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Norway tax alert

Budget 2020 amends interest expense deduction limitation rules, R&D incentives

Two of the key proposals included in Norway's budget for 2020, presented by the Ministry of Finance on 7 October 2019, are amendments to the interest expense deduction limitation rules and the Norwegian research and development (R&D) incentive scheme.

Interest expense deduction limitation rules

Norway's interest expense deduction limitation rules were extended as from the 2019 income year to include interest expense on external (third-party) debt in addition to interest expense on debt from related parties (for prior coverage, see Norway tax alert, 8 October 2018).

The interest limitation applies to all net interest expenses exceeding 25% of the company's taxable income, less tax depreciation and net interest costs (taxable EBITDA), unless one of two exemptions from the interest limitation provisions applies.

The first exemption is a de minimis rule for groups with net interest expense in Norway not exceeding NOK 25 million. Norwegian entities in such a group initially are assumed not to be subject to the interest limitation.

The second exemption applies where the company, or the Norwegian part of the group, qualifies for the "equity escape" clause, i.e.:

1. The ratio between the company's equity and its total balance sheet (equity ratio) is at least as high as the overall equity ratio for the consolidated group; or

2. The equity ratio between the total consolidated equity of the Norwegian entities within the group is at least as high as the equity ratio for the entire consolidated group.

Taxpayers that meet the requirements under the equity escape rule are exempt from the restrictions on the deductibility of interest other than with respect to debts owed to related lenders that are not consolidated, or could not be consolidated in accordance with IFRS, into the same group accounts as the taxpayer, in the previous accounting year. Debts to individual shareholders, corporate shareholders with 50% ownership but no control, intragroup debts where the taxpayer has been acquired by a new group in the income year, etc. may still be subject to interest deduction limitations in accordance with the "old rule," (i.e. if net interest exceeds NOK 5 million per entity, interest exceeding 25% of taxable EBITDA in that entity would be restricted if related to borrowings from a related party that is not a group company).

The 2020 budget proposes several amendments to the interest expense deduction limitation rules (effective from income year 2019 if approved by the parliament) as follows:

- Under the current legislation, interest would not be restricted where the de minimis exemption of NOK 25 million applies to the Norwegian part of the group. Under the budget proposals, the "old rules" would apply even if the de minimis exemption applies. As a result, smaller groups also may be subject to interest deduction limitations on certain related party debt. Smaller groups that previously have determined that they are not affected by the interest deduction limitation rules may need to reassess their position.
- For a taxpayer that is the surviving entity of a merger in the income year, the proposal is that the surviving entity should not be eligible for the equity escape rule at the company level. The proposal aims to prevent abusive tax arrangements by merging a highly leveraged company (compared to the group's leverage) into a low leveraged group company that qualifies for the equity escape clause. The surviving entity would be required to demonstrate that the equity ratio of the Norwegian part of the group is higher than the equity ratio in the whole group to qualify for the equity escape clause.
- The definition of "group companies" would be amended so that only group companies that would be consolidated under an applicable accounting standard qualify as group companies, unless there is a mandatory exemption from consolidation (as opposed to optional consolidation exemptions).

Although the budget proposals clarify a number of previously unresolved issues, some uncertainties remain. The Ministry of Finance has indicated that some of the outstanding issues will be addressed by regulations to be issued in the coming months.

R&D incentive scheme

Norway's R&D incentive scheme ("SkatteFUNN") enables companies conducting R&D activities to apply for a tax credit up to 20% (for small and medium-sized companies (SMEs)) or 18% (for large companies) of their approved R&D costs, subject to certain limits. This tax credit is offset against the tax payable for the year and where the company has no tax liability, the tax credit may be refunded. For an entity to be eligible for the R&D scheme, the relevant R&D project must be approved by the Norwegian Research

Council (Forskningsrådet). If approved, the scheme applies for three years.

In May 2019, the Ministry of Finance issued a consultation paper proposing several amendments to the scheme with a view to simplifying the rules and also reducing the risk of abuse of the scheme. The majority of the proposals put forward during the consultation process now are included in the 2020 budget.

Under the budget proposals:

- The current tax credit of 20% and 18% for SMEs and large companies, respectively, would be replaced with a new single tax credit of 19%.
- The current cap on the maximum expenditure eligible for the credit of NOK 50 million for R&D services purchased from approved research institutions would be reduced to NOK 25 million (in line with the restriction for self-developed R&D).
- The hourly rate for internal employees would be increased from NOK 600 per hour to NOK 700 per hour. A maximum hourly rate for employees of related parties also would be introduced, where the company applying for the credit acquires R&D services from a related party. The maximum hourly rate would be equivalent to the maximum hourly rate for internal employees.
- A geographical limitation on costs may be introduced, which means that R&D costs would be restricted to services from companies within the European Economic Area or countries with a tax treaty or information exchange agreement with Norway.
- The administrative burden of obtaining the R&D tax credit would be increased, e.g. by the introduction of a mandatory requirement for signing the time sheets and documentation requirements for related parties that act as subcontractors of an applying company. Where the applying company acquires R&D services from a related party, the related party also would be required to prepare specific accounts for the project.

If adopted by the Norwegian parliament, the changes will be effective from 1 January 2020.

Contacts

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