

Briefing

Eversheds international tax briefing

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Structuring your Hong Kong – Denmark investments

Background

In many instances investments from outside Europe towards Denmark are made through a holding company in Luxembourg.

The topic of this Eversheds International Tax Group News Briefing is to set out the tax structure options for Hong Kong investments into Denmark. This theme has become of special interest due to the recently ratified double taxation treaty between Hong Kong and Luxembourg that (when coupled with the Denmark – Luxembourg tax scheme) now allows taxation benefits on expatriation of profits from Danish investments held by Hong Kong parents in a Luxembourg holding structure.

The briefing details the rules governing a Hong Kong based company's investment in Denmark through a Luxembourg holding structure, and also briefly touches upon the subject of how you may be able to create a Luxembourg holding structure even if the investment was originally made directly from Hong Kong into Denmark. Finally, the rules governing sale of Danish shares by Hong Kong parents are also briefly described.

Executive Summary

The conclusions of this briefing are:

- Structuring your Danish investments through Luxembourg will earn you the possibility of saving 28 per cent in Danish source taxation when expatriating profits
- Certain requirements to the Luxembourg set-up should be observed
- A Hong Kong parent's sale of its shares in a Danish entity is free of Danish capital gain tax and other sales taxes
- Even if a Danish investment has originally been set up through a direct Hong Kong to Denmark ownership structure, the Danish investment may relatively easy be brought into a Luxembourg holding structure so that tax benefits may be enjoyed.

Profit expatriation – how to save 28 per cent...

One of the most important issues when doing off-shore investments is to ascertain any obstacles, including tax-wise, that will be faced in relation to expatriation of profits earned in the foreign jurisdiction. Often taxation will be one of the main drivers behind the investment structure chosen.

At present, Denmark and Hong Kong have not entered into a double taxation treaty including dividends. As a consequence hereof, dividends paid by a Danish company to a parent company in Hong Kong are subject to Danish withholding tax. The current withholding tax rate is 28 per cent – irrespective of the ownership share held by the Hong Kong company.

On the other hand, a double taxation treaty between Luxembourg and Hong Kong has come into force in 2009 having effect in respect of taxes withheld at source to income derived on or after 1 January 2008. It transpires from article 10 of this treaty, that 0 per cent is the maximum tax rate that may be applied by Luxembourg to the gross amount of dividends paid by a company in Luxembourg to its parent company in Hong Kong. To be able to enjoy this beneficial tax scheme the Hong Kong parent must hold (i) at least 10 per cent of the capital of the company or (ii) a participation with an acquisition cost of at least EUR 1.2 million¹.

Dividends paid by a Danish company to a parent company in Luxembourg are currently not subject to Danish taxation, if:²

- 1) the parent company has at the time of distribution consecutively owned at least 10 per cent of the share capital in the Danish company during the last 12 months; and
- 2) the Danish taxation shall be reduced under the double taxation treaty between Denmark and Luxembourg or according to EU Directive 90/435³.

It is therefore possible to establish a structure where dividends are paid by a Danish target company to a parent company in Luxembourg and onwards to a parent company in Hong Kong without any withholding taxation at source. Consequently, dividends deriving from profits earned in Denmark may be received in Hong Kong without any deductions.

1. The competent authorities of Luxembourg and Hong Kong shall by mutual agreement settle the mode of application of this limitation.
2. Bill no. 202 passed in Parliament on 28 May 2009 implies a rewording of the conditions due to amendments of the Act on Capital Gains on Shares, and the condition regarding ownership period will not apply to distributions of dividends on 1 January 2010 or later.
3. See below regarding tax avoidance

Transfer of shares... free of taxes!

The transfer of shares in Danish companies held by foreign companies are generally not subject to Danish taxation. It is therefore possible for a parent company in Hong Kong to transfer its shares in a Danish company to a Luxembourg company without triggering any taxation in Denmark.

This means that even if a Danish investment was originally set up by way of direct ownership by the Hong Kong parent, the shares in the Danish company may be transferred to a new Luxembourg subsidiary of the Hong Kong parent without – in principle – triggering any Danish source taxation.

The rule also entails that in the event of a Hong Kong parent's exit from a Danish investment in shares through a sale, no capital gain tax is payable in Denmark.

Tax avoidance issues... be aware

It transpires from article 27 of the double taxation treaty between Luxembourg and Hong Kong that nothing in the treaty shall prejudice the right of Luxembourg and Hong Kong, respectively, to apply its domestic laws and measures that directly or indirectly govern tax avoidance issues.

As regards the above exemption rule concerning dividends paid by a Danish company, it is noted that the Danish tax authorities are focused on testing beneficial ownership. Thus, the intermediary company in Luxembourg should not only be a 'pass through' entity. To this end, it is likely that the Danish tax authorities will require that the intermediary company has its own office and staff in Luxembourg and that the staff is engaged in activities regarding the shareholding and/or other activities.

In this context it should also be noted that Denmark and Luxembourg on 4 June 2009 have signed an agreement regarding exchange of information and that the Danish Government since October 2008 has signed tax agreements with Cayman Islands, Bermuda, Jersey, Guernsey and British Virgin Islands. It is therefore likely that the Danish Government will seek to sign new tax agreements with Hong Kong.

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- Memberships: Danish Chinese Business Forum, Danish Chamber of Commerce in Shanghai

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