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Corporate Tax Implications of Denmark's Unilateral Termination of its Tax Treaties with France and Spain

Denmark terminated its tax treaties with France and Spain effective 1 January 2009. This means, among other things, that each country will tax the income in question according to its domestic tax rules, which could result in a higher effective tax rate or double taxation in some cases. This article examines the corporate tax consequences of the terminations for Danish companies with activities in or payments from France or Spain and for French and Spanish companies with activities in or payments from Denmark.

1. Background

In accordance with Act No. 85 of 20 February 2008, Denmark terminated its double taxation treaties with France and Spain with effect from 1 January 2009. The Danish Ministry of Finance announced the terminations in June 2008 and said that the main reason for doing so was to safeguard the Danish taxation of pensioners. According to the explanatory notes to the Act, termination of these treaties has no economic or administrative consequences of importance for the business community.

This is not a correct picture of the situation because there are general and perhaps unforeseen consequences for companies engaged in cross-border activities in or deriving income from Denmark, France and Spain. This article identifies and discusses several scenarios in which termination of these treaties results in a higher effective tax rate and, in some cases, actual double taxation.

In the absence of a treaty, each country will tax the income in question according to its domestic tax rules. For Denmark, France and Spain, however, the domestic tax rules on dividends, interest and royalties are governed by the EC Parent-Subsidiary and Interest and Royalties Directives.

This article focuses on the tax consequences for companies. Additional issues and unforeseen consequences also apply in relation to individuals.[1] It should be noted that certain beneficial provisions in Spain's domestic legislation are tied to the existence of a tax treaty with an exchange of information clause. These provisions are no longer applicable with respect to Denmark.

2. Danish Companies with Activities in or Payments from France or Spain

2.1. Dividends

In France, the standard withholding tax rate on dividends is 25%; in Spain, the rate is 18%. Following Denmark's termination of its tax treaties with these countries, the treaty reduced rates are not available with respect to the dividends received by a Danish parent company from a French or Spanish subsidiary. If, however, the requirements of the Parent-Subsidiary Directive are met, the dividends may be exempt from the French or Spanish withholding tax on dividends.

The Directive applies where the parent holds at least 10% of the shares of the subsidiary for a period of at least two years (one year in Spain) within which the dividends are distributed. The two-year holding period does not have to elapse before the distribution, provided the holding requirement is later satisfied. In addition, the Directive applies only if the relevant companies fulfil three additional conditions, namely:

(a) the companies take one of the forms listed in the Annex to the Directive;
(b) according to the tax law of each Member State, the companies are considered resident in that state for tax purposes and are not considered residents for tax purposes outside the European Union under a tax treaty concluded with a third state; and
(c) the companies are, without the possibility of an option or of being exempt, subject to one of the taxes mentioned in the Directive – *selskabsskat* in Den-

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1. For example, salaries, wages and other similar remuneration for government services are no longer tax exempt, i.e. payments for such services to individuals in Denmark are taxed in Denmark. Examples of such payments are salaries to employees at the embassy and teachers at the French/Spanish school. In addition, individuals resident in Denmark who work in France and vice versa are subject to taxation at source on their salaries, etc. This may result in a higher effective tax rate or actual double taxation since there are no domestic relief provisions in France's domestic tax legislation. Further, Danish resident individuals who work in Spain are subject to tax in Spain on the income earned from the work carried out in Spain. If a Danish resident company employs such an individual and the company is found to "operate" in Spain (even without a permanent establishment), the company is obliged to register with the Spanish tax authorities and withhold tax on the payments to the employee for the work carried out in Spain.

mark, *impôt sur les sociétés* in France and *impuesto sobre sociedades* in Spain.

Even if the requirements of the Parent-Subsidiary Directive are met, the laws of France and Spain contain a special anti-abuse rule (implementing Art. 1(2) of the Directive) whose conditions must also be satisfied for the tax exemption to apply.

2.1.1. French anti-abuse rule

The French anti-abuse rule in relation to the Parent-Subsidiary Directive, i.e. Art. 119 CGI (*Code général des impôts* or General tax code), applies if the Danish parent company is controlled directly or indirectly by companies outside the European Union, e.g. the United States, unless the French taxpayer can demonstrate that the main purpose for interposing EU companies in the shareholding chain was not to obtain the exemption. The taxpayer's burden of proof is satisfied if the total withholding taxes in the entire chain of companies are at least the amount of the French withholding tax that would have been levied on the dividends paid to the non-EU company.

In November 2007, the Administrative Tribunal of Lyon rendered a decision in the *McKechnie* case (No. 0504128) regarding the scope of the French anti-abuse rule. The case involved a French subsidiary that paid dividends to its UK parent company which was indirectly controlled by two companies based in Jersey (Channel Islands). As the French company was already a subsidiary of the EU parent company (i.e. the UK company) when it was acquired by the Jersey shareholders, the main objective of the chain of shareholdings was not tax avoidance. In other words, the Tribunal found that the facts of the case were sufficient to overcome a presumption of abuse.

The European Court of Justice (ECJ) has not yet defined the scope of the anti-abuse provision in Art. 1(2) of the Parent-Subsidiary Directive. It may be assumed, however, that the ECJ will interpret the provision pursuant to the case law regarding fraud or abuse. Thus, according to Para. 43 et seq. of the ECJ's 1997 decision in *Leur-Bloem* (Case C-27/95) regarding Art. 11 of the Merger Directive, the implementation of Art. 1(2) of the Parent-Subsidiary Directive in domestic legislation must be consistent with the ECJ's principle of proportionality. It is uncertain therefore whether the anti-avoidance provision can apply solely based on the fact that a Danish parent company is a holding company.

Notwithstanding that, in the *McKechnie* case, the Administrative Tribunal of Lyon found that the French anti-abuse rule is compatible with EC law, the provision can fail if it is set aside by the ECJ.

2.1.2. Spanish anti-abuse rule

The Spanish anti-abuse rule applies when the majority of the voting rights of an EU parent company is held directly or indirectly by companies or individuals that are not residents of the European Union. However, this limitation only applies if:

(a) the EU parent company does not carry on a business activity that is directly related to that of the Spanish affiliate;
(b) the purpose of the EU parent is not to manage the affiliate through an adequate organization of human and material resources; or
(c) it can be proved that the EU parent company is incorporated for invalid economic reasons and benefits unduly from the Directive.

In February 2002, the Central Economic and Administrative Tribunal of Spain issued a resolution regarding a Dutch BV holding company controlled by US shareholders. The resolution modified a tax ruling issued by the Spanish tax authorities in July 1992 and stated (contrary to the 1992 ruling) that, since the Dutch holding company acquired the Spanish affiliate during the 1980s (before the Parent-Subsidiary Directive was implemented), the EU parent company was incorporated for valid economic reasons. Thus, the fact that the Spanish affiliate was acquired before the Directive was implemented qualifies as proof under (c). Notwithstanding that the resolution amended and clarified the scope of the anti-abuse rule in relation to (c), this result is not surprising.

Like the French rule, the Spanish anti-abuse rule must also be compatible with the principle of proportionality laid down by the ECJ.

2.1.3. Alternative French withholding tax exemption

If the Parent-Subsidiary Directive does not apply, a Danish parent company receiving dividends from a French subsidiary may claim a specific withholding tax exemption under French law. This exemption was originally intended to apply only to French parent companies holding at least 5% of the shares of a subsidiary for a minimum period of two years.

In December 2006, the ECJ rendered its judgement in *Denkavit* (Case C-170/05), an important decision regarding the withholding taxes on dividends paid to non-resident parent companies. The case concerned a Dutch company, Denkavit Internationaal BV, which owned almost 100% of Agro Finance SARL and Denkavit France SARL, both resident in France. At the time, according to French domestic tax law, the dividends paid to non-resident parent companies by their French subsidiaries were subject to withholding tax, but the dividends paid to French parent companies were not. In Para. 36 of its decision, the ECJ stated:

> ... in the present case, parent companies receiving dividends paid by resident subsidiaries are, as regards the taxation in France of those dividends, in a comparable situation, whether they receive those dividends as resident parent companies or as non-resident parent companies which have a fixed place of business in France, or as non-resident parent companies which do not have a fixed place of business in France.

Therefore, the ECJ concluded that the difference in the French tax treatment, based on the registered office of the parent company, is incompatible with the EC Treaty because it constitutes a discriminatory restriction on the freedom of establishment.

Because of the ECJ's judgement in *Denkavit*, the French tax authorities apply the alternative withholding tax exemption to dividends paid to EU parent companies. Accordingly, a Danish parent company holding at least 5% of the shares of a French subsidiary for at least two years can claim the withholding tax exemption, provided the conditions of an anti-abuse provision are satisfied under which the local economic substance of the Danish parent is a critical factor. Like the anti-abuse rules mentioned above, the scope of this anti-abuse provision must be restricted to artificial schemes in order to be compatible with EC law.

2.2. Interest and royalties

As with dividends, following Denmark's termination of its tax treaties with France and Spain, the tax treatment under these treaties does not apply to the interest or royalties received by a Danish company from a related company in France or Spain. In France, however, such interest and royalties are exempt from French tax if the requirements of the Interest and Royalties Directive are met.

In France, the standard withholding tax rate on interest is 18%, but loans contracted outside France benefit from a broad domestic exemption whose conditions are easy to satisfy. Failing that, the exemption provided in the Directive is available in qualifying cases. The withholding tax rate on royalties is 33.33%, but if the requirements of the Directive are met, the royalties are exempt.

Due to termination of the treaties, payments made to a Danish resident for standard services falling outside the scope of the Directive[2] (see below) are subject to a 33.33% withholding tax if the services are utilized in France. The 33.33% withholding tax is due on payments to related as well as unrelated parties.

In Spain, if the requirements of the Interest and Royalties Directive are met, the withholding tax on royalties is 10% (they are not exempt) because Spain has been granted a transition period before fully applying the Directive. The domestic withholding tax rate is 24%. Spain does not impose a withholding tax on interest paid to companies resident in the EU.

For the Interest and Royalties Directive to apply, companies must be "associated" for a consecutive period of at least two years (one year in Spain) during the period in which the interest or royalty payment is made. A company is "associated" with another company if:

– it holds directly at least 25% of the other company's capital;
– the other company holds directly at least 25% of its capital; or
– a third company holds directly at least 25% of both its capital and the capital of the other company.

The Interest and Royalties Directive applies only with respect to direct ownership, which makes the scope of the Directive narrower than the exemption under Denmark's terminated tax treaties with France and Spain. Therefore, termination of the treaties means that an increasing number of Danish parent companies will be subject to the withholding tax on royalties.

In addition, for the Interest and Royalties Directive to apply, the recipient of the payment must be the *beneficial owner*. The definition of "beneficial owner" is subject to interpretation under EC law. As the Directive is silent in this regard and the ECJ has not finally determined the definition of beneficial owner, it cannot be concluded whether this requirement alone means that an increasing number of companies will be subject to the withholding tax on royalties because the treaties were terminated. But this is very likely to be the case.

Further, it is a requirement that the companies in question take one of the forms listed in the Annex to the Directive. Pursuant to the proposal (not adopted) to the Directive (COM(2003) 841 final), the EU Commission listed different types of companies which it suggests should be within the scope of the Directive. The list shows that the Directive is not (yet) applicable in relation to the following companies:

(1) companies under Danish Law – other than *aktieselskaber* and *anpartsselskaber* – subject to tax under the Corporation Tax Act (*Selskabskatteloven*) if their taxable income is calculated and taxed according to the general tax legislation applicable to *aktieselskaber*; and

(2) companies under French law known as *sociétés par actions simplifiés*, *sociétés d'assurances mutuelles*, *caisses d'épargne et de prévoyance* and *sociétés civiles* which are automatically subject to the corporation tax, cooperatives and *unions de cooperatives*.

Anti-abuse rules apply in Spain and France with respect to the Interest and Royalties Directive.

Interest income and royalties are taxable at 25% in Denmark.

2.3. Permanent establishments

If a Danish company conducts activities through a permanent establishment (PE) in France or Spain, these countries could tax the company on the income derived through the PE under their terminated treaty with Denmark. According to Danish domestic tax law, the principle of territoriality applies. Thus, the income derived

2. According to Art. 2(b) of the Directive: "the term 'royalties' means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematograph films and software, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; payments for the use of, or the right to use, industrial, commercial or scientific equipment shall be regarded as royalties."

through a foreign PE is not taxable in Denmark. This has not changed following termination of the treaties with France and Spain.

If, however, the definitions of permanent establishment in the respective domestic tax laws are not identical, double taxation situations may arise. This is most likely to occur if there are different concepts regarding the assets and liabilities which "represent" a PE.

2.4. Real property

According to the principle of territoriality in Danish domestic tax law, income and gains from foreign real property are not taxable in Denmark. Under the terminated treaty with France, most Danish companies obtained a full tax exemption with respect to investments in real property in France if certain conditions were satisfied. With the treaty now terminated, French domestic law applies, and France may tax a Danish company's gains from the sale of real property in France. France will probably also seek to tax the current income from the property and attempt to levy its 3% annual tax on the commercial value of real property.

In October 2007, the ECJ handed down its decision in the *ELISA* case – *Européenne et Luxembourgeoise d'Investissements SA v. Directeur général des impôts, Ministère public* (Case C-451/05). The case concerned a holding company incorporated under Luxembourg law which owned several immovable assets in France subject to the 3% property tax. The *Cour de Cassation* (France) asked the ECJ whether Art. 52 (now Art. 43) et seq. (freedom of establishment) and Art. 73b (now Art. 56) et seq. (free movement of capital) of the EC Treaty preclude legislation such as Art. 990 D CGI (which provides for the 3% tax).

In the main proceedings, it was established that, according to Arts. 990 D and 990 E CGI, legal persons whose place of effective management is outside France and which, directly or through an intermediary (or a chain of intermediaries), own one or more properties in France are subject to the 3% property tax. This tax, however, does not apply to legal persons whose management seat is in a country with which France has concluded a convention on administrative assistance to combat tax evasion and avoidance. French companies can benefit from the exemption, subject only to certain conditions or an annual filing requirement.

The French government submitted that the disputed tax was a measure designed to combat tax evasion. Notwithstanding this, the ECJ ruled:

> Article 73b of the EC Treaty must be interpreted as precluding national legislation, such as that at issue in the main proceedings, which exempts companies established in France from the tax on the commercial value of immovable property owned in France by legal persons, when, in respect of companies established in another Member State, it makes that exemption subject either to the existence of a convention on administrative assistance between the French Republic and that State for the purposes of combating tax avoidance and tax evasion or to the existence of a requirement in a treaty containing a clause prohibiting discrimination on grounds of nationality to the effect that those companies cannot be more heavily taxed than companies established in France, and which does not allow the company established in another Member State to supply evidence to establish the identity of the natural persons who are its shareholders.

The ECJ concluded that, as a general rule, the freedom of establishment does not apply in circumstances such as those in the *ELISA* case. This conclusion was based on the fact that the case concerned a holding company that did not appear to own real property as part of its business or even manage its own immovable assets. It was not precluded, however, that Art. 52 of the EC Treaty under other circumstances must be interpreted as precluding the legislation regarding France's 3% property tax.

By virtue of *ELISA*, companies in the EU may seek to benefit from the same exemption as French companies, subject to certain conditions or the annual filing requirement. With respect to real estate investments in France, it may be possible, notwithstanding termination of the Denmark–France tax treaty, to achieve almost the same outcome as before the termination, while also saving on France's stamp duty/real estate transfer tax.

Under Spanish domestic law, income from real estate in Spain is taxable there at 24% (with no deduction for the costs incurred), and gains from the sale of real estate in Spain are taxable at 18%. Holding property in Spain is generally a complex matter, and professional advice may be needed for transactions involving Spanish real estate.

2.5. Other income derived in Spain or France

Most types of income derived in Spain by non-residents are taxable in Spain under Spanish domestic law, including income from economic activities carried out in Spain by a non-resident company without a PE there. Thus, activities carried out in Spain by Danish residents are now subject to tax in Spain even in the absence of a PE. Other income that may be taxable in Spain includes contractual fees for services connected with the operation of a Spanish business and head office expenses paid by branches.

Further, income from services used in Spain, even if provided by a Danish resident who has no presence there, is subject tax in Spain. The term "services" includes studies and projects carried out, technical assistance, and management fees. The fact that management fees are now taxable in Spain is important to Danish groups with subsidiaries in Spain which pay management fees to the Danish head office.

Spain taxes the Spanish-source income derived by non-residents at the general non-resident rate of 24%, which applies to the gross amount. The tax is levied by way of withholding by the payer in Spain.

Similarly, payments made by a French resident in consideration for services of any kind rendered by a Danish resident are subject to withholding tax (at 33.33%). The withholding tax on services also applies to payments between independent taxpayers. A similar provision (Art. 182 B CGI) generally applies to payments made by a French resident to a Danish resident in consideration for leasing assets of any kind (tangible or intangible).

As in Spain, the withholding tax in France is levied on the gross amount (without deducting the related costs) paid to non-resident companies. In contrast, resident companies are taxed on the net amount.

Taxation on a gross basis has been criticized by the European Commission and may be open to arguments based on discrimination. Consequently, Danish suppliers may be in position to invoke EU principles to claim a refund of the French and Spanish withholding taxes. Nevertheless, it is assumed that Spanish and French companies will deduct the withholding tax from the gross amount in order to avoid issues with their domestic tax authorities.

2.6. Domestic relief

Denmark currently uses the credit method to relieve double taxation, i.e. the tax levied on a Danish individual or Danish company receiving foreign-source income is reduced by the tax charged by the foreign country on that income, but only to the extent of the Danish tax on that income.

Denmark's termination of its tax treaties with France and Spain will have negative consequences for fully taxable Danish companies if the foreign country's tax under its domestic legislation exceeds the Danish tax. Under the terminated treaties, the other country's tax was reduced. The negative consequences will apply in particular to dividends that do not qualify under the Parent-Subsidiary Directive. The domestic tax legislation of most countries imposes a withholding tax of 20% to 30% on dividends paid to foreign shareholders. Tax treaties typically reduce the rate to 5% on dividends paid to related group companies and to 15% on dividends paid to other companies. Thus, it must be established precisely which rate of withholding tax applies in France or Spain to dividends that do not qualify under the Directive.

Due to termination of the tax treaties, the aggregate tax in Denmark could increase if foreign dividends are included in a pension scheme, where the return is taxed at 15% under the Danish Taxation of Pension Schemes Act, or if the foreign tax rate exceeds the 15% Danish tax rate.

The net principle. If a Danish company receives foreign-source income, the company may be entitled to relief in Denmark for the foreign (withholding) tax levied on that income. The following fraction is used to determine the amount of relief with respect to the company's Danish tax liability:

$$\frac{\text{foreign-source net income x Danish tax}}{\text{global net income}}$$

As a general rule, the foreign-source income is reduced by the deductible costs incurred to generate the income; this is referred to as the "net principle". The deductible costs are defined and estimated according to Danish domestic tax law. As the numerator of the fraction is foreign-source net income (not gross income), the amount of relief depends on the costs related to the income in question. Therefore, the fraction results in a higher effective global tax rate if the foreign withholding taxes are levied on a gross basis. This is not an insignificant issue in relation to payments for services within a group of related companies.

Examples 1 and 2 illustrate the tax consequences of the withholding tax on fees for intra-group services paid to a Danish company by (1) a French subsidiary and (2) a Spanish subsidiary.

Since the net principle applies to determine the relief for Danish tax purposes and since the French and Spanish withholding taxes are levied on a gross basis, the effective tax rate for the Danish company increased significantly. The effective tax rate is further increased in Example 1, where the fees are paid from France, because the 33% withholding tax exceeds the Danish corporate tax rate of 25%.

	Example 1 (EUR)	Example 2 (EUR)
global income	2,000,000	2,000,000
Danish tax (25% of global income)	*500,000*	*500,000*
service fee from French subsidiary:		
income	1,000,000	
related costs	950,000	
net income (5% profit)	50,000	
French withholding tax (33% of gross amount)	*330,000*	
service fee from Spanish subsidiary:		
income		1,000,000
related costs		950,000
net income (5% profit)		50,000
Spanish withholding tax (24 % of gross amount)		*240,000*
relief in Danish tax	*12,500*	*12,500*
total global tax	*817,500*	*727,500*
effective global tax rate	*41%*	*36%*

2.7. Special exemption provision

According to Sec. 13(6) of the Danish Debt Recovery Act (*Inddrivelsesloven*) the Danish tax authorities can give tax relief, including an exemption, if the specific circumstances support such relief. In relation to a concrete case, the Danish tax authorities have said that this provision applies only where the authorities have made a mistake similar to force majeure; hence, the provision is administered restrictively. This special exemption provision has, however, been applied to prevent a legislative amendment from having an unintended retroactive effect.

According to the Minister for Taxation, Denmark's termination of its tax treaties with France and Spain will have no important economic or administrative consequences for the business community. The situation of a taxpayer who must make a significantly larger tax payment and/or is subject to actual double taxation differs little from a legislative amendment that has an unintended retroactive effect. Therefore, it cannot be precluded that the exemption provision will apply with respect to Danish taxpayers who have a significantly larger tax liability and/or are subject to actual double taxation because the treaties with France and Spain were terminated.

3. 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 legislation.

3.1. Dividends

In Denmark, the standard withholding tax rate on dividends is 28%, but the Parent-Subsidiary Directive applies to qualifying dividends paid by Danish companies to companies in France or Spain. Under the Directive, the dividends distributed by a Danish subsidiary to a French or Spanish parent may not be taxed in Denmark irrespective of the provisions of a tax treaty. The exemption under the Directive applies if the parent company holds at least 10% of the shares of the subsidiary for a period of at least one year and if the relevant companies fulfil the three additional conditions mentioned above (see 2.1.).

The Directive applies only if the companies in question take one of the forms listed in the Annex to the Directive. Termination of the tax treaties will have a negative effect on dividends paid to a French *société en nom collectif* (SNC), which is not listed in the Annex. In France, an SNC has historically been considered to be an entity that may claim the benefits of a tax treaty, but an SNC is assumed to be a tax-transparent entity according to Danish case law – see TfS 2007.605 SR, where the Danish Tax Assessment Board concluded that it was the participants, not the SNC, that were subject to limited tax liability in Denmark, i.e. none of the Danish exemption rules regarding the withholding tax on dividends paid to companies in France applied. It was concluded, however, that the participants were entitled to relief under the relevant tax treaty since the Tax Assessment Board found that Art. 15 of the treaty also applies to partnerships. It cannot be excluded that similar undesirable results will occur in relation to other company forms.

Alternative Danish withholding tax exemption. If the requirements of the Parent-Subsidiary Directive are not met, dividends paid by a Danish company are subject to withholding tax. Notwithstanding that the standard withholding tax rate on dividends is 28%, dividends distributed to recipients in France and Spain are taxed at 15% if:

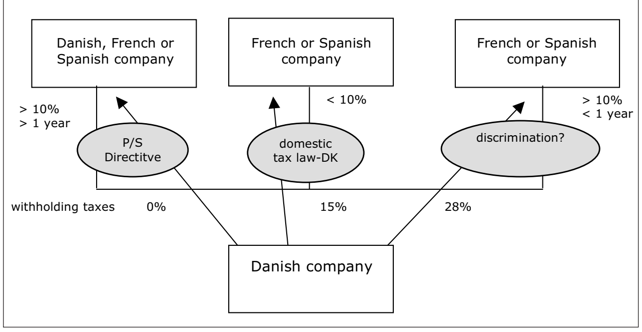
– the recipient owns less than 10% of the capital of the dividend-paying company; and
– the tax authorities of the other country are obliged under an international agreement to exchange information with the Danish tax authorities. According to the *ELISA* decision (see 2.4.), this requirement might be incompatible with EC law.

The Danish provision regarding the withholding tax on dividends has been amended to comply with EC case law, according to which resident and non-resident companies must be subject to the same rate of withholding tax. Even though the dividends received by Danish companies subject to corporate taxation are taxed at an effective rate of approximately 16.5% (25% of 66%), the withholding tax rate according to the alternative exemption rule is 15% since Danish pension funds are taxed at this rate.

The explanatory notes to the amended provision acknowledged the occurrence of situations where an EU parent company receives dividends subject to the Danish withholding tax at 28%, but noted that the withholding tax rate is reduced under a tax treaty. This, however, is no longer the case regarding the withholding tax on cross-border dividends between Denmark and France/Spain because Denmark's treaties with these countries have been terminated. Accordingly, the recently amended provision (applicable as of April 2008) regarding the withholding tax on dividends might still be incompatible with the EC Treaty.

Diagram 1 illustrates three scenarios in relation to the withholding tax on dividends according to Danish domestic tax law where the Parent-Subsidiary Directive is applicable.

Diagram 1



3.2. Interest and royalties

Intra-group interest and royalty payments by Danish companies to French or Spanish companies may be tax exempt in Denmark under the Interest and Royalties Directive if the requirements for associated companies are met (see 2.2.). Pursuant to Act No. 98 of 10 February 2009 (L 23), the Danish legislation has been amended to require that the paying and receiving companies be associated for a consecutive period of at least one year within which the payment must be made. Accordingly, it is sufficient that the payer and recipient companies are associated when the interest or royalty is paid.

The Danish rules on the withholding taxes on interest and capital gains do not apply to interest and capital gains relating to bank loans guaranteed by a group company.

If the requirements of the Interest and Royalties Directive are not met, interest and royalty payments to recipients in France and Spain are subject to a 25% withholding tax in Denmark. If an interest payment is subject to this withholding tax, a special form must be filed with the tax authorities. According to the comments on Sec. A in the guidance to the form, however, no withholding tax is due on interest if the receiving company is resident either in an EU Member State or in a country with which Denmark has a tax treaty. Even though the wording suggests that there is no withholding tax on interest paid to companies resident in France and Spain, the meaning is more likely that there is no withholding tax on interest payments qualifying under the Interest and Royalties Directive, as the existing wording is inconsistent with Danish domestic tax law.

Due to the special domestic tax exemption in Sec. 2 of the Danish Corporation Tax Act, there is no withholding tax on interest and capital gains if the receiving company:

(a) directly or indirectly controls the paying company as defined in Sec. 31C of the Corporation Tax Act, e.g. has the majority of the capital or voting rights;
(b) is subject to Danish CFC taxation;
(c) proves that the French/Spanish corporate tax rate is at least three fourths of the Danish corporate tax rate (18.75%); or
(d) proves that the interest is not transferred to another foreign company subject to a corporate tax rate less than three fourths of the Danish corporate tax rate.

Neither the law nor the preparatory work states how a French or Spanish company must prove that the requirements are satisfied. It is assumed, however, that French or Spanish companies that are usually subject to a corporate tax rate of at least 18.75% can claim this withholding tax exemption if the interest is not transferred to a tax haven.

Because of this domestic tax exemption for interest, the problems arising as a consequence of Denmark's terminating its tax treaties with France and Spain should not be as serious as the problems in relation to royalties.

3.3. Permanent establishment in Denmark

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

Also in this situation, double taxation can occur if the definitions of permanent establishment in the respective domestic tax laws are not identical. Further, there can be undesirable consequences if the definitions in the domestic tax laws differ from the definitions in the terminated tax treaties.

3.4. Real property

With respect to investments made by foreigners in Danish real property, income from real property and gains on the sale of real property are subject to tax in Denmark. However, capital gains on the sale of shares in Danish companies, including Danish real estate companies, are tax exempt in Denmark for non-residents, including French and Spanish companies.

4. Conclusion and Perspective

As this article has shown, Denmark's termination of its tax treaties with France and Spain has resulted in many unforeseen issues of significance. This gives rise to the question whether new tax treaties will be negotiated in the near future and whether they will have retroactive effect. This question cannot be answered with certainty.

The Danish and French tax authorities have agreed to provide solutions to some of the difficulties arising from termination of the Denmark–France treaty. For example, the Danish tax authorities have indicated that the earlier tax exemption for salaries and wages for French government services in Denmark still applies. Further, the Spanish tax authorities have initiated an amendment to Spanish tax laws in order to comply with EC law by ensuring that withholding taxes are levied according to the net principle.

Notwithstanding these developments, termination of the tax treaties has resulted in a higher effective tax rate and actual double taxation in some situations. It is therefore crucial that new tax treaties be negotiated.