



ESA has approved proposed changes to the Norwegian tonnage tax regime

A brief introduction to the Norwegian tonnage tax regime

The shipping industry has played an important role in the Norwegian economy for centuries, and the Norwegian tonnage tax regime has been designed to ensure the competitiveness of the industry. Norway (Oslo) is considered in the top tier of leading maritime capitals globally. There are several reasons for this, including Norway's high ranking as an attractive and competitive shipping center based on established finance, legal and technology structures.

In relation to attractiveness and competitiveness, the Norwegian tonnage tax regime is considered highly favourable and competitive compared to many other regimes, including those found in Europe. Under this regime, shipping profits are generally exempt from tax, except for net financial income, which is taxed as ordinary corporate income at the rate of 23 percent¹. The tax exemption includes both operating profits and gains on the disposal of vessels. Instead of taxing the shipping income, a fixed tonnage tax is levied on the ships operated² under the Norwegian tonnage tax regime regardless of the actual income, at the following rates:

Net tonnage	Tax per day per 1,000 tons
0 - 1,000	NOK 0
1,001 - 10,000	NOK 18
10,001 - 25,000	NOK 12
More than 25,000	NOK 6

The tonnage tax regime is eligible for limited companies incorporated under Norwegian Company law as well as similar companies domiciled in other European Economic Area (EEA) countries provided that the EEA company is tax liable to Norway for the income earned, and only engage in legitimate shipping activities.

¹ The CIT rate was reduced from 24 percent to 23 percent from 1 January 2018

² Includes vessels owned and chartered in when the owner is not liable to tax in Norway on the charter income

In order to be eligible for the tonnage tax regime, a company must either own a qualifying asset, for example, a ship in traffic (transport ships) or a support vessel engaged in petroleum activities, or hold at least three percent ownership in limited companies, partnerships or Norwegian controlled foreign companies (or chain of companies), which in turn own a qualifying asset. Generally, Norway has a liberal regime with regard to types of vessels, including a range of offshore vessels.

Furthermore, qualifying activities are primarily the ownership, leasing or operation of vessels. In addition, some ancillary activities are accepted within the scope of the tonnage tax regime, including strategic and commercial management, as well as daily technical operation and maintenance of own and chartered vessels. Pure ship management companies are not eligible for the Norwegian tonnage tax regime.

In addition to the favourable tonnage tax regime, Norway has also participation exemption rules, which for example, allows distribution of dividends without any withholding tax to shareholders with proper substance within the EEA. Moreover, the threshold for constituting a permanent establishment in Norway is generally higher due to a special regulation for foreign taxpayers that operate vessels in international waters. Further flexibility is provided by a broad set of double tax treaties. Thus, the regime may be of particular interest to investors with a presence in Europe. An investment in a Norwegian shipping company would be comprised by European Union (EU) or EEA's four freedoms, which should prevent EU/EEA states from taxing investments in Norwegian shipping companies under local controlled foreign company (CFC) rules.

Revised Norwegian tonnage tax regime

The Norwegian tonnage tax regime constitutes lawful state aid, and therefore, the regime requires an approval from the EFTA Surveillance Authority (ESA). The previous approved tonnage tax regime was initially approved by the ESA until 31

December 2016 and over two rounds, extended to 31 December 2017.

In a letter on 14 December 2017, ESA stated that the revised Norwegian tonnage tax scheme is in line with state aid rules and approved a new 10 year period for the tax regime until 31 December 2027. In order to comply with Norwegian legislative procedure, the Ministry of Finance (MOF) will have to present a bill to parliament, where it is expected that the proposed changes generally will become effective as from 1 January 2018.

Under the previous regime, no restrictions applied with respect to the chartering out of vessels on bareboat terms, making the Norwegian tonnage tax regime one of the most favorable regimes in the EEA. Apparently, restrictions on chartering out of vessels on bareboat terms was one of the key topics in the discussion between the MOF and the ESA, with the ESA ultimately accepting the MOF's proposed limitations. Although restrictions are introduced to the chartering out of vessels on bareboat terms, the regime is still considered to be competitive due to the exemptions described below.

The salient points of the proposed revised scheme are as follows:

- There are limits on the chartering out of vessels on bareboat terms;
- Intragroup bareboat chartering out is allowed "unconditionally";
- Financial bareboat chartering out is fully excluded;
- Chartering in on time charter or voyage charter is limited to 90 percent of non-EEA flagged vessels;
- The regime is extended to include "windmill farm vessels" not considered "transport ships" (since already included); and
- Transitional rules apply (for example, implying that the new limitations and requirements will apply only to new bareboat chartering out contracts).

New limitations on chartering out of vessels on bareboat terms

The previous tonnage tax regime allowed for both bareboat charter-in and charter-out without any restrictions. Under the new regime, charter-out is restricted as follows:

- Bareboat chartering-out is limited to 40 percent of the group's fleet, which should prevent pure ship lessors and maritime brokers from participating in the regime.
- The 40 percent limitation on bareboat chartering out is measured annually based on the daily tonnage chartered out. An option would be available to measure the share chartered out on bareboat over a four year period (i.e., the preceding three years and the current income year) to prevent the rules from involving any unintended exclusions.
- Companies that own tonnage within the tonnage tax regime through partnerships would be allocated a proportional share of the underlying vessel.
- The length of bareboat contracts would not be allowed to exceed 50 percent of the full expected economic life of the vessel, estimated at the start of the chartering period; otherwise, they would be considered illegal disqualifying financial leases. The term "full expected economic life" is probably referring to the full economic life of a vessel, rather than the remaining economic life at the start of each new charter period.
- Company groups operating within the offshore sector (with vessels not classified as "transport ships") would be able to choose an alternative limitation, where maximum 50 percent of the group's fleet within the scheme can be chartered out on bareboat terms. This rule accommodates the special needs of this sector, as well as the market situation as compared to the traditional shipping sector (i.e., maritime transport). The 50 percent restriction would be measured in the same way as the 40 percent limitation (i.e., annually, based on the daily tonnage, or over four years).

- Contracts within the offshore sector cannot exceed a five year term, with an option to extend the contract for three additional years. Strategic management for such vessel-owning companies must be carried out within the EEA.
- The MOF has proposed pragmatic rules that will introduce an important distinction between a bareboat and a time charter, and in fact reduce the consequences of the new limitations on bareboat chartering. If a ship-owning company delivers the vessel (on bareboat terms) and an affiliate company (that is at least 25 percent owned/controlled by the ship-owning company) provides the crew, the arrangement will, as far as we understand, be considered a time charter and not subject to the new limitations. The way this is structured, i.e., split contract or the chartering out of the vessel to the crewing company would be irrelevant; the important factor would be whether a time charter in fact is delivered to the customer.
- Transitional rules will apply to help affected companies adapt to the new rules.

Financial chartering agreements to be fully excluded

Financial bareboat chartering (pure ship leasing) will be excluded from the tonnage tax regime to ensure that pure ship lessors and maritime brokers do not benefit from the beneficial tax treatment, in line with the position of the European Commission. Currently, a company engaged only in financial chartering out activities does not qualify for the regime, but the new rules imply that taxpayers with otherwise qualifying assets and activities also would be excluded if they were to carry out financial chartering out of vessels.

The new rules will be based on the accounting definition of a financial lease, with some modifications. The main function of the new requirements is to exclude any ship owner from the regime that does not retain the market risk of the vessel beyond the chartering period. There are some uncertainties as to whether existing financial lease agreements would

exclude a ship owner from the new regime or whether the general transitional rules will apply for such leases. Hopefully, this will be addressed during the legislative process.

Flag requirements for chartering in on time charter/voyage charter terms

A new flag requirement will be introduced for groups that charter in vessels on time or voyage charter terms (but not for bareboat chartering in). Under these rules, a group will be able to charter in up to 90 percent of non-EEA flagged vessels on time charters and/or voyage charters. Such chartering is considered essential for shipping companies to maintain commercial and operational flexibility, and the limitation would secure the objectives of the Maritime Guidelines. The 90 percent limitation implies that at least 10 percent of the group's tonnage would have to be owned, chartered in on bareboat terms or registered in a ship register within the EEA.

For general flag requirements, a company within the arrangement have to maintain or increase its portion of EEA-registered tonnage relative to the portion of EEA-registered tonnage per 1 July 2005 or at the time of entering the regime, implying that it is possible to enter the regime with no EEA-registered tonnage.

Windmill farm vessels and barges

The tonnage tax regime would be expanded to include certain windmill farm vessels operating as transport ships (i.e., maritime transport). More specifically, vessels involved in activities relating to the construction, maintenance, repair and disassembly of windmills at sea would now be eligible for the tonnage tax regime. This expansion clarifies the treatment of windmill farm vessels in general, but more importantly the new regime will include types of vessels (support vessels) that otherwise only would be allowed to carry out petroleum-related activities under the previous scheme. This expansion is welcomed and would accommodate this rather new and expanding industry in Europe, as it would be possible to relocate vessels previously used in the petroleum sector (currently suffering from

a downturn). This expansion would apply retroactively as from 1 January 2017, since the relevant provision has already gone through the legislative process.

Under the previous tonnage tax scheme, non-self-propelled barges are eligible assets if the vessel (barge) is operated in connection with a self-propelled vessel. These vessels will now be excluded from the tonnage tax regime under the proposed model, except for barges that are necessary for the performance of certain transport missions, and that actually function as an extension of the deck area/hull space of a vessel. To qualify, the barge will have to meet certain requirements: (i) qualify as a "transport ship" under the tonnage tax rules; (ii) be operated mainly for sea-going transport activities rather than for inland waterway transport; (iii) be operated in connection with a self-propelled vessel; (iv) be at least 1,000 GRT; and (v) be registered in an EEA country.

Transitional rules: Steps to be taken before 1 November 2018

The proposed rules on bareboat chartering out would mean that certain assets/activities that currently are permitted, will not be allowed in 2018. To avoid placing new burdens on existing legal relations and to prevent a forced exit from the tonnage tax regime, transitional rules will be introduced. To encourage adaptation to the new requirements and to secure the presence of companies within the Norwegian tonnage tax regime, the new rules will apply only to new bareboat chartering out contracts. However, to ensure that pure ship lessors and maritime brokers remain outside the scheme, the transitional rule will not apply to long-term contracts (the classification long-term and short-term will depend on whether the vessel falls within the offshore or operational chartering out limitation rule). For offshore chartering out contracts, a remaining period of five years or less (plus, the option for a three year extension) will not be considered a long-term contract, while a contract with remaining period of eight years or less will not be considered a long-term contract for other vessels (i.e., transport ships).

The transitional rules will not apply to contracts that were amended during the period 15 November 2017 to 31 December 2017 to avoid abuse of the transitional rules (i.e., typically reduce the remaining bareboat chartering out period). Finally, under the transitional rules, the limitations regarding chartering-in on a time or voyage charter will only apply to new chartering in contracts, and options to extend existing contracts would be treated the same as existing contracts. This rule is important for a lot of existing shipping structures.

Except for the transitional rules above, companies and groups within the tonnage tax regime will have to comply with all remaining limitations and requirements by 1 November 2018. Companies that enter into the tonnage tax regime after 1 January 2018 have to comply with the new requirements from day one.

Potentially affected company groups that are subject to the Norwegian tonnage tax scheme should use the period until 1 November 2018 to assess whether they meet the new requirements and/or whether any restructuring is needed.



Conclusion

Most companies should be able to adapt to the revised Norwegian tonnage tax regime, which seems to cater to the special needs and requirements of the Norwegian shipping and offshore industry.

The revised regime is still highly attractive and competitive, and Norway should maintain its strong position within the global maritime industry. For international maritime investors and ship owners, the tonnage tax regime combined with the participation exemption rules and wide network of double tax treaties should offer the needed flexibility.

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