29 September 2015

Global Tax Alert

Danish Government publishes report on dividend withholding tax

Executive summary

On 25 September 2015, the Danish Minister of Taxation published an internal audit report addressing a tax scam relating to claims for refund of Danish dividend withholding tax (WHT) together with an action plan addressing how to respond to the matter.

The background is that the Danish customs and tax administration (SKAT) on 24 August 2015, reported a tax scam estimated to involve DKK6.2b (€830m) relating to claims for refund of WHT for the period 2012-2015.[1] It is said to have involved a network of more than hundred nonresident companies that applied for refunds based on fictitious shareholdings and falsified documents. SKAT was warned about the scam through two independent notices given by the tax administration of other countries.

Separately, the Ministry of Taxation received an early warning from SKAT on 7 July 2015, regarding stock lending according to which there is a mismatch between the person that is treated as owner under such arrangements in Denmark and other countries and a practice of some custody banks to request WHT refunds on behalf of the wrong taxpayer. The case may even be that multiple parties have requested WHT refunds regarding the same stock under stock lending arrangements.

On 16 September 2015, the Danish Supreme Audit Institution announced that it would initiate its own investigation into SKATs administration of WHT refunds.

This Alert summarizes the internal audit report, the action plan, the tax treatment of dividends, reporting obligations and the administration of refund claims.

Detailed discussion

Internal audit report

The internal audit report addresses the tax scam but does not address stock lending arrangements. The report sharply criticizes SKAT's administration of the refund process, among other things, because it has not confirmed whether a claimant is actually a shareholder in the distributing company and whether a WHT has been paid. This confirms information in the media that refunds have been accepted regarding stocks in companies that have not paid dividends during the years under investigation. SKAT has also failed to use reported information regarding the WHT for each individual shareholder in the refund process. In many cases SKAT did not have information about the identity of nonresident shareholders.

Action plan

The action plan of the Minister of Taxation outlines the following initiatives:

- A new unit within SKAT staffed with more people will handle all refund claims including the 20,000 pending claims that have been put on hold since 24 August.
- A new unit will monitor and analyze all types of payments made by SKAT.
- A new anti-fraud unit will address international tax fraud and crime.
- A new task force will focus on control of WHT refunds and the practice of deposit banks in relation to stock lending arrangements.
- A working group will analyze the need for law changes in terms of taxation, withholding tax obligation and reporting of dividends. The group must finalize its report by mid-2016.

These initiatives will be supplemented by other more general actions that are aimed at improving the efficiency of SKAT. The action plan does not provide information on new legislative or administrative procedures the may be implemented going forward.

Tax treatment of dividends

The Danish tax treatment of dividends paid to nonresident portfolio investors that own stocks in listed Danish companies is examined below in a basic situation and under a stock lending arrangement.

Basic situation

A person who owns portfolio shares in a Danish company is subject to Danish taxation on dividends paid by the company. The relevant taxpayer is the "current" shareholder at the time the dividend is approved by the shareholders meeting.[2] The law was amended in 2005 in order to clarify that a nonresident shareholder cannot sell the dividend right attached to a stock to a Danish bank in order to circumvent Danish WHT.[3] Hence, Danish tax law does not recognize bifurcation of a stock and the dividend rights attached to it. The distributing company is required to apply a WHT of 27% regarding nonresident shareholders.[4] If a nonresident shareholder is tax resident in a country which has concluded a tax treaty or another agreement with Denmark that includes an exchange of information clause, the applicable domestic tax rate is 15%. Accordingly, in this situation the shareholder is entitled to a refund of 12%. For other nonresident shareholders, the WHT of 27% is a final tax. This treatment is applicable to both individuals and companies.

Stock lending

A stock lending transaction basically involves that: (1) stocks are transferred from a lender to a borrower, (2) the borrower must return the same number of similar stocks to the lender at the end of the arrangement, and (3) compensation is paid by the borrower to the lender. The borrower is registered as owner of the stock with VP Securities A/S which is the central securities depository in Denmark.

A stock lending transaction is normally not treated as a sale for Danish tax purposes, provided that the stock is listed on a stock exchange and that the contractual terms are similar to the terms of certain standard agreements.[5] This means that the lender is treated as tax owner of the stock, subject to tax on dividends paid during the arrangement and entitled to a refund of WHT.[6] There is thus a discrepancy between the owner for tax and securities law purposes. Since the handling of WHT refunds is largely based on registration in VP Securities A/S, refunds may easily be paid to the wrong person.

The borrower may dispose of the stock to a third party as part of short selling strategy. In this situation both the lender and the third party buyer is treated as owner of the stock for capital gains tax purposes. However, in this situation only the third party is taxable of the dividends and entitled to a refund.

Reporting obligations

Reporting of dividend paid and dividend tax withheld

A listed company must report to SKAT the total dividend distributed and dividend tax withheld and remit the withholding tax to SKAT.[7] The information is received by the company from VP Securities A/S. The reporting deadline is at the end of the month following the month of the distribution. The distributing company is not required to submit information about the recipients of dividends.

Reporting of recipients of dividends

Danish custody banks must report to SKAT the following information regarding distributions from listed companies:[8] (1) the identity of the reporting entity, (2) the identity of the recipient, if this information is known, and the bank account, (3) the amount of the dividend before and after WHT, the WHT rate applied, the amount of the WHT and the reason for the application of a reduced WHT, (4) the date of the distribution, (5) the identity of the stock and (6) the country in which the stock is issued and whether the stock is listed. In principle, the information about the identity of the shareholder must include the full name, address and tax identification number (TIN). However, stocks owned by a nonresident shareholder are often held in omnibus accounts in a Danish bank which mean that the Danish bank and VP Securities A/S do not receive information on the identity of the shareholder. This also occurs when a resident shareholder invests in Danish listed companies through a nonresident bank. The information deadline is at the end of the month following the month of the distribution.[9] In practice, VP Securities A/S reports the information to SKAT on behalf of the custody banks.

Refund claims

Nonresident shareholders are entitled to claim a refund of WHT that exceeds the final tax under domestic law or a tax treaty.[10] A request must be filed within five years.[11] A refund is usually handled within a period of six months.[12] However, if SKAT is unable to determine whether the taxpayer is entitled to a refund based on the taxpayer's affairs, the deadline is suspended until the taxpayer makes it possible for SKAT to properly evaluate the refund claim. A refund paid after the deadline is interest bearing.

SKAT's administration of WHT refunds has been based on two different approaches:

- Form 06.003: A shareholder submits to SKAT form 06.003[13] including a tax residence certificate and a dividend advice from the depot bank.
- Bank arrangement: SKAT has concluded agreements with Danske Bank, Nordea and SEB allowing these banks to submit refund claims on behalf of shareholders that have registered their Danish stocks in depots of nonresident banks. This arrangement involves that the nonresident banks submits spreadsheets to the Danish banks specifying the amount of the refund claims. For each separate request a specification is made of the name of the shareholder, the stock, the number of stocks, the distribution date, the amount of dividend and the refund claim. However, a tax residence certificate is not required.

A relief at source principle may be applied upfront regarding individuals of 12 countries according to an agreement between VP Securities A/S and SKAT.[14] Accordingly, individuals of these countries need not rely on the refund process.

Implications

Denmark's refund mechanism system in terms of dividend WHT has made it possible to obtain refunds of significant amounts without owning any Danish shares. More resources are now being deployed and new control measures will be applied to the Danish refund administration. The current 20,000 pending refund claims will be subject to scrutiny since it is expected that some of them are fraudulent. Until a new digital system and new legislation is in place, all requests will be handled manually. Nonresident shareholders should expect that refunds will continue to be handled within six months. However, going forward it is likely that changes will be made to the refund process.

Endnotes

1. See EY Global Tax Alert, *Danish Tax Authorities suspend all claims for refunds of dividend withholding tax*, dated 27 August 2015.
2. Section 16 A(2)(1) of the Danish Tax Assessment Act.
3. Bill No. 79, 2004/05.
4. Section 65(1) of the Danish Withholding Tax Act.
5. TfS 1999.408 and TfS 2002.755. The standard agreement of the Danish Bankers Association and the Danish Securities Dealers Association, Overseas Securities Lending Agreement (OSLA) and Global Master Securities Lending Agreement (GMSLA) have been approved by the Danish Tax Assessment Board.
6. TfS 2004.152 decided by the Danish National Tax Tribunal and TfS 2009.283 decided by the Danish Tax Board. Decisions published by the Danish Tax Assessment Board in 2001 came to the opposite result, i.e. that the borrower was subject to tax on dividends, see TfS 2001.146 and TfS 2001.760.
7. Section 66(1) and (2) of the Danish Withholding Tax Act.
8. Section 9 B of the Danish Tax Control Act.
9. Section 45 of Regulation No. 890 of 10 July 2015.
10. Section 69 B of the Danish Withholding Tax Act.
11. Section 67 A of the Danish Withholding Tax Act.
12. Section 69 B of the Danish Withholding Tax Act.
13. Form 06.002 for Switzerland and form 06.005 for Germany.
14. Belgium, Canada, Ireland, Germany, Greece, Luxembourg, Netherlands, Norway, Sweden, Switzerland, United Kingdom and United States.

For additional information with respect to this Alert, please contact the following:

Ernst & Young P/S, Copenhagen

- Jens Wittendorff +45 51 58 28 20 jens.wittendorff@dk.ey.com
- Jesper Frøkjær +45 73 23 65 53 jesper.froekjaer@dk.ey.com
- Inge Heinrichsen +45 73 23 37 61 inge.heinrichsen@dk.ey.com

Ernst & Young LLP, Scandinavian Tax Desk, New York

- Nina Larsson +1 212 773 1727 nina.larsson3@ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

EYG No. CM5801

ey.com