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DENMARK: Source-Residence Country Coordination

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I. Source Country Taxation

A. Dividends and Similar Payments

1. Under domestic law, how does your country tax a nonresident (lacking a PE or other local establishment) on payments of dividends or similar amounts? How is this domestic treatment generally affected by your country's tax treaties?

Dividends are generally taxed at source, with the dividend-paying entity being obliged to withhold dividend tax at the rate of 27%. Denmark's tax treaties are generally based on the OECD Model Convention, which ensures the source country's right to tax a dividend but also in many cases reduces the tax rate applicable to dividends paid to nonresident corporate shareholders, typically to 15% (but in some cases to a lower rate). Where the taxation of Danish-source dividends is reduced under the terms of an applicable tax treaty, tax is withheld at the domestic law rate and the nonresident recipient of the dividends must apply for a refund.

2. How is a 'dividend' defined for these purposes? For example, does the tax apply to any declared distribution, or some other amount (and how is that determined)?

Under the Danish law definition, any distribution, whether in kind or in cash, from a company to its shareholders is deemed to be a dividend and taxed accordingly.

Dividend taxation applies to any and all income items characterized as a dividend for tax purposes. As Denmark does not tax capital gains from the sale of shares in Danish companies, a number of anti-avoidance rules are in place to ensure that dividend taxation is not avoided by using instruments that would otherwise result in the realization of capital gains on shares. For this reason, certain income items may be reclassified as dividends, including: liquidation proceeds, proceeds from the buy-back of shares, interest on hybrid loans, and certain sale proceeds where the shareholder retains some ownership of the entity whose shares it has sold. In these cases, characterization as a "dividend" is based primarily on objective factors such as: the type of entity (corporate or transparent/hybrid), the country of residence of the taxpayer (tax treaty or non-tax treaty country), and the ownership percentage.

Further, abuse doctrines developed by the courts (the rightful recipient and substance-over-form doctrines) may entail a payment being reclassified as a deemed (disguised) dividend distribution. However, the withholding obligation does not apply to such disguised dividend distributions.

3. Can nonresidents (that lack a PE or local establishment) reduce a taxable amount by any expense (or allowance in place of deductions) to reflect the fact that only a net amount might be taxable in a residence country?

The withholding tax on dividends is in principle computed based on the gross amount declared, which precludes any deduction of expenses from the taxable basis. A number of decisions of the Court of Justice of the European Union (CJEU) suggest that this position may not be sustainable within the European Union, as denying nonresident taxpayers deductions similar to those awarded to resident taxpayers may violate the

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freedoms granted by the EU Treaty (specifically the freedom of establishment and the free movement of capital).

However, the denial of deductions to a nonresident taxpayer would not be in violation of the EU Treaty if similar deductions would not have been allowed to a Danish resident taxpayer. Danish tax law as developed through case law to a significant extent justifies the non-deductibility of expenses relating to dividend income, since, in the case of a resident taxpayer, such expenses are regarded as non-deductible expenses relating to the establishment or expansion of a business, or as expenses attributable to the acquisition price of the shares on which the relevant dividends are paid.

4. Nonresidents with losses: Does your tax system provide any coordination of the gross (withholding) tax on dividends paid to nonresidents (that lack a PE or other local establishment) with the fact that a nonresident may have other losses or an overall loss? If so, please describe how this coordination is put into effect.

Danish tax law does not provide for any right to deduct other losses against Danish-source dividend income.

5. Are any tax reductions or exemptions allowed to account for the possibility of incomplete double tax protection in the residence country? What are those, and when are they permitted?

There is no provision under Danish tax law to account for the non-utilization of foreign tax credits in the residence country.

6. How does your domestic law deal with distributions to foreign holding companies? Do these measures apply in the treaty context as well as the domestic law context? Does the domestic law allow foreign tax credits to be set off against withholding tax on outbound dividends when such foreign tax credits cannot be otherwise used because of the exemption of inbound dividends?

Outbound dividends distributed by a Danish company to its foreign parent company are exempt from withholding tax if the foreign parent company holds at least 10% of the shares of the Danish company, and the parent company qualifies for the elimination or reduction of Danish withholding tax under the Danish law implementation of the EU Parent-Subsidiary Directive, or the terms of a tax treaty between Denmark and the parent company's country of residence. The exemption for dividends paid to parent companies also applies with respect to dividends paid on "group shares," i.e., where the parent holds directly less than 10% of the nominal share capital of the Danish company, but holds indirectly more than 50% of such capital.

Foreign tax credits may not be set off against the withholding tax on outbound dividends.

B. Interest and Similar Payments Related to Interest

1. If the payment from your country is denominated as interest or some equivalent, how would the answers to the questions in I.A. be different from those given in relation to dividends?

While Danish domestic law generally imposes withholding tax on dividends paid to a nonresident, Denmark does not generally impose withholding tax on interest paid to a nonresident. However, a 22% withholding tax does apply to interest payments made by a Danish company to a foreign related entity. For these purposes, a lender is a related entity if it owns or controls, directly or indirectly, more than 50% of the shares or voting rights in the Danish borrowing company.

The withholding tax does not apply if: (1) taxation is required to be reduced or waived under the terms of an applicable tax treaty or the EU Interest and Royalties Directive, (2) the creditor is controlled by a company situated in Denmark or a tax treaty country and the creditor is within the scope of Danish controlled foreign company (CFC) taxation, or (3) the interest is subject to tax in the creditor's country of residence at a rate of at least three quarters of the ordinary Danish flat corporate tax rate (i.e., at a rate of at least 16.5%) and no back-to-back loan arrangement is in place that results in taxation at a rate of less than three quarters of the ordinary Danish tax rate.

In essence, withholding tax on interest is levied only on group-related interest payments where the recipient is resident in a low-tax jurisdiction that is not an EU Member State and that has not signed a tax treaty with Denmark. The scope of Danish interest withholding tax is thus quite limited.

Withholding tax on interest may not be reduced by foreign expenses, losses, tax credits or the like.

C. Royalties

1. If the payment from your country is denominated as a royalty or some equivalent, how would the answers to the questions in I.A. be different from those given in relation to dividends? Are there certain categories of royalty that are treated differently from others?

Payments of Danish-source royalties to a nonresident recipient are liable to Danish withholding tax. However, Danish withholding tax on royalties does not apply to payments for the use of rights to literary, artistic or scientific work, for example, author's royalties, music royalties and motion picture royalties. The withholding tax rate on royalty payments is 22%.

Royalty taxation may be waived or reduced if the recipient qualifies under the EU Interest and Royalties Directive, or the terms of a tax treaty between Denmark and the recipient's country of residence.

2. Royalties are particularly likely to have expenses associated with earning them, whether R&D costs, acquisition costs, or marketing costs. Is any category of royalty reduced in amount, granted an allowance or otherwise taxed after recognition of possible costs?

Withholding tax on royalties may not be reduced by foreign expenses, losses, tax credits or the like.

II. Residence Country Taxation

A. Dividends and Similar Payments

1. What is your country's domestic law's general, or unilateral, method of protecting a resident from economic and juridical double taxation resulting from the imposition of source country tax?

As regards juridical double taxation (i.e., taxation of the same person on the same income in two different countries), Denmark grants unilateral relief for foreign tax paid in the form of an ordinary credit against the Danish tax due. Foreign tax paid on income may thus be credited against Danish tax on the same income, but the credit is limited to the lower of: (1) the foreign tax paid; or (2) the Danish tax payable on the foreign net income. Relief may be restricted to the tax that the foreign country is entitled to levy under an applicable tax treaty. Where a treaty is in effect, alternative relief may be granted pursuant to the methods allowed under that treaty.

No credit is available for foreign tax paid on a dividend that is exempt from Danish taxation.

Inbound dividends distributed by a foreign subsidiary (on a shareholding of at 10% or more) are generally exempt from Danish corporate income tax provided that: (1) the foreign subsidiary qualifies as a "company" under Danish law, (2) the foreign subsidiary is covered by the EU Parent-Subsidiary Directive or is resident in a country that has concluded a tax treaty with Denmark (under which the withholding taxation of dividends is reduced or waived), or (3) the Danish company and the foreign subsidiary qualify for international joint taxation (i.e., where the Danish company controls more than 50% of the votes in the foreign subsidiary) and the foreign subsidiary cannot deduct the dividend payments.

Dividends paid on portfolio shares (i.e., shareholdings of less than 10%) are taxable, but only to the extent of 70% of the dividend received.

As regards economic double taxation, Danish law does not generally provide for relief. However, an exception is made with regard to a dividend received from a subsidiary (where the shareholding is at least 10%) not covered by the tax exemption described above (i.e., a dividend received from a subsidiary resident in a non-tax treaty country outside the European Union). In such a case, Danish tax law provides for credit relief for any underlying taxes paid on the income out of which the distribution was made. The credit is equal to the Danish tax on the dividend but may not exceed the tax paid by the subsidiary.

2. How does your country limit double tax relief, or coordinate the amount of it with its own taxation of a resident? (For example, if there is a limit equal to the domestic tax on foreign income, how is the amount of foreign income determined? Furthermore, is the amount of foreign tax for which relief is granted reduced if the domestic tax on the foreign income is at less than the full corporate tax rate?)

As indicated in II.A.1., above, relief is granted under Danish domestic law using the ordinary credit method. The credit is limited to the lower of the following two amounts: (1) the Danish tax levied on the foreign income concerned, or (2) the actual tax paid on that income in the foreign country concerned. Simply put, the aggregate taxes levied by Denmark and the foreign country on the foreign income can never be lower than the Danish taxes due on that income and, if the foreign tax exceeds the Danish tax on the income, the aggregate taxes due will exceed the Danish tax.

The foreign-source income relevant to the calculation of relief is determined according to Danish law (unless otherwise provided for in the applicable tax treaty, if any). In calculating the relief, the net income principle generally applies, which entails the foreign-source income being reduced by deductible expenses allocable to it. For these purposes, expenses directly related to the foreign income are deducted in full, whereas general expenses incurred by the entity in receipt of the income are allocated proportionally to the foreign income.

There will seldom be deductible expenses related to dividend income.

3. If foreign taxes for which relief is theoretically available exceed the allowed relief because of a limitation described in II.A.2., what does the tax system provide for the excess amount? Is the excess amount subject to being carried to another year, and under what conditions? Can the excess amount be deducted as an expense?

Where there is an excess amount of foreign tax that is not available for credit because of the limitation on the amount of the tax credit (as described in II.A.2., above), the excess cannot be carried forward for use in subsequent years nor can it be deducted. The excess amount thus represents an additional tax.

4. If a resident has a loss on an overall basis, but received income from a foreign country subject to a withholding or other income tax in that country, is a credit or other relief that would otherwise be available still allowed? What measures, if any, exist to preserve that right to relief (for example, a direct refund of the amount of tax in the loss year, a carryover of credit, an alternative deduction of the foreign tax as an expense, etc.)?

If the entity is in a loss position (or has losses carried forward resulting in zero income for taxation) for a particular year, the ordinary credit will also be zero. In such a case, the entity is allowed to defer losses (or part thereof) for utilization in later years, the total taxable income for that particular year being equal to the

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foreign income, thus allowing full set off of the credit. In such a case, the Danish income is taxable at the ordinary Danish tax rate and relief can thus be granted for foreign taxes subject to the ordinary tax credit computational rules, i.e., both the limitation and the net income principle described in II.A.2., above apply.

There is no alternative method for preserving a tax credit, i.e., no refund, carryover of credit, nor deduction as an expense.

B. Interest and Similar Payments Related to Interest

If the payment to a resident of your country is denominated as interest or some equivalent, how would the answers to the questions in II.A. be different from those given in relation to dividends?

The position described in II.A., above also applies to interest income. However, an additional rule regarding timing differences applies only to interest. The rule ensures that interest expenses related to foreign interest income are allocated to the same income year as the interest income, thus preventing arbitrage with respect to interest based on timing differences.

C. Royalties

If the payment to a resident of your country is denominated as a royalty or some equivalent, how would the answers to the questions in II.A. be different from those given in relation to dividends? Are there certain categories of royalty that are treated differently from others?

The position described in II.A., above also applies to royalties.

III. Inconsistencies Between Treaty and Domestic Law Treatment

1. How are conflicts of income classification between treaties and domestic law treated? What happens in the case of a conflict involving the classification of income or differences between the way in which your country, as the residence country, applies a treaty and the way in which the source country applies the treaty? Summarize the principles.

When an income item is expressly defined in a tax treaty, the treaty definition must be applied with respect to the treaty allocation of taxing rights. This does not, however, prevent Denmark from applying the Danish domestic law definition in determining the income tax position for purely domestic purposes (typically when Denmark is the country of residence). For example, Danish domestic law provides a narrow definition of interest, while most of Denmark's treaties (which are based on the OECD Model Convention) provide a wider definition. As a result, certain types of income from debt will be defined as capital gains under Danish law but as interest under a treaty. In such cases, Denmark must respect the source country's right to tax such "interest" (defined as capital gains under Danish law); however in computing the Danish tax due (where Denmark is the country of residence of the recipient), such income items will continue to be classified as capital gains. In practice, Denmark will thus respect the source country's right to tax the income and will grant relief for the foreign tax concerned, but for domestic tax purposes will still treat the income in accordance with the Danish classification.

If an applicable tax treaty expressly refers to the definition in the domestic law of one of the contracting states, this definition must also be respected under the domestic law of the other state. If an income item is defined by reference to the domestic law definition of the source country, that definition must also be applied in the residence country even if the definition is in conflict with residence country's domestic law. The treaty will typically include a provision establishing the limits of the definition to prevent the source country from expanding the definition beyond what is reasonable.

If the applicable tax treaty does not contain any definition of a particular term (in the form of either an autonomous treaty definition or a definition by reference one of the contracting states' domestic law), each contracting state will typically be free to interpret the treaty with respect to that term in accordance with its own domestic law.

There is limited precedent addressing such conflicts of income classification. It appears that the Danish tax authorities and Danish courts will to a certain extent rely on internationally acknowledged definitions such as those in the OECD Model Convention and the Commentary thereon; however, the fact that recourse is had to such guidance does not allow specific definitions under Danish law to be disregarded.

2. Can the application of a tax treaty result in a higher tax burden than would result from the direct application of the domestic law? Summarize the principles.

The application of a tax treaty will, in general, not result in a higher tax burden than would result from the direct application of domestic law.

As regards passive income such as dividends, interest and royalties, Denmark contends that the tax treaty concept of "beneficial ownership" may allow Danish withholding taxes to be levied even in the absence of a similar concept under Danish domestic law and thus in situations where Danish domestic law would not allow withholding taxes to be levied. This debate is, however, not relevant to income derived subsequent to the introduction of a general anti-abuse provisions in Danish law in 2015.

Denmark generally applies a global income principle; however, in the case of corporate bodies, this global income principle is modified to exclude income and expenses related to foreign permanent establishments (PEs) and foreign real property. However, if a tax treaty (or other international agreement) causes the source country to waive its right to tax such income, Denmark will tax the income. In this respect a treaty can have the consequence of income being taxable in Denmark that would not be so taxable if the treaty had been not entered into.

IV. Conclusion

As regards outbound payments, Denmark's tax system has traditionally been quite investor-friendly, with withholding taxes being levied only on dividends and certain royalties—and, as a result of Denmark's fairly extensive tax treaty network and its domestic law implementation of EU Directives, withholding taxes are often mitigated or even eliminated (especially for non-portfolio investors). In recent years, however, the introduction of a number of anti-abuse provisions, including general anti-abuse provisions, has made the regime complex and significantly less investor-friendly.

As regards inbound payments, the case law is very limited. This might suggest that the unilateral relief from juridical double taxation granted under Danish domestic law (as well as under Denmark's tax treaties) adequately protects taxpayers. In recent years, however, it seems that the net income principle applied in computing such relief has resulted in more litigation before the courts and may in the future prove to be a factor that needs to be taken into account in assessing the actual relief position under Danish law.

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