



KROMANN REUMERT

INVESTMENT COMPANIES AND INVESTMENT FUNDS - SIGNIFICANT AMENDMENTS TO DANISH TAX REGIME

On February 5 the Danish Parliament passed bill no. L 23 significantly amending the Danish tax regime for investment companies and investment funds.

Investment companies

Generally, dividends and capital gains realised by a Danish tax resident individual investing in shares are taxed as "share income" (at a rate of up to 45 pct). Dividends realised by a Danish tax resident company investing in shares are generally taxed at a rate of 16.5 pct. Gains on shares held for less than three years by such company are typically taxed as ordinary corporate income (at a rate of 25 pct), while gains on shares held for three years or more generally are exempt from taxation.

However, special rules apply to shares in so-called "investment companies".

Thus, a Danish tax resident owning shares in an investment company is taxed annually on gains on a mark-to-market basis. Furthermore, gains and dividends are for individuals taxed as capital income (at a rate of up to approx. 59 pct) and for companies as corporate income (irrespective of the period of ownership).

Consequently, the tax treatment of dividends and gains on ordinary shares is generally more favourable than the tax treatment of dividends and gains on shares in investment companies.

Until now, investment companies have for Danish tax purposes been defined as:

- undertakings for collective investment in transferable securities, etc. comprised by the UCITS Directive (85/611/EEC); and



- companies whose business consists in investing in securities, etc. and where, at the request of the holders, shares in the company shall be redeemed by means of company funds at a price not materially below book value.

Broader definition of investment companies

Bill no. L 23 significantly broadens the definition of investment companies to include all companies which invest in securities, etc., provided that such companies have at least 8 shareholders.

Thus, following bill no. L 23 all companies which invest in securities, etc. and have 8 or more shareholders will as a starting point be considered investment companies for Danish tax purposes.

However, irrespective of the above the following companies will not be considered investment companies:

- a company, etc., if more than 15 pct of the company's assets are assets other than securities, etc. A shareholding in another company that is not itself an investment company and which equals at least 10 pct of such other company's share capital is in this connection not considered to constitute securities. However, if the company has a controlling influence over or is affiliated with such other company, a proportionate part of the other company's assets is included in the calculation of the 15 pct threshold.
- a company which solely owns (i) shares, warrants or share rights in another company (the "employer company") that is not itself an investment company and (ii) cash or cash deposited in a current account not exceeding 15 pct of the company's total assets, provided that all the shareholders of the first mentioned company at

the time of the purchase of the shares were employed by the employer company or a company affiliated with the employer company.

Consequences for foreign investment funds

The broader definition of investment companies will affect numerous foreign investment funds which are being marketed towards Danish investors and which until now have not been considered investment companies (because they are not UCITS funds and do not offer the investors the right to have shares redeemed).

Typically, investments in such foreign investment funds by Danish investors have until now been deemed investments in ordinary shares resulting in a relatively favourable taxation of gains and dividends (at least when compared to the tax treatment of gains and dividends from shares in investment companies). Following bill no. L 23 investments in such foreign investment funds will normally be taxed under the rules applicable to shares in investment companies.

Furthermore, Danish investors holding shares in an investment fund being caught by the broadened definition of investment companies will for tax purposes be considered to have disposed of their shares due to the change of tax status (i.e. the change of tax status of the investment fund constitutes a taxable event even though the investor continues to hold the shares).

International tax planning opportunities

The only type of income which is taxable at the level of Danish investment companies is dividends received from other Danish companies. Accordingly, a Danish investment company is not taxable of dividends from non-Danish companies, interest and capital gains on shares, bonds or financial contracts. The Danish investment company may therefore be a very interest-



ing vehicle for use in international structures.

Share-based distributing investment funds

The tax treatment of gains on shares in so-called "share-based distributing investment funds" is generally more favourable than the tax treatment of gains on shares in other investment funds.

Until now a share-based distributing investment fund has only been allowed to invest in securities, etc. comprised by the Danish Act on Taxation of Capital Gains on Shares (save for convertible bonds, shares in investment companies and shares in distributing investment funds that are not share-based) and in the investment fund's administration building. However, up to 25 pct of the assets of the investment fund could be invested in certain financial instruments or held in cash.

Bill no. L 23 eases the restrictions on the types of assets in which a share-based distributing investment fund may invest.

Thus, bill no. L 23 permits a share-based distributing investment fund to invest up to 25 pct of its assets in any form of assets (e.g. bonds, etc.). Consequently, following bill no. L 23 an investment fund may benefit from the more advantageous tax treatment avail-

able to share-based distributing investment funds if 75 pct of the assets of the investment fund are invested in securities, etc. comprised by the Danish Act on Taxation of Capital Gains on Shares (save for convertible bonds, shares in investment companies and shares in distributing investment funds that are not share-based). The remaining 25 pct may be invested in any type of assets.

The purpose of this change seems to be to make it easier for non-Danish investment funds to obtain status as share-based distributing investment funds.

However, in order to qualify as a distributing investment fund an investment fund must also calculate and report a so-called minimum dividend and it remains to be seen whether only Danish investment funds in practice are capable of satisfying this requirement. The European Commission has formally requested Denmark to change its tax provisions stating that the preferential taxation is only available to investors if detailed requirements are met that are very difficult or impossible for foreign based investment funds to fulfil. The Commission considers the provisions incompatible with the freedom to provide services and the free movement of capital.



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