Case No: 67488
Event No: 565618
Dec. No: 292/10/COL

EFTA SURVEILLANCE AUTHORITY DECISION
of 7 July 2010
on the proposed amendment to the Norwegian Special Tax System for Shipping

(Norway)

THE EFTA SURVEILLANCE AUTHORITY ("The Authority");

HAVING REGARD to the Agreement on the European Economic Area ("the EEA Agreement"), in particular to Article 61 (3) (c) and Protocol 26 thereof,

HAVING REGARD to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice ("the Surveillance and Court Agreement"), in particular to Article 24 thereof,

HAVING REGARD to Article 1(3) of Part I and Article 4(3) of Part II of Protocol 3 to the Surveillance and Court Agreement ("Protocol 3"),

HAVING REGARD to the Authority's Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement[1], and in particular Part IV on Aid to Maritime Transport ("the Maritime Guidelines") thereof,

HAVING REGARD to the Authority's Decision of 14 July 2004 on the implementing provisions referred to under Article 27 of Part II of Protocol 3 ("the Implementing Provisions Decision"),

Whereas:

[1] Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement and Article 1 of Protocol 3 to the Surveillance and Court Agreement, adopted and issued by the Authority on 19.1.1994, published in the Official Journal of the European Union (hereinafter referred to as OJ) L 231 of 3.9.1994 p. 1 and EEA Supplement No 32 of 3.9.1994 p. 1. Hereinafter referred to as the State Aid Guidelines. The updated version of the State Aid Guidelines is published on the Authority's website: http://www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines/

I. FACTS

1. Procedure

The Norwegian authorities notified an amendment to the Norwegian Special Tax System for Shipping, pursuant to Article 1(3) of Part I of Protocol 3 by letter of 8 December 2009 (Event No 539431).

By letter dated 15 January 2010 (Event No 541620), the Authority requested additional information from the Norwegian authorities.

By letter dated 3 February 2010 (Event No 545369), the Norwegian authorities replied to the information request.

By letter dated 5 March 2010 (Event No 549174), the Norwegian authorities provided additional information.

By letter dated 29 April 2010 (Event No 554692), the Authority requested that the Norwegian authorities provide yet more information.

By letter dated 31 May 2010 (Event No 559091), the Norwegian authorities provided the required information.

2. Description of the proposed measures

The Norwegian authorities notified an amendment to the Norwegian Special Tax System for Shipping which was approved by the Authority on 3 December 2008 by Decision No 755/08/COL.

2.1. Tonnage tax regime in place

The tonnage tax regime which was approved and which is currently in place in Norway is based on the principle of permanent exemption from corporate tax of profits derived from eligible activities: ship owners will pay a tonnage tax instead of the standard corporate tax.[2]

Eligible undertakings and eligible activities

The tonnage tax system is open for limited companies formed under Norwegian law. In order to be eligible for the scheme, a company has to either own a qualifying ship under the scheme or own shares or interest in limited companies, partnerships or Norwegian controlled foreign companies, which own such ships. Mixed companies carrying out both qualifying activities and other activities are not eligible under the scheme. No non-shipping related assets – including real estate – may be owned by companies under the tonnage tax system. Companies are allowed to own financial assets. However, profits derived from financial assets are not tax exempted but are subject to standard taxation. The decision to opt for the new tonnage tax system is taken at the level of the group of companies. Companies that opt for the special tax system have to put all their eligible vessels under the tonnage tax regime.

Qualifying ships

All ships in operation are qualifying ships except:

[2] Decision 755/08/COL of 3.12.2008 contains a detailed description of the Norwegian tonnage tax scheme.

- ships in domestic traffic smaller than 100 gross registered tons;
- ferries in scheduled traffic between Norwegian ports where the distance between the first and last port is less than 300 nautical miles;
- ships operating in inland waterways;
- ships conducting stationary activities (*e.g.* ports) or other activities where the sailed distance is less than 30 nautical miles (applies only to domestic traffic);
- vessels which are not self-propelled;
- receiving boats, and vessels used as working platform;
- pleasure crafts, and
- fishing boats.

Principal activities

Qualifying activities are ownership, leasing and operation of ships whether directly owned or chartered in. Capital gains on the sale of assets used for the purpose of qualifying shipping activities are included in the profits which are tax exempted.

Ship management companies are not eligible under the tonnage tax system. Ship management companies are entities providing different kinds of services to ship owners, such as technical survey, crew recruiting and training, crew management and vessel operation; ship management companies, as defined, do not own ships.

Ancillary activities

The Norwegian authorities have decided to allow the following ancillary activities to come within the scope of the tonnage tax:

- loading and unloading of goods;
- temporary storage of goods at, or near the harbour, pending further transport;
- transport of goods and persons in the port area;
- embarking and disembarking of persons;
- sale of goods and services for consumption on board;
- leasing out of containers;
- operation of ticket offices, and passenger terminals;
- hiring out of conference rooms, and
- door-to-door transport for the maritime leg of the transport only (*i.e.* joint transport that consists of sea transport by a qualifying vessel, and inland/air transport, when the inland/air transport is carried out by an independent contractor).

Ring fencing measures

The Norwegian tonnage tax regime entails the following ring fencing measures:

- lock-in period*:* companies that opt for the tonnage tax regime commit to remain under the favourable tax regime for a ten year period. Should they exit the regime before the expiry of the ten year period, they will not be authorised to re-enter the tonnage tax regime before the expiry of the ten year period.

- all-or-nothing rule: a company which is eligible for the special tax system and belonging to a group of companies, in which some companies have opted for the special tax system, is obliged to opt for the tonnage tax system. The decision to opt for the special tax system is made collectively at the level of the group.

- rule against thick capitalisation (preventing all capitalisation not producing deductible costs being attributable to non eligible activities): a minimum amount of debt for eligible companies is stipulated equal to 30% of the company's total capital. If a company has less debt than 30%, the difference between the actual debt and the minimum debt multiplied with a regulated interest rate, is treated as taxable income.

- limitation on the granting of loans: a company within the amended special tax system is not authorised to extend loans to shareholders outside the scheme with direct or indirect interests in the company, or to persons closely related to such shareholders.

- tax neutral effect of group contributions: companies within the tonnage tax system are allowed to make group contributions to and receive group contributions from companies both within and outside the special tax system. However, a group contribution is tax neutral, *i.e*. a group contribution is not deductible for the contributor and will not be treated as taxable income for the receiver.

- restrictions on group contributions subsequent to an exit from the tonnage tax: companies which exit the tonnage tax system are not entitled to receive group contributions for tax purposes in the exit year and the two following years.

- arm's length principle; the general provision in Norwegian tax legislation which imposes an arm's length principle applies to transactions between associated companies and persons. Normal market conditions are used for tax purposes where a transaction takes place within a group of companies benefiting from the tonnage tax system and companies subject to standard corporate tax.

2.2. Notified amendment

The Norwegian authorities propose that currency hedging instruments connected to qualifying shipping activities shall be, for taxation purposes, treated in the same way as shipping revenues, *i.e.* a profit is tax exempted and a loss is not tax deductible.

Shipping companies often operate in international markets and therefore have income and costs in different currencies. The Norwegian authorities consider that the generalised recourse to currency hedging agreements is one of the specificities of the maritime sector.

Under the existing Norwegian tonnage tax system, companies which have opted for the special tax system are allowed to own financial assets, including currency hedging

instruments, but profits derived from such assets are subject to standard corporate taxation. This rule applies regardless of whether the financial assets are connected to qualifying shipping activities, or are merely a financial instrument.

A currency hedging instrument can either be a foreign exchange contract or a currency option.

A foreign exchange contract is an agreement between a financial institution and a client to buy or sell a currency amount at a certain point in time in the future. The exchange rate is agreed at the time of signing the contract. The company has a more accurate basis for selling and buying calculations, and is in a better position to forecast its liquidity position and results in the longer term.

As with foreign exchange contracts, currency options offer companies a guaranteed rate for exchanging currency at a future date. With a currency option, the company is entitled, but not obliged, to buy or sell an agreed currency amount at a pre-agreed exchange rate, *i.e.* at the time of settlement the company can choose between the agreed exchange rate and the current market rate. The company may benefit from any advantageous exchange rate movements during the period up until the time of settlement. A currency option could therefore be described as an insurance policy providing cover against undesirable exchange rate fluctuations.

The main suppliers of financial instruments to Norwegian shipping companies are the two corporate and investment banks DnBNOR and Nordea.

According to the Norwegian authorities, currency hedging instruments connected to qualifying shipping activities shall be, for taxation purposes, treated in the same way as shipping revenues. However, it would be very difficult to identify the currency hedging instruments that are connected to qualifying shipping activities, and those that are only financial instruments.

The Norwegian authorities therefore propose to apply a distribution formula whereby the company's net profit/loss on currency hedging instruments in a tax year shall be divided proportionally between the financial asset and the fixed asset in the balance sheet. Only the share corresponding to the financial assets would be taxable or deductible, while the share corresponding to the fixed assets would be tax exempted.

2.3. National legal basis for the aid measure

The national legal basis for the notified measure is Section 8-10 to 8-20 of the Norwegian Tax Act (*"lov 26. mars 1999 nr. 14 om skatt av formue og inntekt")* and corresponding Regulation (*"forskrift 19. November 1999 nr. 1158 til utfylling og gjennomføring mv. av skatteloven av 26. mars 1999 nr. 14").*

2.4. Budget and duration

The amendment will enter into force as of the income year 2010. The Norwegian authorities have indicated that they estimate the budgetary consequences of the notified amendments to zero on the basis that overall, gains and losses will be evenly distributed over time.

The Norwegian authorities are committed to re-notify the scheme after ten years.

II. ASSESSMENT

1. The presence of state aid

State aid within the meaning of Article 61(1) EEA Agreement

Article 61(1) of the EEA Agreement reads as follows:

"Save as otherwise provided in this Agreement, any aid granted by EC Member States, EFTA States or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Contracting Parties, be incompatible with the functioning of this Agreement."

Presence of state resources

The aid measure must be granted by the State or through state resources. The application of the tonnage tax rather than the standard corporate tax leads to a loss of state revenues.

Favouring certain undertakings or the production of certain goods

The proposed amendment will give ship owners advantages by way of tax concessions. Such measures are limited to the maritime sector and therefore favour only certain undertakings. Hence, they must be viewed as selective within the meaning of Article 61(1) of the EEA Agreement.

Distortion of competition and effect on trade between Contracting Parties

The aid measure must distort competition and affect trade between the Contracting Parties. The tax relief resulting from allowing profit generated under currency hedging agreements to be tax exempted strengthen the ship owners' position towards their competitors within the EEA. The maritime activities in question are carried out both within the EEA and between Norway and the other EEA States and third countries. Hence, the measures affect trade between the Contracting Parties.

The Authority therefore takes the view that the notified amendment constitutes state aid within the meaning of Article 61(1) of the EEA Agreement. This view is confirmed by the Maritime Guidelines which provide specifically that "*these tax relief measures which apply in a special way to shipping are considered to be state aid. Equally, the system of replacing the normal corporate tax system by a tonnage tax is a state aid*".[3]

2. Procedural requirements

Pursuant to Article 1(3) of Part I of Protocol 3, "*the EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. …. The State concerned shall not put its proposed measures into effect until the procedure has resulted in a final decision*".

By submitting notification of the proposed amendment on 8 December 2009 (Event No 539431), the Norwegian authorities have complied with the notification requirement. They have also indicated that they will not implement the aid measure unless and until it has been approved by the Authority, thereby complying with the standstill obligation.

The Authority can therefore conclude that the Norwegian authorities have respected their obligations pursuant to Article 1(3) of Part I of Protocol 3.

[3] See Maritime Guidelines, II, Section 1.4.

3. Compatibility of the aid

It should be noted that the current notification concerns operating aid, *i.e.* aid which is intended to relieve an undertaking of the expenses which it would normally have had to bear in day-to-day management or its usual activities. Operating aid should normally not be allowed, unless it is explicitly authorised by the Authority's State Aid Guidelines. The Maritime Guidelines provide for operating aid relating to tonnage tax in Section 3.1.

The Maritime Guidelines are applicable to "maritime transport" activities as defined in Regulation (EEC) No 4055/86,[4] incorporated into the EEA Agreement as point 53 of Chapter V in Annex XIII to the EEA Agreement, and in Regulation (EEC) No 3577/92,[5] incorporated as point 53a of Chapter V in Annex XIII to the EEA Agreement, that is to say , to the "*transport of goods and persons by sea, on behalf of a client, between a port and another port or off-shore installation at sea*".[6] They also, in specific parts, relate to towage and dredging.[7]

The European Commission ("the Commission") and the Authority have considered the following as activities ancillary to maritime transport and therefore coming within the scope of maritime transport[8]:

- loading and unloading of goods;
- temporary storage of goods at, or near the harbour, pending further transport;
- transport of goods and persons in the port area;
- embarking and disembarking of persons;
- sale of goods and services for consumption on board;
- hiring out of conference rooms.

The criterion which has been applied by the Authority and by the Commission is whether the service in question is closely linked to the provision of maritime transport services.[9]

The Authority understands that currency hedging agreements are an integral feature of the shipping activities. Indeed, shipping companies may have income and costs in various currencies as a result of operating on international markets. Fluctuations in the exchange rates between the different currencies will be an economic element of uncertainty for the company. To reduce the uncertainty the fluctuations in the exchange rates represent, shipping companies enter into currency hedging agreements with financial institutions.

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[4] Council Regulation (EEC) No 4055/86 of 22.12.1986 applying the principle of freedom to services to maritime transport between member States and between member States and third countries (OJ L 378, 31.12.1986, p.1).

[5] Council Regulation (EEC) No 3577/92 of 7.12.1992 applying the principle of freedom to provide services to maritime transport within Member States (maritime cabotage) (OJ L 364, 12.12.1992, p.7).

[6] See Maritime Guidelines, Section 2(3).

[7] Section 3.1(12) of the Maritime Guidelines provides that "*these Guidelines apply only to maritime transport. The Authority can accept that the towing at sea of other vessels, oil platforms, etc. falls under that definition*".

[8] See for example, Decisions N 114/2004 – Italy, N 330/2005 Lithuania and N 93/2006 – Poland.

[9] See Decision 755/08/COL of 3.12.2008, II, Section 3.2.1.

The Authority considers that the fact that the currency hedging agreements must, in order to come within the scope of the tonnage tax regime, be related to eligible shipping activities will ensure that only those currency hedging agreements that are linked to qualifying activities shall benefit from the regime. A currency hedging agreement related to shipping activities cannot be compared to a speculative financial instrument which should be subject to standard corporate tax.

In many cases, it will be difficult to identify the currency hedging agreements that are connected to shipping activities. The Norwegian authorities have proposed that a distribution formula be applied. The company's total profit or loss on currency hedging instruments in a tax year shall be divided proportionately between the financial assets and the fixed assets in the balance sheet. Only the share equivalent to the financial assets share is taxable or deductible, while the share equivalent to the fixed assets share is tax exempted. The Authority takes the view that the distribution formula that will be applied will ensure that there is no negative spill over effects.

Finally, the Authority has taken note of the fact that currency hedging agreements related to shipping activities are included in other EU tonnage tax schemes approved by the Commission.[10] Therefore, the fact of not allowing Norwegian operators to benefit from the same regime would give Norwegian shipping companies a competitive disadvantage *vis a vis* operators in other EEA States.

4. Conclusion

On the basis of the foregoing assessment, the Authority considers that the notified amendment to the tonnage tax scheme which the Norwegian authorities are planning to implement is compatible with the functioning of the EEA Agreement within the meaning of Article 61 of the EEA Agreement.

The Norwegian authorities are reminded about the obligation resulting from Article 21 of Part II of Protocol 3 in conjunction with Article 6 of Decision 195/04/COL to provide annual reports on the implementation of the scheme.

The Norwegian authorities are also reminded that all plans to modify this scheme must be notified to the Authority.

HAS ADOPTED THIS DECISION:

Article 1

The EFTA Surveillance Authority has decided not to raise objections to the proposed amendment to the tonnage tax scheme notified by the Kingdom of Norway on 8 December 2009 .

Article 2

The implementation of the measure is accordingly authorised.

[10] See Decisions N 563/2001 (DK) and N 790/1999 (UK).

Article 3

This Decision is addressed to the Kingdom of Norway.

Article 4

Only the English version is authentic.

Done at Brussels, 7 July 2010.

For the EFTA Surveillance Authority

Per Sanderud
President

Sverrir Haukur Gunnlaugsson
College Member