, and paras 37-39 Commentary on Article 10 OECD Model.

[140] The French Supreme Administrative Court decided that the French CFC rules infringed on the French tax treaty with Switzerland in *Société Schneider Electric,* Appeal 232 276, 28 June 2002. The opposite conclusion was reached by the

5.2 Nordic countries

The CFC rules of the Nordic countries are summarized in table 15.

Table 15: CFC rules

I. **Requirements**	**Finland**	**Norway**	**Sweden**	**Denmark**	**Iceland**
Control	Yes, ≥ 25%	Yes, ≥ 50%	Yes, ≥ 25%	Yes, > 50%	Yes, > 50%
Low-taxed	Yes, < 15.6%[1]	Yes, < 18.6%	Yes, < 14.5%	No	Yes, < 14.5%
Non-resident	Yes	Yes	Yes	No	Yes
CFC income	No	No	No	Yes, > 50%	No
Financial assets	No	No	No	Yes, > 10%	No
II. **Relevant Exceptions**					
CFC resident in EEA and meets *Cadbury Schweppes* test	Yes	Yes	Yes	No	Yes
CFC meets active business activity test	Yes	Yes (tax treaty country)	Yes[2]	No	Yes (tax treaty country)

[1] The threshold would be 13.2% if the proposal to lower the corporate tax rate from 26% to 22% is enacted.

[2] Income is not considered to be subject to low taxation, if the foreign entity is a tax resident, and liable to income tax, in a country listed in a "white list", provided that the income in question has not been expressly excluded.

All of the Nordic countries apply CFC taxation. Where the CFC rules are applicable, all of the income of the CFC is subject to taxation. For example, it is irrelevant whether the business activity is based on intangibles acquired from a related-party. The Danish CFC rules do not apply if certain categories of financial income represent less than 50 % of total income. Qualifying financial income includes royalty payments and capital gains from the sale of intangibles. However, royalties from third-parties are excluded provided that the intangibles have been developed by the CFC. The Danish rules mean that intangible profits embedded in revenues from the sale of goods and services do not qualify as financial income. CFC taxation may thus be avoided by structuring controlled transactions of a CFC as sale of goods and services rather than licensing. Companies of the other Nordic countries may achieve the same result under the exceptions provided by the *Cadbury Schweppes* test[141] or an active business test. Accordingly, parent companies of the Nordic countries may often steer clear of CFC taxation regarding subsidiaries in low-tax jurisdictions where genuine business activities are undertaken.

Japanese Supreme Court on 29 October 2009, case No 2008 (*Gyou Hi*), 91, the Finnish Supreme Administrative Court in *A Oyj Abp*, KHO: 2002:26, 20 March 2002 (decision was annulled on 11 April 2011 because it was in contradiction with Cadbury Schweppes, see KHO:2011:38); the U.K. Court of Appeal in *Bricom Holdings, Ltd. v. IRC* [1997] STC 1179 (CA); the Swedish Supreme Administrative Court in the *OMX* case (RÅ 2008, not. 61); and the Danish National Tax Tribunal in TfS 2004, 862 LSR.

[141] Case C-196/04 (*Cadbury Schweppes*). Denmark has attempted to avoid the *Cadbury Schweppes* test by expanding the CFC regime to apply also to controlled Danish companies. Whether this clears away any EU issues is questionable. See N. Winther-Sørensen, *Skatteretten 3* (2009), at 516.

6. Withholding taxes

Imposing withholding taxes on royalties may prevent the transfer of intangibles to low-tax jurisdictions. However, this measure is probably not very efficient because intangibles nowadays are normally owned by companies resident in tax treaty countries and tax treaty provision corresponding to Article 12(1) of the OECD Model provides for exclusive residence state taxation. Moreover, controlled transactions are often structured as buy/sell rather than licensing arrangements. Table 16 summarizes the rules on source state taxation of royalties in the Nordic countries.

Table 16: Source state taxation of royalties

	Finland	**Norway**	**Sweden**	**Denmark**	**Iceland**
Tax rate	28%	N/A	26.3%[1]	25%	20%
Net or gross income basis	Gross[2]	N/A	Net[1]	Gross[2]	Gross

[1] If a lower tax treaty rate is applicable, taxation is made on a gross income basis.

[2] If the relevant intangible is allocated to a domestic PE, taxation is made on a net income basis by assessment.

All of the Nordic countries, except Norway, subject royalties derived by non-resident companies to source state taxation. The rules do not differentiate between royalty payments made to related and unrelated parties, the country of residence of the licensor etc. However, the rates are usually reduced under tax treaty provisions or the Interest and Royalty Directive (2003/49/EC). Taxation is made in the form of withholding taxes calculated on a gross income basis in Finland, Denmark and Iceland.[142] In contrast, the main rule in Sweden is taxation by assessment on a net income basis.

[142] The EU and EEA compatibility of gross basis taxation of non-residents is questionable but will not be analyzed further.

Part VI Conclusion

This general report has examined the taxation of the development and exploitation of intangibles in the Nordic countries. The tax systems should, taken together with other direct and indirect support measures, encourage innovation and R&D investments, prevent an erosion of the national tax base, and be compatible with international obligations.

Intangible development is subject to an unequal tax treatment in the Nordic countries. Denmark, Finland and Iceland generally allow expensing of R&D costs whereas Sweden and Norway requires R&D costs incurred in later development stages to be capitalized. Moreover, Sweden and Finland do not offer any specific R&D tax incentives.[143] By contrast, Denmark, Norway and Iceland have adopted tax measures aimed at promoting R&D. Norway and Iceland grant refundable R&D tax credits which are particularly valuable to start-up firms and SMEs with no current profits. On the other hand, Denmark is primarily subsidizing mature firms by allowing an immediate deduction of intangible development costs. A Danish governmental body has recently proposed to replace existing tax incentives with R&D tax credit in order to shift the support from mature firms to start-up firms.[144] Hence, the general trend is to support SMEs rather than mature firms. The Nordic countries generally do not differentiate between the development, licensing or purchase of intangibles. Various measures may be employed in order to determine whether a need for R&D tax incentives exists. The EU 3% target is easy to apply but suffers from a number of shortcomings. There is thus no economic rationale underpinning the 3% target and it does not account for structural differences between the economies of the Member States. Another option is to design R&D tax incentives with the aim of matching the impact of spillover effects in each individual country, sector, etc., i.e. to cause the optimal level of investments for private firms and society to converge. For example, it has been estimated that spillover effect in Denmark amounts to 4% of R&D investments,[145] and that R&D tax incentives amounts to 6% of investments.[146]

Intangible exploitation is not subsidized by the tax laws of the Nordic countries. Domestic exploitation thus entails taxation at the statutory tax rate. International exploitation also triggers residence state taxation if intangible profits appear in the form of royalties or business profits of a foreign PE (and potentially source state taxation). By contrast, where intangible profits are derived by a non-resident subsidiary or a foreign PE located in an exemption country, only source state taxation arises. Dividends from a non-resident subsidiary are thus normally tax exempt and CFC taxation may often be avoided. Intangible exploitation through a PE

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[143] The Finnish government has announced that it intends to introduce R&D tax incentives. See Press release 376/2010 of 21 December 2010. However, due to the recent change of government the destiny of the plan to introduce a R&D tax incentive is uncertain for the time being. See Committee Directive 2011:1 of 13 January 2011. The Swedish government has set up a committee to review the business taxation. Among other things, the committee must recommend whether Sweden should adopt R&D tax incentives.

[144] Ny vækst i Danmark – Hovedkonklusioner fra Vækstforum (Copenhagen: The Prime Minister's Office, March 2011), at 17 and 19.

[145] Økonomi og Miljø 2011 (Copenhagen: The Economic Councils, 2011), at 178.

[146] K. Lange, Dansk økonomisk nationalrapport (Copenhagen: Nordic Tax Research Council, 2011), at 16.

gives rise to significant tax uncertainties. Taken together, this creates an incentive for Nordic MNEs to exploit intangibles through low-taxed subsidiaries.

Migration of intangibles to low-tax jurisdictions may cause an erosion of the national tax bases. Some Nordic MNEs have set up subsidiaries in low-tax jurisdictions in order to exploit intangibles but the actual scope of this issue is uncertain. It is also uncertain to what extent intangibles owned by low-taxed subsidiaries of Nordic MNEs originate from related-party transactions. The policymakers must strike a proper balance between base erosion concerns and the need to provide businesses with competitive tax regimes. Hence, to harsh anti-avoidance measures will hamper the competitiveness and may ultimately leave some MNEs with no other choice than to migrate in order not to be outperformed and eventually taken over by foreign competitors.[147] The Nordic corporate tax regimes are generally quite competitive as they offer reasonable low tax rates and are of a territorial nature (participation exemption). If a trend emerges for Nordic MNEs to locate intangibles abroad for tax reasons, anti-avoidance rules may be tightened or it may be considered to introduce patent box regimes to supplement anti-avoidance rules.

Transfer pricing and exit taxation rules must be able to stem migration of intangibles from the Nordic region to low-tax jurisdictions. The tax authorities are authorized to make transfer pricing adjustments under the arm's length principle. However, no guidelines are provided specifically addressing transfer pricing of intangibles. Rather than developing domestic guidelines it would be appropriate to support the ongoing OECD work in this field in order to ensure an international consensus. The documentation rules applied by the Nordic countries are not designed to deal with the transfer of intangibles. It would thus be warranted to supplement existing rules with special rules on intangibles. Whether the burden of proof rules are reasonable is a complex and highly country-specific question. For example, there are no indications that Danish law makes it unreasonable difficult for the tax authorities to succeed in transfer pricing cases. Hence, the documentation requirements and the authority to make tax assessment on an estimated basis in case of noncompliance with those requirements, in essence imply a reversal of the onus.[148]

The Nordic countries are not relying on substantive rules which depart from the arm's length principle such as realistic alternatives, CWI standards or the AOA. In the opinion of the general reporter, the Nordic countries should refrain from adopting such rules, among other things, because they infringe on tax treaty obligations, have not proven efficient and add further uncertainty to cross-border transactions. Furthermore, it is questionable whether it is necessary with such measures. Thus, the current need seems to be for the creation of internationally agreed arm's length rules by the OECD which may be supplemented by formal and procedural rules under domestic law to address the informational asymmetry.

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[147] Similar point of view regarding U.S. international taxation by B. Wells, "What Corporate Inversions Teach About International Tax Reform", 59 *Tax Notes International* 4 (26 July, 2010), at 281.

[148] J. Wittendorff, "Omvendt bevisbyrde i transfer pricing-sager?", *Ugeskrift for Skatteret* (2009), at 1117.

The recent proposal of the Commission on a common consolidated corporate tax base (CCCTB) would replace the arm's length principle with formulary apportionment (FA).[149] The purpose CCCTB is to reduce compliance costs of MNEs rather than to prevent income shifting which is the traditional argument in favour of FA. The reverse of the coin is that Member States will be required to operate a dual corporate tax system. Whether the Nordic Member States should support this approach would, among other things, depend on its impact on tax revenues. In this respect it is pivotal that CCCTB would be a voluntary scheme. All else being equal, it is reasonable to expect that an MNE would elect for CCCTB treatment if this reduces its EU-wide tax burden and vice versa. If the use of CCCTB actually turns out to follow this path the scheme may benefit low-tax Member States at the expense of high-tax Member States. In addition, the formula for the allocation of the tax base may generally cause an income shifting from entities characterized by intangible property to entities characterized by tangible property and high revenues. This could also be detrimental to the Nordic countries. In line with this, the Commission has estimated that the three Nordic Member States will lose a significant part of their current corporate tax bases under the CCCTB.[150] MNEs would be required to apply the arm's length principle with respect to third-country controlled transactions. An MNE may thus be faced with the situation that its EU-based entities simultaneously are subject to both the arm's length principle and FA. Hence, the attractiveness of CCCTB to business and the Nordic Member States is questionable.

The Nordic countries impose exit taxation if companies migrate or taxable assets otherwise are transferred out of the reach of their tax jurisdictions. It is likely that the rules on exit taxation will be held to infringe on the freedom of establishment of EU and EEA law because a deferral of the payment of exit taxes is not granted to companies (save for Sweden). Should the ECJ decide that such a deferral must be provided, the tax bases of the Nordic countries will come under further pressure with regard to EU/EEA transactions. This could cause the approach of a harmonization of the company tax rates, or at least minimum company taxation, within the EU (and EEA) to gain renewed support.[151]

CFC and dividend taxation may stem the migration of intangibles to low-tax jurisdictions. Nordic MNEs are often able to avoid CFC taxation if genuine business activities are carried out by a CFC. If migration of intangibles turns out to be a significant issue, and transfer pricing and exit taxation rules prove inefficient, a reform of the CFC taxation regimes may be warranted. However, such rules may have limited effect within EU/EEA due to *Cadbury Schweppes*. Alternatively, the dividend taxation could be amended to rely on foreign tax credit rather than exemption in general or in specific situations (switch-over clause).[152] Hence, the case law of the ECJ suggests that switch–over clauses may be in conformity with EU law.[153]

[149] The other pending EU proposal of Home State Taxation (HST) would also involve a shift from the arm's length principle to formulary apportionment.
[150] SEC(2011) 315 final, at 30.
[151] Harmonization of company tax rates is no longer a goal of the Commission. See SEC(2001) 1681 of 23 October 2001.
[152] Case C-298/05 (*Columbus Container*).
[153] On the inconsistency between the ECJ case law on CFC and dividend taxation see B.J.M. Terra and P.J. Wattel, *European Tax Law* (2008), at 823 et seq.