DENMARK

Energy Overview

Denmark stands as a global leader in renewable energy and sustainability, with a longstanding commitment to environmental preservation and carbon neutrality. The Danish Energy Agency's 2023 Energy Outlook report highlights Denmark's achievements and future goals in the energy sector, emphasizing the country's innovative approach to energy production and consumption.

Denmark is renowned for its pioneering role in wind energy, being home to some of the world's leading wind turbine manufacturers and a substantial offshore wind farm infrastructure. The country's investment in wind power has positioned it as one of the highest per capita producers of wind energy globally. Additionally, Denmark has made significant strides in solar energy, biogas, and other renewable sources, contributing to a diverse and resilient green energy portfolio.

The Danish government has set ambitious targets to become independent of fossil fuels by 2050, with interim goals to reduce greenhouse gas emissions by 70% from 1990 levels by 2030. This commitment is reflected in the country's comprehensive Climate Act, which mandates binding targets and regular progress assessments to ensure Denmark stays on track with its climate objectives.

In response to international developments and the European Union's Green Deal, which aims to reach climate neutrality by 2050, Denmark has accelerated its efforts to decarbonize its economy. The country has implemented a range of policies to encourage the adoption of electric vehicles (EVs), including tax incentives and substantial investments in charging infrastructure.

Denmark's focus on energy efficiency extends to the building sector, where stringent codes and retrofitting initiatives aim to reduce energy consumption in both residential and commercial properties.

Tax policy in Denmark supports the transition to a green economy, with carbon taxes and levies designed to incentivize reductions in carbon emissions. The government also provides funding and support for research and development in clean energy technologies, fostering innovation and positioning Denmark as a hub for green technology.

Denmark's approach to energy is holistic, integrating energy production, distribution, and consumption within a framework that prioritizes sustainability and climate action. The country's energy system is increasingly interconnected with those of neighboring countries, allowing for the exchange of renewable energy and enhancing regional energy security.

In summary, Denmark's energy landscape is characterized by a strong commitment to renewable energy, ambitious climate targets, and innovative policies that support a sustainable and carbon-neutral future. The nation's proactive measures in energy efficiency, green taxation, and technology development are key components of its strategy to achieve a fossil-free society by 2050, serving as a model for other countries pursuing a green transition.

Tax Overview

Denmark levies income tax on the world-wide income of individuals tax residents in Denmark. Companies are subject to a territorial tax system where income from permanent establishments and real estate located abroad are exempt from Danish taxes.

Individuals pay a progressive income tax on all forms of personal income, such as wages, pensions, and benefits. Denmark's tax system is divided into state income taxes, municipal taxes, and health contributions, all of which are combined to form the individual's total tax liability.

Companies in Denmark pay a flat 22% corporate income tax rate on their net taxable income.

The Danish VAT, known as "moms," is a general tax applied to most goods and services. As a member of the European Union, Denmark's VAT system is harmonized with EU regulations, ensuring consistency within the internal market. The standard VAT rate is 25%.

Denmark also imposes withholding taxes on certain payments to non-residents, such as dividends, interest, and royalties.

In addition, Denmark levies various environmental taxes and duties aimed at promoting sustainability and reducing the environmental impact of consumption and production.

Generally, Danish companies etc. must apply the arm's length terms and pricing for intercompany transactions. When determining arm's length Denmark overall follows the OECD Transfer Pricing Guidelines.

Danish companies must prepare and retain written documentation regarding the applied pricing and terms for intercompany transactions. However, special rules apply for companies which on a standalone basis or together with other (Danish or non-Danish) group companies have less than 250 employees and either have a total balance sheet of less than DKK 125m or revenues / turnover of less than DKK 250m. If so, written documentation should only be prepared for intercompany transactions with individuals and companies etc. that are domiciled in a country with no tax treaty with Denmark.

Taxation of Energy Projects

Ordinary corporate income taxes

Danish energy projects are often executed through a corporate entity providing a measure of limited liability to investors. In principle, both a Danish corporate entity may be used as well as a non-corporate entities, e.g., partnership. However, as non-corporate entities tend to be more tax compliance burdensome for the investors (as each investor will generally be seen as having a permanent establishment in Denmark and required to fill tax returns etc. in Denmark), then corporate entities tend to be the preferred alternative.

Danish entities are subject to mandatory joint taxation. Based on the joint taxation regime, each entity must prepare stand-alone tax returns, which are subsequently consolidated into a joint taxation return which is filed by the so-called 'administration company' (i.e., the parent company of the group). The administration company has the responsibility to settle the joint tax liabilities of the group with the Danish tax authorities. All entities within the joint taxation group are jointly and severally liable for corporate income taxes and withholding taxes of the group as long as the joint taxation group exists. Entities are deemed to be part of the same joint taxation group if the administration company holds the majority of voting rights in the entity, may appoint or remove a majority of the members of the senior body of the entity, or is able to control the entity in any other way.

Generally, under Danish tax law, a cost is tax deductible if i) the taxpayer claiming the deduction qualifies as the rightful bearer of a cost, and ii) the cost is incurred during the income year in order to obtain, secure and maintain the taxable income. However, there are three rules that may apply to limit the level of interest expenses (arising on both internal and external debt), namely:

- the thin capitalization rule applies where a company's related party debt (which include third party debt where such debt is guaranteed or otherwise secured by a related party) exceeds DKK 10m and the general debt-to-equity ratio exceeds 4:1);
- the interest ceiling rule (limits deductibility of net financing expenses if the expenses exceed a standard rate of return (FY2024 6%) on the tax value of certain qualifying assets), and
- the EBITDA rule (net financing expenses are limited in deductibility if the net finance expenses exceed the higher of DKK 22.3m and 30% of the debtor's EBITDA (earnings before interest, taxes, depreciation, and amortization)).

Special considerations may apply to debt where the creditor's claim against the debtor is restricted. Interest paid to non-resident creditors is generally not subject to withholding tax unless the creditor is closely related to the debtor, or the interest is "participating" (that is, calculated based on profits, revenue, etc.).

Solar plants and wind farms

Solar plants and wind farms which are driven on a commercial basis are taxed as ordinary companies.

Dividends paid to non-residents are subject to 27% Danish withholding tax.

The tax treatment of substantial investments in energy projects is contingent on the category of tax those expenditures fall under. Buildings, equipment, and machinery are typically "depreciable assets", with expenditures on these assets grouped into different classes based on the asset type and usage. Operating equipment and machinery including wind turbines solar cells, are depreciated at a rate of up to 25 percent annually.

However, fixed installations such as wind turbines with a capacity of more than 1 MW, acquired in income years starting on January 1, 2013, or later, are depreciated at a rate of up to 15 percent annually.

Oil and gas activities

The taxation of companies with income from the extraction of oil and gas is effected partly through the general corporate tax and supplementary corporate tax, and partly through the special hydrocarbon tax.

The corporate tax amounts to a total of 25 percent (22 percent corporate tax and 3 percent supplementary corporate tax), and the hydrocarbon tax is 52 percent. The corporate tax can be deducted when calculating the income subject to hydrocarbon tax, resulting in an effective tax rate of 64%.

Income from extraction is separately assessed for the calculation of corporate/supplementary corporate tax and hydrocarbon tax, resulting in two income assessments:

One for the calculation of corporate/ supplementary corporate tax.

One for the calculation of hydrocarbon tax.

In both assessments, the taxpayer can only deduct expenses related to the income from extraction activities, or expenses incurred for preliminary surveys and exploration in connection with the taxpayer's business from hydrocarbon extraction.

If a taxpayer subject to hydrocarbon tax has general costs or joint expenses, such expenses must be allocated between the two types of income.

Drilling rigs, production platforms, and other facilities for preliminary surveys, exploration, extraction, and refining of oil and gas are considered operating assets and machinery, and depreciation is allowed up to 15% annually on a declining balance. Pipelines etc. may be depreciated up to 7% annually.

A temporary tax incentive regime for oil and gas companies allows for increased depreciations of production assets subject to hydrocarbon tax to 20% and an uplift to 6.5% in six years (39% in total).

Taxation of Energy Projects

Further, hydrocarbon companies are entitled to deduct from their taxable income under the Hydrocarbon Tax Act the costs associated with the removal of decommissioning facilities, even after the cessation of hydrocarbon extraction activities. The Hydrocarbon Tax Act also includes a carry-back scheme, which allows companies to receive a payout of the tax value of unutilized losses related to removal costs deductions if the hydrocarbon extraction activities have ended. This scheme aims to place companies in a similar financial position as if the costs had been incurred while the activities were still profitable, thus compensating for the significant expenses that arise post-operations.

CO2 storage (Carbon capture)

On 1 July 2023, new Danish tax legislation came into force which modifies the existing carry-back scheme for companies using hydrocarbon facilities' usage, particularly concerning CO2 storage activities. Following this, companies are able to claim a payout of the tax value of the part of a final loss in hydrocarbon income that relates to deductions for removal costs, even if they choose not to decommission facilities maintained for CO2 storage activities.

Furthermore, the new legislation allows companies to claim the tax value of deductions for the removal of facilities used for CO2 storage activities once those facilities are eventually decommissioned. This two-stage application of the carry-back scheme ensures that companies are not deterred from engaging in CO2 storage due to potential loss of tax benefits.

Relevant Experience

Bech-Bruun has been involved in many of Denmark's largest and leading energy projects. Set out below is a description of some of our work.

- Assisted with M&A tax and other tax restructuring work for Danish and international companies. In the period between 2022-2023, we handled over 70 M&A deals.
- In 2023, we provided advice to a UK-based fund in connection with the establishment of a joint venture with a major Danish infrastructure company.
- In 2022, we provided tax advice to a foreign energy company in connection with the largest Danish biogas transaction.
- In 2022 and 2021, we provided continued tax advice to a major German acquirer of Danish solar plants.

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