EUDTG Newsalert

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EFTA Court rules the combination of the Norwegian interest limitation rules and group contribution rules to be in breach of the freedom of establishment

On 1 June 2022, the EFTA Court delivered its judgement in the case of PRA Group Europe AS v the Norwegian Tax Authorities (E-3/21) concerning the lawfulness of the Norwegian interest limitation rules (as they read from 2014 to 2018) under the freedom of establishment in the EEA Agreement Article 31. The EFTA Court concluded that the combination of the Norwegian interest limitation rules and group contribution rules were in breach of the EEA Agreement as they enabled Norwegian companies having domestic group companies (common ownership of more than 90%) to lessen or remove the effects of the Norwegian interest limitation rules. This possibility was not available for Norwegian entities without domestic group companies.

The facts of the case

PRA Group Europe AS was wholly owned by a Luxembourg resident parent and was partly funded through an interest-bearing loan from its Luxembourg parent. Deductions of interest on the loan had been partly denied under the Norwegian interest limitation rules (as they read in 2014 and 2015). The rules broadly limited deductions of net interest payments to group companies to 30% of a taxpayer's tax EBITDA. The main issue raised for the EFTA Court was whether the denial of these interest deductions was in breach of the EEA Agreement, on the basis that taxable group contributions between Norwegian group companies might be used to increase a company's tax EBITDA, thereby lessening or removing the effects of the Norwegian interest limitation rules for companies having Norwegian group companies. As PRA Group Europe AS had no Norwegian group companies, the company had for its part been unable to utilise this possibility.

The EFTA Court's judgement

The Court first concluded that the Norwegian interest limitation rules, in combination with the group contribution rules, effectively place companies without Norwegian group companies at a disadvantage vis-à-vis companies that are able to utilise the Norwegian group contribution rules to lessen the effects of the interest limitation rules. In this respect, the Court noted that a potential restriction may result also from the interaction between two sets of rules (i.e. the interest limitation rules and the group contribution rules).

Second, the Court considered that a foreign EEA-based company in a group with a Norwegian-based company was in a comparable situation to that of a Norwegian resident company in a group with other Norwegian resident companies. With reference to *Lexel* (C-484/19), the Court held that a situation where a company established in one EEA State makes interest payments on a loan taken out from a group entity established in another EEA State is no different from a situation where the recipient of the interest payments is a group entity established in the same EEA State.

Lastly, the Court held that the restriction was not justifiable neither on the basis of a balanced allocation of taxing rights between EEA States nor for purposes of fighting tax avoidance. As Norway grants the benefit of a potentially increased interest deduction in the domestic situation (and thus renounces part of its taxation rights), it cannot argue that the same taxing right is important in the cross-border situation in an attempt to limit equal treatment of non-residents. Moreover, the rules at issue did not specifically target wholly artificial arrangements, nor did they provide the taxpayer with an opportunity to provide a commercial justification for such arrangements. The rules therefore appeared to go beyond what is necessary to attain the purpose of counteracting wholly artificial arrangements.

Takeaway

The decision in PRA Group Europe AS cannot be considered particularly surprising in light of *Lexel*, where the CJEU had already settled that a combination of interest limitation rules and group contribution rules placing corporate taxpayers that are part of a domestic group at an advantage to corporate taxpayers that have no resident group companies would constitute a restriction under the EEA Agreement. Nonetheless, the EFTA Court's decision raises several questions, notably:

1. To what extent may Norwegian companies having only non-Norwegian group companies reclaim interest deductions denied between 2014 and 2018?
2. Does the decision entail that also the current Norwegian interest limitation rules (in effect as of 2019) are in breach of the EEA Agreement? The current rules contain an equity escape similar to the one set out in ATAD I Article 4 (although the directive is not directly applicable to Norway), which generally is available both to companies part of fully Norwegian groups and those part of cross-border groups. In effect, however, companies that are part of purely Norwegian groups will always qualify for the equity escape and obtain full interest deductions. The rules have already been the subject of complaints made to the EFTA Surveillance Authority.
3. Will Norwegian authorities reassess and potentially amend the current Norwegian rules? One potential approach could be to limit the scope of the Norwegian equity escape clause for Norwegian corporate groups (rather than to extend it also to cross-border groups). It therefore remains to be seen whether the ultimate outcome will be beneficial or detrimental to taxpayers.

Let's talk

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