Finansdepartementet

The Norwegian case study - taxation of dividends from hybrid funds

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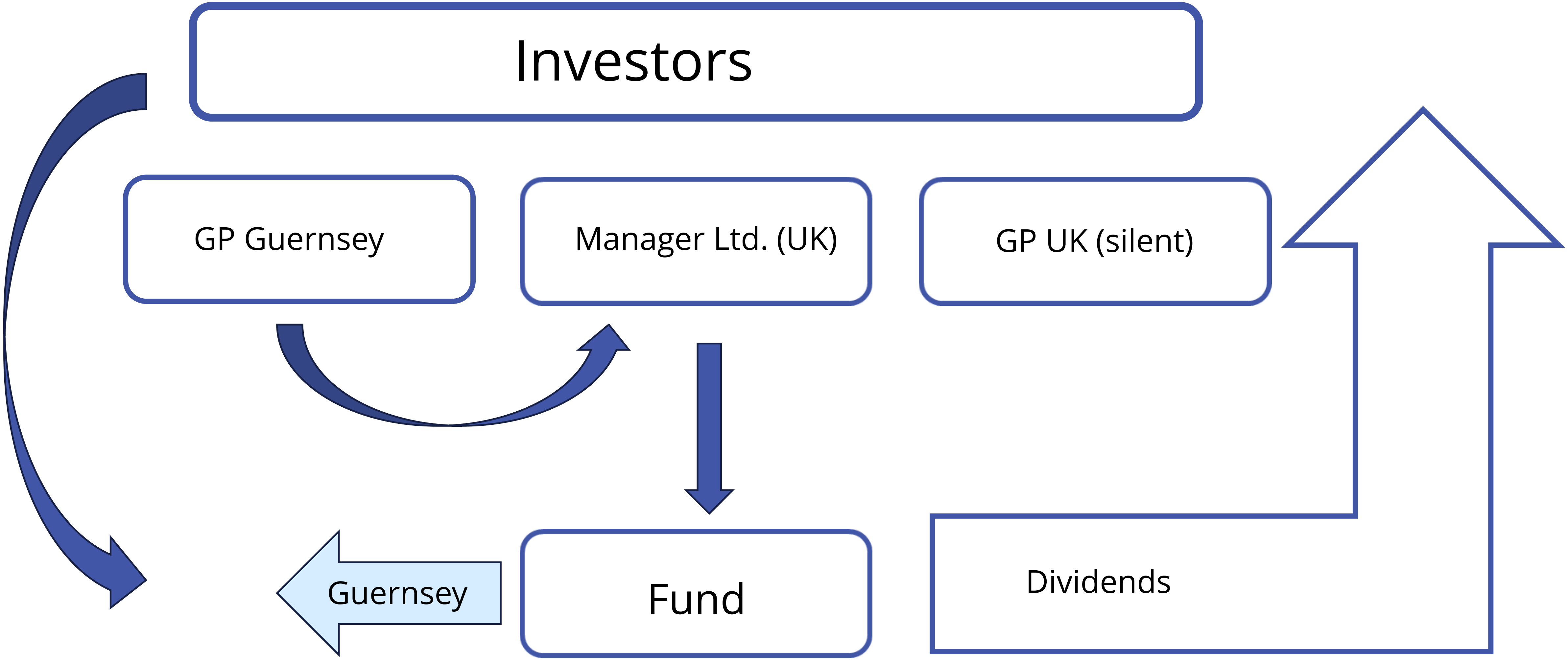
Facts of the case

- A fund (limited partnership) established in the UK and for a time operating in the UK.
  - The fund is considered transparent for tax purposes in the UK, but opaque for tax purposes according to Norwegian law.
    - No tax in the UK, and potentially no tax in Norway (double non-taxation).
  - The GP in Guernsey instructs the manager.
  - The manager of the fund is an LTD in the UK.
  - An extra GP in the UK is appointed, but no part in operations or management.
- The fund moves to Guernsey:
  - Principal place of business is moved from UK to Guernsey.
- Remaining connection to the UK:
  - The fund is listed in Companies House, and has a manager and «silent GP».
- Norwegian investors invest (holding 0,2%) in the fund, and recieves dividends in 2019 and 2020. They claim that the fund is a UK fund (at the time still part of the EU) and therefore fall within the partcipation exemption.


Investors
GP Guernsey
Manager Ltd. (UK)
GP UK (silent)
Guernsey
Fund
Dividends

The Norwegian participation exemption

The Norwegian Tax Act section 2-38 first section:

- Foreign sourced dividends from EEA countries, derived from companies similar to Norwegian companies and tax residents within the EEA are exempt from taxation (exemption method).
  - Purpose: prevent taxation both on the hand of the fund and the investor.
- Are the dividends automatically considered sourced from an EEA country if the fund is a tax resident of an EEA country?
  - According to Norwegian law, the incorporation according to the company law in UK suffices to consider the fund a tax resident in the UK.
  - However, the question arises whether the incorporation of the fund in the UK, leads to the company being a tax resident there after the move to Guernsey.

Back to Cadbury Schweppes (C-196/04)

- Many countries changed their CFC-legislation pursuant to the Courts judgment.
  - Norway did too.
  - and Norway also changed the participation exemption rules:
- The 5th section of § 2-38 therefore reads:
  - «The exemtion from tax pursuant to the first section only applies if the taxpayer is an actual establishment carrying out genuine economic activity in an EEA Member State».
- Link to freedom of establishment. A national rule is proportional as long as actual establishments carrying out genuine economic activity is not coverd by an anti-abuse rule.

CFC-rules vs. partcipation exemption

- Is the Cadbury Schweppes requirement adaptable to taxpayers exercising free movement of capital?
- CFC-rules applies to groups of companies = freedom of establishment. It therefore makes sense to look at «the establishment» in terms of premises, staff and equipment, and the economic activity in terms of business income and added value to the group.
- The participation exemption applies to holdings between 0 and 100 %.
- The CJEU case law: national legislation applicable to holdings which gives the holder definite influence is whithin the scope of freedom of establishment, while laws applicable to portfolio investments are within the scope of free movement of capital.

Previous solution to similar cases

EEA Act section 34 (equivalent to TFEU article 54):

> «Companies or firms formed in accordance with the law of an EC Member State or an EFTA State and having their registered office, central administration or principal place of business within the territory of the Contracting Parties shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of EC Member States or EFTA States.»

The tax office's argument

- Based on the fact that the fund moved its principal place of business from the UK to Guernsey, the tax office argued that according to the EEA Act section 34, the fund now had a sufficient connection to Guernsey which entailed a lack of such connection to the UK = therefore could not be considered as established in the UK (within the EEA).
- However, Art. 34 only lists the connections a taxpayer may have to an EEA Member State in order to invoke freedom of establishment, and does not prescribe that such connections to other countries hinders a connection to an EEA Member State.
- Moreover, this does not impact the assessment under national law.

The Tax Appeal Boards previous decision

The EEA Act section 34 (equivalent to TFEU art. 54) cannot be interpreted as establishing a connection to a non-EEA country which precludes a similar connection to an EEA Member State.

The tax office have however drafted a decision based on the same argument as the previous case, and which the Tax Appeal Board has rejected.

The main issues of the case

- Are the dividends received from the hybrid fund eligible for a tax exemption on the hand of the Norwegian investor?
    - Are the conditions of the first subsection fulfilled?
        - It depends on whether the dividends are considered as received from a fund in the UK or Guernsey.
    - If these conditions are satisfied: can the fund be considered as not being an actual establishment carrying out genuine economic activity in the UK, thus barred from the exemption method on that ground?
        - It depends on whether an actual establishment accords with the condition set in the first section, i.e. whether the fund being established according to the law in the UK must be considered an actual establishment.
        - It depends on whether the fund has remaining activity in the UK to substantiate genuine economic activity.

Questions:

1. Provided that the Norwegian Tax Administration conclude that the dividends are received from a fund inside the EEA (UK). Does the transfer of principal place of business, and the fact that the managing GP is based on Guernsey entail that the fund is not pursuing a genuine economic activity in the UK (wholly artificial)?
2. Provided that the Norwegian Tax Administration conclude that the dividends are received from a fund outside the EEA (Guernsey). Does the funds connection to the UK render the Norwegian legislation contrary to the taxpayers right of free movement of capital? Specifically, is the funds connection to the UK, such that taxpayers can argue that the distribution of dividends is a capital movement within the EEA (free movement of capital only applies within the EEA according to the EEA Agreement)?
3. Norway does not have hybrid mismatch rules like the ATAD or BEPS Action 2 rules: Would these rules apply to the case at hand? Possibly the ATAD GAAR?