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APRIL 2017

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Still No Coordination for Shareholder Loans in Denmark?

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Shareholder loans are generally a complicated area in Denmark because of a lack of coordination between the corporate law and the tax law. But recent changes—still without coordination between corporate and tax law—mean taxpayers must still proceed with caution!

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Corporate Law on Shareholder Loans

For many years shareholder loans, defined as loans from a company to its shareholders and members of the management, has been prohibited under Danish corporate law. These prohibited shareholder loans include:

- direct loans as well as collateral for loans;
- loans to/collateral for the individual shareholders and members of the management in the company as well as in a parent company or other companies with controlling interests in the company; and
- loans to/collateral for close relatives of the aforementioned individuals—e.g. spouses, children/grandchildren, parents, cohabitants etc.

Please note that these restrictions do only apply to individuals. Thus, loans to/collateral for a Danish or foreign parent company have always been, and are still permitted, under Danish corporate law.

Although shareholder loans have been prohibited under corporate law the use hereof in practice has actually been quite common, probably because the enforcement of the rules has been limited and the sanctions for violation of the rules have been rather modest. However, the tax effects of these loans have—on the other hand—been rather severe since 2012 (see below).

The restrictions on shareholder loans in corporate law were relaxed with effect as of January 1, 2017. The effect hereof was that loans to/collateral for the aforementioned individuals would not be prohibited if the loan/collateral is established on market terms *and* provided the loan/collateral amount can be contained in the funds that could legally be distributed as dividends by the company.

However, the tax rules on shareholder loans were not changed. Therefore, the relaxation of the corporate rules will for practical purposes only enable es-

 TPETS ISSN 1754-1646

tablishing non-taxable shareholder loans, i.e. only loans to non-controlling shareholders/members of the management as loans/collaterals to controlling shareholders still have severe tax effects.

Tax Law on Shareholder Loans

Up until 2012 the establishment of shareholder loans did normally not have any tax effects. The only situations resulting in taxation were if:

- The loan was not established on market terms in which case the Danish tax authorities could tax the parties as if the loan had been on market terms, e.g. tax the debtor of the difference between the market interest rate and the actual paid interest rate as a hidden distribution of dividends.
- It was clear that the debtor never should or never would be able to repay the loan in which case the loan amount would be taxed in full as a hidden distribution.

However, the tax legislation on shareholder loans changed dramatically in 2012 with effect for loans established on August 12, 2012 or later.

The reason for this change of the tax legislation was that the tax authorities, allegedly, had seen an increasing number of cases where controlling shareholders were using non-taxable loans from their companies as an alternative to receive taxable dividends or salary payments. The fact that these loans were prohibited under corporate law did, apparently, not have any traceable effect in this regard.

Under the new legislation (section 16E of the Tax Assessment Act), all shareholder loans to or collaterals for controlling shareholders are regarded as taxable payments from the company to the shareholder, either as distribution of taxable dividends or as taxable salary payments.

The legislation does not specify the criteria for regarding the loan/collateral as a taxable dividend distribution or as a taxable salary payment. Thus, the decision on this issue depends on the facts of the situation, and the allocation is, for practical purposes, to a large extent, up to the parties of the transaction. However, the tax authorities are not likely to accept the amount as a taxable salary payment if the shareholder is not working for the company or if the amount far exceeds a normal salary for the work performed. If the amount is treated as a taxable salary payment, the company will be able to deduct the amount for tax purposes, whereas a dividend distribution is not deductible for the company for tax purposes.

The relevant controlling shareholders are individuals who—directly or indirectly—holds a controlling interest (more than 50 percent of the capital or more than 50 percent of the votes) in the company granting the loan/collateral. In the calculation hereof the following shares/votes must be included:

- shares/votes directly or indirectly owned by close relatives of the individual (i.e. spouse, parents, grandparents, children, grandchildren and their spouses); and
- shares/votes owned by companies or other legal entities controlled by the individual or the aforementioned relatives.

The legislation also applies to the following situations:

- loans/collaterals from a Danish company to an individual's resident outside Denmark holding a controlling interest in the Danish company. The loan/collateral will in this case be subject to Danish withholding tax (dividend tax or salary tax);
- loans/collaterals made by foreign companies to an individual's resident in Denmark holding a controlling interest in the company, regardless whether the loan/collateral is legally permitted in the jurisdiction of the company; and
- indirect loans/collaterals, e.g. a loan from a Danish company to a foreign company which makes a similar loan to an individual—Danish or foreign—which has a controlling interest in the Danish company.

There are a few exceptions from the taxation of shareholders loans:

- if the loan to the shareholder is granted as a normal business transaction for the company, e.g. if the company as a part of its normal business activities is selling goods or services to the shareholder on normal credit terms, i.e. on the same terms as credit sales to other customers;
- normal loans from banks, i.e. if the company in question is a bank; or
- the legislation does not apply to loans/collaterals to Danish or foreign companies and other legal entities regarded as separate entities for Danish tax purposes.

The shareholder loans/collaterals are taxable on the date of the payment of the loan amount or the granting of the collateral to the controlling shareholder. Thus, a subsequent repayment of the loan or cancellation of the collateral will not eliminate or in any other way change the taxation.

The Danish tax authorities apply a rather strict interpretation of this legislation. Thus, the taxation of shareholder loans will apply in the following situations:

- granting of direct loans/collaterals from the company to the controlling shareholder;
- the company's payment of the controlling shareholder's private costs, e.g. by the shareholder's use of the company's credit cards;
- the sale of assets from the company to the controlling shareholder for a price lower than the market value; and
- the sale of assets from the controlling shareholder to the company for a price exceeding the market value.

Further, if the company has granted a taxable loan/collateral to a controlling shareholder, then the shareholder will be obliged to refund the applicable withholding tax to the company, as the company will be obliged to pay the withholding tax to the tax authorities. If this amount is not refunded to the company prior to the filing of the company's income tax return for the year of the granting of the loan/collateral, then this amount will be regarded as a new taxable shareholder loan.

The effect of a loan being regarded as a taxable payment is that neither the debt nor the receivable are regarded as existing, however only for tax purposes.

Thus, the debt and the receivable still exists for legal and accounting purposes. The effects hereof are the following:

- The debtor will for legal and accounting purposes be obliged to pay interest on the debt. If the shareholder loan is prohibited pursuant to corporate law, then the annual interest rate cannot be lower than 10 percent. However, as the loan does not exist for tax purposes the calculated interest is not regarded as interest for tax purposes and will, therefore, not be deductible for the debtor, but still be taxable for the creditor. Further, the Danish tax authorities has in a new guideline stated that if the interest calculated for accounting/legal purposes on a taxed shareholder loan is not paid by the debtor prior to the filing of the company's income tax return for that year, then the interest amount is regarded as a new taxable shareholder loan.
- If the receivable on the shareholder is transferred from the company to the shareholder as a dividend distribution or as a salary payment, then such dividend distribution or salary payment will not be taxable, as the receivable/debt does not exist for tax purposes.
- Further, if a taxed receivable/debt cease to exist due to cancellation from the company or due to normal statutes of limitation of debt, then this cancellation will not trigger any further tax effects for the shareholder or the company. Thus, the cancellation of the debt will not be taxable for the shareholder and the loss on the cancelled debt will not be deductible for the company.

Conclusion

The use of shareholder loans or collaterals from a company to its shareholders is rather complicated in Denmark. There are, still, a number of cases where loans/collaterals from a company to its shareholders/management are prohibited under corporate law, although these rules have been relaxed recently.

However, the effect of the current tax legislation—which is interpreted quite strictly by the tax authorities—is that loans/collaterals to controlling shareholders in most cases will be a bad idea and the lack of coordination between corporate and tax law makes it in any case a difficult area to navigate in.

Thus, close contact with Danish accounting and tax experts is recommended.

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ISSN 1754-1646