Denmark

*Charlotte Ellegaard**
*and Jakob Bundgaard***

Recent Changes Regarding Reverse Hybrid Entities, Convertible Bonds and Exit Taxes

This article reviews new Danish rules on reverse hybrid entities, as well as convertible bonds and the group definition under the Tax Assessment Act. The main elements of proposed rules regarding the exit tax on shares are also considered.

1. Introduction

The main focus of the government on the international tax scene is to prevent tax arbitrage and tax avoidance. This article will provide commentary on some of the recent measures in Denmark.

In the spring of 2008, the Ministry of Taxation became aware of an existing asymmetry between the domestic and international classification of limited partnerships and convertible bonds. Consequently, the Ministry introduced a bill, L 181, to close those loopholes.[1] L 181 also includes an adjustment of the group definition of the so-called double-dipping rule. L 181 was passed on 12 June 2008.

Furthermore, the Ministry of Taxation proposed a bill, L 187, aimed at avoidance measures with regard to the exit tax on shares, calculated when leaving Denmark, through a combination of dividend distributions, recalculation of tax and/or moving back to Denmark. L 187 is expected to pass through parliament in near future. This article will describe the new rules on partnership classification in reverse hybrid structures, convertible bonds, group definition under Sec. 5G of the Tax Assessment Act and the proposed rules regarding the exit tax on shares. The reason for the amendments and their consequences will also be explained.

This article will review the new rules on reverse hybrid entities, as well as convertible bonds and the group definition under Sec. 5G of the Tax Assessment Act. Finally, the main elements of the proposed rules regarding the exit tax on shares will be considered.

2. Transparent Entities and Reverse Hybrids

2.1. Background

Until now, a Danish partnership has been treated as a transparent entity regardless of the country in which its owners were domiciled and whether or not it was classified as a taxable entity under foreign rules. As a consequence, it was possible to entirely avoid taxation of the transparent entity's income. For example tax exemption may occur if the US owners of a transparent entity decide that, from a US perspective, it should be considered a taxable entity (the so-called check-the-box approach). At the same time, from a Danish perspective, the entity is regarded as transparent, yet its activities are not deemed to be a permanent establishment in Denmark. As a result, the profit from its activities will not be taxed in Denmark. The profit will not be taxed in the United States either, because the US owners have decided that the transparent entity is to be considered a taxable entity.

A binding ruling of the Tax Council of 21 May 2008[2] contains an example of this issue and confirms the legal status. The case concerned a Danish limited partnership owned by four companies, one of which was a limited partner while the other three were general partners. One of the general partners was Danish; the other three partners were US companies. The US limited partner held 98% of the limited partnership. The remaining 2% was held by the other US owners (each holding 0.5%) and the Danish member (holding 1%). The limited partnership had its registered address at an office hotel and, under Danish law, was regarded as a tax-transparent entity. Because of the check-the-box rules, the limited partnership was, under US law, regarded as a taxable entity. The limited partnership held all the shares in a Danish private limited company owning a manufacturing facility in Denmark. Moreover, it owned different intellectual property rights.

As a result of a manufacturing contract with the limited partnership, the Danish private limited company was to manufacture products in Denmark for the limited partnership. The limited partnership was to be the owner of both the raw materials for the manufacturing process and the finished products. Also, the responsibility for and the risk related to the products (including research and development costs, product liability, product approval and marketing expenses, and inventory risk) rested with the limited partnership. The income of the limited partnership would solely consist of remuneration from the private limited company for assuming such risk, whereas the private limited company would receive income from product sales. The limited partnership has an independent representative in Denmark with access to the office address, and who is authorized only to forward potential correspondence to the management of the limited partnership. The management of the lim-

* Tax consultant, Deloitte, Copenhagen.
** Partner, Deloitte, Copenhagen; Associate Professor, Copenhagen Business School.

1. See question/answer to 13 and 14.
2. Published in SKM 2008.446 SR.

ited partnership is located overseas, and all arrangements regarding the overall and day-to-day management will be made outside Danish borders. Under the check-the-box rules, the Danish private limited company is regarded a transparent entity to the effect that income from the private limited company is deemed to be realized by the limited partnership under US law.

The Tax Council believed that the limited partnership should be regarded a transparent entity under Danish law. It also believed that the US limited partner and both US general partners were not subject to limited tax liability in Denmark because of the manufacturing contract between the limited partnership and the Danish private limited company. The reason was that neither the office hotel nor the activity of the Danish private limited company for the limited partnership could be deemed to be a permanent establishment for the limited partnership, as these were functions of a preliminary and supportive nature. However, the Tax Council made a reservation as to the circumstance that the adoption of L 181 would result in the owners of the limited partnership being subject to taxation in Denmark on the income of the limited partnership.

According to the explanatory notes on L 181, the very idea of introducing Sec. 2C of the Corporation Tax Act and hence the opportunity to reclassify a transparent entity as a taxable entity, was to curtail situations like that outlined in SKM 2008.446 SR, to the effect that the Danish classification of a company may no longer imply that income is not taxed anywhere.

In such case, a Danish transparent entity treated as non-transparent by its foreign owners would, under certain conditions, have to be reclassified as a taxable entity, causing foreign owners that are domiciled in either tax havens or the United States in future to have their income taxed in Denmark.[3]

2.2. Section 2C of the Corporation Tax Act

2.2.1. Requirements for reclassification

The following tax-transparent entities may be reclassified as taxable entities: entities that are required to be registered in Denmark and are domiciled in accordance with the articles of association or the management of which is registered in Denmark, as well as branches of foreign businesses.

Tax-transparent entities mentioned in 2.1. will be reclassified as taxable entities when the following conditions are present:[4]

– more than 50% of the shares or voting rights are held directly by foreign investors, including investors in the Faroe Islands and Greenland; and
– the tax domicile of such foreign investors is in a country (1) in which the Danish entity is treated as a taxable entity or (2) which does not exchange information with the Danish authorities under an applicable income tax treaty, international agreement or any agreement concluded departmentally for assistance in tax cases.

The explanatory notes to this provision state that the determination of whether or not direct ownership exists is to be based on Danish rules.

Example 1

A US-domiciled parent owns a Swedish limited partnership, which owns a Danish limited partnership. The US parent has decided that both the Swedish and the Danish limited partnerships are to be regarded as taxable entities under US check-the-box regulations. The parent is deemed to be the direct holder of the Danish limited partnership, which may then be reclassified.

Example 2

A US-domiciled parent company owns a Danish limited partnership, *A*, which owns a Danish limited partnership, *B*. The US parent has decided that both *A* and *B* are to be regarded as taxable entities under US regulations. The parent is deemed to be the direct holder of *A*, which may then be reclassified. The reclassified entity, *A*, is regarded as the direct holder of *B*.

Exemption of qualified venture funds

Venture funds contributing capital to small and medium-sized companies or groups are exempted from the application of Sec. 2C of the Corporation Tax Act if certain requirements are met. The reason for exempting venture funds is the desire to continue stimulating the start-up and growth of small and medium-sized innovative businesses. Private equity funds are covered by this exemption clause.[5]

The following four requirements must be fulfilled in order for a venture fund not to be reclassified as a taxable entity under Sec. 2C(9) of the Corporation Tax Act.

First, the venture fund invests only in shares etc. subject to the Capital Gains Tax Act for the purpose of acquiring, in whole or in part, public limited companies or private limited companies to take part in the management and operation of these companies, and the venture fund only holds assets in the form of:

– shares, convertible bonds, certain types of warrants, etc. that are subject to the Capital Gains Tax Act;
– cash deposits with credit institutions that are free from any charges or encumbrances; and
– investment commitments.

Second, the venture fund invests, directly or indirectly, only in companies which singly or together with any group companies[6] have less than 250 employees and:

– an annual balance sheet total of less than DKK 125 million; or
– total revenue of less than DKK 250 million.

Third, the owners of the venture fund do not hold more than 50% of its shares or voting rights. Group enterprises and related parties[7] are considered as one member in this regard.

3. See e.g. Appendix 10 to L 181.
4. Sec. 2C(1) Corporation Tax Act.
5. See Report of 9 June 2008 on L 181.
6. See Sec. 3B Tax Control Act.
7. See Sec. 4(2) Gains on Securities and Foreign Currency Act and Sec. 4(2) Capital Gains Tax Act.

Fourth, the venture fund has at least eight owners. Group enterprises and related parties[8] are considered as one member in this regard.

2.2.2. Tax implications

2.2.2.1. Succession to the owners' tax position

In general, owners are not deemed to have disposed of assets, equity and liabilities of the transparent entity or branch at the time of its reclassification.[9] However, the reclassified entity is considered to have acquired assets, equity and liabilities when the owners of the reclassified entity acquired them at the prices paid by the owners.[10] If, before the entity was reclassified, the owners succeeded to the entity at different points in time, for which reason they have different acquisition dates and prices, the reclassified entity must apply a pro rata allocation of such dates and prices.

Example

A limited partnership has three owners, *A*, *B* and *C*, each of which holds a stake of 51%, 45% and 4%, in 2007. *A* and *C* acquired an asset in 2005 for DKK 100,000, and in 2007, the value of this asset was DKK 150,000. The partnership succeeds to the owners' acquisition prices, i.e. 55% of DKK 100,000 plus 45% of DKK 150,000 (DKK 122,500). For 55% of the asset, the time of acquisition is set to be 2005, which is when the limited partnership, consisting of *A* and *C*, acquired it; for the remaining 45%, the time of acquisition is considered to be 2007.[11]

The acquisition price of goodwill and other intellectual property rights that have been accumulated by one or more of the owners is fixed at DKK 0.[12] Any depreciation, amortization or write-downs of assets made by the owners up to the time of reclassification are considered to have been made by the reclassified entity.[13] If the depreciation, amortization or write-downs provided by the owners vary, the reclassified entity must state the asset at a pro rata value.[14]

Example

A limited partnership has three owners, *A*, *B* and *C*, which hold 51%, 45% and 4%, respectively. *A* has written down an asset to a value of DKK 100,000, *B* has written this asset down to DKK 95,000 and *C* to DKK 105,000. The limited partnership must then consider the asset as having been written down to a value of DKK 97,950 (51% of DKK 100,00 plus 45% of DKK 95,000 plus 4% of DKK 105,000).[15]

Any assets that may be depreciated or amortized and which were not subject to Danish tax law prior to reclassification of the entity are to be regarded as having been acquired by the reclassified entity at the time when the individual owners acquired it, at the actual acquisition price, net of maximum depreciation or amortization.[16]

Any assets that were acquired by one or more of the owners as part of their trade are, when determining the income of the reclassified entity, treated as if they had been acquired by the reclassified entity as part of its trade.[17] If the reclassified entity has owners that are traders as well as non-traders, and any disposal of assets would be tax exempt for the non-trader, the entity is not subject to taxation, nor are any losses in this regard deductible. Thus, any unrealized profits or losses at the time of reclassification may be included/deducted only if the owners were at that time liable to tax when disposing of the asset. At the time of reclassification, the reclassified entity is to be considered as having acquired trading assets at fair value if the owners would not have been taxed or any losses from the disposal of the assets would not have been deductible at that time.[18]

Example

A limited partnership holds shares that were purchased more than three years ago and which are related to the owners' permanent establishments in Denmark. All of the owners are companies; one of the owners is regarded as having acquired the shares as part of its trade, whereas the other owners are not. The limited partnership is deemed to have acquired the shares as part of its trade. When determining any subsequent profit, the acquisition price must be adjusted for the portion of the shares corresponding to the other owners' share at the time of reclassification. This portion of the shares must be considered as acquired at fair value at the time of reclassification.[19]

When determining losses, any dividends received by the owners are regarded as having been received by the reclassified entity, as described in Sec. 8(2) and Sec. 17(2) of the Capital Gains Tax Act. The reclassified entity will succeed to the owners' tax loss carry-forwards[20] and any unutilized deductible losses from prior income years[21] when the tax loss carry-forwards and the deductible losses were incurred as part of the activities of the transparent entity or the branch.

Exemptions from the succession principle

If the relevant assets, equity and liabilities are no longer subject to Danish tax after the reclassification, they are deemed to be disposed of at fair value at the time of reclassification.[22] The reclassified entity is deemed to have acquired claims and debts at market value at the time of reclassification if the owners are individuals who would have been subject to taxation or eligible for deduction upon disposal or repayment at the time of reclassification.[23]

2.2.2.2. Income accruing to the reclassified entity

Any income accruing to the reclassifying entity will generally be taxed at the rate of 25%.[24] However, this does

8. Id.
9. See Sec. 2C(3), first sentence Corporation Tax Act.
10. See Sec. 2C(4), first sentence Corporation Tax Act.
11. See report of 9 June 2008 on L 181.
12. See Sec. 2C(4), second sentence Corporation Tax Act.
13. See Sec. 2C(4), fourth sentence Corporation Tax Act.
14. See Sec. 2C(4), second sentence Corporation Tax Act.
15 Id.
16. See Sec. 2C(4), fifth sentence Corporation Tax Act.
17. See Sec. 2C(4), seventh sentence Corporation Tax Act.
18. See Sec. 2C(4), eight sentence Corporation Tax Act.
19. See report of 9 June 2008 on L 181.
20. See Sec. 15 Tax Assessment Act.
21. See Sec. 8(3) and Sec. 9A(3) Capital Gains Tax Act; Sec. 31(3) Gains on Securities and Foreign Currency Act; Sec. 6(4) Act on Taxation of Profit from Sale of Real Property.
22. See Sec. 2C(3), second sentence Corporation Tax Act.
23. See Sec. 2C(4), sixth sentence Corporation Tax Act.
24. See Sec. 17(1) Corporation Tax Act.

not apply to dividends received if the reclassified entity meets the requirements for receiving dividends free of tax.[25] If these requirements are not met, the reclassified entity's dividends are taxable at the rate of 16.5%, unless the distributing entity is domiciled in a tax haven. In that case, 25% tax is imposed on the dividends.[26]

Capital gains on shares are also exempt from tax if the reclassified entity has held the shares for less than three years.[27]

2.2.2.3. Equity interests in the reclassified entity

Disposal of equity interests in the reclassified entity will be comparable to divestment of shares and hence be subject to the Capital Gains Tax Act. The equity interests are considered as having been acquired for an amount equal to the tax base of the member's share of assets, equity and liabilities at the time of reclassification.[28]

Foreign owners disposing of equity interests in the reclassified entity would never be subject to taxation in Denmark on any gains. The opposite is the case if a Danish owner disposes an ownership interest in the reclassified entity, unless the Danish owner is a company having held such interest for less than three years after the reclassification.[29]

2.2.2.4. Distributions made by the reclassified entity

Distributions by the reclassified entity to the owners will be regarded as dividend distributions.[30] Withholding tax to Denmark will crystallize on the distributions unless the owners meet the requirements for receiving dividends free of tax under Sec. 2(1) Para. c and Sec. 13(1)(ii) of the Corporation Tax Act.

2.2.2.5. Discontinuation of the reclassified entity

If the reclassified entity is discontinued, this is treated as a liquidation. This implies that any assets, equity and liabilities remaining at the time of discontinuation are regarded as having been sold by the reclassified entity at fair value at that time. This may lead to taxation of any profits and recovered depreciation or amortization of the reclassified entity. Also, any liquidation proceeds received by the owners will be taxed as a capital gain or as dividends, unless such owners fulfil the requirements for receiving capital gains and dividends free of tax.[31]

2.2.3. Effective date

Sec. 2C of the Corporation Tax Act is generally effective for income years commencing on or after 15 April 2008.

If the check-the-box approach is applied on or after 15 April 2008, the provision will also be applicable for income years beginning before 15 April 2008, although not earlier than from this date. If the check-the-box approach was applied before 15 April 2008, Sec. 2C of the Corporation Tax Act will be applicable from the beginning of the income year commencing after 15 April 2008.

2.2.4. Practical significance of the amendments

The amendments to the Act imply symmetry between the domestic and international classification of transparent entities, to the effect that a Danish transparent entity may now be reclassified as a taxable entity if this is in accordance with the foreign owners' classification of the entity. So now a Danish transparent entity can no longer avoid being taxed in Denmark if the owners of the transparent entity either are domiciled in a tax haven or treat it as being non-transparent. The latter is the case especially for Danish transparent entities held by US owners.

In practice, this means that Danish law ensures that foreign investors who, prior to the adoption of L 181, would have been taxed on the transparent entity's income only upon repatriation to their country, are now taxed prior to repatriation of income from the reclassified entity. During the reading of L 181, an argument was made that, with the adoption of the bill, foreign businesses would perceive Denmark as unstable from a tax perspective. Also, the adoption of L 181, which does not even include reasonable transitional rules, would send a negative signal to those foreign businesses that have already invested in Denmark in reliance on the regulations then in force. If Danish laws are changed constantly, foreign businesses will view Denmark as a high-risk country unsuitable for investment.[32]

Transparent entities with a majority of Danish owners are not affected by the amendment. Here, the owners and not the transparent entity are taxed.

3. Convertible Bonds

3.1. Background

To date, convertible bonds could be disposed of free of tax if a corporation sold the convertible bond after having owned it for at least three years, and any losses were not deductible.[33] As a result, convertible bonds have been used in cross-border financing structures.

The benefit could be achieved, for example if a Danish lender re-lends by means of an interest-free convertible bond to a borrower that is a foreign company domiciled in a country which accounts for convertible bonds as claims. In this situation, the Danish company would be exempt from tax on any gains from the convertible bond after at least three-years' ownership, while the foreign company would be eligible for deduction of any capital losses.

25. See Sec. 13(1)(ii) Corporation Tax Act.
26. See Sec. 13(3 ec) Corporation Tax Act.
27. See Sec. 9(1) Capital Gains Tax Act.
28. See Sec. 2C(5) Corporation Tax Act.
29. See Sec. 9(1) Capital Gains Tax Act.
30. See Sec. 2C(1) Corporation Tax Act.
31. See Sec. 16A(1) Tax Assessment Act. See also Sec. 8(1) Capital Gains Tax Act and Sec. 2(1) Para. c and Sec. 13(1)(ii) Corporation Tax Act.
32. See appendix 13 to L 181.
33. See Secs. 1 and 9 Capital Gains Tax Act.

The legal position is explained, for example in a binding ruling of the Tax Council of 2 July 2007.[34] This case involved the restructuring of a Swedish group in which the Swedish parent sought to transfer its shares in a wholly owned Finnish subsidiary to a newly established Swedish subsidiary (AB, a Swedish public limited company) through a newly established Danish subsidiary (A/S, a Danish public limited company). Three different approaches could be applied to the restructuring. Common to all of the approaches was that the AB was to issue an interest-free convertible debt instrument which in the end would be held by the A/S.

The convertible debt instrument would fulfil the requirements of Sec. 41 of the Public Companies Act regarding convertible debt instruments, and at the same time meet the definition under Danish tax law of a convertible debt instrument that is subject to the Capital Gains Tax Act, such that the A/S would, as a lender, have a genuine right to convert its claim against the AB into shares in the AB.

In more simple terms, the Tax Council believed that an arm's length redemption of the convertible debt instrument is comparable to disposal under the rules of the Capital Gains Tax Act with an ownership period determined from the time of issuance of the convertible debt instrument. The same applies if, during the term of the convertible debt instrument, the A/S transfers it to another company on an arm's length basis.

However, if the A/S opts to convert the convertible debt instrument and then transfer the shares acquired by doing so to another company, the A/S would also be subject to taxation under the rules of the Capital Gains Tax Act, with a period of ownership determined from the time of issuance of the convertible debt instrument because the conversion does not cause any separate tax implications.

According to the explanatory notes to L 181, the introduction of Sec. 9A of the Capital Gains Tax Act was to deal with situations such as that referred to in SKM 2007.464 SR, such that a Danish company can no longer avoid taxation when redeeming or otherwise disposing of convertible bonds when this is done after at least three years of ownership, while at the same time the issuer becomes eligible for deduction of the capital loss. Thus, the adoption of Sec. 9A of the Capital Gains Tax Act is aimed at making sure that taxation is the same regardless of whether it is an ordinary loan or a convertible bond.[35]

3.2. Section 9A of the Capital Gains Tax Act

Companies holding convertible bonds are liable to tax on any gains from the disposal of convertible bonds, even if those bonds are disposed of three years or more after their acquisition.[36] Cash redemption of the convertible bonds at the pre-arranged date and redemption price is comparable to disposal. Any cash redemption that takes place at a date other than at the pre-arranged date or at another price, is taxed as a dividend unless dividends are exempt from tax for the company. If the dividends are tax exempt for the company, the disposal is taxed under the rules of the Capital Gains Tax Act, and accordingly becomes a taxable transaction.[37]

As earlier, the conversion of convertible bonds into shares is not comparable to disposal. However, the time of acquisition of the shares acquired through the conversion is changed.[38] See 3.4.

Any losses arising from the disposal of convertible bonds are deductible. Deduction must take place in the following order of priority:[39]
– the year's taxable gains from convertible bonds; and
– the year's net gains from shares held for less than three years.

If a loss cannot be covered by the gains for the year, it may be deducted in subsequent income years in the order indicated above, and only after the loss for the relevant income years have been set off.

3.3. Tax implications

Any redemption or sale of convertible bonds taking place on or after 15 April 2008 will then be a taxable event. However, conversion is not considered a taxable event, and a tax-free sale of the converted shares may be carried forward for three years after the conversion.

3.4. Other changes resulting from Section 9A

In order not to undermine the substance of Sec. 9A of the Capital Gains Tax Act, the rule was also introduced that any shares acquired through conversion of convertible bonds on or after 15 April 2008 should be regarded as having been acquired at the time of conversion. Furthermore, the rule that other convertibles are subject to the Capital Gains Tax Act was repealed.[40] This will avoid circumvention of Sec. 9A of the Capital Gains Tax Act by converting convertible bonds into shares followed by an immediate disposal of the shares, or by merely using convertibles other than convertible bonds.

3.5. Practical implications of the amendment

The amendment implies symmetry between domestic and international taxation of convertible bonds to the effect that Danish lenders will now be taxed on their capital gains from convertible bonds regardless of the time of disposal. In practice however, this means that Danish law causes Danish companies receiving convertible bonds to be less favourably positioned because foreign issuers may deduct capital losses in their domicile country.

34. As published in SKM 2007.464 SR.
35. See explanatory notes to L 181.
36. See Sec. 9A(1) Capital Gains Tax Act.
37. See Sec. 16B Tax Assessment Act and Sec. 9A Capital Gains Tax Act.
38. See explanatory notes to L 181.
39. See Sec. 9A(2 and 3) Capital Gains Tax Act.
40. See Sec. 29A Capital Gains Tax Act and Sec. 1(ii) of L 181 as adopted on 12 June 2008.

The amendment affects convertible bonds that are issued among Danish companies. This means an increase of the asymmetrical tax treatment of receivers and issuers of convertible bonds, as the recipient company is in every respect taxed on any capital gains from the redemption of convertible bonds, whereas the issuing company will not be eligible for deduction of any related capital losses. Thus, convertible debt instruments are subject to greater taxation than ordinary loans where the borrower may deduct any capital losses.

Also, the general liability to tax of the recipient of the convertible bond implies that it has become less favourable on the face of it to use convertible bonds as a replacement for shares. Consequently, it cannot be ruled out that the amendment may cause a reduction in funding facilities for Danish companies. As regards the specific tax arbitrage structures primarily targeted by L 181, certain planning measures are available to mitigate the impact of the new legislation.

Individuals and issuers of convertible bonds are not affected by this amendment. Convertible bond issuers who are domiciled in a country treating convertible bonds as claims may still deduct capital losses.

4. Adjustment of the Group Definition under Section 5G of the Tax Assessment Act

It follows from Sec. 5G(1) of the Tax Assessment Act that expenses are not deductible if they may be deducted when calculating taxable income under foreign rules, either with the taxpayer or with a group company. When determining whether a company is a group company, the group definition in Sec. 4(2) of the Capital Gains Tax Act has been applied, and it was decisive in this regard whether the same shareholders were directly or indirectly holding more than 50% of the shares or voting rights of the company.

This has been changed so that now the group definition in Sec. 3B of the Tax Control Act is to be applied. Under Sec. 3B, a legal group entity is to be interpreted as a legal entity in which the same owners have a controlling interest or in which joint management exists. Controlling interest means ownership or availability of voting rights to the effect that more than 50% of the shares or more than 50% of the voting rights are held directly or indirectly.

Expenses incurred by a Danish company on or after 15 April 2008 are not deductible when they may be deducted by foreign companies which hold a controlling interest either as a consequence of the controlling interest being held jointly or through a transparent entity.

With this amendment, the application of Sec. 5G of the Tax Assessment Act has been extended.

5. L 187: Proposed Amendments to the Rules regarding Exit Tax on Shares

5.1. Background: current rules under the Capital Gains Tax Act

If an individual who has been a resident of Denmark for at least seven years within the last ten years, ceases to reside in Denmark, the shares owned by the individual at the time of exit are regarded as having been sold. Tax is calculated on the net gain as the difference between the acquisition cost and the value of the shares at the time of exit. A postponement of the time for paying the calculated tax may be granted.

If the individual, at a later time, disposes of the shares subject to exit tax, the individual gains are subject to a recalculation of the tax based on the actual consideration. This will crystallize if the actual consideration is less than the value at the time of exit. If the individual moves back to Denmark, the calculated exit tax is cancelled for the shares still owned by the individual at the time of moving back and the original acquisition cost is assigned to the shares.

The present rules imply that it is possible for an individual to avoid taxation in Denmark of a gain deriving from the time when the individual was resident in Denmark. This may be the case if the individual moves to a country with low taxation of dividends. The individual distributes dividend from its company – emptying the company of value, after which the individual applies for a recalculation or moves back to Denmark and sells the shares at a loss due to the dividend distributions. If the individual had a recalculation at the time of the dividend distributions, the calculated exit tax is cancelled when the individual moves back to Denmark. If the individual sells the shares after moving back to Denmark, a loss from the sale of shares is deductible from other income from shares.

According to the explanatory notes to L 187, the proposed amendments to the Capital Gains Tax Act will deal with situations where the exit tax rules are used an unintended way. See 5.1. Thus the proposed rules are designed so that the calculated tax on gains earned during tax liability in Denmark (exit tax) in principle becomes final.

Accordingly, the option of recalculating exit tax is entirely removed, and if an individual moves back to Denmark, an entry value is applied on the shares subject to exit tax and not disposed of.

5.2. Proposed amendments to Capital Gains Tax Act

5.2.1. Exit with shares having a value less than DKK 100,000

Normally, exit tax is not levied on shares with a value less than DKK 100,000.

5.2.2. Exit with shares having a value of at least DKK 100,000

When a postponement of the time of payment is requested, a portfolio balance and a postponement balance must be prepared for the shares owned by the individual at the time of exit. The initial postponement balance is the tax on shares calculated at the time of exit (the postponement amount). The calculated tax on the postponement balance is due concurrently with e.g.:

– the sale of shares;
– the receipt of dividend;
– the sale to issuing company;
– the raising of a loan in a company the shares of which are included in the portfolio list;
– other distributions and transactions that may affect the value of the shares negatively; and
– the death of a person.

Postponement of the time of payment is conditional upon timely filing of the tax return and submission of the mentioned portfolio list at the same time as the tax return. Upholding postponement is conditional upon a tax return being submitted once a year.

The postponement balance becomes void if all the shares included in the portfolio lists are sold. This applies even if the entire amount for which postponement has been granted, has not been paid.

5.2.2.1. Returning to Denmark

If the individual moves back to Denmark with all or some of the shares, the shares are given an entry value. Thus, the shares are considered to be acquired at their price at the entry date. If part of the postponement balance still remains, the entry value is reduced by an amount corresponding to the value of the postponement balance.

5.3. Tax implications of the proposed bill

The bill is based on requests for a postponement of the time of payment. If exit tax is paid in connection with the exit, the tax is final. If the individual has requested postponement of the time of payment, it is conditional that the portfolio list be timely filed with the tax return, and upholding postponement is conditional upon a tax return being submitted once a year, regardless of whether shares have been sold or a dividend has been received.

If the tax on sale of shares or dividend in the country to which the individual has moved, is less than the comparable Danish tax, the difference between Danish tax and foreign tax must be paid to Denmark, and the postponement balance must be written down by the Danish tax paid. If the tax in the country to which the individual moves is greater than or equal to the comparable Danish tax, only the foreign tax is paid and the postponement balance and the amount for which postponement has been granted remain unchanged.

If a sale triggers a loss, the loss of the postponement balance is written down by the calculated tax value of the loss. If, however, a loss is deductible in the foreign country, that loss is converted into a tax value which the individual must pay to Denmark, and the postponement balance is written down by this amount.

If the individual moves back to Denmark and the value of the retained shares at the returning time is less than the value of the shares at the time of leaving Denmark, the entry value is reduced by the value of the postponement balance. Thus, there is a risk of a higher gain on a later sale.

As the exit tax rules apply only to individuals who, at the time of the exit, have been fully tax liable in Denmark for at least seven years of the past ten years, most foreign individuals stationed in Denmark are exempted from Danish exit tax on shares when moving away from Denmark.

The rules are to be effective from 30 May 2008. Individuals who have moved prior to 30 May 2008 and who have requested postponement of the time of payment, do not lose the postponement, provided that a portfolio list is submitted to the tax authorities no later than 1 July 2009, of the shares subject to the postponement and which are still owned at 30 May 2008. If the portfolio list is not submitted in due time, the postponement lapses and the amount for which postponement has been granted falls due.

With regard to individuals who have moved before 30 May 2008 and who have not requested postponement of the time for payment, the exit tax is final. In addition to losing the option of recalculation (which would be relevant if selling at a lower price than the price at the time of exit), the individual also loses the option of receiving credit for any foreign tax potentially paid in connection with sale of shares, receipt of dividend etc., implying the risk of subjecting a 100% fictitious gain to tax. Not requesting a postponement of the time of payment must therefore be expected to be the exception.

