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Taxation of Cross-Border Mergers and Acquisitions

Denmark

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Denmark

Introduction

Danish tax rules and practice have changed fundamentally in recent years. A number of rules have been introduced to prevent erosion of the Danish tax base, and the Danish tax authorities have adopted a restrictive attitude toward structures aimed at reducing the Danish tax base. However, the Danish parliament has also introduced a number of specific tax initiatives that make it more attractive to invest in Danish companies and jobs. This chapter starts with a brief description of the most important recent developments.

This chapter also addresses three fundamental questions facing a prospective purchaser:

- Should the target's shares or assets be acquired?
- What will the acquisition vehicle be?
- How will the acquisition vehicle be financed?

At the end of the chapter, we briefly describe some accounting, company law and tax issues that may be relevant for a potential purchaser.

Generally, this article is restricted to Danish incorporated companies, namely, public limited companies (A/S) and private limited companies (ApS). The information is based on Danish legislation as of 24 January 2014.

Recent developments

Danish tax law and practice is constantly changing, and amendments are usually comprehensive, complex and detailed. Generally, structures that were tax-efficient 5 years ago may now be either inefficient or exposed to tax audits and contingent tax liabilities.

Developments in the mergers and acquisitions (M&A) tax area over the past 5 years amount to a tightening of anti-avoidance rules and a more aggressive approach by the tax authorities to arrangements that erode the Danish tax base. These developments make it difficult for investors to establish robust, tax-efficient structures, so it is important to consider all aspects of a transaction or acquisition structure to avoid adverse and unintended tax consequences. A number of structures still function, but local advice should be sought when planning a structure involving Danish companies and foreign holding companies, particularly when debt is incurred or increased in the Danish companies.

Aggressive approach to preventing tax erosion

The tax authorities are challenging dividend and interest payments routed through intermediate holding companies resident in countries with a tax treaty with Denmark (e.g. Luxembourg) that is more favorable than the country of residence of the investors/lenders (e.g. Jersey or another tax haven). The tax authorities claim that the intermediate holding companies are conduit companies (not the beneficial owners) and therefore should be disregarded for Danish tax purposes. In several cases, intermediate holding companies have been denied EU directive or treaty protection, and dividend and interest payments have been subject to Danish withholding taxes even though the de facto beneficial owner is resident in a tax treaty country.

Although a few rulings from the Danish High Court have provided some clarification, a significant amount of cases are still pending in the Danish court system and more cases are expected. As the legal position is still unclear and legal practice in this area seems to be fast-moving, KPMG in Denmark recommends considering holding structures carefully before acquisition of a Danish company in order to avoid or reduce exposure to withholding tax (WHT).

In 2012, the Danish Parliament passed a bill in an attempt to prevent the use of Danish companies as conduit companies. As a result of this bill, dividend payments from a Danish company to a foreign parent company are subject to 27 percent WHT where dividend payments are a redistribution of dividend payments received from a subsidiary outside Denmark and the Danish company is regarded as a conduit company and therefore not the beneficial owner of the dividends received. However, this anti-abuse rule does not apply if the distribution from the Danish company is tax-exempt under the European Union (EU) Parent-Subsidiary Directive (90/435).

Thus, the Danish WHT on dividend payments from Danish conduit companies is only levied on payments to parent companies in tax treaty countries outside the EU.

Finally, the Danish WHT is reduced in accordance with a relevant tax treaty, provided this company is regarded as beneficial owner of the dividend payment.

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Current focus on incentives for growth

The aim of some of the most recent developments in Danish tax law is to create incentives for growth. As a result of this focus, the corporate tax rate is being reduced from 25 percent in 2013 to 22 percent in 2016 in stages as follows:

- 2014: 24.5 percent
- 2015: 23.5 percent
- 2016: 22 percent.

As of 1 January 2013, capital gains on unquoted portfolio shares (i.e. shareholdings below 10 percent) are tax-exempt.

Finally, businesses that have had research and development (R&D) expenses resulting in tax losses are currently entitled to a cash reimbursement of 25 percent of the losses. As of income year 2015, the upper ceiling of the reimbursement is raised from the tax value of 5 million Danish kroner (DKK) to the tax value of DKK25 million.

Asset purchase or share purchase

A purchaser may acquire a Danish company (the target company) by purchasing either the assets or the shares in the company. Most transactions involving Danish target companies are share transactions because the capital gain realized by the seller on the sale of shares is often tax-exempt. On the other hand, the Danish target company is liable to tax on gains realized on the sale of the assets. However, a purchase of assets may still be attractive in a number of situations, such as where the target company has tax losses carried forward in the tax group that can offset the capital gains tax, or where the purchaser wishes to acquire a part of the target company's business.

Purchase of assets

Even though the historical tax liabilities remain with the seller, a purchaser may still wish to carry out some due diligence before purchasing the assets. This could be done to reveal any non-compliance practice or procedures in relation to the assets or the nature and tax depreciation profile of the assets for the purpose of valuation, etc.

A foreign company that acquires the assets of a Danish company and carries out the business activity in Denmark is normally regarded as having a permanent establishment (PE) in Denmark after closing. The income derived by the PE is taxable in Denmark in accordance with Danish tax legislation as well as any tax treaty with the country in which the foreign company is resident.

Purchase price

When selling depreciable assets, the purchaser and seller must allocate the total cash value of the transfer to each category of depreciable assets included in the sale. The agreed allocation serves as the basis for capital gains taxation of the seller and as the depreciation basis/acquisition price for the purchaser.

The Danish tax authorities may challenge either the total cash value or the allocation between depreciable assets. Where no allocation is made, the tax authorities may assess an appropriate allocation and both the seller and purchaser are obliged to apply the assessed values.

The transfer agreement should carefully consider the purchase price allocation between the categories of assets because the depreciation profile for the various categories varies, as explained later in this chapter.

Goodwill

Goodwill acquired by a Danish company may be amortized by up to one-seventh annually.

Depreciation

The various categories of assets have different depreciation profiles, as described earlier. Consequently, the purchase price allocation in an asset deal is of major importance for the estimate of future free cash flow.

Most operating assets, such as plant, machinery, equipment and motor vehicles, may be depreciated by up to 25 percent per year in accordance with the declining-balance method. The depreciation rate can vary from year to year at the taxpayer's discretion. The price of minor assets, software and certain equipment for R&D may be written off in the year of acquisition whereas certain heavy fixed assets and infrastructural facilities are subject to a reduced depreciation rate.

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Buildings other than office buildings are depreciated individually using the straight-line method by up to four percent a year. Office buildings are generally not depreciable unless integrated with or closely related to a manufacturing or depreciable building.

Intangibles acquired by a Danish company may be depreciated by up to one-seventh annually. Know-how and patents are subject to favorable rules that allow immediate write-off of the purchase price in the acquisition year.

Generally, the annual depreciation charge for tangible and intangible assets is computed on the basis of the cash equivalent of the cost price. The cash equivalent price is the actual cost price less the excess of the nominal value of loans (taken over from the seller) over market value.

Tax attributes

Tax losses and the tax balances of the target are not transferred to the purchaser in an asset acquisition. They remain with the company or are used at the time of the transaction.

Value added tax

The Danish value added tax (VAT) rate is currently a flat 25 percent and applies to most supplies of goods and services by VAT taxable entities.

The transfer of a business (or part of a business) as a going concern is outside the scope of VAT provided certain conditions are met, for example, that the purchaser continues the transferred business, that the seller no longer continues the transferred business, and that both seller and buyer are VAT-registered in Denmark. However, a transfer of a going concern may also lead to a transfer of the VAT adjustment liability under the capital goods scheme where certain investment goods are included in the transfer. Alternatively, the VAT adjustment liability must be calculated and settled with the Danish tax authorities.

Where the transfer does not qualify as a transfer of a going concern, it is treated as a sale of assets and generally is subject to Danish VAT.

Where receivables are transferred as part of an asset deal, there is a risk that the purchaser would not be entitled to deduct the VAT if the receivables become bad debt. Local advice should be sought to ensure that reserves for bad debts are deductible for VAT purposes by the purchaser.

The transfer of a business in the form of a sale of shares is always a VAT-exempt transaction.

Transfer taxes

No stamp duty is payable on a transfer of assets or shares.

Registration of a change of ownership of land and buildings is subject to a duty of DKK1,660 plus 0.6 percent (2014) of the fair market value.

Mortgage instruments are subject to a duty of DKK1,660 plus 1.5 percent (2014) when the loan is raised or re-financed.

Purchase of shares

There are no immediate Danish tax consequences for a foreign company that acquires the shares of a Danish company.

Apart from the carry forward of losses described later in this chapter, the tax position of the acquired Danish company remains unchanged. Consequently, there is no possibility for a tax-free step-up in the tax basis of the assets of the acquired company.

It is not possible to obtain assurance from the tax authorities that a potential target company has no tax liabilities or whether a potential target is involved in any tax disputes.

Tax indemnities and warranties

As the purchaser takes over the target company together with all related liabilities, including contingent liabilities, the purchaser normally requires more extensive indemnities and/or warranties about any undisclosed tax liabilities of the target company. The extent of the indemnities or warranties is a matter for negotiation.

The purchaser usually initiates a due diligence review where significant sums or complex tax affairs are involved. A normal part of the due diligence process involves an in-depth review of the tax affairs of the target company by the purchaser's advisors.

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Tax losses

Generally, tax losses carried forward may be carried forward indefinitely subject to certain limitations.

Thus, tax losses carried forward can fully offset taxable income of DKK7.5 million, but they only reduce taxable income exceeding DKK7.5 million by up to 60 percent.

On a change of ownership, a tax loss carried forward cannot be used to reduce the taxable income to less than the net financial income (interest and similar income and expenses), including lease income from operating assets and ships that are subject to tax depreciation. As such, the tax losses carried forward can still offset operating profits.

A change of ownership takes place where more than 50 percent of a Danish company's share capital or voting power at the end of any income year is held by shareholders other than those who owned it at the beginning of the year in which the loss arose. In certain circumstances, the assessment of the change in ownership is made at the ultimate parent level. Where the company is inactive at the time of the change of ownership, the loss carry forward cannot be used at all.

Tax losses carried forward by the target company at closing generally are not available for companies participating in the purchaser's tax group.

Pre-sale dividend

A seller may prefer to take out a pre-sale dividend to reduce the capital gain realized on the sale of shares. Taxation of dividends and capital gains on shareholdings of at least 10 percent are aligned in Danish tax law so this does not provide the seller with any special benefits. In respect of unquoted portfolio shares (i.e. shareholdings below 10 percent), dividends are taxed at a corporate tax rate of 25 percent, whereas capital gains are exempt from Danish corporate taxation.

Tax clearances

Taxpayers generally may apply to the tax authorities for a binding ruling regarding the tax consequences of a specific transaction. A ruling is generally binding for 5 years.

Choice of acquisition vehicle

A wide range of acquisition vehicles is available to a foreign purchaser who wishes to acquire the shares or assets of a Danish target. The advantages and disadvantages of the different acquisition vehicles must be considered on a case-by-case basis. The tax value of the interest deductions and the tax treaties entered into by the relevant countries is often decisive in determining the optimal jurisdiction or acquisition vehicle.

Local holding company

A Danish holding company may be used as the acquisition vehicle where the foreign purchaser wishes to benefit from the Danish rules on tax consolidation and offset tax losses (due to financing costs) of the acquisition vehicle against taxable profits of other companies in the Danish tax group. The Danish rules restricting interest tax deductions should be analyzed to ensure that financing costs will be deductible for tax purposes, and thus can reduce taxable profits in the other operating companies.

A foreign purchaser may also consider using a Danish acquisition vehicle to act as a dividend trap. This may be beneficial where the profits are to be reinvested in the Danish or foreign subsidiary since dividends can generally be received tax-exempt if the Danish holding company holds at least 10 percent of the shares in the subsidiary.

Another benefit of using a Danish acquisition vehicle is the relatively low Danish corporate tax rate of 24.5 percent (2014).

Special attention is advisable where the foreign purchaser acquires or incorporates a Danish limited company that is considered transparent for foreign tax purposes (as with US check-the-box rules). For Danish tax purposes, the Danish limited company is also considered as a transparent company and treated as a branch of the foreign company. As a result, interest paid on loans to the shareholders can be disregarded for Danish tax purposes. It is irrelevant whether the treatment of the Danish limited company as a transparent company is due to foreign legislation or an election by the foreign purchaser.

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Foreign parent company

A foreign purchaser may choose to purchase the target directly instead of using an acquisition vehicle where the tax value of the interest deductions is higher in the jurisdiction of the purchaser.

Generally, the Danish WHT rules favor a structure with a foreign holding company because capital gains realized by the foreign acquisition vehicle on a sale of the shares are not subject to Danish WHT. Additionally, dividends and interest generally are exempt from Danish WHT provided the foreign parent company holds at least 10 percent of the shares and is resident in the EU or in a country that has a tax treaty with Denmark. However, there are exceptions that should be considered in each case.

Non-resident intermediate holding company

Where the foreign purchaser would be subject to taxation of capital gains and/or dividends received from the target, an intermediate holding company resident in another country with more attractive taxation could be interposed to benefit from tax treaties or EU directives. However, the intermediate holding company would have to be considered as the beneficial owner and meet the requirement on business substance. As described in this chapter's section on recent developments, business substance in foreign intermediate holding companies is currently a high priority area for the Danish tax authorities. It is therefore advisable to pay due attention to the substance requirement to avoid the possibility that an intermediate holding company would be disregarded for Danish tax purposes.

Local branch

Rather than a direct acquisition of the shares or assets of a target, a foreign purchaser may wish to use a Danish branch of a foreign company as the acquisition vehicle. As of 2010, the shares may be allocated to a Danish PE where the return relates to the Danish branch.

The acquirer should ensure that the Danish branch has sufficient operating activity to constitute a PE for Danish tax purposes.

A Danish branch of a foreign company is not a commonly used acquisition vehicle.

The calculation of taxable income is basically the same for a subsidiary as for a branch since both vehicles are considered as taxable entities for Danish tax purposes. Generally, transactions between the Danish branch and the head office should be based on the arm's length principle. However, special attention must be paid to transactions between the Danish branch and the head office because it is not entirely clear from case law which terms should apply.

From a Danish tax perspective, the use of a Danish branch has no advantages that are not also available to a Danish subsidiary.

Joint venture

Basically, there are three types of joint ventures: a corporate joint venture (the joint venture partners hold shares in a Danish company), an unincorporated joint venture (e.g. the joint venture partners enter into a partnership), and a strategic joint venture (the joint venture partners cooperate on specific strategic objectives). A corporate joint venture is treated as a corporate entity for Danish tax purposes while unincorporated and strategic joint ventures are treated as transparent entities for Danish tax purposes.

The choice of joint venture primarily depends on the most beneficial tax positions with regard to, for example, the offset of losses or interest expenses against profits subject to corporate or personal income tax.

Choice of acquisition funding

A purchaser using a Danish acquisition vehicle that pays cash consideration for the purchase of a Danish target must decide whether to fund the vehicle with debt, equity or a hybrid instrument. The principles underlying each are discussed below.

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Debt

The principal advantage of debt is the potential tax deductibility of interest (see deductibility of interest) as the payment of dividends does not result in a tax deduction.

Where it is decided to use debt, a further decision must be made as to which company should borrow and how the acquisition should be structured.

Tax losses incurred by a Danish acquisition vehicle as a result of tax-deductible financing costs may offset the positive taxable income in the Danish target group as described in the section on group relief/consolidation. Tax losses incurred prior to closing are either entity-specific or only available for offset against any taxable income of companies participating in the purchaser's tax group prior to closing. Thus, the timing of income and expenses should be considered.

It is possible to introduce or increase leverage in a Danish company after the transaction (debt pushdown). There are various ways to complete the debt pushdown, and the Danish interest limitation rules should be considered. As these rules are complex, local advice should be sought to ensure that a debt pushdown will be effective.

Deductibility of interest

Generally, interest expenses are deductible for corporate income tax purposes. However, the Danish tax system includes a number of anti-avoidance rules that may limit the tax-deductibility of interest and other financial expenses. The primary limitations relate to the following three sets of rules:

1. thin capitalization rules
2. interest ceiling rule
4 European Business Initiative on Taxation (EBIT) rule.

The thin capitalization rules apply to Danish companies and branches with controlled debt, restricting the deductibility of interest expenses. Danish companies or branches may be thinly capitalized where the debt-to-equity ratio exceeds 4:1 at year-end. The assessment is based on fair market value, including non-booked goodwill. The effect of the rules is that any deduction is denied for interest expenses and capital losses on the part of the controlled debt that should be re-characterized as equity to meet the 4:1 debt-to-equity ratio. However, the rules do not apply where the controlled debt does not exceed a threshold of DKK10 million or where the company is able to document that similar financing can be obtained from an independent party.

According to the interest ceiling rule, Danish companies may only deduct interest costs and other net financing expenses to the extent that the expenses do not exceed a standard rate of return of 4.2 percent (2014) on the tax values of certain qualifying assets (mainly operating assets). The limitation applies only to expenses exceeding a threshold of DKK21.3 million. The standard rate of return is adjusted on an annual basis. The interest costs exceeding the interest ceiling are lost permanently and cannot be carried forward. However, capital losses may be offset against capital gains in the following three income years.

Under the special EBIT rule, the taxable income before net financial expenses may not be reduced by more than 80 percent by the deduction of net financing expenses after any restrictions due to the thin capitalization and interest ceiling rules. Net financing expenses restricted under the EBIT rule may be carried forward for tax deduction indefinitely.

The three sets of rules must be applied in the above order of priority. Restricted interest costs and capital losses due to thin capitalization are not included in computing limitations under the other two sets of rules.

Unlike the thin capitalization rules, the interest ceiling rule and the EBIT rule apply to all types of debt, both controlled debt and debt to third parties.

The three sets of rules restricting deduction of interest and other financial expenses are very complex and local advice is recommended where a Danish company's right to deduct interest and other net financing expenses is an issue.

Note also that shareholder loans are covered by the Danish transfer pricing rules. Thus, the terms of the loan must reflect market terms and must be documented.

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Withholding tax on interest payments and methods to reduce or eliminate it

Generally, no Danish WHT obligation exists on interest payments on debt to third parties. However, 25 percent WHT is levied on interest payments to related parties. There are a number of exemptions from WHT; the most important apply where:

- The foreign company is already taxable on the interest due to a PE in Denmark; that is, where the interest relates to and is received by the PE.
- The receiving company is resident in the EU, the European Economic Area (EEA) or a country with a tax treaty with Denmark. The companies must be at least 25 percent related in terms of shares for at least 12 months during which the interest must be paid.

Certain other exceptions imply that Danish WHT is imposed where the interest income is taxed at a low rate in a foreign jurisdiction.

WHT protection requires that the receiver is considered as the beneficial owner of the interest and not a mere conduit company. Otherwise, Danish WHT is levied on the interest payment. As stated earlier, the concept of beneficial owner is a high-priority focus area with the Danish tax authorities – and they generally do not accept stepping-stone arrangements. Several rulings are pending on this issue. It is too soon to draw any definite conclusions until further legal precedence has been established. The question of whether the receiver of the interest payments should be considered as the beneficial owner must be analyzed on a case-by-case basis. Local advice should be sought.

The WHT obligation does not apply where the debt is structured as a zero-coupon convertible bond or a similar instrument.

Checklist for debt funding

- The use of bank debt may prevent thin capitalization and transfer pricing problems and eliminate the requirement to withhold tax from interest payments. (The use of bank debt does not affect a restriction of the tax deduction of interest under the interest ceiling rule or the EBIT rule).
- Consider the amount of debt funding in order to avoid limitations on the deductibility of interest payments due to the Danish anti-avoidance tax rules.
- Consider whether the level of profits would enable tax deduction for interest payments to be effective.
- As a general rule, 25 percent WHT applies to interest paid by a Danish company to a company resident in a country outside the EU that has no tax treaty with Denmark.

Equity

A purchaser may use equity to fund its acquisition or to capitalize the target post-acquisition. There is no capital duty on the introduction of new capital into a Danish company or branch (or to a Danish-registered *societas Europaea*), regardless of the nature of the contribution to equity.

As of financial year 2010, there is no Danish WHT on dividends on subsidiary shares or group company shares, that is, where the recipient holds at least 10 percent of the share capital and where the parent company is resident in the EU/EEA or a country that has a tax treaty with Denmark and is considered as the beneficial owner of the distributed dividends. (See recent developments section regarding use of intermediate conduit companies).

A Danish WHT of 27 percent (subject to treaty protection) is levied on dividends on portfolio shares, that is, investments of less than 10 percent of the share capital in the Danish company (main rule).

The use of equity may be more appropriate than debt in certain circumstances, for example:

- Where the target is loss-making, it may not be possible to obtain immediate tax relief for interest payments.
- There are a number of restrictions on Danish tax relief for interest that may eliminate the principal advantage of using debt.
- There may be non-tax reasons for preferring equity. For example, it may be desirable for a company to have a low debt-to-equity ratio for commercial reasons.

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Tax-exempt restructurings

Where the transaction is structured as a share exchange in which the seller receives shares in the purchasing company in exchange for shares in the target company, the seller may rollover the capital gain on the shares in the target company to the new shares. The rollover may be carried out either with or without pre-approval from the tax authorities. Various conditions must be met depending on whether or not pre-approval is obtained, and local advice should be sought.

No pre-approval is required where the transaction is structured as a tax-exempt merger, but special conditions must be met to obtain the rollover of capital gain for the seller and the tax values for the merging companies.

The Danish rules also allow for tax-exempt demerger and contribution in kind of assets. The reorganizations may be carried out without pre-approval from the tax authorities in certain circumstances; however, a number of conditions must be satisfied and the shares received in the transaction generally cannot be sold for a period of 3 years. KPMG in Denmark recommends seeking local advice to avoid adverse tax consequences of such transactions.

Hybrids

Generally, amounts registered with the Danish Register of Companies are classified as equity. If an amount is not registered as equity, it is characterized as a loan even when it carries a right to participate in profits. Conversely, registered preference shareholders are always considered equity investors even where they are not entitled to participate in excess liquidation proceeds.

A subordinated debt is regarded as share capital by virtue of being subordinated to other creditors. Convertible notes are always regarded as loans until conversion. As a general rule, payments made before conversion are taxed as interest. After conversion, the yield is taxed as a dividend.

As of 13 December 2006, the Danish tax qualification of hybrid instruments used by related parties depends on the foreign qualification of the hybrid. Where a hybrid is considered as debt from a Danish tax perspective but is treated as equity from a foreign tax perspective, interest and capital losses on the debt are treated as dividends for Danish tax purposes.

Discounted securities

The tax treatment of discounted securities issued to third parties depends on the principle applied. Where a mark-to-market principle is applied, the discount accruing over the life of the security is deductible for Danish tax purposes for the issuer and the corresponding profit is taxable for the lender. Where the realization principle is applied, deduction and taxation respectively are deferred until redemption.

Where the issuer and lender are related parties or consolidated for Danish tax purposes, the discount is not deductible for tax purposes if the corresponding profit is tax-exempt.

Deferred settlement

An acquisition may involve an element of deferred consideration, the amount of which can only be determined at a later date on the basis of the post-acquisition performance of the business. The right to receive an unknown future amount is regarded as an asset that must be valued for Danish tax purposes where either the duration of the payments or the actual amount paid each year are uncertain at the time of transfer. The transferring parties are then obliged to calculate a capitalized value of the expected future payments at the time of the transfer. The capitalized values serve as a basis for the calculation of a preliminary taxable capital gain. The capital gains tax is due at the time of the transfer as in normal taxable transfers.

A recipient of a deferred settlement of the consideration for goodwill and other intangible assets can apply for a tax reprieve until actual payments are received.

Other considerations

Concerns of the seller

The tax position of the seller may greatly influence any transaction, and one of the first concerns is often the tax liability triggered by the transaction.

The taxation of the seller depends on the rules of the country in which the seller is resident and the legal form of the seller. Capital gains realized by a Danish company are generally tax-exempt. Only capital gains on shareholdings of less than 10 percent in listed companies are subject to Danish corporate tax.

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Sellers resident outside Denmark are generally not taxable in Denmark on capital gains (except on certain disposals by non-resident companies with a PE in Denmark).

Group relief/consolidation

Danish companies, PEs located in Denmark and Danish immovable property owned by non-resident companies are subject to the Danish rules on mandatory national tax consolidation. Where there is a qualifying group relationship between the entities (i.e. a Danish or foreign parent company holds a controlling influence), a Danish tax group must be formed.

The group consolidation means that losses of one company are immediately set off against profits of the other companies. However, losses originating from tax years before the commencement of the tax group may only set off profits in the same company or companies participating in the tax group at the time the loss arose.

All the companies included in the tax group must apply the same financial year, and the rules prescribe which company should be appointed as the administration company for the tax group.

A company's exit from a tax group may give rise to a number of challenges and should be discussed with local tax advisors. Under many share transactions, a target company exits the seller's tax group during a financial year. In this case, income from the first period must be consolidated in the seller's tax group, and income from the second period must be consolidated in the purchaser's tax group. The administrative challenges related to the tax consolidation (and exit from the tax group) should be considered carefully by the seller and the purchaser at the time of a transaction and duly reflected in the share purchase agreement.

It is possible for a Danish company to elect international tax consolidation, but as this implies that all companies with the qualifying relationship must be included in the Danish tax group, only a few Danish companies have made this election. Danish companies within a Danish tax group are jointly and severally liable for corporate tax and WHT.

The joint and several liability ends where a company exits a Danish joint taxation. Accordingly, sold companies do not inherit any liability from other companies in the former Danish tax group.

The remaining part of the selling group remains jointly and severally liable for tax claims against the sold company related to income years before the transfer.

Transfer pricing

Generally, Danish resident companies are subject to the Danish transfer pricing rules. These rules prescribe that all transactions between a Danish company and related companies must satisfy the arm's length principle (i.e. the prices and terms must reflect those that could be applied in a transaction with a third party). In most cases, the company must prepare documentation that supports the basis for the pricing.

The transfer pricing rules are relevant in relation to many aspects of a transaction, such as shareholder loans, inter-company guarantees, cash pool arrangements and transfer of goods, services and assets. The practice of the tax authorities is somewhat unclear, and each case must be examined on its facts. Caution is advisable when determining the basis of the prices, especially where large amounts are involved.

Dual residency

Under Danish tax law, a company is resident in Denmark where it is registered in Denmark or it is a foreign registered company with an effective place of management in Denmark. There are generally no advantages in seeking to establish a dual resident company.

Foreign investments of a local target company

The original aim of the Danish controlled foreign company (CFC) legislation was to reduce the tax benefits of transferring financial income to low-tax countries. The rules no longer take the foreign tax rates into consideration. Thus, the CFC rules may also be relevant for a Danish parent with a subsidiary in a high-tax country.

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The Danish CFC rules apply to a Danish parent company with a controlling influence in a subsidiary whose income is mainly of a financial nature. The effect of the CFC rules is that the income of the subsidiary is apportioned to its Danish parent company and subject to Danish corporate tax. Denmark grants credit for the foreign taxes on the subsidiary's income.

CFC rules may be relevant in many situations. For example, the implications of the Danish CFC rules should be considered where:

- the business functions of an entity change
- a transaction could lead to additional financial income in the subsidiary
- a transaction would lead to a significant capital gain
- the tax rate of the subsidiary country is low.

It is not possible to provide an exhaustive list of the situations in which the CFC rules have implications. Each transaction should be examined based on its facts, and local tax advice should be sought.

Company law and accounting

The Danish Companies Act prescribes how Danish companies may be formed, operated, reorganized and dissolved, and is largely based on EU company law directives. In 2009, the Danish company laws were modernized and amended so that both public limited companies (A/S) and private limited companies (ApS) are now regulated in the same act, the Danish Companies Act. (Previously, these two types of companies were regulated by two separate acts.) This has resulted in considerable flexibility in relation to, for example, the payment of the subscribed capital and financial assistance. Company law has significant importance for a purchaser investing in a Danish company, and some of the areas that could be important for a purchaser are outlined briefly below.

The Danish Companies Act allows for the restructuring of a Danish company through such transactions as mergers, demergers and contributions in kind. Generally, such restructuring may be carried out as tax-exempt transactions provided certain requirements are met.

A distribution of dividends from a Danish company is subject to the company having sufficient distributable profits, retained earnings, etc., available. Dividends may be distributed at the end of the financial year based on the financial statement or as interim dividends during the financial year. The company's financial situation must be taken into consideration at the time of the declaration of an interim dividend, and certain administrative requirements must be satisfied.

Occasionally, the structuring of a transaction raises financial assistance issues. There have been public discussions on whether dividend distributions from a target company used for the repayment of the purchaser's acquisition debt or a merger of the target company and the acquisition vehicle is a violation of the prohibition against self-financing/financial assistance.

Previously, the prohibition against financial assistance stated that it was illegal for a Danish target company (A/S or ApS) to grant direct or indirect financial assistance for the purpose of financing the acquisition of the target company's shares. However, the Danish Companies Act has removed the prohibition against financial assistance by allowing for such assistance within the limitations of the available distributable reserves. Each case must be examined based on its facts, and a number of administrative requirements must be satisfied. Local advice should be sought prior to providing any such financial assistance.

A number of M&A accounting issues also should be considered. A business combination, which is defined under International Financial Reporting Standards (IFRS) as a bringing together of separate entities or businesses into one reporting entity, may be categorized as either a merger or an acquisition.

In essence, a combination is regarded as a merger where it results in a pooling of business interests (i.e. where one company's equity is exchanged for equity in another company) or where shares in a newly incorporated company are issued to the shareholders in the merging companies in exchange for their equity, with both sides receiving little or no consideration in the form of cash or other assets.

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In Denmark, non-listed companies can freely choose to adopt either the Danish Accounting Act or IFRS when preparing their accounts. According to Danish generally accepted accounting principles (GAAP), most business combinations are to be accounted for as acquisitions. Merger accounting is restricted in the Danish Accounting Act to a small number of genuine mergers. One major requirement for a genuine merger is that the fair values of the entities are not significantly different. Further detailed conditions must be met. Merger accounting can always be used for intercompany combinations. Merger accounting is not allowed under IFRS. Where acquisition accounting is applied, the transaction may give rise to goodwill. The net assets are brought onto the consolidated balance sheet at their fair values, and goodwill arises to the extent that the consideration paid exceeds the aggregate of the values. Where the accounts are prepared according to the Danish Accounting Act, goodwill is amortized through the profit and loss account over its useful economic life. Where IFRS is adopted, the goodwill is not amortized, but its value is subject to impairment tests.

Comparison of asset and share purchases

Advantages of asset purchases

- The purchase price (or a proportion) can be depreciated or amortized for tax purposes.
- A step-up in the cost base for tax purposes is obtained.
- No previous liabilities of the company are inherited.
- No acquisition of a tax liability on retained earnings.
- Possible to acquire only part of a business.
- Greater flexibility in funding options.
- Profitable operations can be absorbed by loss-making companies in the purchaser's group, thereby effectively gaining the possibility to use the losses.

Disadvantages of asset purchases

- Possible need to renegotiate supply, employment and technology agreements, and to change stationery.
- A higher capital outlay is usually involved (unless the debts of the business are also assumed).
- May be unattractive to the seller, thereby increasing the price.
- Accounting profits may be affected by the creation of acquisition goodwill.
- Benefit of any losses incurred by the target company remains with the seller.

Advantages of share purchases

- Lower capital outlay (purchase net assets only).
- Likely to be more attractive to the seller, so the price is likely to be lower.
- May benefit from tax losses of the target company.
- May gain benefit of existing supply or technology contracts.

Disadvantages of share purchases

- Acquire unrealized tax liability for depreciation recovery on the difference between market and tax book value of assets.
- No deduction for the purchase price or for underlying goodwill.
- Less flexibility in funding options.
- Losses incurred by any companies in the purchaser's group in years prior to the acquisition of the target cannot be offset against any profits made by the target company.

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Denmark – Withholding tax rates

This table sets out reduced WHT rates that may be available for various types of payments to non-residents under Denmark's tax treaties. This table is based on information available up to 16 January 2014.

Source: International Bureau of Fiscal Documentation, 2014

	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies[2] (%)		
Domestic rates				
Companies:	27	0/15	0/25	0/25
Individuals:	15/27	N/A	0	25
Treaty rates				
Treaty with:				
Argentina	15	10	12	3/5/10/15[3]
Armenia[4]	15	15	0	0
Australia	15	15	10	10
Austria	15	0[5]	0	0
Bangladesh	15	10	10	10
Belarus	15	15	0	0
Belgium	15	0	10	0
Brazil	25	25	15[6]	15/25[7]
Bulgaria	15	5	0	0
Canada	15	5	0/15[8]	0/10[9]
Chile	15	5	5/15[10]	5/10[11]
China (People's Rep.)	10	5	10	10[12]
Croatia	10	5	5	10
Cyprus	15	0[13]	0	0
Czech Republic	15	0[14]	0	10
Egypt	20	15	15	20
Estonia	15	5	10	5/10
Faroe Islands	15	0	0	0
Finland	15	0	0	0
Georgia	10	0/5[15]	0	0
Germany	15	0/5[16]	0	0

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	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies[2] (%)		
Greece	18	0	8	5
Greenland	–[17]	–	0	10
Hungary	15	0[18]	0	0
Iceland	15	0	0	0
India	25	15	10/15[19]	20
Indonesia	20	10	10	15
Ireland	15	0	0	0
Israel	10	0[20]	0/5[21]	0
Italy	15	0[22]	0/10	0/5[23]
Jamaica	15	10	12.5	10
Japan	15	10	10	10
Kenya	30	20[24]	20	20
Korea (Rep.)	15	15	15	10/15[25]
Kuwait	15	0/5[26,27]	0	10
Kyrgyzstan	15	15	0	0
Latvia	15	5	10	5/10
Lithuania	15	5	10	5/10
Luxembourg	15	5	0	0
Macedonia (FYR)	15	0/5[28]	0	10
Malaysia	0	0	–	10
Malta	15	0	0	0
Mexico	15	0	0/5/15[29]	10
Montenegro[30]	15	5	0	10
Morocco	25	10	10	10
Netherlands	15	0	0	0
New Zealand	15	15	10	10
Norway	15	0	0	0
Pakistan	15	15	15	12
Philippines	15	10	10	15
Poland	15	0/5[31]	0/5	5
Portugal	10	0[32]	0/10	10
Romania	15	10	10	10

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	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, companies (%)	Qualifying companies[2] (%)		
Russia	10	10	0	0
Serbia	15	5	10	10
Singapore	10	0/5	10	10
Slovak Republic	15	15	0	5
Slovenia	15	5[33]	5	5
South Africa	15	5	0	0
Spain	15	0	10	6
Sri Lanka	15	15	0/10	10
Sweden	15	0	0	0
Switzerland	15	0	0	0
Taiwan	10	10	10	10
Tanzania	15	15	12.5	20
Thailand	10	10	10/15[34]	5/15[35]
Trinidad and Tobago	20	10	15	15
Tunisia	15	15	12	15
Turkey	20	15	15	10
Uganda	15	10	10	10
Ukraine	15	5	10	0/10[36]
United Kingdom	15	0	0	0
United States	15	0/5[37]	0	0
Venezuela	15	5	0/5	10
Vietnam	15	5/10[38]	10	5/15
Zambia	15	15	10	15

Notes:

1. Many treaties provide for an exemption for certain types of interest, e.g. interest paid to the state, local authorities, the central bank, export credit institutions or in relation to sales on credit. Such exemptions are not considered in this column.
2. The reduced treaty rates given in this column normally apply if the non-resident company owns at least 25 percent of the capital (or the voting power, as the case may be) in the Danish company; no holding period is required.
3. The 3 percent rate applies to royalties paid for news items; the 5 percent rate applies to copyright royalties, except films, etc.; the 10 percent rate applies to industrial royalties and to technical service fees.
4. The treaty concluded between Denmark and the former Soviet Union.
5. The rate applies if the non-resident company owns at least 10 percent of the capital in the Danish company (no holding period required).
6. The domestic rate applies to interest paid by public bodies (under the treaty such interest is taxable only in the source state and there is no reduction).
7. The 25 percent rate applies to trademarks.
8. The lower rate applies to interest paid by public bodies.
9. The lower rate applies to copyrights, except films, etc., as well as to computer software, patents and know-how.
10. By virtue of a most-favored-nation clause, the 15 percent rate on interest is reduced to 5 percent for interest from loans granted by banks and insurance companies, from bonds or securities regularly and substantially traded on a recognized securities market and from credit sales of machinery and equipment.

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11. The lower rate applies to equipment rentals. By virtue of a most-favored-nation clause, the 15 percent general rate on royalties is reduced to 10 percent.
12. This rate is calculated on 70 percent of the gross amount of royalties paid for the use of or the right to use industrial, commercial or scientific equipment, and on the full gross amount in other cases.
13. The 0 percent rate applies if the beneficial owner is (i) a company that owns at least 10 percent of the capital in the Danish company for an uninterrupted period of no less than 1 year, (ii) the other contracting state, the central bank of that other state, or any other agency owned or controlled by the government of that other state; or (iii) a pension fund or other similar institution providing pension schemes (under conditions).
14. The zero rate applies if the beneficial owner is (i) a company (other than a partnership) which owns at least 10 percent of the capital of the Danish company, or (ii) a pension fund or other similar institution (under conditions).
15. The zero rate applies if the participation is at least 50 percent with a minimum investment of more than 2 million; the 5 percent rate applies if the participation is at least 10 percent with a minimum investment of more than EUR100,000.
16. Under this treaty, the exemption applies to dividends qualifying for the EU Parent-Subsidiary Directive. The 5 percent rate applies if the non-resident company owns at least 10 percent of the capital in the Danish company (no holding period required).
17. The domestic rate applies; there is no reduction under the treaty.
18. The 0 percent rate applies if the recipient is (a) a company that owns directly at least 10 percent of the capital in the Danish company for an uninterrupted period of no less than 1 year; or (b) a pension fund or other similar institution providing pension schemes (under conditions).
19. The lower rate applies to interest on bank loans.
20. The 0 percent rate applies if the beneficial owner is (i) a company that owns at least 10 percent of the capital in the Danish company for an uninterrupted period of no less than 1 year and the dividends are declared within that period, (ii) the other contracting state, the central bank of that other state, or any other agency owned or controlled by the government of that other state; or (iii) a pension fund or other similar institution providing pension schemes (under conditions).
21. The 0 percent rate applies to interest paid to a pension fund resident in Israel and interest on corporate bonds traded on a Israeli stock exchange and issued by a company resident in Israel.
22. The rate applies if the non-resident company has owned at least 25 percent of the capital (or the voting power, as the case may be) in the Danish company for at least 1 year.
23. The lower rate applies to copyrights of literary, artistic or scientific work, except computer software and films, etc.
24. The rate applies if the Kenyan company has owned at least 25 percent of the voting power in the Danish company for at least 6 months.
25. The lower rate applies to industrial royalties and know-how.
26. The 0 percent rate applies if the recipient is a company which holds directly at least 25 percent of the capital in the Danish company for an uninterrupted period of no less than 1 year and the dividends are declared within that period.
27. The 5 percent rate applies if the recipient is a pension fund or other similar institution providing pension schemes (under conditions).
28. The 5 percent rate applies if the Macedonian company has owned at least 25 percent of the capital in the Danish company for at least 1 year. The zero rate applies if it is a qualifying pension fund or other similar institution.
29. The zero rate applies to interest paid by public bodies. The 5 percent rate applies to interbank interest.
30. The treaty concluded between Denmark and the former Yugoslavia.
31. The zero rate applies if the recipient company has owned at least 25 percent of the capital in the Danish company for at least 1 year. The 5 percent rate applies if the recipient is a qualifying pension fund.
32. Under this treaty, the exemption applies to dividends qualifying for the EU Parent-Subsidiary Directive.
33. The rate applies if the recipient company (a) has owned at least 25 percent of the capital in the Danish company for at least 1 year or (b) is a qualifying pension fund.
34. The lower rate applies to interest paid to financial institutions.
35. The lower rate applies to copyright royalties.
36. The lower rate applies to secret formulas or processes, and to know-how.
37. The 5 percent rate applies if the non-resident company owns at least 10 percent of the capital in the Danish company. The zero rate applies if the corporate shareholder owns 80 percent or more of the voting stock of the Danish company for the 12-month period ending on the date on which entitlement to the dividend is determined and qualifies under certain provisions of the limitation on benefits article of the treaty.
38. The 5 percent rate applies if the Vietnamese company owns at least 70 percent of the capital in the Danish company or has invested at least US$12 million in such capital. The 10 percent rate applies if the holding is less than 70 percent but at least 25 percent.

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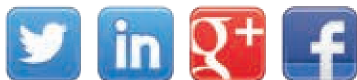

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Designed by Evalueserve.

Publication name: Denmark – Taxation of Cross-Border Mergers and Acquisitions

Publication number: 131036

Publication date: September 2014