FINANS DANMARK

Dividend taxation of foreign shareholders – relief at source model

Note

September 6. 2018

Doc no FIDA-1244909148-21 -v1

The Danish government has decided to introduce a relief at source model for dividend taxation of foreign shareholders to replace the current tax refund model. This note outlines a proposal for a specific relief at source model resulting from discussions between the Danish Ministry of Taxation, the Danish tax authorities, Finance Denmark, selected banks and VP Securities (VP). The model is characterised by the following:

- On the pay date, dividend will be distributed subject to relief at source of dividend tax, ie the individual shareholders receive their net dividend as one final payment.
- The tax authorities will conduct random checks after relief at source, ie after dividend net of tax has been distributed and has "left the country".
- If a random check reveals that the amount of tax withheld was too low, banks will be strictly liable to pay the tax deficiency to the Danish tax authorities. The strict liability of banks will include all types of error situations, except shareholders that must be pre-approved by the tax authorities.

The model is generally considered to offer adequate protection against fraud, while at the same time ensuring an efficient and manageable solution.

1. Main features of the new model

The key principle of the new model is that tax on dividend distributed to foreign shareholders by Danish companies and Danish investment institutions registered with a (Danish or foreign) central securities depository (CSD) will, as a general rule, be subject to *relief at source*, ie the correct and final amount of dividend tax will be withheld. This means that the data required for relief at source must be available prior to the pay date.

Foreign shareholders seeking to obtain (and being entitled to) a dividend tax rate below 27% must have their names and other requisite data registered directly with the Danish tax authorities through their custody bank (or a custody bank further up the chain of banks). When the tax authorities have received the

requisite data, they will issue a unique identification number identifying the relevant shareholder and the shareholder's correct tax rate.
The shareholdings of individual foreign shareholders will be placed in *tax rate pools* with VP (or a foreign CSD recording Danish shares) – ie special omnibus accounts characterised by a specific tax rate, such as 0%, 10%, 15%, 22% or 27% – by Danish (or foreign) account controllers holding custody accounts with VP (or a foreign CSD recording Danish shares) based on the identification number and tax rate of the individual shareholder.

On the basis of this grouping of shareholders according to tax rate, the Danish companies will distribute dividend (net of dividend tax) to the shareholders and pay the dividend tax withheld to the tax authorities. Dividends will be paid on the *pay date*, which is usually one business day from the *record date* and three business days from the date of the annual general meeting – in line with current market practice.

After dividend distribution and relief at source of dividend tax, the tax authorities will conduct *random checks* for the purpose of verifying the validity of the data on which the relief at source was based. Random checks will be conducted according to data-based risk models using data on the identity etc of the foreign shareholders that their custody banks have reported directly to the Danish tax authorities, data on the shareholdings etc of the individual shareholders submitted through the chain of custody banks, as well as previous random check results.

If, in connection with the random checks, the tax authorities conclude that the amount of dividend tax withheld is too low, the account controllers (or other market participants performing corresponding functions relating to the distribution of dividends, for instance foreign CSDs) warrant that the correct amount of dividend tax will be paid to the tax authorities.

Details on the strict liability of banks
Generally, the liability of banks will include all situations where random checks reveal errors in the payment of dividend tax[1]. This could be situations where an incorrect tax rate (under the current tax treaty with the relevant country) was applied or where a transaction relating to a specific dividend payment changes the right to a particular tax rate. In such situations, the banks will be strictly liable

[1] The liability only relates to dividend payments subject to the specific random check, ie not errors in previous dividend payments to the same shareholder from the same company etc.

to pay to the tax authorities the difference between the correct amount of dividend tax and the actual amount of dividend tax withheld.

The liability of banks will also apply if the tax authorities have not (by a specified deadline) received information on the shareholdings of individual shareholders (required for random checking purposes), or if the tax authorities have not (by a specified deadline) received the documentation to be used in connection with random checks. In these situations, the banks will be strictly liable to pay the difference between the 27% dividend tax and the dividend tax withheld.

The only situations that will be *exempt* from the strict liability of the banks concern particular types of shareholders entitled to a tax rate that is lower than the standard rate in the relevant country (under the Tax treaty with that country). This will affect an estimated 1,000 foreign shareholders, including mainly pension funds, some public institutions and some charities in a number of countries. It is a condition under the model that the tax authorities *pre-approve* the tax status of these shareholders, and the liability of banks will not apply if the Danish tax authorities subsequently change their opinion on the tax status of these shareholders in connection with subsequent checks.

The exemption will only concern the pre-approval of shareholders' tax status. The strict liability of banks will consequently still apply in situations – for instance, the lending of shares – where that the dividend recipient is not the beneficial owner for tax purposes under Danish law.

When the liability of banks is invoked in a given situation, the tax authorities will be able to enforce it vis-à-vis the relevant account controllers at VP (or an equivalent foreign CSD).

The legal basis for the liability needs to be examined further. The liability will be activated when the tax authorities rules that a given situation triggers liability. This ruling can be appealed to the National Tax Tribunal.

Process before payment of dividend: Registration, issuance of identification number and pre-approval
The foreign shareholder data required for relief at source must be reported directly by the shareholder's custody bank to the Danish tax authorities. The custody bank may delegate registration to a (typically) larger custody bank further up the chain of banks, which then takes over the responsibility for communicating with the Danish tax authorities.

It is assumed that registration will take place via an online portal provided by the tax authorities. The tax authorities must lay down the requirements for these data, which may depend on the specific type of shareholder, and for the underlying documentation (see below). In general, the data will include:

- The identity of the individual shareholder (name, address, date of birth etc as well as TIN (Taxpayer Identification Number), if applicable
- Fiscal domicile (country)
- Type of legal entity (private individual, legal person/company, trust, pension fund etc)
- Declaration of beneficial ownership for tax purposes (including whether the shares are part of a lending arrangement)
- Name of the shareholder's custody bank (and the recording custody bank, if applicable)[2]

The documentation of these data must be uploaded in connection with registration[3] and will thus be available for the tax authorities for the purpose of random checks etc.

When the tax authorities have received the required data, they will issue a unique tax identification number identifying the relevant shareholder and allowing relief at source at the tax rate resulting from the tax treaty with the relevant country and the reported data on type of shareholder etc. The grouping of foreign shareholders into tax rate pools (with VP etc) must reflect the tax rates assigned.

For shareholder types/legal entities entitled under the relevant tax treaty to a *tax rate lower than the "standard tax rate"* of the relevant country (for instance US pension funds), the Danish tax authorities must *pre-approve* the status of the shareholder[4]. The tax authorities can decide which data (and related documentation) are required for pre-approval of a specific shareholder type.

---

[2] Separate registration of custody banks with the Danish tax authorities, alternatively an agreement between a custody bank and the tax authorities, may be required. This will enable the tax authorities to exclude banks in jurisdictions with insufficient due diligence requirements and to terminate the collaboration with banks that make too many errors. Foreign banks can be potentially be identified by LEI code.

[3] The registration system of the Danish tax authorities may be designed so as to prevent conclusion of the registration and documentation process – and consequently issuance of an identification number – until all relevant data and documentation have been uploaded. It will later be specified how often the information needs to be renewed for particular shareholders.

[4] If the standard tax rate for ordinary shareholders under the relevant tax treaty is 15%, the Danish tax authorities must pre-approve shareholders that are entitled to a rate lower than 15%. If the standard rate of a tax treaty is 10%, the tax authorities must pre-approve shareholders entitled to a rate lower than 10%. In Malaysia, where the general standard tax rate is 0%, the tax authorities will in principle not have to pre-approve any shareholders, i.e.

As a result of such pre-approval, the strict liability of banks will *not* cover any changes to the tax authorities' assessment of the status (and consequently tax rate) of these shareholders in connection with a subsequent random check[5].

The strict liability of banks will, on the other hand, apply to all types of shareholders that have been assigned an identification number but do not belong to the group of shareholders that are subject to pre-approval. This means that if a subsequent random check reveals that relief at source was based on a tax rate that was too low, the issuance of a tax identification number will not exempt the banks from their liability to pay the outstanding amount of dividend tax.

When issuing identification numbers, the tax authorities must make every effort to minimise the risk of incorrect tax rates, for instance by defining separate requirements for different types of shareholders. Some types of shareholders may be subject to extended data and documentation requirements if there is doubt whether the entity constitutes the beneficial owner for tax purposes under Danish tax law. This may prove a particular challenge in connection with types of shareholders that should be deemed transparent entities under Danish law and therefore should not be assigned an identification number.
Detailed rules governing the *duration* of the validity of an issued identification number (and the related tax rate) should be laid down. Types of shareholders subject to pre-approval will generally have to be pre-approved every year. Other types of shareholders will be able to keep their identification numbers for a longer period of time, provided that their circumstances do not change.

If random checks reveal errors in the assumed tax rate, this should prompt a correction of the tax rate before the next dividend payment (a new identification number may have to be applied for). The same could be the case if documentation is not submitted in a timely manner for the purpose of a random check.

The model should therefore enable the regular exchange of information between the tax authorities and the banks on the validity of identification numbers or any changes to tax rates, so that any errors etc identified may be corrected

Note

September 6. 2018
Doc no FIDA-1244909148-13-v1

the liability of banks will apply to all shareholder types. This will generally apply to all countries or jurisdictions where the standard tax rate is 0%.

[5] As mentioned previously, pre-approval of certain types of shareholders by the tax authorities will not affect the strict liability of banks for transactions (such as the lending of shares) where the shareholder is not the beneficial owner for tax purposes.

before the pay date. This can be achieved by for example setting up a database, which is continuously updated, where the banks have access to look up identification numbers and their validity and status.

Distribution of dividend and submission of breakdown
On the *pay date*, dividends will be distributed to the individual custody accounts based on data provided by VP (or a foreign CSD recording Danish shares), subject to relief at source using the (assumed) final tax rate (based on the identification number system).

Dividend distribution and relief at source will be undertaken by the distributing companies (via their issuing agents), which will transfer the dividend tax withheld to the tax authorities and pay the dividends, net of tax, into the accounts of the account controllers with the Danish central bank from where the funds will be redistributed through the chain of banks to the accounts of the individual shareholders.

As a principal rule, all shareholders qualifying for relief at source will thus have their dividends – *net of final dividend tax* – at their disposal on the pay date (typically three business days from the date of the annual general meeting). Shareholders without an identification number will generally be subject to a 27% dividend tax.

After dividend distribution, the account controllers etc must submit a *breakdown* to the tax authorities of the shareholdings etc of individual shareholders. The breakdown will basically include:

- The identification number of the individual shareholder
- The shareholding (number of shares) of the individual shareholder, determined at the record date
- ISIN (identification of the distributing company)
- Distributed dividend (DKK) per share
- Pay date
- Number of relevant custody account with VP (or another CSD)

Data on shareholdings etc will be forwarded by the shareholder's custody bank up through the chain of banks to the account controllers. These data are required in order to make random checks.

If the data on shareholdings etc have not been received 45 business days from the record date[6], the liability of banks will be invoked, and the difference between the tax withheld on the pay date and 27% dividend tax must be paid to the tax authorities[7]. This includes shareholders that have been pre-approved by the tax authorities (pension funds etc). In these cases, subsequent correction is not possible. Liability will apply to the part of the specific tax rate pool where the tax authorities have not received information on the dividend distribution between shareholders by the deadline.

Selection of sample, submission of documentation and random checking
After expiry of the deadline for submission of a breakdown 45 business days from the record date, the tax authorities will select a *sample* – among the identification numbers for which dividend tax has been withheld at less than 27% – for the purpose of control. The tax authorities will set the sampling criteria based on the reported data, and sampling is expected to be completed within [5] days of the deadline for submitting a breakdown, ie [50] business days from the record date.

When the sample has been selected, the account controllers and the custody banks of the relevant shareholders (or the recording custody banks) will be notified of the selected identification numbers, and controlling will commence based on the documentation already uploaded to the tax authorities.

The tax authorities will always be entitled to request further documentation as part of a random check[8]. If the tax authorities find the documentation initially submitted inadequate, or they need documentation of other aspects, the shareholder's custody bank (or the recording custody bank) will receive a request from the tax authorities to submit adequate documentation within [60] business days (the relevant account controller will be notified at the same time).

[6] Banks may operate with a "soft" deadline of 15 business days or a "hard" deadline of 45 business days from the record date. If a breakdown for an identification number has not been received automatically within 15 business days, the shareholder's custody bank (and/or other liable banks in the chain) will have another 30 business days to forward the relevant data to the account controllers etc. After that time, the liability of banks will be invoked, without the possibility of additional corrections.

[7] Example: If a breakdown has been received for 95% of the dividends paid to a given tax rate pool, and data for the remaining 5% are still outstanding after 45 business days, the tax authorities will receive information about the 95% for the purpose of random checks, while the difference between the 27% dividend tax and the tax withheld on the pay date will be payable to the tax authorities. In case of a 15% tax rate pool, for instance, 12% would be payable for the part of the dividends for which no breakdown had been submitted.

[8] The tax authorities will prepare a catalogue with examples of aspects for which they may request detailed documentation, including examples of such documentation. However, it is not possible to make an exhaustive list of all possible documentation requirements, as they will depend on the nature of the aspects to be documented. This applies in relation to documentation in respect of the individual shareholder as well as the specific transaction.

If after this deadline – and potentially following a dialogue with the shareholder's custody bank or the recording custody bank – the documentation presented is still considered inadequate by the tax authorities, the shareholder's custody bank (or the recording custody bank) and the relevant account controller will be notified that the liability of banks will be invoked. In such a situation, the banks must pay to the tax authorities an amount corresponding to the difference between 27% and the tax rate applied on the pay date[9].

As the tax authorities complete their control in relation to the random checks, they will issue regular – e.g. monthly – reports of the random check results to the relevant account controllers and custody banks.

If the checks do not lead to any adjustments to the dividend tax, the matter will be closed, and the banks may write down their liability concerning the relevant tax identification numbers. However, if the checks indicate that relief at source of dividend tax should have been based on a higher tax rate (in principle, the opposite situation may also occur), the liability of banks will be invoked, and the account controllers must pay the dividend tax deficiency to the tax authorities, for instance by monthly settlement (or within a period of 30 business days).

The aim is to complete the processing of the vast majority of sample cases within a period of [6] months from the deadline for submission of a breakdown, i.e. about [7.5] months from the record date.

In complex cases where, for instance, additional documentation is required from the shareholder's custody bank, the tax authorities' administration may extend beyond this period, however. The tax authorities must submit a list of non-completed sample cases to the relevant account controllers within [8] months from the record date.

2. Correction option for trades conducted close to the annual general meeting
The relief at source model targets foreign shareholders that have identified themselves to the Danish tax authorities before the dividend pay date and have been assigned an identification number allowing them to pay dividend tax at a rate lower than 27%. Foreign shareholders that do not fulfil these conditions will generally have to pay dividend tax at a rate of 27%.

[9] As a general rule, shareholders not submitting documentation for control purposes must subsequently be placed in a 27% tax rate pool. If in connection with a subsequent dividend distribution the shareholder submits the documentation required to obtain a lower tax rate, the shareholder may be assigned to another tax rate pool, obtaining relief at source at the lower rate for that distribution.

To provide for dividend taxation at the correct tax rate (under the current tax treaty with the relevant country), also of foreign shareholders that did not have sufficient time to obtain a Danish tax identification number, the relief at source model will be supplemented with a *correction option*. In principle, the correction option is intended only for shareholders that are new to the Danish market and therefore have not previously been assigned an identification number.

The correction option implies that for a period after the dividend pay date, it will be possible to register with the Danish tax authorities and obtain an identification number, which can be used for subsequent correction of the dividend tax.

Registration with the tax authorities will, in line with relief at source, be the responsibility of the shareholder's custody bank (or a custody bank further up the chain of banks) and comprises the same data and documentation requirements – but supplemented with a statement of the intention to apply for a correction of dividend tax paid, as well as documentation for the dividend received in the form of a notice of dividend etc. The tax authorities will then issue an identification number to be used for submission of an application for correction (in principle, this number may also be used to obtain relief at source in connection with subsequent distributions of dividend).

For the correction option to be available, registration must take place within [4] months from the record date. This time limit has been set on the basis of the period required (according to available information) to obtain the relevant documentation, including especially a declaration of domicile.

The application for correction can only be submitted to the Danish tax authorities by the account controllers (and not directly by the shareholder or its custody bank). Specifically, the shareholder's custody bank (or the recording custody bank) will submit an application for correction accompanied by information about the shareholder's shareholding at the record date etc – corresponding to the information supplied in the breakdown for relief at source purposes – up through the chain of banks to the account controllers.

The account controllers collect these applications and reconcile the shareholdings stated therein to the custody accounts in which the shares were registered at the record date and on which dividend tax was withheld at a rate of 27%. This way, you avoid making a correction for a larger dividend amount (larger number of shares) than the amount on which dividend tax was actually withheld. This process must be completed within [6] months from the record date (ie correction applications must be received during that period), after which time the correction applications will be submitted to the tax authorities[10].

Generally, the tax authorities will then refund the difference between the (withheld) 27% and the tax rate assigned to the individual shareholder together with the identification number. The tax authorities may conduct random checks (and may in that connection withhold refunds) of a number of the correction applications based on the submitted documentation and may request additional documentation as needed. Refund will take place to the account controllers, which will pass on the dividend tax refund to the individual shareholders through the chain of banks.

In addition to the correction option outlined, the relief at source model should include the possibility of correcting *accidental errors* occurring in connection with the provision of data. Examples of what will constitute (and will not constitute) accidental errors will be prepared, and it will be specified which process should apply to the correction of accidental errors. A longer period may be allowed for the correction of accidental errors than for the general adjustment option.

3. Situations involving the lending of shares and conduit arrangements

It is a condition that steps be taken to ensure that dividend tax is levied on the beneficial owner of the dividend for tax purposes and that the tax rate assigned to this shareholder is used.

As regards the lending of shares, shares lent over the record date must be placed in a special pool subject to a 27% dividend tax and may not be placed in pools in which tax of less than 27% is withheld. The model assumes that, in connection with the assignment of an identification number, the shareholder must make a statement as to expected loans of shares at the record date. The model will include a possibility of adjustment in order to ensure that correct dividend tax is paid by the parties to a share lending arrangement so as to ensure levying of the correct, final dividend tax.

Other types of transactions, such as repurchase (repo) agreements, may also imply that the recipient of the dividend is not the beneficial owner for tax purposes. It should be considered how (or whether) these situations can be specified in more detail.

[10] Accompanied by data on the total number of shares in the relevant 27% tax rate pools.

4. Foreign CSDs and TARGET2 securities (T2S)

The selected model must be robust relative to the ongoing internationalisation of the CSD market and the commissioning of new systems for the settlement of securities trading etc within the eurozone. The distribution of dividends by Danish companies to foreign shareholders has traditionally taken place through VP, but in a number of situations foreign CSDs may be involved, and the model should allow for that as well.

First, a foreign CSD may set up operations in Denmark, registering Danish companies in line with VP. As the foreign CSD will have to meet the same requirements from the tax authorities as VP, this situation would basically not imply any special challenges in terms of model design.

Second, a Danish public limited company may register with a foreign CSD abroad (for instance, Euroclear in Sweden). In this situation, it is presumed that the foreign CSD will have to enter into an agreement with the Danish tax authorities on compliance with the necessary dividend tax requirements, including the collection of data for relief at source taxation through account controllers etc (in the same way that VP has to comply with the requirements of, say, the Swedish tax authorities if a Swedish company is registered with VP in Denmark).

Third, a Danish company registered with VP could choose to have its shares held in custody with a foreign CSD. In this situation, the custody structure in relation to T2S would imply some challenges, to which there seems to be a practicable solution, however.

On balance, no critical challenges to the model have been identified. But further investigations are warranted.