

Norwegian Government proposes introduction of withholding tax on interest and royalties paid to nonresident related parties

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Executive summary

On 27 February 2020, the Norwegian Ministry of Finance (the Ministry) issued a public consultation paper regarding the introduction of withholding tax (WHT) on interest, royalty and certain lease payments to related parties.

For interest, the WHT will apply only for payments to related parties that are tax resident in a low-tax jurisdiction. For royalty, WHT will apply to all payments to related parties, regardless of whether they are resident in a low-tax jurisdiction.

The proposed tax rate is 15% on the gross amount. An optional net taxation regime is included for companies that are tax resident within the European Economic Area (EEA), provided that they qualify as actually established and carrying out genuine economic activities within the EEA.

Note that this Alert only describes the new proposed rules. However, they will need to be applied in accordance with the tax treaties entered into by Norway.

The Ministry proposes that the rules shall be effective from 1 January 2021. Comments to the proposal must be submitted by 27 May 2020.

Detailed discussion

Interest

Interest payments to related parties, including the interest element embedded in financial lease payments, made from Norwegian payers that are taxable under domestic tax law, would, under the proposal, be liable to WHT if the recipient meets the following conditions:

- ▶ Resident in a low-tax jurisdiction
- ▶ Not a Norwegian branch of a foreign company, which is subject to Norwegian taxation

The Norwegian taxpayers that are required to impose and pay WHT on interest payments to related parties include companies resident in Norway and Norwegian partnerships. Norwegian branches of nonresident companies will also be required to impose WHT on interest payments, provided that the loan and the corresponding payment is attributable to such branch.

The term low-tax jurisdiction is to be interpreted in line with the controlled foreign company (CFC) rules. This means that the interest WHT will apply if the recipient is resident in a country that generally has an effective tax rate below two-thirds of the general effective tax rate in Norway. If the recipient is qualified for any special tax regime, this regime must be compared to similar tax regimes in Norway.

The current interest deduction limitation rule will continue to apply. For background on the current rule, see EY Global Tax Alert, [Norwegian Government issues 2020 Fiscal Budget](#), dated 21 October 2019. Payments that are not deductible according to such rules will also be subject to WHT in Norway.

Royalties

Under the proposal, WHT will be levied on payments to nonresident related parties for the use of intellectual property rights (IPR), including copyrights, patents and patterns, as well as trademarks, licenses, know-how and trade secrets.

Since the scope of royalty taxation will be limited to the use of IPR, payments for services where IPR is used by the service provider to provide the service, will not be included in the royalty definition. The proposal does not specify how mixed contracts with e.g., a license and a service component will be treated.

The obligation to impose and pay WHT will apply on payments made by Norwegian companies and partnerships. Norwegian branches of foreign companies will also be required to impose and pay WHT on royalty payments.

Lease payments - tentative proposal

The Ministry is considering introducing WHT on lease payments to related parties for ships, rigs, airplanes and helicopters.

Lease of assets that are qualified under the Norwegian tonnage tax regime will not be subject to WHT. This exception will also apply to the embedded interest element in financial lease payments for such assets.

Payments for assets that are present in Norway and thus already taxable for the recipient will not be subject to WHT.

Payments that qualify under the special rule for international shipping and oil field services will not be subject to WHT.

Related-party definition

The proposed WHT on interest, royalties and certain lease payments will apply only if the parties are related. The related-party definition is aligned with the rules on transfer pricing disclosure and interest limitation rules. This means that payments will be liable to WHT if the payer and recipients are directly or indirectly under the same ownership and control by at least 50% at any time during the income year.

By limiting the WHT liability to payments to related parties, the WHT will not apply to interest payments on external loans and listed bonds, which would otherwise have implied a significant increase in the compliance burden for nonresident lenders.

Recipients in the EEA - net taxation option

To avoid a potential violation of Norway's obligations under the EEA Agreement, recipients within the EEA will be entitled to opt for a net taxation regime, both for interest and royalty payments. Under this alternative taxation method, the recipient may choose to submit a corporate income tax return and claim deductions for relevant costs. To be considered relevant costs, the Ministry states in relation to royalty income on licenses, that costs related to the licensing of the IPR in Norway are relevant, but development costs are not.

The option of net taxation will only be available to recipients that are considered genuinely established and carrying on genuine economic activities in the EEA, similar to the qualification for the dividend exemption method. If the recipient opts for the net taxation method, the ordinary tax rate will apply (currently 22%).

Tax treaties

Since Norway traditionally has not levied WHT on interest and royalties, many of Norway's tax treaties prevent Norway from levying WHT. The Ministry comments that in future tax treaty negotiations, Norway's position will be to allow for the taxation of WHT on interest and royalties by the source state.

Administration and liability

The payers are liable for deducting and reporting the WHT. The withholding amount will be based on the gross rate of 15%. There is no proposal for a reduced withholding if the recipient opts for net taxation. However, if the recipients opt for and is qualified for net taxation, the withheld tax will be credited against the final tax.

The proposed deadline for paying and reporting the WHT is seven days after the payment was made.

If the tax authorities conclude that the withheld tax is insufficient, the payer can be held liable for the unpaid amount, unless they can document that the under-withholding was not due to negligence or a lack of due care from the payer or someone in the payer's service.

Impact

The proposal implies a broadening of the Norwegian tax base to taxpayers and income that has previously not been subject to tax in Norway.

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