Operational Tax News

Denmark - New tax regime applicable to foreign investment funds in 2020

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1. Summary

As from 1 January 2020, new rules for investment funds will be effective which will ease access to retail market for foreign equity-based investment funds.

If an investment fund wants to be covered by the new rules as from 2020, it must notify the Danish tax authorities (DTA) no later than 1 November 2019.

2. New rules on equity based investment entities

The Danish Parliament enacted in January 2019 new tax rules regarding equity-based investment funds.

Under the new rules, investment funds may opt to be considered equity based. In such case yield is taxed as equity income with Danish individual investors. Gains and losses are made up and taxed on a mark-to-market basis.

Generally, investment income is taxed with Danish individuals as either “equity income” or “capital income”:

- Equity income
  - Equity income consist in gains and losses on shares and dividends from shares.
  - Annual equity income up to DKK 54,000 is taxed at 27% and equity income exceeding this amount is taxed at 42%. Double brackets apply for spouses.

- Capital income
  - Capital income consist in interest income and expenses, gains and losses on bonds and derivatives.
  - Capital income is taxed at progressive rates from approx. 27-42% depending on other income and total capital income of the individual. The
maximum rate is 42% with the addition of church tax. Church tax is optional. The church tax rates depends on municipality, but the average tax rate is 0.7%. Positive net capital income exceeding DKK 44,800 is taxed at 42% (plus church tax) and net positive capital income below this amount is taxed at approx. 37.7% (plus church tax). Double brackets apply for spouses.

Taxation as share income is in general more favorable than taxation as capital income.

In order to qualify as an equity based investment company the fund must fulfill the following requirements:

2.1 Notification

In September 2019, the DTA have published draft guidelines on notification and reporting requirements under the new tax regime.

No later than on 1 November prior to the year where the fund wants to be equity based, it must notify the DTA to this effect. If the fund wishes to qualify as equity based as from 2020, notification should be made no later than 1 November 2019.

Notification must be filed for the investment entity being considered a separate legal entity for tax purposes (opaque). In case the investment funds has several sub-funds, which each should be considered a separate legal entity for tax purposes, notification must be made for each sub-fund separately.

2.2 Annual reporting – asset test

In order to qualify as an equity based investment company, at least 50% of the assets in the fund must consist in shares. The remainder of the assets must be invested in securities.

“Shares” comprise securities covered by the Danish Share Taxation Act, with the exception of certain shares, including bond-based investment companies/funds and IMBs.

When doing the asset test derivatives are included with the value of the underlying assets.

In case the equity based investment company holds at least 25% of the capital in another equity based investment company or in an equity based IMB, the investment company must also file information on the asset test with respect to this entity.

The draft guidelines further state with respect to the asset test, that it must be based on an average over the calendar year. Measurement can e.g. be each calendar day, once a month or one each quarter. The minimum requirement is that the test must be based on at least 4 dates which must be evenly distributed over the calendar year. The equity based investment company may not change the method without approval from the DTA.

The fund must each year no later than 1 July file information with the DTA for the assessment of whether the asset test is met.
2.3 The fund must be a separate legal entity for Danish tax purposes (opaque)

In order to be an investment company, the fund must be a separate legal entity for Danish tax purposes. In the draft guidelines, the DTA specifically state that they will not upon receipt of notification or reporting make an assessment of whether the fund is opaque for Danish tax purposes. It is furthermore stated, that the assessment of whether a fund is opaque should be made according to Danish tax practice.

In general, funds of the corporate type should be considered opaque. The assessment of whether a fund is opaque is made case by case and depend on the concrete facts regarding the fund.

In case a fund wants certainty on whether it should be considered opaque for Danish tax purposes, it should apply for a binding ruling with the DTA. This process normally takes approx. 6 months.

3. Outstanding questions

The new rules and the draft guidelines still leave some outstanding questions, including:

- The new rules are applicable as from the income year 2020, whereas the draft guidelines as from 1 January 2020. How do the new rules apply to funds whose income year does not correspond to the calendar year?

- Does it have any impact of the eligibility under the new regime, if there are more share classes and how should the asset test be calculated in case of more share classes?

- More detailed rules on how to make up the share of equity in the fund has been asked for, including which types of securities should be considered shares and how derivatives are included in the asset test.

- Clarification of the look-through-rule in case of 25% ownership of another fund
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