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EFTA SURVEILLANCE AUTHORITY DECISION

of 16 July 2003

regarding amendments to the existing Norwegian Special Tax Regime for Shipping Companies
(NORWAY)

THE EFTA SURVEILLANCE AUTHORITY,

HAVING REGARD TO the Agreement on the European Economic Area¹, 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 Justice², in particular to Article 24 and Article 1 of Protocol 3 thereof,

HAVING REGARD TO the Authority's Guidelines³ on the application and interpretation of Articles 61 and 62 of the EEA Agreement, in particular Chapter 24A⁴ thereof

WHEREAS:

I. FACTS

1. The notification

By letter from the Ministry of Finance dated 20 December 2002, received and registered by the Authority on 20 December 2002 (Doc. No. 02-9306-A), the Norwegian Government notified pursuant to Article 1(3) of Protocol 3 to the Surveillance and Court Agreement, amendments to the existing aid scheme "Norwegian Special Tax Regime for Shipping Companies"⁵.

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 (State Aid Guidelines), adopted and issued by the EFTA Surveillance Authority on 19 January 1994. Published in Official Journal L 231, 03.09.1994. The Guidelines were last amended 18 December 2002 (not yet published).

⁴ Aid to maritime transport.

⁵ Dec. No. 164/98/COL on tax-related measures in favour of the maritime transport sector (Norway), dated 1 July 1998. Published in Official Journal C 337, 05.11.1998, page 5.

By letter dated 24 January 2003 (Doc. No. 03-460-D), the Authority acknowledged receipt of the notification.

By letter dated 4 March 2003 (Doc. No. 03-1177-D), the Authority asked the Norwegian authorities to submit additional information on the amendments to the scheme. The Norwegian Government responded by letter from the Norwegian Mission to the European Union dated 1 April 2003, received and registered by the Authority on 3 April 2003 (Doc. No. 03-2090-A), forwarding a letter from the Ministry of Finance dated 28 March 2003.

By letter dated 24 April 2003 (Doc. No. 03-2504-D), the Authority acknowledged the receipt of the letter and requested additional information. The Ministry of Finance responded by letter dated 26 May 2003, received and registered by the Authority on that same day (Doc. No. 03-3378-A).

2. The contents of the amended aid scheme

2.1 The special rules for taxation of shipping companies approved in 1998

By decision of 1 July 1998 (Dec. No. 164/98/COL), the Authority approved tax-related measures in favour of the maritime transport sector in Norway. By the decision two aid measures were authorised:

- refund schemes for employment and training of seafarers; and
- special rules for taxation of shipping companies.

In the following, only the special rules for taxation of shipping companies will be addressed as relevant for the notification at issue.

In the Authority's decision of 1 July 1998 the aid in the form of a favourable fiscal treatment of shipping companies, as introduced in 1996, was considered to be compatible with the provisions of Chapter 24 A of the State Aid Guidelines, "Aid to maritime transport." In point 3.2 of the decision the relevant requirements of the State Aid Guidelines were summarised (quoted below), and the scheme was subsequently assessed according to each of these requirements:

- a) *"The amount of aid should not exceed the total amount of taxes collected from shipping activities, i.e. a reduction to zero of corporate taxation is the maximum level of aid, which may be permitted."*
- b) *"Aid of this kind must be restricted to shipping companies, i.e. it must be ensured that there is no spill-over of this exceptional type of aid into other activities."*
- c) *"Given the recognised common objective of shipping aid, it should, as a main rule, require a link with a flag of an EEA State. However, flag-neutral measures may exceptionally be approved, provided that a clear economic link to the territory of the Contracting Parties to the EEA Agreement can be demonstrated."*
- d) *Vessels operated by companies receiving aid must comply with the relevant international and EEA safety standards".*

In the following, the Authority's assessment according to each of these conditions will be described in the same order as mentioned above.

a) Amount of taxation on the shipping companies

The special rules for taxation of shipping companies were adopted with effect as from 1996 and laid down in Section 51A of the law on wealth and income tax No 8 of 18 August 1911.⁶ The measure implied that shipping companies covered by the special tax regime were exempted from regular corporate tax (28 per cent) on profits derived from shipping; *i.e.* from the ownership, leasing and operation of ships and other qualifying vessels. Net financial income was taxable on the current basis at 28 per cent. Untaxed profits were eventually taxed upon distribution to shareholders or exit of the company from the special tax system.

Companies eligible under the scheme were, however, required to pay a so-called tonnage tax based on the net tonnage of their ships. The tonnage tax was based on the net tons of the vessel as stipulated at any time in its valid letter of measurement. The net tonnage was rounded off to the nearest 1000 tons.

The rates of the tonnage tax were set out in Chapter 5 of the Annual Tax Decree by the Parliament. For the fiscal years 1996 and 1997, the daily rates were the following:

- first 1.000 net ton; no tax, thereafter;
- NOK 18 per day per 1.000 net tons up to 10.000 net tons, thereafter;
- NOK 12 per day per 1.000 net tons up to 25.000 net tons, thereafter;
- NOK 6 per day per 1.000 net tons above 25.000 net tons.

Regarding the compatibility with the above-mentioned condition a) of the State Aid Guidelines, the Authority's decision of 1 July 1998 stated in point 3.2.4:

“On the basis of the information available to it, the EFTA Surveillance Authority concludes that the new tax regime will lead to a significant reduction in the overall fiscal pressure on the Norwegian shipping sector. However, it will not result in Norwegian shipping companies becoming tax free, and it does not provide for the possibility of a negative income tax for individual companies. It can therefore be concluded that the tax alleviation resulting from the special taxation arrangement for shipping companies will never surpass a reduction to zero, which is the maximum level of aid permitted under the guidelines on aid to maritime transport.”

b) Avoidance of spill-over of aid to other sectors / ring-fencing mechanisms

A number of different and elaborated ring-fencing mechanisms were introduced as part of the special shipping taxation. These included requirements regarding the organisation of the eligible companies, the types of assets, which they on the one hand had to own and on the other hand were allowed to own, and the activities in which they were allowed to engage. The most relevant of these requirements were described in point 3.2.3 of the Authority's decision of 1 July 1998.

⁶ As from 1 January 2000, the rules have been laid down in Section 8-10 to Section 8-20 of the General Tax Act, adopted 14 March 1999 No. 14.

In the following, the ring-fencing mechanisms, which have been subject to modification in later years, will be briefly explained:

Rules on overcapitalisation

As interest payments have a tax value for eligible companies only to the extent that they offset (taxable) financial income, the approved scheme involved an incentive for such companies to be “overcapitalised” and for debt and interest payments to be shifted to related companies subject to ordinary taxation. To address this problem, a minimum amount of debt interest had to be stipulated. Interest costs for companies within the scheme had at least to equal the market rate of interest times a fictional debt equal to 30 per cent of the company’s total capital. If actual interest costs were lower than the stipulated costs, the difference would be treated as taxable financial income.

Rules concerning which assets companies eligible under the scheme may own – indirect ownership

In order to be eligible for the special tax rules, the companies under the scheme had to directly own a vessel qualifying under the scheme. Limited liability companies could own shares or interests in limited companies, partnerships or controlled foreign companies (hereinafter CFCs), which own such qualifying vessels. As opposed to limited liability companies, “net assessed” partnerships, companies and CFCs, were not permitted to hold participation or ownership in other net assessed partnerships, companies or CFCs⁷.

Regarding the compatibility with the above-mentioned condition b) of the State Aid Guidelines, the Authority stated in point 3.2.3.5 of its decision of 1 July 1998:

“Operating a separate, preferential tax system for shipping companies presents a challenge on the monitoring functions of the tax authorities and, in principle, clearly involves the risk that tax benefits may spill over to activities which fall outside the scope of the Authority’s guidelines on aid for maritime transport and do not qualify for such aid. However, with reference to the above considerations, the various strict and elaborate conditions and limitations which have apparently been formulated with great care in the Norwegian legislation, can be expected to sufficiently ring-fence these tax benefits round the targeted shipping activities and thus to prevent spill over to non-shipping activities.”

c) Economic link and contribution to common EEA objectives

The tax regime for shipping companies was flag neutral. The conditions for companies being eligible under the scheme did not include the requirement that the qualifying vessels had to be registered in Norway or elsewhere within the EEA.

Regarding the compatibility with the above-mentioned condition c) of the State Aid Guidelines, the Authority concluded in point 3.2.1 of its decision of 1 July 1998:

“With reference to the above considerations, it is concluded that despite the fact that the special tax regime for shipping companies is not restricted to companies owning

⁷ The phrase “net assessed” partnerships or companies means that partners and participants in such companies are assessed on the basis of the net income attributable to the company or partnership, computed as if it were a taxable entity (net assessment).

or operating ships registered in Norway or other EEA countries, it is likely - other things being equal - to slow down or even reverse the trend of relocation of Norwegian shipping activities to non-EEA countries offering favourable tax regimes, and thereby retain or increase employment and value added in Norway and within the EEA. Given the significant size of the Norwegian-controlled shipping sector and its close economic ties with a variety of other maritime related activities, it is considered likely that securing extensive ship management activities in Norway will have the positive effect of enhancing the competitive position of the broad maritime environment in Norway and within the EEA.”

d) Compliance with international and EEA safety standards

International safety standards were reflected in the Norwegian maritime legislation, and in some respects the national provisions went beyond what was required by international standards. In 1998, as the scheme was approved, Norway had notified full implementation of all EEA acts in the field of EEA secondary legislation on maritime safety. However, the Norwegian Tax regime for shipping companies contained no requirements concerning compliance with safety standards.

Regarding the compatibility with the above-mentioned condition d) of the State Aid Guidelines, the Authority had no objections, but noted:

“(…)the Authority finds it appropriate, in order to ensure that all vessels operated by companies receiving State aid comply fully with the relevant international and EEA safety standards, to request Norway to provide annually monitoring reports demonstrating how this requirement is complied with.”

2.2 Amendments to the special tax rules adopted with effect from 1999 and 2000

a) Increase of the tonnage tax rates

In connection with the National Budget for 1999, the tonnage tax rates were increased by 100 per cent compared to the rates applicable for 1996 and 1997. The new rates were estimated to increase the state revenue in 1999 by approximately NOK 50 million (approximately EUR 6.25 million). Other amendments to the scheme of a more technical character were also adopted.

As from 2000, the tonnage tax rates have been increased by another 100 per cent. At the same time a possible reduction in the tonnage tax was introduced for ships fulfilling certain environmental requirements. A special regulation⁸ established rules for voluntary classification of ships according to environmental standards. The environmental impact classification was based on criteria set by the Norwegian Maritime Directorate. According to these criteria each classified ship is allocated an environmental impact factor from zero to ten. For each point above zero the tonnage tax is reduced by 2.5 per cent. The highest possible reduction (for factor equal to ten) is 25 per cent.

b) Amendments to the ring-fence mechanisms

⁸ Regulation of 28 November 2000 No. 1194 “Forskrift om miljødeklarasjon i forbindelse med miljødifferensiering for skip og flyttbare innretninger.”

In connection with the National Budget for 2000, and by a further amendment of the General Tax Act later in 2000, the Parliament adopted several modifications to the scheme. The amendments were mainly aimed at clarifying the rules and improving technicalities with no significance on the substance. Some amendments implied a strengthening of the ring-fencing of the tax measure. For instance, the rules on overcapitalisation were amended by tightening the equity requirements for the shipping companies. A minimum interest deduction had to be computed based on a fictional debt equal to 50 per cent of the total capital of the company according to the financial balance sheet and by applying an interest rate determined by the Ministry of Finance.

2.3 Notified amendments with effect from 2002

a) Reduction of the tonnage tax rate by 30 per cent

Due to the fact that the tonnage rates in Norway seem higher than corresponding tax rates in other European tonnage tax regimes, the Parliament decided, in connection with the budget for 2003, to reduce the tonnage tax rates by 30 per cent as from the fiscal year 2002. After the amendment, the new daily rates are as follows:

- first 1.000 net tons; no tax, thereafter;
- NOK 50 per day per 1.000 net tons up to 10.000 net tons, thereafter;
- NOK 33 per day per 1.000 net tons up to 25.000 net tons, thereafter;
- NOK 16 per day per 1.000 net tons above 25.000 net tons.

b) Amendments to the ring-fence mechanisms / the rules concerning the avoidance of spill-over effects

Rules on overcapitalisation

As regards the existing rules on overcapitalisation, the method for calculating the minimum amount of debt interest was amended by the Parliament in connection with the budget for 2003. If the equity is more than 50 per cent of the total capital base of the eligible companies, the excess will be multiplied by an interest rate, which is determined by the Ministry of Finance, and taxed as financial income. If the company's equity according to the financial balance sheet is less than 50 per cent of the total capital base of the company, no financial income will be stipulated.

Rules concerning which assets a company benefiting from the scheme may own – indirect ownership

The amendment implies that now “net assessed” partnerships, companies and CFCs are also permitted to hold participation in other net assessed partnerships, companies and CFCs in order to fulfil the conditions for eligibility under the scheme. This amendment was made in connection with the budget 2003 with effect as from the fiscal year 2002.

c) Reports concerning the relevant development of the maritime sector

Concerning *the absence of flag link and the compliance with international and EEA safety standards*, no legal amendments have been adopted in relation to the situation in 1998. However, the Norwegian authorities have reported that the Norwegian maritime sector is still an important source of employment. The employment of Norwegian seafarers increased during the period 1994 to 1999, while there was a decrease in 2000. The situation is similar for the employment of non-Norwegian

seafarers from the EEA. About 80.000 employees are attached to the maritime industries in Norway.

As regards the number of vessels registered under the Norwegian flag, Norway is the 8th largest shipping nation measured by flag⁹. Compared to the situation in 1994, the share of the fleet flying the national flag has decreased, as 53 per cent of the fleet owned by Norwegian companies sails under the national flag today. Since the implementation of the special tax system in 1996, the Norwegian registered merchant fleet has increased by 3 per cent, while the growth in Gross Tonnage (GT) in the same period has been 1 per cent.

As of 1 January 2003, Norwegian ship owners had 113 new building contracts. 87 of these are expected to fly the Norwegian flag, while 26 are expected to use foreign flags.

All ships in international trade are subject to the regulations of the International Maritime Organisation (IMO). As for foreign flagged vessels visiting Norwegian ports, the Norwegian port state control arrangements identify vessels of non-compliance. The Norwegian authorities are not aware of any case of significant non-compliance by vessels under non-EEA flags owned by Norwegian companies benefiting from the special tax regime.

To date, all EEA acts in the field of maritime safety are implemented in Norway.

d) Aid beneficiaries

In 2001, 516 Norwegian joint-stock companies were taxed according to the special tax regime for shipping companies. In addition, the tax assessment for 172 “net assessed” partnerships and companies and 47 CFCs were based on the special tax regime.

e) Cumulation

Norway presently has two other schemes in favour of shipping companies; the refund schemes for employment and training of seafarers and the special scheme for ferries registered in the Ordinary Norwegian Shipping Register (NOR) and engaged in foreign trade. Ferry companies eligible under the latter scheme do not make use of the tonnage tax regime, but are subject to ordinary company taxation.

f) Entry into force and duration

The amendments applied for the fiscal year 2002 and onwards are not of limited duration. The aid scheme will remain in force until the Norwegian Parliament decides otherwise.

g) Budget

As a consequence of the amendments, the State Aid to shipping companies within the tax regime is calculated to increase by NOK 92.8 million (approximately EUR 12.4 million¹⁰) compared to a continued application of the tax rules of 2001. The accrued taxes on shipping companies within the specific tax system amounted to about NOK

⁹ ISL Bremen June 2002.

¹⁰ Calculations are based on average exchange rates for 2002.

365 million (approximately EUR 48.6 million) in 2001, of which the tonnage tax represented about NOK 135 million (approximately EUR 18 million).

II. APPRECIATION

1. The presence of State Aid

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

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

In its decision of 1 July 1998 the Authority based its authorisation of the Norwegian Special Tax Regime for Shipping Companies on the assumption that the scheme implied State aid in the meaning of Article 61 (1) of the EEA Agreement. As the amendments to the special tax regime do not affect the fundamental elements of the authorised scheme, this assumption will apply similarly to the modified special tax regime.

2. Compatibility of the aid

By its decision of 1 July 1998 the Authority authorised the Norwegian Special Tax Regime for Shipping Companies, as adopted in 1996, as State aid compatible with the conditions stipulated in Chapter 24 A of the State Aid Guidelines and thus qualifying for an exemption under Article 61 (3) (c) of the EEA Agreement. The reasons for declaring the initial scheme compatible with the functioning with the EEA Agreement are equally valid for the current assessment.

The Authority notes that tonnage tax rates applicable as of 2002 are higher than the rates that were approved in 1998. The increases in the rates in 1999 and 2000 more than offset the 30 per cent reduction in the notified rates in 2002 and even the maximum reduction of 25 per cent for ships that fulfil specified environmental criteria.

It is further noted that the ring-fencing mechanisms have been revised and partly strengthened. Compared to the provisions authorised in 1998, the modifications of the rules to prevent overcapitalisation by computing a stipulated financial income for overcapitalised companies will have minor effects and are to be regarded as of a more technical nature.

It is also noted that a larger group of undertakings, namely the “net assessed” partnerships, companies and CFC’s, may now be organised as multi-tier companies to fulfil the requirement for owning qualifying vessels under the special tax regime. In the view of the Authority this extension cannot be considered to be incompatible with the provisions of the State Aid Guidelines for maritime transport.

Based on the information submitted by the Norwegian Government, the Authority concludes firstly that despite the absence of flag link, the special tax regime still promotes the competitiveness of the EEA fleets in the global shipping market.

Secondly, the Authority finds that the Norwegian maritime legislation still ensures compliance with international safety standards.

The special reduction in tonnage tax rates for environmental reasons establishes a system of environmental impact points under which ships are rated on a scale from zero to ten. The scores are based on detailed objective criteria determined by the Norwegian Maritime Directorate and apply equally to all ships according to predefined ship types. The higher a ship scores on the enacted environmental impact scale the higher the tax reduction. For each obtained point above zero the tonnage tax is reduced by 2.5 per cent. As ten points is the highest score obtainable, a 25 per cent reduction is maximum possible relief. Undertakings benefiting from the environmental tax option will in practice pay 97.5 per cent of the tonnage tax or less, but in any event not less than 75 per cent. This means that they pay the lion's share of the tax in any event and, in fact, higher rates than those applicable under the scheme approved in 1998.

In view of these facts, with reference to the Authority's State Aid Guidelines, "Aid to maritime transport", which, among other things, provides that tax relief may be granted up to 100 per cent, and with reference to Articles 73 to 75 and the recital of the ninth preamble to the EEA Agreement establishing environmental protection as one of the objectives of the Agreement, the Authority finds the special tax reduction based on the environmental impact score to be compatible with the EEA Agreement.

On the basis of the above-mentioned points, the Authority concludes that the Norwegian Special Tax Regime for Shipping Companies, as applied from 2002, is compatible with the EEA Agreement.

3. Cumulation

As described in the Authority's decision of 1 July 1998, the refund schemes for employment and training of seafarers will not exceed the income tax and social security contributions paid in respect of the same seafarers. Thus, no cumulative effect will occur with regard to the aid ceiling for refund schemes on the one hand and the aid ceiling for the special tax regime on the other.

4. Conclusion

The amendments to the scheme do not, in the Authority's view, alter the assessment regarding the compatibility of the aid scheme. Thus, the "Norwegian Special Tax Regime for Shipping Companies" aid scheme continues to fulfil the requirements set out in Chapter 24A of the Authority's State Aid Guidelines. Therefore, the Authority concludes that the amendments to the "Norwegian Special Tax Regime for Shipping Companies" aid scheme qualify for exemption under Article 61(3) (c) of the EEA Agreement.

The Norwegian Government is reminded to submit separate simplified annual reports on the application of the "Norwegian Special Tax Regime for Shipping Companies"

aid scheme, in accordance with Chapter 32 and Annex IV to the Authority's State Aid Guidelines.

Mention should also be made of the ongoing efforts by the European Commission to revise the Community Guidelines on State Aid to Maritime Transport, which by their adoption by the Authority may require notifications and assessments regarding existing aid schemes.

HAS ADOPTED THIS DECISION:

1. The Authority has decided not to raise objections to the amendments to the "Norwegian Special Tax Regime for Shipping Companies" aid scheme, as applied by the Norwegian Government from 2002.
2. With reference to Chapter 32 of the Authority's State Aid Guidelines, the Norwegian authorities shall submit annual reports on the operation of the schemes in a form comparable to the format set out for simplified annual reports in Annex IV of those Guidelines. The reports shall also contain other relevant information on the extent to which the objectives of the aid schemes are achieved, including in particular (i) statistics on changes in the size, composition and registration of the Norwegian-controlled fleet; (ii) development of the number of Norwegian, other EEA and non-EEA seafarers employed by recipients of the aid, as well as of their land-based employment; (iii) relevant statistics demonstrating, on a current basis, what contribution the special tax treatment of shipping companies makes to economic activity and employment within the EEA; and (iv) relevant information demonstrating, for the reporting period what measures the Norwegian authorities have taken to ensure that all vessels operated by companies benefiting from the special tax treatment of shipping companies comply with the relevant international and EEA safety standards. Furthermore, the reports shall contain information on the number and aggregate size of shipping companies subject to the two alternative tax regimes, together with a breakdown for both tax regimes according to the country of registration of the companies concerned (Norway, other EEA countries and non-EEA countries).

Done at Brussels, 16 July 2003

For the EFTA Surveillance Authority

Einar M. Bull
President

Hannes Hafstein
College Member