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Dual residence and the right to migrate under EEA law (Arcade Drilling).

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The case brings about the opportunity to fill a gap in the Norwegian tax law. In order to determine the fiscal residence of a corporation, the current formula stipulated by art. 2(2) Tax Act uses the notion of 'belonging to the jurisdiction', while the OECD model employs the term 'place of effective management'[1] as a method to delimit the tax jurisdiction in cross-border situations. The Norwegian Public Prosecutor spent more than nine years on this case, so a defeat can not be easily accepted. Parts of the presently analysed judgment – issued by Oslo Tingrett on 2nd of July 2014 – make subject to a pending action for annulment.

A) Tax liability as a social contract obligation

The social contract argument was used by Socrates in his effort to explain to Crito why he had to remain in prison and accept the death sentence. National tax authorities may reason in a similar manner in their attempt to control the activities of legal persons. Social contract theory upholds that the acceptability of obligations are contingent on the agreement among persons to form the society in which they live. Fact is that the legal persons playing the main role in international tax law cases are typically living in a global society characterised by regulatory competition, which allows them to terminate and perpetually participate in social contracts. They shape the global society by exercising the rights to exit and move in.

Arcade Drilling AS has been established in Norway and its legal existence is contingent on the provisions of the Norwegian company law. On the other hand, the objective nature of the trade performed by this creature of Norwegian law implied a high level of international mobility. The company operated two drilling rigs – Paul B. Lloyd and Henry Goodrich – on the UK continental shelf. Henry Goodrich has been sold and leased back in 1999 for operation in Canada. The departure of Henry Goodrich is seen chronologically as the first critical event.

Following a merger completed on 31 January 2001, the Norwegian company Arcade Drilling AS becomes part of the Transocean group. The parent company, Transocean Inc. has its head office in the Cayman Islands, while the leading company of the group – Transocean Ltd. – is established in Switzerland, Zug. Transocean Inc. holds 99.30% of the capital stock as a consequence of the merger. The acquisition by which Transocean gains control over its subsidiary is the second significant event of the Arcade saga.

B) Brief excurse into previous EEA case law

The incomplete fiscal federalism applied in the EEA is a constitutional model that preserves national diversity, subsidiarity and regulatory competition. As known the exercise of the right to

exit is protected within the EEA, since any restriction against free movement must comply with the proportionality principle. In the aftermath of Centros [2], Cartesio [3] and National Grid Indus [4] the entire legal agora discussed the antagonism between the theories of Incorporation and Real Seat. However in this specific case, the pertinent model is undisputedly, the incorporation theory. The Scandinavian countries and the UK recognise the existence of any legal person being established and ruled in accordance with the law of incorporation of any other jurisdiction.

The incorporation theory in itself is transfer-friendly. The backside of this model from the state perspective reveals nonetheless an administrative difficulty to verify compliance with fiscal obligations of a company that does not maintain any economic activity in the territory. The model allows the delocalisation of the central administration provided that the company continues to comply with the laws of the state of incorporation.

Arcade Drilling AS transferred its central administration from Stavanger, Norway to Aberdeen, Scotland. The exact moment of this transfer may be disputable, but it can be agreed that starting with December 2002, the lack of an operational office and the absence of any other economic links could engender the obligation to liquidate the company according to the Norwegian company law. The Ministry of Finance in Norway has been nonetheless criticised for its opinion that an incomplete liquidation according to tax law entails the same type of assessment as a liquidation according to company law . In any case the main factor seems to be the presence of the head office in Norway, matter which is made subject to an overall assessment.

Arcade argued that a liquidation tax would imply a restriction of its right to freedom of establishment and the EFTA Court was to decide whether the company enjoyed the right to migrate according to EEA law. Relying on the CJEU jurisprudence, the EFTA Court found that a general anti-avoidance rule would be liable to deter a company incorporated under Norwegian law from relocating its place of management to another EEA State and that such a restriction would be in breach of the proportionality principle, if any possibilities of deferring the payment were denied. By noticing that a deferment implied a risk of non-recovery, the EFTA Court recognised that Norway retained the right to take measures to prevent tax avoidance. This risk could nonetheless be hedged by less restrictive means. '*[A] bank guarantee might even be unnecessary if the risk of non-recovery is covered by the personal liability of shareholders for outstanding tax debts of the company*' said the EFTA Court in paragraph 105 of its ruling of 3 October 2012 in case E-15/11. It was up to the Oslo District Court to apply the proportionality test.

C) Drilling deeper into the fiscal situation of Arcade (CY 2001, 2002)

The UK tax authorities considered that the company was subject to British tax jurisdiction starting with January 2001 in accordance with the provisions of the tax treaty between Norway and the UK and the Norwegian authorities accepted initially this theory. Later on, Arcade together with several other corporations – members of the Transocean group – were indicted by Økokrim for filing fraudulent tax returns. The tax advisers of the Norwegian Arcade Drilling AS were confronted with confinement terms of 3-6 years and a compensation claim of NOK 1.8 billion (approx. EUR 180 million). The Public prosecutor claimed that Arcade had continued to be tax liable in Norway until the 19 December 2002, when the required connecting factor was displaced by changing the composition of the Board of Directors. With no economic activity and no other link to Norwegian jurisdiction, Norway could no longer be 'the society in which Arcade lives', so the initial 'social contract' ceased to produce effects.

Until CY 2001, Arcade had been tax liable in Norway for its global profits and gains and its permanent establishment in the UK had been recognised by the Norwegian authorities, as the tax paid in the UK for the PE was deductible in Norway. Arcade was subject to source taxation in Canada too, but this tax was not deductible in Norway. The UK tax authorities informed that unless Henry Goodrich was transferred back to the UK continental shelf within two years, the departure would be deemed permanent and Arcade would become liable to pay claw-back taxes in the UK. In order to avoid this scenario, the company had to redefine its fiscal position starting with 2001 and become globally tax liable in the UK for its worldwide profits and gains.

D) The verdict of Oslo Tingrett (2014-07-02)

From the point of view of company law, Arcade continued to be a Norwegian company until 19 December 2002. However the Oslo District Court recognised that a significant event had already taken place in June 2001, when the first general meeting of the Board was kept in Aberdeen. Starting with 13 June 2001 the place of effective management has been Scotland and in order to make things easier, the time of the transfer was pinpointed to 1 January 2001. While still a Norwegian resident for company law matters, Arcade ceased to be a resident for tax matters on the same day[5]. The Oslo District Court makes an important statement (my translation):

> ‘Even if the risk of claw-back taxation were considered to be the triggering factor for the change of fiscal residence beginning with the fiscal year 2001, the Court appreciates nonetheless that the acquisition completed on the 31st January 2001 constituted a suitable moment to reassess the fiscal position of the company’.

The Oslo District Court reached the conclusion that Arcade was not fiscal resident in Norway as to CY 2001 and CY 2002 and consequently, it could not be held responsible for filing fraudulent tax returns. While Arcade described itself as a dual resident for tax matters – being connected to Norway according to national law and to the UK according to the tax treaty – the Court ruled that this subjective account lacked any legal relevance.

Instead of unconditionally accepting its fiscal burdens, the liable person may try to obtain an advantage. The availability of such relief is the immediate consequence of the European market-preserving federalism[6]. The Oslo District Court recognised the right to take advantage of the differences between national laws in the context of a merger that changed the ownership structure of the group. The transfer of the central administration from Stavanger to Aberdeen did not constitute an artificial arrangement designed to circumvent the legislation of Norway, even if it could be assumed that the change aimed to avoid the claw-back taxation in the UK.

According the Norwegian law, the place of incorporation cannot in itself determine the fiscal residence of a company. However, the transfer of the central administration does not automatically entail an interference which in itself implies a loss of residence. In the meanwhile, the fact that the British Tax Authorities confirmed that Arcade became resident for fiscal purposes in the UK starting with January 2001 constituted a significant indication for a change of status. In any case, in the light of the CJEU ruling in National Grid Indus, the EFTA Court requires that a decision determining that the company has lost that status is issued by competent authorities before an immediate recovery of tax on unrealised assets and tax positions can be enforced. The appeal procedure regarding the unsettled company law aspects is scheduled for October 2015.

[1] The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the enterprise's business are in substance made.

[2] Case C-212/97 Centros [1999] ECR I-1459.

[3] Case C-210/06 Cartesio [2008] ECR I-9641.

[4] Case C-371/10 National Grid Indus [2011] ECR I-12273.

[5] Joined Cases 11-104857MED-OTIR/01 and 11-191007MED-OTIR/03, The Public Prosecutor v. Arcade Drilling AS and Others, 2 July 2014, p. 214.

[6] Weingast laid out a set of three conditions for a federal system to be definable as 'market-preserving federalism'. These conditions require that (1) decentralised governments have the primary regulatory responsibility over the economy; (2) the system constitutes a common market in which there are no barriers to trade; and (3) decentralised governments face 'hard budget constraints' meaning that lower-level governments have neither the capacity to create money nor access to unlimited credit.

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