The Private Equity Review

Twelfth Edition

Editor
Stephen L Ritchie

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Editor
Stephen L Ritchie

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PREFACE

The 12th edition of *The Private Equity Review* comes in the wake of a successful – but bumpy – year for dealmakers, which came on the heels of 2021's record-breaking level of activity. While private equity dealmakers remained active in 2022, with merger and acquisition (M&A) activity at the second-highest level on record (and well above 2020 and pre-pandemic levels), that activity was largely a continuation of 2021's unprecedented momentum carrying into the first half of 2022 before dropping sharply in the latter part of the year. That drop was due to a confluence of factors, including rising borrowing costs, challenged debt markets, high inflation, fears of a potential recession and declining boardroom confidence. The net result was an overall reduction in deal activity of roughly 40 per cent by value and 15 per cent by deal count from 2021. Large deals were up slightly as a percentage of overall M&A value but down in absolute numbers from 2021 levels, driven by the steep drop in mega-deals in the second half of 2022. Private equity exit activity decreased substantially in 2022, with value down 63 per cent and count down 28 per cent. Consistent with these trends, initial public offering and M&A by special purpose acquisition corporations (SPACs) – one of the biggest drivers of 2021's record-breaking deal volume – came to a screeching halt in 2022. The number of liquidated SPACs, with SPAC funds being returned to investors without a deal being done, shot up in the fourth quarter of 2022, with more expected as additional SPACs face upcoming expirations. Although 2022 did see a steady increase in announced de-SPAC M&A activity, likely due in part to SPAC sponsors seeking a deal ahead of the significant number of SPACs approaching their expiry dates, these deals were done at much smaller average sizes than peak 2021 levels and amid an overall background of increasing numbers of terminated de-SPAC transactions.

That said, more than US$1 trillion of global activity in 2022 was attributed to private equity sponsors – at roughly 33 per cent of global deal value, exceeding the prior all-time-high metric set in 2021. Private equity sponsors continued to seek out larger public targets in record number, with overall take-private activity and value surpassing recent levels – the average take-private deal size was US$3.5 billion in 2022, up significantly from US$2.6 billion in 2021. With continued confidence in the performance of private equity as an asset class, fundraising activity remained strong as well, with private equity funds raising aggregate capital of over US$1.2 trillion and continued record amounts of available capital, or dry powder, at, by one estimate, over US$1.4 trillion.

The year 2022 again demonstrated private equity's enormous impact and the continuing creativity of private equity dealmakers. Given private equity funds' success, creativity and available capital, private equity will continue to play a major role in the global economy, not only in North America and Western Europe, but also in developing and emerging markets in Asia, South America, the Middle East and Africa, notwithstanding ongoing and potential additional political, regulatory and economic challenges.

Private equity professionals need practical and informed guidance from local practitioners about how to raise money and close deals in multiple jurisdictions. We intend for *The Private Equity Review* to help address this need. It contains contributions from leading private equity practitioners in 14 different countries, with observations and advice on private equity dealmaking and fundraising in their respective jurisdictions.

As private equity has grown, it has faced increasing regulatory scrutiny throughout the world. Adding to this complexity is the fact that regulation of private equity is not uniform from country to country. As a result, the following chapters also summarise these various regulatory regimes.

I want to thank everyone who contributed their time and labour to making this 12th edition of *The Private Equity Review* possible. Each of these contributors is a leader in their respective markets, so I appreciate that they have used their valuable and scarce time to share their expertise.

Stephen L Ritchie
Kirkland & Ellis LLP
Chicago, Illinois
March 2023

Part I

Fundraising

Chapter 8

NORWAY

Peter Hammerich and Markus Heistad[1]

I GENERAL OVERVIEW

During the past 25 years, the Norwegian private equity market has matured and become more internationalised. One contributing factor has no doubt been the establishment of Argentum Fondsinvesteringer AS, in 2001. Argentum is a government-owned investment company established to make private equity investments. It has committed substantial amounts in funds managed by Norwegian and Nordic managers since its inception, and had a portfolio valued at 13.8 billion Norwegian kroner at the end of 2021.[2] Another factor may have been the implementation of the Alternative Investment Fund Managers Directive (AIFMD). Before this, the Norwegian private equity sector was unregulated. Regulation and prudential supervision have contributed to standardisation and institutionalisation of the actors in this sector. With widening mandatory disclosure and reporting obligations under the Sustainable Finance Disclosure Regulation (SFDR) and the Taxonomy Regulation, we expect the difference between fully authorised and smaller registered alternative investment fund managers (AIFMs) to become less relevant.

The Norwegian economy is relatively small with a limited number of sponsors. The fundraising level is therefore variable from year to year.

In respect of the amount of capital raised by Norwegian sponsors,[3] 2021 saw a sharp increase with 34.4 billion Norwegian kroner raised, compared with 20 billion Norwegian kroner in 2020 and 7.4 billion in 2019.[4]

Notable fundraisings by Norwegian sponsors in 2021 were newcomer Equip Capital closing its first fund at €180 million (1.9 billion Norwegian kroner), as well as Norvestor's Fund VIII, Verdane Edda II, Longship Fund II and FSN Capital Fund VI.

The overall trend has been towards larger fundraisings, with firms having established their track record and a more international investor base. Further, more firms have come to market than in previous years. Although the barrier to entry for new sponsors is low from a purely regulatory point of view, significant fundraisings by newcomers are the exception rather than the rule. Newcomers will rarely be able to demonstrate any track record, unless they are spin-offs from previous sponsors or internal asset management departments.

1 Peter Hammerich is a partner and Markus Heistad is a specialist partner at BAHR.
2 Source: Argentum 2020 annual report.
3 Defined as capital raised through funds advised or managed by a firm with its head office established in Norway (Norwegian Venture Capital and Private Equity Association (NVCA)). This differs from Invest Europe's definition, which defines the nationality depending on where the responsible advisory team is located.
4 NVCA 2020 and 2021 activity report.

The duration of fundraisings may vary significantly, depending on a number of factors. The economic uncertainties caused by the covid-19 pandemic and the Russian war against Ukraine have generally made fundraising more time-consuming as investors are more wary, and sponsors now typically hold more closings and for longer than 12 months.

The year 2021 was a challenging one for businesses and private equity managers with more wary investors. The geopolitical challenges following on from the Russian war against Ukraine in 2022 have added to the level of uncertainty from both a purely business risk perspective but also in terms of interest rate and inflationary risks. Depending on the amount of dry powder and time to realisation periods, private equity funds may benefit from larger market movements, but the level of risk will put investment strategies and internal risk management systems to the test.

II LEGAL FRAMEWORK FOR FUNDRAISING

Norway is a Member State of the European Economic Area (EEA). As such, the main body of legislation regulating the financial sector consists of European Union (EU) legislation transposed into Norwegian law. Management and marketing of private equity fund managers are regulated under the Norwegian Alternative Investment Fund (AIF) Act, which transposes the AIFMD.

At the fund level, private equity funds are unregulated in Norway. Closed-ended funds and open-ended funds investing in asset classes other than financial instruments and bank deposits (e.g., real property, commodities (directly and not in derivatives)) generally fall outside the scope of the Norwegian Investment Fund Act. The EU-regulated fund types European venture capital (EuVECA) funds and European social entrepreneurship funds (EuSEFs) have been implemented into Norwegian law, and European long-term investment funds (ELTIFs) were introduced into Norwegian law as of 1 January 2023. There are, to date, 14 EuVECA funds established in Norway, which is a relatively limited amount. The brief history – so far – of such regulated funds entails that the legal form and key legal terms for private equity funds are primarily shaped by investor expectations and based on international market standards.

The preferred jurisdictions for the establishment of funds by Norwegian firms have traditionally been Norway for smaller funds and the Channel Islands for larger funds by sponsors that also target non-Norwegian investors. Following Brexit, several fund managers have been assessing whether to move new funds to within the EEA or to establish parallel structures inside and outside the EEA. For Norwegian sponsors, Luxembourg has shown to be the most natural jurisdiction for such funds, with several fund sponsors having made this choice for their most recent funds (e.g., Explore Equity and Norvestor VIII).

In terms of legal form, the preference has been for companies that are tax transparent for the purposes of Norwegian tax law, namely limited partnerships, with a general partner having invested an amount into the partnership directly. In the past, smaller Norwegian private equity funds were also established as limited companies.

Key legal terms for private equity funds correspond to those of market standard private equity funds established as limited partnerships. Outside commercial considerations, such as a team's potential for deal sourcing, prospective investors may be expected to be concerned primarily with the correlation between total fund size and management fee, risk alignment or carried interest investment by the team, key man provisions, length of investment or commitment period and length of term, and conditions for extending the investment period or term. Fundraising in the institutional market typically sees extensive negotiations over key terms.

It is standard market practice and a clear investor expectation for funds to include a most favoured nations clause in respect of side letters. For authorised managers, this is also likely to be required under the AIF Act, as is the obligation of fair treatment of investors, whereby any preferential treatment accorded to one or more investors shall not result in an overall material disadvantage to other investors. Side letters represent a major compliance burden for managers, as such bespoke demands are becoming more extensive and may often include more discretionary elements, such as environmental, social and governance (ESG) reporting. It remains to be seen whether cost saving measures and an increased compliance burden in general will force a larger degree of standardisation and reduce the current willingness of sponsors to negotiate side letter regulation. The SFDR and the Taxonomy Regulation will work to standardise ESG disclosures, and general provisions will likely replace bespoke terms in side letters on this point (see Section III.i).

Authorised alternative fund managers are subject to statutory disclosure requirements to both investors and competent authorities in respect of both pre-investment disclosures and ongoing disclosures. The SFDR has introduced statutory disclosure requirements also for registered alternative fund managers. The SFDR and the Taxonomy Regulation entered into effect in Norwegian law as of 1 January 2023. Norwegian managers targeting investors within the EU are required to comply with the rules as implemented in such states in respect of both the SFDR and the Taxonomy Regulation. Disclosures are also market driven, and investors have typically required more extensive disclosures and reporting obligations than those required by law alone.

The trend for increased disclosure requirements is mainly driven by institutional investors such as insurers and pension funds, which typically require more extensive ESG reporting, as well as financial reporting, making insurers capable of employing the Solvency II 'look-through' approach for calculating capital requirements. Good-quality financial reporting is also required by fund of funds investors that have become large investors in private equity funds.

The AIF Act imposes certain requirements in respect of ongoing reporting to investors and requires periodic reporting to the competent authorities. Institutional investors will typically have specific reporting requirements, such as insurance companies (and, going forward, Norwegian pension funds – see Section I) subject to Solvency II capital requirements, and be obliged to adopt the look-through approach to the underlying investments of a private equity fund.

Marketing of interests in private equity funds is regulated under the AIF Act. The AIF Act and its marketing rules have had a substantial impact on the Norwegian market. While marketing of unregulated funds previously could be made without specific restrictions (other than prospectus rules, general marketing law and rules regulating investment services), the AIF Act introduced common marketing rules for all types of AIFs.

The marketing rules differ depending on the jurisdiction of the manager and the fund, whether the manager is authorised or registered, and the jurisdiction of target investors. Implementation of the amendments to the AIFMD introducing rules on pre-marketing has not yet entered into effect.

The AIF Act and the implementation of the AIFMD in Norway are, to a large extent, based on a copy-out approach, with little or no 'gold plating'. Norway has implemented the

AIFMD thresholds, allowing for light touch regulation of managers of smaller funds that are not mutual funds (in simple terms, less than €500 million for closed-ended funds and less than €100 million for open-ended funds).

For private equity managers, that threshold will typically be €500 million, as such funds, as a rule, are unleveraged at the fund level. In practice, the authorisation requirement will typically be triggered by the fact that the manager wishes to manage a fund established outside Norway, or to market fund interests to investors that are not 'professional' according to the definition in the AIFMD. Norwegian rules concerning marketing of interests in AIFs to non-professional investors require that the manager is authorised under the AIFMD.

Whether or not the fund sponsor corresponds to the fund manager (on which the onus of regulation of the AIFMD lies) will vary depending on how the fund structure has been organised. Norwegian private equity funds will typically be managed by an external manager that is either registered or authorised. Internally managed private equity funds are rare. Certain larger sponsors with funds established outside Norway and the EEA, typically the Channel Islands, may have a structure whereby the manager (typically the general partner) is also established in the Channel Islands, and any Norwegian entities operate in an advisory function to the general partner. Advice in the context of private equity funds has been viewed by the Financial Supervisory Authority of Norway (FSAN) as being outside the scope of 'investment advice' as defined in the Markets in Financial Instruments Directive (MiFID II). This mode of organisation requires that the actual management of the fund be undertaken outside Norway, and that the advisory company not engage in investment advice or any other regulated activities.

Marketing of Norwegian unregulated funds by managers falling below the threshold values of the AIFMD and established in Norway are not subject to the specific marketing notification rules under the AIF Act. Managers of sub-threshold funds may opt in to benefit from the marketing passport under the AIFMD.

Norway has implemented the private placement provisions of the AIFMD in respect of funds and managers established outside the EEA. On this point, however, the rules are somewhat stricter than those under the AIFMD, as they require prior authorisation from the FSAN to carry out marketing, rather than relying on notification only. In addition, for fund managers established outside the EEA, there is a requirement that they be registered with a competent authority and subject to prudential supervision in their home state for the purposes of asset management. Upon the pre-marketing rules entering into effect, non-EEA managers will be prohibited from carrying out pre-marketing. The rules are expected to enter into force during 2023.

If the interests issued by unregulated investment funds are financial instruments, then services relating to those interests (such as arrangement services or second-hand share sales) constitute investment services that fall within the scope of MiFID II, transposed into Norwegian law through the Securities Trading Act (the ST Act). Under Norwegian law, interests in limited partnerships are generally not viewed as financial instruments, but there is a specific extension of the scope of the ST Act to include interests in limited partnerships where those interests represent a commitment of less than 5 million Norwegian kroner or the investors are not 'professional investors' per se according to the definition in MiFID II.

In addition, the offer of interests that are financial instruments may trigger a requirement to publish a prospectus under the public offering rules of the ST Act, unless an appropriate exemption is available.

Marketing of private equity funds to non-professional investors requires a separate authorisation by the FSAN and is available only to funds managed by an EEA-authorised AIFM. The EuVECA, EuSEF and ELTIF regulations contain specific rules on marketing also to non-professional investors.

There have been few supervisory actions in the private equity segment, largely because the majority of funds have targeted institutional and professional investors. The FSAN has focused primarily on monitoring marketing activities by sub-threshold managers in respect of non-professional investors and selling practices in respect of shares in investment companies for real estate investments. In respect of reverse solicitation, the FSAN will typically require firm documentation for reverse solicitation to substantiate that no marketing has been undertaken in respect of non-professional investors without authorisation.

The scope of fiduciary duties that a fund manager owes to the fund investors is different for authorised AIFMs and for registered AIFMs.

Authorised AIFMs are subject to overarching business conduct rules, as further specified in the AIF Act and the AIFM delegated regulation. Registered AIFMs are subject only to contractual obligations towards fund investors and general marketing and contract law. The entry into force of the SFDR and the Taxonomy Regulation will introduce certain statutory investment restrictions also for registered AIFMs, if they elect to manage or market funds that are 'Article 8' or 'Article 9' funds.

Authorised AIFMs are required to appoint a single depository to each fund under management. This includes unregulated funds not previously subject to such a requirement. Although there are a limited number of available Norwegian service providers in this segment, this has not proven to be a bottleneck for the establishment of new funds. However, the FSAN has proved sceptical of depositaries in the same group as the AIFM. Further, authorised AIFMs are subject to specific requirements concerning internal organisation, including separation of risk management and valuation and compliance functions, as well as rules limiting their activities to managing AIFs and certain MiFID investment services as ancillary activities subject to prior authorisation. Authorised AIFMs may therefore also offer managed account products, provided that the AIFM has the relevant authorisation.

III REGULATORY DEVELOPMENTS

i Regulatory oversight and registration obligations

Private equity fund managers and their activity fall under the oversight of the FSAN. The FSAN is responsible for the prudential supervision of managers – including both registered and authorised managers – and, indirectly, the funds managed by such managers. The Consumer Authority has oversight of actors in the financial sector providing services to consumers, including investment products such as private equity fund interests offered to consumers and the marketing of such products and services.

The EU Packaged Retail and Insurance-based Investment Products Regulation (the PRIIPs Regulation), which has a requirement for a key information document (KID) when making interests in private equity funds available to non-professional investors, has not been implemented in Norwegian law. Instead, there are non-EEA-based rules requiring a KID to be drawn up to obtain authorisation to market AIFs to non-professional investors. For asset managers active in the retail markets, the impact of the PRIIPs Regulation may introduce increased competition and cost transparency. Higher costs and risks connected to retail products may also lead to reduced competition, if non-Norwegian sponsors do not find the market large enough to warrant the investment. Distribution of private equity interests in the retail segment is also be affected by MiFID II and stronger investor protection rules. The new rules on inducements under MiFID II may affect sponsors in terms of how they can distribute funds in a cost-effective manner. It remains to be seen whether the increased transparency offered by PRIIPs will also affect the marketability of different segment (and higher-cost) funds in the retail markets, and whether this transparency will also affect the approach of institutional investors, especially smaller institutional investors that are not large enough to directly influence costs of management.

The coming year will see the entry into force of statutory ESG reporting and disclosure requirements for AIFMs. Rules implementing the SFDR and the Taxonomy Regulation entered into effect as of 1 January 2023. Managers that have been targeting EU investors or managing EU funds have been subject to the rules already and may have obtained some experience in compliance. For other Norwegian managers (and entities subject to those rules), the abrupt entry into force, announced on 20 December 2022, will require a significant and fast effort to comply. The rules do not – as a starting point – contain substantive investment restrictions. However, investor appetite for ESG and sustainability products from institutional investors is a sign of private equity fund managers being required to integrate ESG into their investment and risk management processes to a much higher degree than has been the case to date.

As mentioned above, private equity funds are not regulated at the fund level in Norway, except for EuVECA, EuSEF and ELTIF regulated fund types, for which the ELTIF regulation applies as from 1 January 2023. For unregulated funds, there are no specific regulatory requirements concerning the funds themselves. However, the rules of the AIF Act that apply to fund managers require that the funds be registered with the FSAN as being managed by the manager, irrespective of whether the manager is a registered or authorised AIFM. Further, certain provisions of the AIF Act, such as those concerning valuation, will have some bearing on the terms of the fund. In June 2019, the FSAN issued a circular concerning project finance companies and the scope of the AIF Act. Project finance companies that are single asset funds have been widely distributed in both the professional and retail spaces, as it has been the market view that these were outside the scope of the AIF Act. Pursuant to the FSAN circular, the FSAN holds that most such undertakings constitute AIFs subject to the AIF Act, unless they are joint ventures or the investors otherwise have day-to-day discretion or control.

Registered and authorised AIFMs are equally subject to the Norwegian Anti-Money Laundering Act (transposing the EU Fourth Anti-Money Laundering Directive into Norwegian law) and the General Data Protection Regulation (GDPR), as well as to requirements under tax reporting legislation implementing the Foreign Account Tax Compliance Act (FATCA) and the Organisation for Economic Co-operation and Development Common Reporting Standard (CRS).

ii Taxation of Norwegian funds and investors

In respect of taxation of Norwegian private equity funds and investors, Norwegian taxation broadly depends on whether a Norwegian fund is transparent (typically a limited partnership) or opaque (typically a limited liability company) for Norwegian tax purposes.

iii Taxation of transparent Norwegian funds and their investors

A transparent fund is not subject to Norwegian taxation. Instead, the income, gains, costs and losses of the fund are calculated at the level of the fund and taxed at the hands of its investors on a current basis (irrespective of whether the fund makes any distributions).

An investor (Norwegian or foreign) is taxable for its share of the fund's net income and gains at the ordinary tax rate of 22 per cent (25 per cent if the investor is subject to the financial tax rate; see Section III.vi). However, any gains deriving from the fund's qualifying equity investments (see Section III.v) are tax exempt, while any dividends from such investments are subject to effective taxation (3 per cent of dividends taxable at the ordinary tax rate) of 0.66 per cent (0.75 per cent if the investor is subject to the financial tax rate).

An individual investor is further subject to an effective tax rate of 37.84 per cent on distributions from the fund to the extent that they are not treated as tax-free repayments of paid-in capital, as well as on gains upon disposal of interests in the fund. The individual investor is, however, allowed a deduction in the distributions or gains for any taxes paid by the investor on the income and gains of the fund and, further, is allowed a minor shielding deduction.

A corporate investor is subject to 0.66 (0.75) per cent effective taxation on distributions from the fund (3 per cent of distributions taxable at the ordinary tax rate), to the extent that they are not tax-free repayments of paid-in capital. The corporate investor is tax exempt on any gain upon disposal of interests in the fund, provided that at least 90 per cent of all equity investments held by the fund have been qualifying equity investments (see Section III.v) for a consecutive period of at least two years immediately prior to the investor's disposal. Otherwise, the gain would be subject to the ordinary tax rate of 22 (25) per cent.

An investor may generally deduct costs, although a corporate investor may not deduct acquisition or realisation costs relating to qualifying equity investments. Losses are generally deductible to the extent that corresponding gains would be taxable, but with certain limitations that are not dealt with further in this chapter.

The above generally applies to both Norwegian and foreign investors, but the foreign investors may, for example, be exempt from Norwegian taxation under an applicable double tax treaty, and certain other deviations may apply.

iv Taxation of opaque Norwegian funds and their investors

An opaque fund in the form of a limited liability company is subject to the ordinary tax rate of 22 per cent on its income and gains. The rate is 25 per cent if subject to the financial tax rate (see Section III.vi). However, any gains deriving from the fund's qualifying equity investments (see Section III.v) are tax exempt, while any dividends from such investments are subject to effective taxation (3 per cent of dividends taxable at the ordinary tax rate) of 0.66 per cent (0.75 per cent if the investor is subject to the financial tax rate). Such dividends are fully exempt from taxation if they are paid by an EU- or EEA-resident company in which the fund holds more than 90 per cent of both share capital and votes (subject to certain conditions). The fund may generally deduct costs to the extent that they are not acquisition or realisation costs relating to qualifying equity investments. Losses are generally deductible to the extent that corresponding gains would be taxable, but with certain limitations that are not dealt with further in this chapter.

A Norwegian individual investor is subject to an effective tax rate of 37.84 per cent, minus a minor shielding deduction, on gains and dividends from the fund, and is entitled to deductions for associated costs and losses.

A Norwegian corporate investor is tax exempt on any gains from the fund and is subject to effective taxation (3 per cent of dividends taxable at the ordinary tax rate) of 0.66 (0.75) per cent on any dividends from the fund. Correspondingly, losses are not deductible.

A foreign investor is, in general, subject to 25 per cent Norwegian withholding tax on dividends from the fund, while any gain upon disposal of interests in the fund is not subject to Norwegian taxation unless the shares are connected to a permanent establishment maintained by the foreign investor in Norway. The foreign investor may be entitled to a reduced withholding tax rate under an applicable double tax treaty. Foreign corporate investors that are genuinely established and carrying on genuine economic activities within the EEA are normally exempt from withholding tax. Further, individual investors resident within the EEA may claim a reduced withholding tax if the withholding tax exceeds the net taxation that would have been borne by a Norwegian individual investor.

v Qualifying equity investments

Norway has a tax exemption method that applies to qualifying equity investments. Qualifying equity investments include (1) shares in Norwegian limited liability companies and similar opaque entities; (2) shares in corresponding EEA limited liability companies, provided that the EEA company in question is not a wholly artificial arrangement established in a low-tax country; and (3) shares in corresponding non-EEA limited liability companies, provided that the non-EEA company is not resident in a low-tax country and, further, provided that the fund holds at least 10 per cent of the share capital and votes of the non-EEA company for at least two consecutive years. Qualifying equity investments further include investments in tax-transparent entities, provided that at least 90 per cent of all equity investments held by the transparent entity have been qualifying equity investments for a consecutive period of at least two years.

vi Financial tax rate

A specific finance tax applies to Norwegian asset managers (and Norwegian branches of foreign asset managers). The tax is composed of two elements: a 5 per cent tax on the aggregate payroll expenses and a 25 per cent tax on net income (compared with 22 per cent, which is the ordinary tax rate for 2023).

vii Carried interest

For funds sponsored by Norwegian managers, the right to carried interest normally depends on the investors having received payment for the entire contributed amount, in addition to a minimum return (typically 8 per cent). The excess proceeds are normally divided (usually 80:20) between the investors and those who have the right to carried interest.

The year 2013 saw the first court case on taxation of carried interest, involving the management company Herkules Capital and three partners. The case concerned the validity of a reassessment of income for 2007 by the tax authorities against Herkules Capital and the three partners, who had received amounts under carried interest. The tax authorities had concluded that the amounts – which had accrued to the partners' personal wholly owned investment companies – constituted ordinary income (salary) for the relevant persons, and that the amounts received by the general partner were taxable as business income in the hands of Herkules Capital.

After an annulment of the tax authorities' reclassification in the court of first instance (district court) and a full win for the tax authorities in the court of appeal, the Supreme Court rendered its judgment on 12 November 2015. The Supreme Court found that the amount of carried interest received by the partners' investment companies was not taxable as ordinary income (salary) for those persons. Further, the Court found that the part of the carried interest amount received by the general partner corresponding to the partners' share could not be reallocated to Hercules Capital as business income. In coming to its conclusion, the Supreme Court emphasised that the taxation of carried interest must be based on the agreed allocation of income between the parties (unless the agreed allocation constitutes a tax avoidance in breach of the general anti-abuse rule or is not based on the arm's-length principle). Further, the Supreme Court emphasised that even though the contribution by the partners was an important factor for the achievement of carried interest, carried interest was also a result of other factors, such as the persons working in the relevant portfolio companies and market developments.

IV OUTLOOK

In 2014, the AIFMD was transposed into Norwegian law and was a watershed for the industry. Before that, both management and marketing of private equity funds were unregulated. Compliance practices were purely market driven.

Following the introduction of the AIFMD, Norwegian fund managers have also been subject to the Norwegian implementation of the EU Anti-Money Laundering Directive, the FATCA/CRS and the GDPR. The SFDR and the Taxonomy Regulation entered into effect in Norwegian law on 1 January 2023 and will further widen the scope of regulatory rules applicable to Norwegian fund managers. They will also apply to registered (and not only authorised) alternative fund managers.

Outside market developments, there are three important challenges going forward for the Norwegian private equity sector. First, the Norwegian financial sector – and, indirectly, the investors and clients, both Norwegian and foreign – has been affected by the long and seemingly growing delay in implementing EU financial legislation in Norway. After the entry into force of the EEA Agreement in 1994, Norway generally implemented EU legislation with great assiduity. This changed following the establishment of the EU system of financial supervision in 2011 and the increasing legislative activity of the EU following the financial crisis.

The EU supervisory organisations – the European Banking Authority, the European Securities and Markets Authority, and the European Insurance and Occupational Pensions Authority – have partially supranational authority, and this conflicts with the principle of the EEA Agreement, whereby no sovereignty shall be relinquished by the EEA Member States. An agreement concerning the incorporation of the EU regulations establishing the European supervisory authorities into the EEA Agreement and integration into the EU system of financial supervision was concluded on 14 October 2014[5] and approved by the Norwegian Parliament in June 2016. This led to a delay in implementation of EU law passed during that time, and it seems that the legal mechanism of the relevant agreement concerning financial supervision is too slow compared with the number of legal mechanisms

5 www.efta.int/about-efta/news/eea-efta-and-eu-ministers-reach-agreement-european-supervisory-authorities-3211.

adopted in the EU. The backlog of outstanding legislation is significant and has led to some hasty implementations due to the long delays. In the asset management area, the regulations concerning EuVECA, EuSEF and ELTIF funds were implemented in autumn 2022 and, in respect of ELTIF, as of 1 January 2023.[6]

Under Norwegian law, providing credit (both loan originating and secondary acquisition of loans) is a regulated service and, as a rule, only credit institutions and similarly regulated entities may provide credit. The entry into effect of the EuVECA, EuSEF and ELTIF regulations will allow for such funds to provide credit (within the restrictions of those regulations). These fund types – and, in particular, ELTIF – considering the amendments tabled in the EU, could provide Norwegian managers with greater flexibility and market opportunities in their investment activity in the unlisted markets in Norway. Together with the current proposals under the AIFMD review on loan-originating funds, it is possible that AIFs may be allowed to originate loans on a more general basis in the future.

6 The EuVECA and EuSEF regulations have been partially implemented.

Appendix 1

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