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Thin capitalisation rules in Denmark

In essence, if the Danish company has excess debt (compared to its equity), and some of that debt is from a related party ("controlled debt"), an amount of the interest paid by the Danish company on the controlled debt is not tax deductible.

"Controlled debt" is debt due by a Danish company to a non-Danish physical or legal person as described in § 3 B (1) of the Taxation Administration Law. Paragraph 3B refers to foreign physical and legal persons who "control" the Danish company, as well as to foreign legal person who are "group related" with the Danish company.

"Control" means owning, directly or indirectly, more than 50% of the share capital of the Danish company, or having, directly or indirectly, more than 50% of the voting rights. Related companies and physical persons with certain family relationships are taken into account in deciding whether the foreign shareholder controls the Danish company. In determining whether the Danish company is "group related" with a foreign legal person, the ultimate shareholdings of the two entities are taken into account.

For the thin capitalisation sanction (see below) to have effect the Danish company's total debt in proportion to its equity must exceed the ratio 4:1 and at the same time there must be at least some controlled debt. It is noted here that all debt is taken into account, not only controlled debt.

This ratio is measured at year's end.

The sanction – the negative consequence of exceeding the 4:1 ratio - is that interest and any foreign exchange loss relating to the controlled debt, to the extent the controlled debt forms part of the excess over the 4:1 ratio, is not tax deductible. Such a foreign exchange loss can be deducted against a later foreign exchange gain on that same debt.

However, the deductions will not be limited in this way if the Danish company can show that similar financing could be arranged with independent parties.

Controlled debt is deemed to include debt from third parties, such as banks, if the controlling owners or related group members have directly or indirectly provided security for that loan.

It is noted that the sanction does not include a re-characterisation of the non-deductible interest as a dividend.

"Debt" means debt as defined in the Law on the Tax Treatment of Gains and Losses on Debt-claims, as well as convertible bonds.

“Equity” is calculated as the market value of all assets less “debt”. Equity contributed by the foreign owners is only taken into account if it remains in the Danish company for at least two years.

If two or more Danish group companies are controlled, then the above rules apply by taking all assets and liabilities in these Danish group companies, but the Danish companies’ shares in the other group companies are ignored, as is debt between these companies.

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