

International Tax News*

Tax update

Norway

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1. Minor tax rules changes in the Revised National Budget 2007

The Revised National Budget 2007 was presented on May 15, 2007. Only minor changes in the tax legislation are proposed, including a proposal for reorganisation of the Inland Revenue Services.

2. New transfer pricing documentation rules

On 15 May 2007, the Ministry of Finance issued a white paper containing a proposal of new Transfer Pricing documentation rules. The rules will apply to all inter-company transactions, including transactions between Norwegian entities.

Basically, the proposed rules will apply to any Norwegian entity (including permanent establishments) which holds or controls at least 50% of another entity, or which is owned or controlled by another entity to the same extent.

The rules will apply only if the Norwegian entity engages in inter-company transactions which, in total, exceed a minimum amount. The white paper suggests NOK 10 million as the threshold, but the actual minimum amount(s) will be specified in more detailed regulations expected to be introduced this fall.

Affected taxpayers will be required to submit a summary statement of all inter-company transactions to which they are party. The statement shall be submitted together with the tax return.

In addition, within 45 days upon demand from the Tax Authorities, these taxpayers will be required to submit extensive documentation on how terms in inter-company transactions are determined. The documentation shall constitute a basis for the evaluation of whether the terms are at arm's length, and should contain, inter alia;

- a description of the taxpayer's and the related parties' businesses and the group of which the taxpayer is a part;
- a description of the inter-company transactions (type and extent);
- a functional analysis and normally a comparability analysis; and
- a description of the transfer pricing method applied.

To a large degree, the documentation requirements are based on the OECD Transfer Pricing Guidelines, and the extent of the requirements entails that documentation will typically have to be prepared consecutively. However, the documentation requirements shall not apply to smaller enterprises¹. On the

¹ I.e. enterprises which, on a Group basis, employ no more than 250 people and whose turnover does not exceed MNOK 400 or whose balance sheet total does not exceed MNOK 350.

other hand, they will apply to all entities subject to Special Tax under the Petroleum Tax Act, regardless of the entity's size. In addition, any inter-company transactions with an entity located in a jurisdiction not party to a tax treaty with Norway are subject to the documentation requirements.

The proposal does not indicate that failure to comply with the rules will trigger any particular sanctions. However, in case of failure to submit the summary statement or the required documentation within the given deadlines; the Tax Authorities may estimate the taxpayer's tax liability on a discretionary basis. Similarly, if the statement or documentation has not been submitted as required, the Tax Authorities are under no obligation to hear a possible complaint from the taxpayer.

The obligation to submit a summary statement of all inter-company transactions shall be effective from 2007, whereas the more extensive documentation requirements will come into effect from 2008 onwards. More specific regulations and guidelines as to how the documentation shall be prepared are expected this fall.

It is important to keep in mind that any entity taxable to Norway is subject to general documentation requirements. Hence, Norwegian entities to which the proposed rules do not apply could still be subject to detailed transfer pricing inquiries by the tax authorities.

3. Interpretation statement from the Ministry of Finance on the tax exemption method

The Ministry of Finance has published an interpretation statement regarding the holding and ownership requirements under the tax exemption method. Capital gains on shares in companies resident in high-tax jurisdictions outside the EU/EEA are tax free for a corporate shareholder provided that a minimum 10 percent of the shares are held for a two year holding period.

The investor in question initially purchased 15 percent of the shares in a non EU/EEA company at the beginning of a year and additional 4 percent of the shares later the same year. After two years, another 1 percent of the shares were purchased and the plan was to sell all shares in year 3. The question to the Ministry was whether the total capital gain was tax exempt or only the gain relating to shares held for a two year period.

The Ministry concluded that the total capital gain was tax exempt. It was sufficient that 10 % of the shares were held for more than two years at the time of disposal.

4. Interpretation statement from the Ministry of Finance on the Cadbury Schweppes case

The Ministry of Finance has as a consequence of the Cadbury Schweppes decision in the European Court of Justice ("ECJ") from September 2006 given an interpretative opinion to the Norwegian Directorate of Taxes regarding the Norwegian NOKUS rules (Norwegian CFC legislation). As expected, the Ministry states that the ECJ judgment affects the interpretation of the NOKUS rules as regards to the applicability of the said rules on entities resident for tax purposes within EU/EEA.

In Cadbury Schweppes, the ECJ found that British CFC rules were in breach with the EEC treaty when applied to companies' resident within the EU, to the extent that the legislation applied to other than "wholly artificial arrangements intended to escape the national tax normally payable". Correspondingly, Norwegian CFC taxation on investments within EU/EEA beyond "wholly artificial arrangements" conflicts with the EEA Agreement and cannot be applied. The ECJ elaborated to some extent on how the "wholly artificial"-test should be considered. It was emphasised in the decision that the incorporation of a CFC must reflect economic reality and correspond with an actual establishment intended to carry on genuine economic activities in the host Member State. The consideration must be based on objective factors ascertainable by third parties, and especially focus on whether the CFC physically exists in terms of premises, staff and equipment.

In its interpretative statement, the Ministry provides clarifications on how they will consider the "wholly artificial"-test in light of the Cadbury Schweppes case. The Ministry states that the CFC is required to participate in the economic life in the state of establishment on a fixed and enduring basis. The following aspects must be considered in order to determine this:

- Whether the company employs offices, furniture and equipment in the state of establishment;
- Whether the company permanently employs management and other employees carrying out the actual business in the establishment state;
- Whether the said employees have sufficient qualifications, skills and authorities to conduct the company's business, and whether they actually make relevant decisions;
- Whether the company's activity has economic substance, i.e. by demonstrating income contribution from its own business activities; and
- Provided that the company mainly provides inter-company services, whether the services are necessary and creates excess values for the related party.

In our view, the Ministry's list of relevant aspects to some extent emphasises on aspects beyond the wholly artificial establishment-doctrine laid down in the Cadbury Schweppes case. This applies especially to the requirement for income contribution from the company's own business activities and the conditions relating to intercompany transactions. If applied in practice, we see a risk that the Norwegian interpretation of the NOKUS rules is in conflict with ECJ's understanding of the community law including the free movement of capital and Norway's obligations under the EEA agreement.

5. EC opens formal proceedings against 9 EU Member States on the taxation of foreign EU pension funds

The European Commission recently opened an infringement procedure against 9 EU member states concerning their national tax legislation under which foreign pension funds are subject to higher withholding taxes than domestic pension funds. The Commission states in its press release that it doubts that such higher taxation is compatible with the EC Treaty and with the EEA Agreement.

In most Member States, domestic pension funds are exempted from corporation and/or income tax. Further, dividends and interests paid to domestic pension funds are also usually exempt from any withholding tax, or where there are no such exemption at source, the Member State provides a refund procedure under which the domestic pension fund can reclaim the withholding tax.

If the Member State does not provide the same tax exemptions and/or tax refund benefits to foreign pension funds, it may dissuade foreign pension funds from investing in that Member State and, accordingly, hinder companies in that member State to attract capital from foreign pension funds. The higher taxation of foreign pension funds may thus be a restriction of the free movement of capital as protected by Article 56 EC and Article 40 EEA. According to the Commission, there are no justifications for such a restriction.

EU/EEA pension funds with investments in the Member States covered by the Commission's infringement procedure (the Czech Republic, Denmark, Lithuania, the Netherlands, Poland, Portugal, Slovenia, Spain and Sweden) should review their tax status and safeguard their positions by filing timely and correct claims for repayment of taxes.

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