Global Tax Guide - Denmark

Global Tax Guide – Denmark

Neil Smith,
Equinor A/S, Copenhagen

I. Key Facts

A. Population/GDP

Population: 5.5million
GDP: USD$193bn (2008)

B. Currency

Danish Krone, abbreviated here to DKK (Denmark is not part of the Eurozone but the Krone is tightly pegged against the Euro at a rate of around DKK 7.45 to EUR 1).

C. Membership of economic groups

Member of EU, OECD

D. Major industries

Services, agriculture, furniture, shipping and electronics

E. Website of tax/finance authority

www.skat.dk – Tax Authority
www.oem.dk – Ministry for Business
www.eogs.dk – Commerce and Companies Agency

II. Introduction

Denmark's traditional social and political values are along similar lines to its Scandinavian neighbours. The region is renowned for its welfare state and in Denmark this can mean generous unemployment payments as well as free hospital care and university education. This, however, must be funded through taxation resulting in Denmark having, by international standards, a high overall burden of taxation. This fact, combined with a general belief that a low level of inequality is an appealing aim, has meant that taxes on top earners are amongst the highest in the world.

Denmark has also traditionally had a strong environmental feeling and some of the taxes, in particular the heavy tax on purchases of cars, should be seen in this light. Further, the country has in recent years run a significant budget surplus with the aim of bringing the national debt down to a low level, although this is unlikely to continue in the current economic circumstances.

Corporate and indirect taxes are the same nationwide. Personal income tax is generally deducted from monthly wages by the employers and paid to the central tax authorities. Some though is allocated thereafter to the central government and some to the local authority the taxpayer resides in, and tax rates can therefore vary slightly according to the local authority in question.

III. Recent Developments

A. General outline

After being re-elected in November 2007, the Government appointed a Tax Commission to report on the modernizing of the tax system following concerns that Denmark's high rates of direct personal taxation could prove to be a hindrance to the economy in an increasingly globalised market and a general wish to increase the labor supply given that most of the "Baby Boom" generation will be retiring in the next decade. The Commission was headed by a former Tax Minister and also consisted of experts in the field of economics, law and finance.

The Commission reported its findings in February 2009 and a month later the Government entered into an agreement with its regular support party, the Danish People's Party, for a formal bill being presented to the Danish Parliament. Certain formalities remain to be completed before the bill comes into force, which is expected to be in late May or early June 2009, although, given that a majority has already agreed on the key contents, significant changes are highly unlikely.

The bill provides for significant changes in the Danish tax system in the coming years with marginal personal tax rates to be brought down but with a reduction of certain allowances and an increase of green taxes. The proposals are roughly revenue neutral in the long term but, as a response to the global downturn, provide for a significant impetus in the initial years. Throughout the course of this article, I have detailed the law as it stands at May 2009 but I have detailed a brief summary of the proposals in the last section.

Since coming into power in November 2001, the current centre right government has implemented a tax freeze which means that taxes or tax rates should not generally be increased and, should they be, other taxes should be reduced to compensate. The tax freeze does not prevent measures to close perceived loopholes and, particularly corporate tax (to be discussed in more detail below) has seen significant changes in recent years as the tax ministry have sought to curb perceived aggressive tax planning with new rules.

As a full member of the EU, Denmark is bound to provide for the basic freedoms espoused in the Treaty of Rome and there have been instances in recent years (in relation to pensions and CFC rules) where it has adjusted its tax policies in response to a judgement from the European Court of Justice.

B. Changes Currently Proposed

As detailed in the introduction, a bill featuring significant changes to the Danish system is currently being debated before the Danish Parliament and expected to be passed, in the main as proposed, in the near future. In this section, the major points are outlined briefly.

The bill provides for some major reductions in the marginal rate of personal taxation.

- The 6% middle tax bracket will be abolished effective from 1 January 2010.
- The basic rate of tax will be reduced by 1.5% from 1 January 2010 - this particular move will benefit almost all people in employment.
- The top rate of taxation will remain the same but, as the system is cumulative, top rate taxpayers will have their marginal rate reduced due to the increased in the basic and middle rates. In addition, the threshold after which the top rate will be paid will be increased by DKK 36,000 in 2010 and a further DKK 18,400 in 2011. Taken with the measures detailed above, this amounts to significant tax reductions for top rate taxpayers, and the maximum rate of taxation the changes will be around 51.5% (as opposed to 59% at the moment) as well as reducing the number of people actually paying the top rate of tax.
- The employment allowance will increase from 4.25% (from a maximum of DKK 13,500) to 7% (up to a maximum of DKK 22,500).

Traditional, Danish individuals have been able to deduct some of the interest on debt. The percentage deduction permitted will be reduced from 33% to 25% but this will be phased in between 2012 and 2019 (with the relief decreasing by 1% each year). Further, the reduction will only apply on interest in excess of DKK 50,000 for individuals and DKK 100,000 for married couples. As well as this, if a taxpayer should be disadvantaged by the new package as a whole there will be scope for special compensation to make up the difference. The complicated calculation system reflects the fact that this particular proposal was politically contentious thus concessions needed to be made following the original proposals.

It is also proposed that the participation exemption will change for companies. Both dividends and capital gains for shareholdings of 10% or more will be exempt regardless of the holding period, assuming that a tax treaty or the Parent Subsidiary Directive is applicable. Shareholdings of less than 10% will be taxed according to the mark to market principle at the end of the tax year and income in this instance shall not be exempt. These proposals represent a significant widening and therefore improvement of the participation for substantial shareholdings but a reduction in the desirability (from a taxpayer's perspective) of the rules for small shareholdings given that tax could be due without the liquidity to pay.

This list is not intended to be exhaustive but rather detail the most prominent aspects of the proposed legislation. For interested readers further literature is available.[1]

---

[1] N Smith, New Tax Proposal in Denmark, BNA International, European Tax Service, March 2009

IV. Corporate Taxes

A. General outline

In recent decades, Denmark has had fairly low rates of corporate taxation – compared to other countries in Western Europe and the high rates of personal taxation and indirect taxes in Denmark – as the government has sought to pursue generally business friendly policies.

As mentioned above, though, there have been significant changes in corporate taxation in recent years. Since 2005 domestic joint taxation has been compulsory (see further details below) and in 2007 a comprehensive package was introduced which, amongst other things, limited interest deductions in particular instances.

B. Corporate Tax Rates

The tax rate has been 25% since 2007 (the previous rate was 28%).It is a flat rate and all companies/income which do not fall under a specific regime are taxed accordingly. Consistently profitable companies are obliged to pay to pay tax on account in March and November according to their result in previous years.

As a general rules, expenses incurred with the aim of securing and maintain the income of the company are deductible for tax purposes. There are specific tax rules in relation to interest expenses (to be discussed in more detail later).

Assets which cost less than DKK 11,900 (2008) or have an estimated life of three years or less can be written off immediately. Machinery, furniture and fittings are depreciated using the reducing balance method. The maximum permitted depreciation is being tapered down from 25% of value (in 2007) to 15% in 2016 by a reduction of 2% every two years, so e.g. in 2008 and 2009 the maximum depreciation permitted will be 23%, in 2010 and 2011 it will be 21% and so on.

Manufacturing buildings can be depreciated by a maximum of 4% using the straight line method – residential buildings cannot be depreciated. The cost of intellectual property can be depreciated over seven years using the straight line method.

A tonnage tax operates for Danish shipping companies or Danish permanent establishments of other EU shipping companies. This involves the deeming of income according to the total tonnage operated by the company in question and the number of days ships are operated and deductions are limited.

Hydrocarbon Related Taxes

There are two special hydrocarbon related taxes applicable. The first applies mainly to non-residents engaged in exploration whereas the second one relates to resident companies (or those with a Danish PE) extracting hydrocarbons.

In the first scenario, foreign enterprises are subject to tax in Denmark where the enterprise earns incomes in connection with preliminary surveys, exploration and extraction of hydrocarbons in Denmark even if the entity would normally not be considered resident in Denmark. The costs of preliminary survey and exploration may be deducted and the acquisition cost of machinery, equipment, ships and buildings used in this connection can be depreciated in line with the normal rules. The rate of tax payable is 30% and self-employed individuals in this field are subject to the same tax. The amount and the precise rules in questions may be adjusted according to the tax treaty in force with the country of residence of the company/individual in question.

The second tax is only liable on companies who extract hydrocarbons. These entities are still liable to corporation tax but after this they are also liable to a hydrocarbon tax (the corporation tax is deductible). The rate of tax is generally 70% but is 52% in respect of activities carried out without state participation (in connection with the 1962 sole concession) and in respect of new licenses issued after 1 January 2004.

C. Capital gains taxes

There is no specific concept of capital gains tax and, as a general rule, capital gains or losses are included in the taxable income of the company. The main exception to this is capital gains on the sale of shares which are exempt if they meet certain criteria, the main one being that the shares are held for three years. This does not apply where the seller is deemed to be consistently dealing in shares.

D. Position of losses

Losses can be carried forward indefinitely. There is no provision for carry back losses. There are specific rules which may restrict carry forward losses upon change of ownership or conversion of debt to equity.

Where the joint taxation rules are applicable (see also below) companies should use their own losses first and, only once these are fully used, losses of other group companies.

E. Group Treatment

A company is deemed to be part of a group where it is controlled by the parent company. This will generally be by voting rights, but can also be through having the right to appoint a majority of directors or a contractual agreement which means that the parent company effectively has control of operations.

Joint taxation is mandatory for all Danish group companies (together with any PEs or immoveable property in Denmark) resulting in the group having to submit a global tax return. Where one company uses another group company's losses, the profitable company should pay the value of the losses used (effectively the tax it would otherwise have paid) to the loss-making company.

International joint taxation is optional but is only available on an "all or nothing" basis i.e. it is not possible to include one foreign subsidiary but not another and it is binding for a 10 year period. The stringent criteria mean that very few groups have chosen this.

Denmark has a relatively wide participation exemption for dividends received from a domestic or foreign subsidiary. The criteria provides that the Danish company should hold at least 10% of the total share capital for at least 12 months, the subsidiary is a company and (for a foreign subsidiary) the subsidiary is resident in the EU or a country with a tax treaty with Denmark.

V. Withholding Taxes

A. Position of Resident companies

Companies which are incorporated in Denmark or have their central management and control in Denmark are deemed to be resident and therefore fully liable to tax in Denmark.

Denmark employs a limited territoriality principle whereby income from immoveable property or a permanent establishment outside of Denmark is exempt from tax. Other income sourced outside Denmark is taxable in the normal manner.

B. Position of non-Resident companies

Non-resident companies are generally only taxable in Denmark if the income is attributable to immoveable property or a permanent establishment in Denmark.

C. Dividends, interest & royalties (include table if appropriate)

Dividends: There is a relatively wide exemption from withholding tax on dividends where the shareholder owns more than 10% for a 12 month period and the withholding rate is reduced by a tax treaty or the EU Parent-Subsidiary Directive. Where this is not applicable the tax treaty rate will be applied. Where no tax treaty exists the withholding rate will be 15% if the shareholder holds less than 10% and there is provision for exchange of information between Denmark and the country of residence of the recipient. Otherwise, the withholding rate is 28%.

Interest: There is no general interest withholding tax but there is provision for withholding at 25% where interest is paid to a related foreign entity and the foreign entity is taxed substantially lower than in Denmark and its activities are mainly of a financial nature. This does not apply where a tax treaty (regardless of the rate) or the Interest and Royalties Directive is applicable.

Royalties: A final withholding tax of 25% is applied to most payments relating to intellectual property, but not copyright. The rate may be reduced by a tax treaty or eliminated by the Interest and Royalties Directive.

VI. Indirect Taxes

A. VAT/GST: main and reduced rates, exemptions

The standard rate of VAT is 25% which applies to almost all entities above a *de minimus* level of DKK 50,000 per annum (approx. EUR 6,700). VAT is reported monthly, quarterly or half yearly according to the turnover of the company. Groups will normally report VAT together.

There are few exceptions to the main rate although a zero rate does apply to newspapers and certain aircraft and ships are exempt (the rules in this area are set to change from 1 January 2010).

B. Other indirect taxes

Denmark applies excise duties on (amongst other things) petrol, alcohol and cigarettes. Of particular note is the environmental tax on cars which vastly increases the cost of Danish registered cars. The precise amount of the tax depends on the exact nature of the car and its engine, but a tax of 180% of the value of the car is normal.

VII. Personal Taxes

A. Domicile and Residency requirements

An individual is deemed a resident of Denmark (and thus fully taxable) if 1) they stays in Denmark for more than three consecutive months; or 2) they stay in Denmark for 180 days or more in a 12 month period; or 3) work is performed during their stay in Denmark. The third rules means that workers located in Denmark will generally be fully taxable in Denmark regardless of how short their stay may be.

B. Main rates and bands

The tax paid is built up as a combination of municipal tax and central government tax – both are collected at the same time and an aggregate amount is deducted from the employee's wages. The municipal rate differs slightly according to the council of residence. Detailed below is the rate combined between the national rate and the average municipal rate although an employee's actual effective rate may be plus or minus up to approximately 1% according to the council of residence. The figures shown are applied to the net amount after the social security contribution detailed below.

Traditionally, there has been three bands of tax for general income (top, middle and basic), all thresholds detailed are 2009 rates. The basic rate is 38 percent and applies up to DKK 347,200. In previous years there has been a distinct band of middle tax where an additional 6% is charged (i.e. a marginal rate of 44%) but the threshold for middle band has been getting closer and closer to that of the top band and, from 2009, the thresholds were identical. This means that in 2009 an employee would go straight from paying a marginal rate of 38% to a marginal rate of 59% (38% basic rate plus 6% middle rate as well as 15% top rate) at the threshold of DKK 347,200. The top rate applies above DKK 335,800 and is additional 15% (when adding basic, middle and top rates this gives a marginal rate of 59%). This top tax threshold of around EUR 45,000 is fairly low by international standard and around 40% of full-time employees are subject to the top rate of tax.

Included in personal income are all remuneration received from an employer (including the likes of accommodation, use of car etc.) as well as any pension receipts or unemployment benefits. Benefits in kind are generally taxed at market value, although there are specific rules for e.g. company cars.

The standard allowance for an individual is DKK 42,900 *per annum*. Travelling allowances are provided where an individual travels more than 24 kilometres per day and an employment allowance of up to DKK 13,600 is provided in certain circumstances. Trade union membership fees and unemployment insurance premia are deductible.

There is a specific expatriate provision which provides that those who are either involved in research or earning more than DKK 63,800 (approximately EUR 8,500) per month (after deduction of the 8% social security provision) can opt to pay a flat rate of 25%. No deductions are available in this instance and the scheme can be chosen for up to three years. Alternatively, an individual meeting the criteria can elect to pay a flat rate of 33% (again after social security deductions) for a period of five years.

Dividends

Dividends and gains and losses on the disposal of shares are taxed together in a different category. The tax rate on this income is 28% on amounts up to DKK 48,300; 43% on amounts between DKK 46,700 and DKK 106,100 and 45% on the surplus (all figures 2009).

C. Social Security/National Insurance payments

A flat rate national insurance contribution (or Labour Market Contribution as it is known in Danish) of 8% is payable by all employees. Thus amount is deducted before income tax is due (please see above) and the amount income tax is due on is the gross salary less the social security contributions.

Traditionally, there has been a compulsory pension savings payment of 1% of salary. This has been suspended from 2004 to 2009 but it is expected to be re-activated thereafter.

VIII. Transfer Pricing and Anti-Avoidance Rules

A. Transfer Pricing rules (Documentation requirements, APAs, etc)

Transactions between related parties (generally meaning common ownership of over 50% and applying to resident and non-resident companies alike) should be conducted on an arms length basis. For documentation purposes, the transfer pricing methods stated in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations are generally applicable.

There is no specific procedure for obtaining advance approval for transfer pricing matters but these fall under the general rules whereby a taxpayer can apply to the tax authorities for a binding ruling as to how a particular transaction would be treated.

B. Anti-Avoidance Provisions

There are no general anti-avoidance rules in Denmark. A small number of cases have suggested a case law lead "substance over form" principle where a particular transaction or stage can be re-classified or set aside where it seems to have no obvious economic benefit to one or all of the parties and the tax authorities have suggested of late that conduit companies could be regarded as transparent in certain circumstances, but there is little clear legislation to back either approach up and no clear doctrine has emerged in either case.

C. Thin capitalisation/other interest deductibility rules

These apply where controlled debt (generally regarded as common direct or indirect control over voting rights or shares) is over DKK 10 million (approx. EUR 1.35 million). The permitted debt:equity ratio at tax year end is 4:1 and interest expenses above that threshold are not allowed.

From July 2007, additional detailed interest deductibility rules were brought in, which apply over and above the thin capitlaisation rules. These apply to both related and third party debt but net financial expenses below DKK 20 million (approx. EUR 2.7 million) *per annum* are still allowed, meaning that normally only large groups would be affected. The first rule limits the deductible interest expenses to a standard rate (7% in 2008) on the tax value of the company's business assets. The second rule limits the net financing expenses may not exceed 80% of the annual taxable profits.

D. Controlled Foreign Company (CFC) rules

For companies the Danish CFC rules apply where the following cumulative tests are held: 1) A majority of the voting rights in the subsidiary are held directly or indirectly; 2) over 50% of the income of the subsidiary is of a financial nature – this includes, in particular, interest, dividends, royalties and capital gains on shares; 3) more than 10% of the subsidiaries' assets are of a financial nature.

For an individual owner, CFC rules apply if the subsidiary is controlled by the individual and both low-taxed (at a rate of less than 18.75%) and financial (income from financial sources of more than 50%) although there is a derogation in the rules if the subsidiary is a company within the EU conducting genuine economic activity.

Where applicable, the CFC rules mean that the income of the subsidiary should be brought in into the tax calculation of the Danish resident regardless of whether any funds have been formally distributed. A credit is given for the tax paid in the subsidiary.

IX. Tax Treaties

Denmark has more than 80 double tax treaties, including treaties most OECD countries and major emerging nations. Two noticeable absences from the list are Spain and France as the Danish government unilaterally rescinded its treaties with the two countries, with effect from 1 January 2009 due to a long-standing dispute concerning the right to tax Danish pensioners who have moved to the Mediterranean following retirement. At the time of writing it is not clear when revised treaties will be renegotiated.

The countries main general trading partners include Germany, Sweden, the United Kingdom, France, the Netherlands and the United States of America.

X. Miscellaneous Taxes

A. Taxes on Payroll

There is no general payroll tax in Denmark although there is provision that companies working in certain fields (generally exempt from VAT) are liable to a form of payroll tax.

B. Taxes on Capital

There is no capital tax in Denmark and neither is there stamp duty on the transfer of shares or loans, although there is a tax on the change of ownership of real estate and mortgages. Further, there is no general wealth tax.

C. Taxes on Property

Owner occupied dwellings are taxed on the basis of their value (this includes both the buildings themselves and the surrounding land). Generally, the public assessment on 1 January 2002 is used as the base and a yearly charge is made of 1% of the value of the property up to DKK 3,040,000 and 3% on the excess.

D. Other taxes

There is an optional church tax which is paid by many Danes and gives certain rights of access to churches (for example to be married in a church). The exact amount depends on an individual's municipality of residence but it is normally around 1%.