

Update: An Introduction to the Taxation of Financial Instruments

This article is an update of an article regarding the taxation of financial instruments, published earlier this year in this journal. The update concerns the period from 1 January 2009 to 28 May 2009, and includes Act 98 of 10 February 2009 and bills 195 and 202 that were passed in the parliament on 28 May 2009.

1. Introduction

Tax rates applicable to resident individuals and companies have been amended generally as from income year 2010. The table has therefore been amended, as shown in Table 1.

The rates applicable to share income (28% and 43%/45%, depending on the total share income) have been amended to 27% and 42%, depending on the total share income. The new rates are effective as from income years 2012 and 2010, respectively.

The maximum capital income tax rate of 59% has been lowered to 51.5% effective as from income year 2010.

The tax rates applicable to non-resident individuals and companies effective as from 1 January 2012 can be summarized as shown in Table 2.

The effective tax rate may be less than 27%.

2. Options, Forward Contracts and Swaps: Companies

The restrictive rules concerning deductibility of losses on financial contracts including a right or obligation to dispose of shares have been amended as a consequence of the amendments regarding the taxation of shares. See 4.2. Thus, two new categories have been introduced, one of which includes shares in a subsidiary, shares in a group and shares in the company issuing or acquiring the financial contract. The other category includes other shares that are not traded on a regulated market or a multilateral trading facility, and are taxed according to the realization principle. The financial contract is taxed based on the mark-to-market principle.

Accordingly, two new categories have been introduced with regard to (1) a share index, (1) a share index including shares in a subsidiary and shares in a group owned by the issuer, the acquiror or companies related to the issuer or the acquiror and (3) a share index including shares in the company which is the issuer or acquiror of the contract.

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Table 1

	Individual (%)	Company (%)	Pension funds (%)
Options, forward contracts and swaps	up to 51.5	25	15
Bonds adjusted based on developments in prices etc.	up to 51.5	25	15
Bonds; general rules	up to 51.5	25	15
Convertible bonds	up to 51.5	25	15
Shares: general rules	28 or 42	25 or 0	15
Shares in a CFC	25 on CFC income	25 on CFC income	0 on CFC income
Shares in investment companies	up to 51.5	25	15
Shares in investment associations	up to 51.5	25	15
Share lending	up to 51.5	25	15

Table 2

	Individual (%)	Company (%)
Options, forward contracts and swaps	0	0
Bonds adjusted based on developments in prices etc.	0	0
Bonds; general rules	0	0
Convertible bonds	0	0
Shares: general rules	0 or 27	0 or 27
Shares in a CFC	0 on CFC income	0 on CFC income
Shares in investment companies	0 or 27	0 or 27
Shares in investment associations	0 or 27	0 or 27
Share lending	0 or 27	0 or 27

3. Convertible Bonds: Companies

The rules regarding other shares (see 4.2.) apply accordingly to convertible bonds, although losses deriving from the disposal of convertible bonds issued by related group companies are not included in taxable income. In order to assure that such losses cannot be deducted, the value at the end of an income year and the value at disposal, both relevant to the mark-to-market taxation of the convertible bond, may not be lower than the acquisition amount for tax purposes. Furthermore, the corporate holder of convertible bonds other than convertible bonds issued by related group companies and convertible bonds traded on a regulated market or multilateral trading facility, may not opt for taxation according to the realization principle if the convertible bond may be converted into shares that are traded on a regulated market or a multilateral trading facility.

4. Shares in Companies: General Rules

4.1. Individuals

New rules on the taxation of preferential capital fund partners have been introduced with regard to shares owned by a capital fund (capital fund shares). A capital fund is defined as an investment entity investing in shares with the aim of participating in the management and the business of companies acquired by the capital fund. The capital fund may be transparent or non-transparent for Danish tax purposes. Preferential capital fund partners are defined as individuals where the individual's proportional part of the result of the capital fund exceeds the individual's proportional part of the total participating capital including capital contributions and loans provided by the participants. Gains, including dividends and proceeds in connection with a share buy-back, and losses on capital fund shares are included in taxable income of the preferential capital fund partner.

Gains on capital fund shares exceeding a standard yield (defined as the yield received by non-preferential capital partners) are taxed as personal income at a rate of up to 51.5%. Gains that do not exceed the standard yield are taxed as share income.

Losses on capital fund shares are only treated as negative share income. However, a preferential capital fund partner may receive an amount in cash corresponding to taxes paid in respect of yield to the extent that the yield is repaid to the other investors due to an adjustment of the allocation of yield within the capital fund.

If an individual directly or indirectly controls a Danish or foreign company that is a preferential capital fund partner, the company's share income defined for this purpose must be included in the taxable income of the individual as CFC income. The defined share income includes dividends and proceeds from a share buy-back and gains and losses on shares, minus the standard yield of the capital contributed to the capital fund by the company (see above regarding the standard yield). If the defined share income of an income year constitutes a loss, the loss may be carried forward. If the individual

owns less than 100% of the share capital of the company, a part of the share income corresponding to the average ownership share through the relevant income year is included. Dividends received by an individual not exceeding the tax payable by that individual on the income of the company will not be included in the taxable income of the individual. If the individual receives an amount in cash paid due to an adjustment of the allocation of yield within the capital fund (see above), the amount is taxable to the extent that the individual has received such tax-exempt dividends. If the individual's shares in the company constitute shares in an investment company, the individual is not taxed under the above rules.

4.2. Companies

The general three-year exemption rule has been replaced by exemption rules including shares in a subsidiary, shares in a group and shares owned by the issuing company. Shares other than those mentioned are not subject to exemption rules.

Shares in a subsidiary constitute as a minimum a 10% ownership of the share capital of the subsidiary. If the subsidiary is not subject to full tax liability in Denmark, it is a further condition that the Danish taxation of dividends would be reduced under EU Directive 90/435 or an applicable tax treaty. Shares in a subsidiary are deemed to be owned by the corporate shareholders of the parent company if:

- the parent company is a pass-through company (subject to definition);
- more than 50% of the share capital of the parent company is directly or indirectly owned by companies subject to full tax liability in Denmark; and
- the shares in the parent company are not traded on a regulated market or a multilateral trading facility.

This transparency rule can be said to constitute an internal Danish beneficial ownership rule.

Shares in a group are defined as shares where the owner and the subsidiary are subject to national mandatory joint taxation or may be subject to optional international joint taxation. The above transparency rule applies accordingly in respect of the corporate shareholders of the parent company.

Gains and losses on shares in a subsidiary, shares in a group and shares owned by the issuing company are not included in taxable income.

Gains on other shares are included in taxable income. Losses are deductible if the mark-to-market principle is applied by the shareholder. If the realization principle is applied by the shareholder, deductibility is limited to such gains of the income year in question, and any further loss may be carried forward and deducted from such gains taxed under the realization principle. The shareholder cannot opt for the realization principle if the shares are traded on a regulated market or a multilateral trading facility. The acquisition amount of such shares

for the purpose of mark-to-market taxation is assessed under certain rules.

If shares in a subsidiary or shares in a group shift to constitute other shares, the shift is treated as a disposal of shares at market value for tax purposes. It is accordingly a disposal of shares at market value for tax purposes, if other shares shift to constitute shares in a subsidiary or shares in a group.

The rules governing the taxation of dividends have been amended as a consequence of the new categories of shares.

Dividends received by companies subject to full tax liability in Denmark are tax exempt if the dividends derive from shares in a subsidiary or shares in a group. This exemption rule does not apply if the company paying the dividends is subject to a tax deduction in respect of the dividends and the foreign taxation is not reduced under EU Directive 90/435. The 66% rule has been repealed. Thus, dividends deriving from shares other than shares in a subsidiary, shares in a group and shares in the receiving company (i.e. shares owned by the issuing company), are taxed in their entirety at the general rate of 25%.

Dividends received by companies not subject to full tax liability in Denmark are exempted from Danish withholding tax if:

- the dividends derive from shares in a subsidiary, and the Danish taxation would be reduced under an applicable tax treaty or EU Directive 90/435; or
- the dividends derive from shares in a group that are not shares in a subsidiary and the Danish taxation would have been reduced under EU Directive 90/435 or an applicable tax treaty had the shares been shares in a subsidiary.

Companies subject to the above exemption rules are taxed on liquidation proceeds distributed before the final calendar year of the liquidating company, and on proceeds in connection with a capital decrease under the rules concerning dividends, unless the shares are treated as shares held by a trader in shares. Thus, this exception to the general rule under which such distributions are treated as dividends has been narrowed to include only shares held by a trader in shares.

The rules governing the taxation of liquidation proceeds distributed in the final year of the liquidating company have been re-worded. It is the general rule that such liquidation proceeds are taxed under the rules concerning the disposal of shares. However, the exception that concerns companies not resident in the European Union, the EEA or in a country with which Denmark has entered into a tax treaty, has been amended in connection herewith, as this condition has been replaced by the condition that the proceeds must not fulfil the conditions for tax-exempt dividends paid to companies not subject to full tax liability in Denmark. Therefore, under the amended wording, it is not sufficient in respect of shares in a subsidiary and shares in a group that the receiving company is resident in a certain country; it is further required that the proceeds would have been sub-

ject to a reduced Danish withholding tax under an applicable tax treaty or EU Directive 90/435. It appears that the Ministry of Taxation may have amended the wording for the purpose of applying a beneficial ownership test to such proceeds. For example if the receiving company is resident in a tax treaty country, but not respected by the Danish tax authorities as the beneficial owner in respect of dividend payments with the consequence that Danish withholding tax is not reduced, the Danish tax authorities as a consequence of the amended wording may apply the same beneficial ownership test with regard to such proceeds.

The rules concerning proceeds in connection with a buy-back of unlisted shares (shares not traded on a regulated market, cf. Bill 202) have been amended in accordance with the above amendments concerning liquidation proceeds distributed before the final calendar year of the liquidating company and liquidation proceeds paid in the final year of a liquidation company respectively.

5. Shares in Investment Companies

The definition of "investment companies" has been expanded to include companies similar to investment entities under EU Directive 85/611 with no obligation of the issuing company to purchase issued shares on request, provided that the issuing company has at least eight shareholders. Certain related group shareholders are deemed to be one shareholder in this regard. However, such similar entities are not included in the definition where more than 15% of the assets of the company (calculated as an average through the financial year based on the company's accounts) constitute other than securities etc., not including ownership of more than 10% of the share capital in companies other than investment companies. A transparency rule applies to related group companies, i.e. the portion of the assets of the group company corresponding to the ownership share is included when determining the 15% test.

Furthermore, an employee holding company owning only shares in the employer company or a related group company is not included in the definition. However, the employee holding company may own cash, up to 15% of the assets of the company calculated as an average through the financial year based on the company's accounts. It is a condition that the employer company and the related group companies not be investment companies.

6. Shares in Investment Associations: Companies

The rules on shares in distributing investment associations have been amended, there being generally no distinction between different distributing investment associations as opposed to the rules applicable to individuals. Thus, the special definition of bond-based distributing investment association has consequently been repealed. Gains and losses on such shares are generally included in taxable income based on a mark-to-market principle.