

TAXATION OF FOREIGN EXPATRIATES IN DENMARK

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Introduction

Denmark has since 1992 had a favourable regime for the taxation of foreign expatriates working temporarily in Denmark. In general, after paying social security contributions at the rate of 9 per cent, any income received was subject to taxation at a flat rate of 25 per cent. The effective tax rate was thus 31.75 per cent, which from a Danish point of view is very attractive, taking an effective marginal tax rate of approximately 62 per cent into consideration.

The flat rate of 25 per cent applied to income received during the first three years in Denmark. Thereafter, taxation was imposed according to the ordinary provisions. However, one of the major drawbacks under the old law was a clawback provision, which was triggered if the expatriate stayed in Denmark for more than four years after the initial three-year period. In this case the income originally taxed at the rate of 25 per cent became subject to taxation under the ordinary income tax provisions. The 25 per cent tax was considered a payment on account of the final tax due.

In the spring of 2002 the law was changed significantly and the clawback provision was limited significantly. Since 1998 the clawback provision had applied to all employees except for certain scientific researchers.

Section 48E of the Tax at Source Act (*kildeskatteloven*)²

Section 48E lists a number of conditions, which must be met before the election under section 48E may be made.

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² Act No. 678 of 12 August 2002.

Subject to Taxation to Denmark on Worldwide Income

Taxation under section 48E is an option available to individuals who become taxable in Denmark on their worldwide income³ in connection with employment by an employer subject to Danish taxation. The option is thus not available for expatriates stationed in Denmark by a foreign employer.

Full tax liability to Denmark is triggered if a foreigner acquires a residence in Denmark and actually takes up residence there. Further, a stay for more than six consecutive months is a sufficient basis to become fully taxable. The election to be taxed under section 48E may be made at the time the employee begins to work, but may also be made at a later stage provided the conditions for taxation under section 48E were met at the commencement of the position in Denmark.

Under the Tax Administration Act (*skattestyrelsesloven*)⁴ a taxpayer may request that his tax return be amended up to three years after the end of an income year. As a consequence of becoming fully taxable on their worldwide income, other kinds of income which the expatriate may receive, such as interest, dividends, royalties and other salaries, are taxed in Denmark according to the ordinary provisions. No special relief or exemption is granted in respect of other income the expatriate may have.

However, in order to attract highly-qualified foreign scientific researchers, the condition concerning becoming fully taxable to Denmark does not apply if the qualification as a researcher prior to the beginning of the employment is approved by a public research institution or other research body, or the research body certifies that the individual in question is carrying out scientific or development work⁵. The body making the certification must meet certain requirements under the Act on Research Advice (*lov om forskningsrådgivning m.v.*). If such a certification is obtained then the researcher may live abroad and will thus only be taxable to Denmark on the remuneration received for the scientific work.

Work to be Carried Out in Denmark

Section 48E applies in principle only to remuneration received for services carried out in Denmark. However, if travelling abroad is necessary to perform

³ Section 1 No. 1 and 2 of the Tax at Source Act.

⁴ Act No.859 of 13 September 2000 as amended – section 34.2.

⁵ Section 48E 2.

such services then the work will be considered performed in Denmark if more than two thirds of the services rendered by the expatriate are performed in Denmark.

Further Conditions⁶

The expatriate may not at any time during the three years preceding the time of employment have been taxable to Denmark on his worldwide income, or been taxable to Denmark on remuneration for personal or received income from a permanent establishment which the expatriate may have had in Denmark.

It is a further condition that the taxpayer does not – directly or indirectly, have or at any time during the five years preceding the time of employment have had part in the management control or ownership of the share capital of the company with which the service agreement is concluded. The control condition will be deemed met if the employee owns or has owned more than 25 per cent of the share capital, or controls or has controlled more than 50 per cent of the votes in the company. Holdings by certain relatives must be taken into consideration when calculating whether this test is met. The threshold must not be exceeded at any time prior to the election to be taxed under section 48E or at any time where the income is taxed at the flat rate of 25 per cent.

If the taxpayer has, prior to the employment, been stationed abroad by the research institution or the company with which the service agreement is concluded, the flat rate taxation cannot be invoked. This is also the case if the agreement is concluded with a company which is a member of the same group as the company with which the expatriate originally was employed. The same holding or control requirement as mentioned above applies for the purposes of determining whether a company is a member of the same group.

A taxpayer having obtained a PhD degree abroad cannot be taxed under section 48E upon returning to Denmark if the stay abroad has been financed by public sources from Denmark.

Finally, the employee must receive a monthly salary of at least DKK 52,400 (2002)⁷ or €7,000. This figure is adjusted annually in accordance with inflation. The minimum salary requirement does not apply to approved researchers. However, this amount is the net amount after Danish social security

⁶ Section 48E 3. 1-5.

⁷ Section 48E 3. 5.

contributions, which amounts to 9 per cent. The relevant amount before social security contributions is thus DKK 57,582 or €7,760.

Certain Limitations

Pecuniary remuneration⁸ falls within the scope of Section 48E. Salary holiday payment fees, profit-sharing and bonuses paid under the services agreement are considered pecuniary remuneration. Items such as free lodging and free provision of a car are subject to taxation under the ordinary provisions. This is also the case with regard to any fees received as a board member.

Social security payments paid in Denmark as well as mandatory foreign contributions⁹ are not taken into consideration when calculating the 25 per cent tax.

Contributions to pension schemes with Danish pension funds are excluded when calculating the 25 per cent tax. Contributions to a pension scheme with a foreign pension fund are considered pecuniary remuneration and as such taxable unless relief may be claimed under the pertinent double taxation treaty. This is the case as far as Holland, Switzerland and the UK are concerned.

The tax is imposed at a flat rate of 25 per cent and no deductions or allowances are available. Any other income is calculated according to the ordinary provisions and all available deductions and allowances may be claimed for this purpose.

Time Limit

The lower taxation under Section 48E is only available for up to 36 months within 10 years from the time of the commencement of the first service agreement. If the position of the taxpayer is terminated and the taxpayer is employed within a month after the position is terminated the condition concerning becoming taxable to Denmark does not apply. Further, the conditions concerning not having been taxable to Denmark during the last three years prior to commencement of the employment are also waived¹⁰.

⁸ Section 48E 4.

⁹ Section 48E 5.

¹⁰ Section 48E 6.

If the taxpayer decides to give up his residence in Denmark and thus terminate the tax liability, the tax payer may return to Denmark after three years and then be taxed under section 48E for the remaining part of the 36 month period if the conditions otherwise are met.

Once a taxpayer has elected to be taxed under Section 48E such an election cannot be changed¹¹

Clawback Provisions¹²

The clawback provisions have been significantly changed. Under the old law, income tax at the rate of 25 per cent would be subject to ordinary income taxation if the employee remained in Denmark for more than 48 months after the end of the original 36 month period where the income was taxed at 25 per cent. The 48 month period may consist of one or more periods.

Under the new law the clawback provision only applies if the tax payer has been subject to full or limited tax liability to Denmark on salary income at any time during the five year period preceding the commencement of the employment where the income is taxed at the rate of 25 per cent. In this case the employee may stay in Denmark for a period of up to 48 months after the initial 36-month period has expired. Then the employee will have to terminate his tax liability to Denmark in order not to trigger the clawback provision.

In order to terminate the full tax liability to Denmark it is necessary that the taxpayer no longer has a personal dwelling available in Denmark. A dwelling will be considered to be available if the spouse of the taxpayer continues to live in the dwelling even though the taxpayer moves to another country. It is further a condition that the taxpayer during this three-year period does not receive any remuneration from a Danish employer, which would be subject to limited taxation. A typical example would be remuneration for personal services.

The clawback provision does not apply to approved researchers or other individuals who have not been taxable to Denmark during the five years preceding the commencement of the employment where an election to be taxed under Section 48E is made.

¹¹ Section 48E 7.

¹² Section 48E 8.

If the clawback provision is triggered then the 25 per cent tax paid will be considered a payment on account of the final taxes due.

Transitional Provisions

Any persons subject to taxation under the old regime in force prior to 13th May 2000 may continue to use the regime as long as the conditions under the new law are met. This is of particular importance with regard to the clawback provisions, which now only apply to individuals who have been fully taxable to Denmark within five years prior to the election to be taxed under section 48E being made.