

Case No: 67943
Event No: 582510
Dec. No: 407/10/COL

EFTA SURVEILLANCE AUTHORITY DECISION
of 27 October 2010
on the amendments 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 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,

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

HAVING REGARD to the consolidated version of the Authority’s Decision No 195/04/COL of 14 July 2004 on the implementing provisions referred to under Article 27 of Part II of Protocol 3 (“the Implementing Provisions Decision”)¹,

HAVING REGARD to Part IV of the Authority’s State Aid Guidelines on Aid to Maritime Transport referenced in this Decision²,

Whereas:

I. FACTS

1. Procedure

The Norwegian authorities notified the amendments to the Norwegian special tax system for shipping (“the Tonnage Tax system”), pursuant to Article 1(3) of Part I of Protocol 3 by letter of 2 July 2010 (Event No 562824).

By letter dated 30 July 2010 (Event No 563571), the Authority requested additional information.

By letter dated 1 September 2010 (Event No 568141), the Norwegian authorities replied to the information request.

¹ Available at: <http://www.eftasurv.int/media/decisions/195-04-COL.pdf>

² Herein after referred to as “the Maritime Guidelines”, available at: <http://www.eftasurv.int/state-aid/legal-framework/state-aid-guidelines/>

2. Description of the proposed measures

2.1. General presentation of the Tonnage Tax system in Norway: prior Tonnage Tax system, Transitional measures, current Tonnage tax system

Further to the judgment of the Supreme Court of 12 February 2010, the Norwegian authorities have notified amendments to the Tonnage Tax system which was approved by the Authority by Decision No 755/08/COL. By a judgment of 12 February 2010, the Norwegian Supreme Court held that the transitional rules constituted a breach to section 97 of the Norwegian Constitution as they resulted in a retroactive application of a fiscal measure.

The previous Tonnage Tax system offered eligible undertakings a postponed taxation of profits derived from the operation of ships until either untaxed income was distributed to shareholders or the company exited the special tax system (instead of paying standard corporate tax on profit generated by eligible maritime activities). Eligible undertakings paid a tonnage tax, *i.e.* the ship owner paid an amount of tax linked directly to the tonnage of the ships. Such tax was payable irrespective of the company's actual profits or losses.

The new Tonnage Tax system approved by the Authority by Decision No 755/08/COL is the one currently in place. The new regime is an exemption regime, *i.e.* shipping income is tax exempt on a permanent basis. Only the actual tonnage tax is due irrespective of the company's actual profits or losses.

In addition to the new Tonnage Tax system, the Norwegian authorities had also notified transitional measures from the prior Tonnage Tax system to the new one. These measures were also approved by Decision No 755/08/COL. As the prior Tonnage Tax system was based on postponed taxation of profits, putting an end to the prior system resulted in the question of how deferred taxation should be dealt with. The Norwegian authorities have indicated that taxable profit would be calculated as the difference between the market value of the company and the balance of the account of retained taxed income plus paid up share capital and premium. As a practical approach, the market value would be based on the accounting values per 31 December 2006. In order to address the issue of the tax treatment of the deferred taxation, the Norwegian authorities had put in place the following transitional measures:

- up to one third of the deferred tax could be set aside to an environmental fund to be used for different kinds of environmental investments. The aim of the environmental fund was to provide incentives for companies to achieve higher environmental protection.
- two thirds or more of the deferred tax would be subject to corporate tax over ten years with a 10% linear depreciation.

Only those undertakings that opted for the new Tonnage Tax system could benefit from the transitional measures. Companies which decided not to enter into the new Tonnage Tax system either because they wished to transfer the headquarters of their company(ies) outside Norway or because they choose not to enter into the new Tonnage Tax system, could not benefit from the transitional measures and would pay the entire deferred tax in the year of exit.

2.2. The notified amendments regarding transitional rules

The Norwegian authorities have notified amendments to the above-mentioned transitional rules. These amendments do not affect the new tonnage tax regime currently in force.³

The amendments will take effect as from the income year of 2010.

The Norwegian authorities have decided that there would be no tax relief for environmental measures anymore and the environmental fund has been abolished. The tax charged under the 2007 transitional rules has been repaid.

The main changes made are the following:

- regarding taxation of untaxed income upon distribution, or when the company exits the tonnage tax system, a new **sequence rule** is introduced. According to this new sequence rule, all dividend payments made by the company will be considered to be distributed from the untaxed income and will be taxed upon distribution. Once all the untaxed income accumulated before 2007 has been distributed and taxed upon distribution, the tax exempted shipping income and taxed financial income may be distributed without further taxation. In order to avoid any retroactive effects, the sequence rule will only apply to dividend payments and group contributions where the general meeting's decision to make such distributions is made on or after 26 March 2010.⁴ Furthermore, there is an exception from the sequence rule for any tax exempted shipping income and taxed financial income earned in 2007 and 2008. According to the exception, the companies can distribute such income as dividend payments (or group contributions) before untaxed shipping income earned before 2007. The exception applies regardless of when the company decides to distribute such income as dividend payments (or group contributions).
- the **prohibition on loans and guarantees** is tightened. Under the transitional rules of 2007, companies with deferred tax liability were not entitled to extend loans or guarantee for loans to personal shareholders (or individuals closely related to such shareholders) or companies outside the scheme with a direct or indirect ownership interest in the company. However, the companies were entitled to guarantee for loans to companies outside the scheme, if the guarantee was provided to an authorised financial institution. Under the new notified rules, companies with a deferred tax liability are not in any case allowed to extend loans or guarantee for loans to companies outside or inside the scheme.
- a **minimum fixed assets share**⁵ is introduced. Indeed, shipping companies may try to avoid the amended sequence rule by transferring the shipping activities to group related companies without a deferred tax liability. If such was the case, the shipping income could be distributed to the shareholders without triggering taxation of the untaxed shipping income. The principle is that a company's fixed assets share cannot be lower than its average fixed assets share for the income years from 2007 to 2009. A company's fixed assets share shall be measured by 31 December of each income year. If the fixed assets share is lower than the average fixed assets share for the income years 2007 – 2009, the

³ Regarding all the other aspects of the scheme which are unaffected by the notification, reference is made to the description of the Tonnage Tax scheme in Decision 755/08/COL of 3 December 2008 on the notification of amendments to the Norwegian Special Tax System for Shipping.

⁴ 26 March 2010 is the date on which the Ministry disclosed the main content of the planned proposals to the public.

⁵ The fixed assets share is the share of the company's total assets which are not financial assets, *i.e.* ships/vessels etc.

company must increase the fixed assets share by 31 December of the subsequent income year. If the fixed assets share is not increased by then, the company must enter as income a part of the settlement account, equal to the proportional reduction of the fixed assets share. The company must repeat this every year until the fixed assets share is equal to or higher than the average fixed assets share for the income years 2007-2009.

- in 2011, the companies can opt for a **settlement of the deferred tax**. According to the settlement scheme, the total untaxed shipping income calculated by 31 December 2006 will be taxed at about 6,7%. The settlement tax is evenly divided to the income years 2010- 2012. The Norwegian authorities have explained that, despite the fact that this scheme entails taxation of shipping income which the companies could avoid by not opting for the settlement scheme, some undertakings may find it attractive. Indeed, companies opting for the settlement scheme will no longer have a latent tax liability from the previous deferred tax system. The undertakings will only be subject to the general conditions of the tonnage tax system, *i.e.* no limitations will apply to lending and guarantee agreements, and no requirements will apply concerning the minimum fixed assets share of the company. In addition, companies opting for the settlement scheme will avoid the “lock-in” of tax exempted shipping income and taxed financial income that the sequence rule may imply (before the company can distribute such income, it must distribute and be taxed for all the untaxed income earned before 2007). The companies must chose between the settlement scheme and the basic scheme when they fill in the income tax return for the income year 2010, *i.e.* at the latest in May 2011. Under the settlement scheme, no limitations apply to lending or guarantee agreements. There are no requirements concerning the minimum fixed assets share of the company.

II. ASSESSMENT

1. The presence of state aid

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.”

1.1. Presence of state resources

The aid measure must be granted by the State or through state resources. The application of the lower Tonnage Tax rather than the standard corporate tax leads to a loss of state revenues. Likewise, the possibility for undertakings opting for the new Tonnage Tax to benefit from preferential conditions to settle taxes deferred under the previous Tonnage tax also involves the foregoing by the State of tax revenues.

1.2. Favouring certain undertakings or the production of certain goods

Both the Tonnage Tax and the transitional measures from the prior Tonnage Tax to the new Tonnage Tax give ship owners advantages by way of tax concessions. Such measures are limited to the maritime sector and therefore favour only certain undertakings. They must therefore be viewed as selective within the meaning of Article 61(1) of the EEA Agreement.

1.3. Distortion of competition and affect on trade between Contracting Parties

The aid measure must distort competition and affect trade between the Contracting Parties. The tax relief in the form of the transitional measures 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.

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 a notification of the proposed amendment to the transitional rules with a letter dated 2 July 2010 (Event No 562824), the Norwegian authorities have complied with the notification requirement. In the notification the Norwegian authorities state that the amendments will not take effect before the Authority has approved them. By doing so, the Norwegian authorities have complied with their 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. Compatibility of the aid

The original Tonnage Tax scheme was approved by the Authority by Decision No 164/98/COL of 1 July 1998. The current Tonnage Tax scheme and the accompanying transitional measures allowing for transition from the prior system to the current one was approved by the Authority by Decision No 755/08/COL.

The current Tonnage Tax system, as approved by Decision No 755/08/COL, remains unchanged. Only the transitional rules change. The original transitional rules imposed upon the undertakings subject to the prior Tonnage Tax that they pay standard corporate tax on at least two thirds of the deferred tax over ten years. The new Tonnage Tax system provides for different options which will allow the eligible undertakings to benefit from a lower taxation than that provided for in the first set of transitional rules approved by the Authority by Decision No 755/08/COL.

As the Guidelines on Aid to Maritime Transport allow for a total exemption of corporate tax for those undertakings eligible under the Tonnage Tax system, the Authority sees no objections to the proposed amendment of the transitional rules resulting in applying a lower corporate tax rate than initially anticipated.

Furthermore, the Authority having approved the new Tonnage Tax system entailing a definitive exemption of corporate tax for those undertakings having opted for the Tonnage Tax system, it sees no reason to object to applying a lower corporate tax rate for the deferred tax.

The Authority therefore considers that the transitional measures notified by the Norwegian authorities comply with the Maritime Guidelines.

4. Conclusion

On the basis of the foregoing assessment, the Authority considers that the notified amendments concerning the transitional rules from the prior Tonnage Tax system to the new one which the Norwegian authorities are planning to implement are 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 Articles 5 and 6 of Decision No 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 notified amendments to the Norwegian Tonnage Tax system for shipping.

Article 2

The implementation of the measures is accordingly authorised.

Article 3

This Decision is addressed to the Kingdom of Norway.

Article 4

Only the English language version of this Decision is authentic.

Decision made in Brussels, on 27 October 2010

For the EFTA Surveillance Authority,

Per Sanderud
President

Sverrir Haukur Gunnlaugsson
College member