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Global Tax Alert

Norway proposes 15% withholding tax on interest, royalty and certain lease payments to related parties tax resident in a low-tax jurisdiction

Executive summary

In the Norwegian Ministry of Finance's (the Ministry) proposal for the 2021 State Budget published on 7 October 2020, the Ministry introduced a 15% withholding tax (WHT) on interest, royalties and certain lease payments to related entities resident in a low-tax jurisdiction. If passed, the effective date would be 1 July 2021.

This WHT may be reduced or exempt under the provisions of a tax treaty entered into by Norway or when the recipient is a company that is actually established and carrying on genuine economic activities within the European Economic Area (EEA).

The proposal still must be approved by the Norwegian Parliament. However, as it has already been subject to public comments[1] and there is broad political consensus in support of the purpose of the proposal, it is expected to be approved as proposed.

Detailed discussion

Purpose and scope of the rules

The main purpose of the proposed rules is to counteract base erosion and profit shifting (BEPS). According to the Ministry, the proposed WHT is a necessary addition to the current Norwegian tax regime, which already includes transfer pricing rules and interest deduction limitation rules. In order to limit the effect of the rules to arrangements where the BEPS risk is higher, the WHT will apply only on payments to related parties that are tax resident in a low-tax jurisdiction.

For the purpose of the rules, a company will be considered a "related party" if the payer and the recipient are directly or indirectly under the same ownership and control by at least 50%.

The term "low-tax jurisdiction" is to be interpreted in line with the controlled foreign company (CFC) and tax exemption rules. In general terms, this means that the WHT will apply if the recipient is resident in a country that imposes an effective corporate income tax rate that is lower than two-thirds of the corporate income tax rate that would have applied in Norway.

Payments subject to WHT

The proposed WHT will apply on the following types of payments from companies that are tax resident or otherwise liable to corporate tax in Norway to related parties that are tax resident in a low-tax jurisdiction:

- Interest on debt
- Royalties (remuneration for the use of or the right to use intellectual property rights)
- Lease payments for leasing ships, vessels, rigs and helicopters

The terms "interest" and "royalty" will be defined in accordance with the understanding of these terms under Norwegian tax law. In relation to royalties, the Ministry proposes to issue more detailed regulations that may be updated later to reflect technological developments.

In relation to lease payments, the Ministry mentions bareboat/dry lease payments as typical transactions that will be subject to WHT, specifying that WHT will also be levied on the asset lease component of time charter payments. Note that the proposal excludes lease payments for qualifying assets taxed under the Norwegian tonnage tax regime from the application of the WHT.

Entities obliged to withhold tax

Payers of interest, royalties and certain lease payments are withholding agents and are required to impose the WHT, and also report and remit the correct withholding tax amount. The withholding agent obligation extends to:

- Norwegian limited companies
- Foreign companies liable to Norwegian corporate income tax
- Partnerships with at least one Norwegian participant

The above also includes payments from Norwegian branches of nonresident companies, provided that the payment is attributable to such branch.

Tonnage-taxed companies are exempt from the withholding obligation on lease and interest payments for qualifying assets.

Recipient with domestic tax liability

If the payment is made to a recipient that is taxable under Norwegian domestic tax law, no WHT liability will arise.

Foreign companies whose profits are subject to Norwegian CFC taxation and thus taxable under Norwegian domestic law in the hands of its shareholders, will nevertheless be subject to the proposed WHT. However, the WHT may be credited against the CFC tax.

Substance exemption for EEA recipients

Payments to EEA companies will be exempt from the WHT obligation, provided that these companies are actually established and carrying out genuine economic activity within the EEA. This substance requirement is similar to the requirement for exemption from dividend WHT under the Norwegian exemption and CFC rules.

Tax treaties

If a tax treaty has been entered into between Norway and the recipient's jurisdiction, the WHT can also be reduced or set to zero according to the terms set out in the tax treaty. Since Norway traditionally has not levied WHT on interest, royalties or lease payments, many of Norway's tax treaties prevent Norway from levying such 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.

Liability

If the payer has not withheld the correct tax, it will be liable for the difference. This liability can be avoided if the payer can document that the lack of withholding was not due to negligence or a lack of due care on its own part or by someone in the payer's service. However, the Ministry states that since the WHT only applies between related parties, the liability assessment will be strict.

Endnote

1. See Global Tax Alert, *Norwegian Government proposes introduction of withholding tax on interest and royalties paid to nonresident related parties*, dated 28 February 2020.

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