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TAX EXEMPTION FOR ENTREPRENEUR SHARES

Background

The Danish Parliament has, as a part of the Finance Act of 2011, passed a bill which will introduce an arrangement for entrepreneur shares resulting in that shares of entrepreneur companies (entrepreneur shares) can be sold without any taxation being implied if certain requirements are met. The bill will first become effective after it has been approved by the European Commission.

Requirements for Tax Exemption

Before the investment company can sell the entrepreneur shares without taxation being implied and receive tax exempted dividends, certain requirements shall be fulfilled. The requirements concern the company in which the shares are being issued (the entrepreneur company), the entrepreneur shares and finally the investment company respectively.

The requirements for the entrepreneur company and the entrepreneur shares appear from the Danish Capital Gains Tax Act and are:

- The shares shall be newly issued at market price.
- During any 12-month period, shares may not be issued at a market price exceeding DKK 18.7 million in the entrepreneur company. If the limit is exceeded, the shares which have been issued first will be regarded as entrepreneur shares.
- The entrepreneur company shall either be fully or partly tax liable in Denmark or be covered by the term "company" in the Parent-Subsidiary Directive.

- The entrepreneur company shall either be a so-called "small company" (employing 50 persons or less and have an annual revenue or a total annual balance not exceeding DKK 74.5 million and be at the initiator, start-up or expansion stage or
- A "medium sized company" (employing 250 persons or less and have an annual revenue not exceeding DKK 373 million or a total annual balance not exceeding DKK 321 million and be at the initiator or start-up stage.
- The entrepreneur company must not mainly carry on a business consisting of real property rental, possession of cash etc. or being in the shipyard, coal or steel industry.
- The entrepreneur company must not be crisis-torn according to the rules of the European Union governing this.
- The entrepreneur company must not receive any other kind of state aid with the same purpose from other sources.
- The entrepreneur company must not have issued listed shares.
- The entrepreneur company's lawyer or auditor shall ensure that the above-mentioned requirements are fulfilled.

The investment company shall fulfil the following requirements:

- The investment company shall either be fully or partly tax liable in Denmark or be covered by the term "company" in the Parent-Subsidiary Directive.
- The investment company may not be under deciding influence by the public.
- The investment company shall prove that the investment has profit as a goal and that the investment is being managed on a commercial basis. The investment can either be made directly or through a venture capital fund. The venture capital fund can e.g. be a limited partnership or a partnership and shall be managed on a commercial basis. What is meant by a venture capital fund is not described in the bill, but it is likely that the definition which will be used is the same as the one used in the preparatory work of the Corporate Tax Act.

The investment company can also be a distributing unit trust if all of its investors fulfil the requirements concerning tax liability and public influence.

Taxation of the Entrepreneur Shares

A profit from the sale of the shares will be tax exempt if the above described requirements are fulfilled, provided that the shares have been held for at least three years. An exception from this is that the sale will be tax liable in cases where the investment company or a company which is consolidated with it has had tax-deductible losses on other shares in the entrepreneur company in the same period, provided that the shares are not subsidiary or affiliated company shares.

Losses on the entrepreneur shares can be deducted in the income year's profits on shares which are being taxed due to the realisation principle.

Concerning the on-going taxation of the dividends, the bill prescribes that these will be tax exempt if the shares have been held for at least three years, provided that the dividends are paid out after the end of the three-year period. The dividends will be due to taxation if they are paid out before the end of the three-year period, provided that they are not subsidiary or affiliated company shares.

The investment company is obliged to use the realization principle when assessing profits or losses on the entrepreneur shares.

Further on the requirements for the entrepreneur company

As mentioned above, the entrepreneur company is required to be in a certain stage dependent on its size and economics. The requirement also applies to partnerships and associated companies.

Small companies

If the entrepreneur company due to its size and economics is within the limits of a ”small company”, it has to be at the initiator, start-up or expansion stage before the shares can be considered as entrepreneur shares.

The stages are described in the bill and are as follows:

- The initiator stage covers financing in connection with studying, estimating and developing a new concept in advance of the start-up stage.
- The start-up stage covers financing of product development and initiate marketing to companies which do not yet commercially sell their products and services and do not generate a profit.
- The expansion stage covers financing of growth and expansion of a company regardless of whether the company balances or generate a profit, in connection with an increase of the production capacity, market or production development or an increase of working capital.

Medium sized companies

If the entrepreneur company due to its size and economics is within the limits of a ”medium sized company”, it must be at the initiator or start-up stage before the shares can be considered as entrepreneur shares.

The effective date of the entrepreneur share arrangement

The arrangement must be approved by the European Commission before in can come into force due to the fact that the tax exemption for entrepreneur shares results in state aid.

It is therefore uncertain at which time the arrangement will come into force, but the Danish Ministry of Taxation states that it is expected to happen at the earliest in the fall of 2011.

The arrangement is intended to be effective for investments which are made on and after 1 January 2011. Approval by the European Commission is required.

Should you have questions or wish further information about the arrangement for entrepreneur shares, you are welcome to contact partner, adjunct professor Jakob Bundgaard (jbu@mwblaw.dk) or junior associate Kim David Lexner (kdl@mwblaw.dk).

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