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Transfer pricing and the limits of legal certainty

A comparability analysis of legality, legal certainty, and economic reality in Danish transfer pricing regulation

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Contents

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Abstract

This thesis examines the compatibility of the Principle of Economic Reality against the Principle of Legality in Danish law and the Principle Legal Certainty in EU law within the context of Danish transfer pricing regulation.

Utilizing the legal dogmatic method, the thesis establishes the principles and the Danish transfer pricing framework. It then employs the Dubai A case as a central case study to analyse the progression from technical pricing adjustments between controlled entities to substantive reclassification as a masked dividend.

The analysis undertaken demonstrates that the Danish transfer pricing framework operates within a structurally dual system in which formally rule-based standards are increasingly supplemented, and in practice, displaced by, discretionary substance-based assessments. It demonstrates that the current framework shifts the determination of tax liability from ex ante compliance to ex post evaluation, creating a structural mismatch which struggles to maintain balance between the principles.

Despite this mismatch, however, the thesis argues that substantive evaluation may be a necessity of transfer pricing due to the nature of transactions between controlled entities and in totality concludes that the principles are compatible only in a limited and conditional sense with proposed safeguards to ensure better balance.

Abbreviations

ATAD: Anti-Tax Avoidance Directive

ApS: Anpartsselskab (Limited liability company)

CJEU: Court of Justice of the European Union

CUP: Comparable Uncontrolled Price method

DKR: Danske Kroner (Danish Crowns)

EU: European Union

GAAR: General Anti-Avoidance Rules

MNE: Multinational enterprise group

OECD: Organisation for Economic Co-operation and Development

SAAR: Specific Anti-Avoidance Rules

TEU: Treaty on European Union

TNMM: Transactional Net Margin Method

1 Introduction

1.1 Background

In the Dubai A case before the Danish Supreme Court[1], a transfer pricing adjustment did not merely correct the pricing of intra-group transactions. Instead, it set in motion a progression that extended beyond the corporate level, ultimately leading to the reclassification of the adjusted amounts as taxable personal income of the shareholder.

As a result, a mispricing within a multinational entity group gave rise to taxation at the shareholder level, significantly increasing the individual's tax liability. This outcome was not the product of a single legal assessment, but of multiple stages of administrative discretion, combining methodological choices in the pricing analysis with a subsequent substantive analysis culminating in reclassification as a masked dividend.

This development raises fundamental questions of legality and predictability. From the perspective of the taxpayer, the underlying transactions consisted of genuine services between two legal entities, even if priced incorrectly. Yet, the decisive tax consequences resulted in not only correcting the pricing of the transactions at the corporate level, but by a subsequent reclassification of the adjustment to personal taxation, something which could not be derived from the formal contractual arrangement directly.

1.2 Purpose and research questions

Whether a rule qualifies as applicable law depends on the degree to which its application can be predicted to apply.[2] If the applicability of a rule cannot be predicted with a meaningful degree of certainty, it cannot properly be regarded as applicable law. If the unpredictable rules are enforced by public authorities, their application risks becoming indistinguishable from arbitrary exercise of power.

This concern is particularly pronounced in the field of transfer pricing. Transfer pricing concerns the determination of pricing between entities under common ownership within a multinational enterprise group (MNE). It operates within a complex legal framework shaped by domestic legislation, bilateral and unilateral measures, and non-binding international instruments such as the OECD Transfer Pricing Guidelines.

[1] Combined cases of BS-22176/2021-HJR (estimate pricing) and BS-22171/2021-HJR (masked dividend)

[2] Alf Ross, Om Ret og Retfærdighed, 1953, § 9. Særligt om verifikation of retsvidenskabelige sætninger vedrørende forholdsnormer

Given this complexity, the ability to predict the applicable legal standard with sufficient certainty is essential, however, the need for flexibility and assessment by the tax authority is also necessary.

In this context, a structural tension arises between the need for flexibility, as reflected in the Principle of Economic Reality, and the requirements of legal grounding and predictability, as expressed in the Principles of Legality in Danish law and Legal Certainty in EU law. That tension raises the question of whether, and to what extent, a system that relies on substantive and discretionary assessments can be reconciled with the requirements of legality and predictability.

Accordingly, this thesis examines:

To what extent is the Principle of Economic Reality compatible with the Principle of Legality in Denmark and the Principle of Legal Certainty in the European Union in connection with Danish transfer pricing regulation?

1.3 Delimitations

The thesis is focused on Danish taxation and therefore first and foremost apply Danish statutes, case law, and scholarly literature. However, as Denmark is a Member State of the European Union and apply international instruments to statutes, EU law and the guidance from the OECD will be included where appropriate.

The thesis is centered on the cumulative effect of the Dubai A rulings and while other cases are included to establish context in specific sections, it does not include a historical survey of transfer pricing cases.

Principles of law are broad and encompass many topics which often overlap, and this makes it impossible to include everything in a thesis of this size. Legal certainty in Danish law is not articulated in a single, autonomous doctrine in the same way as in EU law but is instead embedded across several principles and practices. One of such is the Principle of Legality, which is therefore chosen to test against the Principle of Economic Reality, alongside the Principle of Legal Certainty found in EU law. The Principle of Legal Certainty in EU law is furthermore an ‘umbrella’ principle, which includes many aspects which goes beyond the scope of this thesis. The thesis therefore had to exclude elements such as accessibility, non-retroactivity, and the protection of legitimate expectations.

The Danish transfer pricing statutes examined in the thesis is delimited to § 2 and 3 of the Danish Tax Assessment Act. It therefore excludes the exception to the Arm’s Length Principle for qualitive distribution transactions found in § 2 B of the Danish Tax Assessment Act. Furthermore, § 3 of the Danish Tax Assessment Act is included despite not being referenced in the case of Dubai A. This is due to its relevance in context with the tension of the principles and its status as implemented EU regulation. It therefore serves as an essential example of the link between Danish and EU law and to aid the analysis of the tension between formal legality and substance-based assessments.

The thesis furthermore does not include any examination of tax agreements between nation states. This is excluded due to the size of the thesis and the aim of analysing the principles generally on the topic of transfer pricing, not only between specific states.

1.4 Method and materials

The thesis applies mix of textual and contextual interpretation with the use of the legal dogmatic method in order to establish applicable law.

The materials used are chosen and organised to reflect the structural hierarchy of the legal landscape. At the top, the principles with either constitutional, EU primary or secondary law, or case law sources. Principles are then contextualised with Danish transfer pricing statutes and the accompanying international instruments. After this, the Dubai A case serves as the examination subject to analyse the interactions of the principles in the field of Danish transfer pricing. This specific case is chosen due to the illustration of progression from contractual form to substantive reclassification.

1.5 Outline

Chapter 2 establishes the theoretical tension at the core of the thesis. It contrasts the Principle of Economic Reality, an unwritten substance over form doctrine developed over a century of Danish case law, against the Danish Principle of Legality, and the Principle of Legal Certainty in EU law. These principles set the boundary to the conflict of the thesis, how a principle which seeks to prevent the misuse of civil law structures may be reconciled with the constitutional requirement of clear statutory basis and the cross-border requirement of predictability.

Chapter 3 examines the statutory and instrumental dimension of Danish transfer pricing. It establishes how § 2 and § 3 of the Danish Tax Assessment Act interacts with international instruments, such as the OECD Transfer Pricing Guidelines and EU law Directives like the ATAD. The chapter will furthermore highlight the administrative discretion found in transfer pricing, such as choosing which methodology and within the chosen methodology, such as the Transactional Net Margin Method (TNMM).

Chapter 4 utilizes the Dubai A case as a practical example to test the compatibility of the principles. It illustrates the intensifying interference of the tax authorities beginning with a pricing adjustment based on an estimated arm´s length assessment and culminating with the reclassification of the income as a masked dividend. With this case the chapter demonstrates how the courts apply the Principle Economic Reality to depart from contractual form in favour of probable conduct.

Chapter 5 synthesizes the elements of the previous chapters to analyse the structural mismatch between the principles and analyse how this is expressed in practice, such as ex ante compliance for the taxpayer with ex post assessment by the tax authority. The chapter also provides concrete safeguards to better balance the principles, without relying on formalism entirely, to ensure that the pursuit of economic reality does not come at the expense of legality and predictability.

2 Principles of law as a legal framework

2.1 The Principle of Economic Reality in Danish Tax Law

The Principle of Economic Reality (*realitetsgrundsætningen*) is an unwritten general principle in Danish tax law. When applied it enables tax authorities and courts to distinguish between tax arrangements that rely on formal legal structure to obtain an unintended advantage and those that reflect genuine economic substance.[3]

At its core, the principle does not focus on the economic content of an arrangement but rather how these arrangements are characterised in a civil law context.[4] Commonly in taxation, consequences of transactions may only be determined per its character, whether its a loan or a salary for example, and therefore, if it is possible for a transaction to be mischaracterised without substance, it is possible to change the tax liability resulting from the transaction. The Principle of Economic Reality therefore reflects the tension between legal form and economic substance.

An example of this is in TfS 1992, 250:

> Here, the court examined loan arrangements that did not involve any real risks. The arrangement was found to constitute purely formal constructions, created for accounting purposes and driven by tax considerations, rather than reflecting genuine commercial activity. It was therefore found not to contain the necessary economic and business reality needed to be approved in connection with taxation and thus disregarded for tax purposes.

The case illustrates the substance-over-form approach necessary to prevent arbitrary mischaracterisation, as the court focused on the absence of economic and business reality rather than the formal legal structure of the arrangement. While this approach ensures that taxation reflects actual economic outcomes, it also introduces a degree of uncertainty, as the assessment depends on a substantive evaluation that may not be fully apparent from the legal form of the arrangement.

The Principle of Economic Reality has long been debated. Although it is unwritten, it is not without legal weight, having been developed over almost a century through precedence-setting decisions by the Danish Supreme Court.

For example, in the case of *Havnemølledom*[5]:

> In this case a company sought to avoid double taxation through separating a branch into a formally independent entity established by its shareholders, while still retaining effective control within the original enterprise. This arrangement was found to lack economic substance and therefore recharacterized as a masked dividend.

The Principle of Economic Reality is still deployed regularly in situations where the legal form of arrangements does not reflect the economic substance. Although often used, it is not without critics, however. Critiqued an unprovable claim and pointless,

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[3] Pedersen, J, Realitetsgrundsætningen I ti år, TfS2000, 142, p. 350
[4] Pedersen, J, Realitetsgrundsætningen I ti år, TfS2000, 142, p. 351
[5] UfR 1960, p. 353

since no separate definition of civil law classifications exists in public law[6], it was furthermore argued that the Principle of Economic Reality meant an undermining of the Principle of Legality[7]. This concern is countered in literature on the basis that the Principle of Economic Reality is a general clause which does not give answers to concrete legal questions, nor say anything regarding the way in which statutes are to be interpreted,[8] nevertheless, its reliance on a substantive evaluation introduces significant practical challenges.[9]

That critique is similar to that of this thesis, however, the focus of this thesis is not whether the Principle of Economic Reality undermines the Principle of Legality, but rather if the Principles of Economic Reality, Legality, and Legal Certainty are compatible, specifically in the Danish transfer pricing framework.

It is especially critical, if it is possible to achieve a balance which serves both the ethos behind legality and legal certainty, and the necessary grounding required to prevent the use of legal forms as a means of achieving tax outcomes that are disconnected from actual value creation and risk allocation.

For this thesis, the Principle of Economic Reality is understood as a function of a corrective mechanism, allowing the Danish tax authority to look beyond formal legal structures where such structures lack genuine substance

2.2 Legal Certainty

2.2.1 Legal certainty in Denmark

As stated in section 1.3 Delimitations, legal certainty in Danish law is not articulated in a single, autonomous doctrine in the same way as in EU law but is instead embedded across several principles and practices. Comparatively to the Principle of Legal Certainty in EU law, legal certainty in Denmark derives from a combination of principles like the Principle of Legality both generally and specifically for taxation[10], specific statutes[11], and the longstanding ethos expressed in the motto of "*Med Lov skal land bygges*"[12]. ("By law shall land be built").

For the purpose of this thesis, the Principle of Legality in Denmark will be relied on as the benchmark for further analysis. This is selected due to its close relationship with legal certainty, as they overlap to a degree and have a clearer definition.

[6] Strobel, I. A, SR-Skat, 1991, p. 377 ibid

[7] Michelsen, Aage, Lærebog om indkomstskat, 8. udgave, p. 78

[8] Pedersen, J, Realitetsgrundsætningen I ti år, TfS2000, p. 352, See also: Nielsen, T, Indkomstbeskatning I, p. 35-39 and Fejlberg Jørgensen, J, Omgåelse af retsregler, 1966, p. 235

[9] Pedersen, Jan, SR-Skat, 1992, p. 101 ibid

[10] LOV nr 169 af 05/06/1953 The Constitutional Act of the Kingdom of Denmark (Grundloven), 1953, §§ 43, 61-62 & 64

[11] For example: LBK nr 1647 af 04/08/2021 Bekendtgørelse af lov om retssikkerhed og administration på det sociale område

[12] Danish origin found in intro to Jyske Lov (1241), Also found in other Scandinavian legal documents from the period

However, transfer pricing cases also often contain a cross-border element. It is therefore insufficient to formulate a benchmark which contains only principles of law found in domestic legal traditions. Therefore, the Principle of Legal Certainty as found in EU-law will be included.

By measuring the Principle of Economic Reality against both the Principle of Legality in Denmark and the Principle of Legal Certainty in EU law, the benchmark will be more comprehensive and cover both a domestic and an international perspective.

2.2.2 The Principle of Legality in Denmark

2.2.2.1 General legality

In the Danish legal system, civil law is largely structured around contractual autonomy and the enforcement of binding agreements[13], while public law is constrained by the Principle of Legality, traditionally expressed through the maxims nulla crimen sine lege (*No crime without law*) and nulla poena sine lege (*no penalty without law*).

The Principle of Legality, in its essence requires that exercises of public authority to have a basis in law. Thus, state action must be grounded either in a specific legal provision or in a broader statutory authorization. Where such a legal basis in absent, such action may be deemed invalid or unlawful and overturned. In the Danish system, such action is generally conducted by the general courts or administrative tribunals, like the tax appeal authority (*Skatteankestyrelsen*) and are additionally often subject to criticism from the parliamentary ombudsman[14].

The Principle of Legality in Danish law is furthermore referenced in the Constitutional Act of the Kingdom of Denmark:

> *§61: "Den dømmende magts udøvelse kan kun ordnes ved lov[15]"*
>
> *Translation: The exercise of judicial power may only have a basis in law*
>
> *§62: "Retsplejen skal stedse holdes adskilt fra forvaltningen. Regler herom fastsættes ved lov"[16]*
>
> *Translation:* The *judiciary must be kept separate from the executive. Rules on this shall be down by law.*
>
> *§64: "Dommerne har i deres kald alene at rette sig efter loven"[17]*
>
> *Translation: Judges, in their calling, are solely bound by the law*

Chapter 6 of the Constitutional Act of the Kingdom of Denmark sets out fundamental rules governing the judiciary. These expressions of legality emphasise that the exercise of judicial power may only have a basis in law, judicial independence,

[13] LOV nr 11000 af 15/04/1683, Danske lov 5-1-1

[14] LOV nr 473 af 12/06/1996, Ombudsmandsloven, Chapter 7, §§ 21-25

[15] LOV nr 169 af 05/06/1953, The Constitutional Act of the Kingdom of Denmark (Grundloven), § 61, stk. 1

[16] LOV nr 169 af 05/06/1953, The Constitutional Act of the Kingdom of Denmark (Grundloven), § 62, stk. 1

[17] LOV nr 169 af 05/06/1953, The Constitutional Act of the Kingdom of Denmark (Grundloven), § 64, stk. 1

emphasising that judges are bound solely by the law in the exercise of their duties and the establishment of separation of powers, which states that rules regarding separation must be laid down by law.

However, in Danish law, there is a constitutional reference to legality specific to taxation.

2.2.2.2 Legality in taxation

The Principle of Legality for taxation:

> *§43: "Ingen skat kan pålægges, forandres eller ophæves uden ved lov"*[18]
>
> *Translation: No tax may be imposed, altered or abolished except by law.*

For the field of taxation, §43 of the Constitutional Act of the Kingdom of Denmark prescribes that no taxes shall be imposed, altered or repealed except by statute.

This constitutional requirement forms a cornerstone of the interpretation of Danish tax law. The wording of the paragraph, placement, and specification are altered from the previous examples of expressions of the Principle of Legality in Denmark. It is specified to include imposition, alteration, and repeal of taxation. This emphasises that the changes found in §43 should have special attention.

This change could be argued to mean the expression of a positive and a negative Principle of Legality, specifically on the field of taxation. Where a positive Principle of Legality would require the existence of legislation for taxation to take place, a negative Principle of Legality would require the necessity of legality in order to alter or abolish taxation. The consequences of this change, however, is a constitutional discussion which goes beyond the scope of this thesis.

In theory, the Principle of Legality in taxation limits the powers of the tax authority. Executive measures cannot conflict with statutory law, cannot constitute an independent legal basis for taxation and only permit tax authorities to impose taxes where legal basis for taxation exists.[19]

A series of Danish Supreme Court decisions in the mid-to-late 1990's confirmed that a clear statutory basis is a precondition for the imposition of tax.[20] It should be noted, however, that these cases did not concern situations involving tax avoidance, evasion, adjustments, or reclassification. Furthermore, there is significant disagreements in scholarly literature regarding the scope of § 43 of the Constitutional Act of the Kingdom of Denmark.

One view holds that § 43 constitutes a strict constraint on the tax authorities, comparable to the legality requirement in criminal law and in legislation interfering with citizens private life[21]. Another view suggests that it merely precludes the use of

[18] LOV nr 169 af 05/06/1953, The Constitutional Act of the Kingdom of Denmark (Grundloven), § 43

[19] Nielsen, J. G., Legalitetskravet ved beskatning, p. 355

[20] Schmidt, Peter Koerver, Legal Pragmatism – A Useful and Adequate Explanatory Model for Danish Adjudication on Tax Avoidance?, 2020, p. 11

[21] Nielsen, J. G., Legalitetskravet ved beskatning, p. 264

interpretation based on analogy as a basis of taxation without imposing broader requirements of statutory clarity, as opposed to other kinds of administrative law[22]. A third position rejects both these interpretations, arguing that § 43 of the Constitutional Act of the Kingdom of Denmark does not prescribe a specific standard of clarity required as statutory bases and that case law precedence varies to such a degree that abstract assertions are not appropriate.[23]

However, due to the dogmatic approach adopted for this thesis, it is necessary to formulate a benchmark to measure against. Although other viewpoints hold merit, not all interpretations can be included. The analysis on the Principle of Legality in this thesis must be balanced and specified to reflect the text of the Constitutional Act of the Kingdom of Denmark, first and foremost, and protected to at least the same degree as legality in general, to not be in conflict. The Principle of Legality will therefore be viewed as a restriction on tax authorities as the benchmark for this thesis.

Specifically, the Principle of Legality on taxation from the Danish legal perspective, for the purpose of this thesis, is an assessment of whether the exercise of taxing powers explored in this thesis is sufficiently grounded in clear statutory authority.

2.2.3 The Principle of Legal Certainty in the European Union

2.2.3.1 Recognition of the Principle of Legal Certainty

Principles of law in the context of the European Union is an accepted unwritten source of law,[24] and occasionally treaty inspired.[25]

The Principle of Legal Certainty in the European Union is a general rule expressed by Art. 2 of the Treaty on European Union (TEU). Art. 2 of the TEU concerns the values of the European Union and defines them as "*equality, the rule of law and respect for human rights*".

Although the Principle of Legal Certainty is not mentioned directly in the treaties[26], it is a well-recognized and widely accepted by the Member States, EU institutions, and particularly by the CJEU.[27] The CJEU first acknowledged the Principle of Legal Certainty in 1961 and by 2014 had more than 2500 decisions containing the expression "legal certainty".[28]

[22] Pedersen, J., Grundlovens § 43: "Ingen skat kan pålægges, forandres eller ophæves uden ved lov" – pas, kørekort og nummerpladegebyrer, Tidsskrift for skatter og afgifter, 1992, p. 413

[23] Christensen, J. P., grundloven med kommentarer, p. 297

[24] Brokenlind, Cécile, Principles of Law: Function, Status and Impact in EU Tax Law, Chapter 1: Introduction, 1.2. What is a principle of law

[25] For example: C 326/13, Consolidated version of the Treaty on European Union (2012), Art. 2

[26] Not mentioned in: C 326/13, Treaty on European Union (2012), C 326/47, Treaty on the Functioning of European Union (2012), C 364/1 Charter of fundamental rights of the European Union (2000)

[27] Weber, Dennis and Sirithaporn, Thidaporn, Principles of Law: Function, Status and Impact in EU Tax Law, Chapter 11, 11.1.1. Introduction

[28] Van Merbeeck, Jérémie, European law review: The Principle of Legal Certainty in the Case Law of the European Court of Justice: From Certainty to Trust, p. 280

The CJEU defines legal certainty to require "*that rules of law be clear, precise and predictable as regards their effects, in particular where they may have unfavourable consequences for individuals and undertakings*"[29].

While tax law is generally considered a 'hard law', due to mandatory rules and its strict basis in statutory references rather than case law[30], literature argues that legal certainty requires the law to have "*a proper balance between stability and flexibility*"[31].

From this, the Principle of Legal Certainty in EU law requires that rules of law are clear, precise and their effects be predictable by those subject to them. However, a degree of flexibility may be required.

The primary case study of this thesis is the Dubai A case. While EU law may be applicable to this case specifically, the purpose of this thesis is to examine Danish transfer pricing framework against the principles generally. It will therefore be examined whether EU principles of law apply generally.

2.2.3.2 Application of EU principles of law in cross-border tax situations involving third countries

Cross-border tax situations involving a Member State of the European Union and a third country raise important questions regarding the applicability of EU law.

It is well established that EU law may confer rights upon individuals which national courts are required to protect. As recognised in the Case 26/62 Van Gend en Loos, provisions of EU law may have direct effect, thereby conferring rights directly to individuals, which national courts must uphold.[32] Furthermore, under the principle of primacy as established in the in the Case 6/64 Costa v ENELdk), once EU-law applies, it overrides conflicting national law.[33] In addition to this, general principles of EU law, including the Principle of Legal Certainty, must be observed whenever a situation falls within the scope of EU law.[34] Alternatively, the applicability of EU law is contingent upon the existence of a sufficient connection to EU law. As established in Case C-299/95 Kremzow, situations which do not fall within the scope of EU law remain within the competence of the Member States.[35]

Thus, EU law may be a binding legal system that directly affects individuals and overrides national law, if the conditions are met.

[29] Case C-72/10, Costa, para 74

[30] Vanistendael, Frans, Principles of Law: Function, Status and Impact in EU Tax Law, principles of law, Chapter 3: The Role of (Legal) Principles in EU Tax Law, 3.2.1. The role of principles in tax law in general

[31] Weber, Dennis and Sirithaporn, Thidaporn, Principles of Law: Function, Status and Impact in EU Tax Law, Chapter 11: Legal Certainty, Legitimate Expectations, Legislative Drafting, Harmonization and Legal Enforcement in EU Tax Law, 11.1.1. Introduction

[32] Case 26-62, *NV Algemene Transport- en Expeditie Onderneming van Gend & Loos v Netherlands Inland Revenue Administration*, ECLI:EU:C:1963:1, Operative part, 1st point

[33] Case 6-64, *Flaminio Costa v E.N.E.L.*, ECLI:EU:C:1964:66, Operative part, 4th point ibid

[34] Jörgen Hettne, Principles of law: Function, Status and Impact of EU Tax Law, 2.3 The scope of general principles of law. See also: A. Rosas and L. Armati, EU Constitutional Law, 2nd edn, p. 165 (Hart Publishing 2012)

[35] Case C-299/95, *Friedrich Kremzow v Republik Österreich*, ECLI:EU:C:1997:254, Operative part

In the field of direct taxation, the CJEU has recognised that national measures may fall within the scope of EU law where they affect fundamental freedoms. In Case C-524/04 Test Claimants, concerning thin capitalization rules, which are governed by transfer pricing rules, the CJEU held that transfer pricing rules may constitute a restriction to the freedom of establishment.[36] This confirms that domestic transfer pricing rules may, under certain circumstances, be subject to EU law.

Additionally, tax situations which involve third countries is another complexity. The applicability of EU law on national measures which implement EU Directives may also extend to contexts that goes beyond purely intra-EU situations.[37] This implies that domestic provisions implementing EU law may trigger the application of EU principles as interpretive benchmarks.

Accordingly, in cross-border transfer pricing situations involving third countries, EU law may apply depending on the strength of the connection to EU law. Where a sufficient link exists, either through the implementation of EU law or the impact on fundamental freedoms, general principles such as the Principle of Legal Certainty may function as interpretive constraints on national law.

Against this background, the Danish transfer pricing framework will be examined.

[36] Case C-524/04, Test Claimants in the Thin Cap Group Litigation v Commissioners of Inland Revenue, ECLI:EU:C:2007:161, paras 13, 63

[37] An example of this is: EU Council Directive 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries

3 Transfer pricing adjustments and Anti-Avoidance

3.1 Introduction

Rules governing anti-avoidance rules are generally categorised as either Specific Anti-Avoidance Rules (SAAR) or General Anti-Avoidance Rules (GAAR). While GAAR provides a 'catch-all' framework with broad terminology, like Art. 6 of ATAD[38]., SAAR is primarily used for specific predefined financial practices, like transfer pricing, although GAAR may also be applicable.

This duality is also found in the Danish statutes for transfer pricing adjustments, expressed by § 2 and § 3 in the Danish Tax Assessment Act which codifies the Arm's Length Principle for transfer pricing (SAAR) and implements the general anti-tax avoidance statute (GAAR) found in Art. 6 of the ATAD.

3.2 The Danish Tax Assessment Act

3.2.1 The Arm's Length Principle

In § 2 of the Danish Tax Assessment Act requires that trade or economic transactions between associated enterprises, both domestic and cross-border[39], be on conducted on terms that would have been achieved by independent parties[40]. By requiring that taxable income be determined on arm's length terms, the provision seeks to ensure an appropriate allocation of profits within multinational enterprise groups and serves as the primary legal basis for the Danish tax authorities to make transfer pricing adjustments in cases where the pricing deviate from these standards.

Furthermore, § 2 of the Danish Tax Assessment Act must be interpreted in accordance with the Arm's Length Principle found in Art. 9 of the OECD Model Tax Convention[41] and guidance for the application and interpretation of this on § 2 of the Danish Tax Assessment Act is found in the OECD Transfer Pricing Guidelines[42].

Art. 9 of the OECD Model Tax Convention consists of three elements:

First, it defines the scope of the application, referring to situations: where (a) an enterprise or (b) a person, either through direct or indirect participation in

[38] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market

[39] Bekendtgørelse af lov om påligningen af indkomstskat til staten (ligningsloven) § 2, stk. 1, punkt. 1-6 (Tax Assessment Act)

[40] Bekendtgørelse af lov om påligningen af indkomstskat til staten (ligningsloven) § 2, stk. 1, 2. Del (Tax Assessment Act)

[41] OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter 1, B.1 part 1.6

[42] Vejledning C.D.11.2.1.1 Armslængdeprincippet og Transfer Pricing Guidelines

management, control or capital of an enterprise of a contracting state and an enterprise of the other contracting state.

Second, it defines the relevant condition: where commercial or financial relations between such enterprises differ from those that would be made between independent enterprises.

Third, it provides the consequence of such deviation, namely that: any profits which would have been accrued by the enterprise, if not for the conditions above, may be included in the profits of that enterprise and be taxed accordingly.

In order to determine this concerning pricing adjustments, the OECD Transfer Pricing Guidelines prescribes a comparability analysis.

3.2.1.1 The comparability analysis

The core objective of transfer pricing adjustments is to ensure that profits arising from transactions between entities under common ownership or parent and subsidiary control within a MNE group are allocated on terms which would be possible for independent parties, otherwise known as on arm's length terms.[43]

In practice, the Arm's Length Principle is applied through a two-step analytical framework.

First, the commercial or financial transactions between the associated enterprises are identified. Second, these transactions are compared with those observed in transactions between independent parties, also referred to as uncontrolled transactions.[44]

When identifying the commercial or financial relationship between associated enterprises, five comparability factors are considered.

The first factor concerns the contractual terms of a transaction. A contractual interpretive analysis is done on the agreement between the parties as it represents the consequence or expression of the commercial or financial relations between the parties.[45] These provide the starting point for analysis, as they reflect the formal allocation of rights and obligations between the parties. However, contractual terms are not decisive, as contractual terms may only reflect the original intentions and anticipated outcomes of a transaction. As they may not fully reflect the actual conduct of the parties, the terms examined also include communications between the parties in formats other than a written contract.[46]

[43] OECD (2019), Model Tax Convention on Income and on Capital 2017 (Full Version), Commentary to Article 9, para 1, including updated language from: OECD (2025), The 2025 Update to the OECD Model Tax Convention, Commentary to Article 9, para 1

[44] OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter 1, D.1 part 1.33

[45] OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter 1, D.1.1 part 1.42

[46] Ibid

The second factor involves a functional analysis which is based on the compensation between the parties as it often reflects the functions, assets used and risks assumed. As these may differ from otherwise comparable transaction, it is necessary to identify the economically significant activities and responsibilities between the associated parties to accurately compare these transactions between independent parties.[47]

The third factor concerns the characteristics of the property or services accompanying the transaction. Physical features, quality and reliability, the availability and volume of the supply and other characteristics may separate the transactions between associated parties from otherwise comparable transactions between independent parties.[48] This is particularly relevant for transactions involving intangible property, where the variety of characteristics make comparison highly technical.

The fourth factor relates to the economic circumstances of the transaction, including market conditions, geographical location, and the availability of substitute goods or services. For transactions to be comparable, a difference in the market of the associated and independent transactions must not have a material effect or be appropriately adjusted.[49]

The fifth factor concerns the business strategies pursued by the parties, such as market penetration or innovation schemes, product development, diversification, risk, assessment of the duration or changes to the political and legal landscape. These strategies may create significant differences between otherwise comparable transactions and must therefore be taken into account when assessing comparability.[50]

These comparability factors provide the baseline of what should be included when determining arm's length terms.

The OECD Transfer Pricing Guidelines furthermore establish up to five different methodologies to establish this, depending on the type of transactions. Such as directly comparable transactions may enable the use of the Comparable Uncontrolled Price (CUP) method while more complex transactions, like intangibles or intra-group services, may necessitate other methods like the Transactional Net Margin Method (TNMM) which compares based on profit level indicators.

The comparability analysis constitutes the central mechanism though which the Arm's Length Principle is operationalised, however, it is also the point at which the application of statutory rules becomes dependent on discretionary and evaluative assessments. The choice of methodology and choice of uncontrolled comparable are not clarified in statute nor in the guidelines and these therefore more or less depends

[47] OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter 1, D.1.2 part 1.51-1.53
[48] OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter 1, D.1.3 part 1.127-1.129
[49] OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter 1, D.1.4 part 1.130-1.133
[50] OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter 1, D.1.1 part 1.42

on the practicalities of the assessment or the discretion of the entity or authority conducting the comparability analysis. The comparability analysis therefore marks the transition from ex ante compliance to ex post assessment, which is the primary source of tension between the requirements of the Principles of Legality in Denmark, the Principle of Legal Certainty in EU law, and the application of the Principle of Economic Reality.

3.2.2 The Anti-Tax Avoidance Directive

In § 3 of the Danish Tax Assessment Act, Art. 6 of the ATAD is implemented.[51]

Like Art. 6 of the ATAD, § 3 targets arrangements that formally comply with the law but are primarily designed to obtain a tax advantage contrary to the purpose and intent of the tax statutes. This allows the Danish tax authorities to disregard arrangements which are considered 'non-real'[52] when calculating corporate tax liability.

'Non-real' means in this context that they lack valid commercial justification and do not reflect economic reality.[53] Furthermore, "arrangement(s)" should be interpreted broadly to encompass any agreement, common understanding, wording, transaction or series hereof, regardless of its formal legal structure.[54]

Since the wording of § 3 of the Danish Tax Assessment Act is consistent with Art. 6 of the ATAD it must be interpreted in accordance with the provisions of the Directive.[55]

Art. 6 of the ATAD provides, that Member States of the European Union shall ignore arrangements or series of arrangements which have been put in place for the main purpose or one of the main purposes of obtaining a tax advantage, when determining corporate tax liability.

According to the CJEU, a finding of an abuse requires both a subjective and an objective element.[56] The objective element concerns the existence of a non-genuine arrangement while the subjective element concerns an intention to obtain a tax advantage contrary to the object or purpose of the Directive[57].

This builds on cases where the CJEU gave guidance regarding the determination of an abusive practice, colloquially referred to as the Danish cases:

> "Proof of an abusive practice requires, first, a combination of objective circumstances in which, despite formal observance of the conditions laid down by the EU rules, the purpose of those rules has not been achieved and, second, a subjective element consisting in the intention to obtain an advantage from the EU rules by artificially creating the conditions laid down for obtaining it. The presence of a certain number of indications may demonstrate that there is an abuse of rights, in so

[51] Implementation of Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, Art. 6 (ATAD)

[52] Bekendtgørelse af lov om påligningen af indkomstskat til staten (ligningsloven) § 3, stk. 1 (Tax Assessment Act)

[53] Bekendtgørelse af lov om påligningen af indkomstskat til staten (ligningsloven) § 3, stk. 2 (Tax Assessment Act)

[54] Karnovs noter in relation to Ligningsloven § 3, number 34

[55] P. Rose Bjare og S. Sønderholm, Den nye generelle omgåelsesregel i ligningslovens § 3, p. 3

[56] C-110/99, Emsland-Stärke GmbH v Hauptzollamt Hamburg-Jonas, paras. 52-53

[57] C-228/24, Nordcurrent group, para. 47

> far as those indications are objective and consistent. Such indications can include, in particular, the existence of conduit companies which are without economic justification and the purely formal nature of the structure of the group of companies, the financial arrangements and the loans. The fact that the Member State where the interest arises has concluded a convention with the third State in which the company that is the beneficial owner of the interest is resident has no bearing on any finding of an abuse of rights."[58]

Herein, the CJEU makes it clear that an assessment of abuse requires both an artificial structure, and a tax advantage. The CJEU thereby exclude artificial structures which cannot be said to seek or obtain a tax advantage.

At a first glance, the Principle of Economic Reality appear similar to Art. 6 of the ATAD as both seek to differentiate between genuine structures and formal arrangements without substance to exclude the latter from the calculation when determining tax liability. However, the delimitation to corporate tax liability and have the requirement of a tax advantage found in the text of Art. 6 of the ATAD and CJEU case law does set it apart. Thus, the Principle of Economic Reality appears have a wider scope than the GAAR.

Whether this expanded scope provides a sufficient mechanism to apply to the case study of Dubai A, goes beyond the scope of this thesis, however, it should be clarified that the GAAR is another layer of substantive evaluation which may apply to the taxpayer. While it is likely, but uncertain, whether § 2 of the Danish Tax Assessment Act has enough of a link to EU law for it to apply to cross-border situations involving third countries, § 3 of the Danish Tax Assessment Act automatically necessitates the application of EU law as it implements an EU Directive.

This has the effect of creating a situation where the taxpayer must be able to navigate effectively three different jurisdictions simultaneously, Danish law in isolation, should the connection to EU law not be sufficient, EU law via application of the GAAR, and legislation of the third country. This is prior to the inclusion of the difficulties of administrative discretion and the multiple layers of substantive analysis required of the taxpayer. Art. 6 of the ATAD therefore provides essential perspective for the arguments of this thesis.

The following chapter concerns the case study of Dubai A.

[58] Joined Cases C-115/16, C-118/16, C-119/16 and C-299/16, N Luxembourg 1 v Skatteministeriet, para 139 and ruling number 3

4 From transfer pricing to reclassification: The Dubai A case

4.1 Introduction

Dubai A regards corporate tax liability determination via a transfer pricing adjustment, and uniquely, the application of this adjustment as personal tax liability on the shareholder as a masked dividend.

For the purpose of this thesis, cases BS-22171/2021-HJR (masked dividend) and BS-22176/2021-HJR (estimate pricing) are collectively referred to as the Dubai A case.

The cases are examined in separation but analysed together due to their close factual and legal connection and since they were addressed jointly by the court, they only make sense jointly. While BS-22171/2021-HJR (masked dividend) constitute the primary focus, BS-22176/2021-HJR (estimate pricing) provides important insight in the transfer pricing assessment and the reasoning of both the Danish tax authority and references to the lower courts.

4.2 The case of BS-22176/2021-HJR (estimate pricing)

Case BS-22176/2021-HJR (estimate pricing) originally concerned a dispute between Appellant ApS 1 and Appellant ApS 2 (the Danish entities) and the Danish tax authority.

The Danish entities formed part of a multinational enterprise group with a company located in Dubai. The Danish entities engaged in controlled transactions with the company located in Dubai and while both the Danish entities and the company in Dubai were ultimately owned by the same individual, this individual was not a direct party to the transactions.

The central issue in the case was whether the Danish tax authority was justified in adjusting the pricing of the controlled transactions on an estimated arm's length assessment. The dispute began in relation to transactions concerning law advisory services under a service agreement concluded in 2007 and accompanying management fees, which the Danish tax authority determined not to be on arm's length terms.

The company in Dubai in the years 2006-07 received a management fee of 800.000 DKR as a fixed amount and a fee of 50-70% of Appellant ApS 1's profits, and in the years 2008-10 a basic fee with full expense coverage, including the profit-based fee.

The Danish tax authority adjusted the pricing of these transactions using an estimate approach based on the Transactional Net Margin Method (TNMM). The guidance on this method can be found in the OECD Transfer Pricing Guidelines[59].

The legal reference for this adjustment came from § 2 of the Danish Tax Assessment Act, as depicted in the previous chapter. The estimate was furthermore supported by a benchmarking analysis involving 25 legal and accounting firms.

According to the Danish tax authority, this estimate reflected the level of earnings that the company in Dubai would have achieved had the transactions been conducted between independent parties under arm's length conditions, however, also argued that the estimate did not constitute a *'manifestly unfair result'. ("åbenbart urimeligt resultat").*[60]

In disagreement with the assessment of the Danish tax authority, the Appellants referenced a report made on the competition in the legal field. They applied this report to argue that their pricing was not unlike the pricing of uncontrolled transactions between independent parties.

Ultimately, the Danish Supreme Court ruled that there were no grounds for not accepting the tax authority's estimate and ruled to uphold the estimate of the tax authority, confirming the ruling of the lower court.

4.3 The case of BS-22171/2021-HJR (masked dividend)

In case of BS-22171/2021 (masked dividend), Applicant A contested the decision by the Danish tax authority in which the adjustment above was applied to the personal income tax liability of applicant A. It was ruled in connection with the estimate pricing case above and concerns the same transactions.

Applicant A, being the owner of both entities in Denmark and the company in Dubai, was acknowledged by the Danish tax authority to not be party to any of the transactions. This opens the question as to how a physical person, who is not party to a transaction, could have adjustment to the pricing of said transactions, be applied to their personal income.

Applicant A, who was in the years 2006-2010 liable for limited taxation in Denmark, would be liable for taxation on dividends coming from a Danish entity according to § 16 A, section 1 of the Danish Tax Assessment Act.

It was in this connection established by the Danish Eastern High Court and acknowledged by the Danish Supreme Court, that masked dividend is included under dividend taxation found in § 16 A, section 1 of the Danish Tax Assessment Act.

The Danish Eastern High Court stated, that per textual interpretation of § 16 A, section 1 of the Danish Tax Assessment Act, that all forms of dividend which is

[59]OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter 2, B part 2.64-2.113

[60] Case BS-22176/2021-HJR (estimate pricing), p. 2

distributed to actual shareholders shall be included in the calculation of taxable income. Furthermore, although The Danish Eastern High Court only references caselaw broadly, the Danish tax authority highlighted two cases in support of changing the classification.

> In the first case of TfS2002.336.LSR, a bonus agreement between a production company and sales company, which were owned by the same shareholders (a mother and two sons), was not considered commercially justified. Therefore, the transferred amounts were considered as non-deductible subsidies to the sales company. By transferring the funds directly to the sales company, the mother had avoided a dividend taxation which would otherwise have taken place had she paid herself a dividend from the production company and then transferred the funds into the sales company.[61]

This case illustrates two companies owned by the same shareholders, though it does differ from the Dubai A case significantly as the case does not include the transfer pricing element. The case also does not involve genuine services. The services in the Dubai A case, while not priced correctly, are acknowledged as genuine by both the courts and the Danish tax authority. In the mother and two sons' case, no agreement or service was provided. Its referential legal value therefore questionable.

> In the second case of SKM2001.248.LSR, the transfer of 1.870.000 DKK from an operating company to a loss-making company was considered a taxable subsidy to the loss-making company by the Danish Regional Court. The transferred funds were considered taxable income in both companies, however, the shareholder who were the sole owner of both companies, was not taxed as a masked dividend under § 16 A, section 1 of the Danish Tax Assessment Act. This was due to the shareholder not achieving any economic advantage via the transfer.[62]

In this case the transferred funds were not taxed as a masked dividend, nor does it concern transfer pricing. The case highlights that it was not taxed as a masked dividend due to the shareholder not achieving any economic advantage from the structure and that it would have been taxed as such if a tax advantage existed.

This could suggest that there is both an objective and subjective requirement in order to be taxed as a masked dividend under § 16 A, section 1 of the Danish Tax Assessment Act similar to that found in Art. 6 of the ATAD. Oppositely, it could suggest that the element of taxable advantage must be included in the substantive analysis. However, this question goes beyond the scope of the thesis and therefore, the case is at best an analogy to the case of Dubai A.

The Danish Supreme Court argued further that the additional funds which were transferred to the company in Dubai *'which could' ("vil kunne")*[63] be payable to applicant A. And if it was, would not be taxable in Denmark nor in Dubai. In effect, the mispriced funds would shift a large majority of the Danish entities' profits to the company in Dubai where dividend taxation was set to 0%.

The Danish Supreme Court therefore found that the excess payments to the company in Dubai were not done in the interest of said company, but rather in the interest of applicant A.

[61] SKM2021.319.ØLR Dubai A at the Danish Eastern High Court, 4.3.1 Indledende bemærkninger

[62] SKM2021.319.ØLR Dubai A at the Danish Eastern High Court, 4.3.1 Indledende bemærkninger

[63] BS-22171/2021-HJR (masked dividend), p. 3

While not specifically stated, this appears to be a reference to the Principle of Economic Reality, whereby the Danish Supreme Court separates the formal structure from the substance of the economic reality.

It was ultimately ruled, that the overpayments to the company in Dubai, due to the transfer mispricing, constitute a masked dividend to applicant A, taxable as a dividend under applicant A's limited tax liability in Denmark.

The Dubai A case illustrates how tensions between legality, legal certainty, and economic reality manifests during the application of transfer pricing rules and reclassification. The following chapter will analyse this in detail.

5 Analysis of the Principles in practice

5.1 Analytical criteria

To recapitulate, Chapter 2 established the legal principles forming the analytical framework of this thesis. From that illustration the specific analytical criteria are derived.

First, the analysis of the Principle of Legality in Denmark serves as the benchmark for whether the exercise of taxing powers is sufficiently grounded in clear statutory authority. The analysis therefore examines whether transfer pricing adjustments are subsequent reclassification are constrained by clear statutory authority capable of limiting overt and arbitrary administrative discretion.

Second, the Principle of Legal Certainty in EU law introduces a more stringent requirement of predictability. The relevant question is whether applicable rules and their application enable taxpayers to anticipate, with reasonable precision, the legal outcomes of their conduct, i.e. their tax liability. While scholarly work suggest that a flexible approach may be necessary, such flexibility must remain compatible with the requirements of clarity and predictability.

Third, the Principle of Economic Reality functions as a corrective mechanism, allowing the Danish tax authority to look beyond formal legal structures where such structures lack genuine substance. The analysis therefore considers how this influences the balance of the requirements of the Principle of Legality in Denmark and the Principle of Legal Certainty in EU law.

Taken together, these principles establish a framework within which the legitimacy of the transfer pricing framework and reclassification may be assessed. The following sections apply this framework.

5.2 Ex ante vs ex post

5.2.1 Predictability in a dual framework

A central tension throughout this thesis is the distinction between ex ante compliance and ex post assessment. The Dubai A case demonstrated how this dynamic operates in practice. The transfer pricing framework formally operates within a structure in which formal rules are applied via the comparability analysis. However, it is done with several layers of discretion and the possibility of a reclassification with a high degree of flexibility. In a sense, the system presents itself as predictable and rule based ex ante while also allowing the tax authority to estimate tax liability ex post based on unclear discretion and estimation.

The case of Dubai A demonstrates that the final tax liability may depend less on such ex ante compliance and more on subsequent ex post evaluations conducted by the tax authority and courts. The taxpayer structured its transactions on the basis of a service agreement and comparative prices, yet the outcome depended on a reassessment of both pricing and the nature of the transaction.

The shift is particularly evident in the use of estimated taxation. The Danish tax authority justified its approach by arguing that the estimate did not constitute a 'manifestly unfair result' ("åbenbart urimeligt resultat").

This standard as a legal argument reflects a move away from a determination based on predefined rules toward discretionary approximation. As a result, this reduces the taxpayer's ability to anticipate the outcome in advance, as both the choice of methodology and the construction of the estimate remain uncertain.

At the same time, the estimate cannot be characterised as arbitrary. The methodology applied is grounded in internationally recognised standards and the benchmark was conducted using professionals and technical methods. This suggests that the assessment, while discretionary, is not entirely unpredictable.

Nevertheless, from the perspective of the taxpayer, the reliance on ex post assessments weakens the function of formal agreements and statutory frameworks as reliable indicators of tax liability. The service agreement, which operates as an ex ante structuring tool, is ultimately subordinated to an ex post evaluation of economic substance which creates a situation in which compliance with formal requirements does not necessarily secure a predictable outcome.

Thus, the tension is expressed as uncertainty, but not arbitrary and not entirely unpredictability. Whether this is compatible with the Principle of Legal Certainty in EU law remains unsure.

It should be noted that the absence of arbitrariness does not in itself satisfy the requirements of Legal Certainty in EU law. The Principle of Legal Certainty in EU law requires that a proper adherence to the terms and pricing of the agreement will allow parties to the agreement to predict, with reasonable precision, the legal consequences of their conduct, ie. their tax burden, at least insofar as the agreement is conducted on arm's length terms. A system may therefore be methodologically sound and consistently applied yet still fail to meet the standard of legal certainty if its outcome cannot be anticipated ex ante.

However, the tension could be argued to reflect a broader structural feature of transfer pricing. Controlled transactions are inherently difficult to compare, and a purely formal approach could enable artificial arrangements that undermine the tax base. Ex post assessments may therefore be, to some extent, necessary.

5.2.2 Requirement of statutory basis

The Principle of Legality requires that the statutory basis for exercises of public authority, particularly in matters of taxation, is sufficiently clear to prevent arbitrary or overly discretionary decision-making.

While § 2 of the Danish Tax Assessment Act provides the legal basis for pricing adjustment in the Dubai A case, it does not prescribe a specific method for calculating the adjustment.

The practical application of § 2 of the Danish Tax Assessment Act relies heavily on the OECD Transfer Pricing Guidelines and the OECD Model Tax Convention. While the TNMM method is mentioned as an appropriate means by which to determine arm's length terms on intra-group services, it is not the only methodology highlighted by the OECD Transfer Pricing Guidelines.[64] The Danish tax authority's reliance on an estimated outcome based on the Transactional Net Margin Method (TNMM) and benchmarking analysis therefore introduces an element which is not defined in the statutory framework and involves a degree of administrative discretion.

While the use of interpretive guidance is not incompatible with legality and complex areas such as transfer pricing necessarily require technical methodologies and comparative frameworks that work on an international basis, concerns arise where the decisive elements of the assessment are derived from discretionary application of non-binding guidance. Particularly where unexplained methodological choices substantially influence the final tax outcome.

While it has not been shown that the methodological discretion changed the tax outcome, the hypothetical difference alone is a cause of concern. If the extent of such methodological discretion can be said to determine the severity or leniency of an adjustment, it is questionable whether this statutory basis can satisfy the requirement of the Principle of Legality.

Furthermore, the substantive analysis could be argued to reflect the influence of the OECD Transfer Pricing Guidelines, which emphasise the importance of analysing the actual conduct of the parties over the contractual allocation of functions, risk, and renumeration. As a result, the agreement is effectively reinterpreted through an OECD-based framework. This would raise the question as to whether the decisive elements of the assessment derive from statutory law, legal principles, or from non-binding international guidance, further making it questionable whether it can satisfy the requirement of the Principle of Legality.

Additionally, an ex ante versus ex post divide implies that legal provisions may be interpretated either according to their literal formulation, or their intended objective, and therefore creates the existence of two equally valid statutes, or one more valid than the other without clarity, on a given situation. Such duality raises concerns for both legality and legal certainty. For the law to be distinguishable from arbitrary exercises of power from the perspective of taxpayers, it must avoid unilaterally defining formal structures in connection to taxation while leaving them intact for civil law considerations. In layman's terms, only one legal reality must exist, and if more than one is found to exist, it may be impossible to determine the right one.

[64] OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, Chapter 7, B.2.3.1. part 7.31.

However, a difference in interpretive methods is a common feature of legal systems colliding internationally. While it presents a challenge if the interpretive methods were applied arbitrarily, it cannot be argued that the mere existence of other methods disqualify taxation. Via simple practicality, some methods are more accurate, less cumbersome, and thus make sense to apply practically. Additionally, having multiple applicable methods may grant the taxpayer more opportunity to argue the selected pricing as being on arm's length terms. In this sense, the dual framework arguably exists not as two separate realities, but rather the method by which to reach the closest estimate in situations where a fixed result is difficult, if not impossible to reach.

The issue is therefore not the coexistence of multiple interpretive approaches, which is a common feature of modern legal systems, but may be the absence of sufficiently clear criteria governing when a substance based assessment will prevail over the legal form. Where such criteria are unclear, the taxpayer furthermore cannot determine in advance which interpretive approach will be decisive, thereby undermining both legality and legal certainty.

In totality, the reliance on discretionary assessments arguably introduces a risk of uncertainty regarding how transactions will be assessed in practice and poses some questions regarding legality when the discretion is based on non-binding guidance. However, the practical evaluation of economic substance, comparability, and purpose necessarily involves judgement. While it is not evident that the decisive elements of cases are decided arbitrarily, the absence of a clearly defined criteria makes it difficult determine whether the requirement of statutory basis is achieved to ensure arbitrary use of power is avoided.

The solution may therefore be in better transparency, not the reliance on formalism.

5.3 Cumulative discretion and reclassification

5.3.1 Cumulative discretion

The Principle of Legality does not require that all legal assessments operate mechanically without discretion, only that such discretion is to some degree referenced within statutory reference.

The Principle of Legal Certainty in the European Union requires clarity, precision, and predictability. Similarly to legality, however, it does not require the elimination of discretion, only that such discretion is precise and predictable. To achieve this in taxation, it would require the ability of taxpayers to reasonably anticipate how the law applies to them and thereby the potential tax consequences from their transactions.

Transfer pricing regulation presents a unique challenge to both of these requirements. The complexity of the comparability analyses and technical methodologies when determining arm's length conditions necessitate concrete evaluations, which both require administrative discretion, and subsequently make it harder for taxpayers to anticipate the outcome.

The issue presented in the Dubai A case is therefore not the existence of discretion per se but could be described as whether the repeated and cumulative effect of discretionary assessments goes beyond the requirements of legality and legal certainty.

To determine the tax liability in cases such as Dubai A, discretion is used in the selection of methodology which include discretion in identification of comparables, discretion in benchmarking adjustments, and discretion in the reconstruction of arm's length conditions as shown in the comparability analysis, and finally, discretion in the substantive assessment to reclassify the income as a masked dividend.

Different methodologies may produce different outcomes. The determination of taxable income depends on the discretion in this and while the OECD Transfer Pricing Guidelines prescribe applicable methods for intra-group services, it does not clearly prescribe the criteria of selection.

As a result, the taxpayers may be able to identify the statutory framework while unable to reasonably predict the methodology by which their transactions will be evaluated. This extends to the comparability assessment, and each layer further obfuscate their ability to predict the outcome. Similarly, while each step individually may be justifiable from the perspective of the Principle of Legality, their cumulative effect becomes progressively more problematic and may in totality obscure legality.

The issue of discretion is therefore not the existence of administrative discretion as such, but a certain point at which such discretion becomes cumulative obscure. While individual instances of discretion may be compatible with the requirements of legality and legal certainty, problems arise where cumulative discretion is not sufficiently anchored in clear legal criteria and viewed in context while capable of materially determining the final tax outcome. With each additional layer, the distance increases between the taxpayer's ex ante position and the final tax outcome as the combined effect of the cumulative discretions creates a compounding dynamic.

This problem of cumulative discretion becomes additionally significant in the substantive reclassification like in the Dubai A case. When the pricing adjustment ultimately forms the basis for reclassification of income as a masked dividend at the shareholder level, the risk of not fulfilling the requirements goes up. Whether such a step fulfils the requirements of the Principle of Legality in Denmark and the Principle of Legal Certainty in EU law, is uncertain.

5.3.2 Reclassification

A critical question of reclassification is whether the classification of income as a masked dividend constitutes a legal qualification within the existing statutory framework or effectively results in the creation of a new taxable event. The latter would require a clear and explicit legal basis under the Principle of Legality in Denmark.

The Danish tax authority reclassified a transaction between two legal entities, located in separate jurisdictions, onto the physical person who owns the entities but is not a party to the transactions. While the transfer pricing adjustment is grounded in § 2 of the Danish Tax Assessment Act, the reclassification requires its own sufficiently clear legal bases as it no longer involves adjustment of income but where to allocate the change. Accordingly, the reclassification was done based on § 16 A of the Danish Tax Assessment Act. The basis of the Danish Supreme Court's reasoning in the Dubai A case was that the arrangement cannot be compared to something 'which could' have happened between independent parties.

From the perspective of the Principle of Legality in Denmark, this raises the question of whether § 16 A provides a sufficiently clear and autonomous legal basis for such reclassification, particularly where the decisive elements of the assessment derive from a broader evaluation of economic substance rather than explicit statutory criteria. As this was accepted by the Danish Supreme Court, § 16 A is arguably sufficiently grounded.

From the perspective of the Principle of Legal Certainty in EU law, the reclassification introduces a significant degree of unpredictability, as the taxpayer's liability is determined not only by the contractual framework and applicable transfer pricing rules, but by a subsequent and less clearly defined assessment of the transactions overall character.

At the same time, this approach can be understood as a necessary corrective mechanism. While transfer pricing rules functions to correct the pricing of transactions, the reclassification as a masked dividend takes the step beyond and questions the nature of the transaction by placing it in a larger perspective. The outcome therefore appears to be a result of the relationship between the necessity of transfer pricing adjustments and the influence of the Principle of Economic Reality to determine the difference between the formal structures and the substantive reality, necessitating a masked dividend reclassification.

In this sense, a reclassification of transactions as a masked dividend is a strong expression of the emphasis on substance rather than form. This serves as a corrective mechanism, ensuring that distributions are taxed according to their economic benefit rather than their formal designation.

In the Dubai A case, the Danish Supreme Court therefore departed from the contractual framework of the service agreement and placed greater emphasis on probable conduct because the formal structures did not match the reality on the ground. While the services of the transactions were genuine, the pricing was not, and thus a reclassification was required.

5.4 Summary and possibility of safeguards

5.4.1 Summary of analysis

The case of Dubai A, in short, can be understood as a progression from contractual form to substantive reclassification. The analyses demonstrate how the theoretical tension manifests in practice within the Danish transfer pricing framework. Through the interaction of statutory provisions, international guidance, and judicial reasoning, the case illustrates how the Principle of Legality in Denmark, the Principle of Legal Certainty in the European Union, and Principle of Economic Reality operate both in conjunction and in tension.

As the analysis of economic substance moves from pricing adjustments to reclassification, the degree of interference on the taxpayer's legal position increases. This progression suggests that the requirements of legality and legal certainty should become correspondingly stricter. Whether the current framework provides sufficient safeguards in the regard is unsure.

Foundationally, the application of § 2 of the Danish Tax Assessment Act establishes a formal rule-based framework grounded in the Arm's Length Principle. However, the comparability analysis and the selection of methodology introduce a layer of administrative discretion, as the decisive elements of the assessment depend on evaluate choices not explicitly prescribed by law. This discretionary element is further reinforced by the reliance on non-binding international instruments. The introduction of § 3 of the Danish Tax Assessment Act, as a general anti-avoidance rule, further emphasise this relationship of substance-based assessment versus formal structures with the aim of determining their economic reality.

These elements reveal a structural mechanism in which tax liability is not determined solely through ex ante compliance with formal rules, but through a series of ex post assessments of economic substance. The reclassification of income as a masked dividend extends this mechanism beyond pricing adjustments and into a substantive evaluation of the nature and allocation of income.

While each stage of this progression may be justifiable, their combined effect is to shift the determination of tax outcomes from a rule-based system towards a discretionary and substance-oriented evaluation. This creates a structural mismatch between how taxpayers are expected to comply with the law and how their tax liability is ultimately assessed.

Furthermore, the reliance on discretionary methodologies and non-binding international instruments challenges the extent to which taxpayers can reasonably predict their tax liability. This concern becomes particularly significant where the taxpayer is assessed based on transactions or arrangements to which they are not themselves a direct party, but such tax liabilities are nonetheless attributed to them.

At the same time, the approach adopted in the Dubai A case can be understood as a necessary mechanism to ensure taxation reflects the underlying economic substance rather than formal legal structures. The Principle of Economic Reality thereby serves as a counterbalance to the use of civil law arrangements as a means of avoiding taxation.

In totality, the case illustrates that the tension between the Principle of Legality in Denmark, the Principle of Legal Certainty in EU law, and the Principle of Economic Reality is not incidental, but structurally embedded within the Danish transfer pricing framework. While substance-based assessment enhances the effectiveness of the tax, it does so at the cost of reduced predictability and increased reliance on administrative discretion.

The analysis of this thesis therefore demonstrates that the Danish approach to transfer pricing operates within a dual framework in which legality and predictability are formally maintained, but in practice to a degree constrained by discretionary evaluation of economic reality.

The following section will suggest some possible safeguards to provide a better balance between the principles, thereby protecting the interests of the taxpayer without leaving the systems of taxation without the flexibility needed to prevent the misuse of civil law structures.

The intention is to not replace the substance-based taxation with formalism, but to ensure that the pursuit of economic reality preserves legality and predictability.

5.4.2 Codified methodological hierarchy

A possible safeguard could be the introduction of a codified methodological hierarchy within the statutes or accompanying guidance. Such a hierarchy could prioritise traditional transaction comparison methods over profit-based, unless specific and clearly defined conditions justify deviation.

While the OECD Transfer Pricing Guidelines already contain natural preferences, the non-binding nature limits their ability to ensure predictability for taxpayers. A statutory or quasi-statutory anchoring of methodological priority would therefore strengthen the taxpayer's ability to anticipate the applicable method ex ante.

5.4.3 Transparent comparability disclosure

Another safeguard could be the structuring of the comparability analysis with better transparency. A mandatory disclosure of the selection criteria and clearer rules on when adjustments are required would provide a scope of divergent interpretations visible to taxpayers without eliminating the necessary flexibility required for transfer pricing.

5.4.4 Burden of proof

A clarification of the allocation of the burden of proof may also enhance legal certainty. A requirement for tax authorities to demonstrate that an estimate represents the most reliable approximation of arm's length conditions, rather than a result which is not "manifestly unreasonable", could strengthen the legal basis of such assessments.

5.4.5 Reclassification threshold

With regards to reclassification, it was the biggest interference upon the taxpayer yet had the weakest predictability as each discretionary level added obscurity. A clearer threshold may therefore be required.

Given that the reclassification moves beyond transfer pricing and alters the legal nature of a transaction, it could be limited to where demonstrably inconsistent with the actual conduct of the parties. A codified threshold for transfer pricing, similar to the conditions found in § 3 of the Danish Tax Assessment Act and the GAAR, placing restrictions on corporate versus personal tax liability, could assist in both legality and predictability, by keeping the adjustment within the parties of the transaction.

6 Conclusion

6.1 Core finding of the thesis

The preceding sections examined the principles of law which establish the boundaries in the legal landscape which the case of Dubai A exist in. This reveals a structural tension between competing foundational objectives. The analysis undertaken demonstrates that the Danish transfer pricing framework operates within a dual structure system. While the Arm's Length Principle and its statutory anchor in § 2 of the Danish Tax Assessment Act provide an appearance of ex ante predictability, the practical application of the comparability analysis, methodological discretion, and subsequent reclassification mechanism reveals a system in which tax liability is ultimately determined through ex post evaluation of economic reality. The Dubai A case illustrates this progression from contractual form to substantive reclassification, showing how each step from pricing adjustments to masked dividend taxation intensifies the interference with the taxpayer's legal position while simultaneously reducing the relevance of formal legal structures. The development can be argued to create a structural misalignment between the expectations placed on taxpayers and the criteria by which they are ultimately assessed. While such flexibility may be necessary to prevent the misuse of civil law structures and ensure that taxation reflects genuine economic substance, especially in the field of transfer pricing, it also challenges the requirements of sufficiently clear legal basis and predictability.

6.2 Answer to research question

The research question of this thesis concerned:

> To what extent is the Principle of Economic Reality compatible with the Principle of Legality in Denmark and the Principle of Legal Certainty in the European Union in connection with Danish transfer pricing regulation?

The Principle of Economic Reality is not inherently incompatible with the Principle of Legality in Denmark nor the Principle of Legal Certainty in EU law. However, its compatibility is conditional upon the existence of sufficiently clear statutory anchoring and the lack of arbitrary administrative discretion.

In the Danish transfer pricing framework, § 2 of the Danish Tax Assessment Act provides the legal basis for adjustments while § 3 provides the GAAR substance over form regulation. However, the decisive elements in § 2 of methodology, comparables, and the reclassification logic are not codified in statutes but rather rely on OECD guidance. While this guidance provides some clarifications and specific appropriate methods, they generally rely on administrative discretion in their selection.

The Principle of Economic Reality struggles to be reconciled with the Principle of Legality where it effectively determines tax outcomes through non-codified and discretionary assessments.

Transfer pricing inherently requires evaluation which makes absolute predictability unrealistic. However, the taxpayer cannot adequately predict the methodological choices, the chosen comparables, or the potential taxation at the shareholder level resulting from this. The shift from ex ante compliance to ex post assessment creates a structural limitation on predictability, particularly where tax liability depends on cumulative discretionary evaluations rather than clearly defined criteria.

In conclusion, the Principle of Economic Reality is compatible with the Principle of Legality in Denmark and the Principle of Legal Certainty in EU law only in a limited and conditional sense. While it serves as a necessary function in ensuring that taxation reflects substantive economic activity, its application within Danish transfer pricing framework relies on layered and insufficient constrained discretion. This creates a structural imbalance, in which legality and predictability are formally preserved but materially weakened. The restoration of this depends not on the abandonment of substance-based assessment, but on the introduction of clearer statutory guidance and more precise limits on administrative discretion.

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