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Global Tax Alert

Danish Parliament amends certain international tax provisions

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On 6 September 2018, the Danish Parliament enacted bill no. L 237 A that amends various international tax provisions in Danish law. The key provisions are summarized below.

Double taxation of dividends derived by permanent establishments

If a permanent establishment (PE) in Denmark owns portfolio shares in Danish companies it would previously be subject to the double taxation of dividends. First, the distributing company would be required to apply a 27% withholding tax on dividends distributed, and second the dividends would be subject to corporate tax in the hands of the PE without credit given for the withholding tax. By contrast, if dividends where received by a resident company, the withholding tax would be creditable against the final tax liability of the company. This difference in tax treatment of resident and nonresident companies has been contrary to the free movement of capital under the Treaty of the Functioning of the European Union (TFEU) article 63 and article 40 of the European Economic Area (EEA) Agreement. For this reason the law has been amended allowing PEs to be entitled to a credit for withholding tax. The law change takes effect from income year 2015.

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Nonresident pension funds' investments in Danish real property

Resident pension funds are subject to tax at a rate of 15.3% on income from real property on a mark-to-market basis. By contrast, nonresident pension funds have been subject to tax at a rate of 22% on income from direct investments in Danish real estate on a realization basis. In 2016, the European Commission notified the Danish Government that the Danish taxation was incompatible with the free movement of capital. For this reason the Danish taxation of nonresident pension funds' *direct* investment in Danish real estate has been reduced to 15.3% on a mark-to-market basis. The new rules are applicable to nonresident pension funds covered by EU Directive 2016/2341/EU or Directive 2003/41/EEC or funds that meet the conditions in section 52(2-4) of the *Danish Pension Taxation Act*. Insurance companies do not qualify even if they are covered by article 4 of the directives. The pension fund must be tax resident in another EU Member State or EEA country. The new rules apply from 1 July 2018, but a nonresident pension fund may request the tax return for income year 2015 and onwards to be reopened in order to be taxed under the new rules.

The new rules do not cover nonresident pension funds' *indirect* investments in Danish real estate through a Danish property company. In this situation, the property company will be subject to tax at a rate of 22% on a realization basis. If a resident pension funds makes such an indirect investment, the property company will be treated as transparent for tax purposes and the income will be subject to 15.3% tax in the hands of the pension fund on a mark-to-market basis. This difference in tax treatment is potentially also incompatible with EU law.

Thin capitalization – *Masco Denmark*

The Danish tax rules on thin capitalization are applicable to controlled loans granted by both resident and nonresident shareholders. A resident shareholder is exempt from taxation on interest income and capital gains on loans granted to a Danish debtor company, if a tax deduction for the corresponding interest expenses or capital loss is disallowed for the debtor company. This rule does not apply to interest income and capital gains on loans granted to nonresident companies where a tax deduction for the corresponding expenses are disallowed under foreign thin capitalization rules. In 2016, the Court of the European Union held that the difference in tax treatment between controlled loans granted to resident and nonresident companies is incompatible with freedom of establishment in TFEU article 49, see case C-593/14, *Masco Denmark*.

For this reason a new rule has been introduced under which a creditor is exempt from Danish taxation on interest income and capital gains on controlled loans granted to nonresident debtor companies if the following conditions are satisfied:

- The nonresident debtor company is tax resident in another EU Member State or an EEA country.
- The nonresident debtor company would be disallowed a tax deduction for the interest expenses or capital loss under the Danish thin capitalization rule if it had been a resident company.
- The nonresident debtor company has not been entitled to claim a tax deduction for the interest expenses or capital loss under foreign tax rules that are similar to the Danish thin capitalization rule.

The new rule is applicable from 1 July 2018. However, the tax authorities are expected to issue a circular that will make it possible to apply the new rule for older income years.

Section 2 D(2) – scope of anti-avoidance rule regarding dividends broadened

Under section 2 D(2) of the *Danish Corporate Tax Act*, certain internal reorganization and similar arrangements where a taxpayer disposes of shares but remains a shareholder in the company that acquires the shares or companies that are affiliated with this company, receive dividend treatment rather than capital gains treatment. The scope of section 2 D(2) has been expanded to cover situations where shares are sold to an "empty" company in a pure cash transaction, but affiliated persons owns shares in the acquiring company or affiliated companies. The law changes is applicable from 1 July 2018.

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