

International Tax News*

Foreign investment funds and the Norwegian participation method

Norway

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Foreign investment funds and the Norwegian tax exemption method

The Norwegian tax exemption method – Interpretative statements from the Norwegian tax authorities regarding foreign investments funds

In March 2008, the Norwegian Directorate of taxes issued three interpretative statements regarding the applicability of the Norwegian Tax Exemption Method (TEM) on foreign investments funds.

According to the Norwegian Directorate of taxes, Danish, Irish and German investment funds are not covered by the TEM due to the funds not being liable to general corporate income tax in their respective countries of residence.

Norwegian investment funds are specifically covered by the TEM. Foreign investment funds will in principle be covered by the TEM provided they are comparable to Norwegian entities qualifying for the TEM.

The criteria for a foreign entity to be considered as comparable to a Norwegian entity according to Section 2-2 (1) of the Tax Act has been subject to much discussion.

The Norwegian Ministry of Finance issued an interpretive statement on 25 September 2007 setting out its view of the conditions that must be satisfied for an EU/EEA entity to be entitled to benefit from the TEM.

The first condition brought forward in the statement is that the company must be a “resident in a EU/EEA country” according to a tax treaty. The two main conditions that have to be fulfilled in order to be “resident” in an EU/EEA country according to a tax treaty is that the company is an entity for tax purposes and a resident for tax purpose according to domestic provisions.

The second condition found in the statement is that the recipient is the “real owner” (beneficial owner) of the distributed dividends. The traditional interpretation of the term is that the owner according to private law is considered to be the “real owner” unless the substance over form rule is applicable where another than the owner according to the private law has a more qualifying interest in the asset (share) and the setup is typically tax driven.

The last condition is that the recipient of the dividends has to be subject to corporate income tax.

In the statements, the Directorate of taxes followed these three conditions set out by the Ministry of Finance. Hence, according to the Norwegian Directorate of taxes, foreign investment funds will not benefit from the TEM unless they, without any general exemption, are liable to corporate income tax in their home country.

Based on fact that the relevant funds were exempt from corporate income tax in their home country, the Norwegian Directorate of taxes found that Danish investment companies, Irish Qualifying Investment Funds and German Investment Funds

are not comprised by the Norwegian participation exemption method. Thus, dividends and capital gains derived from shareholdings in such funds will be taxable for the Norwegian investor. Furthermore, the funds will be liable to withholding tax on dividends from shareholdings in Norwegian companies.

Norwegian investment funds are subject to corporate income tax in Norway. However, almost all the relevant types of income are exempt in the hands of a Norwegian investment fund and management fees are deductible. The net effect of which is that almost all Norwegian investment funds do not have profits upon which they pay tax.

In our view, these rulings, as well as the statement from the Ministry of Finance, sets out conditions that implies that non-Norwegian EEA investment funds are treated less favorable than comparable Norwegian investment funds. In our opinion, this is in violation of the EEA Agreement Article 40 concerning the right of free movement of capital and Article 4 concerning discrimination on the grounds of nationality.

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