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Taxation of dividends: Grant of tax credit solely for shareholders resident in the State concerned violates the EEA provisions on free movement of capital

(Case E-1/04 Fokus Bank ASA v The Norwegian State, represented by the Directorate of Taxes)

In a decision given today, the EFTA Court declared the Norwegian imputation tax credit system with regard to the taxation of dividends, to be in breach of EEA law.

Under the Corporate Tax Act of 1991 (replaced by the Tax Act of 1999), dividends paid out by Norwegian companies to shareholders are taxed in the hands of the distributing company and again as general income in the hands of the shareholder. To avoid this so-called economic double taxation, shareholders resident in Norway are granted an imputation tax credit to the effect that dividends will only be taxed in the company's hand. However, this credit is not granted to shareholders non-resident in Norway. Instead, they are taxed by way of a withholding tax for which the distributing company is liable. In making this differentiation, the Norwegian legislation is based on the assumption that non-resident shareholders are reimbursed in their respective home state. The case referred to the Court by the Frostating Court of Appeal concerned companies from Germany and the United Kingdom that held shares in a Norwegian bank and allegedly were engaged in a so-called "dividend-stripping" arrangement, intended to avoid Norwegian withholding tax.

The EFTA Court held that the Norwegian legislation at issue restricts the right to free movement of capital in violation of Article 40 EEA. The differential treatment may have the effect of deterring non-resident shareholders from investing capital in Norwegian companies and of impeding Norwegian companies from raising capital outside Norway. Moreover, the differential treatment constitutes discrimination. The Court rejected the attempt of the Norwegian Government to justify the restriction contrary to Article 40 EEA, finding that shareholders resident and non-resident in Norway were considered to be in a comparable situation. Further, the Court did not accept cohesion of the international tax system as justification. The preparatory works to the Corporate Tax Act gave rise to the assumption that an important purpose of the imputation tax credit system is to protect the Norwegian tax base. Finally, the Court held that possible tax advantages in the home state cannot offset the restriction and discrimination resulting from tax legislation in Norway.

In answering a second question referred to it by the national court, the EFTA Court found that dealing solely with the distributing company when assessing the withholding tax without notifying the non-resident shareholders constitutes a separate discrimination under Article 40 EEA.

The full text of the judgment may be found on the Internet at: www.eftacourt.lu.

This press release is not an official document. Please note that the Court may not comment on the case.