



MERGERS AND ACQUISITIONS

# Denmark

Taxation of Cross-Border  
Mergers and Acquisitions

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TAX

# Denmark

## Introduction

Danish tax rules and practice have changed fundamentally in recent years. A number of new rules have been introduced to avoid erosion of the Danish tax base, and the Danish tax authorities have adopted a restrictive attitude towards structures aimed at reducing the Danish tax base. KPMG in Denmark begins this chapter with a description of these developments.

The chapter will also address 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 KPMG in Denmark briefly describes some accounting, company law, and tax issues that may be relevant for a potential purchaser.

In general, this survey is restricted to Danish incorporated companies; that is, public limited companies (A/S) and private limited companies (ApS), and is based on Danish legislation as at 1 October 2009.

## Recent Developments

Danish tax law and practice is constantly changing and amendments are usually comprehensive, complex and very detailed. Generally speaking, structures which were tax efficient two or three years ago may now be either inefficient or exposed to tax audits and contingent tax costs.

Developments in the mergers and acquisitions (M&A) tax area over the past four years amount to a tightening of anti-avoidance rules and a more pro-active approach by the tax authorities to arrangements that erode the Danish tax base. They make it hard for investors to establish robust, tax-efficient structures, so it is very important to consider carefully all aspects of a transaction or acquisition structure to avoid adverse and unintended tax consequences. A number of structures still work, 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.

It should be noted that KPMG in Denmark's description of the new rules is not exhaustive. Recent developments are grouped under three main headings:

- The government's intervention against private equity funds and highly leveraged transactions.
- The pro-active approach of the tax authorities to prevent tax erosion.
- The 2009 tax reform.

### ***Government's Intervention against Private Equity Funds and Highly Leveraged Transactions***

Over the past five years the Danish parliament has taken several initiatives against private equity funds and highly leveraged transactions.

2006 saw the first intervention in which the Danish transfer pricing rules were extended to transactions between a Danish company and private equity funds/investors, by including legal persons exercising so-called joint management in the definition of controlled transactions. The amendment provided the legal basis to impose withholding taxes (WHT) on interest paid by a Danish company to investors.

An intervention in 2007 introduced new rules restricting a company's right to deduct interest expenses for tax purposes. Two new sets of rules, the interest ceiling rule and the EBIT rule, were introduced as an addition to the existing thin-capitalization rules to prevent the high degree of leverage which characterizes acquisitions by private equity funds. At the same time, the Danish controlled foreign company (CFC) rules were extended significantly in response to the European Court of Justice (ECJ) judgment in the Cadbury-Schweppes case (C-196/04). A number of other Danish tax rules, such as on the depreciation profile for certain assets, were also amended. The rules restricting the right to deduct interest expenses for tax purposes and the CFC rules are described below.

The 2007 rules are particularly complex and comprehensive. The wording of some of the rules is somewhat unclear and legal precedents are limited, thus increasing the tax risks. Amendments adopted in

2008 and 2009 seek to clarify the rules or avoid some of their unintended consequences. And although the rules have been patched up with some success, they remain difficult to handle in practice and subject to uncertainty.

It is, therefore, important that the acquisition structure and funding of a transaction is analyzed and planned carefully before implementation, to avoid any adverse tax consequences. Despite all the uncertainties, some structures and funding scenarios involving Denmark still work if the investment is planned and structured appropriately.

### ***Pro-Active Approach by the Tax Authorities to Prevent Tax Erosion***

The Danish tax authorities have adopted a more pro-active approach to erosions of the Danish tax base, and have recently challenged dividend and interest payments routed through intermediate holding companies resident in countries with a more favorable tax treaty with Denmark, such as Luxembourg, than the country of residence of the investors/lenders, such as 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. Accordingly, payments should be subject to WHT in accordance with the less favorable tax treaty with the jurisdiction of the investors.

The main conclusion to be drawn from these tax cases is that business substance does not equal a business registration, and the local corporate income taxation of the intermediate holding company. On the contrary, substance should be carefully considered on a case-by-case basis, and companies must be able to document the substance.

The Danish tax authorities have also adopted a more aggressive approach to intercompany transfers of assets and business re-structuring. New guidelines on the valuation of businesses and goodwill/other intangible assets were published in September, 2009 describing acceptable valuation methods and the transfer pricing documentation requirements. In our view the guidelines give the tax authorities room to choose the method most favorable for the Danish tax base and it is doubtful whether they will eliminate the valuation issues experienced in practice.

### ***2009 Tax Reform***

The 2009 tax reform introduces a wide range of amendments to Danish tax rules, the most important for M&A tax being the new rules on taxation of capital

gains on shares and dividends. Most of the rules will be effective for the financial year 2010.

The new rules replace the current three-year holding rule regarding tax-exempt capital gains on shares and distinguish between subsidiary shares, group-company shares, and portfolio shares. Gains, losses and dividends related to subsidiary shares and group-company shares are not included in the company's taxable income, whereas gains, losses, and dividends related to portfolio shares are included, irrespective of the period of ownership.

Subsidiary shares are generally defined as investments of at least 10 percent of the share capital of companies resident within the European Union (EU) or in a country which has a double tax treaty (DTT) with Denmark. Group company shares are generally shares in companies where the shareholder has a controlling influence in the company. Portfolio shares are defined as the remainder (mainly investments below 10 percent of the share capital). An anti-avoidance rule has been introduced to prevent Danish companies from investing via a common intermediary holding company for the purpose of meeting the requirement of at least 10 percent of the share capital.

Structures that involve portfolio shareholders and intermediate holding companies should be analyzed particularly carefully, as these structures could result in double or even triple taxation of dividends/capital gains.

Broadly speaking, the amendments to the dividend rules mean that in-bound dividends from subsidiary shares and group company shares are not included in the Danish parent company's income, irrespective of the period of ownership. Outbound dividends on subsidiary shares and group company shares are exempt from WHT if the tax on the dividends is reduced or waived under the Parent/Subsidiary Directive or a DTT. Dividends on portfolio shares are generally subject to 28 percent or 15 percent WHT, which may be reduced under a double tax treaty or the Parent/Subsidiary Directive.

The 2009 tax reform also amends other rules of relevance for M&A. Effective 2010, carried interest received by venture and private equity partners taxable in Denmark will be classified as personal income (taxed at a rate of up to 56.5 percent) instead of as equity income (taxed at a rate of up to 42 percent). Furthermore, the special rules previously allowing companies a tax deduction for pre-entry market survey costs and to auditors and lawyers in relation to the establishment/expansion of a business entity, such as

consultancy fees for due diligence etc., have been abolished.

## 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 will be 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 if the target company has tax losses carried forward in the tax group that can off-set the capital gains tax, or if 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 nevertheless wish to carry out some due diligence before purchasing the assets. This could be to verify any non-compliance practice or procedure 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 will normally be regarded as having a permanent establishment (PE) in Denmark after closing. The income derived by the PE will be 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 are obliged to make an allocation of the total cash value of the transfer to each category of depreciable assets included in the sale. The agreed allocation will serve 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. If no allocation is made, the tax authorities may assess an appropriate allocation and both the seller and purchaser would be obliged to apply the values assessed by the tax authorities.

The transfer agreement should carefully consider the purchase price allocation between the groups of assets,

because the depreciation profile for the various classes of asset vary, 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 groups of assets have different depreciation profiles, as described below. As the depreciation profile for the assets differs, the purchase price allocation in an asset deal is of great 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 a year in accordance with the declining balance method. The depreciation rate can vary year-to-year at the taxpayer's discretion. The price for minor assets, software, and certain equipment for research and development may be written off in the year of acquisition, whereas certain heavy fixed assets and infrastructural facilities are subject to a reduced rate of depreciation.

Buildings, other than office buildings, are depreciated individually using the straight-line method by up to 4 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 an immediate write-off of the purchase price in the acquisition year.

In general, 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 (VAT)

The Danish VAT rate is currently a flat 25 percent and applies to most supplies of goods and services by VAT-registered 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, such as the purchaser continues the transferred business and that the seller no longer continues the transferred business. A transfer of a going concern may, however, lead to a liability under the capital goods scheme if certain investment goods are included in the transfer. Transfers of receivables must also be planned carefully.

If the transfer cannot be qualified as a transfer of a going concern, it will be treated as a sale of assets, which is subject to Danish VAT.

If receivables are transferred as part of the asset deal, local advice should be sought to ensure that reserves for bad debts are deductible for VAT purposes for the purchaser.

#### *Transfer Taxes*

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

Registration of changes of ownership of land and buildings is subject to a duty of DKK 1,400 plus 0.6 percent of the fair market value (2009).

Mortgage instruments are subject to a duty of DKK 1,400 plus 1.5 percent (2009) 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, as described later in the 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 a statement from the tax authorities giving assurance 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 will normally require 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 if 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 advisers.

#### *Tax Losses*

Tax losses carried forward by a Danish target company will generally transfer along with the target company. There are no carry back rules, but losses realized in 2002 and onwards may be carried forward indefinitely. However, the use of the tax losses may be restricted for the target company and for any company participating in the purchaser's tax group (see later in the chapter).

Under a change of ownership, a tax loss carried forward cannot be used to reduce the taxable income below the net financial income (interest and similar income and expenses), including lease income from operating assets and ships, which is subject to tax depreciation. As such, the tax loss carried forward can still off-set operating profits.

A change of ownership takes place if 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. If the company is inactive at the time of the change of ownership, the loss carry-forward cannot be used at all.

The tax losses carried forward by the target company at closing will generally not be 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 are aligned in Danish tax law, so this will not yield special benefits for the seller.

#### *Transfer Taxes*

No stamp duty is payable on a transfer of shares.

Registration of changes of ownership to land and buildings is subject to a duty of DKK 1,400 plus 0.6 percent of the fair market value (2009).

Mortgage instruments are subject to a duty of DKK 1,400 plus 1.5 percent (2009) when the loan is raised or re-financed.

#### *Tax Clearances*

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

### **Choice of Acquisition Vehicle**

A wide range of acquisition vehicles are available to a foreign purchaser who wishes to acquire the shares or assets of a Danish target. Generally, 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 will often be decisive in determining the optimal jurisdiction or acquisition vehicle.

#### ***Local Holding Company***

A Danish holding company may be used as acquisition vehicle if the foreign purchaser wishes to benefit from the Danish rules on tax consolidation and off-set 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 considered and analyzed to ensure 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 if the profits are to be reinvested in the Danish or foreign subsidiary, because dividends can generally be received tax exempt if the Danish holding company holds more than 10 percent of the shares in the subsidiary (a holding period is no longer required). For the rules on the taxation of dividends, please see the section "recent developments".

Other benefits of using a Danish acquisition vehicle are the Danish corporate tax rate of 25 percent and gains realized by the Danish acquisition vehicle will generally be tax exempt provided the vehicle holds more than 10 percent of the shares.

Special attention is advisable when the foreign purchaser acquires or incorporates a Danish limited company which is considered transparent for foreign tax purposes (as with the U.S. check-the-box rules). For Danish tax purposes, the Danish limited company will

also be considered as a transparent company and will be treated as a branch of the foreign company with the result that 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.

#### ***Foreign Parent Company***

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

In general, the Danish WHT rules favor a structure with a foreign holding company, because capital gains realized by the foreign acquisition vehicle at a sale of the shares will not be subject to Danish WHT. Dividends would be exempt of Danish WHT, provided the foreign parent company meets the conditions for receiving tax-exempt dividends (main rule: holds more than 10 percent of the shares). As a general rule, interest paid by a Danish company to a foreign acquisition vehicle is not subject to WHT if the acquisition vehicle is resident within the European Union or in a country that has a tax treaty with Denmark. However, there are exceptions which should be considered in each case.

#### ***Non-Resident Intermediate Holding Company***

If 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 a 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 the section Recent Developments, business substance in foreign intermediate holding companies is currently a high priority area for the Danish tax authorities. It is, therefore, advisable that due attention is paid to the substance requirement, to avoid the possibility that an intermediate holding company will 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. A Danish branch of a foreign company is not a frequently used acquisition vehicle, because under current case law the shares are only allocated to a Danish branch if the branch is a professional trader in shares. However, with effect from 2010, shares may be

allocated to a PE if the return on the shares 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.

The calculation of taxable income is basically the same for a subsidiary as for a branch, because both vehicles are considered as taxable entities for Danish tax purposes. As a main rule, transactions between the Danish branch and the head office should be based on the arm's length principle. Special attention must, however, 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 not available when using a Danish subsidiary (no double dip in the Danish income).

### **Joint Ventures**

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 (such as the joint venture partners have entered into a partnership), or a strategic joint venture (the joint venture partners co-operate on specific strategic objectives). A corporate joint venture is treated as a corporate entity for Danish tax purposes, while an unincorporated joint venture or a strategic joint venture is treated as a transparent entity for Danish tax purposes.

The choice of joint venture will primarily depend upon 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 a 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.

### **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.

If it is decided to use debt, a 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 off-set the positive taxable income in the Danish target group as described in the section Group Relief/Consolidation. Tax losses incurred prior to closing are either entity-specific or only available for off-set 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 push-down). There are various ways to complete the debt push-down, but the Danish rules restricting companies' right to deduct interest should be considered. As the rules are complex, local advice should be sought to ensure a debt push-down will be effective.

It should be noted that company law largely prohibits financial assistance, as described in the section "Company Law and Accounting".

### **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:

- The thin-capitalization rules
- The interest ceiling rule
- The 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 if the debt-to-equity ratio exceeds 4:1 at year-end. 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 four-to-one debt-to-equity ratio. However, the rules do not apply if the controlled debt does not exceed a threshold of DKK 10 million or if 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 6.5 percent on the tax values of certain qualifying assets (mainly operating assets). The limitation applies only to expenses exceeding a threshold of DKK 21.3 million. Both the threshold and the standard rate of return are adjusted on an annual basis. The interest costs and other net financing expenses exceeding the interest ceiling will be lost permanently and cannot be carried forward. However, capital losses may be offset against capital gains in the following three income years.

Under the earnings before interest and tax (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 on the basis of thin-capitalization and the interest ceiling. Net financing expenses restricted under the EBIT rule may be carried forward for tax deduction in the following years and are not limited in time.

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

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

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

The reader should note that shareholder loans are covered by the Danish transfer pricing rules. Thus, the terms of the loan must reflect the market terms and must be documented.

### ***Withholding Tax on Debt and Methods to Reduce or Eliminate***

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There is generally no WHT obligation for foreign companies receiving interest paid by Danish companies on loans. However, 25 percent WHT is levied on interest payments to related parties. There are a number of exemptions from WHT, the most important being:

- The foreign company is already taxable on the interest due to a PE in Denmark; that is, when the interest relates to and is received by the PE.

- The receiving company is resident within the European Union/European Economic Area or in 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. The receiving company must be the beneficial owner of the interest.
- There are some other exceptions, which imply that Danish WHT is imposed if the interest income is taxed at a low rate in a foreign jurisdiction.

As stated above, the receiver must be the beneficial owner of the interest in order to avoid WHT. If the receiver of the interest is a conduit company (lacks business substance), WHT will be imposed as if the interest was paid directly to the beneficial owner. It should be noted that business substance is a highly prioritized focus area of the Danish tax authorities as mentioned in the section Recent Developments, and stepping-stone arrangements are generally not accepted by the Danish tax authorities. Whether the receiver of the interest payments has the required substance should be analyzed on a case-by-case basis. Local advice should be sought

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

### ***Checklist for Debt Funding***

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- The use of bank debt may avoid thin-capitalization and transfer pricing problems and it should eliminate the requirement to withhold tax from interest payments. (The use of bank debt will, however, not affect a restriction of the tax deduction of interest in accordance with 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 main rule, 25-percent WHT will apply to interest paid by a Danish company to a company resident in a country outside the EU with no have a tax treaty with Denmark.

### ***Equity***

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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.

With effect from financial year 2010, there is no Danish WHT on dividends on subsidiary shares or group company shares; that is, where the recipient has an interest of at least 10 percent of the share capital if the parent company is resident within the EU/EEA or in a country which has a tax treaty with Denmark.

A Danish WHT of 28 percent (subject to treaty protection) applies to 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, such as:

- 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.

### *Tax-Exempt Restructurings*

If the transaction is structured as a share exchange, that is, the seller receives shares in the purchasing company in exchange for shares in the target company, the seller may roll over the capital gain on the shares in the target company to the new shares. The roll-over 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 if the transaction is structured as a tax-exempt merger, but special conditions must be met to obtain the roll-over of capital gain for the seller, and the tax values for the merging companies.

The Danish rules also allows for tax exempt demerger and contribution in kind of assets. The reorganizations may be carried out without preapproval from the tax authorities, however a number of conditions must be satisfied and a sale of the shares received at the

transaction is generally restricted for a period of three years. We recommend seeking local advice to avoid adverse tax consequences of such transactions.

### **Hybrids**

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

A subordinated debt will not be regarded as share capital by virtue of being subordinated to other creditors. Convertible notes are always regarded as loans until conversion. As a main rule, payments made before conversion are taxed as interest. After conversion, the yield is taxed as dividend.

Effective as of 13 December 2006, the Danish tax qualification of hybrid instruments used by related parties depends on the foreign qualification of the hybrid. If a hybrid from a Danish tax perspective is considered as debt, but from a foreign tax perspective is treated as equity, interest and capital losses on the debt will be treated as dividend for Danish tax purposes.

### **Discounted Securities**

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

If 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 business' post-acquisition performance. The right to receive an unknown future amount is regarded as an asset that must be valued for Danish tax purposes if 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

Tax is only one of the issues that should be considered when planning a transaction. Other questions, such as the legal form of the transaction and accounting issues should also be considered. The following section summarizes some of them.

### Concerns of the Seller

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

The taxation of the seller will depend on the rules of the country in which the seller is resident and the legal form of the seller. The rules for taxation of capital gains realized by a Danish company have recently been changed and are outlined in the section 2009 Tax Reform. As set out in this section, most capital gains realized on shares will now be tax exempt.

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).

### Company Law and Accounting

The Danish Companies Act prescribes how Danish companies may be formed, operated, re-organized, and dissolved, and is based to a large extent on EU company law directives. In 2009, the Danish Companies Act was modernized and amended to cover public limited companies (A/S) and private limited companies (ApS), and has resulted in considerable flexibility, such as in relation to the payment of the subscribed capital and financial assistance. Company law has a significant influence for a purchaser investing in a Danish company, and some of the areas that could be of importance for a purchaser are outlined briefly later in this chapter.

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

Distribution of dividends from a Danish company must only be made out of the company's distributable profits; retained earnings, etc. The dividend may be distributed at the end of the financial year based on the financial statement or possibly as an interim dividend 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 a number of administrative requirements must be satisfied.

Occasionally, the structuring of a transaction raises financial assistance issues. There have been public discussions on whether huge dividend distributions from the target company used for the repayment of the purchaser's acquisition debt or a merger of the target company and the acquisition vehicle has been a violation of the prohibition of financial assistance. Previously, the prohibition on financial assistance stated that it is illegal for a Danish target company (A/S or ApS) to give directly or indirectly financial assistance for the purpose of the acquisition of the target company's shares. After the recent amendment, financial assistance is possible within the limitations of the distributable reserves, but each case must be examined on its facts and local advice on the issue should be sought.

A number of M&A accounting issues should be considered. A business combination, which under IFRS is defined 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 when it results in a pooling of business interests (that is, where one company's equity is exchanged for equity in another company), or shares in a newly incorporated company are issued to the merging companies' shareholders in exchange for their equity, with both sides receiving little or no consideration in the form of cash or other assets.

In Denmark non-listed companies can freely choose to adopt either the Danish Accounting Act or IFRS when preparing the accounts. According to Danish GAAP most business combinations are to be accounted as acquisitions. Merger accounting is restricted in the Danish Accounting Act to a very 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 inter-company combinations. Merger accounting is not allowed under IFRS.

If 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 given exceeds the aggregate of the values. If the accounts are prepared according to the Danish Accounting Act, goodwill is amortized through the profit and loss account over its useful economic life. If IFRS is adopted, the goodwill is not amortized, but the value is subject to impairment tests.

### **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. If there is a qualifying group relation between the entities, that is, if a controlling influence is held by a Danish or a foreign parent company, 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 the 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 of the companies 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 advisers. Under many share transactions, a target company leaves the seller's tax group during a financial year. In this case, income from the first period must be consolidated with 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 an 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 relation must be included in the Danish tax group, only a few Danish companies have made this election.

### **Transfer Pricing**

In general, 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 (that is, that the prices and terms reflect those that could be used in a transaction with a third party) and in most cases the company must prepare documentation which supports the basis of 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 tax authorities' practice is somewhat unclear, and each case must be examined on its facts. Caution is advisable when determining the basis of the prices, especially if large amounts are involved.

### **Dual Residency**

Under Danish tax law a company is resident in Denmark if it is registered in Denmark or if 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. As set out in the section Recent Developments, the rules were amended in 2007 and do not 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 county.

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 a large number of situations and the implications of the Danish CFC rules should be considered, such as if the business functions of an entity are changed, if a transaction could lead to additional financial income in the subsidiary, if a transaction would lead to a significant capital gain, if the tax rate of the subsidiary country is low, etc. It is not possible to provide an exhaustive list of the situations in which the CFC rules have implications, and each transaction should be examined based on its facts and local tax advice should be sought.

## Comparison of Asset and Share Purchases

### ***Advantages of Asset Purchases***

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- 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.
- There is no acquisition of a tax liability on retained earnings.
- It is possible to acquire only part of a business.
- There is greater flexibility in funding options.
- Profitable operations can be absorbed by loss-making companies in the purchaser's group, thereby effectively gaining the ability to use the losses.

### ***Disadvantages of Asset Purchases***

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

### ***Advantages of Share Purchases***

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- Lower capital outlay (purchase net assets only).
- Likely to be more attractive to the seller, therefore 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***

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- 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.

## Withholding Tax Rate Chart

The rate information and footnotes contained in this table are from the 2009 IBFD/KPMG Global Corporate Tax Handbook.

Country	Dividends		Interest <sup>1</sup>	Royalties
	Individuals, Companies (%)	Qualifying Companies <sup>2</sup> (%)		
Argentina	15	10	12	3/5/10/15 <sup>3</sup>
Armenia <sup>4</sup>	15	15	0	0
Australia	15	15	10	10
Austria	15	0 <sup>5</sup>	0	0
Bangladesh	15	10 <sup>5</sup>	10	10
Belarus <sup>4</sup>	15	15	0	0
Belgium	15	0	10	0
Brazil	25	25	-/15 <sup>6</sup>	15/25 <sup>7</sup>
Bulgaria	15	5	0	0
Canada	15	5	0/10 <sup>8</sup>	0/10 <sup>9</sup>
Chile	15	5	5/15 <sup>10</sup>	5/10 <sup>11</sup>
China (People's Rep.)	10	10	10	7/10 <sup>12</sup>
Croatia <sup>13</sup>	15	5	0	10
New treaty <sup>34</sup>	10	5	5	10
Cyprus	15	10	0/10 <sup>14</sup>	0
Czech Republic	15	15	0	5
Egypt	20	15	15	20
Estonia	15	5	10	5/10 <sup>12</sup>
Faroe Islands	15	0 <sup>5</sup>	0	0
Finland	15	0 <sup>5</sup>	0	0
Georgia	10	0/5 <sup>15</sup>	0	0
Germany	15	0/5 <sup>16</sup>	0	0
Greece	18	18	8	5
Greenland	- <sup>17</sup>	- <sup>17</sup>	0	10
Hungary	15	5	0	0
Iceland	15	0 <sup>5</sup>	0	0
India	25	15	10/15 <sup>14</sup>	20
Indonesia	20	10	10	15
Ireland	15	0	0	0
Israel	15	5 <sup>18</sup>	25	10
Italy	15	0 <sup>19</sup>	0/10 <sup>8</sup>	0/5 <sup>20</sup>
Jamaica	15	10	12.5	10
Japan	15	10 <sup>19</sup>	10	10
Kenya	30	20 <sup>21</sup>	20	20
Korea (Rep.)	15	15	15	10/15 <sup>22</sup>
Kyrgyzstan <sup>4</sup>	15	15	0	0
Latvia	15	5	10	5/10 <sup>12</sup>
Lithuania	15	5	10	5/10 <sup>12</sup>
Luxembourg <sup>23</sup>	15	5	0	0
Macedonia	15	0/5 <sup>24</sup>	0	10
Malaysia	0	0	- <sup>17</sup>	10
Malta	15	0 <sup>19</sup>	0	0
Mexico	15	0	0/5/15 <sup>25</sup>	10
Montenegro <sup>13</sup>	15	5	0	10
Morocco	25	10	10	10
Netherlands	15	0 <sup>5</sup>	0	0
New Zealand	15	15	10	10
Norway	15	0 <sup>5</sup>	0	0
Pakistan	15	15	15	12
Philippines	15	10	10	15
Poland	15	0/5 <sup>26</sup>	0/5 <sup>8</sup>	5
Portugal	10	0 <sup>27</sup>	0/10 <sup>8</sup>	10
Romania	15	10	10	10

Country	Dividends		Interest <sup>1</sup>	Royalties
	Individuals, Companies (%)	Qualifying Companies <sup>2</sup> (%)		
Russia	10	10	0	0
Serbia <sup>13</sup>	15	5	0	10
Singapore	10	0/5 <sup>26</sup>	10	10
Slovak Republic	15	15	0	5
Slovenia	15	5 <sup>28</sup>	5	5
South Africa	15	5	0	0
Sri Lanka	15	15	0/10 <sup>8</sup>	10
Sweden	15	0 <sup>5</sup>	0	0
Switzerland	0	0	0	0
Taiwan	10	10	10	10
Tanzania	15	15	12.5	20
Thailand	10	10	10/15 <sup>29</sup>	5/15 <sup>30</sup>
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 <sup>31</sup>
United Kingdom	15	0	0	0
United States	15	0/5 <sup>32</sup>	0	0
Venezuela	15	5 <sup>19</sup>	0/5 <sup>8</sup>	10
Vietnam	15	5/10 <sup>33</sup>	10	5/15 <sup>22</sup>
Zambia	15	15	10	15

### Notes

- Despite applied treaties. Many treaties provide for an exemption for certain types of interest, such as 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.
- 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. Despite applied treaties there is no withholding tax on dividends from Danish subsidiaries to foreign parent companies, provided that the parent company holds a minimum of 10 percent of the subsidiary's capital for a continuous period of at least 12 months during which the dividend distribution must fall.
- 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.
- The treaty concluded between Denmark and the former USSR.
- The rate applies if the non-resident company owns at least 10 percent of the capital in the Danish company (no holding period required).
- 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).
- The 25-percent rate applies to trademarks.
- The lower rate applies to interest paid by public bodies.
- The lower rate applies to copyrights, except films, etc., as well as to computer software, patents, and know-how.
- 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.
- 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.
- The lower rate applies to trademarks.
- The treaty concluded between Denmark and the former Yugoslavia.
- The lower rate applies to interest on bank loans.
- The zero rate applies if the participation is at least 50 percent with a minimum investment of more than EUR 2 million; the 5-percent rate applies if the participation is at least 10 percent with a minimum investment of more than EUR 100,000.
- Under this treaty, the exemption applies to dividends qualifying for the EC 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).
- The domestic rate applies; there is no reduction under the treaty.
- The 5-percent rate applies if the Israeli company controls at least 50 percent of the voting power in the Danish company.
- 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 one year.
- The lower rate applies to copyrights of literary, artistic or scientific work, except computer software and films, etc.
- The rate applies if the Kenyan company has owned at least 25 percent of the voting power in the Danish company for at least six months.
- The lower rate applies to industrial royalties and know-how.
- The treaty does not apply to income paid to exempt Luxembourg holding companies.
- 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 one year. The zero rate applies if it is a qualifying pension fund or other similar institution.
- The zero rate applies to interest paid by public bodies. The 5-percent rate applies to interbank interest.
- The zero rate applies if the recipient company has owned at least 25 percent of the capital in the Danish company for at least one year. The 5-percent rate applies if the recipient is a qualifying pension fund.
- Under this treaty, the exemption applies to dividends qualifying for the EC Parent-Subsidiary Directive.
- The rate applies if the recipient company (a) has owned at least 25 percent of the capital in the Danish company for at least one year or (b) is a qualifying pension fund.
- The lower rate applies to interest paid to financial institutions.
- The lower rate applies to copyright royalties.
- The lower rate applies to secret formulae or processes, and to know-how.
- 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.
- 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 USD 12 million in such capital. The 10-percent rate applies if the holding is less than 70 percent but at least 25 percent.
- Effective from 1 January 2010.

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