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Termination of the double taxation treaties with France and Spain

Consequences for companies

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Background

The Danish Ministry of Finance announced on 10 June 2008 that Denmark will terminate its double taxation treaties with France and Spain with effect from 1 January 2009, in accordance with Act no 85 of 20 February 2008. The principal reason for this decision was to safeguard Danish taxation of pensioners.

The termination of the double taxation treaties with France and Spain will have a number consequences for companies. These are outlined below.

Terminating the double taxation treaties means each country will, unless and until any new treaties are negotiated, tax the relevant income according to its domestic tax rules.

The domestic tax rules on dividends, interest and royalties are, however, governed by the EU Directives on Parents/Subsidiaries and Interest/Royalties.

Danish companies with activities in or payments from France and Spain

Dividends

Following the termination of the tax treaties, a Danish parent receiving dividends from a French or Spanish subsidiary should not pay French or Spanish tax on the dividends if the terms of the Parent/Subsidiary Directive are met. [The Directive applies where the parent holds at least 15% of the shares in the subsidiary (10% from 2009) for a period of at least two years (one year in the case of Spain) within which the distribution is made.] The two year period does not have to elapse before the distribution, provided the distribution is later completed.

In France, the standard tax rate is 25%. The exemption based upon the EC parent subsidiary Directive is also available if the required conditions are met. It is worth noting that the French provisions include a special anti abuse provision that has also to be satisfied.

In Spain, the tax rate is 18%, reduced to 0% if the terms of the Directive are met. An anti abuse provision also applies in Spain, where the majority of the ultimate shareholders of the parent company are resident outside the EU.

Interest and royalties

France

As is the case with dividends, following the termination of the tax treaties, a Danish company receiving interest or royalties from a group enterprise in France should not be liable to pay French tax on this this income, provided the terms of the Interest/Royalty Directive have been met.

In France, the standard tax rate for tax at source on interest is 18%. However loans contracted outside of France benefit from a broad domestic exemption, the conditions of which are easy to satisfy. Failing that, the exemption provided for by the EC interest Directive would also be available under certain conditions; for royalties, the tax rate is 33.33% (which may also be reduced to 0% in certain circumstances).

Spain
In the case of Spain, provided the terms of the Interest/Royalty Directive have been met the withholding tax on royalties will be limited to 10%, as Spain has a limitation on the application of the directive. The domestic rate of withholding tax is 24%.

In Spain there is no tax at source on interest to companies domiciled in the EU.

Interest/Royalty Directive
For the Interest/Royalty Directive to apply, companies would need to be 'associated' for a consecutive period of at least two years (one year in the case of Spain) within the period in which the payment is made. A company is 'associated' with another company if:

(i) It directly holds a share of at least 25% of the other company's capital; or
(ii) The other company directly holds a share of at least 25% of its capital; or
(iii) A third company directly holds a share of at least 25% of both its capital and the other company's capital.

Again in the case of Spain anti abuse rules will apply.

Denmark
Interest income and royalties will be taxable at 25% in Denmark.

Permanent establishment in France or Spain
Where a Danish company conducts activities through a branch in France or Spain, the two countries may already tax the company on this income according to the applicable treaties. Under Danish domestic tax rules, income in a foreign permanent establishment is not taxed in Denmark. This will not change following the termination of the tax treaties with France and Spain.

Real property
Under Danish domestic tax rules, income from and gains on a foreign real estate is not taxed in Denmark. Under the current double taxation treaty with France, most companies obtain complete tax exemption on investments in real property in France, provided certain conditions are in place.

Following the termination of the tax treaty with France, French domestic law will apply. Thus French tax will be levied on a Danish company's profit from sale of a real property in France. France will probably also seek to tax current income, and may also seek to levy a special French property value of 3% (with regards this 3% annual tax, please note that companies located within the EU may seek to benefit from the same exemption rules as French companies subject to certain conditions or annual filing requirements).

Regarding real estate investment in France, it may be possible, notwithstanding the abolition of the Danish/French tax treaty, to effectively achieve almost the same outcome as before abolition, while also making savings on French stamp duty/real estate transfer tax. Please contact us for further advice if this may affect you.

Under Spanish domestic law the sale of and income arising from Spanish real estate is taxed in Spain. Gains will be taxed at 18%, while income arising will be taxed at 24% (with no deduction for costs incurred).

In general holding property in Spain is a complex area and as such, professional advice may be required for Spanish real estate transactions.

Internal relief

Currently, Denmark reduces the tax levied on a Danish person or a Danish company receiving income from a foreign state by the tax which that foreign state in question has charged on the income.

The termination of the tax treaties will have negative consequences for Danish fully taxable companies if the foreign state's tax under domestic legislation is higher than the Danish tax, and the applicable double taxation treaty has formerly operated so that the other foreign state has reduced this tax in order for it to be lower than the Danish tax. This will particularly apply for dividends. Most countries' national tax rules impose a tax at source of between 20% to 30% on dividends paid to foreign shareholders. Typically, double tax treaties reduce this rate to 15% for shareholders other than parents. It should, accordingly, be established precisely what rate of tax at source is charged in France or Spain.

The termination of the tax treaties could result in an increase in the aggregate taxation in cases where foreign dividends are included in a pension scheme, where the return is taxed at 15 % under the Danish Taxation of Pension Schemes Act, and where the foreign tax is higher than the 15% Danish tax rate.

French and Spanish companies with activities in or payments from Denmark

Termination of the tax treaties means that Denmark taxes the income concerned in accordance with Danish tax rules.

Dividends

With respect to dividends paid from Danish companies to companies in France or Spain, the EU's Parent/Subsidiary Directive applies. Under the Directive, when a Danish subsidiary distributes dividends to a French or Spanish parent, Denmark cannot impose tax on dividends, irrespective of the termination of the treaties.

However, if the terms of the Directive are not met, distribution of dividends to recipients in these countries will be taxed at 15% if the recipient owns less than 10% of the dividend-paying company, and the tax authorities of the other country are obliged under an international agreement to assist the Danish tax authorities in exchanging information.

Interest and royalties

Intra-group interest and royalty payments from Danish companies to French or Spanish companies may be tax-exempt in Denmark under the Interest/Royalty Directive, assuming the associated companies requirements are met. Under new Danish legislation, the paying company and the receiving company must be associated for a consecutive period of at least one year, within which period the payment is made. Accordingly, it is sufficient that the payer and recipient are associated when the interest is paid.

Danish rules on tax at source on interest and capital gains do not apply to interest and capital gains relating to bank loans that are guaranteed by a group company.

Where the Interest/Royalty Directive requirements are not met, interest and royalty payments to recipients in France and Spain will be subject to 25% Danish tax at source.

Permanent establishment in Denmark

Termination of the treaties will not have a significant impact where a French or Spanish company conducts activities through a branch in Denmark. Under Danish domestic tax rules, Denmark already imposes tax on the income from these activities.

Real property

With respect to French and Spanish companies' investments in Danish real properties, both income from real property and profits on sales of real property will be subject to Danish tax.

However, capital gains on shares in Danish companies, including Danish real estate companies, is tax exempt in Denmark for non-residents, including French and Spanish companies.

Other Issues

It should be noted that certain beneficial provisions in domestic Spanish legislation are tied to the existence of a double tax treaty with an exchange of information clause.