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by Wendy Singer and Jérôme Delaurière

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HIGHLIGHTS

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by Wendy Singer and Jérôme Delaurière

After thinly veiled warnings by Denmark's government, followed by the Danish parliament's enactment of a law authorizing the government to terminate Denmark's tax treaties with France and Spain, the Danish Ministry of Finance on June 10 announced that the two treaties will be terminated effective January 1, 2009. (For prior coverage, see *Doc 2008-12962* or *2008 WTD 115-3.*)

The principal bone of contention that led to this relatively radical measure was Denmark's insistence on the right to tax Danish private pensions paid to retirees who have taken up residence in the Riviera or the Costa del Sol. But this news would be of little interest other than for the retirees concerned if the only consequence were a risk of double taxation of Danish private pensions paid to those taxpayers.

Terminating the treaty with France may have serious collateral effects on international investors who have structured their French real estate investments using Danish companies — a possible consequence that has not displeased the French tax authorities. When the protocol to the France-Luxembourg tax treaty came into effect on January 1, the Denmark-France treaty probably became the last treaty that allowed investors in French real estate a double exemption — both in France and in Denmark — for capital gains realized on the sale of French real estate held directly by a foreign company (provided the company has no permanent establishment in France to which the gain is effectively connected).

It is generally believed that it is still possible to achieve tax-free capital gains on the sale of shares of French companies owning real estate under the Luxembourg treaty (as amended) and others, such as the Belgian treaty, but because that does not normally provide a buyer with a step-up in basis, that exit approach is less attractive than the structure that was possible using a Danish company — until the repudiation of the treaty.

Accordingly, international investors who took advantage of the opportunity afforded by the Danish treaty to secure an optimal exit strategy from French real estate investments will have to consider reorganizing their existing structures before January 1, 2009. Failing that, capital gains realized by the investors' Danish companies on the sale of French real estate will be subject to French tax at the rate of 33-1/3 percent or even, in the case of transactions by a dealer, up to 50 percent.

While the loss of the opportunity afforded by the Danish structure for French real estate investors may be the most visible effect of the treaty's termination for international investors ultimately situated outside Denmark, other treaty provisions will also be missed, and risks of double taxation will arise as a result.

Because of the lack of an operative bilateral PE definition, a Danish company could be exposed to French corporate income tax as a result of having activities in France that would not rise to the level of a PE under most OECD model treaties. For example, under French domestic law, if a foreign company simply carries out a ''complete commercial cycle'' in France, that is sufficient nexus to trigger French corporate income tax liability.

While in principle Denmark does not tax its resident corporations on their income from foreign establishments as defined under Danish domestic law, Danish tax rules may not construe the ''complete commercial cycle'' in France as amounting to such an establishment.

Regarding dividends paid between France and Denmark, the treaty generously provided for a zero withholding tax rate without any minimum threshold requirement, and the EU parent-subsidiary directive will often provide similar protection from withholding tax. However, France's implementation of the directive contains an antiabuse requirement that may be more stringent than its interpretation of its tax treaties that do not contain a specific treaty-shopping provision. These types of issues might be resolved when a new treaty is negotiated between France and Denmark.

However, the window of opportunity for direct real estate investment by a foreign company will likely not be reopened.

The termination of the Denmark-France treaty is an unusual event — and hopefully will remain so — in international tax policy and politics. Some observers will remember the United States' termination in 1987 of its tax treaty with the Netherlands Antilles; 10 days

later, the U.S. Treasury Department found it necessary to reinstate a section on the withholding tax exemption for interest in order to stabilize the eurobond market. Argentina also terminated a tax treaty with Germany in 1973. To the authors' knowledge, however, in the case of France, this is the first time that the threat of termination of a treaty with another OECD member country has failed to result in a negotiated amendment of the treaty. And once the treaty is terminated, it is doubtful that the termination could be withdrawn following negotiation between the parties. At the least, it raises some nice questions of constitutional law.

It remains to be seen whether this strategy will be effective in helping Denmark achieve its aims. ◆

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