PRACTITIONERS' CORNER

Out of Denmark — Dividend Withholding Taxation Expanded

by Jens Wittendorff

Jens Wittendorff is an international tax partner with Deloitte Copenhagen and an honorary professor with the Department of Business Law of Aarhus School of Business and Social Sciences, Aarhus University, Denmark.

The Danish parliament has passed two bills that significantly expand the scope of dividend withholding taxes: Bill No. 10 and Bill No. 49.[1] The new provisions are broadly worded, and genuine business transactions may easily trigger unintended taxation. For example, a U.S. parent company's sale of a U.S. subsidiary to a Danish subsidiary against a note may now trigger 27 percent Danish dividend withholding tax calculated on the basis of the sale proceeds (see Section I.E.3 below). During the parliamentary hearing, the minister of taxation stated that this exact example did not cause him to believe that the scope of the new rules was too wide. It is thus essential that all reorganizations involving Danish companies are now made carefully.

Bill No. 10 aims at preventing nonresident taxpayers from circumventing dividend withholding tax by internal reorganizations. The rationale for such transactions is the asymmetric taxation of the nonresident's capital gains and dividends. Hence, Denmark does not levy tax on capital gains on shares in Danish companies derived by nonresidents unless the shares are attributable to a permanent establishment in Denmark. By contrast, nonresidents are subject to a 27 percent withholding tax on dividends from Danish companies. Nonresidents that intend to repatriate cash from a Danish subsidiary may thus be better off by adopting a transaction that receives capital gains treatment rather than dividend treatment. This bill also aims to make it less attractive to use Denmark as an international holding company location.

Bill No. 49 aims at preventing resident minority corporate shareholders from transforming taxable dividends into tax-exempt capital gains through liquidations, share redemptions, and repurchase strategies. Again, the basic issue is the asymmetric taxation of dividends and capital gains. For unspecified reasons the new rules also are applicable to nonresident minority shareholders even though they are generally not subject to Danish taxation on capital gains. This bill also covers the sale of shares to companies that are controlled by the issuing company. This part of the bill affects both majority and minority shareholders regardless of whether they are tax residents or nonresidents.

Section I of this article describes the dividend withholding tax rules applicable to nonresident parent companies. It also addresses recent law changes made to cope with withholding tax avoidance schemes and the scope and impact of the new rules on group reorganizations. Section II analyzes the new rules on sales of shares to subsidiaries. Section III discusses the new

[1]Bill No. 10 of Oct. 3, 2012, enacted as Act No. 1254 of Dec. 18, 2012; and Bill No. 49 of Nov. 1, 2012, enacted as Act No. 1255 of Dec. 18, 2012.

rules affecting minority shareholders. Section IV analyzes the new rules' effect on tax provisions in Danish tax treaties.

I. Group Reorganizations

A. General Rules

Nonresident parent companies are subject to tax on dividends from a Danish company at a rate of 27 percent,[2] and the distributing company is required to apply a withholding tax of 27 percent.[3]

However, dividends paid to a nonresident parent company are exempt from Danish taxation under domestic law provided specific conditions are satisfied,[4] whereby the distributing company is relieved from applying the withholding tax.[5] Tax exemption applies if all the following conditions are satisfied:

- the parent company owns at least 10 percent of the share capital of the Danish company;
- taxation of the dividends must be eliminated or reduced under the parent-subsidiary directive (2011/96/EU) or a Danish tax treaty; and
- the dividends paid do not qualify as redistribution of dividends received from nonresident group companies, unless the Danish company is the beneficial owner of the dividends (see Section I.F of this article).

A nonresident parent company that is tax resident in another EU member state or in a country with which Denmark has concluded a tax treaty is thus normally exempt from Danish tax on dividends from a Danish subsidiary provided that the parent company is the beneficial owner thereof.

If the ultimate parent company is tax resident in a non-treaty country outside the EU, the 27 percent withholding tax will apply. To avoid the withholding tax in this situation, holding companies resident in an EU member state or treaty country have been interposed between the Danish subsidiary and the ultimate parent company. These structures have also been used by private equity funds organized in non-treaty jurisdictions. In response, the tax authorities have adopted a broad interpretation of the beneficial ownership requirement laid down in article 10 of most Danish tax treaties, and have further argued that this requirement also applies regarding the parent-subsidiary directive even though it is not mentioned in the directive. On this basis the tax authorities have determined that a large number of Danish subsidiaries have neglected their withholding tax obligation because intermediary holding companies have been deemed not to satisfy the beneficial ownership requirement. In 2011 the taxpayer prevailed in *ISS*, the first Danish court case dealing with the tax authorities' interpretation of the beneficial ownership requirement.[6] However, because the facts of this case were somewhat extraordinary, the tax authorities have not abandoned other cases with different fact patterns.

Facing intensified withholding tax audits and a broad interpretation of the beneficial ownership requirement, nonresident taxpayers have adopted new strategies to escape the dividend withholding tax. As mentioned above, such strategies may rely on the fact that Denmark does not levy tax on capital gains derived by nonresidents. Among other things, the dividend withholding tax could be avoided by the following types of transactions:

- migration of Danish subsidiary;
- tax-exempt cross-border merger;
- liquidation and share redemption in some situations; and
- reorganization of the ownership of Danish subsidiary.

While the first three transaction types were addressed by law changes in 2009 and 2010, the fourth transaction type was the subject of Bill No. 10 in 2012.

B. Migration of Subsidiary

If a Danish company ceases to be subject to full Danish taxation, or if it becomes tax resident in another country under the tiebreaker provision of a tax treaty, the company is deemed to have disposed of all its assets and liabilities at fair market value.[7]

Effective March 11, 2011, the net value of a company migrating from Denmark receives dividend treatment if a dividend from the company would have triggered Danish taxation.[8] Danish taxation may thus be triggered at both the company and shareholder levels. Hence, it is no longer possible to ensure a tax-exempt repatriation of retained earnings from a Danish subsidiary by paying a dividend to a Danish holding company that is then migrated to a foreign state.

C. Cross-Border Merger

A Danish company may enter into a tax-exempt cross-border merger as the ceasing company in some situations.[9] Taxpayers have relied on this option in order to avoid withholding tax on retained earnings of a

[2]Section 2(1)(c) and (2) of the Danish Corporate Tax Act.

[3]Section 65(1) of the Danish Withholding Tax Act.

[4]Section 2(1)(c) of the Danish Corporate Tax Act.

[5]Section 65(5) of the Danish Withholding Tax Act.

[6]TfS 2012, 502 (SKM2012.409). The decision has not been subject to appeal and is thus final.

[7]Section 5(7) of the Danish Corporate Tax Act. An exemption applies for assets and liabilities that are subject to Danish taxation afterwards; for example, real estate located in Denmark or assets and liabilities attributable to a PE in Denmark.

[8]Section 5(5) of the Danish Corporate Tax Act. *See* Act No. 254 of Mar. 30, 2011 (Bill No. 84 of Nov. 24, 2010).

[9]Section 15(4) of the Danish Merger Tax Act.

Danish company by merging the company with a group company in another EU member state. Retained earnings were transferred out of Danish tax jurisdiction without any withholding taxes.[10]

Effective November 24, 2010, cash proceeds paid to a shareholder in the ceasing company, and the cancellation of shares in the ceasing company by the continuing company, receive dividend treatment if a dividend from the company would trigger Danish taxation.[11]

D. Share Redemption and Liquidation

Previously, liquidation proceeds and share redemptions received capital gains treatment provided that the proceeds were paid in the calendar year in which the company was finally dissolved. A nonresident parent company thus would not be subject to Danish taxation on the proceeds from a Danish subsidiary even if a distribution of dividends from the company would have triggered withholding taxes. It was thus possible to repatriate retained earnings from a Danish subsidiary by paying a dividend to a Danish holding company and then liquidating the holding company.

Effective from the 2010 tax year, liquidation proceeds and share redemptions receive dividend treatment in the following two situations:[12]

- The nonresident shareholder owns more than 10 percent of the share capital and does not qualify for exemption from dividend taxation.
- The nonresident shareholder owns less than 10 percent of the share capital, is subject to dividend tax, and is affiliated with the liquidating company (unless the shareholder is tax resident in another EU or European Economic Area member state and the taxation should have been eliminated or reduced under the parent-subsidiary directive or a Danish tax treaty if the shareholding had exceeded 10 percent).

In these situations the dividend treatment means that share redemptions or liquidation proceeds trigger dividend withholding tax.

E. Group Reorganization

A straight dividend that would trigger withholding tax has sometimes been transformed into a tax-exempt sale of shares and repayment of a note. This has been accomplished in the following way: (1) a nonresident parent company establishes a Danish NewCo, (2) the shares of a Danish subsidiary are sold to NewCo against a note, (3) the subsidiary pays a dividend to NewCo, and (4) NewCo uses the dividend proceeds to repay the note.

Effective October 3, 2012, the sale of shares in an affiliated company to another affiliated company may receive dividend treatment under the new section 2 D of the Corporate Tax Act.[13] Section 2 D applies to both resident and nonresident sellers.

1. Conditions

Section 2 D applies to the sale of shares, convertible bonds, and subscription rights to such securities, if all the following conditions are met:

- the seller is a ''legal person'' that is a resident or nonresident;
- the target is an ''affiliated company'' that is a resident or nonresident;
- the buyer is an affiliated company or an ''affiliated foundation or trust''; and
- the consideration for the shares is not in the form of shares issued by the buyer.

The seller must be a legal person, meaning a resident or nonresident company that is treated as a separate entity for Danish tax purposes, or a company that is treated as a transparent entity for Danish tax purposes but that is governed by company law rules, a company agreement, or articles of association. This latter ensures that private equity funds organized as limited partnerships and so forth are within the scope of section 2 D.

The target will usually be tax resident in Denmark since the purpose of the law is to counteract the avoidance of Danish withholding taxes. However, the broad language of the provision means that the target may also be a nonresident company.[14]

The buyer may be a resident or nonresident company. However, a nonresident buyer is not required to apply a Danish withholding tax.[15] In this situation a resident seller is required to file the dividend income on the Danish tax return and pay the tax itself. By contrast, a nonresident seller should not be required to file and pay the tax because a sale of shares hardly is a transaction covered by section 16 A(1) or (2) or section

[10]This scheme was addressed by the following decisions: SKM2010.772.SR, SKM2010.782.SR, and SKM2011.159.LSR.

[11]Sections 9(2), 15(4), 15(5), and 15a(10) of the Danish Merger Tax Act. *See* Act No. 254 of Mar. 30, 2011 (Bill No. 84 of Nov. 24, 2010).

[12]Sections 16 A(3)(1) and 16 B(2)(2) of the Danish Tax Assessment Act. *See* Act No. 525 of June 12, 2009 (Bill No. 202 of Apr. 22, 2009). The law was amended by Act No. 254 of Mar. 30, 2011 (Bill No. 84 of Nov. 24, 2010).

[13]Act No. 1254 of Dec. 18, 2012 (Bill No. 10 of Oct. 3, 2012). A similar provision has been enacted for individuals; *see* section 2(1)(6), third sentence, of the Danish Withholding Tax Act.

[14]Bill No. 10, exhibit 4, p. 23.

[15]A nonresident buyer is not obliged to apply a dividend withholding tax. *See* Bill No. 10, exhibit 4, p. 21; exhibit 27, p. 5; and exhibit 27, p. 6 (example 2). A dividend tax liability for a nonresident is finally settled by the application of a withholding tax; *compare* section 2(2) of the Danish Corporate Tax Act.

16 B of the Danish Tax Assessment Act (compare section 65 A(1) of the Danish Withholding Tax Act). Section 2 D is thus inefficient if both the seller and the buyer are nonresident companies. However, if the target pays a dividend to a nonresident buyer after the transaction, this may trigger Danish withholding taxes under the general rules if, for example, the buyer is not the beneficial owner of the dividends.

Section 2 D defines the term ''affiliated companies'' by reference to section 2 of the Danish Tax Assessment Act. Under section 2(3) of the latter law, affiliated companies are defined to include: (1) companies owned or controlled by more than 50 percent by the same group of shareholders, and (2) companies that share a common management. However, the legislative history to section 2 D applies the term ''affiliated companies'' in a broader sense that includes any relationship covered by section 2. It is thus uncertain whether the narrow definition of section 2(3) or the broader definition of the legislative history must be applied. The tax authorities may prevail by arguing that the broader definition applies because the reference in section 2 D is to section 2 rather than section 2(3), and because the legislative history is quite clear.

The seller must be affiliated with the target both before and after the transaction, and the seller must be affiliated with the buyer after the transaction.[16] If an investor in a transparent private equity fund disposes of its entire interest in the fund, section 2 D will not apply unless the investor otherwise owns shares in the target. By contrast, if the investor only disposes of part of its interest in the fund, section 2 D will apply because the investor will be affiliated with both the target and buyer after the sale.[17] However, in this situation an exemption applies (see below).

2. Exceptions

There are two exceptions from the dividend treatment:

- The seller is tax exempt on dividends from the target immediately before the sale of shares under section 2(1)(c) (nonresident seller) or section 13(1)(2) (resident seller) of the Danish Corporate Tax Act.
- The buyer is not affiliated with the seller before the transaction but became affiliated with the buyer after the transaction due to joint controlling influence over the target, and the seller or an affiliated company does not provide financing to the buyer.

This first exception is straightforward. According to the minister of taxation, section 2 D may apply when a nonresident seller disposes of shares in a nonresident target to a resident buyer.[18] Hence, in this situation the seller cannot rely on the first exception because a nonresident company technically is not tax exempt on dividends from the target under any of the Danish tax provisions. Since no Danish withholding taxes are avoided in this situation, the scope of section 2 D goes far beyond what is necessary to achieve the purpose of the provision.

The second exception will, for example, apply if an unaffiliated investor joins a private equity fund and none of the existing investors leaves the fund, whereby a share of the target is sold.[19] The term ''joint controlling influence'' is defined in the second sentence of section 2 D(2), dealing with entities that are transparent for Danish tax purposes. Hence, a seller will be deemed to be affiliated with the buyer if both the seller and the buyer are members of a transparent entity that controls the target.[20]

3. Tax Consequences

Application of section 2 D means that the sale proceeds are treated as a dividend to the extent that it is not paid in the form of shares issued by the buyer. Since the tax basis is the sale proceeds without a deduction for the purchase price, the deemed dividend may easily exceed a capital gain on the shares.[21] Taxation is even triggered if the seller realizes a capital loss on the shares. On the other hand, no taxation is triggered in a pure share-for-share transaction.

A nonresident seller is subject to Danish tax at a rate of 27 percent of dividend income. However, under the general rules, a tax exemption usually applies if the seller is tax resident in another EU member state or treaty country provided that the seller is the beneficial owner of the dividend (see Section I.A of this article).

The scope of the dividend taxation of nonresident shareholders includes:

- dividends covered by section 16 A(1) and (2) of the Danish Tax Assessment Act;
- proceeds from share redemptions covered by section 16 B of the same law; and
- intercompany contributions covered by section 31 D of the Danish Corporate Tax Act.

The problem from the lawmaker's perspective is that sale proceeds deemed to be dividends under section 2 D are hardly covered by any of these provisions. This suggests that section 2 D does not trigger any taxation

[16] Commentary on section 2(4) of Bill No. 10, and exhibit 27, p. 9.

[17] Bill No. 10, exhibit 4, p. 23.

[18] Bill No. 10, exhibit 27, p. 6 (example 3).

[19] Commentary on No. 2 of Report on Bill No. 10, and exhibit 27, p. 9.

[20] Section 2 D is premised on an incorrect understanding of the term ''affiliated companies'' in section 2 of the Danish Tax Assessment Act. Hence, members of a transparent entity are not deemed to be ''affiliated companies'' under section 2 of the Tax Assessment Act.

[21] Bill No. 10, exhibit 4, p. 21, and exhibit 27, p. 7.

of nonresident sellers whereby the entire purpose of the law is forfeited. However, the legislative history of the provision clearly assumes that a nonresident seller will be subject to Danish taxation. At present it is uncertain whether the minister of taxation will rely on the legislative history or whether the deficiency will be fixed by a law change. In any case, a nonresident seller should not expect that the tax authorities will accept that a transaction covered by section 2 D is not subject to Danish taxation.

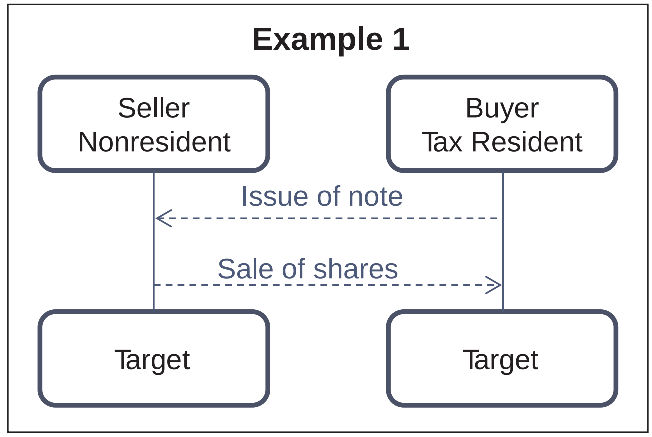
A resident seller is subject to tax on dividend income covered by section 2 D on the basis of section 4 of the State Tax Act.

Another possible deficiency of the law relates to the withholding provision. A Danish company is obliged to apply a dividend withholding tax for all decisions leading to the payment of dividends and redemption of non-quoted shares.[22] In this context the term ''dividend'' is defined to include all distributions to the shareholders with some exceptions. A dividend under section 2 D arguably is not covered by section 65(1) because an economic benefit does not accrue to the seller assuming that the shares are sold at an arm's-length price. Moreover, since the definition in section 65(1) specifically mentions redemption of shares, it must be concluded that the sale of shares at arm's length is not covered by this provision. This analysis suggests that section 65(1) does not require the company to apply a withholding tax regarding sale proceeds that are deemed to constitute dividends under section 2 D. Again, the legislative history of section 2 D clearly assumes that a withholding tax must be applied. Whether the minister of taxation will rely on the legislative history or amend the law is uncertain.

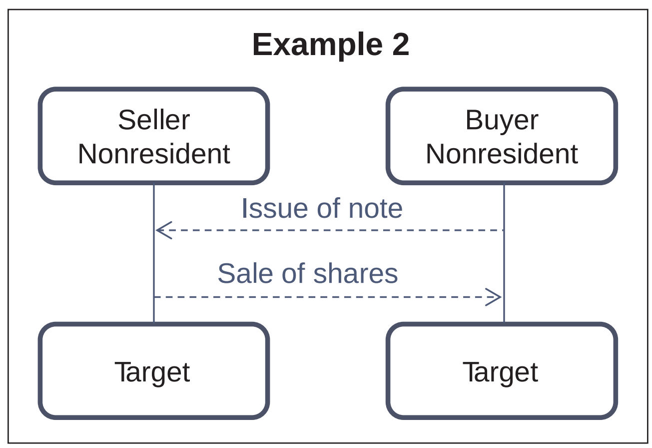
The buyer is deemed to be the company making the distribution.[23] Subject to the foregoing discussion, the buyer must apply a dividend withholding tax of 27 percent in the sale proceeds that qualify for dividend treatment, unless the seller is tax exempt on dividends from the buyer under the general rules (see Section I.A of this article).[24] The withholding tax is due when a binding agreement to transfer the shares is made,[25] and the tax must be submitted to the tax authorities on the last day of the relevant month for large companies, and on the 10th day in the following month for small companies.[26]

4. Examples

Section 2 D is relevant in four basic scenarios depending on the tax residence of the seller and the buyer. The tax residence of the target is irrelevant under section 2 D. The following examples explore the scope of section 2 D.



Example 1 is the standard example of a situation when section 2 D may apply. The buyer will be required to apply a withholding tax of 27 percent regardless of whether the target is a resident or nonresident company. This is surprising if the target is a nonresident company because the transaction is hardly entered into with a view of avoiding Danish withholding taxes.[27]



In example 2, section 2 D may apply in principle. However, because the buyer is not obliged to apply Danish withholding tax, and because the seller is not required to file the dividend income on a Danish tax return and submit the tax, section 2 D is inefficient. It is immaterial whether the target is a resident or nonresident company. If dividends are subsequently paid

[22]Section 65(1) of the Danish Withholding Tax Act.

[23]Bill No. 10, exhibit 27, p. 2.

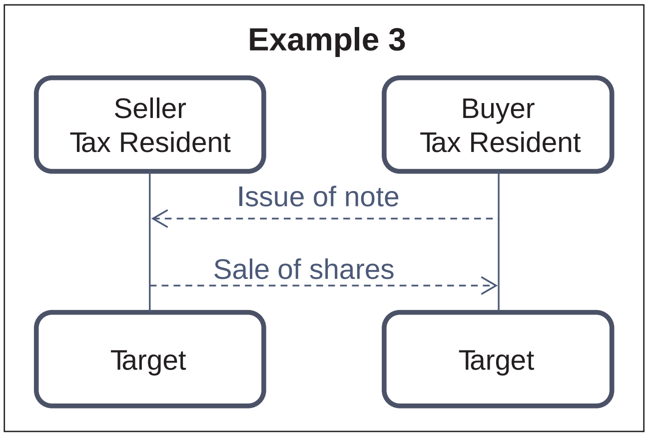
[24]Bill No. 10, exhibit 4, p. 20.

[25]Section 66(1) of the Danish Withholding Tax Act.

[26]Section 2(5) and (6) of the Danish Collection Act.

[27]Bill No. 10, exhibit 27, p. 6.

from the target to the buyer, and the buyer does not qualify as the beneficial owner thereof, the target will be required to apply Danish withholding tax of 27 percent under the general rules.

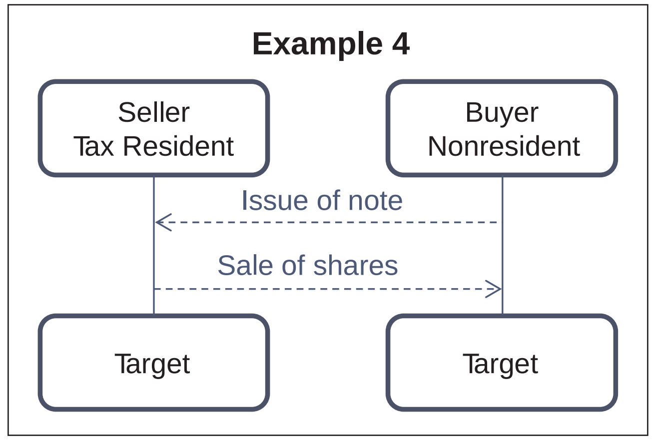


In example 3, section 2 D may apply regardless of whether the target is a resident or nonresident company. The buyer will be required to apply a 27 percent withholding tax. If the target is a nonresident company, the result is surprising because no Danish withholding taxes are avoided.

In example 4, section 2 D may apply. The buyer will not be required to apply a withholding tax. However, the seller will be required to file and pay the tax.

The application of section 2 D regarding a private equity fund (PE) is illustrated in example 5.

In example 5, a private equity fund organized as a transparent entity admits a new investor by the sale of a 5 percent interest from each of the existing investors.



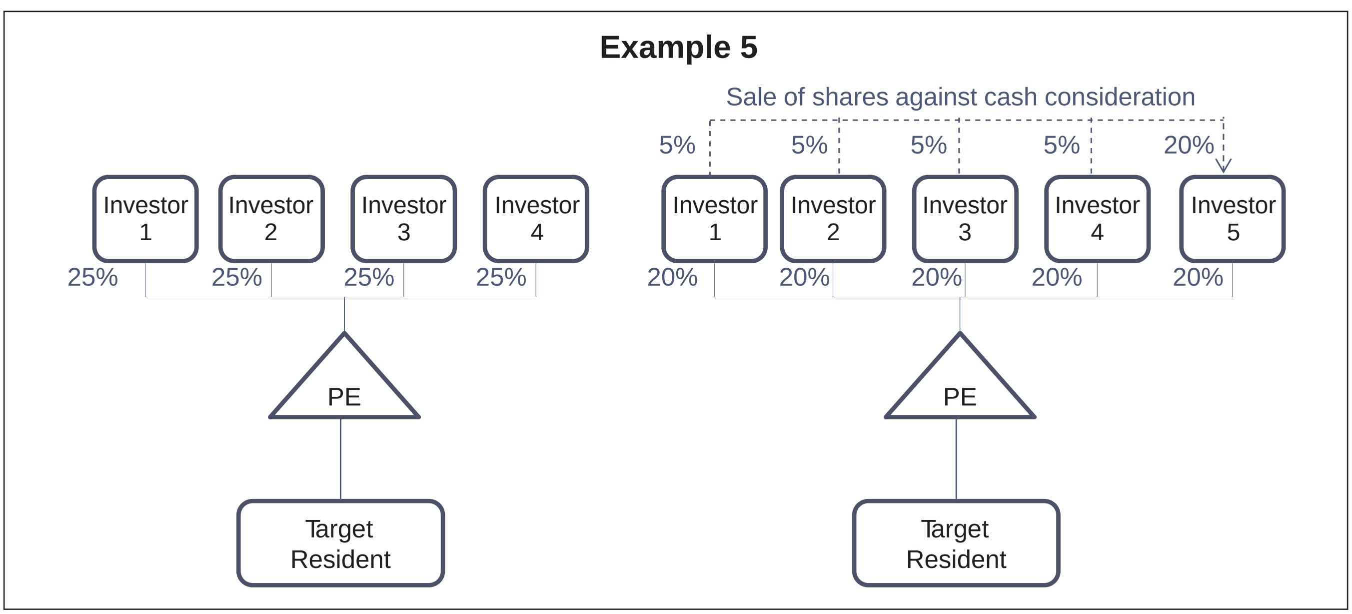
Section 2 D will not apply if investor 5 is not affiliated with investors 1-4 before the transaction, and if investors 1-4 do not finance investor 5's purchase price.

F. Use of Danish Holding Company

Denmark has been widely used as an international holding company location since the domestic dividend withholding tax was abolished for nonresident parent companies in 1998.[28] The law was tightened in 2001 when the zero rate was made dependent on the fact that the foreign parent company was resident in another EU member state or a treaty country (see Section I.A of this article).[29] Recently, the Danish tax authorities have been preoccupied with ensuring that Danish

[28]Act No. 1026 of Dec. 23, 1998 (Bill No. 53 of Oct. 21, 1998).

[29]Act No. 282 of Apr. 25, 2001 (Bill No. 99 of Nov. 10, 2000).



withholding taxes are not circumvented. Against this background it is also the government's position that Danish tax law should not assist taxpayers in avoiding withholding taxes in other countries. For this reason the domestic zero rate dividend withholding tax under section 2(1)(c) of the Danish Corporate Tax Act is not applicable from January 1, 2013, if the distributing Danish company is used as an intermediary vehicle to channel dividends between nonresident group companies.

The new law applies if the following two conditions are met:

- the dividend distributed by the Danish company is a redistribution of dividends received, directly or indirectly, from nonresident group companies; and
- the Danish company was not the beneficial owner of the dividends received from the nonresident group companies.

Regarding the first condition, the dividends may be received directly from a nonresident company or indirectly through one or more Danish subsidiaries. The law does not clarify what is meant by the term ''redistribution.'' If a company makes a distribution immediately after having received a dividend from a nonresident subsidiary, this condition is satisfied.[30] However, the condition may also be satisfied if redistribution is postponed. If a Danish company has income from other sources it must be decided case by case whether redistribution has occurred. This lack of guidance in this respect may cause considerable uncertainty.

Regarding the second condition, it is uncertain whether the concept of beneficial owner must be interpreted in line with the relevant tax treaty or with domestic Danish law. The provision does not refer to the relevant tax treaty. From the legislative history it is unclear whether an autonomous or domestic law interpretation must be adopted. The commentaries on the bill both discuss the relevant tax treaty and the meaning of the concept according to the OECD commentary on article 10.[31] It is most likely that the concept will be given a domestic law interpretation and that this interpretation will be made on the basis of the OECD's commentary on article 10. The fact that a Danish company has other income-generating activities does not in itself mean that it will qualify as the beneficial owner.[32]

If the two conditions are met, the domestic withholding tax is increased from 0 percent to 27 percent. However, if the nonresident parent company is tax resident in another EU member state or a treaty country, Denmark is obliged to reduce its taxation to the lower treaty rate. For a nonresident parent company, this will often mean that a zero rate will apply. The law will thus usually not be effective regarding parent companies of other EU member states, Malaysia, Mexico, Switzerland, and the United States. By contrast, the law will be effective for parent companies tax resident in, for example, Australia, Canada, China, Japan, Korea, New Zealand, and Russia.

II. Sale of Shares to Issuing Company's Sub

A sale of shares to the issuing company (redemption) receives dividend treatment in order to prevent dividends being disguised as capital gains.[33] Bill No. 49 expands the dividend treatment to include a sale of shares to a company that is controlled by the issuing company if the following conditions are met:

- the seller is a resident or nonresident individual or company;
- the buyer is a resident or nonresident company; and
- the issuing company has controlling influence over the buyer.

A tax resident buyer must apply a withholding tax of 27 percent if the above conditions are met.[34] A nonresident buyer is generally not subject to Danish withholding tax obligations. In the latter situation, the seller will be required to file the income on a Danish tax return and submit the tax to Denmark.

The key issue under the new provision is whether the issuing company controls the buyer. The term ''controlling influence'' is defined in section 2(2) of the Danish Tax Assessment Act. This requires ownership of more than 50 percent of the share capital or control of more than 50 percent of the voting power. In this respect shares and voting power owned by, for example, sister companies and some individuals controlling the issuing company must be taken into account. This is illustrated in example 6 in which the issuing company owns 20 percent of the buyer and a sister company owns 40 percent of the buyer.

In this example, the issuing company will be deemed to control the buyer because the shares owned by the sister company must be considered whereby the total ownership share is 60 percent.

If the issuing company does not own any shares in the buyer, the provision is arguably not applicable even though the seller or another affiliated company owns 100 percent of the buyer.

III. Dividends Paid to Minority Shareholders

A. General Rules

A nonresident corporate minority shareholder is subject to tax at a rate of 27 percent on dividends from

[30] Bill No. 10, exhibit 4, p. 12.

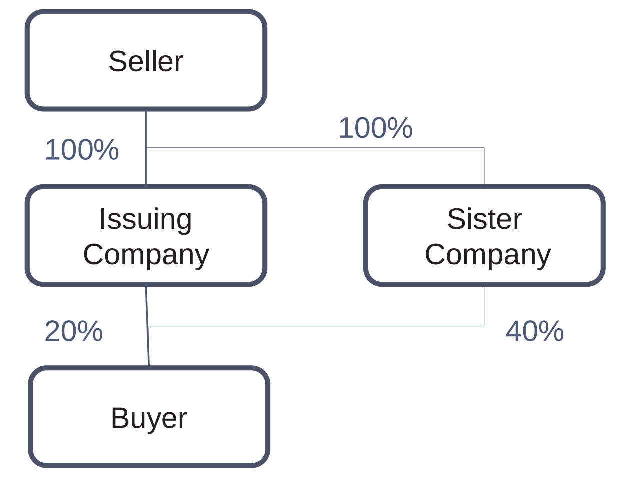
[31] Comments to section 2(3) in Bill No. 10.

[32] Bill No. 10, exhibit 4, p. 13.

[33] Section 16 B(1) of the Danish Tax Assessment Act.

[34] Section 65(1) of the Danish Withholding Tax Act.

Example 6



a Danish company,[35] and the distributing company is required to apply a withholding tax of 27 percent.[36] The tax liability is reduced to 15 percent under domestic law if the shareholder is tax resident in a country that is obliged to exchange information with the Danish tax authorities according to a tax treaty or another convention, and the shareholder owns less than 10 percent of the capital of the Danish company.[37] If the shareholder is tax resident outside the EU, it is further required that the shareholder, together with its affiliated companies, owns less than 10 percent of the share capital of the Danish company. Even if the tax liability is reduced from 27 percent to 15 percent, the distributing company must apply a withholding tax of 27 percent, but the shareholder may request a refund from Denmark.

In Danish tax law, the term ''minority shares'' is generally defined as shares that are not ''subsidiary shares'' or ''group shares.'' A share qualifies as a subsidiary share if the shareholder owns at least 10 percent of the share capital of the company. A share qualifies as a group share if the shareholder and the company are subject to mandatory national joint taxation or qualifies for voluntary international joint taxation regardless of the size of the shareholding (compare sections 31 and 31 A of the Danish Corporate Tax Act).

Effective January 1, 2013, companies are exempt from capital gains tax on minority shares provided specific conditions are met, including that the shares are not quoted on a stock exchange.[38] Dividends and capital gains on tax-exempt minority shares thus receive an asymmetric tax treatment. In order to prevent shareholders from transforming taxable dividends into tax-exempt capital gains, the scope of the dividend concept has been expanded. Although this issue is normally confined to resident companies (nonresident companies are normally not subject to Danish capital gains taxation), the expanded dividend definition may cause adverse tax consequences for nonresident companies that own tax-exempt minority shares in Danish companies.

B. Repurchase Transactions

A sale of shares receives dividend treatment if all the following conditions are satisfied:[39]

- the issuing company is tax resident in Denmark (only a condition for a nonresident shareholder);
- the shares qualify as tax-exempt minority shares;
- the seller is a resident or nonresident company;
- the seller repurchases shares in the same company within six months after the initial sale;
- the counterparty to the sale and repurchase is a resident or nonresident person;
- the sale price exceeds the repurchase price; and
- a dividend (of any size) has been declared in the interim period between the sale and the repurchase.

A capital gain thus receives dividend treatment if the conditions are satisfied. A nonresident shareholder is required to file the dividend income on a Danish tax return and submit the tax to Denmark.[40] A withholding tax is not applicable.

For nonresident shareholders the new rule causes the absurd result that taxation is triggered on tax-exempt minority shares, whereas no taxation is triggered on taxable minority shares.

C. Liquidation Proceeds and Share Redemptions

Liquidation proceeds and the redemption of shares receive dividend treatment in a number of situations. The scope of the law has been expanded so that liquidation proceeds and redemption proceeds paid in the calendar year in which the company is finally dissolved receive dividend treatment if all of the following conditions are satisfied:[41]

- the shareholder is a resident or nonresident company;

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[35] Section 2(1)(c) and (2) of the Danish Corporate Tax Act.

[36] Section 65(1) of the Danish Withholding Tax Act.

[37] Section 2(2) of the Danish Corporate Tax Act.

[38] Sections 4 C and 8 of the Danish Capital Gains Tax Act. *See* Act No. 1255 of December 18, 2012.

[39] Section 16 A(2)(5) of the Danish Tax Assessment Act.

[40] Section 65 A(1) of the Danish Withholding Tax Act.

[41] Sections 16 A(2)(5) and 16 B(2)(2)(d) of the Danish Tax Assessment Act.

- the shareholder owns tax-exempt minority shares in the (liquidating) company; and
- either:
  — at least 50 percent of the fair market value of the assets of the liquidating company consists, directly or indirectly, of subsidiary shares or group shares; or
  — such shares have been transferred from the liquidating company to its direct or indirect shareholders or to an affiliated company within three years before the liquidation.

Liquidation proceeds and sale prices receive dividend treatment if the conditions are met. The company is required to apply a withholding tax of 27 percent.[42]

IV. Tax Treaties

The new rules mean that nonresident companies will more often be deemed to receive dividend income from Danish companies. Danish taxation of a deemed dividend under the new rules may be eliminated or reduced under the terms of a tax treaty or the parent-subsidiary directive.

The new broad definition of dividends gives rise to the question whether Denmark is entitled to levy tax on dividends derived by persons that are tax resident in a treaty country.

Danish tax treaties normally contain a provision similar to article 10(3) of the OECD model under which the term ''dividends'' must be interpreted based on domestic law of the country where the distributing company is tax resident. The table outlines whether Denmark is entitled to levy tax on a deemed dividend received by a nonresident shareholder that is resident in a tax treaty country.

Treaty Taxing Rights

Transaction	Buyer	
	Resident	Nonresident
Cross-border merger of Danish company	Yes	
Liquidation/redemption of shares in Danish company	Yes	
Group reorganization	Yes	No
Sale of shares to a subsidiary of issuing company	Yes	No
Repurchase of tax-exempt minority shares	Yes	No

Denmark is entitled to levy tax on a nonresident shareholder under the expanded dividend definition when the source of the dividend is a company that is tax resident in Denmark. This means that Denmark is entitled to tax a nonresident shareholder on a cross-border merger when a Danish company is the ceasing company and any liquidations and share redemptions relate to Danish companies. Under the new rules on group reorganizations, in a sale of shares to a subsidiary of the issuing company and repurchase of minority shares, the source is deemed to be the buyer of the shares. If the buyer is nonresident, Denmark is not entitled to levy tax on nonresident shareholders under article 10 of the tax treaties.

V. Conclusion

Denmark has significantly expanded the definition of dividends recently in order to protect its tax base from transactions aimed at circumventing withholding taxes. The new rules are so broadly worded that genuine business transactions may trigger unintended taxation. For example, an internal transfer of a U.S. subsidiary from a U.S. parent company to a Danish subsidiary receives dividend treatment and may trigger Danish withholding tax. Taxation may be eliminated or reduced under the terms of the Danish tax treaties and the parent-subsidiary directive. The new rules suffer from technical errors and the scope seems to be too broad. At present it is unknown whether and how these issues will be rectified. ◆

[42]Section 65(1) of the Danish Withholding Tax Act.