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Norway Tax Alert

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Consultation paper released on limit on related party debt interest deduction

Contacts

Petter Gruner
pgruener@deloitte.no

Rolf Saastad
rsaastad@deloitte.no

Per Evers
pevers@deloitte.no

Norway's Ministry of Finance released a consultation paper on 11 April 2013 that would introduce limits on the deduction of interest on related party debt. The main purpose of the proposal is to restrict earnings stripping via intercompany debt financing.

Under the proposal, net interest expense paid to a related party would not be deductible in a year to the extent such expense exceeds 25% of EBITDA, subject to certain adjustments as described below. The limitation would be calculated separately for each entity.

Net interest expense in excess of the limitation would be able to be carried forward for five years provided the expense falls within the 25% limitation for those years. The proposal is not clear as to whether current year net interest expense would be deducted before or after any excess net interest carried forward.

The proposal suggests that the rules would apply as from fiscal year 2014. No grandfathering rules are proposed.

Related parties

According to the consultation paper, the holding of a direct or indirect common ownership or controlling interest by another entity or individual (plus certain closely related individuals) in the borrower or the lender of at least 50% would mean that the borrower and lender were related parties. Back-to-back loans via an independent lender also would be caught by the rules.

A branch (permanent establishment) of a foreign company and its head office would be considered to be related parties. All debt allocated to a branch would be considered related party debt, unless the debt was taken out by the branch with a third party without any involvement of the head office.

The proposal does not make any distinction between loans between Norwegian related parties and loans where at least one of the parties is non-Norwegian. Hence, the proposal would apply equally to 100%-Norwegian groups without any foreign affiliates and to groups with foreign affiliates.

Basis for imitation

The basis for the 25% limitation would be the basis for corporate tax before taking into account interest earned by the corporation, interest accrued on debt taken out by the corporation and tax depreciation. (Corporate tax is imposed at the rate of 28%). Foreign exchange gains or losses would not reduce or increase the basis.

Net interest expense

"Net interest expense" would be defined as interest accrued on debt less interest earned. Gains or losses on certain bonds would be treated as interest earnings or interest accrued on debt.

The 25% of EBIDTA limitation would not apply to annual net interest under NOK 1 million, and this threshold would include interest paid to unrelated parties. As currently worded, however, if the NOK 1 million safe harbor is exceeded (even by NOK 1), the limit would apply with respect to *all* of the interest expense, not merely to the interest exceeding NOK 1 million.

Although interest paid to both related and unrelated parties would be included in calculating the 25% limitation, the amount disallowed would be limited to net interest expense paid to related parties. For example:

Taxable profits before any adjustment	200
Tax deprecation	40
Net interest expense	160
Basis for calculation	400
Limitation	100

In the example, if the net interest expense paid to related parties included in the total net interest expense of 160 is 40, the expense disallowance would be 40, i.e. no part of the net interest expense incurred with related parties would be deductible.

Impact on acquisitions

The proposed 25% of EBIDTA limitation would affect acquisitions.

Typically, an acquisition in Norway by a non-Norwegian acquirer is financed by setting up an acquisition company funded with intercompany debt. Norway's current thin cap rules are based on the general arm's lengths principle, i.e. whether an independent financing party would be willing to grant a similar loan on a standalone basis (i.e. without any parent company guarantees, etc.).

Losses of the acquisition company can then be set off against (deductible) group contributions from the target company provided there is a more than 90% ownership relationship. (Group contributions are Norway's equivalent of tax consolidation within a group that is more than 90% owned and controlled by an ultimate parent).

The basis for the proposed 25% limitation normally would be the group contribution from an operating entity (i.e., the acquired target) plus foreign exchange gains or losses on debt, as this typically would be the only income of

the acquisition company constituting the basis for the limitation.

Companies subject to petroleum taxation regime

Companies granted licenses to explore and exploit petroleum resources on the Norwegian continental shelf are subject to a specific petroleum tax regime, with specific limits applying to the deduction of their net financing expenses. The proposed 25% limit would adversely impact such companies as well – effectively against the basis for ordinary corporate tax and ordinary petroleum tax (rate 28%).

Further proceedings

Comments on the proposed restriction must be submitted by 24 June 2013. While extensive objections are expected, the proposal is likely to be enacted broadly along the lines outlined in the consultation paper.

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