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Global Tax Alert

Norwegian Government issues 2019 Fiscal Budget

Executive summary

On 8 October 2018, the Norwegian Government published its proposal for the 2019 Fiscal Budget. The proposal will now be discussed by the Norwegian Parliament, and subject to any potential changes, it is expected to be approved in December 2018. In short, the following changes are proposed:

- A reduction of the corporate income tax rate from 23% to 22% with effect from 1 January 2019.
- For companies taxed under the special petroleum tax regime and the hydro power regime, the reduction in corporate tax rate will be offset by a corresponding increase in the special tax rates for these regimes.
- Amendments to the domestic tax residency rule, hereunder stating that a foreign company with its "place of effective management" in Norway will be regarded as tax resident in Norway. The proposal aligns the interpretation of the term "place of effective management" with the Organisation for Economic Co-operation and Development (OECD) definition providing that the place of the day-to-day management is increasingly important.
- An extension of the scope of the interest cap rules to comprise both internal and external interests. This extension only applies to companies that are part of a consolidated group for financial accounting purposes, or companies that can be part of such group. The Government also proposed to introduce two alternative equity escape rules for these group of companies. There are no proposed changes to the interest cap rules for related parties.

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Building a better working world

The Ministry of Finance was given a mandate by the Government to address how Norway should follow up the recent OECD and European Union (EU) developments regarding taxation of multinational enterprises deriving income from digital business models. The Ministry expects to issue a proposal for temporary domestic measures to tax digital businesses by the fall 2019. It is stated that withholding tax on royalties could mitigate the need for such measures from a short-term perspective.

Further, the Norwegian Government announced that they intend to publish, by the end of 2018, a proposal for the introduction of withholding tax on interest and royalty payments, which may be implemented in 2019.

Detailed discussion

Corporate income tax rate reduction

The Government proposes to reduce the corporate income tax rate from 23% to 22% with effect from 1 January 2019.

Petroleum and hydro power taxation

The general reduction in the corporate income tax rate from 23% to 22% will be offset by a corresponding increase in the tax rates for the hydro power regime and the special petroleum tax regime. For companies owning hydroelectric power plants, an increase of the tax on resource rent from 35.7% to 37% is proposed.

For companies that carry out petroleum related activities, it is proposed to increase the rate of the special tax on petroleum income from 55% to 56%. In addition, the rules for calculating the taxable base will also be amended. To calculate the special tax on petroleum income, the taxable base is reduced by an uplift of 5.3% (*friinntekt* – exempt income) in order to compensate any loss of value due to the fact certain investments have to be depreciated. It is proposed to reduce this uplift from 5.3% to 5.2%.

Amendments to the domestic tax residency rule

Background

Historically, the crucial factor for determining a company's tax residency has been where the board functions and the top level management of the company is located and where they exercise their powers. However, this will be changed under the new rules.

The proposal is more or less in line with the proposal issued by the Norwegian Government for public consultation on 16 March 2017 and apply to both Norwegian and foreign companies and other companies with limited liability.[1]

Companies incorporated in Norway

According to the proposal, a company incorporated in Norway shall be regarded as a Norwegian tax resident and obliged to file a Norwegian tax return. The rule will also apply for companies that have emigrated.

Companies incorporated in foreign jurisdictions

It is proposed that companies incorporated outside Norway shall be deemed tax resident in Norway if management activities are carried out in Norway. The assessment comprises a specific analysis of:

- The place of effective management at board level
- The place where the day-to-day management activities are carried out

If residency is not solved from the above analysis, other circumstances concerning the organization of the company and its activities will be relevant for the further assessment.

Double tax treaty (DTT) exemption

If a company is resident in another country according to a DTT, the company shall not be regarded as tax resident in Norway under domestic law either.

If a company is considered resident in the two countries, some DTTs provide that residency will be determined by the competent authorities in Norway and foreign country through a Mutual Agreement Procedure (MAP). Until the authorities have agreed, the company is regarded as a resident in both jurisdictions without any possibility to obtain treaty benefits.

A consequence of the proposal is that many companies which previously have been considered resident outside Norway, could be regarded resident in Norway. Especially for industries where it is usual to have separate management companies (such as the investment management and shipping industry), the proposal can result in companies being regarded as resident in Norway. Such a situation can result in double taxation for the affected companies, until the issue around double taxation is resolved by the tax treaties entered into between the respective states.

Entry into force

The rules will enter into force with effect from 1 January 2019. For companies with a non-calendar financial year, the rules will enter into force with effect from the first financial year starting after 1 January 2019 but not later than 1 January 2020.

Amendments to the interest cap rules

The Norwegian Government has proposed several amendments to the Norwegian interest cap rules. In summary, the following main changes are proposed to take effect from 1 January 2019:

- Extended scope to cover interest on external loans in addition to internal loans. This extension applies solely to companies that are part of a consolidated, multinational group for financial accounting purposes, or companies that can be part of such group. There are no proposed changes to the interest cap rules for related parties.
- Introduction of two alternative equity escape rules, whereby the interest cap rules do not apply if a Norwegian group company can demonstrate that its adjusted equity over total assets ratio (equity ratio), or alternatively the adjusted equity ratio of the Norwegian group, is no more than two percentage points lower than the equivalent equity ratio of the worldwide group. Pure Norwegian domestic groups will by definition always satisfy the second leg of this test, and are therefore not affected by the proposed amendments.

The fixed ratio rule will continue to apply in its current form to internal interest expenses incurred by: (i) standalone entities which are not part of a group; and (ii) group companies involved in borrowing arrangements with related parties that are not part of the consolidated group. The latter applies irrespective of whether the group company were to satisfy the equity escape rule. Consequently, if interest expenses exceed NOK5m, net related party interest can be deducted only to the extent both internal and external net interest expenses do not exceed 25% of taxable earnings before interest, taxes, depreciation and amortization (EBITDA). There are no proposed changes to this fixed ratio rule.

In order to apply the equity escape rules, all assets and liabilities need to be valued using the same accounting methodology in the company's/Norwegian division's financial statements and in the global consolidated financial statements. Any accounting adjustments that are made to achieve this must be approved by an auditor.

The extended interest cap rule will apply to Norwegian group entities that do not benefit from the equity escape rules, meaning net interest expenses can be deducted only to the extent both internal and external net interest expenses do not exceed 25% of taxable EBITDA. However, the extended interest cap rule will not apply where total net interest expenses do not exceed NOK25m (de minimis threshold). This threshold is based on the combined net interest expenses of all Norwegian entities within the global consolidated group.

Disallowed interest expenses may be carried forward up to 10 years.

The Norwegian Ministry of Finance maintains that the existing interest cap rule as well as the proposed amendments are compatible with the European Economic Area agreement.

Taxation of digital business models

The Ministry of Finance was given a mandate by Parliament to address how Norway should follow up the recent OECD and EU developments regarding taxation of multinational enterprises deriving income from digital business models. Recognizing that new international tax rules necessitate wide international consensus, the Ministry of Finance held that its primary aim at this point was to contribute to developing international solutions. The Ministry expects to provide a proposal for temporary domestic measures to tackle digital business taxation by the fall 2019. It was stated that withholding tax on royalties could to some extent mitigate the need for such measures from a short-term perspective.

Proposal to introduce withholding tax on interest and royalty payments

In line with the white paper released on 7 October 2015, the Government also intends to publish for public consultation a proposal on withholding tax on interest and royalty payments within 2018.[2] Interest and royalty payments (typically payments for use of intangibles) and payments for leasing certain assets (typically bare boat charters of vessels) are currently not subject to Norwegian withholding tax. The Government aims to propose a new bill based on the proposal to implement withholding tax on such payments within 2019.

Endnotes

1. See EY Global Tax Alert, *Norwegian Government proposes amendments to domestic tax residency rule*, dated 21 March 2017 for further details.
2. Further details on the white paper from 2015 are included in the Global Tax Alert, *Norwegian Government issues Fiscal Budget for 2016 and white paper on tax reform*, dated 9 October 2015.

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