



Executive bonus was non-deductible pursuant to Section 6 of the Danish Central Government Tax Act

In a recent ruling, the Danish Supreme Court had the opportunity to assess whether it is possible to deduct a bonus issued to a managing director in consideration of the director's work in connection with the sale of the company.

The case in brief

The case is about a sale of a company (the "Company") and two of its affiliated limited partnerships. Two of the Company's directors had entered into an agreement with the Company on payment of bonuses to the directors as remuneration for their work and for the work to be carried out in connection with the sale of the companies.

The size of the bonus depended on the size of the purchase price and was conditional on the companies being sold, and that the directors remained employed until the date of the sale and thus not past the date of the sale. The bonus was further conditional on the directors investing a minimum of 75% of the bonus in shares in the company that the buyer was expected to establish in connection with the sale of the companies.

The companies were sold in May 2001, and the directors were paid an approximate 14.5 million bonus. The Company deducted the paid bonuses as operating costs.

According to the Company, the bonus agreement was part of the regular payment to the directors. Neither the Danish National Tax Tribunal nor the Danish High Court acknowledged this view.

The legal frame of reference for salaries and bonuses

According to Section 6(1)(a) of the Central Government Tax Act, it is possible to deduct operating costs when calculating taxable income. Operating costs include costs spent during the year to acquire, ensure and maintain income, including ordinary depreciation.

Typical operating costs covered by Section 6(1)(a) of the Danish Central Government Tax Act are e.g. salary payments. From a tax point of view, bonus payments have traditionally been treated as salary payments.

The Supreme Court ruling of 8 April 2009

The Supreme Court ruled that the purpose of the bonus agreements was to pay the directors for their work in connection with the sale of the companies and to ensure that the directors remained employed until the date of the sale. The Supreme Court based their ruling on the bonus payments being awarded to ensure the highest possible purchase price for the companies.

Based on the above, the Supreme Court stated that the paid bonus were thus not connected to the Company's operations, which pursuant to Section 6(1)(a) is necessary for the cost to be deductible. However, the Supreme Court stated that the bonus had been paid in the shareholders' interest, and that the bonus amount was thus not paid to acquire, ensure or maintain the Company's income.



Consequences of the Supreme Court ruling

In connection with bonus agreements, it is our recommendation that companies should be aware that these are not deductible if their purpose is to pay directors for their work in connection with a sale of a company. We therefore advise caution when entering into bonus agreements in which payment is related to a conditional sale of a company, and where the bonus is dependent on the size of the purchase price and employment until the date of the sale.

It cannot be concluded from the Supreme Court ruling whether all bonuses are to be considered non-deductible operating costs. Thus, deductible bonus agreements can be made pursuant to Section 6(1)(a), if the bonus is related to the company's operations – e.g. retention bonuses.

If you have any questions or require additional information on the above, please contact attorney Lasse Dehn-Baltzer (ldb@mwblaw.dk) or attorney Henning Hedegaard Thomsen (hht@mwblaw.dk).

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