

NEW PROVISIONS CONCERNING THE TAXATION OF DANISH HOLDING COMPANIES

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Introduction

The Danish Parliament passed on 18th December 1998 Bill No. 53 (hereinafter referred to as the "Act")² which contains some very interesting features relating to the taxation of Danish holding companies. The new law makes Denmark an interesting country in which to set up a holding company of an international group of companies.

Abolition of withholding tax on dividend distributions

Under the Act no Danish withholding tax is imposed on distributions made by Danish companies provided that the company receiving the foreign dividend owns at least 25% of the Danish company. This holding requirement must be met for a continuous period of one year during which period the decision to make the distribution must be made. It is further a condition that the Danish company is a company as defined in Article 2 of the Parent Subsidiary Directive (EU/90/435). Article 2 refers to Danish "Aktieselskab or A/S" or "Anpartsselskab or ApS". The Bill does not set forth any requirements as to the kind of foreign company to which distributions can be made or the place of incorporation for such companies.³

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2 Act No. 1026, 23rd December 1998 concerning the amendment of several tax acts.

3 Section 2.1.a of the Corporate Tax Act - Act No. 727, 7th October 1998 as subsequently amended (The Corporate Tax Act).

If the above mentioned tests cannot be met dividend distributions will be subject to ordinary withholding tax of 25%.⁴

Foreign dividends received by Danish companies

The Act introduces an exemption for taxation of foreign source dividends. Such distributions will be exempted from Danish corporate taxation if the Danish parent company owns at least 25% of the share capital in the foreign subsidiary for a continuous period of at least one year during which period the decision to make the distribution shall be made.⁵ This exemption will not apply if the foreign company conducts financial business and is subject to taxation under provisions which deviate significantly from Danish corporate income taxation.

If the above exemption provision does not apply a taxpayer may according to the Act apply to the Minister of Taxation for a relief for the Danish taxes imposed on the dividend distribution.⁶

The Act contains amendments concerning capital gains taxation of shareholdings in financial companies incorporated in low tax countries. These changes are to be seen in connection with the significant changes of the Danish CFC legislation, which will be described below. Under the new provisions dividend distributions and capital gains on such shares will, under certain conditions, be exempted from Danish corporate income taxation. In order to qualify under the new provisions, the income of the company having issued the shares must either since the acquisition of the shares or for a continuous period of at least three years prior to the time of sale be:

- (1) taxed under Danish CFC legislation;
- (2) taxed in Denmark as a resident company;
- (3) taxed abroad under provisions which do not significantly deviate from Danish corporate taxation;

⁴ Section 65 of the Tax at Source Act - Act No. 735 of 10th October 1998 as subsequently amended.

⁵ Section 13.1.2 of the Corporate Tax Act.

⁶ Section 17.2 of the Corporate Tax Act.

(4) or taxed under any combination of (1)-(3).⁷

Once these conditions are met capital gains or dividends received will be exempted from Danish corporate income taxation.

Changes in CFC legislation

Generally, the income of a controlled foreign company is to be included in the taxable income of the Danish parent if the business conducted by the subsidiary to a significant degree is of a financial nature and secondly its profits are taxed at a significantly lower rate than they would have been according to Danish law.⁸ Under Danish CFC taxation the income of the Danish and foreign companies are jointly taxed according to the so-called forced joint taxation principle.

A foreign subsidiary is deemed to be controlled if the Danish parent directly or indirectly owns at least 25% of the share capital or directly or indirectly controls more than 50% of the votes. Holdings by certain related persons are to be included for purposes of determining whether the holding requirement is met.

According to the Act the business of the subsidiary will to a significant degree be deemed to be of a financial nature if at least 33.3% of its income is derived from financial or insurance business or if the market value of its financial assets amounts to at least 33.3% of the total assets of the company.⁹

A holding company is generally considered to conduct financial business. However, if the foreign subsidiary is a local holding company, the company is transparent for Danish CFC purposes and the activities of those of its subsidiaries resident in the same country as the local holding company are to be taken into consideration when deciding whether the Danish CFC provisions apply. The application of this transparency provision is limited and the ordinary 33.3% tests concerning the qualification apply if the holding company has subsidiaries in other countries.

With regard to the requirement governing the level of taxation the following general observation is expressed in a circular letter. A foreign company will not be considered to be taxed according to provisions which deviate significantly from the

⁷ Section 2a.6-8 of the Act on Taxation of Gains on Shares - Act No. 642, 8th August 1998.

⁸ Section 32 of the Corporate Tax Act.

⁹ Section 32.2 of the Corporate Tax Act.

Danish provisions if taxed at a rate of 25% or above and the taxable income is made up according to principles similar to the Danish ones.¹⁰

As a consequence of the change of the capital gains treatment of shares in financial companies incorporated in low tax jurisdictions a further limitation provision is to be introduced. Capital gains on such shares will, as explained above, be taxed as any other capital gain on shares realised by a corporate taxpayer and as such exempted from capital gains taxation after three years of ownership.

The limitation provision applies if the shares in the foreign financial company are sold to shareholders that are not considered related to the selling shareholder. If they are, the parent company must include in its taxable income the gain the subsidiary would have realised had it sold all its assets on which gains would have been taxable, according to the Danish Act on Gains and Losses on Claims Debentures and Financial Instruments, had the subsidiary been subject to Danish taxation.¹¹ In the absence of this provision it would have been possible to structure the income flow in such a manner that no taxable amount would have been realised within the first three years of ownership. The company, including accrued income, could then have been sold after three years without triggering any taxation.

Conclusion

Under the new Act a Danish holding company will be taxed as follows:

- (1) No withholding tax on dividend distributions made;
- (2) Dividend distributions made by qualifying companies are exempt if the Danish holding company has owned at least 25% of the share capital for a continuous period of one year, during which the decision to make the distribution shall be made;
- (3) No capital gains on qualifying shares if owned for more than three years. Capital gains on shares owned for less than three years are taxable at the rate of 32% and capital losses on shares owned for less than three years may be deducted from capital gains on other shares. The acquisition price for taxable shares is made up as an average of the purchase price for such shares;

¹⁰ Circular letter No. 82, 29th May 1997.

¹¹ Section 32.4 of the Corporate Tax Act.

- (4) The corporate tax rate is 32% as of 1st January 1999;
- (5) No capital duty is imposed on the formation of a holding company;
- (6) A binding tax ruling may be obtained.