

### **Does new Legislation make Denmark an Attractive Holding Company Location?**

With effect from 1 January, 1999, the Danish Parliament changed the regime for taxation of Danish Holding Companies - including for third-country investors.

The principal change is that the domestic withholding tax on dividends, paid to foreign parent companies, is abolished with effect from financial years beginning 1 January, 1999. The new legislation also makes dividends received by a Danish Holding Company exempt from taxation regardless of the underlying taxation of the foreign subsidiary.

Both inbound and outbound dividends are consequently exempt from taxation. This will enable third-country investors to repatriate profits from Europe without suffering any withholding taxes. A Danish Holding Company suppresses no capital duty and enjoys full deductibility of financing expenses incurred with respect to foreign subsidiaries.

The most important features of the Danish tax law applicable to Danish Holding Companies are set out below.

#### **Dividends Received**

Dividends received by a Danish Holding Company from a foreign company are exempt from Danish taxation, provided that the shareholding amounts to at least 25% of the share capital and the shares are owned for at least one year. Tax-exempt dividends may be received immediately after the acquisition of a subsidiary, provided that the minimum shareholding is retained for at least one year afterward.

As a result of the EU parent-subsidiary directive and the extensive number of tax treaties concluded by Denmark, dividends paid to a Danish Holding Company often will not suffer local withholding taxes. Under these arrangements, a Danish Holding Company is exempt from local withholding taxes on dividends received from more than thirty countries and benefits from reduced withholding tax rates with respect to another more than forty countries.

In some EU countries local anti avoidance legislation, however, has to be observed.

### **Dividends Paid**

Dividends paid by a Danish Holding Company to a foreign company will no longer suffer Danish withholding taxes, provided that the foreign company owns at least 25% of the share capital of the Danish company and that the shares are owned for at least one year. The exemption from withholding tax applies regardless of the place of residence of the foreign parent company.

### **Capital Gains and Losses**

Capital gains and losses on shares are exempt from taxation regardless of the underlying taxes paid by the subsidiary, the residence of the subsidiary, and the size of shareholding provided that the shares were held for at least 3 years. Liquidation proceeds received from a subsidiary are treated in the same manner as capital gains and losses. Otherwise gains are taxable at the normal corporate tax rate. Losses may be set off against capital gains on other shares held for less than three years. Capital gains on shareholdings less than 25% (or less than 50% of the voting power) held in low-tax finance companies are, however, subject to taxation, and losses are not deductible.

### **Financing Expenses**

In general, financing expenses that are incurred on a borrowing taken out to fund the acquisition of a foreign subsidiary are fully deductible and may be set off against other profits of a subsidiary, Danish or foreign, jointly taxed with the Danish Holding Company.

According to the Danish thin capitalization rules, interest expense on debt owed to foreign group companies and on debt guaranteed by group companies is restricted if the debt-to-equity ratio of the Danish company exceeds 4:1. However, under an arm's length test, the restriction does not apply if the Danish company substantiates that a similar financing arrangement would be available between independent parties.

## **CFC Taxation**

Subsidiaries with finance income in low-tax countries, may be treated as transparent for Danish taxation, i.e. the income of the subsidiary is directly taxed as if the income was acquired directly by a Danish shareholding company, if the Danish Holding Company directly or indirectly owns at least 25% of the company's share capital or more than 50% of the votes in the company.

A company is regarded as financial for CFE tax purposes when at least 33~~a~~% of the company's income derives from financing activities, or if the commercial value of the company's financial assets amounts to at least 33~~a~~% of the company's total assets.

As before, income from financing typically includes interest income, profits and income from financial leasing. As something new, profit from insurance activities must also be regarded as financing activities.

Only provided a foreign financial subsidiary has been subject to a taxation that does not differ considerably from Danish taxation, the profit will be exempt from tax according to the corresponding rules as those that apply to non-financial companies, cf. above.

However, if a profit received from a low-taxed financial company (e.g. company tax under 24%) is in question, then the profit will be fully liable to taxation, unless the company has been subject to the Danish CFC-taxation (mandatory group taxation) since the share acquisition or for at least 3 years in advance of the dividend distribution.

As to the extent that the profit is not exempt from tax, Denmark will modify the underlying company tax according to special rules.

In international group companies at least one company usually carries on activities that according to Danish taxation regulations, will be regarded as financing. Since such companies usually are located in low-tax countries either the earnings from the shares will be taxed in Denmark or the company will be taxed according to the regulations regarding compulsory Danish group taxation (CFC-taxation).

In order to avoid the above Danish taxation, it may of course be consid-

ered whether the foreign company should reorganize, so that only production companies are owned by the Danish Holding Company, while the company's financial companies are owned by the foreign Holding Company, and thereby it will be a sister company to the Danish Holding Company. In the mean time profit directly or indirectly deriving from a company which has sold off a financial company for an uncertain period, however probably for a period of approximately 3 years, will apparently only be taxed through the general company tax within the Danish Holding Company.

### **Situs of management**

However, a Danish Holding Company will usually not carry on other activities than acting as parent company, just as the administration will not be appointed actual business-related authority. This implies a risk of the company being regarded as fiscally domiciled where the actual group management is domiciled, and being taxed according to this county's regulations.

### **Divestment**

Foreign shareholders are not subject to Danish corporate taxation or any other taxation on capital gains derived from the sale of Danish Holding Companies.

### **No withholding tax on interest**

Denmark does not levy withholding taxes on interest payments. Foreign subsidiaries may choose to be jointly taxed with a Danish Holding Company, thus allowing foreign losses to be set off against Danish taxable profits.

### **Conclusion**

It is not very attractive to choose Denmark as Holding country, if financial companies with substantial income comprised by special Danish taxation

regulations (CFC-taxation) either are in the chain of companies or have been established within a period of supposedly 3 year before a Danish Holding Company is established.

On the other hand, this would be the case if there, within the group, only are and have been such companies, which the Danish Minister of Taxation characterizes as "production companies".

The Danish regulations on taxation of foreign financial companies are restrictive, and to a great extent the range is unsettled.

### **Advance rulings**

The Danish tax consequence of complex transactions, including transfer pricing issues, may be clarified by a binding advance ruling from the tax authorities. This procedure, however, is highly bureaucratic and will demand some period of time (often no less than 6 months and frequently more).