Event No: 319006
Case No: 55362
Dec. No.: 127/05/COL

EFTA SURVEILLANCE AUTHORITY

EFTA SURVEILLANCE AUTHORITY DECISION
OF 1 JUNE 2005
PROPOSING APPROPRIATE MEASURES TO ICELAND
IN RESPECT OF
TAX AND FEE CONCESSIONS IN FAVOUR OF THE
ALUMINUM SMELTER, NORÐURÁL HF. AT GRUNDARTANGI
ICELAND

Only the English Version is authentic

THE EFTA SURVEILLANCE AUTHORITY,

HAVING REGARD TO the Agreement on the European Economic Area[1], in particular to Articles 61 to 63 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[2], in particular to Article 24 thereof, Article 1 in Part I and Article 19 in Part II of Protocol 3 thereof,

HAVING REGARD TO the Authority's State Aid Guidelines[3] on the application and interpretation of Articles 61 and 62 of the EEA Agreement, and in particular Chapters 17B, 25 and 26A thereof,

WHEREAS:

Procedure – introduction of review procedure for existing aid

The EFTA Surveillance Authority (hereinafter the "Authority") has undertaken the review procedure regarding existing aid pursuant to Article 1(1) in Part I of Protocol 3 to the Surveillance and Court Agreement with respect to state aid granted on the basis of recurrent tax and fee concessions to the construction of an aluminium smelter, Norðurál hf., at Grundartangi, Iceland with a capacity of 60.000 tonnes per annum. The grant of the aid was approved by the Authority's decision of 8 July 1998 (174/98/COL).

[1] Hereinafter referred to as the EEA Agreement.
[2] Hereinafter referred to as the Surveillance and Court Agreement.
[3] Procedural and Substantive Rules in the Field of State Aid - 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 EFTA Surveillance Authority on 19 January 1994, published in OJ 1994 L 231, EEA Supplements 03.09.94 No. 32. The Guidelines were last amended on 15.12.2004.

More specifically, the review procedure for existing aid was initiated in the context of reviewing a notification, enclosed in a letter from the Icelandic Mission to the European Union, dated 6 November 2003 (Doc. No: 03-7671 A), forwarding a letter from the Ministry of Finance, dated 31 October 2003, both received and registered by the Authority on 6 November 2003. The purpose of said notification was to notify an expansion of Norðurál hf.´s aluminium smelter from 90.000 to 260.000 tonnes per annum (with the possibility of increasing the capacity up to 300.000 tonnes per annum by increasing potline output).[4]

By the same letter of the Ministry, dated 31 October 2003, the Authority became aware of a previous expansion of the aluminium smelter, Norðurál hf. which took place in 2000-2001 and which brought the capacity of the smelter up from 60.000 to 90.000 tonnes per annum.

The Authority has received various information from the Icelandic authorities in order to asses the aid measures under the EEA rules.

In this regard the Icelandic authorities stated in the letter, dated 31 October 2003, that further information would still be forthcoming regarding various issues in order to complete the enclosed notification. By letter of 18 May (Event no: 281687), forwarding a letter from the Ministry of Finance dated 14 May 2004, both received and registered by the Authority on 19 May 2004, the Icelandic authorities submitted part of such supplementing information. By letter dated 8 July 2004 (Event no: 287358), forwarding a letter from the Ministry of Finance dated 1 July 2004, both received and registered by the Authority on 8 July 2004, the Icelandic authorities forwarded yet further information.

Subsequently, the Icelandic authorities have been asked to provide the Authority with further necessary information to assess the aid measures under the EEA state aid rules.

The Authority has requested information from the Icelandic authorities by letter dated 8 September 2004 (Event No: 289638). The response to this letter was enclosed in an e-mail from the Icelandic Mission to the European Union, dated 22 September 2004, forwarding a letter, including annexes from the Ministry of Finance dated 21 September 2004, received and registered by the Authority on 22 September 2004 (Event no: 293453).

The Authority requested further information from the Icelandic authorities by letters dated 3 and 26 November 2004 (Event Nos: 295505 and 299411) in response to which the Icelandic Mission to the European Union sent a letter dated 8 December 2004, forwarding two letters from the Ministry of Finance both dated 8 December 2004, both received and registered by the Authority on 10 December 2004 (Event no: 302659).

The Authority requested yet further information from the Icelandic authorities by letter dated 16 December 2004 (Event no: 302307). The response was enclosed in a letter from the Icelandic Mission to the European Union, dated 17 January 2005,

[4] In actual fact the letter dated 31 October 2003 notified an expansion with a capacity up to 240.000 tonnes per annum, but the Icelandic authorities have subsequently informed the Authority that the expansion would increase the capacity up to 260.000 tonnes per annum.

forwarding a letter from the Ministry of Finance dated 17 January 2005, both received and registered by the Authority on 18 January 2005.

Following a meeting between the Icelandic authorities and the Authority on 16 February 2005 on specific issues regarding existing aid, the Icelandic authorities submitted further information and argumentation in a letter, dated 22 March 2005 from the Ministry of Finance, forwarded by the Icelandic Mission to the European Union on 22 March 2005, both received and registered by the Authority on 22 March 2005 (Event no: 316081). By e-mail of 23 March 2005 the Icelandic authorities stated that it would substantiate further its arguments on issues relating to existing aid in the context of submitting further comments to the Authority.

By letter dated 23 March 2005 (Event no: 308471), sent pursuant to Article 17(2) in Part II of Protocol 3 to the Surveillance and Court Agreement, the Authority informed the Icelandic authorities that it considered the recurrent tax and fee concessions approved in the Authority's decision of 8 July 1998 (174/98/COL) to constitute an existing aid scheme for the grant of operating aid which is not compatible with the functioning of the EEA Agreement. The Authority gave the Icelandic authorities one month to submit comments. The Icelandic authorities requested an extension of this deadline until Friday 29 April 2005 by letter dated 22 April 2005 from the Icelandic Mission to the European Union, forwarding a letter, dated 22 April 2005, from the Ministry of Finance, both received and registered on 25 April 2005 by the Authority (Event no: 317312). The requested extension of the deadline was granted by the Authority by letter dated 26 April 2005 (Event no: 317492).

By fax dated 2 May 2005 from the Icelandic Mission to the European Union, forwarding a letter from the Ministry of Finance, dated 29 April 2005, both registered and received by the Authority on 4 May 2005 (Event no: 318460), the Icelandic authorities submitted comments to the Authority's letter dated 23 March.

In the present decision the Authority upholds its preliminary view that the recurrent tax and fee concessions, approved in the Authority's decision of 8 July 1998 (174/98/COL), constitute an aid scheme for the grant of operating aid which is not compatible with the functioning of the EEA Agreement for the reasons which are set out below. On this basis the Authority proposes the appropriate measures specified below in order to ensure compatibility with the functioning of the EEA Agreement.

I. FACTS

1. Description of the existing aid scheme and its application to investments

1.1 The aid scheme approved in the context of the original construction of Norðurál hf.

By letter from the Ministry of Finance dated 22 June 1997, received and registered by the Authority on 1 July 1997 (Doc. No. 97-4636-A), the Icelandic authorities notified the grant of state aid in the form of various tax and fee concessions to the construction of an aluminium smelter, Norðurál hf. at Grundartangi, Iceland. On 8 July 1998 the Authority adopted decision 174/98/COL (hereinafter the "Grundartangi Decision" or the "Decision") in which it considered that the notified grant of state aid to Norðurál

hf. qualified as investment aid which was compatible with the functioning of the EEA Agreement on the basis of the rules on regional aid in the State Aid Guidelines.

It appears from the Grundartangi Decision that the provisions granting the relevant derogations from statutory Icelandic tax and fee legislation are set out in (i) Act No. 62/27 May 1997 on Enablement to Enter into Agreements on an Aluminium Smelter at Grundartangi (hereinafter the "Grundartangi Act"); and (ii) the Investment Agreement of 7 August 1997 between the sole shareholder of Norðurál hf., Columbia Ventures Corporation, and the Government of Iceland (hereinafter referred to as the "Investment Agreement").[5]

In the Grundartangi Decision the duration of the Investment Agreement is referred to in loose terms (e.g. *"The measures are limited in time to 20-23 years."*).[6] Although it appears from the Investment Agreement that the duration of it can be longer than 20 years,[7] the Authority did not impose any time limit as a condition for approving the grant of state aid in the Grundartangi Decision. Nor did the Authority fix a ceiling which would limit the amount of state aid to be granted in relation to the investment costs.

The following describes the recurrent tax and fee concessions which are considered as part of the aid scheme approved in the Grundartangi Decision.

(a) Absence of right to deduct from taxable income dividends up to 7% of the nominal value of the shares

Article 7.1 of the Investment Agreement and Article 6.1 of the Grundartangi Act provides that the provisions in Act No. 75/1981 allowing for the deduction of 7% of the nominal value of the shares from taxable income is not applicable to Norðurál hf.

In the Grundartangi Decision the absence of this right was considered to increase the annual tax liability of Norðurál hf. by 2.3% of the nominal value of the shares and that this restrictive rule should be counted against those deviations from the standard tax rules, which would be more favorable to the smelter.

(b) Exemption from withholding tax on dividend income

Article 7.1 of the Investment Agreement and Article 6.1 of the Grundartangi Act provides that notwithstanding the rules in Act No. 75/1981 and Act No. 94/1996, a withholding tax on dividends shall not be imposed on dividends where the shareholder is resident in an OECD country and where the shareholder meets the requirements of Article 12 paragraph 2(b) (i) and 2(b) (ii) of the Convention of the United States of America and the Government of the Republic of Iceland No.

[5] However, Norðurál hf. recently received new owners. On 28 march 2004, Columbia Ventures Corporation and Century Aluminum company executed a stock purchase agreement for the transfer of 100% of the shares in Norðurál hf. from Columbia Ventures Corporation to Norðurál Holdings I ehf. and Norðurál Holdings II ehf., both wholly owned subsidaries of Century Aluminum company.

[6] See second paragraph of Section 3 in Part II of the Grundartangi Decision.

[7] The Investment Agreement provides that it shall remain in force until 31 October 2018 (which is referred to as the Initial Term), but also states that, within 17 years of the signature date, the parties should have agreed on an extension of no less than 10 years following the date of expiration (which is presumed to be 31 October 2018). Moreover, the Act 62/1997 which constitutes the legal basis for the tax and fee derogations applying to Norðurál hf. provides that the term of the Agreement "*shall not be less than 20 years from the establishment of the Company."*

22/1975. The latter provisions essentially require that a corporate shareholder has held 10 percent of the stock for the preceding taxable year and that not more than 25 percent of the gross income of the dividends paying company for such prior taxable year consists of interest or dividends. [8]

In the Grundartangi Decision the Authority considered that the exemption from the payment of dividends withholding tax, the rate of which was fixed in the otherwise applicable double taxation treaty between the USA and Iceland, should be considered as an item reducing overall tax liability of the company**.**

(c) Right to allocate tax free profits of up to 4% of the nominal value of share capital into a special internal investment account

Article 7.1 of the Investment Agreement and Article 6.1 of the Grundartangi Act provides that Norðurál hf. shall be entitled to deduct from taxable income in any given year and allocate into a special internal investment account an amount equivalent to 4% of the nominal value of shares. Amounts allocated in the investment account used for investment in depreciable assets within six years, succeeding the allocation, shall be added to the taxable income of Norðurál hf. in the year of investment. In the same year Norðurál hf. shall have the right to accelerate the depreciation of the assets by the same amount used from the investment account. It appears moreover that amounts in the special investment account that have not been invested or have been offset against operating losses within the mentioned period of time (six years) shall be added to taxable income and taxed at the tax rate applicable in the year of allocation. The same shall apply if Norðurál hf. is dissolved.

In the Grundartangi Decision the Authority held that the right to allocate profits into the account should be considered as a possible tax deferral and thus as involving the grant of state aid.

(d) Exemption from net worth tax

Article 7.2 of the Investment Agreement and Article 6.2 of the Grundartangi Act provides that Norðurál hf. shall be exempt from net worth tax provided for in Act No. 75/1981 of 1.2 % of the company's net worth (i.e., the total assets for the company less total liabilities and less nominal value of the shares) and the special net worth tax under Act No. 83/1989 of 0.25% of the company's net worth.

[8] The criteria to be satisfied are the requirements of Article 12 paragraph 2(b)(i) and 2 (b) (ii) of the Convention. Article 12 paragraph 1 provides that *"Dividends derived from sources within one of the Contracting States by a resident of the other Contracting State may be taxed by both Contracting States."* Article 12 paragraph 2 provides *"The rate of tax imposed by one of the Contracting states on dividends derived from sources within that contracting state by a resident of the other Contracting state shall not exceed: a) 15 percent of the gross amount actually distributed*; *or b) When the recipient is a corporation, 5 percent of the gross amount actually distributed if – (i) During the part of the paying corporation's taxable year which precedes the date of payment of the dividend and during the whole of its prior taxable year (if any), at least 10 percent of the outstanding shares of the voting stock of the paying corporation was owned by the recipient corporation; and (ii) Not more than 25 percent of the gross income of the paying corporation for such prior taxable year (if any) consists of interest or dividends (other than interest derived from the conduct of a banking, insurance, or financing business and dividends or interest received from subsidiary corporation, 50 percent of more of the outstanding shares of the voting stock of which is owned by the paying corporation at the time such dividends or interest is received).*"

In the Grundartangi Decision the measure was considered as reducing overall tax liabilities and thus as involving an element of state aid. However, in this context it was also stated that the assessment was based on the assumption that profits will be retained in the company only to a limited extent and that there would therefore be very limited tax liability under the standard rules. On this basis the exemption was considered to be of minor significance to the investor.

(e) Exemption from Industrial charge, Market charge and Industrial Loan Fund charge

Article 7.3 of the Investment Agreement and Article 6.3 of the Grundartangi Act provides that Norðurál is exempt from the Industrial Loan Fund charge under Act No. 76/1987 and the Industrial charge Act No. 134/1993 calculated as 0.08% of turnover; and the Market charge under Act No. 114/1990 calculated as 0.015% of turnover. The exemptions apply to any identical or substantially similar taxes or charges which might be imposed subsequently in addition to, or in place of the Industrial Loan Fund charge, the Industrial charge and the Market charge.

The exemptions from the Industrial charge and the Market charge were considered to involve state aid in the Grundartangi Decision. However, due to the fact that the Loan Fund charge was abolished as of 1 January 1998 the involvement of state aid in this measure was not assessed.

(f) Reduction in stamp duties

According to Article 11 of the Investment Agreement and Article 6.7 of the Grundartangi Act Norðurál would, when the duty to pay stamp duties under Act 36/1978 is triggered, only pay a reduced rate of 0.15% (instead of the statutory rate of 1.5%) on all stamp duty incurring documents issued or entered into by the company in connection with the construction and operation of the smelter. Moreover, all documents related to refinancing as well as shares in the company would be exempt from stamp duties as well as any identical or substantially similar taxes or duties which might subsequently be imposed in addition to, or in place of, such duties.

In the Grundartangi Decision the Authority considered that the permission to pay a reduced rate of 0.15% (instead of 1.5%) on loan and purchase contracts as well as the exemption from paying stamp duties on shares and loans for refinancing involved the grant of state aid.

(g) Special calculation of municipal property fee

Article 8 of the Investment Agreement and Article 6.6 of the Grundartangi Act provides that Norðurál hf. shall pay an annual property tax fixed in a special manner which shall be in lieu of (i) property tax under Act No. 4/1995; and (ii) a special property tax for office and commercial use under the same Act as well as any identical or substantially similar taxes which might be subsequently imposed in place of the property tax.

It follows from Act No. 4/1995 that a municipal property tax shall be levied annually on all real estate (including all industrial real estate), the value of which is assessed by the Valuation Office of Iceland. The tax base is the depreciated replacement value. Tax rates are fixed by individual municipalities up to, in principle, a rate of 1.32% for

industrial property although municipalities have discretion to raise this tax rate with up to 25% more i.e. up to a maximum of 1.65%.

Instead of applying the formula prescribed in Act No. 4/1995 for fixing the municipal property tax, Norðurál hf. would according to the Investment Agreement and the Grundartangi Act be subject to an annual property tax based on a fixed estimated value of buildings and other taxable production facilities of ISK 2,393 million, and taxed at a special rate of 0.75% (instead of the tax rates fixed by the relevant municipality). The amount of the tax will be linked to the building cost index. Moreover, the tax base will not be subject to any depreciation as is the case according to the standard rules.

As regards the special property tax under Act No. 4/1995 the arrangement described above in respect of the municipal property tax entails that Norðurál hf. will be exempt from paying the special property tax.

In the Grundartangi Decision the application of the special method for fixing the applicable municipal property tax was considered as a reduction in tax burden. For purposes of calculating the aid an average of the rates currently applied by the two municipalities where Norðurál hf. is located (of 1.3% and 0.85%) was used.

1.2 The aid scheme applied to the first expansion of Norðurál hf.

In the context of reviewing the notification, dated 31 October 2003 for a subsequent expansion of Norðurál hf., the Authority learned that Norðurál hf. had been expanded already once during 2000-2001 (hereinafter referred to as "Expansion I") which brought the capacity of the smelter up from 60.000 to 90.000 tonnes per annum. The Icelandic authorities have informed the Authority that Expansion I has benefited from state aid granted by means of tax and fee concessions that are identical to those that form part of the aid scheme approved by the Authority in the Grundartangi Decision of 1998.

1.3 The aid scheme applied to the second expansion of Norðurál hf.

By the notification dated 31 October 2003 the Icelandic authorities informed the Authority that it planned to grant state aid to a further expansion to be constructed during 2004-2008 (hereinafter referred to as "Expansion II") in order to bring the capacity up from 90.000 to 260.000 tonnes per annum (with a possibility to increase further up to 300.000 tonnes per annum by increasing potline output). In this respect the Icelandic authorities have informed the Authority that Expansion II will benefit from state aid by means of identical tax and fee concessions as those that form part of the aid scheme approved in the Grundartangi Decision. However, in the same context the Icelandic authorities informed the Authority of certain changes to the aid scheme. These changes will be addressed in a separate Decision by the Authority.

1.4 Sum of state aid granted under the aid scheme up to 2003

The Icelandic authorities have informed the Authority that for the period between 1998 and 2003 the aid incurred under the aid scheme approved in the Grundartangi Decision is estimated to amount to 4,8 million USD based on 2003 price levels.

1.5 Investment costs

The Icelandic authorities have provided the Authority with an overview of the investment costs incurred in order to carry out the original construction of the smelter as well as for the two subsequent expansions, including a further breakdown into separate cost categories.

Table 1
Investment Overview

Norðurál ehf
All figures in millions of USD

Status:	**Com-pleted 1998**	**Com-pleted 2001**	**Currently under construction, startup planned in 2006**		**Expecte d 2007-2008 depen-ding on power supply**	
	Current prices	**Curre nt prices**	**Expansion II cost estimate is based on July 2004 building costs**			
From:	**Initial Invest-ment**	**Expan -sion I**	**Expan-sion II a)**	**Expan-sion II b)**	**Expan-sion II c)**	**Expan-sion II total**
To:	**0 mtpy 60,000 mtpy**	**60,000 mtpy 90,000 mtpy**	**90,000 mtpy 180,000 mtpy**	**180,000 mtpy 212,000 mtpy**	**212,000 mtpy 260,000 mtpy**	**90,000 mtpy 260,000 mtpy**
Site and infrastructure	25.7	0.0	6.8	1.6	2.4	10.8
Raw materials and handling	3.8	4.6	25.1	6.0	9.0	40.1
Anode Rodding	21.7	8.2	19.4	1.2	1.8	22.4
Power supply and utilities	35.2	2.3	56.8	4.1	6.2	67.1
Potlines	72.7	40.9	170.3	66.7	100.1	337.1
Casthouse	6.1	0.7	7.0	6.0	9.0	22.0
Service and administration	6.8	4.8	8.7	2.4	3.6	14.7
Sum of Physical Cost	**172.0**	**61.5**	**294.1**	**88.0**	**132.0**	**514.1**
Engineering and construction supervision	20.4	1.4	23.5	5.1	7.7	36.3
Owner management	4.1	6.5	3.6	0.8	1.2	5.6
Start-up, testing & Commissioning	1.4	1.4	6.9	3.0	4.5	14.4
Construction Insurance and Other Cost	13.7	7.9	20.5	9.1	13.7	43.3
Sum of Non	**39.6**	**17.2**	**54.5**	**18.0**	**27.0**	**99.5**

Physical Cost						
Total Investment Cost	**211.6**	**78.7**	**348.5**	**106.0**	**159.0**	**613.5**

Due to the fact that each of the three investments are dispersed over several years it has been necessary to identify one specific year as a reference year which for the present purposes is 2003.

Using 2003 as a reference year Table 2 expresses the investment costs in 2003 value terms.

Table 2 Investment costs expressed in 2003 present value terms in million USD

Original Investment Costs from Table 1 above	**211.6**	**78.7**	**348.5**	**106.0**	**159.0**	**613.5**
Actual months from original costs to October 2003	**71.5**	**34**	**-9**	**-9**	**-9**	
Rate	**34 %**	**15 %**	**- 4 %**	**- 4 %**	**- 4 %**	
Total Investment @ Oct 2003 Base level	**284.3**	**90.6**	**335.8**	**102.1**	**153.2**	**591.1**

Total investment costs in 2003 present value terms in million USD	**966.0**

According to the Icelandic authorities all investment costs are depreciable costs for tax purposes governed by Act No. 90/2003 on income and net Worth Tax.

1.6 Primary aluminium market

The Icelandic authorities have provided preliminary information on the market of primary aluminium and its expected future developments based on the expert opinion of the CRU Group.[9] In this regard the Icelandic authorities have informed the Authority that according to said opinion of the CRU Group the world demand for primary aluminium was expected to increase in 2004 by 7.4% (which is a slightly lower increase than in 2003 when consumption grew by 8%), and that prices had been increasing. In terms of London Metal Exchange ("LME") prices (based on 3 months USD/Tonne) the prices were averaging USD 1364 in 2002, and USD 1428 in 2003, and were estimated to be USD 1642 in 2004.

The Icelandic authorities have also submitted more recent information on the market circumstances prevailing in early 2005 and the expected future developments based on the opinion of CRU Group. In this respect the Icelandic authorities have stated that while volatility has been the feature of the market in 2004 it appears that by the end of the year prices moved up further, with the three-month LME price reaching a nine-year high of USD 1960. In this respect it has also been stated, however, that although the market fundamentals are decidedly positive, the price spike appears to have been

[9] The source is CRU International, which is the world leading business consultants in metals and mining. Established in 1969, the company is wholly independent and has a staff of over 170 in London, the USA and Singapore. Further information can be found at http://www.crugroup.com.

driven more by fund and speculative interest. According to the CRU Group the market price continued to be driven by technical factors over this period, and in particular, the value of the US dollar, as emphasised by the 8% fall in the LME prices in early January, triggered by a rebound in the value of the US dollar.

The CRU Group has nonetheless found that the world consumption of primary aluminium grew by 9.3% in 2004, driven mainly by the economical growth in the USA and continued activity in Asia and China in particular, which expanded its aluminium consumption by 17%. Western world average demand also grew strongly, rising by 7.5%. According to the expert opinion (CRU Group) demand growth is expected to ease back from the levels seen in 2004, but the prices will remain firm in 2005 and 2006 before easing in the medium term as surplus capacity re-emerges. World consumption is projected to be 37,5 million tonnes by 2009, compared with 30,1 million tonnes in 2004, with an annual average rise of 4.5% over the next five years period. The forecast for the average nominal LME aluminium price over the period is down to USD 1450 in 2009 from USD 1721 average price in 2004.

The table below provides an overview of the world consumption forecasts and the European share of it. Based on the figures in this table the primary aluminium consumption is expected to grow by an annual average of 4.5% over the forecast period.[10]

Table 3

	World aluminium consumption forecasts in 1000 tonnes per year				**LME 3-months avg. price USD[11]**
Year	**Western Europe**	**Total World**	**Western**	**Total World**	**LME price**
1999	5,768	19,709		23,565	
2000	5,933	20,483		24,972	
2001	5,829	18,933		23,734	
2002	6,022	19738		25,341	
2003	6,422	20,920		27,539	1,428
2004	6,580	22,492		30,102	1,721
2005	6,696	23,100		31,558	1,778
2006	6,817	23,641		32,837	1,666
2007	6,967	24,128		34,087	1,590
2008	7,108	24,868		35,668	1,546
2009	7,289	25,759		37,549	1,479

Source: CRU Group

Finally, according to statements by the European Commission primary aluminium is traded and transported throughout the world, and the pricing of aluminium ingots is substantially uniform because of the link to the LME. The EEA is a net importer of primary aluminium and there are substantial trade flows and imports into the EEA of

[10] The following table is a complete reproduction of the table of the CRU Group except for the headings which had to be adjusted to the format of the present document.
[11] The LME 3-months average price forecast in US$/tonne (Nominal prices).

aluminium remelt ingots which are then remelted and converted into each and every form which allows customers for further processing (inter alia, into billets).[12]

1.7 Objective of the aid scheme

The Icelandic authorities have informed the Authority that the Norðurál hf. smelter is located at Grundartangi on the northern side of Hvalfjörður, in the municipalities of Hvalfjarðarstrandarhreppur and Skilamannahreppur. These municipalities belong to the Vesturland region (i.e., in the mid-western part of Iceland). The Authority has, by decision 103/96/COL of 28 August 1996 on the map of assisted areas in Iceland, and, by decision 253/01/COL of 8 August 2001, found the municipalities of Hvalfjarðarstrandarhreppur and Skilamannahreppur in the Vesturland region to qualify for regional aid up to a limit of 17% NGE of eligible investment costs.

In the Grundartangi Decision the Authority considered that in terms of employment and income the aid scheme would make a significant contribution to economic development in the southern part of the Vesturland region which had been characterised by unemployment above the national average and slow depopulation. At that point in time it was expected that the Norðurál hf. would employ 130 persons upon reaching its full capacity and that further jobs would be created in the area in dependent businesses. Moreover, the project was considered to have a positive impact in terms of diversifying the Icelandic economy with respect to its export industries. Also, it was expected that the construction of the smelter and investments in the energy sector would lead to a rise in overall investment in Iceland and that GDP should be growing by 1% more in 1997 than it would otherwise have done.

The Icelandic authorities have informed the Authority that the expectations to the investment project of 1998 have largely been met. In this regard the Icelandic authorities have stated that since 1998 the Vesturland region has experienced a considerable population increase and the construction of Norðurál hf. has been a significant factor in reversing the previous trend of the 1990s of fluctuating and declining population in the area. This statement is supported by information from the Institute of Regional Development in Iceland ("Byggðastofnun") from which it appears that the unemployement rate for the area decreased from being 2.7% of workforce in 1997 to 0.9% in 1999/2000 with a slight increase in 2004 up to 1.9%. Moreover, the number of inhabitants in the area has been increasing from 2000 to 2004 at an annual rate of 1,1%. Norðurál hf.´s contribution to this development appears from the fact that it started up with a workforce of 150 persons in 1998 and hired another 40 persons in the context of Expansion I, leading up to its current workforce of 200 employees. 85% of these employees are from the Vesturland region.

Moreover, the Icelandic authorites estimate that the most recent expansion to benefit from the aid scheme (i.e., Expansion II) will also have chief socio-economic impacts which will be felt within a radius of 50 km from the plant site. The Icelandic authorities expect that the smelter expansion will create a considerable number of new jobs which will contribute significantly to the continuation of the poluation increase in this area of Western Iceland. Furthermore, it is expected that Expansion II will contribute to the growth in other sectors in the area. Demand for various types of services will increase as will demand for various forms of industrial activities such as

[12] See the Commission's decision in the merger case No COMP/M.2702 Norsk Hydro/VAW of 4 March 2002 paragraph 9, available at: http://www.europa.eu.int/comm/competition/mergers/cases/decisions/m2702_en.pdf

construction. Also increased employment opportunities at the smelter will enable farmers in the neighbouring areas to supplement their declining income from farming, thus further countering the depolulation trend seen in most rural areas of Iceland in recent years. It is considered that Expansion II will create around 300-450 new jobs, thereby increasing the total number of jobs at Norðurál hf. to 500-650. It is foreseen that the vast majority of new employees (approximately 90%) will come from the Vesturland region since, as stated above, at present approximately 85% of Norðurál hf.´s employees are residents in this area. Finally, the Icelandic authorities state that the project will make a considerable positive contribution to the Icelandic economy and will contribute to the diversification of exports reducing the current strong reliance on the one commodity of fish.

The Icelandic authorities consider that Expansion II will contribute an additional 1.5% per annum to GDP during construction of the first expansion phase and of the associated power plant. For the latter phase, the level could be 1% higher. Expansion II's permanent contribution to GDP is estimated to be about 0.5%.

1.8 Comments from the Icelandic authorities

The Icelandic authorities have submitted the following comments in response to the letter sent by the Authority pursuant to Article 17(2) in Part II of Protocol 3 to the Surveillance and Court Agreement.

(a) Comments entitled: "Nature of the notified measures. Direct link to a specific investment project with significant regional impact."

The Icelandic authorities argue that it is not a decisive factor whether the aid is in the form of an ad hoc aid or is aid based on a scheme but that it is rather the effect of the aid on regional development versus the effect on competition which determine whether the aid can be regarded as being compatible regional aid. In this regard references are made to certain statements by the Icelandic authorities in the notification, dated 31 October 2003 which provides that the low state aid intensity involved does not have a major impact on competition and that the proposed aid measures do fulfil the requirements set out in Chapter 25 of the State aid Guidelines. According to the Icelandic authorities this means that the positive equilibrium between the resulting distortions of competition and the advantages of the aid in terms of the development of a less-favoured region is guaranteed.

On this basis the Icelandic authorities conclude that the *"aid measures in question"* should be regarded as an *"ad hoc regional investment aid", as in previous similar decisions from the Authority. In general the Icelandic authorities are of the opinion that an ad hoc regional investment aid is in fact less distortive than an established state aid scheme because the actual scope and possible magnitude of an ad hoc aid can be less than a state aid scheme since an ad hoc aid is better to identify and quantify (i.a. as regards time and amount of aid)."*

(b) Comments entitled: "Definitions of an 'aid scheme' vs. 'individual aid.'"

While the Icelandic authorities recognise that *"the initial investment agreement…"* authorised by the Authority on the basis of the Grundartangi Decision 174/98/COL involves existing aid, the Icelandic authorities considers that the aid do not fall within the scope of Article 1(d) of Part II of Protocol 3 to the Surveillance and Court

Agreement.[13] The Icelandic authorities argue that the defintion given in Article 1(d) of an aid scheme refers to two types of aid schemes and that *"The Investment Agreement, and the notified measures,..."* do not fall within the scope of the first limb of this definition. As regards the second limb of the definition requiring that the aid must not be linked to a specific project, the Icelandic authorities argue that *"...only if the aid is not linked to a certain project, the provided time period or the amount of the aid granted would become of further importance to characterize the measures as and aid scheme."* In this regard the authorities also state that *"Therefore, the link to a specific project and the amount of aid granted have to be well distinguished and must not be mixed. It appears that the CSA mixes these different conditions by assuming on page 12 of it's letter, dated 23 March, that 'in order for the aid to be linked [to] the investment (project) in question, the grant of the aid should be dependent on the level of the investments made.' However, according to the abovementioned distinct wording of Article 1(d) in Part II of Protocol 3 to the Surveillance and Court Agreement, only the question whether the aid is granted in favour of one single project or not is of relevance for the aid to be linked."*

The Icelandic authorities continue by stating that *"the aid provisions in the Investment Agreement and the Act are in fact explicitly 'in favour of the investment project by Columbia Ventures Corporation and its subsidiary, Norðurál hf. for the construction and operation of an aluminum smelter at Grundartangi.' It is therefore evident that the aid measures only apply to the company's activites concerning its project in Grundartangi."*

The Icelandic authorities conclude this line of argument by arguing that *"even if the notified aid measure were regarded as 'not linked to a specific project' the Icleandic authorities submit that they can not be regarded as a scheme due to the fact that the aid is neither being granted for an indefinite period of time nor for an indefininte amount."* The authorities continue by stating that *"the time period of the aid measures is, as mentioned in the notification, valid for the remainder of the inital term covered by the Investment Agreement, i.e. until 31 October 2018. This time limit was acknowledged by the Authority in it's Decision No 174/98/COL. Secondly, a double ceiling on the amount of aid was submitted in the notification whereby it was stated that the maxium amount of aid would never exceed 49.9 million EUROs or 17% NGE, according to the existing map of assisted areas for Iceland. The Authority's Decision No 174/98/COL had previously established the 17% NGB state aid intensity ceiling."*

(c) Comments entitled "Legitimate expectations."

The Icelandic authorities argue that *"The Icelandic authorities are of the opinion that the Authority has not submitted explanations as to why the notification of the aid measures involved in the expansion of the aluminium smelter at Grundartangi, notified on 31 October 2003, are defined differently than the similar state aid measures in the Authority's decisions No 174/98/COL and No 40/03/COL, and are now to be regarded as a 'state aid scheme'. Apparently it would seem that this means, in accordance with the definition in Article 1(d) in part II of Protocol 3 to the SCA, that the notified aid measures are in fact not linked to a specific project, may be*

[13] Article 1(d) of Part II of Protocol 3 to the Surveillance and Court Agreement defines an aid scheme as "*...any act on the basis of which, without further implementing measures being required, individual aid awards may be made to undertakings defined within the act in a general and abstract manner and any act on the basis of which aid which is not linked to a specific project may be awarded to one or several undertakings for an indefinite period of time and/or for an indefinite amount;*",

awarded to several undertakings for an indefinite period of time and/or for an indefinite amount."

The Icelandic authorities maintain that they had certain legitimate expectations when they submitted the notification, dated 31 October 2003 to the effect that the Authority *"would address the notification with a similar methodology as the Authority had done in it's previous decisions No 174/98/COL and No 40/03/COL. It was first at a meeting in Brussels on 16 February 2005 that the Authority indicated that the aid measures should be regarded as a state aid scheme and not an ad hoc individual aid."*

The Icelandic authorities conclude by stating that the European Commission has *"in a number of decisions approved of regional investment aid as individual ad hoc aid, and not as aid schemes. Reference can inter alia be made to the following recent state aid decisions of the Commission:*

1. *N 614 /2003 – Investment aid in favour of Infineon Technologies – Portugal (MSF 1998).*
2. *N 611 /2003 – Large investment aid under the 1998 multisectoral framework in favour of e-glass AG*
3. *N 610 /2003 – MSF 1998: Investment aid for the extension of Dow Pet's production of granulate*
4. *N 309 /2003 – Large investment aid under the 1998 MSF in favour of Wacker Siltronic AG"*

(d) *Comment entitled: "Specific points in the CSA letter, dated 23 March, which the Icelandic authorities would like to comment on."*

Reference is made to the opinion expressed by the Authority that the Grundartangi Decision did not impose any time limit nor any ceiling limiting the amount of state aid to be granted in relation to the investment costs.

In this regard the Icelandic authorities first point out that the Investment Agreement does include a time limit for the grant of aid until 31 October 2018 and that the Grundartangi Decision 174/98/COL explicitly provides for a limit on the amount of state aid granted.

It also argued that *"the grant of the aid is in fact dependent on the level of investments made…"*. This argument is substantiated by stating that: *"More investment means more aid and less investment means less aid. If there is no investment there is no aid. This is for example reflected in the previously submitted calculations on previous aid granted and previous investment costs, compared to the estimated aid to be granted in connection with Expansion II and estimated investment costs in connection with the expansion. The previously submitted breakdown of the total investment costs and the total aid amount for the whole period inter alia establishes that the aid is dependent on the level of investments made. The aid is therefore granted on the basis of measures which are related to the amount of investment. The investment triggers the aid measures. The aid measures are mainly imposed on revenue and property and are therefore directly linked to the amount of investment."*

The Icelandic authorities also argue that the Grundartangi Decision and the notification dated 31 October 2003 *"stipulate that the total amount of aid (aid intensity) shall under no circumstances exceed 17% of the net grant investment costs*

(the applicable regional aid ceiling).” In this regard the Icelandic authorities also refer to the notification, dated 31 October 2003, in maintaining that the total aid amount will never exceed 49,9 million Euro.

Finally, the Icelandic authorities argue that they do not understand why the aid scheme shall expire on 8 July 2018 and cannot remain in force until 31 October 2018.

(e) Comments by the Icelandic authorities entitled “Conclusion.”

Apart from a brief summary of the main points of the argumentation that the aid measures is not to be considered as an aid scheme but as an ad hoc individual aid, the Icelandic authorities state that they can in principle *“agree with the CSA calculations on state aid intensity (10,7%) and the ceiling for total aid to be granted to Norðurál hf. of 88,3 million Euro in 2003 prices. The Icelandic authorities furthermore agree with the Authority that based on this fixing of the aid ceiling, the aid measures in question are to be defined as regional investment aid.”*

II. APPRECIATION

1. Existing aid

In the Grundartangi Decision of 8 July 1998 the Authority approved various tax and fee concessions for the grant of state aid to Norðurál hf., at Grundartangi, Iceland which at the time was in the process of constructing an aluminium smelter with a capacity of 60.000 tonnes per annum. Since the grant of such state aid to Norðurál hf. was therefore authorised it constitutes existing aid within the meaning of Article 1(b) in Part II of Protocol 3 to the Surveillance and Court Agreement.

2. Procedural requirements regarding the review of existing aid schemes

Article 1 (1) in Part I of Protocol 3 to the Surveillance and Court Agreement provides that: “*The EFTA Surveillance Authority shall, in co-operation with the EFTA States, keep under constant review all systems of aid existing in those states. It shall propose to the latter any appropriate measures required by the progressive development or by the functioning of the EEA Agreement.”*

According to Article 17 in Part II of Protocol 3 to the Surveillance and Court Agreement, the Authority shall obtain from the EFTA State concerned all necessary information for the review, in cooperation with the EFTA State, of existing aid schemes pursuant to Article 1 (1) in Part I of Protocol 3 to the Surveillance and Court Agreement.

Information relevant for assessing the existing aid measures originates in part from responses by the Icelandic authorities to various information requests (listed in the introductory section in Part I, above) sent by the Authority within the framework of addressing the notification submitted by the Icelandic authorities on 31 October 2003 for purposes of notifying amendments to the aid measures approved in the Grundartangi Decision. Furthermore, following a meeting between the Icelandic authorities and the Authority on 16 February 2005 on specific issues regarding existing aid, the Icelandic authorities submitted information and argumentation in a

letter, dated 22 March 2005 from the Ministry of Finance, forwarded by the Icelandic Mission to the European Union on 22 March 2005 (Event no: 316081). By e-mail of 23 March 2005 the Icelandic authorities stated that it would substantiate further its arguments on issues relating to existing aid in the context of submitting further comments to the Authority.

By letter dated, 23 March 2005 (Event no: 308471), sent pursuant to Article 17(2) in Part II of Protocol 3 to the Surveillance and Court Agreement, the Authority informed the Icelandic authorities that it considered the recurrent tax and fee concessions approved in the Authority's decision of 8 July 1998 174/98/COL to constitute an existing aid scheme for the grant of operating aid which is not compatible with the functioning of the EEA Agreement. The Authority gave the Icelandic authorities one month to submit comments.

By fax dated 2 May 2005 from the Icelandic Mission to the European Union, forwarding a letter from the Ministry of Finance, dated 29 April 2005 (Event no: 318460) the Icelandic authorities submitted comments to the Authority's letter dated 23 March 2005.

Against this background, the Authority concludes that the procedure regarding the review of "existing aid" was carried out in accordance with Article 17 in Part II of Protocol 3 to the Surveillance and Court Agreement.

3. The presence of state aid

3.1 Approach for assessing the involvement of state aid

In the following each of the provisions that involve the grant of state aid and which forms part of the aid scheme approved in 1998 by the Grundartangi Decision will be assessed for purposes of determining the presence of state aid. As a preliminary point it should be recalled that in the Grundartangi Decision the Authority accepted an approach whereby individual deviations from the standard tax rules which increase the company's tax burden could be counted against those deviations which were considered to involve state aid and hence would reduce the overall tax burden.[14] It was therefore only the net result of this calculation which was classified as state aid. This approach was employed with respect to a number of various taxes and charges which each were of a different nature both with respect to the logic and reasoning for their imposition and the point in time at which they fall due.

However, in the following this approach will not be used due to the fact that according to jurisprudence a state aid granted in the form of a tax relief to a company cannot be compensated by another tax or charge which is imposed on the company for other reasons.[15] The Authority considers that each tax or charge corresponds to a specific logic and reasoning and can hence not be off-set.

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[14] See the second paragraph of subsection (c) of section 1 of Part II of the Grundartangi Decision which states the following: *"The Authority can in this case accept the approach that individual deviations from the standard tax rules, which increase the company's tax burden, should be counted against those which reduce it. In other words, what matters here is the overall effect of the Investment Agreement on the net tax liability of the smelter company over time."*

[15] In Case 173/73, Italy v. Commission, ECR (1974) 709, paragraph 16 of the English version, it was stated that *"The argument that the contested reduction is not a "state aid", because the loss of revenue resulting from it is made good through funds accruing from contributions paid to the unemployment insurance fund, cannot be accepted."* See also the Commission's decision in the France Télécom case

3.2 The derogations from recurrent tax or fee provisions in the Grundartangi Act constitute a scheme

The Authority considers that the derogations from recurrent tax or fee provisions specified below, entailing the grant of aid to Norðurál hf., constitute an aid scheme within the meaning of Article 1(d) of Part II of Protocol 3 to the Surveillance and Court Agreement. This conclusion is supported both from the definition of an aid scheme set out in Protocol 3 to the Surveillance and Court Agreement and from recent case law.

As a preliminary point the Authority observes that by virtue of the fact that the derogations to statutory legislations, referred to below, are derogations from a recurrent duty to pay the relevant taxes and fees, the derogations themselves have an "ongoing" character in the sense that the derogations allow for aid to be granted automatically every year without further action being necessary on the part of the state. Such aid measures may qualify as an aid scheme.

With respect to the definition of a scheme it appears from Article 1(d) of Part II of Protocol 3 to the Surveillance and Court Agreement that an aid scheme can, *inter alia*, consist of *"...any act on the basis of which aid which is not linked to a specific project may be awarded to one or several undertakings for an indefininte period of time and/or for an indefinite amount;"*.

First, it is clear from this definition that the fact that there is only one company, i.e., Norðurál hf. which benefits from the aid measure, is not sufficient to bring a measure outside the definition of a scheme.

Secondly, the fact that the aid recipient (i.e., Norðurál hf.) is referred to by name in the aid measure[16] does not mean that the aid measure cannot be defined as an aid scheme. A recent example of this is the European Commission's decision in the France Télécom case of 2 August 2004 (not yet published) in which the Commission considered that the Act providing for the enjoyment of France Télécom of special conditions concerning local direct taxes (saving France Télécom for an amount of up to 1.1 billion Euro) was state aid granted via a scheme. France Télécom was (along with "La Poste") referred to by name in the Act as the only beneficiaries.

Thirdly, as regards the reference in Article 1(d) of Part II of Protocol 3 to the Surveillance and Court Agreement to the requirement that the aid granted via a

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of 2 August 2004, paragraphs 22 and 37. In paragraph 22 the Commission states the following: *" Pour ce qui est de ce point, la Commission observe que, conformément à la jurisprudence, l'existence d'une aide ne peut être niée du fait qu'une entreprise bénéficiant d'un régime fiscal avantageux est soumise à un autre titre à des impositions plus lourdes. Chaque impôt, en effet, répond à une logique et à des présupposés différents.*" See also paragraph 35 of the Commission's decision on the tax measures for banks and banking foundations implemented by Italy (OJ 2002 L 184/27) where it is stated that *"These selectivity elements do not disappear in cases where the banking sector is generally subject to a heavier tax burden. If the bias in the tax system is justified by the nature of the business, it does not call for compensation; otherwise, it is the bias itself that should be corrected. A selective measure might be justified by the specificity of the activity covered by it, but not by the presence of other selective measures."*

[16] As opposed to an aid measure which is open for all but which, without referring to names in the provision itself, happens to benefit one company only.

scheme "*is not linked to a specific project"* it appears that in order for the aid to be linked the investment (project) in question, the grant of the aid should be dependent on the level of the investments made. However, in the present case the aid is granted on the basis of measures which are not related to the amount of the investment and there is no other link by virtue of a ceiling, expressed as a percentage of the investments. The aid may therefore be granted independently of the amount of investments made in respect of the project. On this basis the abovementioned aid measures in the Grundartangi Decision is considered not to be linked to the (investment) project in the form in which they have been approved in this Decision.

In light of the above the Authority takes the view that the derogations from recurrent tax and fee provisions providing for aid to Norðurál hf. which have an on-going character qualify as an aid scheme. Those measures are in the following identified to include the derogations from the dividends withholding tax, the time at which payment of corporate income tax falls due in respect of amounts allocated into a special account, the net worth tax, Industrial charge, the Market charge, the reduction in stamp duties and the municipal property tax.

3.3 Review of individual state aid measures

(a) Absence of right to deduct from taxable income dividends up to 7% of the nominal value of the shares

In the Grundartangi Decision the Authority held that the disadvantage, consisting of the absence of the right to deduct dividends up to a certain amount, increased the tax liability of Norðurál hf. with 2.3% of the nominal value of shares, and should be counted against the aid element involved in the exemption from net worth tax.

However, the Authority considers that, in line with what has been stated above, a measure which provides for the grant of state aid cannot be offset against any other tax measure which results in the recipient paying more than other companies. Hence the Authority considers that the absence of a right to deduct dividends from taxable income – which affects the imposition of corporate income tax - cannot be offset against the aid involved in net worth tax. The Authority therefore considers that the absence of the right to deduct from taxable income dividends up to 7% of the nominal value of the shares is irrelevant for the assessment of the presence of state aid.

(b) Exemption from withholding tax on dividend income

The Authority held in the Grundartangi Decision that *"The exemption from withholding tax on dividends will therefore be counted amongst items reducing overall tax liability…"* In other words, the dividends withholding tax exemption from the otherwise applicable rate in the double taxation treaty between Iceland and the US was considered as state aid. In this regard the Authority took account of the fact if dividends would not be paid out the aid element would be overestimated. However, this was considered "*to a certain extent to be offset by an underestimate of the aid element derived from the exemption from net worth tax,…"*

As regards the possibility of offsetting a measure which involves state aid with another measure, the Authority considers that, as also stated above, it is not possible to offset a measure which involves state aid against another (tax) measure which imposes on the recipient a harder regime than that following from statutory

legislation. In this respect it is clear from the Grundartangi Decision that the exemption from dividends withholding tax was considered to involve state aid since it was referred to as such cf. the quotes set out above.

The Authority considers that the relevant provision which provides for an exemption from dividends taxation when certain conditions are met involves state aid both to Norðurál hf. and the corporate shareholders since both Norðurál hf. and the shareholders are benefiting from an economic advantage which is granted out of state resources and which neither Norðurál hf. nor the shareholder would have received during the normal course of business and which affect trade and distort competition.

The provision involves the grant of state aid to the shareholders who receive a direct economic benefit in the form of not being taxed on dividends which would not have been available to the shareholder in the normal course of business. The measure is also selective since it is only certain shareholders that are resident in OECD countries (thus excluding Liechtenstein) that can benefit from this economic advantage.[17]

The provision also involves the grant of state aid to the company, i.e., Norðurál hf. because only shareholders which invest in this company will be granted the exemption from paying dividends taxation as opposed to shareholders investing in other companies not being able to offer an exemption from dividends tax. All other things being equal the presence of the exemption will make it more attractive to invest in Norðurál hf. compared to other Icelandic companies and is thus likely to influence the behavior of investors that will be rewarded for investing in precisely that company. As a result capital is made accessible on more favorable terms for for Norðurál hf. than for other companies and the exemption confers therefore an indirect economic advantage on the indirect benficary of Norðurál hf. [18]

(c) Right to allocate tax free profits of up to 4% of the nominal value of share capital into a special internal investment account

The Authority considers that the provision stating that Norðurál hf. shall be entitled to deduct from taxable income in any given year and allocate into a special internal investment account an amount equivalent to up to 4% of the nominal value of shares involves state aid on two levels.

The first of these was identified in the Grundartangi Decision where the Authority held that the right to allocate profits into the account involved a tax deferral. The Authority upholds this assessment as the allocated funds which are used for investment (within six years after the allocation) are only taxed in the year of investment.

However, in addition hereto the Authority considers that state aid is granted by virtue of the fact that the assets purchased for the allocated funds may benefit from an accelerated depreciation down to 0% residual value (cf. "*In the same year Norðurál hf. shall have the right to accelerate the depreciation of the assets by the same amount used from the investment account.*") instead of the residual value of 10% following

[17] There are currently 30 members of the OECD. Liechtenstein, one of the Contracting Parties to the EEA Agreement, is not a member. See http://www.oecd.org/document/58/0,2340,en_2649_201185_1889402_1_1_1_1,00.html.
[18] Case C-156/98 ECR [2000] I-6857.

from statutory Icelandic legislation.[19] The possibility to depreciate down to 0% residual value constitutes an economic advantage for Norðurál hf. which it would not have enjoyed during the normal course of its business. The advantage is granted out of State resources as the State is foregoing revenue.[20] Moreover, taking account of the fact that Norðurál is active in the internationally competitive aluminium market the aid measure affects trade and distorts competition.[21]

(d) Exemption from net worth tax

In the Grundartangi Decision the measure was considered as reducing overall tax liability and hence considered to involve state aid.

The Authority upholds its previous assessment that the exemption to Norðurál hf. from net worth tax involves state aid. Since the Grundartangi Decision was adopted in 1998, the rates of the net worth taxes in statutory legislation has as of 2002 changed from being 1.2% and 0.25% of the company's net worth into 0.6%, thus reducing the aid amount involved.[22] In the context of this amendment the Icelandic authorities announced that the remaining net worth tax is to be abolished as of 2006.

(e) Exemption from Industrial charge, Market charge and Industrial Loan Fund Charge

The exemptions from Industrial charge, calculated as 0.08% of turnover, and Market charge, calculated as 0.015% of turnover, were considered as state aid in the Grundartangi Decision.

The Authority upholds its previous assessment that both the exemptions to Norðurál hf. from Industrial charge and Market charge involve state aid. However, it appears that Act No. 114/1990, regulating the Market charge, has been replaced by a new Act No. 160/2002, which amended both the rate and the tax base of the Market charge. In this regard the letter dated 8 July 2004 from the Icelandic Ministry of Finance states that the new rate is 0.05% (as opposed to 0.015% previously applicable) calculated on the basis of total wages of the company (as opposed to turnover).

While the Industrial Loan Fund charge has been abolished from Icelandic law the exemption from the Industrial Loan charge has nonetheless remained in the Investment Agreement. [23] The Authority takes the view that should the Industrial Loan Fund charge be reintroduced the exemption from this charge constitutes state aid as it is granted out of state resources and relieves Norðurál hf. of a charge that should normally be borne out of its budget. Considering Norðurál hf.'s presence on the internationally competitive aluminium market the measure affects trade and distorts competition.

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[19] See Article 42 of Act No. 90/2003.

[20] See also point 3 of Chapter 17B.3 of the State aid Guidelines on the *"Application of state aid rules to measures relating to direct business taxation"* which provides that *"A loss of tax revenue is equivalent to consumption of state resources in the form of fiscal expenditure."*

[21] See subsection 2.2 in Section II of the Decision 40/03/COL regarding the aluminium smelter Alcoa of 14 March 2003 where a similar provision on accelerated depreciation was considered to constitute state aid.

[22] See Act No. 90/2003.

[23] The Industrial Loan Charge was abolished according to Act No. 60/1997 with effect from 1 January 1998.

In addition to the above, the Investment Agreement provides that the exemptions to the Industrial charge, the Market charge and the Industrial Loan Fund charge apply also to any identical or substantially similar taxes or charges which might be imposed subsequently in addition to, or in place of the Industrial Loan Fund Charge, the Industrial Charge and the Market charge. The Authority considers that the Icelandic authorities must inform the Authority of any changes of such a nature for purposes of obtaining the Authority's assessment of whether any such new arrangement involves the grant of state aid.

(f) Reduction of and/or exemption from stamp duties

The Authority upholds its previous position in considering that the reduced rate in stamp duties as well as the exemption from paying stamp duties constitutes state aid to Norðurál hf. In addition the Authority has taken note of the fact that the exemption from stamp duties apply also to any identical or substantially similar taxes or charges which might be imposed subsequently in addition to, or in place of the stamp duties. Should this provision be triggered the Icelandic authorities should inform the Authority for a verification of whether and to which extent the new arrangement involves the grant of state aid.

(g) Special calculation of municipal property fee

In the Grundartangi Decision the application of the special method for fixing the applicable municipal property fee was considered as a reduction in tax burden for Norðurál hf. and hence as state aid. The Authority upholds its previous assessment in this respect. The advantage consists of the difference between applying, on the one hand, the respective municipal property tax rates and a special property tax for office and commercial use, and on the other hand, the result of having used the reduced rate formula set out in the Investment Agreement and the Grundartangi Act.[24]

The Authority observes that the entitlement to deviate from the normal rates of municipal property tax apply also to any identical or similar taxes or charges which might be imposed subsequently in addition to, or in place of the property tax. Should this provision be triggered the Icelandic authorities should inform the Authority for a verification of whether and to which extent the new arrangement involves that grant of state aid.

Between 1998 and the present date the rates applied in one of the two municipalities where Norðurál hf. is placed has changed from being 0.85% to 1.1%, resulting in a larger difference between the rates generally applicable in the municipalities where Norðurál hf. is situated compared to the rate applied to Norðurál hf. The aid amount in this respect is therefore increased.

4. Compatibility of the Aid

In the following the Authority reviews the possibility of considering the aid scheme compatible on the basis of the rules on regional aid and the multisectoral framework in Chapters 25 and 26 A of the State Aid Guidelines.

4.1 Operating aid versus investment aid – the necessity of a ceiling

[24] The special property tax has been abolished as of 1999.

The various tax and fee provisions, described above, from which derogations are permitted, are imposed on revenue and property (such as dividends withholding tax, net worth tax, Market charge, Industrial charge, municipal property tax etc.) rather than in relation to investment costs. Nor is there a general ceiling limiting the aid in terms of a percentage of the investment costs. The Grundartangi Decision is therefore "open-ended" in the sense that the aid to Norðurál hf. could, in principle, be granted for an indefinable amount, irrespective of the level of investment costs. Such aid constitutes operating aid**.**

In the Grundartangi Decision the aid granted in the form of derogations to various tax and fee measures was approved on the grounds that the aid was conditional on initial investment and constituted therefore investment aid directly linked to the investment project. In this regard the Decision states the following;

"The measures are limited in time to 20-23 years. Although their effect is partly to mitigate operating expenses, they are directly linked to the investment project. They are therefore considered not to be operating aid, but to represent incentives for undertaking the investment project concerned, i.e. the aid is clearly conditional on initial investment. The measures therefore fall to be assessed under the rules on regional aid, cf. Part VI of the Authority's State Aid Guidelines."

However, this reasoning needs to be qualified since the Regional Guidelines and recent precedents provide that in order to qualify for investment aid the aid must be limited in terms of a fixed percentage of the investment costs. In this regard it appears from the rules on the grant of regional aid in point 8 of Chapter 25.4 of the State Aid Guidelines that aid for initial investment is to be calculated as a percentage of the investment's value.[25] Moreover, it appears from footnote 2 to Annex X of the Guidelines concerning the calculation of the Net Grant Equivalent of investment aid that any tax "*may be connected with an investment if one sets a ceiling expressed as a percentage of the amount invested in the region."* Finally, it appears from point 3 of Chapter 17B.4 on the application of the State aid rules to measures relating to direct business taxation that a fiscal aid may be treated as any other aid where it is granted as an incentive for investment and *"where its intensity is limited with respect to the costs of carrying out the project*,…"

These guidelines provide that in order for aid to qualify as investment aid the aid must be limited in terms of a fixed percentage of the investment costs. This conclusion is confirmed by case law.[26] The Authority considers that the required link to investment costs does not necessarily have to be expressed in the tax measure itself.[27] If the grant of the aid is subject to an overall aid ceiling which is expressed as a percentage of the amount of the investment this would be sufficient to classify the aid as investment aid

[25] This is repeated in footnote 36 (which relates to point 30 in Chapter 25.4 of the Guidelines) in the context of cumulation of aid where rules are laid down for combining job creation aid and investment aid.

[26] Joined cases C-186/02 P and C-188/02 P Ramondin v Commission, not yet published and Joined cases C-183/02 P and C-187/02 P, not yet published.

[27] See point 3 of Chapter 17B.4 of the State aid Guidelines on the "Application of the state aid rules to measures relating to direct business taxation" which provides that *"Where fiscal aid is granted in order to provide an incentive for firms to embark on certain specific projects (investments in particular) and where its intensity is limited with respect to the costs of carrying out the project, it is no different from a subsidy and may be accorded the same treatment."*

irrespective of the fact that the tax measure, providing for the grant of the aid, is not related to investment costs but rather to profits or revenues for example.

On the basis of the above the Authority therefore considers that, with the exception of the aid granted via the exemption from dividends withholding tax, all other aid measures under the aid scheme which would currently be considered as operating aid in the Grundartangi Decision can qualify as investment aid by means of imposing an overall ceiling which is expressed as a percentage of total investment costs.[28] This manner of proceeding is supported by the approach used by the European Commission in the context of accession of the ten new EU member states where the Commission required several Polish tax measures to be limited in terms of a percentage of eligible investment costs in order to qualify the aid measures as investment aid.[29]

However, as regards the exemption from dividends withholding tax, referred to above in Part I under point 1.3(b) and point 3.3(b) of this Part, the Authority considers that the tax relief involves the grant of operating aid to the shareholders of Norðurál hf. which cannot qualify as investment aid in the present case.

In this regard Authority considers that the state aid granted via the dividends tax relief to the shareholder cannot qualify as investment aid due to the fact that it is the company, i.e., Norðurál hf., which undertakes the relevant investments as opposed to the shareholder of the company. In this regard, the Authority considers that the mere fact that the dividends tax relief in the present case is not conditional on any investments being made by the shareholder means that the tax relief is not linked to an investment. Due to the fact that none of the other grounds set out in Article 61 of the EEA Agreement for a finding of compatibility can be applied to the exemption from dividends withholding tax, the Authority considers that the dividends tax relief cannot be considered as compatible with the functioning of the EEA Agreement for the future.

4.2 The assessment of advantages versus distortions of competition

Chapter 25.2 of the State Aid Guidelines provide that a derogation from the general prohibition against State aid established by Article 61(1) of the EEA Agreement may be granted in respect of regional aid only if the equilibrium between the resulting distortions of competition and the advantages of the aid in terms of the development of a less-favoured region can be guaranteed. The weight given to the advantages of the aid is likely to vary according to the derogation applied, having a more adverse effect on competition in the situations described in Article 61(3) (a) than in those described in Article 61(3) (c).

However, Chapter 25.2 of the State Aid Guidelines also provide that an individual ad hoc aid payment made to single firm or aid confined to one area of activity may have a major impact on competition in the relevant market and that its effects on regional development are likely to be too limited. Such aid is therefore considered often not to

[28] That is, the aid elements identified in relation to the right to allocate amounts into a special account, the net worth tax, Industrial charge, Market charge, reduction in stamp duties and the municipal property tax.

[29] See Section 5 on "Competition Policy" in Annex XII to the Accession Act of Poland concerning the conditions for accession where regional state aid measures have been limited in terms of a percentage of eligible investment costs (OJ 2003 L 236/875).

be in keeping with the spirit of regional aid policy as such. The aid granted in such a context must be neutral towards the allocation of productive resources between the various economic sectors and activities. The Authority considers that unless it can be shown otherwise such aid does not full the requirements set out above.

The Icelandic authorities have submitted comprehensive information on the socio-economic impact of the investments made in respect of the aluminium smelter of Norðurál hf.; see point 1.7 of Part I above. This information shows, amongst others, that previous expectations to the effect that the investments in Norðurál hf. would reverse the fluctuating and declining depopulation trend in the Vesturland region, have been met. In line herewith it also appears from the relevant information that the Icelandic authorities consider that the more recent investments in the form of Expansion II is expected to further improve the socio-economic situation of the region both in terms of growth and job creation. For example it appears that Expansion II is expected to create around 300-450 jobs (which will bring the total number of jobs at Norðurál hf. up to 500-600 jobs) and that the majority of future employees will come from the Vesturland region.

On this basis the Authority considers that the aid scheme benefiting investments made for the construction and the two subsequent expansions of the aluminium smelter of Norðurál hf. has already, and will continue, to make a significant contribution to the economic development in the Vesturland region.

Moreover, as is apparent from the information provided in point 1.6 of Part I above on the primary aluminium market, the relevant market has grown by 8% in 2003 and 9.3% in 2004 which shows that the expectations of a future market increase have been met. Moreover, it appears that world consumption is projected to increase even further although not at the same high rate as in recent years. Based on this information as well as Table 3, set out in point 1.6 of Part I above, showing that primary aluminium is traded world-wide, including in the EEA, and how world consumption and prices for primary aluminium are presumed to develop, the Authority considers the primary aluminium market to be a well-functioning world market.

On this basis the Authority considers that, with the exception of the exemption granted from dividends withholding tax, the Icelandic authorities have demonstrated that, as a consequence of the aid granted on the basis of the aid scheme, potential distortions of competition in the world, including on the level of the EEA, are limited while positive regional effects of the aid scheme are significant.

4.3 The aid ceiling fixed in the light of the application of the regional aid ceiling and the multisectoral framework

As mentioned above, the Authority considers that in order to ensure that the aid granted under the aid scheme approved in the Grundartangi Decision can be considered as investment aid it is necessary to fix a ceiling in terms of a percentage of the investment costs.

It appears from point 1.7 of Part I above that the municipalities where the Norðurál hf. smelter is located of Hvalfjarðarstrandarhreppur and Skilamannahreppur have been considered by the Authority to qualify for regional aid up to a limit of 17% NGE of eligible investment costs by decision 103/96/COL of 28 August 1996 on the map of assisted areas in Iceland, and subsequently by decision 253/01 of 8 August 2001.

However, Chapter 26A of the State Aid Guidelines on the "Multisectoral Framework on Regional Aid for Large Investment Projects" (hereinafter referred to as the "MSF") contains rules which limit the aid intensity normally permitted for regional investment to be approved under Articles 61(3)(a) and (c) on the basis of the consideration that large investment projects may be in excess of the regional handicaps they are aimed at addressing.[30] On this basis the MSF provides that the regional aid ceiling for regional investment aid is lowered where certain thresholds for eligible expenditure are exceeded according to a pre-fixed scale. According to point 1 of Chapter 26A.3 of the State Aid Guidelines the lowest threshold of this scale is triggered when the investment costs are equal to or more than 50 million Euro.

The Icelandic authorities have submitted that the total investment costs for the original construction of Norðurál hf. and subsequent expansions amount to 944,8 million USD based on 2003 price levels (see point 1.5 of Part I above) which is equal to 807,1 million Euro based on the applicable exchange rate on 1 January 2003. [31]

The investment costs are therefore well beyond 50 million Euro which is the threshold at which the scale in the MSF is triggered. However, in applying the MSF to the investments undertaken under the aid scheme approved in the Grundartangi Decision of 1998, the Authority considers that the three investment projects of 1997-1998 for the original construction of Norðurál hf. and the two subsequent expansions in 2000-2001 and 2004-2008, respectively should be considered independently and separately from each other due to the fact that each of them qualify as "initial investments" within the meaning of the rules on regional aid in Chapter 25 of the State Aid Guidelines.[32]

It appears from point 1.5 of Part I above, that the investment costs of the original construction of the smelter was 284,3 million USD (equal to 242,9 million Euro) whereas, 90,6 million USD (equal to 77,4 million Euro) and 591,1 million USD (equal to 504,9 million Euro) constitute the investment costs of the subsequent expansions, respectively. On the basis of point 8 in Chapter 25.4 of the State Aid Guidelines and the fact that all investments costs are depreciable according to national law, the Authority accepts that the investment costs in respect of each of the three investment projects constitute eligible investment costs.[33]

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[30] Chapter 26A of the State Aid Guidelines incorporates the Communication from the Commission on the multisectoral framework for large investment projects (OJ 2002 C 70/8), which is a revision of the previous Communication from the Commission on Multisectoral framework on regional aid for large investment projects (OJ 1998 C 107/7).

[31] Chapter 33 of the Authority's Guidelines states that: *"Any amounts expressed in these guidelines in ECUs will be converted into the currencies of EFTA States throughout any calendar year at the exchange rates prevailing on the first day of the year on which exchange values for ECUs into all currencies of the EEA are available. The exchange rates may be revised during the year by agreement between the EFTA Surveillance Authority and an EFTA State if necessitated by a significant change."*

[32] Point 6 of Chapter 25.4 of the State Aid Guidelines provide that *"Aid for initial investment means an investment in fixed capital relating to the setting-up of a new establishment, the extension of an existing establishment, or the starting-up of an activity involving a fundamental change in the product or production process of an existing establishment (through rationalisation, diversification or modernisation)."*

[33] Chapter 25.4(8) of the State Aid Guidelines provide that *Aid for initial investment is calculated as a percentage of the investment's value. This value is established on the basis of a uniform set of items of*

On the basis of the fact that at the time the aid scheme was approved in 1998 by the Grundartangi Decision there was no multisectoral framework in force, the Authority will not apply the MSF to the investments undertaken for constructing Norðurál hf. in 1997-1998. As a concequence the Authority will only apply the MSF to the investments made for each of the subsequent expansions.[34]

For purposes of fixing a ceiling in respect of the three investment projects the calculations involved are, based on the table set out below, as follows:

Eligible expenditure	**Adjusted aid ceiling**
Up to 50 million Euro	100 % of regional ceiling = 17 %
For the part between 50 million Euro and 100 million Euro	50 % of regional ceiling = 8.5 %
For the part exceeding 100 million Euro	34 % of regional ceiling = 5.78 %

- **Original Construction: 242,9 million Euro**:

Regional aid ceiling: 17%
Total aid ceiling: 41,29 million Euro.

- **First Expansion: 77,4 million Euro:**

1. Up to 50 million Euro (17% of 50 million Euro) 8,5 million Euro
2. 50 – 100 million Euro (8.5% of 27,4 million Euro) 2,33 million Euro
3. + 100 Million Euro NA

Total aid ceiling: 10,83 million Euro.

- **Second Expansion: 504,9 million Euro:**

1. Up to 50 million Euro (17% of 50 million Euro) 8,5 million Euro
2. 50 – 100 million Euro (8.5% of 50 million Euro) 4,25 million Euro
3. + 100 million Euro (5.78% of 404,9 million Euro) 23,4 million Euro

Total aid ceiling: 36,15 million Euro.

It appears from the above that the ceiling for the total aid to be granted to Norðurál hf. for all three investments is 88,3 million Euro in 2003 prices and that the aid intensity – which forms an integral part of the absolute ceiling for the grant of state aid to Norðurál hf. - is 10.7%. This means that under no circumstances can overall aid to Norðurál hf. exceed this amount and aid intensity. In this regard the aid incurred each year must be calculated on the basis of the discounted value applying the annual reference rates.

expenditure (standard base) corresponding to the following elements of the investment: land, plant/machinery."

[34] The Authority has decided to assess both of the expansions under the currently applicable MSF in Chapter 26A of the State Aid Guidelines.

The aid scheme can in no circumstances be applied beyond the date of 31 October 2018 irrespectively of whether the total amount of aid under the above stated ceiling has been granted.[35]

Aid already granted up to 2003, and the time already passed as of July 1998 will be deducted from the ceiling fixing the total aid amount and the time limit, respectively.

Point 4 of Chapter 26A.3 on the MSF of the State Aid Guidelines provide that

"Individually notifiable projects will not be eligible for investment aid in either of the following two situations:

(a) the aid beneficiary accounts for more than 25% of the sales of the product concerned before the investment or will, after the investment, account for more then 25%; or

(b) the capacity created by the project is more than 5% of the size of the market measured using apparent consumption data of the product concerned unless the average annual growth rate of its apparent consumption over the last 5 years is above the average annual growth rate of the European Economic Areas' GDP."

In considering the application of the above provision the Authority had to form a preliminary view on the definition of the market in the present case. In this regard the Authority considers that in view of the information set out point 1.6 of Part I above, from which it appears that primary aluminum is traded throughout the world, including in the EEA where there are substantial trade flows and imports of processed primary aluminum, and in line with European Commission decisions on mergers in this area, the geographical market for primary aluminium is world-wide.

The Authority considers that the abovementioned provision is not applicable due to the fact that as appears from point 1.6 of Part I above, world consumption of primary aluminium in 2004 was 30,1 million tonnes compared to the fact that Norðurál hf. will, after the most recent expansion, reach a capacity of maximum 300.000 tonnes per annum, reflecting the fact that Norðurál hf.'s position on the world market is less than 1%. Moreover, based on the figures given for the consumption of Western Europe (in the table from point 1.6 of Part I) for the year 2004 where the consumption was 6580 thousand tonnes, Norðurál hf.´s position on the market is below 5%. It follows that neither of the investment projects considered individually will create a capacity of more than 5% of the size of neither the world market nor the European Market.

On the basis of the ceiling(s) fixed above the Authority considers that the requirement in point two of Chapter 25.4 of the State Aid Guidelines on the grant of regional aid which provides that the recipient's contribution to the financing of the aided investment must be at least 25%, is met in the present case - both in respect of each investment made and the total investment costs.

4.4 Arguments submitted by the Icelandic authorities

[35] This means that the aid scheme can only be applied for a total period of 20 years 3 months and 23 days counting from 8 July 1998 which is the date of the adoption of the original decision of the Authority, approving the aid scheme in respect of Norðurál hf.

In the following the Authority responds to the arguments submitted by the Icelandic authorities in their response to the Authority's letter, dated 23 March 2005, sent pursuant to Article 17(2) in Part II of Protocol 3 to the Surveillance and Court Agreement.

(a) Comments entitled "Nature of the notified measures. Direct link to a specific investment project with significant regional impact"

As a preliminary remark, the Authority points out that the Icelandic authorities seem to be arguing that the *amended* aid measures, notified on 31 October 2003 (cf. the reference to the notification dated 31 October 2003) constitute ad hoc aid. In this respect it should be made clear that the letter of the Authority, dated 23 March 2005 and the present decision addresses solely the aid measures that have been approved by the Grundartangi Decision in 1998. The subsequent amendments made to such aid measures and the introduction of new aid measures or aid measures that were previously not notified will be addressed in a separate decision to be adopted by the Authority.

As to the substance, the Authority has never disputed that a finding of compatibility under the state aid rules is the result of balancing the impact of competition with the effect of the aid on regional development. As appears from section 2.2 on *"The assessment of advantages versus distortions of competition"* in the letter of the Authority, dated 23 March 2005 and section 4.2, above, the Authority first quotes Chapter 25.2 of the State Aid Guidelines which states that a derogation from Article 61(1) of the EEA Agreement may be granted in respect of regional aid only if the equilibrium between the resulting distortions of competition and the advantages of the aid in terms of the development of a less-favoured region can be guaranteed. The Authority then proceeds to apply this test of compatibility in the present case and in this regard explicit references are made to the favourable socio-economic impact of the investments made by Norðurál hf. (in terms of growth and job creation) in the region versus the impact of the aid on competition.

Aside from this, as regards the statement of the Icelandic authorities to the effect that compatibility of the aid does not depend on whether the aid in question is classified as an ad hoc aid or as aid awarded on the basis of an aid scheme, the Authority merely observes that it has never made any statements to the contrary. Apart from the statements contained in the State Aid Guidelines (see for example Chapter 25.2[36]), the Authority considers that it cannot take a general position on whether an ad hoc aid is more or less distortive than a state aid scheme since this will depend on the circumstances of each case.

(b) Comments entitled: "Definitions of an 'aid scheme' vs. 'individual aid'"

[36] Paragraph 3 in Chapter 25.2 of the State Aid Guidelines refers to the fact that an ad hoc regional aid may have a major impact on competition without necessarily producing positive regional benefits*: "An individual ad hoc aid payment made to a single firm, or aid confined to one area of activity, may have a major impact on competition in the relevant market, and its effects on regional development are likely to be too limited. Such aid generally comes within the ambit of specific or sectoral industrial policies and is often not in keeping with the spirit of regional aid policy as such. The latter must remain neutral towards the allocation of productive resources between the various economic sectors and activities. The EFTA Surveillance Authority considers that, unless it can be shown otherwise, such aid does not fulfil the requirements set out in the preceding paragraph."*

The Authority first addresses the argument of the Icelandic authorities that in order for the requirement in the second limb of Article 1(d) of Part II of Protocol 3 to the Surveillance and Court Agreement to be met "*...only the question whether the aid is granted in favour of one single project or not is of relevance for the aid to be linked."* which is concluded by stating that *"the aid provisions in the Investment Agreement and the Act are in fact explicitly 'in favour of the investment project by Columbia Ventures Corporation and its subsidiary, Norðurál hf. for the construction and operation of an aluminum smelter at Grundartangi.'"*

In this regard the Authority refers to what has been pointed out above in section 3.2. above, (entitled *"The derogations from recurrent tax or fee provisions in the Grundartangi Act constitute a scheme")*. The essence of these previous statements is that if the aid measures themselves do not limit the amount of aid in relation to the investment costs there must be an overall ceiling which does so. Otherwise, potentially an indefinite amount of aid can be granted, irrespectively of what the investment costs might be. There must therefore be a link between the aid granted and the investment costs in the manner in which this is referred to in footnote 2 to Annex X of the State aid Guidelines (concerning the calculation of the Net Grant Equivalent of investment aid) which provides that any tax *"may be connected with an investment if one sets a ceiling expressed as a percentage of the amount invested in the region."*[37]

Secondly, the Authority addresses the arguments by the Icelandic authorities that the aid is neither being granted for an indefinite period of time nor for an indefininte amount, and that a double ceiling on the aid results from a commitment in the notification that the aid would not exceed 49,9 million Euro and from the Grundartangi Decision 174/98/COL where the Authority established the 17% NGE state aid intensity ceiling.

In this regard the Authority points out that the Icelandic authorities seem again to refer to the amendments notified on 31 October 2003 (cf. the reference to *"the notified aid measures"* and what has been *"mentioned in the notification"*). However, as stated above, the letter of the Authority, dated 23 March 2005 and the present decision address only the aid measures that have been approved by the Grundartangi Decision in 1998 and not the subseqent amendments.

Assuming however, that the Icelandic authorities intend to refer to the existing aid approved by the Grundartangi Decision (although most of the comments in this regard appear to refer to the aid measures notified on 31 October 2003) the Icelandic authorities argue that the aid is not granted indefinetely nor is it indefinite in amount. However, the Icelandic authorities do not provide any evidence for these statements in the form of a specific reference to the Grundartangi Decision 174/98/COL, but limits itself to state that the time period is the remainder of the *"initial term"* covered by the investment Agreement as indicated *"in the notification"* and that this was acknolwledged in the Grundartangi Decision. In this respect the Authority considers that it is sufficient to point out that the only relevant statement in the Grundartangi Decision as regards the time period involved, is a statement to the effect that *"The measures are limited in time to 20-23 years."* However, this rather loosely defined timeframe is neither committed to by the Icelandic authorities nor made a condition for approval in the Grundartangi Decision.

[37] This reference to the State Aid Guidelines is also given in section 2.1 on *"Operating aid versus investment aid – the necessity of a ceiling"*, above.

In any event, in the opinion of the Authority the fact that the measures are not time limited in the Grundartangi Decision is not the decisive factor for considering the aid measures not to be linked to a specific project. As mentioned above, the reason for this is that the aid is not limited in terms of a fixed portion of the investment costs. In this regard the Icelandic authorities have not referred to or quoted any specific statements by the Authority to the effect that the amount of aid granted in the Grundartangi Decision has been limited. The only argument of the Icelandic authorities in this respect is that "*The Authority's Decision No 174/98/COL had previously established the 17% NGB state aid intensity ceiling."* However, as the Icelandic authorities are aware the Grundartangi Decision 174/98/COL did not impose the condition that the amount of aid granted could not exceed the 17% aid ceiling, nor did the Icelandic authorities commit to such a ceiling and there was no other ceiling fixed as a percentage of the investment cost. In fact, the Grundartangi Decision is limited to a statement that based on the presumed revenues of Norðurál hf. and the expected future standard rules of the Icelandic tax regime, the state aid involved would amount to an aid intensity of 3.6% which *"is well below the admissible ceiling of 17% NGE, according to the existing map of assisted areas for Iceland."* In the opinion of the Authority this statement does not fix a limit on the amount of aid to be granted.

The fact that there was no ceiling fixed in the Grundartangi Decision means that the amount of aid granted on the basis of measures approved in the Grundartangi Decision was not limited in relation to the investment costs for the specific project of constructing the original smelter with a capacity of 60.000 tonnes per annum. As a concequence, Norðurál hf. can benefit from aid approved in the Grundartangi Decision with regard also to subsequent investment projects for extending the Norðurál hf. smelter. In this regard, the Icelandic authorities have themselves shown that the grant of aid approved in the Grundartangi Decision was not limited with respect to the investments made for the original construction of the smelter since currently Norðurál hf.'s investment project of Expansion I[38] is benefitting from aid granted on the basis of the very same aid mesures (as those approved in the Grundartangi Decision) - without that the Icelandic authorities found the need to notify this project.

Finally, the Authority considers that the fact that the notification of 31 October 2003 on amendments to the existing aid scheme suggests a ceiling of 49,9 million Euro is irrelevant in this context since it refers to a ceiling applicable only for the aid granted as a result of the *amendments* to the existing scheme (or aid measures) and only as of the time of the entry into force of such amendments. Moreover, the Icelandic authorities do not explain to which investment project (nor the amount of investment costs) the ceiling of 49,9 million Euro should relate, i.e., the original construction, Expansion I or Expansion II, or alternatively all of them. In any event a ceiling fixed for purposes of limiting the amount of aid granted in relation to one investment for expanding Norðurál hf. (such as Expansion II) can easily be exceeded when at the same time there is a decision by the Authority (i.e., the Grundartangi Decision) authorising the grant of aid for an unlimited amount in general to the same company.

(c) Comments entitled: "Legitimate expectations."

[38] Both Expansion I and II qualify allegedly as an "initial investment" under Chapter 25 on regional aid in the State Aid Guidelines.

As regards the argument that the Authority has not explained the reason for dealing with "*…the notification of the aid measures involved in the expansion of the aluminium smelter at Grundartangi, notified on 31 October 2003,..*" as an aid scheme and thus in a different manner than "*…the similar state aid measures in the Authority's decisions No 174/98/COL and No 40/03/COL,…*" the Authority first points out that the letter of the Authority, dated 23 March 2005, requesting the Icelandic authorities to submit comments pursuant to Article 17(2) in Part II of Protocol 3 to the Surveillance and Court Agreement and the present decision, concern exclusively the aid measures that have been approved in the Grundartangi Decision and therefore not the notified aid measures amending the Investment Agreement. The allegation that the Authority treats the aid granted on the basis of aid measures approved in the Grundartangi Decision differently than the subsequent amendments hereto is therefore without bearing since the latter are not addressed in the present decision.

Aside from this, it is correct that in the letter of the Authority, dated 23 March 2005 and the present decision the Authority takes the view that the aid granted on the basis of the Grundartangi Decision involves existing operating aid granted on the basis of a scheme. While the reasons that the Authority considers that the aid measures in the Grundartangi Decision involves an aid scheme have already been addressed in section 1.2 of Part II in the letter of the Authority, dated 23 March 2005, and in section 3.2, above, the Authority will elaborate on this explanation in the following in order to respond to the specific arguments of the Icelandic authorities.

The aid measures which the Authority considers in the present decision to constitute a scheme have an "on-going" character, in the sense that the derogations allow for aid to be granted automatically every year without further action being necessary on the part of the state. With respect to the definition in Article 1(d) of Part II of Protocol 3 to the Surveillance and Court Agreement, stating that an aid scheme can, *inter alia*, consist of *"...any act on the basis of which aid which is not linked to a specific project may be awarded to one or several undertakings for an indefininte period of time and/or for an indefinite amount;"* and the European Commission's decision practice, it is clear that the fact that there is only one company, identified by name i.e., Norðurál hf. which benefits from the aid measure, is not sufficient to bring a measure outside the definition of a scheme. Also, the Authority considers that the requirement that the aid granted via a scheme "*is not linked to a specific project"* in Article 1(d) of Part II of Protocol 3 to the Surveillance and Court Agreement is met in the present case due to the fact that the aid is granted on the basis of measures which are not limited in relation to the amount of the investment and that there is no other link by virtue of a ceiling, expressed as a percentage of the investments. The aid may therefore be granted independently of the amount of investments made in respect of the project. As pointed out above, it is irrelevant that the Grundartangi Decision contains a statement to the effect that aid is in favour of *"an investment project by Columbia Ventures Corporation and its subsidiary, Norðurál hf., for the construction and operation of an aluminum smelter at Grundartangi"* (referred to by the Icelandic authorities as a proof that the aid involved is "individual aid") due to the fact that in reality the aid is not limited in relation to the investment costs.

As to the argument that the Icelandic authorities had certain legitimate expectations that the Authority *"would address the notification with a similar methodology as the Authority had done in its previous decisions No 174/98/COL and No 40/03/COL."*, the Authority points out that the situation in the Authority's decision in Alcoa

40/03/COL is different from the present case already due to the fact that in Alcoa 40/03/COL the Icelandic authorities committed not to grant aid which would exceed a ceiling of 49,9 million Euro. While the involved tax and fee concessions in the Alcoa 40/03/COL case also have an ongoing character the fact that there is a ceiling in this case means that the aid amount is limited. The aid intensity resulting from applying this ceiling to the investment costs means that the amount of aid is also limited in relation to the investment costs. The circumstances in the Alcoa 40/03/COL case cannot therefore be compared to the circumstances in the present case where the aid amount is not limited. Apart from this, neither the Grundartangi Decision nor the Alcoa decision 40/03/COL makes any reference to the effect that the aid concerned is to be considered as ad hoc aid. On this basis it is difficult to understand how the Icelandic authorities could have legitimate expectations as to the classification of the aid with reference to those decisions.

Finally as to the Icelandic authorities' reference to four state aid decisions in arguing that the European Commission has *"in a number of decisions approved regional investment aid as individual ad hoc aid, and not as aid schemes."* the Authority first points out that all four decisions concern individual aid awards which exceed the thresholds set out in the multisectoral framework. Such individual aid awards must be notified and are classified as individual aid under Article 1(d) of Part II of Protocol 3 to the Surveillance and Court Agreement as a result of the fact that this particular award exceeds the thresholds of the multisectoral framework. In other words, the duty to notify and the classification of the relevant aid as individual aid is a direct consequence of the fact that the aid falls within the scope of the multisectoral framework. The Authority has never disputed the fact that individual awards exceeding the thresholds of the multisectoral framework have to be notified.

However, in the opinion of the Authority the relevant issue in these cases is that the individual aid awards were granted on the basis of underlying schemes. The point is that the aid granted in the relevant decisions constitutes regional investment aid already due to the fact that the relevant underlying aid schemes are based on measures which provide for the grant of aid up to a maximum percentage of the eligible investment costs. In other words, the aid measures in these cases are themselves limited in relation to the investment costs.

Cases N 611 and N 309 refer to the German law on investment aid (i.e., the law on *"Ein Investitionszuschuss im Rahmen der Gemeinschaftsaufgabe ,Verbesserung der regionalen Wirtschaftstruktur'…"*) and to European Commission decisions dealing with the underlying scheme based on the aforementioned German law.[39] It appears from these references that the main aspects of the scheme which were approved by the European Commission concern the grant of state aid of up to 50% of the gross eligible investment costs in the case of SMEs and up to 35% of the gross eligible investment costs in the case of large companies. References are made also to the aid intensities following from the German regional aid map. Thus one of the underlying aid measures for granting aid in cases N 611 and N 309 was an aid scheme which provides for the grant of aid in respect of a certain percentage of the eligible costs and the aid measure is therefore linked to the investment costs.

[39] In this regard reference is made to Commission decision N 642/2002 of 1 September 2003 which indirectly refer back to a previous approvals of the scheme, including Commission decision C 52/97 (ex N 123/97) which provides that the scheme allows for the grant of aid of up to 50% of the gross eligible investment costs in the case of SMEs and up to 35% of gross eligible investment costs in the case of large enterprises.

Cases N 611, N 610 and N 309 refer to the German Investment Allowance law (i.e., the law on "*Investitionszulage"*). In these cases references are made to various Commission decisions dealing with different aspects of the aid scheme based on the Investment Allowance Law.[40] These references reflect that the main aspects of the scheme which were approved concern the grant of an investment allowance ranging from 5% to 27.5% of the assessment basis of equipment or buildings, that is, of the eligible costs. Therefore one (other) of the underlying aid measures for granting the aid involved in cases N 611, N 610 and N 309 was an aid scheme which provides for the grant of aid in respect of a certain percentage of the eligible costs (i.e., buildings and equipment) and the aid measure is therefore linked to the investment costs.

Case N 614/2003 involves a grant for a specific amount and a tax credit. The latter was awarded under an aid scheme which provides for tax exemptions limited in amount to between 5-20% of the eligible investment costs.

Hence, as stated above, the four cases referred to by the Icelandic authorities involve aid schemes which qualify as investment aid already because the aid measures themselves are linked to the investment costs. They do therefore not prove anything in relation to the assessment of the state aid granted to Norðurál hf. which is based on aid measures not linked to the investment costs.

(d) Comments entitled: "Specific points in the CSA letter, dated 23 March, which the Icelandic authorities would like to comment on."

With respect to the argument of the Icelandic authorities that the Investment Agreement includes a time limit for the grant of aid until 31 October 2018 and that the Authority's decision 174/98/COL explicitly provides for a limit on the amount of state aid granted, the Authority draws the attention to the fact that, as stated in section 1.1 of Part I of the letter of the Authority, dated 23 March 2005 and in the same section of the present decision, the Investment Agreement provides that it shall remain in force until 31 October 2018 (which is referred to as the *"Initial Term"*), but also states that, within 17 years of the signature date, the parties should have agreed on an extension of no less than 10 years following the date of expiration (which is presumed to be 31 October 2018). Moreover, the Act 62/1997 which constitutes the legal basis for the tax and fee derogations applying to Norðurál hf. provides that the term of the Agreement "*shall not be less than 20 years from the establishment of the Company"*. The Authority therefore considers that the aid measures referred to in the Investment Agreement and the Grundartangi Act are therefore not limited to 20 years. As mentioned above, the Grundartangi Decision does not contain a time limit either as it refers only loosely to a duration of the aid measures of 20-23 years without imposing this as a condition for approving the state aid involved. Finally, and more importantly, the Authority considers, as mentioned above, that the Grundartangi Decision does not limit the amount of aid to be granted in relation to the investment costs since the

[40] In this regard references are made to Commission decisions of C 72/98 (ex 702/97) in OJ 1999 C 76/2, C(2001) 668) in OJ 2002 L 282/15, and N 336/2003. While in the first case the Commission initiated proceedings in respect of specific provisions of the scheme (C 72/98), in the second case C(2001) 668) the Commission approved other aspects of the scheme based on the Investment Allowance Law until 31 December 2003. The main aspects approved concern the grant of an investment allowance ranging from 5% to 27.5% of the assessment basis of equipment or buildings, that is, of the eligible costs. The last case N 336/2003 concerns the approval of a prolongation of the same scheme for the year 2004.

Decision merely refers to the fact that the aid intensity of the estimated aid involved (based on profit forecasts and the expected future tax regime) is below 17%.

The Authority recalls the argument of the Icelandic authorities that *"the grant of the aid is in fact dependent on the level of investments made…"* which is *"… reflected in the previously submitted calculations on previous aid granted and previous investment costs, compared to the estimated aid to be granted in connection with Expansion II…"* and *"The previously submitted breakdown of the total investment costs and the total aid amount for the whole period inter alia establishes that the aid is dependent on the level of investments made."* However, the Authority points out that the Icelandic authorities do not submit any proof to substantiate the allegation that the aid is dependent on the investments made but limit itself to a reference to the submission of calculations on *"previous aid granted and previous investment costs, compared to estimated aid to be granted in connection with Expansion I..."*. In this regard the Authority considers that the submission of calculations on the amount of state aid actually granted up until now does not prove that the amount of aid which can be granted on the basis of the aid measures approved in the Grundartangi Scheme is limited with respect to the investment costs. Nor does the submission of calculations as to how much aid would be granted in the future based on estimated future profits and the expected tax regime prove that the aid amount is limited in relation to the investment costs for the future. Finally, the fact that the Icelandic authorities themselves state that the aid measures are related to *"revenue and property"* just shows that the aid measures themselves are not related to the investment costs.

As regards the statement of the Icelandic authorities that the Grundartangi Decision and the notification dated 31 October 2003 *"stipulate that the total amount of aid (aid intensity) shall under no circumstances exceed 17% of the net grant investment costs (the applicable regional aid ceiling.)"*, the Authority points out that the Grundartangi Decision does not provide for such a statement. As regards the further reference in this context by the Icelandic authorities to the ceiling of 49,9 million Euro for the notified amendments of 31 October 2003, the Authority considers this as irrelevant since the notification is not addressed in the present context and, in any event, that ceiling would only limit the amount of aid granted as a result of the *amendments* to the aid measures approved by the Grundartangi Decision. Moreover, the Icelandic authorities do not refer to the amount of investment costs which the ceiling of 49,9 million Euro should relate.

(e) Comments entitled: "Conclusion"

The Authority takes note of the fact that the Icelandic authorities, in principle, agree with the ceiling on total aid and state aid intensity as it has been fixed in section 4.3, above, in the present decision.

HAS ADOPTED THIS DECISION:

1. Pursuant to Article 1(1) in Part I and Article 19 in Part II of Protocol 3 to the Surveillance and Court Agreement, the Authority proposes to the Icelandic authorities the following appropriate measures:

(a) The authorities shall take any legislative, administrative and other measures necessary to ensure that the following aid measures in the Grundartangi Decision, considered above to constitute an aid scheme, do not involve incompatible operating aid:

- The right to allocate amounts into a special account pursuant to Article 7.1 of the Investment Agreement and Article 6.1 of the Grundartangi Act;
- the exemption from net worth tax pursuant to article 7.2 of the Investment Agreement and Article 6.2 of the Grundartangi Act;
- the exemption from Industrial charge and Market charge pursuant to article 7.3 of the Investment Agreement and Article 6.3 of the Grundartangi Act;
- the reduction of stamp duties pursuant to article 11 of the Investment Agreement and Article 6.7 of the Grundartangi Act; and
- the special calculation of municipal property tax pursuant to Article 8 of the Investment Agreement and Article 6.6 of the Grundartangi Act.

Measures must be taken to ensure that aid granted on the basis of the abovementioned aid measures under the aid scheme does not exceed the ceiling of 88,3 million Euro in 2003 prices, representing the total amount of aid which may be granted to Norðurál hf. for all three investments, as well as that the aid intensity of 10.7% - which forms an integral part of the absolute ceiling for the grant of state aid to Norðurál hf. - is not exceeded.

The Icelandic authorities must calculate the aid incurred each year on the basis of the discounted value applying the annual reference rates.

The aid scheme can in no circumstances be applied beyond the date of 31 October 2018 irrespectively of whether the total amount of aid under the above stated ceiling has been granted. Measures must therefore be taken in order to ensure that the aid scheme will expire on 31 October 2018.

(b) The authorities shall take any legislative, administrative and other measures necessary to abolish incompatible aid resulting from the exemption from dividends withholding tax provided for in Article 7.1 of the Investment Agreement and Article 6.1 of the Grundartangi Act and must therefore abolish this provision in its entirety.

2. The relevant measures to comply with the appropriate measures must be effective within three months of the date of the adoption of the present decision, unless the Authority agrees to a later date should that be considered objectively necessary and justified by the Authority.

The Icelandic authorities shall communicate to the Authority the relevant measures it will take to comply with the appropriate measures as soon as possible and in any event not later than six weeks from receipt of this proposal.

3. Iceland is requested to submit simplified annual reports regarding the implementation of the aid in accordance with Chapter 32 of the Authority's Procedural and Substantive Rules in the Field of State Aid.

4. The Authority asks the Icelandic authorities to agree to this proposal for appropriate measures, pursuant to Article 19(1) in Part II of Protocol 3 to the Surveillance and Court Agreement, and to provide the answer within six weeks from receipt of this proposal.

5. This decision is addressed to Iceland.

Done at Brussels, 1 June 2005

For the EFTA Surveillance Authority

Einar M. Bull
Acting President

Bernd Hammermann
College Member