The Danish Supreme Court's ruling in the Maersk and Total case

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On September 6, 2023, the Danish Supreme Court rendered a pivotal verdict in a legal dispute between the Danish Ministry of Taxation and Total-Energies EP Denmark A/S, formerly known as Maersk Oil and Gas A/S ("MOGAS"), and A.P. Moller - Maersk A/S ("APMM"). In doing so, the Supreme Court overturned the High Court's verdict, which had ruled in favour of the taxpayers.

The case involves the Danish tax authorities' ("DTA") discretionary adjustment of MOGAS's taxable income for the years 2006-2008 and a subsequent adjustment to the parent company APMM's consolidated income for the same period. These adjustments are a consequence of a transfer pricing adjustment concerning MOGAS' intercompany transactions with two of its subsidiaries. The case revolves around the question of whether MOGAS' preliminary surveys, aimed at discovering new oil fields, the performance guarantees extended to the newly established subsidiaries, and the alleged associated know-how, as asserted by the DTA, held economic value for the subsidiaries, commensurate with what an independent entity would have required in terms of ongoing compensation, such as profit-sharing, royalties, or comparable arrangements. Additionally, the case delves into the issue of whether the technical and administrative support (time-writing) could be invoiced at cost.

Background

Until 2018, MOGAS' business covered several different activities. MOGAS acted as an operator on behalf of APMM in the Danish Underground Consortium ("DUC"). Additionally, MOGAS conducted preliminary surveys in various parts of the world with the aim of discovering new oil fields.

In the first phase, preliminary surveys and location assessments were conducted before applying for licenses. This phase's work was executed by MOGAS from its headquarters in Copenhagen, Denmark. In the first phase, external data was collected, analysed, and processed by experts at MOGAS. Subsequently, in the second phase, the possibility of acquiring licenses was explored in the event the first phase analyses showed sufficient potential. Phase two primarily involved the economic and legal aspects in the form of due diligence, which was also managed by MOGAS.

In this industry, licenses are typically obtained through competitive bidding processes and are often acquired in collaboration with other (independent) entities in joint ventures. If a license is obtained, the group establish a local business entity (in the form of a subsidiary or branch) that holds the rights and incur all the expenses related to future exploration and extraction activities. MOGAS also handled the negotiation of the license and its terms, serving as a guarantor in this regard. Ultimately, it was MOGAS that guaranteed and was responsible for ensuring that the obligations under the license, towards the oil-producing country and the contract with the independent joint venture participants, were fulfilled by the local MOGAS subsidiary or branch.
Any further oil exploration and initiation of oil production was thus conducted in subsidiaries/branches established following these surveys, including in Algeria and Qatar. Furthermore, MOGAS provided various technical and administrative support (time writing) to companies within the group, including APMM and its subsidiaries.

In Algeria, MOGAS' oil activities began in 1990 following preliminary surveys. In connection with MOGAS' subsidiary, Maersk Oil Algeria A/S, acquiring a share of the rights and obligations under a licensing agreement with the Algerian state company Sonatrach, MOGAS provided a performance guarantee to Sonatrach. The guarantee stated, among other things, that MOGAS "*will support Maersk Oil Algeria A/S the full technical and financial capacities needed by Maersk Oil Algeria A/S in order to commit and comply with its share of obligations under the Sonatrach Agreement*." Maersk Oil Algeria A/S consisted of a branch in Algeria with no employees and did not undertake operator responsibilities in connection with the oil project.

In Qatar, MOGAS' oil activities began in 1992 after the preliminary surveys with the establishment of a local branch of MOGAS' subsidiary, Maersk Oil Qatar A/S, and the signing of an agreement between the subsidiary and the state of Qatar for oil extraction ("EPSA"). MOGAS provided a performance guarantee to Qatar, wherein the guarantee stated that MOGAS would ensure 'the due and timely performance of all the obligations of the subsidiary under and arising out of the EPSA' and would 'provide the Subsidiary with all technology and specialist personnel necessary for the Subsidiary to fulfil its obligations under the EPSA.' The subsidiary's branch in Qatar served as the operator for the oil project.

MOGAS did not receive remuneration from its subsidiaries for the preliminary surveys or performance guarantees. Additionally, in situations where a license was subsequently acquired and a subsidiary or branch was established for further exploration, no subsequent invoicing took place.

During the tax audit, the taxpayer took the position regarding the preliminary surveys, that the expenses were not considered to be related to the work in existing group companies and therefore could not be allocated to them. MOGAS firmly asserted that these expenses were incurred as a natural part of MOGAS' own business activities as the parent company in an international oil business, with the purpose of securing earnings from potential oil and gas reserves worldwide. Furthermore, the taxpayer asserted that preliminary surveys did not constitute an intangible asset in the form of know-how, which is made available to the subsidiaries and for which MOGAS should be remunerated for. Conversely, these preliminary surveys served as essential analyses used in MOGAS's deliberations regarding potential investments. MOGAS considered itself an investment company. In an investment company, the expense side naturally comprises costs associated with researching future investment opportunities, while the income side consists of dividends. It's essentially the core "operation" of an investment company. Therefore, the taxpayer's view remained that no transactions took place from a transfer pricing perspective.

Additionally, the taxpayer asserted that the performance guarantees did not have economic value, as the company had never incurred costs for parent company declarations to its subsidiaries. The taxpayer claimed that it was not a question of performance guarantees for the benefit of the subsidiaries, but rather a declaration by the parent company to the relevant oil state to ensure that the licensed subsidiary would be able to fulfil the obligations according to the agreement entered into. It was not a guarantee in favour of the subsidiary but in MOGAS' interest.

Consequently, the expenses associated with the preliminary surveys and the performance guarantees were not included and analysed in MOGAS group's transfer pricing documentation.

MOGAS emphasized that during the relevant income years, the sole services extended by MOGAS to its subsidiaries and their branches were technical and administrative support (time writing). MOGAS received compensation from its subsidiaries, equivalent to the actual cost incurred for offering time writing services. The taxpayer contended that this practice aligned with established industry norms, thus asserting that these services were indeed provided at arm's length. According to the taxpayer, this was therefore considered a CUP, as it follows the same billing method when sharing a license with others.

The Danish tax authorities' decision

Firstly, the Danish tax authorities (DTA) stated that the preliminary surveys in 1990 and 1992, the performance guarantees, and the associated know-how had an economic value for the subsidiaries, which an independent party would have demanded ongoing compensation for in the form of profit-share, royalty, or similar.

Secondly, the DTA disregarded the taxpayer's transfer pricing documentation for the years 2006-2008, citing the absence of timely transfer pricing documentation for any potential profit in MOGAS that corresponded to the taxpayer's contribution to value creation in the MOGAS group and throughout the entire APMM group or for the group's internal guarantees.

Thirdly, the DTA stated that the taxpayer had, over a long period of time, experienced chronic and increasing losses, while the group as a whole had realized quite substantial profits during the same period. According to the DTA, this created a strong presumption of income distortion within the group and a lack of taxable income in the Danish parent company. The tax loss did not arise from any issues with either the business setup or the transfer pricing arrangement at MOGAS.

In contrast, the taxpayer stated that the losses solely resulted from the fact that the taxpayer handled the incurred expenses in accordance with the specific rule in Section 8B, paragraph 2, of the Danish Tax Assessment Act, which permits deductions for expenses related to the exploration for natural resources associated with the taxpayer's trade or industry. Otherwise, MOGAS would not have had a tax deficit. Thus, when the DTA highlighted that MOGAS had a tax deficit while the foreign branches of its subsidiaries had profits solely taxed abroad, MOGAS asserted that it was solely due to the changed Danish tax legislation at that time, and not because MOGAS had adjusted itself or its transactions in relation to this.

Despite MOGAS' objections, the DTA increased MOGAS' taxable income for the fiscal years 2006-2008 through discretionary assessments.

In its decision, the DTA emphasized that the local units were initially mere legal entities, lacking any substantive business activity, and that the entire business foundation and income generation were based on and enabled by contributions from MOGAS. The DTA stated that the results of the preliminary surveys would influence whether a collaborator wished to enter and under what conditions, i.e., become an integral part of the agreement. Already on this basis, the DTA stated that the preliminary surveys had an economic value that an independent party would pay for. Furthermore, the DTA emphasized that MOGAS continued to play a role in income generation for the local units through guarantees and expertise in the subsequent process.

Subsequently, MOGAS and APMM brought the increases in taxable income before the Danish National Tax Tribunal.

The Danish National Tax Tribunal's decision

The majority of the Danish National Tax Tribunal (""DNTT") found that the branches in Algeria and Qatar had utilized intangible assets that could be considered owned by MOGAS, and these intangible assets could be characterized as know-how and rights related to oil extraction in the form of licenses. The majority of the DNTT also found that independent parties would have paid a fee for the use of these types of intangible assets, such as royalties or similar compensation. In making this determination, the majority of the DNTT considered that MOGAS had incurred expenses for preliminary surveys which formed the basis for obtaining licenses, and that MOGAS made the extraction rights available to the branches. Consequently, the DNTT found that MOGAS was the owner of the know-how used to determine the existence of oil and gas for extraction. MOGAS had, according to the DNTT, also negotiated and entered into license agreements in the respective countries, making the rights to actual extraction assets owned by MOGAS and made available to the branches. Additionally, the majority of the DNTT considered that MOGAS provided performance guarantees for the subsidiaries' obligations.

On this basis, the majority of the DNTT members found that the decision of DTA should be upheld.

Subsequently, MOGAS and APMM brought the increases in taxable income before the courts.

The High Court ruling

The negative pre-tax and pre-financial results during the period from 1986 to 2010

The High Court determined that MOGAS' pre-tax and pre-financial result during the period from 1986 to 2010 had generally been negative, including in the specific income years 2006 to 2008. However, MOGAS' result, including financial items like dividends, had been positive during the same period. The High Court concurred that income from dividends could not be considered a business income in the sense that the dividends received by MOGAS as an owner did not constitute payment for transactions covered by Section 2 of the Danish Tax Assessment Act.

Nevertheless, the High Court found that the fact that MOGAS' pre-tax and pre-financial result had predominantly been negative during the period from 1986 to 2010 could not justify the tax authorities' ability to make a discretionary assessment.

The preliminary surveys

Based on the evidence presented, the High Court establishes that the subsidiaries are both the formal and actual owners of the licenses for oil extraction in Algeria and Qatar. The High Court placed importance on the provided legal agreements and the companies' financial statements. Therefore, it is also undisputed before the High Court that MOGAS is not the licensee. Consequently, it cannot be assumed that there was a transaction covered by Section 2 of the Danish Tax Assessment Act between MOGAS and the subsidiaries during the income years 2006-2008, in the sense that the licenses for oil extraction were made available to the subsidiaries by MOGAS.

The performance guarantees

Conversely, the High Court found that the performance guarantees provided by MOGAS must be considered controlled transactions covered by Section 2 of the Danish Tax Assessment Act, for which an annual fee would have been paid between independent parties. The High Court emphasizes that the guarantees must be provided in the interest of the guarantor (the subsidiary) and for its benefit. Moreover, the guarantees, by their content, are unlimited parent company guarantees, constituting more than just a capitalization commitment.

The transfer pricing documentation and the discretionary assessment

The High Court found that MOGAS' transfer pricing documentation regarding technical and administrative support (time writing) for the income years 2006-2008 was not insufficient to such a significant extent that it could be equated with lacking documentation. The High Court placed importance on the fact that the disagreement or reasonable doubt raised by tax authorities concerning the comparability analysis related to MOGAS' provision of technical and administrative support did not, by itself, imply that the documentation was significantly lacking. Further, the High Court found that the Ministry of Taxation did not provide specific evidence regarding the significance of any potential deficiencies or inadequacies in functional analyses for the specific assessment of whether the arm's length principle had been adhered to.

MOGAS' transfer pricing documentation concerning technical and administrative assistance (time writing) did not, therefore, provide a basis for assessing MOGAS' income on a discretionary basis.
As mentioned above, the High Court found that the performance guarantees provided by MOGAS and the technical and administrative assistance (time writing) rendered by MOGAS constituted controlled transactions within the scope of Section 2 of the Danish Tax Assessment Act.

The performance guarantees, which were provided free of charge to the subsidiaries, are not addressed in the transfer pricing documentation, and the High Court found that this provides a basis for MOGAS' income related to the performance guarantees to be assessed on a discretionary basis.

The High Court concluded that simply because MOGAS neither participated in a joint venture nor acted as an operator in relation to oil extraction in Algeria and Qatar, the High Court found that MOGAS' provision of technical and administrative assistance to its subsidiaries was not comparable to the reported industry practice or MOGAS' provision of services to DUC, where MOGAS served as an operator. Based on this, the High Court found that the Ministry of Taxation had demonstrated that MOGAS' provision of technical and administrative assistance (time writing) to its subsidiaries at cost price fell outside the scope of what could have been achieved if the agreement had been made between independent parties, as per Section 2, paragraph 1 of the Tax Assessment Act.

In conclusion, the High Court found that there was a basis for making a discretionary assessment of MOGAS' taxable income for the income years 2006-2008 regarding the performance guaranties and time writing.

However, the High Court concluded that the tax authorities' assessment was based on incorrect premises and was evidently unreasonable. As a result, the case was remanded for further consideration by DTA.

The Danish Supreme Court ruling

The preliminary surveys and performance guarantees

The Supreme Court established that, prior to the establishment of subsidiaries and the acquisition of licenses in Algeria and Qatar, MOGAS conducted necessary preliminary surveys to assess whether oil exploration and potential oil or gas extraction should be established. Furthermore, the Supreme Court found that MOGAS played a significant role in contract negotiations in these countries, as it can be assumed that the subsidiaries were only able to enter into contracts because MOGAS guaranteed all of the subsidiaries' obligations and made its technical and financial capacity available. The Supreme Court also found that MOGAS possessed specific knowledge and expertise (know-how), particularly regarding horizontal drilling, which MOGAS continuously provided to the subsidiaries. The Supreme Court stated that the preliminary surveys, performance guarantees, and the associated know-how had an economic value for the subsidiaries, which an independent party would demand compensation for, such as profit share, royalties, or similar payments. In light of this, the Supreme Court concluded that the preliminary surveys and performance guarantees constituted controlled transactions, and, therefore, the tax authorities were justified in assessing the income related to these transactions on a discretionary basis. Furthermore, the Supreme Court stated that MOGAS' provision of time writing at cost price fell outside the scope of what could have been achieved if the agreement had been made between independent parties.

Time writing

The Supreme Court, for the reasons stated by the High Court, concurred that MOGAS' income related to the technical and administrative assistance (time writing) could not be estimated on a discretionary basis under the former tax control law Section 3 B, paragraph 8, cf. Section 5, paragraph 3, due to the lack of transfer pricing documentation.

Furthermore, based on the reasons provided by the High Court, the Supreme Court also agreed that the Ministry of Taxation had demonstrated that MOGAS' provision of time writing to its subsidiaries at cost price fell outside the boundaries of what could have been achieved if the agreement had been made between independent parties, in accordance with Section 2, paragraph 1, of the Tax Assessment Act. Since MOGAS had not received payment for time writing on arm's length terms, the Supreme Court affirmed that the tax authorities had correctly assessed the taxable income on a discretionary basis concerning this service.

The discretionary assessment

The Supreme Court found that the transactions in question were so closely connected that they had to be assessed collectively. Since MOGAS had not demonstrated a basis for setting aside the estimate of the income adjustment, DTA's increase in income was upheld.

KPMG observation

The Supreme Court's ruling in the MOGAS case represents the third consecutive victory for tax authorities in this judicial context, underscoring the significance of this case. This landmark decision greatly bolsters the authority and position of the tax authorities. Moreover, tax authorities have recently demonstrated a notable track record of success in cases brought before the High Courts. These developments undoubtedly reinforce their confidence in pursuing additional transfer pricing cases and, when deemed necessary, elevating them to the Supreme Court.
It is important to highlight that this ruling by the Supreme Court grants tax authorities an expanded scope to exercise their discretion in assessing the taxable income of companies, surpassing previous boundaries.

In instances where tax authorities successfully introduce ambiguity regarding profit allocation within a corporate group under arm's length principles, this ruling, along with recent judgments, indicates a shift from the precedents set by the Microsoft and Adecco cases. Previously, these rulings had established that the mere presence of tax authorities' beliefs regarding controlled transactions or disagreements with transfer pricing documentation did not automatically render the documentation inadequate, especially when the documentation clearly demonstrated that the transactions in question were not part of intra-group pricing.

Crucially, this ruling suggests that if tax authorities can substantiate the existence of a transaction (even if disputed by the group) and the group cannot provide documentation supporting a specific industry practice or similar rationale for the employed transfer pricing setup, there is a significantly heightened risk of granting tax authorities the authority to assess income on a discretionary basis.

Content requirements for transfer pricing documentation cannot rely solely on a checklist of formal prerequisites. On the contrary, it necessitates a broader perspective and a more profound understanding of the tax authorities' methodology to mitigate associated risks. These risks encompass potential tax audits concerning income allocation, the possibility of income assessments by the Danish Tax Agency, the risk of double taxation, potential adverse rulings by Danish courts against the corporate group, and ultimately, the imposition of fines.

This new practice undeniably increases the likelihood of tax authorities imposing fines on corporate groups for each income year where they determine that documentation requirements have not been met. The typical fine amount is 250,000 DKK (33,531 EUR), although this may be reduced by half if the previously absent documentation is subsequently prepared to meet the required standards. Furthermore, the fine can increase by 10 percent of the income adjustment if the arm's length principle is not adhered to, thereby leading to an income increase. Fines, however, require either intent or gross negligence. Distinguishing between gross and simple negligence can be quite challenging. It will always entail a specific assessment, although legal precedents suggest that the failure to submit proper TP documentation within the deadline will generally be considered as gross negligence. The assessment of whether the documentation suffers from such significant deficiencies that fines may be imposed can, as a starting point, likely be based on the same test applied to determine whether there is a basis for discretionary assessments due to inadequate TP documentation. Therefore, the practice in this regard is also relevant to the provision concerning fines.

Additionally, it is worth noting that the Supreme Court, in the MOGAS case, permits a "lump-sum assessment" of the value associated with preliminary surveys, performance guarantees, related know-how, and technical and administrative assistance (time writing). This stands in contrast to Danish legislation, which typically aligns with OECD recommendations advocating a transaction-based analysis as the preferred approach.

Contact us

For more information, contact a KPMG tax professional in Denmark:

Rune Meldgaard Christensen | rune.christensen@kpmg.com

Johnny Bøgebjerg | johnny.bogebjerg@kpmg.com

Henrik Lund | henrik.lund@kpmg.com

Simon Schaadt | simon.schaadt@kpmg.com