



# Mark-to-market taxation of real estate – an initial presentation



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**On 10 October 2020, the Social Democratic Party, the Danish People's Party, the Socialist People's Party, and the Red-Green Alliance agreed on an early-retirement pension scheme, of which a part is to be funded by mark-to-market taxation of the value of real estate owned by companies. The mark-to-market taxation will take effect as from 2023 and is expected to inject annual revenue of DKK 850m into the public purse, based on a total real-estate portfolio value of approx. DKK 350bn and an annual value increase of 2.2%.**

Mark-to-market taxation counters the present possibility whereby taxation of gains from the sale of real estate can be avoided by transferring properties through transfer of shares. Moreover, mark-to-market taxation also provides for taxation at an earlier stage, i.e. before realisation, whereby the public purse obtains revenue as early as from 2023. Other countries have different schemes concerning taxation upon the sale of shares in companies that own real estate, but such taxation gives rise to a number of issues, for instance as to the value of the properties in proportion to the total value of the company to consider the company a 'property company'.

Below is a presentation of the preliminary principles of the mark-to-market taxation based on the agreement wording, questions to and answers from the Danish Minister for Taxation, accompanied by our comments and assumptions.

## Mark-to-market taxation principle

Mark-to-market taxation of real estate will imply that any increase in the value of properties owned by companies will be regularly taxed in a way which is similar to how pension providers are taxed today.

Any real estate purchased for pension-fund assets by pension providers etc. is covered by section 15 of the Danish Pension Returns Tax Act by which capital gain or loss on real estate is calculated as the difference between the value of the said property at the end of the income year and its value at the beginning of the income year (the mark-to-market taxation principle (corresponding to the market-value principle used in accounting)). If the property was purchased during the income year, the gain or loss is calculated as the difference between the value of the said property at the end of the income year and the purchase price (converted to a cash value plus the transaction costs). If the property was sold during the income year, the gain or loss is calculated as the difference between its selling price (converted into a cash value less transaction costs) and its value at the beginning of the income year.

## Valuation

The precise valuation model is to be laid down in connection with the pre-legislative work. The Minister for Taxation has, however, communicated that the intention is that, at the end of each year, companies must determine the current open-market value of each property according to applicable accounting standards, using a model similar to the one applied by pension providers today.

The Danish Pension Returns Tax Act is silent on the values that are to underlie the annual valuations. Generally, pension providers etc. must, however, present their financial statements according to market-value principles. This means that assets and liabilities must be recognised at their current fair value, stating the market value (open-market value) of each individual property. This corresponds to the principle to be applied by companies that measure investment properties at current value in pursuance of section 38 of the Danish Financial Statements Act.

## Deductibility

As regards deductibility, the Minister for Taxation has communicated that the natural practice concerning mark-to-market taxation will be that future losses are deductible. Furthermore, it is stated that it will be possible to deduct losses etc. from other parts of a group in joint taxation. The principle of deduction in the event of a decline in value can already today be found in section 9(2) of the Danish Capital Gains on shares Tax Act in cases where shares are subject to mark-to-market taxation.

The precise definition of deductibility in the event of a sale at a loss or a decline in value is to be laid down in connection with the pre-legislative work.

## Companies and properties covered

Mark-to-market taxation is to apply to companies etc. that are covered by Danish general corporation taxation. As a result, the taxation is not to apply to personally owned businesses. Furthermore, the Minister for Taxation has communicated that co-operative housing associations and non-profit housing associations will be exempt from mark-to-market taxation.

Mark-to-market taxation will primarily cover rental properties, while properties which the company or group mainly uses for its own operations, including for the purpose of administration, storage, production, etc., are exempt from mark-to-market taxation.

## Minor property portfolios and the group concept

A threshold of DKK 100m will be introduced, so that groups holding minor property portfolios are exempt from the mark-to-market taxation.

In this connection, we assume that a "group" will be defined in the same way as is the case within joint-taxation rules, meaning similar to the corporate-law definition, which states that if a company has a controlling interest in another company (a subsidiary), such construction constitutes a group, and that two companies, both owned by one company having a controlling interest, are deemed to be affiliated. On that basis, properties directly or indirectly owned by the same parent company and of which the total maximum value is DKK 100m will be exempt from mark-to-market taxation. However, we assume that such minor property portfolios are to be covered by the mark-to-market taxation if, at the end of the income year, their total value exceeds that threshold.

## Commencement and entry value

The mark-to-market taxation will be introduced with effect from 2023. The Minister for Taxation has communicated that the precise model for entry values and transitional provisions is to be laid down in connection with the pre-legislative work, however, the intention is that gains ascertained (but not yet realised) at the time when the mark-to-market taxation comes into force are not to be subject to mark-to-market taxation. Therefore, it can be assumed that only value increases ascertained after 1 January 2023 will be subject to taxation.

The Minister further communicated that the entry values forming the basis of the taxation must be fixed in connection with the introduction of the mark-to-market taxation, i.e. in 2023, meaning that a subsequent value increase compared to the entry value will then be taxed. The entry value is to be fixed in the same way as the regular annual valuation. We assume that a company may decide to make a specific determination of the market value in connection with the transition to mark-to-market taxation, irrespective of the principle applied so far in its annual report.

Based on the information available, property companies will benefit from carrying out renovation and construction prior to the introduction of the mark-to-market taxation in 2023, so that the entry value of the properties is as high as possible.



The introduction of the mark-to-market taxation is expected to have a major impact on the real estate market, including in particular the market for transactions concerning property companies and the activity level within renovation and construction.

Should you wish to discuss the proposed mark-to-market taxation and the options for property companies in this connection, please do not hesitate to contact us.

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