

International Taxation of Dividends

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|-----|--|----|
| 1.0 | Introduction | 1 |
| 2.0 | Dividends distributed by a Danish subsidiary to a foreign parent company... | 3 |
| 2.1 | Exemption from [withholding] tax on distribution of dividends | 3 |
| 2.2 | Required Documentation..... | 3 |
| 2.3 | Requirements regarding company receiving dividends..... | 4 |
| 2.4 | Requirements regarding the company distributing a dividend..... | 5 |
| 2.5 | Effective date | 6 |
| 2.6 | Foreign minority shareholders | 6 |
| 3.0 | Dividends received by a Danish parent company from a foreign subsidiary.. | 7 |
| 3.1 | Exemption from taxation of dividends from subsidiaries | 7 |
| 3.2 | Conditions for exemption from tax | 7 |
| 3.3 | Deduction account | 8 |
| 3.4 | Dividends on shares subject to Section 2a of the Act on Taxation of Capital Gains | 9 |
| 3.5 | Effective date | 10 |

Note: the following article is an unofficial translation of the Danish circular on International Dividends. It is an extract from Circular No 135 of 2.9.1999 regarding Act no. 1026 of 23 December 1998 on changes to various tax laws (International taxation of dividends and capital gains on shares etc.)

1.0 Introduction

Act No. 1026 of 23 December 1998 (Bill no. L 53) introduced a number of changes regarding the rules for taxation of dividend payments to and from Denmark. Furthermore, changes were made to the rules on CFC taxation and to the rules on thin capitalisation. Finally, various minor changes, principally of a technical nature, have been passed.

Act No. 1026 of 23 December 1998 includes the following main elements:

- Dividends distributed by a Danish subsidiary to a foreign parent company are exempt from Danish withholding tax.
- Dividends received by a Danish parent company or foundation from a foreign subsidiary company are in principle exempt from taxation in Denmark.
- Dividends received by a Danish company or foundation from minority participations in foreign companies are in principle taxed according to the same rules as dividends from minority participations in Danish companies.
- Foreign dividends received by individuals are in principle treated as share income in the same way as dividends from Danish shares.
- Section 2a of the Act on Taxation of Capital Gains on Shares has been changed to the effect that shares in financial companies in low-tax countries are treated in the same way for tax purposes as Danish shares, when the income in the low-taxed company has been taxed at the "Danish" level either through CFC taxation or in another way, for an unbroken period of at least 3 years starting with the acquisition of shares or continuously for an unbroken period of at least 3 years immediately prior to the taxable event.
- The CFC rules have been changed to the effect that in future they apply to companies etc, foundations and individuals, who own at least 25% of the shares or control more than 50% of the votes in a foreign low-taxed financial company. At the same time, the definition of a financial enterprise has been changed to the effect that income in a foreign low-taxed company will be subject to CFC taxation in Denmark if at least 33 1/3% of its income derives from financial business or at least 33 1/3% of its total assets comprise financial assets.
- Rules on thin capitalisation have been introduced in respect of foreign companies' permanent establishments in Denmark.
- Eligibility to obtain relief under the Assessment Act Section 33A has been extended.
- Various changes of a more technical nature have been passed.

2.0 Dividends distributed by a Danish subsidiary to a foreign parent company.

2.1 Exemption from [withholding] tax on distribution of dividends

Dividends distributed by a Danish subsidiary to a foreign parent company are exempt from taxation in Denmark if the foreign company owns at least 25% of the share capital of the Danish company for a continuous period of at least one year according to the (Danish) Act on Corporation Tax Section 2, ss.1, c). This does not mean one income year or one calendar year, but a continuous period of 12 months. The dividend must be distributed, i.e. approved by the General Meeting of the subsidiary, within the period during which the foreign parent company owns the shares.

The exemption from tax also includes deemed distributions of dividends, including those deemed distributions of dividends, which arise, for example, if the Danish Tax Authorities carry out arm's length adjustments in respect of a Danish subsidiary in connection with an inter-company loan to a foreign parent company pursuant to the Assessment Act Section 2.

Application of the tax exemption is not conditional upon the parent company having owned at least 25% of the shares in the subsidiary for one year at the time of the dividend distribution. Thus, the exemption from tax applies to dividends distributed at any time after the acquisition of shares provided that the parent company retains the shares for at least 12 months.

In case of deemed distributions, the tax exemption is conditional upon the deemed distribution being attributable to a time when the above mentioned requirements as to duration of holding and the proportion of shares owned are fulfilled.

2.2 Required Documentation

The same requirements for documentation apply to dividend distributions by a Danish subsidiary to a foreign parent company as apply to the payment of dividends by a Danish subsidiary to a Danish parent company. The provisions found in Chapter

11 of the Statutory Instrument no. 734 of the Ministry of Taxation dated 10 October 1998, regarding the collection of income tax for individuals etc (Statutory Instrument on Withholding Tax) are therefore applicable.

2.3 Requirements regarding company receiving dividends

It is a fundamental condition of the tax exemption according to Section 2, ss.1, c) of the Corporation Tax Act that the foreign parent company receiving the dividend is a "company etc." in accordance with the Danish Corporation Tax Act. The Act no 1026 of 23 December 1998 has not modified existing practice regarding the recognition of foreign legal entities as companies in this context.

If a foreign parent company receiving the dividends falls under the EU parent/subsidiary directive (Directive 90/435/EEC), the company will always be a "company etc." under the Danish Corporation Tax Act. The same is true of a foreign company covered by the EU Mergers Directive (Directive 90/434/EEC). The lists of companies covered by the two directives are at present identical.

In other cases, the decision as to whether a foreign legal entity can be classified as a "company etc." must be made, as before, in accordance with the Danish rules. Therefore, it is still a decisive criterion that the foreign entity can be treated as an independent non-transparent taxpayer according to Danish rules.

In addition, the decision is dependant upon a specific evaluation of the nature of the foreign entity. One of the many elements included in this evaluation is the foreign legal status of the entity as a company or another entity. However, this element is not decisive in itself. For example, a foreign parent foundation may be treated as a parent company in the context discussed here, if the foreign foundation has characteristics that are comparable to those of a Danish foundation or a Danish company.

The criteria described in LV 98 (The 1998 Tax Assessment Guidelines), S.A.1.2 and S.A.1.8.1. must be used when deciding whether a foreign legal entity is a "company etc" according to the Danish Corporation Tax Act.

If the foreign entity receiving the dividends is considered to be transparent, the dividends can only be received free of tax to the extent that the owners of (or the partners in) the entity individually fulfil the conditions for receiving tax-exempt dividends.

For example, if a Danish subsidiary is owned by a foreign partnership which in its turn, is owned by various companies and individuals, an exemption from tax will only be granted for that portion of the dividend that is attributable to companies which can be classified as a "company etc" in accordance with the Danish Corporation Tax Act and which, by virtue of their share in the partnership, hold at least 25% of the share capital in the Danish subsidiary.

2.4 Requirements regarding the company distributing a dividend

In order to obtain an exemption from [withholding] tax, it is furthermore required that the company distributing the dividend is covered by the term "company in a Member State" as defined in Article 2 of the Parent/Subsidiary Directive (Directive 90/435/EEC). In accordance with the present text of the directive, this will in practice primarily mean Danish Aktieselskaber (Public Limited Companies) and Anpartsselskaber (Private Limited Companies).

According to the provisions of the directive, the term "company in a Member State" refers to any company that:

- is organised in one of the forms included on the Member States' list of companies covered by the Directive [in the case of Denmark, an A/S (PLC) or ApS (Ltd company)],
- is recognised as a tax resident of a Member State under the tax legislation applicable in that state and is not resident in a third country under the terms of a double taxation treaty, and
- is subject to one of a number of specified taxes (in case of Denmark, corporation tax) without any possibilities to opt out or to obtain exemption.

The Directive does not require a company included in a particular Member State's list of companies to be a tax resident in the same Member State in order to be included under the Directive's definition of the term "company in a Member State". A company in another EU country can thus certainly be a "company in a Member State" in accordance with the Danish Corporation Tax Act, and thereby included under the exemption entitlements in Section 2(1)(c). A company is required to be resident in Denmark for tax purposes and to be subject to the ordinary obligations of Danish corporation tax. This will be the case if a foreign registered company has its seat of management in Denmark and by virtue of a double taxation treaty is resident in Denmark for tax purposes.

When deciding whether a foreign company has its seat of management in Denmark in a case such as the one described above, the criteria will be those stipulated in the Ministry of Taxation Circular no. 82 of 29 May 1997 on international taxation, item 2.1.1.

2.5 Effective date

The exemption from [withholding] tax on dividends distributed by a Danish subsidiary to a foreign parent company takes effect in respect of income years beginning on 1 January 1999 or later. As it is the foreign parent company that is the taxpayer, it is the financial year of the foreign company that is of relevance as to when dividends can be distributed free of [withholding] tax. The financial year of a foreign company receiving the dividend is always deemed to follow the calendar year and the exemption will thus be available for all dividends, which are distributed on or after 1 January, 1999.

2.6 Foreign minority shareholders

There have been no changes to the Act no. 1026 of 23 December 1998 affecting the taxation of dividends distributed to foreign minority shareholders. Thus, dividend [withholding] tax is still to be deducted from distributions of dividends to foreign minority shareholders according to the Act on Taxation at Source, Section 65.

3.0 Dividends received by a Danish parent company from a foreign subsidiary

3.1 Exemption from taxation of dividends from subsidiaries

According to Act no. 1026 of 23 December 1998, dividends received from Danish subsidiaries and dividends received from foreign subsidiaries are in principle treated in the same way for tax purposes. Pursuant to the Corporation Tax Act, Section 13, ss.1, 2, dividends on shares and participations will not be included in the taxable corporate income if dividends are received from a Danish public limited company or private limited company or from a company resident abroad. Similar rules apply when dividends are received by foundations according to the Act on Taxation of Foundations, Section 10. However, the exemption from tax does not apply to dividends from shares subject to Section 2a of the Act on Taxation of Capital Gains on Shares.

When deciding whether a foreign entity is a subsidiary according to the Corporation Tax Act to the effect that its dividends qualify for the participation exemption from Danish tax, the same criteria are used as in the corresponding evaluation of whether a foreign entity is a parent company, c.f. item 2.3.

3.2 Conditions for exemption from tax

There are certain conditions attached to the tax exemption for foreign dividends. First, the general conditions regarding the receipt of dividends from a tax-exempt subsidiary company must be fulfilled. This means that a Danish parent company has to own at least 25% of a subsidiary's share capital for a continuous period of at least one year. This does not mean a financial year or a calendar year, but a continuous period of 12 months. The dividend must be distributed, i.e. declared at the General Meeting of the subsidiary, within the period during which the Danish parent company owns the shares.

[Under Danish tax regulations, dividends are deemed to be distributed on the date they are declared, not on the date of payment.]

Second, in order for the exemption from tax to apply, the shares in the subsidiary may not be subject to Section 2a of the Act on Taxation of Capital Gains on Shares. Thus, the exemption from tax is not available for dividends that are received by a Danish parent company from financial companies in low tax countries, unless the financial income has been taxed at a level which is not materially lower than that which would apply according to Danish rules either as a result of CFC taxation or in some other way. See item 6 below, concerning the modifications to Section 2a of the Act on Taxation of Capital Gains on Shares, for the detailed rules regarding the fulfilment of these conditions.

With regard to all shares other than those subject to Section 2a of the Act on Taxation of Capital Gains on Shares, the taxation of subsidiaries abroad is of no relevance for the exemption of dividends from Danish tax. In these cases, therefore, there is no need to evaluate whether the corporate profits from which the dividend is distributed have been taxed according to rules which do not differ materially from the Danish rules.

In order for the tax exemption to apply, a parent company is not required to have held at least 25% of the shares in the subsidiary for one year at the time of dividend distribution. Thus, the exemption from tax applies to dividends which are distributed at any time after the acquisition of the shares on the condition that the parent company retains its participation for at least 12 months.

3.3 Deduction account

If shares in a foreign subsidiary are subject to Section 2a of the Act on Taxation of Capital Gains on Shares, the Danish parent company is required to maintain a deduction account to avoid Danish taxation of dividends and gains on shares in respect of profits which already have been subject to Danish taxation according to the rules on CFC taxation as per Section 32 Ss. 9 and 10 of the Corporation Tax Act.

If shares are not subject to Section 2a of the Act on Taxation of Capital Gains on Shares, it is no longer necessary to keep a deduction account. In practice, this means that it is only necessary to keep a deduction account in cases where the shareholder increases its participation in the foreign low-tax financial company from under 25% to at least 25% (or increases its number of votes in the company to more than 50%) and thereby becomes subject to CFC taxation in Denmark in respect of its share of the financial income of the foreign company. In these cases, a deduction account must be kept during the qualifying period of 3 years while these shares continue to be subject to Section 2a of the Act on Taxation of Capital Gains on Shares.

The provisions pertaining to deduction accounts set out in item 7.3.5. of Circular no. 82 on International Taxation adopted by the Ministry of Taxation on 29 May 1997 are still applicable with this modification. Furthermore, please refer to item 7.3.7 of the Circular.

3.4 Dividends on shares subject to Section 2a of the Act on Taxation of Capital Gains

Dividends on shares subject to Section 2a of the Act on Taxation of Capital Gains constitute taxable income of the Danish parent company. The full dividend is taxable in accordance with the Tax Assessment Act Section 16 A and the Corporation Tax Act Section 13, ss.1, no. 2, last paragraph, and Section 13, ss.3. If a Danish company receives dividends on shares in companies that are or have been registered abroad, and the dividends are not eligible for the tax exemptions granted in Section 13 of the Corporation Tax Act, the Minister of Taxation or a person authorised by the Minister may upon application grant a dividend-receiving company relief from a portion of the tax pursuant to the Corporation Tax Act Section 17, ss.2.

According to these regulations, the maximum relief that may be granted is determined in a such a way that the total foreign and Danish tax paid by the distributing company and the dividend-receiving company on the profits out of which the dividend is distributed, and on the dividend itself will correspond to the amount,

which the two companies together would have paid in tax if both companies had been taxed in Denmark.

The relief rule in Section 17, ss. 2 of the Corporation Tax Act applies irrespective of the size of the participation. For foreign companies subject to compulsory joint taxation with a Danish company (CFC-taxation), the rules regarding the deduction account will in practice mean that relief according to Section 17, ss. 2 of the Corporation Tax Act will only apply in cases where the foreign low-tax financial company distributes dividends out of financial income, which was derived from the period before the company became subject to CFC-taxation, within the three year qualifying period.

3.5 Effective date

The general exemption from tax for dividends received from foreign subsidiaries takes effect from the income year starting on 1 January, 1999 or later. In this case, it is the income year of the Danish parent company that is of relevance for determining when dividends can be received free of tax.

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Notes on tax articles

We have avoided the use of technical tax terminology where possible in favour of the non-tax professionals and non-English speaking readers.