Direct Tax News Alert

Denmark: New tax regime gives easy access for foreign investment funds to Danish retail investors

The Danish Parliament has adopted a bill that among other things improves the possibilities for foreign investment fund managers to target Danish retail investors. As from the 2020 income year of fund, foreign investment fund managers can elect tax status as equity-based investment company for their funds. For such investment funds, the investors will be taxed in the equity income opposed to the capital income.

Foreign investment fund managers should consider obtaining the new tax status as an equity-based investment company for their investment funds.

PwC Denmark will be pleased to assist foreign investment fund managers in electing the new tax status.

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In January this year, the Danish Parliament adopted bill L 114. In headlines, the new tax law improves the possibilities of marketing foreign equity-based investment funds, including ETFs, to Danish individual investors. Furthermore, the new law also contains elements, which aim to improve the possibilities for the Danish fund industry to market distributing investment funds to foreign investors. Below you will find a description of the main elements of the new law.

Import of foreign equity-based investment funds to Danish retail investors

Current rules

Under current rules, Danish investment funds marketed to individuals typically have tax status as investment funds with minimum taxation (In Danish "investeringsinstitut med minimumsbeskatning" or "IMB"). Such investment funds may have tax status as either equity funds or bond funds where individuals are taxed in the equity income basket or the capital income basket. An IMB must calculate a minimum income, which is distributed or reported annually to the investors and taxed at investor level.

Very few foreign investment funds have elected the IMB status due to the administrative challenges in relation to calculating the minimum income etc. Therefore, typically foreign investment funds are taxed as so-called investment companies, meaning that Danish investors are taxed according to a mark-to-market principle. At the moment, individual investors are taxed in the capital income basket regardless of whether the investment fund in question is an equity fund or a bond fund. For individual investors, investment funds with tax status as investment companies are typically subject to a less beneficial taxation than investments in investment funds with tax status as IMBs.

The new rules

The new law allows both Danish and foreign equity-based investment funds to elect tax status as equity based investment companies. Consequently, individual investors will be taxed on any distributions, gains and losses in the equity income basket, i.e. the same income type as if the investments were made directly in the underlying shares or in an IMB with equity fund status.

Taxation in the equity income basket will typically be more beneficial than taxation in the capital income basket. Moreover, for individual investors the new rules are considerably more favourable when it comes to utilizing any losses on the units. Individual investors can utilize any losses on the units in equity-based investment companies in the equity income while losses on units in equity-based IMBs can only be set off against dividends and gains derived from shares listed on a regulated market and units in equity-based IMBs/investment companies.

However, according to the new law individual investors in equity-based investment companies are still taxed annually according to a mark-to-market principle on any realized dividends as well as unrealized losses and gains and not according to the realization principle. Taxation according to a mark-to-market principle is often considered less beneficial than taxation according to a realization principle as it advances the timing of taxation of gains.

Table 1 shows in headlines the tax rules for individual investors in the two types of equity-based investment funds. The investors' preferred choice of taxation in the equity income and capital income based on thresholds and rates for 2019 is shown in table 2.

How to elect tax status as equity-based investment company

To elect tax status as an equity-based investment company, the investment fund must give notice to the Danish tax authorities no later than on 1 November of the calendar year prior to the calendar year in which the election should have effect.

In order to elect the new tax status, the fund has to qualify as an equity fund. The election is made at sub-fund level, i.e. the election cannot be made at unit class level. In order to fulfil the requirements, the investment fund should invest at least 50 percent of its assets in equity encompassed by the Danish Capital Gains Tax Act on Shares, i.e. mainly shares in companies and units in equity-based investment companies/IMBs. The rest of the assets have to be invested in other types of securities. The calculation should be based on an average during the relevant calendar year according to special rules. Hence, the calculation is based on the calendar year and not necessarily the financial year of the fund.

Please note that when making the calculation, equity-based derivatives etc. are not regarded as equities. Moreover, the value of such derivatives are set to the value of the underlying assets and not the value of the derivative itself. This means that investment funds with strategies based on derivatives may have difficulties qualifying as equity-based investment companies. It also has to be mentioned that investments in target funds, where the fund owns at least 25 percent of the capital of the target fund, are treated as transparent. In such case, the investment fund must include a proportionate share of the assets in the target fund in the calculation.

In order to qualify as an equity-based investment company, the fund must also be a taxable person under the Danish Corporate Income Tax Act. Both UCITS and AIFs of the corporate type fulfils the condition while investment funds of the contractual or unit trust type may fulfil the condition on a case-by-case basis depending on the specific fund set-up.

The investment fund must submit information to the tax authorities to show compliance with the investment requirements no later than on 1 July of the following year. Any delay can result in an automatic switch of the tax status from equity fund to bond fund status. Please note that opposed to IMBs, no minimum income should be calculated/reported annually to the investors, which makes it much simpler to meet the requirements.

The new rules come into force as of income year 2020 of the fund. Since a foreign fund is not domiciled/a taxable person in Denmark, it is unclear when the new rules come into force for foreign investment funds in general. We have discussed the issue with the Danish Ministry of Taxation and we have understood that a bill may be put forward as soon as possible in order to clarify the question.

Example
The financial year of the foreign investment fund runs from 1 January 2020 to 31 December 2020. It the fund gives notice to the Danish tax authorities no later than 1 November 2019, the fund will most likely have tax status as equity based investment company from the beginning of the calendar year 2020. Accordingly, before 1 July 2021, the fund has to submit information to the Danish tax authorities showing that the investment requirements for the calendar year 2020 are met.

Equity savings account and business tax scheme

According to the new law, individuals with so-called equity savings accounts in banks can also invest in stock-based investment companies. The return from such investments are taxed according to a mark-to-market principle at a tax rate of 17 percent only. Only one equity savings account is allowed per individual and at the moment only with a very low maximum deposit of 50,000 DKK.

Furthermore, self-employed individuals can invest funds encompassed by the special business tax scheme in investment companies whether the investment company is equity- or bond-based.

Export of Danish distributing investment funds to foreign investors

Previous rules

When foreign investors invest in Danish investment funds, they usually pay 27 percent dividend tax on dividends from the fund. However, according to the double tax treaties the dividend tax is normally reduced to 15 percent. This dividend tax makes it less attractive for foreign investors that face the administrative burden of recovering said tax pursuant to the tax treaties etc.

New rules

Pursuant to the new law, foreign investors who invest in Danish investment funds do not have to pay dividend tax provided that the Danish investment fund at the level of the fund pays 15 percent tax on Danish sourced dividends, if any. Investment funds with tax status as investment companies generally pay 15 percent tax on Danish sourced dividends and for such investments funds the condition is automatically met. For investment funds with tax status as an IMB, the tax exemption for foreign investors is conditional on the fund in question having specifically elected a 15 percent tax on Danish sourced dividends. The election has to be made at the same time as the fund elects tax status as IMB.

However, please note that under the new rules the fund is still obliged to withhold Danish tax on dividends up front. Consequently, foreign investors must afterwards contact the Danish tax authorities in order to recover the full withholding tax with reference to the new rules.

The new rules came into force on 1 March 2019.

PwC's comments

PwC finds that the new rules for equity-taxed investment companies are an easy alternative for foreign investment fund providers that wish to market equity-based investment funds to Danish individual investors.

As a main rule, we find that it will be beneficial to elect the new tax status as equity-based investment company. Many Danish investors that invest in foreign investment funds may also have a portfolio of quoted shares listed on a regulated market and consequently such investors may prefer to be taxed on the equity income, among others because taxable losses on such quoted shares etc. can be set off against taxable gains on equity-based investment companies.

Hence, we recommend that foreign investment fund providers consider electing the new tax status as equity-based investment company for their equity-based funds. PwC Denmark will be pleased to assist foreign investment fund managers in electing the new tax status.

In our opinion, the new export rules will not improve the possibilities sufficiently for Danish dividend-paying investment funds to be sold widely to foreign investors because a withholding tax is still payable up front. Although foreign investors can make a full reclaim by contacting the Danish tax authorities afterwards, foreign investors will typically still prefer investment funds located in for example Luxembourg or Ireland where there is generally no local tax withheld on fund distributions.

Table 1
Taxation in headlines of individual investors in equity-based investment companies and IMBs.

	Equity-based investment company	**Equity-based Investment funds with minimum taxation (IMB)**
Taxation principle	Taxation according to a mark to market principle	Taxation according to a realization principle
Gains	Equity income with 27/42 per cent.	Equity income with 27/42 per cent.
Losses	Losses are deducted in the equity income	Losses can only be set of against dividends and gains on shares listed on a regulated market and units in equity-based investment companies and IMBs

Table 2
Individuals preferred choice of taxation in the equity income and capital income based on thresholds and tax rates for 2019

Net capital income	**Marginal tax rate**	**Low Equity Income****	**High Equity income**
High positive net capital income Positive net capital income greater than DKK 44,800 (double amount for spouses) and top rate tax paying investor	42.7	**E**	**E**
Positive net capital income	37.8	**E**	**C**
Negative net capital income (derived from interests on mortgages etc.)	33.6	**E**	**C**
High negative net capital income Negative net capital income over DKK 50,000 (double amount for spouses)	25.6	**C**	**C**

E = Individuals prefer taxation in the equity income
C = Individuals prefers taxation in the capital income
* Including the average municipality tax and the church tax
** Equity income up to DKK 54,000 (2019-level) for single and double amounts for spouses