

Shipping Group newsletter*

Revised National Budget 2008

Norway

May 2008

Norwegian Government proposes amendments to the tonnage tax system

The new revised Norwegian tonnage tax system with definite tax exemption for qualifying shipping profits entered into force 1 January 2007.

The Norwegian Government has now proposed several changes to the tonnage tax system in connection with the presentation of the revised National Budget for 2008 15 May 2008.

Extension of the transitional period for companies that have previously been taxed under the ordinary tax system to 2009

Companies that enter into the tonnage tax system will be subject to capital gains taxation upon entry. The gain is as a starting point calculated applying market value of tonnage taxed assets, including vessels, newbuilding contracts, ownership interests in qualifying partnerships and shares in NOKUS/CFC companies. However, special transitional rules apply. According to the transitional rules previously ordinary taxed companies can during a transitional period apply book value on tonnage taxed assets when calculating the taxable gain upon entry. The transitional rules originally applied in 2007 and 2008.

The effective period for these transitional rules has now been extended to cover the income year 2009. This implies that tonnage taxed companies that enter into the tonnage tax system 1 January 2009 can still apply book value on tonnage taxed assets when calculating the gain upon entry. Ordinary taxed companies are thereby given one additional year to adjust to the conditions for tonnage taxation without having to use market values when calculating the transitional gain.

Transfer or ownership interests in partnerships (and shares in NOKUS/CFC companies)

Background

The taxable gain upon entry into the tonnage tax system will include gains related to ownership interest in partnerships and shares in NOKUS/CFC companies. The gain will from 2010 be based on the difference between the market value and tax value of the ownership interest/ share (during the transitional period 2007-2009 the gain will be calculated based on the difference between the book value and tax value). If ownership interest or shares that are covered by the participation exemption method are transferred from an ordinary tonnage taxed company to a tonnage taxed company, there will be no calculation of a taxable gain when the ownership interest or share is transferred into the tonnage tax system.

Since gains upon disposal of ownership interests that are covered by the participation exemption method¹ will also be exempt from taxation on the hand of an ordinary taxed company, groups of companies will therefore as a starting point have a strong initiative to transfer ownership interests from ordinary taxed companies to tonnage taxed companies. (As far as NOKUS/CFC companies are concerned the participation exemption method will in practice not apply because the scope of the participation exemption method and the NOKUS/CFC rules coincide.)

¹ The participation exemption method applies to ownership interests/ shares in companies that are genuinely established and carries out real economic activity in an EU/EEA country and to ownership interests/ shares in companies resident outside the EU/EEA area if the company is not resident in a low tax country (less than 2/3 of Norwegian tax rate) and the ownership interest is at least 10% over a period of at least 2 years.

Original rules

On this background special rules were introduced in connection with the adoption of the new tonnage tax system 1 January 2007 to prevent circumvention of the capital gains taxation upon entry by transferring ownership interest/ shares from non tonnage taxed to tonnage taxed companies.

The original rules imply that purchase by tonnage taxed companies of ownership interests in partnerships (and shares in NOKUS/CFC companies) covered by the participation exemption method from ordinary taxed companies with direct or indirect ownership interest in the acquiring company will result in calculation of a taxable gain for the acquiring company. The same applies if ownership interests in partnerships (and shares in NOKUS/CFC companies) are sold from an ordinary taxed company in which a company that has ownership interest in the tonnage taxed company has direct or indirect ownership interest. The gain will be calculated based on the difference between market value and tax value of the ownership interest/ shares, including over-/ undercharge, and will be subject to taxation on the hand of the acquiring tonnage taxed company. There is no minimum joint ownership requirement, i.e. any joint ownership interest will result in an income settlement.

Proposed correction to cover all forms of realisation/ transfer, not only sale

The original rules only prescribe that a taxable gain should be calculated if ownership interests or shares are sold. The rules are proposed to be corrected by applying the rules to all forms of realisation, not only sale.

Proposed extension – transfer to non tonnage taxed company that later enters into the tonnage tax system

The original rules did not take into consideration that it will as a starting point also be possible to limit the taxable gain upon entry into the new tonnage tax system by transferring ownership interest/ shares to a ordinary taxed company that later enters into the tonnage tax system. The background is that the tax value of the ownership interest/ share will in connection with the transfer be stepped up to market value, and the gain upon a later entry into the tonnage tax system will therefore be limited compared to if the original owner company should enter into the tonnage tax system itself.

The Government has now proposed an amendment to the legislation that will apply if a non tonnage taxed company acquires from a related company an ownership interest in a partnership or shares in NOKUS/CFC companies that are covered by the participation exemption method. (In practice the rules are only of practical interest for partnerships, since shares in NOKUS/CFC companies are in practice not covered by the participation exemption method.)

The proposed amendment applies if a company that acquires the ownership interest/ shares from a related party later enters into the tonnage tax system. The Government proposes that the company must in these cases apply the related company's original overcharge/ undercharge when calculating the taxable gain upon entry into the tonnage tax system. The tax value upon entry will therefore be equal to the tax value on partnership level at the time of entry into the tonnage tax system (which includes taxed and tax free income in the partnership until it enters into the tonnage tax system), with a correction for the over/ undercharge of the original owner/ the related company. This will ensure that profits that have been taxed outside the tonnage tax system or are exempt from taxation are not included when calculating the gain upon entry (not subject to double taxation). At the same time the company that enters into the tonnage tax system will only be able to benefit from the original owners over/undercharge.

The rules only applies if the correction of the over/ undercharge results in a higher taxable gain than if the company's own overcharge/ undercharge should be applied.

If the ownership interest or shares are transferred through several related companies, the overcharge/ undercharge on the original owner company's hand shall be applied.

The rules apply in cases of joint direct or indirect ownership as described above. As under the original rules for transfer to tonnage taxed companies any joint ownership is sufficient.

The rules will apply for companies that enter into the tonnage tax system from 2008 onwards if the ownership interest is transferred to that company during the last three years before entry into the tonnage tax system. The Ministry of Finance has on our request informed that the rules will apply even if the ownership interests/ shares were acquired prior to introduction of the new tonnage tax system 5 October 2007.

Group transfer of assets to tonnage taxed companies

According to the present rules an income settlement will be performed in the transferee company if vessels are transferred from an ordinary taxed company to a tonnage taxed company through a tax free group transfer – either directly by transferring the vessel or indirectly through a transfer of an ownership interest in a partnership or share in a NOKUS/CFC company.

Under the new tonnage tax system a company is allowed to own not only vessels, but also assets that are used in connection with management activities etc. It may therefore be desirable to transfer also other assets than vessels into the tonnage tax system by way of group transfer.

On this background the Government proposes an amendment to the rules implying that an income settlement should be performed in connection with transfer of any asset by way of group transfer.

Disposal ownership interests and shares in NOKUS/CFC companies upon disposal of assets or exit from the tonnage tax system within three years

Gains upon sale of vessels, ownership interest in partnerships and shares in NOKUS/CFC companies are exempt from taxation on the hand of a tonnage taxed company.

The Government has proposed that the transitional rule should apply not only apply if the aforementioned assets are sold (as according to the wording in the present legislation), but also in relation to other forms of realisation and withdrawal from the tonnage taxed company.

For an ordinary taxed company gains upon disposal of vessels are subject to taxation, while gains upon disposal of ownership interests and shares may be subject to taxation if the ownership interest/ share are not covered by the participation method.

It could therefore as a starting point be favourable for a ordinary taxed company to enter into the tonnage tax system in the period 2007-2009 when the transitional rules apply (i.e. valuation of vessels, ownership interests and shares at book value) and thereafter dispose of the assets under the tonnage tax system.

In order to prevent that ordinary taxed companies enter into the tonnage tax system before a planned sale transitional rules apply. According to the transitional rules a taxable gain will be calculated if the tonnage taxed company disposes of such assets or exits the tonnage tax system during the first three years.

However, gains upon disposal of ownership interest and shares in NOKUS/CFC companies that are covered by the participation exemption method are also exempt from taxation on the hand of an ordinary taxed company. The Government therefore proposes to limit the scope of the transitional rules to ownership interest and shares in NOKUS/CFC companies that are not covered by the participation exemption method. (In practice the link between the NOKUS/CFC rules and the participation exemption method implies that NOKUS/CFC companies cannot be covered by the participation exemption method. The narrowed scope of the transitional rules will therefore in practice only be of practical interest as far as ownership interests in partnerships are concerned.)

Correction tax

The Norwegian tax legislation contains general rules regarding the distribution of non-taxed profits ("correction tax"). If there are temporary (negative) differences between the companies' equity for accounting and paid in and taxed equity, correction tax will be invoked if dividends are distributed or group contributions made. The same applies if temporary differences arise as result of the distribution.

In connection with previously tonnage taxed companies' entry into the new tonnage tax system 1 January 2007 a taxable gain should be calculated. At least two thirds of the calculated gain may be deferred using a 'Settlement account' and a minimum of 10% of the original balance must be entered as income each year from the 2007 tax year. Tax for up to one third of the calculated gain will be waived if an amount equal to

the tax on the amount (28% of the 1/3) is invested in qualifying environmental measures within year 2021.

The non-taxed profit in connection with exit from the old tonnage tax system (temporary differences) will include the remaining amounts on the settlement account and the unused environmental funds. When the amount on the settlement account is entered as income (1/10 each year) and environmental investments are made, the share of non-taxed profits will decrease, and the basis for correction tax thus be reduced.

When calculating the net temporary differences, the estimated tax related to the untaxed income is deducted in the basis of comparison. The ordinary rules regarding correction tax, the General tax Act Section 10-5 (2) fourth sentence, prescribe that the estimated tax liability should in this connection be calculated applying the ordinary corporate tax rate (28%), i.e. nominal value should be applied.

However, according to the Government some companies have discounted the value of the tax liability related to the settlement account in the accounts. If the company should still be allowed the deduct the nominal value of the estimated tax liability when calculating the temporary difference, this would mean that the company would be allowed to distribute the difference between the nominal value and the present value of the tax liability without provoking correction tax.

On this background the Government proposes that the tonnage taxed company should only be allowed to deduct the tax liability that is booked in the accounts (i.e. present value if present value is applied and nominal value if nominal value is applied). This will ensure that the tonnage taxed companies are not allowed to distribute untaxed income without provoking correction tax.

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