



ICLG

The International Comparative Legal Guide to:

Alternative Investment Funds 2013

1st Edition

A practical cross-border insight into Alternative Investment Funds work

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Denmark

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Claus Bennetsen



1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

The principal legislation governing AIFs is the recently adopted Danish Alternative Investment Fund Managers Act (the “AIFMA”). The AIFMA governs primarily AIF Managers (“AIFMs”), although its provisions also apply to self-managing AIFs, and it provides some structural guidelines on the establishment and operation of capital funds that are AIFs. The AIFMs are subject to supervision by the Danish Financial Supervisory Authority (the “Danish FSA”), whereas AIFs are not. The legislation makes a distinction between AIFs licensed in an EU/EEA country (“EU/EEC-AIFs”) and AIFs licensed in a third country (“TC-AIFs”).

As regards the establishment and operation of closed-ended AIFs structured as limited liability companies, the Danish Companies Act (the “DCA”) applies besides the AIFMA.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

The AIFMA does not explicitly distinguish between managers and advisers. However, an extended authorisation is required to provide investment advisory services.

As regards Danish AIFMs, depending on the volume of assets under management, licensing or registration is a prerequisite for managing AIFs.

For EU-AIFMs licensed by competent authorities within EU/EEA which intend to manage Danish AIFs in Denmark, no licensing or registration is required with the Danish FSA, provided that the AIFMs are authorised to manage the particular type of AIFs. Such EU-AIFMs may initiate managing the AIFs, when the AIFMs have received a notification from their competent authorities stating that information has been forwarded to the Danish FSA for either direct managing or managing through branch. If the EU-AIFMs are simply registered with their competent authorities, and hence are not licensed to manage AIFs, they are not entitled to manage Danish AIFs.

TC-AIFMs must be licensed to manage AIFs in accordance with their Member State of reference. If Denmark is the Member State of reference, the licence must be obtained from the Danish FSA and the AIFMs will be governed by the AIFMA. If another EU country is the Member State of reference and the TC-AIFMs are licensed according to the AIFM regulation in this Member State, the TC-

AIFMs may start managing Danish AIFs when the AIFMs have received a notification from their competent authorities stating that information has been forwarded to the Danish FSA for either direct managing or managing through a branch of the AIFMA, provided that the TC-AIFMs are authorised to manage the particular type of AIFs in their Member State of reference.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

Danish capital funds (e.g. professional, special or restricted associations or hedge funds) are required to be registered with the Danish Business Authority. Such capital funds, which meet the conditions for being AIFs, are required to be licensed or registered with the Danish FSA only if they are self-managing AIFs.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds) and if so how?

The AIFMA distinguishes between open-ended and closed-ended AIFs in relation to cash management. The AIFMs are required to have and utilise appropriate cash management systems and procedures to control the AIFs cash risk, except when the AIFs are closed-ended and do not use gearing.

The AIFMA requires AIFMs of open-ended AIFs or AIFs to undertake stress tests if they use gearing. The results of these tests shall form part of the risk assessment of the AIFs and shall be used to clarify the appropriate cash management system and control procedures. The AIFMs must ensure that the AIFs maintain cash resources to meet redemptions to the extent AIFs are obliged to redeem.

1.5 What does the authorisation process involve?

AIFMs to be licensed in Denmark must satisfy the conditions set forth in the AIFMA, including certain requirements on capital, management (including fit and proper tests, experience, reputation), etc. The initial capital required is EUR 125,000 for AIFMs and EUR 300,000 for self-managing AIFs. The application for authorisation must contain information on the AIFMs and the AIFs, which the AIFMs intend to manage. TC-AIFMs applying for a licence in Denmark must add to the application further documentation as required by the AIFMA.

Within three months after the filing of a complete application, the Danish FSA will notify an applicant in writing, whether

authorisation has been granted. This time-limit may be extended by three months if the Danish FSA finds it necessary due to the circumstances (for TC-AIFMs the time-limit is postponed with the period ESMA spends on certain statutory evaluations). The AIFMs may initiate managing AIFs in accordance with the application when the licence has been granted.

As regards licensed EU-AIFMs, or TC-AIFMs which are licensed according to the AIFM regulation in another Member State of reference within the EU, reference is made to question 1.2 above. The documentation to be submitted to the Danish FSA is: i) an operating plan describing the AIFMs services; ii) specification of the AIFs which the AIFMs plan to manage and, when managing through a branch; iii) the organisational structure of the branch; iv) the address in the AIFs home country from where documents may be requisitioned; and v) names and contact information for the persons responsible for the management of the branch.

1.6 Are there local residence or other local qualification requirements?

TC-AIFMs applying for a licence to manage AIFs in Denmark must ensure that: i) appropriate co-operation agreements exist between the Danish FSA and the competent authorities in the home states of the AIFs; ii) the third country, in which the TC-AIFM has its registered office, is not registered as a non-cooperative country; iii) the third country has an agreement with Denmark, which complies with the standards in section 26 of the OECD Model Tax Convention; and iv) the supervisory functions of the Danish FSA as provided in the AIFMA are not restricted by any TC-regulation, administrative provisions or practices.

Additionally, TC-AIFMs applying for a licence to manage AIFs in Denmark are required to have a legal representative, established in Denmark, who possesses the competencies and resources to ensure that the AIFM complies with the AIFMA. The legal representative is the point of contact for the AIFMs towards the Danish FSA, other competent authorities within EU/EEA, investors within EU/EEA and ESMA.

1.7 What service providers are required?

Danish AIFMs must ensure that a custodian is selected in compliance with the AIFMA for each AIF under management. Furthermore, each AIF and the AIFMs are required to have a certified auditor. As regards TC-AIFMs, reference is made to question 1.6 above for the requirement of a legal representative.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

AIFs may be limited liability companies (A/S, ApS), limited partnerships (K/S), limited partnership companies (P/S) or capital funds. The main principle in relation to companies limited by shares is that the shareholders are liable only to the extent of their contribution to the company.

P/S and K/S companies are transparent companies, which means that taxation takes place with each investor based on each investor's ownership share. Thereby, a tax loss/deduction is set off in the investors' personal income. Unlike K/S companies, P/S companies are subject to the procedures and requirements under the DCA.

2.2 Please describe the limited liability of investors.

As noted, the main rule is that investors' liability is limited to the amount invested. In cases where capital to the company need not be paid in full, such as ApS, A/S, K/S and P/S companies investors may be required to pay the residual capital (the callable capital) if needed for a proper operation of the company. Furthermore, the investors could lose their limited liability by agreements, e.g. by guaranteeing for the company, or - in the case of active investors - by becoming liable to the company or its creditors according to the general principles of tort law.

An investors' ability to participate in the management of AIFs is covered by the AIFMA and the DCA, which include no statutory restrictions. In general, AIF managers must have a good reputation, sufficient experience to hold their positions and be capable of ensuring a sound and proper operation of the AIF. Furthermore, the AIFMs must ensure that reasonable steps are taken to prevent conflicts of interests, e.g. between the AIFM, including its managers, and the AIFs managed by the AIFM or the investors in those AIFs.

Foreign AIFMs must comply with other sections of the AIFMA, which, however, imply no further restrictions on an investors' ability to participate in the management of AIFs.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

Danish-licensed AIFMs must be structured as legal persons according to the DCA, i.e. as limited liability companies or limited partnership companies. Limited partnership companies will often be preferable due to tax transparency, as stated above in question 2.1.

EU-AIFMs are allowed to manage AIFs either directly or through a branch in Denmark. If the AIFMs want to establish a branch, the DCA applies and requires the branch to be registered with the Danish Business Authority. Otherwise, the AIFMD simply requires the EU-AIFMs to be legal persons.

TC-AIFMs which have Denmark as their Member State of reference must hold the legal structure of a limited liability company.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

No, with the exception of section 36 of the Danish Contracts Act stipulating the possibility to modify or setting aside - in whole or in part - any contract term considered unreasonable. The Danish FSA may, in addition, lay down rules on the mandatory cash management systems and redemption policies.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

There are no legislative restrictions on the transfers of investors' interests in AIFs. Such restrictions may, however, be imposed by the funds' articles of association or in contractual terms.

3 Marketing

3.1 What legislation governs the production and offering of marketing materials?

Besides the AIFMA, the Executive Order on Marketing Carried out by Foreign Investment Undertakings in Denmark (the "MFIU") and

the Danish Marketing Act (the “DMA”) regulate the marketing of units or shares in AIFs.

EU-AIFMs, which are licensed to manage AIFs in accordance with the AIFMD, are holders of a marketing passport. Such AIFMs may initiate marketing of EU-AIFs (including Danish AIFs) towards professional investors in Denmark, when the AIFMs have received a notice from the competent authorities in the home state declaring that a notification letter and a statement have been submitted to the Danish FSA. Marketing of TC-AIFs may be initiated, when the AIFMs have been notified that a complete application and a statement have been submitted to the Danish FSA.

EU-AIFMs which are only registered with their competent authorities, and hence are not licensed to manage AIFs, do not have a marketing passport. Such AIFMs are not entitled to market units or shares in Denmark, whether towards professional or retail investors, unless specific authorisation is granted by the Danish FSA.

TC-AIFMs which are licensed (hold a marketing passport) in another EU Member State as managers of the types of AIFs, which the AIFMs plan to market in Denmark, may initiate marketing when the AIFMs have been notified by the competent authorities in the Member State of reference that a complete application and a statement have been submitted to the Danish FSA. As regards marketing of TC-AIFs, some more stringent requirements must be met, e.g. appropriate cooperation agreements must exist between the Danish FSA and the competent authorities of the TC-AIFs home state.

TC-AIFMs which do not hold a marketing passport may obtain a special authorisation by the Danish FSA to market units or shares in the managed AIFs towards Danish professional investors, depending on the AIFs being EU- or TC-AIFs. Further conditions to be met by TC-AIFMs to obtain the marketing authorisation include requirements on annual reports, investor information, disclosures to the Danish FSA and co-ordination agreements between the Danish FSA and the competent authorities in the AIFMs’ home state.

3.2 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

The content requirements for marketing materials on each AIF marketed by AIFMs can be found in the AIFMA, which loyally implements the AIFMD. Key items are information on the AIF’s investment strategy and objectives, asset investment specifications, the AIF’s historical performance, fees and costs, leverage permitted, identification of the AIFM, custodian, auditor and other service providers, etc.

Content requirements may be stricter when units or shares are marketed towards retail investors, e.g. some key investor information may be provided. We further notice that in case of an overlap between the AIFMA requirements and the prospectus directive only the information not included in the prospectus needs to be published.

3.3 Do the marketing or legal documents need to be registered with or approved by the local regulator?

Marketing must be notified to the Danish FSA by the competent authorities of the AIFMs, as specified above in question 3.1. The Danish FSA has 20 working days to verify the content of the notification and to inform - in writing - the authorities in the AIFM’s home state in this regard.

TC-AIFMs marketing foreign AIFs with Denmark as the Member State of reference utilising the marketing passport are required to provide the FSA with all content included in the marketing materials. The same applies to Danish AIFMs, who wish to market foreign AIFs in Denmark.

3.4 What restrictions are there on marketing Alternative Investment Funds?

Besides the restrictions set forth above in questions 3.1 to 3.3 and below in question 3.5, the AIFMs may not apply misleading or incorrect statements or withhold substantial information if this is capable of distorting customer behaviour.

3.5 Can Alternative Investment Funds be marketed to retail investors?

The marketing of AIFs is allowed only towards professional investors. The Danish FSA may, however, grant permission for marketing one or more AIFs towards retail investors to AIFMs licensed by the FSA or to foreign AIFMs licensed according to rules implementing the AIFMD. Neither Danish nor foreign AIFMs which are only registered may obtain a licence to market towards retail investors.

Stricter marketing procedures and content requirements may apply when marketing towards retail investors.

3.6 What qualification requirements must be carried out in relation to prospective investors?

The AIFMs must ensure that the AIFs are offered only to professional investors; that is investors who possess the experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs as set forth in the MIFID Directive. In this respect, a simple warning on a webpage is not sufficient.

3.7 Are there additional restrictions on marketing to public bodies such as government pension funds?

No. Pension funds may invest in AIFs in accordance with the Danish FBA which sets out requirements as regards the articles of association of the capital funds, in which pension funds are allowed to invest.

3.8 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

Yes, the brokering of any securities is subject to having a brokerage licence either in Denmark or validly passported into Denmark from another EU/EEA country. Acting as an introducer also requires a brokerage licence.

3.9 Are there any restrictions on the participation by financial institutions in Alternative Investments Funds (whether as sponsors or investors) arising from the 2008 financial crisis?

No, there are not.

4 Investments

4.1 Are there any restrictions on the types of activities that can be performed by Alternative Investment Funds?

In principle, there are no restrictions but if the activities do, in effect, amount to activities that require a licence such as e.g. discretionary portfolio management, such activities would not be permitted.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio whether for diversification reasons or otherwise?

Generally no. However, the Danish FSA may lay down further rules on what securitisation positions can be included in an AIF's portfolio. If an AIFM is licensed to perform discretionary portfolio management, it is not permitted to invest all or part of the client's portfolio in units or shares of the AIFs it manages, unless approved by the client.

4.3 Are there any restrictions on borrowing by the Alternative Investment Fund?

No. The only limitations as regards borrowing are that AIFMs are obliged to stipulate proper individual leverage limits for each AIF it has under management. Note that in the event of leverage above 4:1, interest tax deductions may not be permitted.

5 Disclosure of Information

5.1 What public disclosure must the Alternative Investment Fund make?

Unless the AIFs are self-managing, AIFMA does not require any public disclosures from the AIFs but from the AIFMs.

The AIFMs are obliged to disclose information to its AIF investors on a regular basis regarding leverage and specifically, information about the percentage share of illiquid assets, new arrangements for controlling the AIF's liquidity and the AIF's current risk profile and risk controlling systems. Furthermore, the AIFMs must inform AIF investors and other relevant parties of potential conflicts of interest.

The Danish Business Authority may stipulate rules governing the AIFM's duty to disclose information based upon the Danish FSA's evaluation of the AIFM.

The AIFMs are required to publish on their website any supervisor reactions/statements made to them by the FSA.

5.2 What are the reporting requirements in relation to Alternative Investment Funds?

Unless the AIFs are self-managing, AIFMA does not require any annual reports from the AIFs but from the AIFMs. The reporting provisions require the AIFMs to make available an annual report no later than six months following the end of the financial year. The annual reports shall be prepared in accordance with the accounting rules and standards in the AIFs' home state and must be audited by an authorised auditor.

The AIFMs are further obliged to report to the Danish FSA on a regular basis. Those reports shall contain information on the AIFM's most important markets and the instruments used in the

portfolio management as well as information on substantial risk exposures and concentrations for each AIF managed. At the end of each quarter, the AIFMs shall, if requested, submit to the FSA a list of the AIFs under management.

For all EU-AIFs individually, the AIFM must submit information covering, *inter alia*, the current risk profile and the market risk controlling systems, specifications on the important asset categories in which the AIF has invested, the results of the appropriate stress tests, all new arrangements for controlling the liquidity and the percentage share of illiquid assets.

Furthermore, the AIFM must make available to the FSA certain information in the event an AIF acquires control over a non-listed company. The same applies to AIFs which use substantive leverage.

5.3 Is the use of side letters restricted?

No, there are no restrictions on the use of side letters. The AIFMA, however, stipulates that no investors in the AIFs shall obtain preferential treatment, unless such treatment is disclosed in the relevant AIF's articles of association or fund provisions.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds?

Resident AIFs, and non-resident AIFs having their effective management in Denmark or carrying on business activities through a permanent establishment in Denmark, are taxed in accordance with the Danish Corporation Tax Act at a flat corporate tax rate of 25 per cent (expected to drop to 22 per cent). The effective rate is, however, less – as business expenses and depreciation are tax-deductible.

Open-ended funds that comply with a complex system may avoid taxation of funds distributed. No foreign funds have as yet qualified for this exemption.

An important distinction in relation to taxation is whether the fund is structured as a taxed or a tax transparent entity. Resident investors in taxed funds will be taxed on gains at realisation at rates of 15.3 per cent for pension funds (whether managed by life insurance companies or individually), 25 per cent for companies (expected to drop to 22 per cent) and 43.5 per cent for individuals (dropping to 42 per cent in 2014). Non-resident investors will be taxed in their home country on gains while dividends may be subject to a withholding tax of 27 per cent which is often reduced or eliminated in double taxation treaties, resident as well as non-resident investors in tax transparent funds will be taxed in Denmark on an on-going basis on the type of income (capital gains, dividends, financial instrument gains, etc.) that the fund generates and at the rates indicated above.

6.2 What is the tax treatment of the principal forms of investment manager / adviser?

Resident AIFMs, and non-resident AIFMs having their effective management in Denmark or carrying on business activities through a permanent establishment in Denmark, are taxed at a flat corporate tax rate of 25 per cent (expected to drop to 22 per cent). The effective rate is, however, less – as business expenses and depreciation are tax deductible.

Branches of foreign companies located in Denmark are taxed on trading income and capital gains arising on disposal of trading assets situated in Denmark at a flat corporate tax rate of 25 per cent. Thus, branches are generally subject to double taxation in both Denmark and abroad, unless avoided by double taxation agreements.

Partnerships are transparent for tax purposes, meaning that only the partners are subject to tax and consequently that tax loss/deduction is set off in the investors' personal income.

Representation offices are not subject to taxation and shall not be registered for corporate purposes as long as they are not actually trading.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

Denmark levies no capital duties, share transfer taxes, nor wealth taxes (except on real property). Denmark has an extensive network of double taxation agreements and the Danish transfer pricing legislation is in accordance with the OECD guidelines.

6.4 What is the tax treatment of (a) resident and (b) non-resident investors in Alternative Investment Funds?

An important distinction in relation to taxation is whether the fund is structured as a taxed or a tax transparent entity. Resident investors in taxed funds will be taxed on gains at realisation at rates of 15.3 per cent for pension funds (whether managed by life insurance companies or individually), 25 per cent for companies (expected to drop to 22 per cent) and 43.5 per cent for individuals (dropping to 42 per cent in 2014). Non-resident investors will be taxed in their home country on gains while dividends may be subject to a withholding tax of 27 per cent which is often reduced or eliminated in double taxation treaties resident as well as non-resident investors in tax transparent funds will be taxed in Denmark on an on-going basis on the type of income (capital gains, dividends, financial instrument gains, etc.) that the fund generates and at the rates indicated above.

In general, Danish companies may pay dividends to other foreign companies free of any withholding taxes, if the shares in the distributing company qualify as subsidiary shares or group shares and the foreign company is domiciled in an EU/EAA country or another state with which Denmark has concluded a double taxation agreement, and the receiving company is able to claim a reduction of the taxation on dividends under a tax treaty or under the EU Parent Subsidiary Directive. If the shares in the distributing company qualify as portfolio shares and the receiving company is domiciled in a country with which Denmark has an agreement

under which the countries are obliged to share information regarding the taxation, the withholding tax is 15 per cent. Otherwise, dividends are subject to 27 per cent withholding tax.

As regards capital gains on shares for corporate shareholders taxes are exempted provided that the shares are group shares or subsidiary shares. Other capital gains for corporate shareholders are taxed at the corporate tax rate of 25 per cent. This gain is taxed annually on a mark to market basis. For shares not traded on a regulated market the taxpayer may, however, opt for taxation on a realisation basis.

6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

No, it is neither necessary nor advisable to obtain a tax ruling from the Danish Tax Administration (SKAT) or the Danish Tax Assessment Council. Nonetheless, if desired, a binding ruling from the tax authorities may be obtained against a fee.

6.6 Are there any other material tax issues?

It is noteworthy, that losses may be carried forward indefinitely up to certain thresholds, and that losses on shares can be set off only against gains on other shares if the shares are qualified as portfolio shares.

Investors holding units or shares in AIFs via pension schemes are taxed at a rate of 15.3 per cent on the return pursuant to the Danish Pensions Tax Act.

7 Reforms

7.1 What reforms (if any) are proposed?

No reforms are proposed at present, though the Danish Minister of Business and Growth and the Danish FSA are authorised to lay down further rules and guidelines relating to the AIFMA.

Note

By Alternative Investment Funds ("AIFs") we presuppose the definition as set forth in Article 4 of the AIFM Directive, that is any collective investment undertaking, which raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors, and which does not require authorisation as a Danish UCITS in accordance with the Danish Investment Associations Act (the "DIA").

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Claus Bennetsen (b.1964) is specialised within banking and finance law. Claus has more than 20 years of law firm experience advising banks, financial institutions and their customers about financing and reorganisation, including acquisition finance, financing of real estate portfolios and other major assets like windturbines, and preparation of standard documentation for financial institutions. Claus benefits in this respect from Horten's membership of the Loan Market Association (LMA) where he is a regular participant in seminars.

Claus has special knowledge of and wide experience in the structuring of cross-border financial transactions. He also provides advice within fund management to, *inter alia*, Danish and foreign fund managements, investment funds, hedge funds etc., and he also advises on the regulation of the financial sector, including on the establishment and operation of stockbrokers in particular.

Claus is also an active advisor for the Danish subsidiaries of foreign groups and for a number of production, service and trade companies which he has often assisted in relation to acquisition or establishment.

HORTEN

Horten is one of the five largest law firms in Copenhagen and offers a full range of legal services. The investment funds practice has many years of in-depth experience advising foreign funds and their managers on their activities in the Danish market and advising the pension fund industry in Denmark on its fund management contract. The group undertakes both regulatory and contract work.

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