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EFTA Court holds that Liechtenstein trusts fall within the scope of the EEA Agreement

Executive summary

On 9 June 2014, the European Free Trade Association (EFTA) Court issued its ruling regarding Norwegian controlled foreign corporation (CFC) taxation of the beneficiaries in a discretionary Liechtenstein trust in the case *Fred Olsen and Others v. Norway*.[1]

The EFTA Court held that Liechtenstein trusts fall within the scope of the freedom of establishment or eventually within the scope of the free movement of capital as set out in the European Economic Agreement (EEA). Further the EFTA Court held that a difference in the net wealth tax rate between comparable net wealth in Norway and elsewhere in the EEA area is not jaustified by grounds of overriding public interest.

The judgment is not binding, but as a main rule the guidance given by the EFTA Court is taken into account by Norwegian courts.

Detailed discussion

Background

The Norwegian personal beneficiaries of a discretionary trust in Liechtenstein were subject to Norwegian CFC taxation on the trust's income regardless of any distributions from the trust. Dividend income and capital gains on shares derived by the trust were subject to economic double taxation in the hands of the personal beneficiaries as such CFC income was not subject to tax relief under the Norwegian participation exemption regime. Further the beneficiaries of the Liechtenstein trust were levied net wealth tax of 1.1%. In contrast to Norwegian undertakings under independent management, foundations and family foundations are subject to wealth tax at a rate of 0.3%, whereas beneficiaries in Norwegian foundations and asset funds are not subject to wealth tax.

Building a better working world

Application of the freedom of establishment or the free movement of capital for discretionary trusts established in a low tax country within the EEA area
The EFTA Court held that a Liechtenstein trust falls within the scope of the freedom of establishment as set out in the EEA Agreement provided that the trust pursues a real and genuine economic activity within the EEA area for an indefinite period and through a fixed establishment.

Whether the entity in question conducts a real and genuine economic activity depends on a specific assessment of the actual terms of the entity's statutes and the actual activities of that entity and its management. If a specific assessment reveals e.g., that the trust is involved in the management of a group's companies or other activities for a group, such as managing a pool of resources, and its actual incorporation reflected its actual activities, it has to be regarded as a real and genuine economic activity, which constitutes an establishment. It is not required that the economic activities take effect in the EEA State of establishment. It is sufficient that the economic activities take place in the EEA area.

It is the case for the national courts to perform an overall assessment of all the circumstances of the case in order to decide whether the activities in question are real and genuine. If yes, the freedom of establishment entails that the beneficiaries are entitled to rely on Articles 31 and 34 EEA to the extent the application of national rules contrary to those provisions affects their legal position.

Further the EFTA Court held that beneficiaries of capital assets set up in the form of a trust that are subject to national tax measures may be able to invoke the freedom of capital in the event that the beneficiaries are not found to have exercised definite influence over an independent undertaking in another EEA State or engaged in an economic activity that comes within the scope of the right of establishment.

CFC rules entail restrictions on the freedom of establishment, eventually on the right to free movement of capital
National CFC legislation (including economic double taxation) constitute a restriction on the freedom of establishment or, where applicable, the free movement of capital. Such restrictions may be justified on grounds of overriding public interest, in particular on considerations of preventing tax avoidance or maintaining the balanced allocation of taxing powers between EEA States. The restriction is proportionate if it relates only to wholly artificial arrangements which seek to escape the national tax payable in comparable situations. Thus, a restriction is not justified when it is proven, on the basis of objective factors which are ascertainable by third parties that despite the existence of tax motives a CFC is actually established in the host EEA State and carries on genuine economic activities, which take effect in the EEA area.

The restrictive Norwegian rule involving economic double taxation of dividend income and capital gains on shares derived by the trust was abolished with effect from 1 January 2013. However, the taxpayer may on certain conditions, request that the tax assessment for up to the last ten years may be changed.

Net wealth tax
The EFTA Court states that a difference in the net wealth tax rate between two comparable situations constitutes a restriction on the freedom of establishment or the free movement of capital, which cannot be justified by overriding reasons of public interest. However, it is for the national court to determine whether the beneficiaries of the Liechtenstein trust in question are in a comparable situation to beneficiaries of family foundations or asset funds.

Endnote

1. Joined Cases E-3/13 and E-20/13.

For additional information with respect to this Alert, please contact the following:

Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Munich

- Dr. Klaus von Brocke +49 89 14331 12287 klaus.von.brocke@de.ey.com

Ernst & Young AS, Oslo

- Gjert Melsom +47 982 06 845 gjert.melsom@no.ey.com

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