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Norway Tax Alert

15 October 2013

Budget for 2014 contains interest deduction limitation rule

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Norway's budget for 2014, presented by the government on 14 October 2013, includes a limit on the deduction of interest on related party debt. The proposed rule is designed to restrict earnings stripping via intercompany debt financing in Norway. There is also a proposal to reduce the corporate income tax rate from 28% to 27% in 2014.

The proposed limit on the deduction of interest on related party debt generally is in accordance with the measures in the consultation paper issued by the government in April 2013. The consultation paper proposed that net interest expense paid to a related party would not have been deductible in a year to the extent the expense exceeded 25% of earnings before interest, tax depreciation and amortization (EBITDA), subject to certain adjustments. The limit would have been calculated separately on an entity-by-entity basis, so no consolidated group approach would be available. Net interest expense in excess of the limitation would have been available for a five-year carryforward, provided the expense fell within the 25% limitation for those years. The 25% of EBIDTA limitation would not have applied to annual net interest under NOK 1 million, and this threshold would include interest paid to unrelated parties.

The budget proposes several changes to the measures in the consultation paper:

- The maximum interest deduction on related party debt would be increased from 25% to 30% of (adjusted) EBITDA;
- The threshold for the limitation to apply would be increased from NOK 1 million to NOK 3 million;
- The carryforward period for disallowed interest expense would be extended from five to 10 years;
- External debt for which a related party has provided security would be considered internal debt and, therefore, would fall within the scope of the rules; and
- Tax losses carried forward and group contributions would not be deductible if the tax base before the limitation for deducting net interest expense was negative or zero. In cases where an interest deduction is disallowed, the taxpayer could thus have a positive tax base and tax payable even though it has tax losses carried forward.

Related parties

As was proposed in the consultation paper, a related party relationship would be deemed to exist where an entity or individual (and certain closely related individuals) holds directly or indirectly at least a 50% common ownership or controlling interest in the borrower or the lender. Notably, no distinction would be made between loans between Norwegian related parties and loans where at least one of the parties is non-Norwegian. Hence, the proposed rules would apply equally to 100%-Norwegian groups without any foreign affiliates and to groups with foreign affiliates.

Basis for limitation

The base for the 30% limitation would be corporate taxable profit before taking into account interest earned, interest accrued on debt taken out by the corporation and tax depreciation. Foreign currency gains or losses would not reduce or increase the base. Taxable group contributions to be received would not reduce the base and group contributions to be paid would not increase the base. Net interest paid to related and unrelated parties would be included in the 30% limitation, but only net interest expense to related parties would be disallowed. Thus, net interest expense paid to an independent third party could result in a disallowance of an interest deduction for related party interest, but unrelated party interest itself would not be disallowed.

Example:

Taxable profit before any adjustment	200
+Tax deprecation (addback)	40
+Net interest expense (addback)	160
=Basis for calculation	400
Limitation of 30%	120

In the example, if the net interest expense paid to a related party included in the total net interest expense of 160 is 30, the interest expense disallowance would be 30, i.e. no part of the net interest expense paid to the related party would be deductible in the current year and, thus, it would have to be carried forward for deduction.

External debt for which a related party provides security would be considered internal debt and would fall within the scope of the limitation. If a Norwegian company obtains a loan from a third party bank and the loan is guaranteed by the parent company, the bank loan would be considered related party debt. As was the case in the consultation paper, back-to-back loans via an independent lender also would be caught by the limitation.

Under the budget proposal, it would not be possible to deduct tax losses carried forward from previous years or to provide additional group contributions if the tax base is zero or negative before the interest limitation calculation is made. As a result, in cases where an interest deduction is disallowed, the taxpayer could have positive ordinary income and tax payable even if it has tax losses carried forward.

Example:

Assume a company has 200 in tax loss carryforwards and net interest expense of 60:

Taxable profits before any adjustment	100
-Tax losses carried forward	100
= Taxable profit	0
+ Tax depreciation	40
+ Net interest expense	60
= Basis for calculation	100
Limitation of 30%	30

In this case, the disallowed interest expense would be 30 and the taxable income would be increased to 30, resulting in a tax payable of 8.1 (assuming the reduction in the corporate tax rate is approved by parliament) even though the company has tax losses carried forward. The taxpayer also would not be allowed to deduct any part of the 30 as a group contribution to another group company.

Threshold for triggering limitation

The threshold for triggering the interest deduction limitation rule would be increased from NOK 1 million to NOK 3 million under the budget proposals. Thus, if the total unrelated and related net interest expense of a company is NOK 3 million or less, the total amount of interest expense would be tax deductible and not subject to the limitation. However, if the amount of net interest expense exceeds NOK 3 million, the limitation would apply to the total net interest expense.

Carryforward of disallowed interest subject to limitation

It is proposed that disallowed net interest expense may be carried forward up to 10 years (rather than five years) to the extent the net interest expense is within the 30% limitation after the carryforward. Excess net interest carried forward would have to be deducted before the current year net interest expense.

Companies subject to the limitation

The proposed new measure would apply to limited liability companies and other companies and entities that are taxed as separate entities, as well as partnerships, controlled foreign companies and companies and facilities with limited tax liability in Norway. Financial institutions and individuals, however, would fall outside the scope of the proposal.

A branch (permanent establishment) of a foreign company and its head office would be considered to be related parties. In the consultation paper, all debt allocated to a branch would have been considered related party debt, unless the debt was taken out by the branch from an unrelated party without any involvement of the head office. This has been amended under the budget proposal, so that related and unrelated interest expense allocated to the branch would have to be equal to the ratio between the internal and external debt of the company.

Under the consultation paper, companies granted a license to explore and exploit petroleum resources on the Norwegian continental shelf would have been covered by the limitation despite being subject to other specific limitations on their net financial expense. The budget proposal removes these companies from the scope of the rules.

Comments

The proposals are expected to be debated by the parliament in November and, if approved, would apply as from fiscal year 2014. For taxpayers with a divergent financial year, the rules would apply for the financial year ending during 2014. No grandfathering rules would apply.

Since the newly proposed measure would apply to both international and Norwegian groups, it is expected that it would create challenges and might require certain international and Norwegian groups to reorganize.