

Denmark: New tax rules ease access to retail market for equity-based investment funds

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Executive summary

The Danish Parliament has adopted new tax rules for a Danish individual's investment in foreign equity-based investment funds. The purpose of the tax rules easement is to remove tax barriers for Danish individuals' investments in non-Danish mutual investment funds; the changes are effective from the income year 2020. Investment funds interested in the Danish retail market should consider marketing their shares/units in the Danish market under the new tax scheme.

Detailed discussion

Reduced tax rates for individuals

Under current law, investment funds may choose status as an investment fund with minimum taxation (IMB). An IMB can be either "equity-based" or "bond-based." IMBs are, on an annual basis, required to calculate and report so called minimum income in accordance with Danish tax calculation and inclusion principles. Equity-based IMBs in general benefit from more favorable tax rates for Danish individual investors (gains and dividends included as "equity income" and subject to tax upon realization of the shares/units).

Foreign investment funds (that have not elected IMB status) would typically qualify as “investment companies” (gains and dividends included as “capital income” and both realized and unrealized gains/losses included in accordance with a mark-to-market principle). Only very few foreign investment funds have opted to apply the IMB scheme, due to rather burdensome reporting requirements and restrictions against structuring a fund/sub-fund with certain types of share classes.

The revised rules for 2020 allows foreign investment funds to classify as “equity-based investment companies” benefitting from the same tax rates as equity-based IMBs for Danish individual investors, as gains and dividends from equity-based investment companies under the new rules will be included as “equity income.” Gains/losses will continue to be included in accordance with a mark-to-market principle.

The new rules introduce another easement of the taxation for individuals as losses from equity-based investment companies may generally be offset against all types of equity income, which is more favorable compared with the rules for equity-based IMBs. Utilization of losses from equity-based IMBs are subject to certain ring-fencing restrictions.

Requirements for equity-based investment companies

To classify as an equity-based investment company a fund must fulfill the following requirements:

- ▶ **Notification to the Danish tax authorities**
- ▶ **Asset test - annual reporting**
- ▶ **Qualification as a non-tax transparent fund from a Danish tax perspective**

Notice to the Danish tax authorities

Status as an equity-based investment company must be elected with notice to the Danish tax authorities no later than 1 November of the calendar year prior to the year from which this tax status should be effective. The tax status election is available at the sub-fund level. Accordingly, an umbrella fund structure may have sub-funds applying different Danish tax classifications.

Asset test (50%-test) - annual reporting

To qualify as an equity-based investment company, a fund (or sub-fund) must hold at least 50% of its assets in equities (as defined in the *Danish Capital Gains on Shares Act*).

The remainder assets must be securities and may consist of e.g., bonds, derivatives or money market instruments. Equity-based derivatives are in this respect not regarded as equities. Compliance with the 50% asset test must be based on an average throughout the calendar year, meaning that sporadic breaches of the 50% threshold do not jeopardize the tax status.

Compliance with the 50% test must be reported to the Danish tax authorities on an annual basis and no later than 1 July of the following year. The Danish tax authorities have not yet published guidelines on how to report.

Besides the 50% asset-test compliance reporting, there are no other tax reporting requirements for nonresident funds that intend to apply the equity-based investment company tax scheme. The reporting requirements for equity-based investment companies should thus be far less burdensome compared to the IMB requirements.

Non-tax transparency

To qualify as an equity-based investment company, the fund must be qualified as opaque (non-transparent) for Danish tax purposes. Corporate-based funds should typically fulfill this requirement while contractual funds or unit trusts may be analyzed on an individual basis.

Taxation of investors

Under the new rules returns from shares/units in Danish and foreign equity-based investment funds are included as “equity income” for Danish individuals according to a mark-to-market principle. Annual equity income up to DKK54,000 (2019) is taxed at 27% with income exceeding DKK54,000 taxed at 42% (double brackets applies for spouses).

The new rules do not change the taxation of Danish corporate investors, personal pension plans and pension funds.

Timeline and important deadlines

The new rules will enter into force for the 2020 income year.

The election of the tax status as equity-based investment company should be made no later than 1 November of the calendar year.

The equity-based investment fund should submit information to the Danish tax authorities documenting compliance with 50% asset test by 1 July of the following year.

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