

Danish Taxes on Royalties

International double taxation may result; licensor may act to alleviate problem

BY PER BORUM*

The royalties a Danish business receives from abroad are taxable in Denmark in the same way as royalties from Danish sources. Such income will, however, often be taxed abroad too, e.g. because the foreign country levies tax-at-the-source on royalties paid to another country. In Denmark we do not levy such tax-at-the-source on non-residents who receive royalties from Denmark, but many other countries do.

It is, therefore, very important for Danish enterprises about to enter into license agreements with foreigners to know if they have to pay taxes on royalties in the foreign country in addition to Danish taxes. If they are exposed to such international double taxation, the question arises whether or not it is possible to obtain a subsequent alleviation or elimination of the double taxation.

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TAXATION CONVENTIONS

The first question that arises is: Has Denmark concluded an agreement to avoid double taxation with the foreign country in question?

At present we have general agreements concerning taxation of income and capital with 29 countries (included the Faroe Islands). In addition, there are a number of special agreements concerning income derived from shipping and aviation, inheritance etc.

To complete the picture it may be mentioned that a former general agreement with England has been extended to include about 30 now partly independent overseas territories, and that the agreement with the Netherlands also applies to the Antilles.

For the purpose of taxation of royalties the 29 general agreements may be divided into three groups.

1. No foreign taxation

The first group comprises agreement under which Denmark has the sole right of taxation as regards royalties from abroad. The foreign countries in question have, in other words, by signing the agreements, bound themselves not to tax Danish recipients of royalties. If such countries,

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according to their international laws, nevertheless levy tax-at-the-source on royalties payable abroad, it may happen that tax is also levied on payments to Denmark. But the tax amount shall then upon request be refunded in full to the Danish enterprise.

The following countries have thus committed themselves, according to a treaty, not to tax Danish recipients of royalties: Austria, Belgium, the Faroe Islands, Finland, France, Germany, Ireland, Iceland, Italy, Malaysia, the Netherlands, Norway, Pakistan, Sweden, Switzerland, the U.K. and the U.S.A.

2. Limited foreign tax-at-the-source

The second group comprises agreements according to which the source country is entitled, within a certain maximum rate, to tax Danish recipients of royalties.

Such countries will, as a rule, levy taxes at the permitted maximum rate, but they may levy taxes at a lower rate or they may not at all levy any tax-at-the-source. (As mentioned above Denmark does not levy tax-at-the-source on royalties to foreign countries, although we formally have a right to do so according to some taxation agreements).

The below-mentioned countries may, under the agreements, levy tax-at-the-source at the maximum rates indicated:

Canada	15 percent
Israel	10 percent
Japan	10 percent
Kenya	20 percent
Portugal	10 percent
Spain	6 percent
Thailand	15 percent
Trinidad and Tobago	15 percent

3. Special regulations

Ceylon: No fixed maximum has been established, but Ceylon is to reduce the tax levied according to Ceylonese rules by 50 percent.

India: No maximum. Denmark cannot tax royalties from India, but there is a provision concerning progression (see below under Singapore).

The Philippines: No fixed maximum, but the usual tax is reduced by one third if the income is derived from special investment areas.

Singapore: Royalties are exempt from taxation in Singapore and cannot be taxed in Denmark either. The Danish authorities may, however, when establishing the tax rate that is applicable to the general income of the Danish concern, take into account royalties derived from

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gated to give improvements to people from other countries, particularly the U.S., where history would indicate an instability in the relations between the countries. Sohio, therefore, offered to give Sohio's improvements, but not those of our other licensees for a very short period of time which would essentially be equal to the date on which the plant was started up and running smoothly.

Unusual Aspects of the Negotiations

The negotiators we were dealing with seemed to follow the practice of "keeping the ball in our court." For example, in a situation where we agreed to reduce our demands for the term of secrecy agreement, if the Chinese were going to make a counter-proposal they would do so immediately. If they were going to give a "turn down" but make no counter-proposal, it was generally given at the next negotiating session.

During the final negotiating session we were still some distance apart with respect to the amount of the royalty. The representative of the China National Technical Import Corporation told us, much to our surprise, that they had authority to supplement the offer of their client. They did so only in those cases where they had made a determination that it would be in the best interests of China to obtain the technology even though the licensor was not able to reduce his royalty to the level that their client agency was willing to pay. This supplemental payment permitted us to close the financial aspects of the deal.

Negotiators and Translators

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The representatives of the China National Technical Import Corporation seemed to be extremely intelligent and intellectually honest people. They were represented by three people; one man about 39 years old who mainly took notes, a chief negotiator who was about 35 years old, and a senior member who was about 45 but did not participate actively in the negotiations. It could be that the Chinese were following our lead in having the less senior man conduct the negotiations in view of the fact that I did almost all of the negotiating on our side even though I had with me a member of our Board of Directors who is also a Senior Vice-President of Sohio. The interpreters were furnished by the Chinese, and the gentlemen which we had for our business negotiations was a fully-qualified engineer who had no problem with the technical details. However, the Chinese were short of English-Chinese interpreters and therefore he interpreted for the negotiation sessions from morning until night. As a result, he became quite tired and I am sure that his ability to interpret was hampered because of it. If we were to be involved in another complex negotiation in China, I would seriously consider taking a back-up interpreter with us.

Plant Construction

Our last word is that engineering has been completed, equipment ordered and ready for shipment, and civil work nearing completion. In due time the plant will be producing acrylonitrile which will be used to provide acrylic fabrics which, in turn, will help provide a more comfortable life for the people of China.

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Singapore. (This so-called reservation of the progression is of importance to natural persons, not to companies, which are taxed according to a flat rate).

ROYALTIES CONNECTED WITH PERMANENT ESTABLISHMENT ABROAD

It appears from the above summary that, according to the taxation agreements, the source country may in principle only to a very limited extent impose tax on outgoing royalties. If a Danish business has a permanent establishment (branch office) in another country, the gross profit of the branch will usually be taxed at a considerably higher rate. Most countries impose tax on branches of foreign enterprises in the same way as on other enterprises in the country.

If a Danish business has a branch office in another country, and if the business simultaneously receives royalties from activities in that country, the profit of the branch and the royalties cannot, according to the taxation agreements, be aggregated and taxed together at the usually higher tax rate that is applicable to the branch office.

Such an aggregation is permissible only if the right or property giving rise to the royalties is connected, directly and efficiently, with the permanent establishment. If the royalties are derived from the activities of the Danish business in the foreign country and have no connection with the operation of the branch, no aggregation may take place, and the royalties will either be entirely exempt from taxation in the foreign country or they will be taxable only within the limits established in the agreement.

Increased taxes sometimes may be levied in the source country, where a special dependence exists between the licensor and the licensee, and such dependence may be assumed to have influenced the terms of the license agreement. This may, for example, be the case if the Danish licensor has a possibility of exerting a determining influence on the transactions of the foreign licensee, e.g. through a shareholding, or in any other way.

ELIMINATION OF DOUBLE TAXATION

If a business is exposed to international double taxation — either because the royalties are derived from a country with which Denmark has no taxation agreement or because the taxation agreement provides for some foreign tax-at-the-source — the business will be entitled to a so-called tax credit for taxes paid abroad. Under the tax credit system royalties from abroad are included in Danish taxable income. Foreign taxes paid on such income are, however, allowed as a deduction from Danish tax, but in an amount not exceeding that proportion of the Danish taxes which the foreign income bears to the total income subject.

If a company is taxed at the ordinary corporation tax rate of 37 percent, it will accordingly always receive full refund for taxes paid abroad if such taxes amount to 37

percent or below. If the foreign taxes exceed 37 percent, no refund is obtainable for the excess amount.

The foreign tax credit rule is included in Danish Income Tax Law, and similar rules are incorporated in some taxation agreements. The taxation agreement may never increase the taxation that follows from Danish rules, but may only ease such taxation. Some of the taxation agreements, especially with the developing countries, have "tax-sparing" clauses which provide for a greater relief from double taxation than internal Danish legislation.

TURNOVER TAX

In some countries indirect taxes are levied on royalties. Such taxes are neither comprised by the general taxation agreements nor by the internal Danish tax credit rule which relates to income taxes only. The taxes are, however, deductible from the taxable income of the Danish recipient.

A business which is about to sign license contracts with foreign enterprises should, of course, in addition to the knowledge of Danish tax rules and taxation agreements, also obtain detailed information from local sources about taxes and any other expenses that may be of importance in the negotiations regarding the amount of the license.

Criteria for Applying Mexican Law

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A contract may be accepted although it contains some of these limitations if any of the following circumstances occur:

- When the contract involves license to use a trademark owned by the licensor.
- The purpose of the limitation is to prevent the disclosure of technical information of a confidential nature furnished by the licensor.

FRACTION IX. "When the obligation to sell the goods produced by the acquirer solely to the supplier of technology is established."

In connection with this provision, a contract shall not be registered if:

1. The licensee is obligated to sell to the licensor all the products manufactured by licensee at the price fixed by the licensor.
2. The licensee is obligated to sell all its production to a company designated by the licensor.

A contract may be admitted if:

- The licensee engages solely in the manufacture of intermediate products, parts or components for their subsequent processing, assembly or finishing by the licensor and said licensor is the only potential buyer of said intermediate products.

- This obligation is established on an exclusive basis as regards certain export markets and the provision is beneficial to the licensee.

FRACTION X. "When the acquirer is compelled to use on a permanent basis personnel specified by the supplier."

The exception to enforcement of this provision is:

- If there are no national technicians who can perform the function in question and licensor furnishes personnel designated by it temporarily and assuming the obligation to train national technicians capable of replacing the personnel so designated.

FRACTION XI. "When limitations are imposed on production volumes or sale or resale prices are set for national production or for exportations of the acquirer."

In connection with this provision, a contract shall not be registered if:

1. A minimum production volume is established under penalty of contract termination in the event such is not reached.

2. The receiving company is not authorized to exceed certain specified production volumes.

3. It is provided that at expiration of the contract the acquiring company cannot continue using the technology transferred to it unless the contract involves solely the use of patents and said patents are in force.

4. The licensor is granted the right to fix the prices of the products.

5. Any other obligation not to do, such as not to manufacture the products which are the object of the contract upon expiration of the same, is established.

FRACTION XII. "When the acquirer is obligated to enter into exclusive sale or representation contracts with the supplier of technology in national territory."

Application of this provision may be excepted in the event licensor shows that it has an adequate distribution system or enjoys commercial prestige which enables licensor to carry out the marketing of the products under the contract on better conditions than the licensee.

FRACTION XIII. "When excessive terms of duration are provided. Said terms may not exceed in any case 10 years mandatory for acquirer."

In connection with this provision, the contract shall not be admitted if:

- Notwithstanding stipulation of a term of duration of less than the maximum (10 years), it is deemed that the technology can be assimilated in less time than that specified in the contract.

- The contract contains obligations for the licensee after termination of the contract for an indefinite period or for a term in excess of the maximum time authorized by the law.

FRACTION XIV. "When cognizance of or decision on the actions which may arise due to interpretation or performance of the contracts is submitted to foreign courts of law."

A contract may be admitted for registration if:

1. It does not contain an express submission to national courts since in this case the rules of the Civil Code for the Federal District and Territories in force relating to jurisdiction apply in any case.

2. A clause is included containing an arbitration commitment in conformance with the terms of the Covenant on recognition and execution of arbitration awards rendered abroad, published in the Federal Daily Gazette of June 22, 1971.

The last paragraph of Article 7, fraction XIV indicates that acts, agreements or contracts shall be governed by Mexican laws.

In the event the contract does not contemplate which laws are to regulate the same, it should be admitted for registration anyway.