Estate planning tax initiatives in Denmark

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Introduction

This article reviews recent and forthcoming Danish tax initiatives, which significantly affects the succession and estate planning landscape in Denmark, including a reduction in Danish gift tax on successions from 15% to (potentially) 0%, a new tax treatment of distributions from foundations and tax succession for business foundations.

Overview of the current Danish succession tax regime

Generally, any actual or deemed transfer of an economic value within a family (direct succession line) is subject to a 15% gift or estate taxation under Danish tax law. Transfers between spouses are, however, tax exempt. In addition, any transfer of assets (or liabilities) within a family is generally a tax event for capital gains purposes. However, in addition, in respect of capital gains taxes, transfers between spouses are generally tax exempt.

As the point of departure, the transfer of an enterprise or company owned by a Danish tax resident individual to his children will therefore trigger Danish capital gains taxes (up to 42%) plus gift or estate taxes of 15% of the value of the assets (if the assets are transferred in kind). It is, however, possible to request a deferral, which will be granted subject to certain conditions, of the payment of gift and estate taxes incurred in respect of a transfer (in kind) of an enterprise or company for up to 15 years. No time limit applies for real estate. Such deferral is subject to an annual interest rate of at least 3% (reduced from 6% in 2013). The capital gains and gift/estate tax base is generally calculated on the basis of the fair market value of the transferred assets.

Until 5 February 2015, it was possible to apply a simplified valuation model for, for example, the transfer of shares in unquoted companies for purposes of calculating both capital gains and estate tax. The simplified valuation basically entailed that the net book value of the underlying assets was applied, subject to certain adjustments, including a standard premium for off balance sheet goodwill. The simplified method most often led to a valuation which could be significantly lower than the fair market value, not least for companies with significant intellectual property rights. When abolished and replaced with a fair market value valuation method, as per 5 February 2015, the abolishment of the simplified valuation method was deemed by the Danish Tax Authorities in itself to entail an increase in the annual Danish tax revenues of DKK500 million (approximately €67 million).

A simplified valuation method can, however, still be used for transferring real estate, where a valuation corresponding to the latest property tax value assessment (the property tax value assessment is currently based on more or less automated value assessments made by the Danish Tax Authorities in 2011) plus or minus 15% is generally accepted by the Tax Authorities (even if such simplified valuation deviates significantly from fair market value).

For capital gains tax purposes – but not for gift or estate tax purposes – Danish tax law allows for tax succession, ie a transfer of deferred taxes from the seller to the acquirer of an enterprise, subject to certain requirements. The possibility to avoid triggering capital gains taxes by having

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the acquirer succeed in the capital gains tax base of the seller is generally available in respect of transfers to qualifying family members and/or employees.

The exact requirements for tax succession depends on whether the transfer of the enterprise is a share transfer (ie the transferred enterprise is a company) or an asset transfer (ie the assets and liabilities of the enterprise are held personally by the owner or held through a tax transparent entity such as a partnership or a limited partnership).

In either case, the rules on tax succession are meant for the succession of 'business assets' rather than for assets in general. In particular, business assets in this context do not include rental property, cash positions and securities etc. Succession for tax purposes in the event of an asset transfer is therefore applicable on an asset-by-asset basis, and it only applies if and to the extent each asset qualifies as a business asset and not as a private asset.

For share transfers, access to tax succession is determined on an all-or-nothing basis, hereby implying that the shares in the company either qualify for tax succession as a whole or do not qualify for tax succession at all. The test is made on the basis of the total assets and income in the underlying company. If at least 50% of the assets and income of the company qualify as business assets/income, tax succession is generally allowed. Financial assets and income do not qualify at the point of departure as business assets/income, and cash positions, including working capital, never qualify as business assets under the regime.

In relation to assets, the 50% threshold must be met both at the time of the succession as well as on an average basis over the last 3 financial years (based on the balance sheet in the annual company accounts) prior to the succession. In the case of a significant cash inflow in connection with, for example, a partial divestment of the company's business or an equity injection or draw down of debt prior to a contemplated expansion of the business, it may therefore make it difficult to transfer shares in the company with succession until such cash position has been reduced.

It is worth noting that – contrary to what could be expected within the EU – Danish tax law only allows for tax succession, both in relation to shares and assets if the acquirer is a Danish tax resident or, in the case of an assets transfer, if the transferred enterprise for tax purposes constitutes a permanent establishment in Denmark for the acquirer.

Reduction of gift and estate taxes

As part of the political agreement on the Danish financial budget for 2016, in November 2015 it was agreed to reduce the gift and estate taxes applicable to the transfer of enterprises from the current 15% to approximately 5% in 2020.

2015	2016	2017	2018	2019	2020
15%	13%	13%	7%	6%	5%

In late August 2016, the Danish Government announced its ambition to reduce further the rates to zero in 2025.

A draft Bill for the implementation of the reduced rates was published on 16 December 2016. The proposed tax rate reduction is not a general reduction of the gift and estate tax rates, but only a reduction of the gift and estate tax rate on 'qualifying assets'. In order to qualify for the reduced rates, the assets transferred as a gift or inheritance must in principle qualify for succession (ie constitute 'business assets' as described above). It is, however, not a requirement that the rules on succession are actually applied. In addition to qualifying for succession, the

transferor must have held the business directly or indirectly for at least the last 12 months, and the transferor (or the transferor's close relatives) must have been actively involved in the management of the business for a period of at least 12 months at some point during the transferor's ownership of the business.

If the party receiving the gift or inheritance subject to the reduced tax rate sells the business or part of the business within 36 months, a proportionate part of the reduced rate is recaptured; ie if a business is received as a gift on 1 January 2017 at the reduced rate of 13% and half the business is sold after 18 months, an additional gift tax is imposed on the recipient corresponding to 0.5% (calculated as the difference between the reduced rate of 13% and the full rate of 15%, multiplied by 18/36 months, and multiplied by half as only half the business is sold).

The draft Bill and the interpretive notes thereto leave a number of questions unanswered in relation to the scope and application of the reduced rates and adjustments are likely to be made before the Bill is presented to the Danish Parliament. It is anticipated that the final Bill will be presented in early 2017 and passed by Parliament before 1 April 2017.

The reduction of the tax rate for certain qualifying assets is likely significantly to increase the demand for estate tax planning in the future as it will make a big difference whether the estate assets are qualifying assets or not.

Currently, the increase of the tax base (as a consequence of the abolishment of the simplified valuation method) and the expected reduction in rates has to a large extent put estate planning on hold, partly due to the fact that the specific criteria for qualifying for the reduced rates are still unknown and partly due to the fact that the lowest rates will not apply before 2020.

New tax regime for distributions from foundations

On 17 September 2015, the European Court of Justice in *FE Familienprivatstiftung Eisenstadt* (Case C-589/13) ruled that the Austrian rules on the right of Austrian foundations to claim a tax deduction for distributions were contrary to the free movement of capital (Art 63 of the Treaty on the Functioning of the European Union) due to the fact that a deduction was only granted if the recipient of the distribution was subject to Austrian tax.

Denmark has a tax regime much like the Austrian regime, and a Bill was therefore presented to Parliament on 5 October 2016 abolishing the general right for foundations to claim a tax deduction for distributions. As of 1 January 2017, only distributions for charitable purposes will be deductible for Danish tax resident foundations. In relation to the deduction for charitable purposes, no formal distinction is made between Danish and foreign charitable purposes.

At the same time, it is proposed that the revenue generated from the abolishment of the general tax deduction for foundations is used to reduce the taxation of distribution in the hands of the recipients. As of 1 January 2017, the tax base for the recipients in respect of non-charitable distributions from Danish foundations and associations, or from similar foreign funds, is reduced to 80% of the received gross amount/distribution (entailing an effective tax rate of up to approximately 41% for a Danish tax resident individual).

The amended tax regime for foundations seems to favour foreign foundations over Danish foundations, especially since the reduced taxation of the recipient is not subject to the distribution not being deductible for the foundations. As such, a tax advantage may be available for income earned by a foreign foundation and subsequently distributed to a Danish tax resident individual when compared to the same income being earned directly by the individual.

It is, however, important to note that effective as of 1 July 2015 a number of quite broad anti-abuse tax measures were introduced in relation to the setting up and use of non-resident trusts or foundations as intermediary vehicles.

Capital contributions made by a Danish tax resident individual to trusts or foundations in 'low-tax jurisdictions' are now disregarded for Danish tax purposes. As such, the assets and income of the non-resident trust or foundation is for Danish tax purposes deemed to be held and accrued by the settlor – and thus subject to tax in the hands of the settlor even if deemed to be legally owned by the trust/foundation (a form of 'CFC taxation'). Taxes paid by the trust/foundation itself on income taxed in Denmark pursuant to these rules will be credited for Danish tax purposes.

A foundation or trust is deemed resident in a low-tax jurisdiction if:

(1) the taxation is substantially lower than in Denmark (for example, an applicable tax rate of 16.5% or less);

(2) an agreement concerning the applicable tax rate or tax base has been entered into with the local tax authorities; or

(3) taxation depends on the residence of the settlor.

The anti-abuse measure does not apply to contributions made to non-resident charitable foundations etc.

Possible introduction of tax succession involving business foundations

Previously in April 2013, a political agreement was reached to promote the use of business foundations in estate planning by introducing tax succession for the transfer of enterprises to foundations.

Two years later, in May 2015, the Danish Ministry of Taxation, after having analysed the options and impacts of different alternatives in an internal working group, published a proposal for implementing tax succession involving foundations. The proposed model contained two main elements:

(1) tax succession for the foundations, ie the contribution of an enterprise to a foundation would not trigger Danish capital gains taxes for the contributor; and

(2) a transfer tax of 15% imposed on the contributor (the proposal included an option for the foundation to pay the transfer tax, in which case the tax rate was increased to 20%).

The proposal included a number of significant anti-avoidance provisions, in particular that any capital gains or dividends received by the foundation on shares transferred to the foundation would be subject to income tax (at a rate of 22%). Furthermore, the existing tax consolidation opportunities for foundations and their corporate subsidiaries would not be available to a foundation having received the shares in the subsidiary under the proposed tax succession regime.

The proposed model was heavily criticised, and rightly so, by the Danish business community for being completely unattractive and irrelevant (it is in practice already possible to include a foundation as part of estate planning in a much more tax efficient manner under existing tax rules), and the proposal therefore did not result in a Bill being adopted by Parliament. Instead, the Danish Ministry of Taxation announced in August 2016 that a new working group with external participants would be established with the purpose of finding a model for the implementation of the tax succession for business foundations. It still remains to be seen whether it will be possible to find an actual and attractive model for the introduction of tax

succession involving foundations – not least having in mind the currently very limited budget of approximately DKK360 million per year (approximately €48 million) for the loss of tax revenue when compared to existing tax rules.

Conclusion

The recent and forthcoming Danish tax initiatives significantly affect estate planning in Denmark. The gap between the effective taxation in the case of no or very little estate planning, and the effective taxation if estate tax planning is carried out is about to widen considerably. At the same time the way of making Danish estate tax planning efficient just a few years ago is to some extent soon going to become obsolete, and new models for bridging an efficient tax position with diverse individual personal and commercial drivers must be established.

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