Case No: 63030
Event No: 484856
Dec. No: 502/08/COL

EFTA SURVEILLANCE AUTHORITY DECISION
of 16 July 2008
on CO2 tax exemption and reduced heating oil tax rate
(Norway)

THE EFTA SURVEILLANCE AUTHORITY[1]

Having regard to the Agreement on the European Economic Area[2], 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[3], in particular to Article 24 thereof,

Having regard to Article 1(3) of Part I and Article 4(3) of Part II of Protocol 3 to the Surveillance and Court Agreement,

Having regard to the Authority's State Aid Guidelines[4] on the application and interpretation of Articles 61 and 62 of the EEA Agreement, and in particular the sections on state aid for environmental protection and the application of the state aid rules to measures relating to direct business taxation,

Whereas:

I. FACTS

1. Procedure

By letter submitted electronically on 28 September 2007 by the Ministry of Government Administration and Reform (Event No. 444558), the Norwegian authorities notified, pursuant to Article 1(3) of Part I of Protocol 3 to the Surveillance and Court Agreement, a scheme for the purposes of (i) exempting from CO_2 tax on mineral oil undertakings which

[1] Hereinafter referred to as "the Authority".
[2] Hereinafter referred to as "the EEA Agreement".
[3] Hereinafter referred to as "the Surveillance and Court Agreement".
[4] 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 Part I of Protocol 3 to the Surveillance and Court Agreement, adopted and issued by the Authority on 19 January 1994, published in OJ 1994 L 231, 3.9.94, p. 1, and EEA Supplement No. 32, 3.9.94. The Guidelines were last amended by Decision No. 500/08/COL of the Authority of 16 July 2008. Hereinafter referred to as "the State Aid Guidelines".

are subject to the Norwegian Emission Trading Scheme; and (ii) amending the application of heating oil tax to the paper and pulp sector.

By letter submitted electronically on 12 October 2007 (Event No. 445805) the Authority requested additional information. By letter submitted electronically on 6 November 2007 (Event No. 450680) the Ministry of Government Administration and Reform replied to the information request.

By letter submitted electronically on 14 December 2007 (Event No. 455743) the Authority requested further information. The Ministry of Government Administration and Reform responded by letter submitted electronically on 17 January 2008 (Event No. 460968). As the response was incomplete the Norwegian authorities sent further information by e-mail submitted on 19 February 2008 (Event No. 466211). By letter submitted electronically on 25 February 2008 (Event No. 466211) the Authority confirmed the receipt of the e-mail.

Finally, by letter submitted electronically on 18 March 2008 by the Ministry of Government Administration and Reform (Event No. 470284) the Norwegian authorities requested the Authority to postpone the adoption of a decision on the notification until the adoption by the Authority of new State Aid Guidelines on aid for environmental protection.

2. The Norwegian system on tax on mineral oil

The following describes the measures notified by the Norwegian authorities with respect to CO_2 tax and heating oil tax on mineral oil. The Norwegian tax rules impose three different taxes on the use of mineral oil. First there is a *general* CO_2 tax which in principle applies to *all* users of mineral oil. Secondly, there is a *specific* CO_2 tax which applies only when the oil is used by the petroleum production sector. The same sector has been exempted from the general CO_2 tax. Thirdly, a *heating oil tax* applies to all users of mineral oil for heating purposes, except for the petroleum production sector.

2.1 General CO_2 tax on the use of mineral oil

In 1991 the Norwegian authorities introduced a general tax on mineral oil to internalise the costs of CO_2 related environmental damage and encourage cost effective reductions of CO_2 emissions. This tax formed part of an umbrella tax, covering not only CO_2 emissions but also other types of pollution caused by the use of mineral oil (such as sulphur content). In 1999 a separate tax on mineral oil was introduced, targeting pollution in the form of CO_2 emissions only.[5] The CO_2 tax, hereinafter referred to as the “general CO_2 tax”, applies to the use of (i) mineral oil which is defined as kerosene, heating kerosene, gas oil, (auto) diesel oil, heating oil and any other oil usable for tax liable purposes; and (ii) petrol.[6]

[5] The Norwegian Parliament adopts annual decisions which provide for the obligation to pay CO_2 tax on the use of mineral oil. Based on a mandate given in the annual Parliament decisions and the Norwegian law on excise duties (“*Lov 1933-05-19 nr. 11, Lov om særavgifter*”) the Ministry of Finance issued in 2001 a Royal Decree on excise duties, describing CO_2 taxable products and generally delimiting the scope of the CO_2 tax (“*Forskrift om særavgifter 200 1-12-11-1451*”).

[6] According to section 1 of the Royal Decree on excise duties the general CO_2 tax is levied on the purchase and import of mineral oil.

As of 1 January 2008 the rate of the general CO_2 tax on mineral oil was increased from NOK 0.54 per litre in 2007 to 0.55 per litre (NOK 550 per 1000 litre, approx. Euro 71.54).[7]

The Norwegian authorities have explained that as of the introduction of the general tax on mineral oil in 1991 (and the general CO_2 tax in 1999), the petroleum production activities (carried out on the continental shelf) have been exempted from the tax.[8]

While the petroleum production activities have benefitted from an outright exemption from the general CO_2 tax, other industries have benefitted from a reduced rate. In this regard the paper and pulp industry as well as the herring & fish flour industry have benefitted from a reduced CO_2 tax rate of NOK 0.27 per litre in 2007.[9] The reduced rate for the paper and pulp industry was approved by the Authority until 31 December 2004 in a decision of 30 June 2004 and again in a second decision of 15 December 2004 until 31 December 2010.[10]

2.2 Specific CO_2 tax on mineral oil used for petroleum production on the continental shelf

The use of mineral oil in the context of the production of petroleum is subject to a specific CO_2 tax according to a law introduced in 1991 and annual Parliament decisions giving effect to the law (hereinafter the “specific CO_2 tax”).[11] While the specific CO_2 tax is targeted at the use of mineral oil in the context of petroleum production no matter where it takes place, so far, the extraction of gas and oil have only been taking place on the continental shelf.[12]

The motivation behind the introduction of a specific CO_2 tax in the context of petroleum production was to ensure effective reduction of CO_2 emissions and other greenhouse gases in this sector. In this regard statistics show that compared to other activities, petroleum production accounts for more than a fourth (about 26%) of Norway’s total volume of CO_2 emissions in industrial processing in 2006, thereby making petroleum production the most

[7] All rates in Euro have been calculated on the basis of the exchange rate issued by the Bank of Norway on the first working day of October of the previous year.

[8] St. prp. nr.1 (1990-91) p. 57. The text of section 3(6) of the Parliament’s decision on CO_2 tax for 1991 is published in “*Rundskriv nr. 11/1991 S*”. The legislation is explained in general in St. prp. nr.1 (1998-1999) in which context it is also mentioned that the exemption for the petroleum production activities - which until 1999 were exempted under a provision covering a much wider group (such as supply ships and other transport related to petroleum activity) – would be singled out into a separate exemption provision covering only petroleum production.

[9] St. prp. nr. 1 (2006-2007) confirmed by the Parliament Decision 1342 of 28 November 2006.

[10] Decision No. 148/04/COL of 30 June 2004 and Decision No. 370/04/COL of 15 December 2004. The approved rate was NOK 0.26 per litre.

[11] *“Lov 1990-12-21 nr 72: Lov om avgift på utslipp av* CO_2 *i petroleumsvirksomhet på kontinentalsokkelen”* which provides that establishments engaged in the extraction or transport of petroleum and combusting fuel (which includes mineral oil and condensate), or emitting natural gas or CO_2 segregated from petrol is subject to the tax (the “Law on specific CO_2 tax on Petroleum Production”). The Parliament adopts annual decisions setting the rate of the tax.

[12] The production of petroleum consists of the extraction, treatment and pipeline transport of oil and gas. Those activities are collectively referred to in the following as “petroleum production”.

CO_2 polluting sector in Norway.[13] The growth rate of CO_2 emissions from the petroleum production sector is also considerably higher than that of total CO_2 emissions in Norway.[14]

Since the main source of CO_2 emissions in the context of petroleum production activities is the combustion (or flaring) of gas, the CO_2 tax in the context of petroleum production was principally aimed at the emission of natural gas. However, in order to prevent a switch-over effect in the means of energy supply (from gas to mineral oil) the tax was extended to cover CO_2 emissions stemming also from the use of mineral oil and condensate.[15]

Given the intention of targeting specifically the considerable amount of CO_2 emissions for which the petroleum sector is accountable, an important element of the effectiveness of the tax was that the rate should be sufficiently high to have the desired effect. Hence as of its introduction the rate has been considerably higher than the general CO_2 tax on mineral oil. In 2007, for example, the rate was NOK 0.80 per litre oil (NOK 800 per 1000 litre, approx. Euro 95.89). This is almost 50% higher than the rate of the general CO_2 tax which in 2007 was NOK 0.54 (NOK 540 per 1000 litre, approx. Euro 64.7).

Due to the fact that the petroleum production activities are subject to a specific and high CO_2 tax on the use of mineral oil, the petroleum activities have been exempt from the general CO_2 tax as of the date of its introduction.[16] The Norwegian authorities have explained that the specific CO_2 tax was introduced in order to take into account the fact that the petroleum production industry emits more CO_2 than any other sector in Norway and increases its annual emissions with more than the double of any other industry in Norway. The tax is therefore specifically targeted at this highly polluting sector.

The petroleum production activities are also in other areas subject to a particular tax regime that reflects the specific characteristics of the sector. For example, in addition to the corporate income tax at a rate of 28% generally applied in Norway, income related to the extraction of oil and gas above a certain threshold is subject to an additional tax of 50%,[17] meaning that in practice, income of the petroleum production activities is taxed at a rate up to maximum 78%.

2.3 Heating oil tax

On 1 January 2000 the Norwegian authorities introduced a separate “heating oil tax” on mineral oil in order to discourage users to switch from energy supply in the form of

[13] Based on preliminary statistics from “*Statistisk sentralbyrå, Statens forurensningstilsyn, 2008*”. For 2006 CO_2 emissions from the petroleum sector have been estimated at 11.3 million tonne CO_2 compared to total processing related CO_2 emissions of 43.3 million tonne CO_2, see statistics from “*Statistisk sentralbyrå*”.

[14] CO_2 emissions from the petroleum sector increased from 7 million tonne in 1990 to 11.6 million tonne in 2005, i.e., an increase of about 66% while total CO_2 emissions in Norway increased merely from 34.8 million tonne to 42.9 million tonne, i.e., about 23%, over the same period; see statistics from “*Statistisk sentralbyrå, Statens forurensningstilsyn, 2008*”.

[15] Cf. sections 6 and 2 of Ot. prp. nr. 17 (1990- 1991) which form part of the preparatory works for the Law on specific CO_2 tax on Petroleum Production.

[16] The exemption from general CO_2 tax in favour of the petroleum production sector was first included in the annual Parliament decisions on the general CO_2 tax. This was changed as of 2002. As of that year the exemption was carried on via a rule stating that the rate of the specific CO_2 tax for petroleum production activities would be proportionately reduced in case the general CO_2 tax on mineral oil had already been paid. The new rule was introduced in the annual Parliament decisions fixing the specific CO_2 tax rate.

[17] Decision no. 1380 of the Norwegian Parliament of 28 November 2007 for the financial year 2008.

electricity (the use of which had just been the subject of a tax increase)[18] to heating oil. Such a switch was not considered desirable from an environmental point of view due to CO_2 emissions.[19]

The tax on heating oil was increased from NOK 0.429 per litre in 2007 to NOK 0.845 (NOK 845 per 1000 litre, approx. Euro 109.92) in 2008.

All utilisation of heating oil is subject to a heating oil tax albeit some derogations apply, notably for the herring & fish flour industry as well as for the pulp and paper industry which are fully exempted.[20] The exemption for the pulp and paper industry was approved by the Authority in its Decisions of 30 June 2004 and 15 December 2004.[21]

Moreover, the petroleum production sector on the continental shelf is not subject to heating oil tax. The Norwegian authorities have explained that in this sector the power is generated on the platforms on the basis of gas, which is an easy available source of energy. According to the authorities the more environmentally friendly alternative of importing hydro generated electricity is not realistic due to extreme costs and practical difficulties.[22] The imposition of a tax on the third alternative, mineral oil (i.e., the heating oil tax), would only reinforce the reasons to use gas. It would therefore neither produce energy saving effects nor have the effect of making companies use a more environmentally friendly alternative.[23]

2.4 Total tax burden

Based on the above, mineral oil has been subject to a general CO_2 tax as of 1991 and a heating oil tax as of 2000. Mineral oil is thus effectively subject to two cumulative taxes. In its Decisions of 30 June 2004 and 15 December 2004 the Authority held that given the fact that the CO_2 tax on mineral oil and the heating oil tax are imposed on the same product, they must be assessed jointly as two components of one tax, thereby allowing the Authority to make an integrated assessment of their compatibility with the state aid rules.[24]

Hence as of 2000 the overall tax burden on the use of mineral oil has been the result of applying both the general CO_2 tax and heating oil tax.

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[18] The objective of the electricity tax is energy saving. Virtually all electricity in Norway is hydro generated (and hence environmentally friendly). So while the electricity tax was introduced to save energy it had the undesired effect of making users switch to an environmentally unfriendly alternative, namely mineral oil, which resulted in the heating oil tax.

[19] As of 2000 the Norwegian Parliament has adopted annual decisions which provide for the obligation to pay heating oil tax on the use of mineral oil. In the Royal Decree on excise duties the scope of the heating oil tax is described in further detail (“*Forskrift om særavgifter 2001-12-11-1451*”).

[20] Section 3 of the Royal Decree on excise duties.

[21] See footnote 10.

[22] A Report issued by a State agency for surveying pollution (”*Oljedirektoratet, Statens forurensingstilsyn, Norges vassdrags- og energidirektorat og petroleumstilsynet*”) in January 2008, entitled ”*Kraft fra land til norsk sokkel”* shows that the construction costs involved in enabling electricity supply from land to the petroleum production sector are at least about NOK 1 600 per ton CO_2 due to the complexity involved in reconstruction combined with the life time of the oil fields.

[23] Moreover, the petroleum production sector is also not subject to the (energy saving) electricity tax.

[24] See footnote 10.

	Total tax burden
	Total tax (CO_2 tax and heating oil tax) in NOK/Euro per litre[25]
2000	(0.47 plus 0.190)= 0.66/0.080
2001	(0.48 plus 0.382)= 0.862/0.107
2002	(0.49 plus 0.389)= 0.879/0.109
2003	(0.50 plus 0.398)= 0.898/0.123
2004	(0.51 plus 0.405)= 0.915/0.111
2005	(0.52 plus 0.414)= 0.934/0.112
2006	(0.53 plus 0.421)= 0.951/0.121
2007	(0.54 plus 0.429)= 0.969/0.116
2008	(0.55 plus 0.845)= 1.395/0.181

As regards the petroleum production activities the overall tax burden on the use of mineral oil has followed from the specific CO_2 tax rate on petroleum production. [26] While the rate of the specific CO_2 tax was NOK 0.89 per litre in the year of its introduction (1999) it has since been between NOK 0.70 in 2000 and 0.80 in 2007.

3. Proposed amendments

In their notification the Norwegian authorities have proposed to amend the scope of application of the general CO_2 tax on mineral oil as a consequence of recent amendments made to the Norwegian legislation on the emission trading system on CO_2 emissions. Linked hereto is a proposal for amending the application of the heating oil tax to the paper and pulp sector.

(i) The Norwegian emission trading system

On 1 January 2005 the Norwegian authorities introduced an emission trading system (the "Norwegian ETS") with effect for the first trading period (between 1 January 2005 until 31 December 2007) according to which undertakings in several sectors are required to hold an emission permit and a number of allowances corresponding to their extent of CO_2 emissions (the "ETS Law").[27] The ETS Law was amended on 29 June 2007 in order to take account of the incorporation into the EEA Agreement of Directive 2003/87 on an emission trading system of the European Union (the "ETS Directive").[28]

Prior to the amendment of the ETS Law its scope was defined as covering all installations falling under the ETS Directive but excluding those which were subject to CO_2 tax in Norway. Moreover, while the ETS Directive covers larger installations above certain capacity thresholds such limitations did not form part of the ETS Law. The amendment of the ETS Law extended the coverage of the Norwegian ETS to cover activities identical to those covered by the ETS Directive. Thus, amongst others the petroleum production sector and pulp & paper industry are now part of the Norwegian ETS.

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[25] In the relevant period the exchange rate has varied around 8 NOK/Euro.

[26] As mentioned above, the petroleum production activities have been exempt from the general CO_2 tax.

[27] *"Lov 2004-12-17 nr 99: Lov om kvoteplikt og handel med kvoter for utslipp av klimagasser (klimakvoteloven)"*

[28] Directive 2003/87/EC establishing a scheme for greenhouse gas emission allowance trading within the Community; OJ L 275, 25.10.2003, p. 32, as amended. By decision 146/2007 of 26 October 2007 the EEA Joint Committee incorporated the ETS Directive into the EEA Agreement (not yet published).

(ii) Proposed exemption from general CO_2 tax

Against that background the current proposal of the Norwegian authorities is to exempt from CO_2 tax those sectors/installations which are covered by the ETS Law.[29]

Although the ETS Law covers specific sectors it is not known beforehand who would use (CO_2 tax liable) mineral oil. It has therefore not been possible to establish an exhaustive list of those who would be eligible for a CO_2 tax exemption. However, based on experience with the most intensive mineral oil users the Norwegian authorities have established a tentative list of the sectors expected to be covered by the exemption. This list includes the herring and fish flour industry, paper and pulp industry, energy producers in the chemical and petro-chemical industry and remote heating systems.

With the exception of the petroleum production sector, all the aforementioned sectors have up until this stage been subject to the general CO_2 tax (albeit the paper and pulp industry has benefited from a reduced rate).

The objective of the proposed exemption is thus to avoid that entities are subject to two sets of legislative requirements pursuing the same environmental objective of reducing CO_2 emissions.

(iii) Proposed elimination of exemption from heating oil tax in favour of the paper and pulp sector

The proposed exemption from general CO_2 tax is linked to a proposal to lift the exemption from heating oil tax for the pulp and paper industry. However, instead of applying the general rate for heating oil tax (which for 2008 has been increased to NOK 0.845 per litre) to the paper and pulp industry, the proposal provides that as of 2008 this sector is to benefit from a reduced rate on heating oil tax of NOK 0.12 per litre (NOK 120 per 1000 litre approx. Euro 15.61).[30]

(iv) Consequences for the petroleum production activities

First and foremost the abovementioned proposal by the Norwegian authorities relating to general CO_2 tax implies that the previous exemption from general CO_2 tax in favour of the whole petroleum production sector is abolished.

Instead the newly proposed CO_2 tax exemption will mean that ETS covered petroleum undertakings will be exempt from general CO_2 tax. Such ETS covered petroleum production activities will continue to be subject to the specific CO_2 tax. Since petroleum production undertakings must buy allowances the Norwegian authorities have reduced the rate of the specific CO_2 tax from NOK 0.80 in 2007 to NOK 0.45 (NOK 450 per 1000 litre, approx. Euro 58.54) in 2008.

The Norwegian authorities have moreover explained that those petroleum production activities that are *not* covered by the ETS law will be subject to the general CO_2 tax - in addition to the specific CO_2 tax.[31]

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[29] Section 3.10 of St. prp. nr.1 (2007-2008).

[30] Section 3.8 of St. prp. nr.1 (2007-2008) and Budsjett-innst. S. nr. 1 (2007-2008), see also St.meld. nr. 1 (2007-2008).

[31] Although for the moment a different rule provides that for the year 2008 petroleum undertakings subject to general CO_2 tax (i.e., not exempt due to ETS) will be exempt from specific CO_2 tax (see Parliament

3.1 The ETS Law

The ETS Law covers the following installations[32]

Energy production in the form of
- combustion installations[33] with thermal input exceeding 20MW, mineral oil refineries and coke ovens;

Production and processing of ferrous metal, covering
- metal ore (including sulphide ore) roasting or sintering installations;
- production of pig iron or steel (primary or secondary fusion) with a capacity exceeding 2.5 tonnes per hour;

Mineral industry, covering:
- cement clinker production in rotary kilns with production exceeding 500 tonnes per day, or lime in rotary kilns with a production capacity exceeding 50 tonnes per day or in other furnaces with a production capacity exceeding 50 tonnes per day;
- glass (including glass fibre) production with a melting capacity exceeding 20 tonnes per day;
- manufacturing of ceramic products by firing, in particular roofing tiles, bricks, refractory bricks tiles stoneware or porcelain with a production capacity exceeding 75 tonnes per day, and/or with a kiln capacity exceeding 4 m3 and with a setting density per kiln exceeding 300kg/m3";

Other activities, covering
- pulp production from timber or other fibrous materials;
- paper and board production with a capacity exceeding 20 tonnes per day.

3.2 Budget and duration

Since the total tax burden on the use of mineral oil consists of the aggregate sum resulting from applying both the CO_2 tax and the heating oil tax, revenue foregone covers any reduction or exemption from either tax. According to the Norwegian authorities revenue foregone by introducing the proposed exemption from general CO_2 tax compared to the full rate amounts to approx. NOK 140 million (approx. Euro 17.9 million).[34] As regards heating oil tax, the Norwegian authorities consider that the proposed reduced rate for the paper and pulp industry compared to the full rate results in revenue foregone of approx. NOK 70 million (approx. Euro 9 million).

The Norwegian authorities have notified the above mentioned proposed amendments for an approximate period of 10 years, that is, for the period from 1 January 2008 until 31 December 2017.

decision for 2008 on specific CO_2 tax). However, this rule was a mistake and there exists currently no non-ETS covered petroleum production activities (and no such new installations are foreseen to be established within the next three years). The current rule will be deleted as of 2009.

[32] The capacity thresholds are stated in section 1(1) of Royal Decree on the emission trading system issued on the basis of the ETS Law.

[33] While the ETS Law refers to energy production ("energiproduksjon") as such the term is presumed to include "combustion installations" as stated in the ETS Directive.

[34] Of which the petroleum production sector accounts for approximately NOK 15 million.

II. APPRECIATION

1. The presence of state aid

As a preliminary point, the Authority considers that state aid to the herring and fish flour industry do not fall within the scope of the EEA Agreement. This is based on Article 8(3) of the EEA Agreement according to which the Agreement, unless otherwise specified, applies to the products listed in Chapters 25 to 97 of the Harmonised Commodity Description and Coding System. Herring and fish flour industry is covered by Chapter 23 thereof. The herring and fish flour industry is therefore not addressed further.[35]

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

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

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

To constitute state aid within the meaning of Article 61(1) EEA, a measure must meet the following four cumulative criteria: the measure must (i) confer on recipients an economic advantage which is not received in the normal course of business; (ii) the advantage must be granted by the State or through State resources; (iii) the measure must be selective by favouring certain undertakings or the production of certain goods; and (iv) it must distort competition and affect trade between the Contracting Parties.

The following addresses the (i) proposed exemption from general CO_2 tax for ETS covered undertakings and (ii) the proposed reduced heating oil tax rate in favour of the paper and pulp sector.[36]

1.2 Economic advantage

As regards the requirement that the measure must confer an economic advantage, such an advantage may be provided through a reduction in the undertaking's tax burden in various ways, including a reduction in the tax base or in the amount of tax as well as by means of a deferment, cancellation or rescheduling of tax debt.[37] In the present case undertakings which normally are subject to general CO_2 tax but which will benefit from an exemption under the proposed measures (by reference to ETS coverage) receive therefore an economic advantage. Moreover, undertakings in the pulp and paper sector will, under the proposed measures, benefit from an economic advantage by means of the reduced heating oil tax rate.

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[35] See the Authority's decision 176/05/COL of 15 July 2007.

[36] Since the specific CO_2 tax is applicable only to the petroleum production sector the reduction of the rate of the tax from NOK 0.80 in NOK 0.45 in 2008 constitutes a general measure and is therefore not addressed any further.

[37] Section 3(2) of the State Aid Guidelines on the application of state aid rules to measures relating to direct business taxation.

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1.3 Presence of state resources

As to the requirement that the aid measure must be granted by the State or through state resources, it follows from the State Aid Guidelines that a loss of tax revenue is equivalent to the consumption of State resources in the form of fiscal expenditure.[38] Since both of the proposed measures involve either tax exemptions or tax reductions they involve a loss of tax revenue and thus state resources are involved.

1.4 Favouring certain undertakings or the production of certain goods

The measure must favour certain undertakings or the production of certain goods.

Under the proposed exemption from general CO_2 tax only undertakings which operate in sectors covered by the ETS Law and which are above certain capacity limits will be exempt from general CO_2 tax. Moreover, only the pulp and paper industry benefits from a reduced heating oil tax rate. The measures therefore favour certain sectors or undertakings within such sectors to the exclusion of others and is hence selective in nature. In this respect the EFTA Court has held that a measure may be selective even if it covers (undertakings in) an entire sector.[39]

1.5 Distortion of competition and effect on trade between Contracting Parties

The aid measure must distort competition and affect trade between the Contracting Parties.

The proposed measures and the new tax exemption in favour of the petroleum production activities concern undertakings operating in energy production, ferrous metals production, the mineral industry, the pulp and paper sector as well as in petroleum production or in one of those sectors. In view of the fact that, for the year 2006, there were both exports to the EU from Norway as well as imports from the EU to Norway in three of the relevant sectors (that is, energy, ferrous metal and pulp & paper), there is trade between Norway and the EU.[40]

In such circumstances, the grant of support via tax alleviations to undertakings in the relevant sectors will strengthen the position of recipients compared to other undertakings which are located in Norway or in other EEA countries and competing in such (and related) businesses. On this basis, the Authority considers that the grant of financial support via the proposed measures to undertakings operating in the abovementioned sectors will distort competition and affect trade.

[38] Section 3(3) of the State Aid Guidelines on the application of state aid rules to measures relating to direct business taxation.

[39] Joined Cases E-5/04, E-6/04 and E-7/04 *Fesil and Finnfjord* [2005] EFTA Court Report p. 117, paragraph 77. This judgment confirms the case law of the European Court of Justice as laid down in Case C-75/97 *Belgium* v *Commission* [1999] ECR I-3671, paragraph 33. See also Case C-66/02 *Italy* v *Commission* [2005] ECR I-10901, paragraph 95.

[40] Statistics issued by "Statistisk Sentralbyrå" entitled "*Utenrikshandel med varer, årsserier 2006*"; Table 17 "*Import etter handelsområder, verdensdeler og land*" for 2001-2006 and Table 18 "*Eksport etter handelsområder, verdensdeler og land*" for 2001-2006; http://www.ssb.no/emner/09/05/nos_utenriks/. http://www.ssb.no/english/.

1.6 Conclusion on the existence of state aid

In the light of the above, the conclusion is that (i) the proposed exemption from general CO_2 tax; and (ii) the proposed reduced heating oil tax rate in favour of the pulp and paper sector constitutes state aid within the meaning of Article 61(1) of the EEA Agreement.

2. Procedural requirements

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

By means of a letter dated 28 September 2007, the Norwegian authorities notified the exemption from general CO_2 tax in favour of ETS covered installations and the reduced heating oil rate for the paper and pulp sector. According to preparatory legislative works the CO_2 tax exemption may enter into force only following a notification to, and approval by, the Authority.[41] Therefore, the authorisation by the Norwegian authorities of the entry into force of the CO_2 tax exemption is conditional upon the prior approval of the scheme by the Authority.

In these circumstances, the Authority considers the Norwegian authorities have respected the notification and standstill obligation pursuant to Article 1(3) of Part I of Protocol 3 to the Surveillance and Court Agreement.

3. Compatibility with Article 61(3)

Reductions from environmental taxes fall within the scope of the State aid guidelines for environmental protection (hereinafter "the Environmental guidelines"). In paragraph 68 of the Environmental Guidelines the Authority has stated that it is to early to provide general guidance on the compatibility of environmental tax reductions/exemptions in favour of undertakings subject to an emission trading scheme. It is further stated that therefore reductions which are due to beneficiaries' participation in tradable permit schemes should be assessed on the basis of Article 61(3)(c) EEA. Nevertheless, the compatibility assessment of the notified schemes with that article can be made taking inspiration from the Environmental Guidelines.

Article 61(3)(c) EEA provides that state aid may be considered compatible with the functioning of the EEA Agreement where it facilitates the development of certain economic activities or of certain economic areas and does not adversely affect trading conditions to an extent contrary to the common interest.

As a preliminary point and as referred to above, the Authority has previously held that since the heating oil tax is imposed on the same product (i.e., mineral oil) as the general CO_2 tax, mineral oil is effectively subject to two cumulative taxes, namely the general CO_2 tax and the heating oil tax. The Authority upholds this view and the two taxes are assessed jointly as two components of one tax.

According to the Environmental Guidelines aid in the form of reductions of, or exemptions from, environmental taxes will be considered compatible with the functioning of the EEA Agreement on the condition that the tax reductions or exemptions (i)

[41] Section 3.10 of St.prp. nr.1 (2007-2008) approved by Parliament in Budsjett-innst. S. nr.1 (2007-2008).

contribute at least indirectly to improving the level of environmental protection; (ii) do not undermine the general objective pursued; and (iii) any reductions or exemptions from a tax which corresponds to a tax which has been harmonised via Directive 2003/96/EC must comply with the limits and conditions set out therein.[42]

Re (i) Is the tax reduction/exemption improving environmental protection?

According to the Environmental Guidelines the possibility to be able to derogate from environmental taxes for certain sectors or groups of undertakings may enable national authorities to maintain a higher environmental tax level in general and thereby contribute more to internalise costs of environmental damage and give further incentives to improve environmental protection.[43] Therefore aid in the form of reductions or exemptions from environmental taxes may be necessary for purposes of facilitating the maintenance of a generally high national environmental tax.

For the past eight years the combined level of Norwegian environmental taxes on mineral oil (i.e., the general CO_2 tax and the heating oil tax, on the one hand, and the specific CO_2 tax on the other hand) have been in the range of Euro 100-180 Euro per 1000 litre. The taxes have therefore been well above the harmonised minimum level of mineral oil taxes in the European Community.[44] Norway has therefore maintained a generally high environmental tax level in the area of mineral oil. In the present case the maintenance of such a high taxation level is made possible by the fact that the Authority may authorise exemptions or reductions from the tax. The possibility to derogate from a tax is particularly important for groups which are covered by other instruments, such as the ETS, which addresses a purpose identical to that of the CO_2 tax, namely of ensuring efficient CO_2 emission reductions. The maintenance of high taxes also makes it important to be able to derogate in favour of energy intensive users which have considerably higher energy costs than other users.[45]

On this basis the Authority considers that aid in the form of the exemption from the general CO_2 tax (by reference to ETS) enables Norway to maintain a high environmental taxation level and therefore improves environmental protection. Similarly, since, as will appear from below, the pulp and paper industry does qualify as an energy intensive user group, the Authority considers that aid in the form of the reduced heating oil tax rate in favour of the pulp and paper sector enables Norway to maintain a high environmental taxation level and therefore improves environmental protection.[46]

Re (ii) Does the tax reduction/exemption undermine the general objective of the tax?

First, as the Authority will demonstrate below, the proposed exemption from general CO_2 tax (or rather reduction of the overall tax burden applicable to mineral oils) results in a taxation level which is above the minimum level in the European Community. This in itself shows that the general objective of the tax is not undermined. Secondly, the proposed exemption from general CO_2 tax will apply to those covered by the ETS Law.

[42] Paragraphs 151-152 of the Environmental Guidelines. See also paragraphs 70(15) and 10.
[43] Paragraph 57 of the Environmental Guidelines.
[44] The minimum taxation level fixed by Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity (OJ L 283, 31.10.2003, p. 51), as amended. See below for more details on the exact minimum level.
[45] See section (iii) for more details on the qualification of the paper and pulp sector as energy intensive.
[46] The European Commission recently accepted the same reasoning in a similar case, see case N 22/2008 of 19 May 2008, not yet published.

The ETS Law has as its objective to reduce CO_2 emissions and imposes a ceiling on such emissions. This means that where undertakings increase emissions as a result of lower taxation such increases will result in (i) undertakings having to purchase allowances thereby resulting in a corresponding decrease of other undertakings' emissions; or (ii) undertakings will be prevented from selling allowances, thereby contributing to maintaining the level of the overall ceiling of CO_2 emissions for Norway. Hence, not only does the ETS have an objective identical to that of the general CO_2 tax but imposes also a ceiling to achieve the objective. On this basis the Authority considers that the exemption from the general CO_2 tax for ETS covered undertakings does not undermine the objective of the general CO_2 tax of reducing CO_2 emissions.[47]

Moreover, as the Authority will also demonstrate below, the introduction of a reduced rate in heating oil tax for the paper and pulp industry also results in a taxation level which is above the minimum level applicable to such taxes in the European Community. Furthermore, the paper and pulp sector already benefits from an exemption from electricity tax and the reduction in the heating oil tax is therefore unlikely to undermine the environmental objective of preventing a switch-over from electricity to mineral oil.[48]

Re (iii) Does the tax correspond to a tax harmonised by Directive 2003/96/EC and, if so, is the Directive complied with?

The general CO_2 tax and the heating oil tax are both taxes on mineral oil which is a product having been the subject of Community harmonisation via Directive 2003/96/EC on taxation of energy products and electricity (the "Energy Taxation Directive).[49]

As a preliminary point Article 13 of the Energy Taxation Directive provides that exchange rates applied for a given year must be those applicable during the previous year on the first working day of October.[50] While Article 13 also provides that exchange rates applied shall be those published in the Official Journal of the European Union, the exchange rate between Euro and NOK is not published in the Official Journal of the European Union. For purposes of the present case exchange rates (applicable in the relevant year on the relevant day in October) have therefore been obtained from the Bank of Norway.

Exemption from general CO_2 tax

The exemption from general CO_2 tax reduces the overall tax burden for ETS covered undertakings down to the level of the heating oil tax. For ETS undertakings in the petroleum production sector, the reduced tax burden will correspond to the level of the reduced specific CO_2 tax.

According to Article 17(1)(b) of the Energy Taxation Directive, taxes on the consumption of energy products for heating purposes and electricity may be reduced down to the minimum levels fixed by the Directive where tradable permit schemes are implemented in so far as they lead to the achievement of environmental protection objectives or to improvements in energy efficiency.

[47] The European Commission has recently used a similar reasoning in case N 22/2008 of 19 May 2008, not yet published in the Official Journal.
[48] The exemption from electricity tax was approved by the Authority in Decision 151/05 of 22 June 2005.
[49] Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity (OJ L 283, 31.10.2003, p. 51), as amended.
[50] All rates in Euro are approximate rates.

The Norwegian ETS is a tradable permit scheme. Under the ETS Law undertakings in several sectors are required to hold an emission permit and a number of allowances corresponding to their extent of CO_2 emissions. The petroleum production sector must purchase all allowances while other sectors, which emit more than the number of allowances received for free, must purchase additional allowances. The ETS Law therefore incentivises CO_2 emission reductions and therefore leads to the achievement of environmental protection objectives.[51]

Thus, if following the reduction in the overall tax burden (as a result of being CO_2 tax exempt by reference to ETS) the minimum level set forth by the Energy Taxation is respected, the conditions set forth in Article 17(1)(b) of the Energy Taxation Directive are fulfilled.[52]

According to the Energy Taxation Directive the minimum taxation rate for heavy fuel oil is 15 Euro per 1000 kg.[53] 1 litre heavy fuel oil weighs 0.98 kg which means that the minimum taxation rate is Euro 0.0147 per litre, that is, Euro 14.7 per 1000 litre.[54]

The total tax burden on the use of mineral oil as of 1 January 2008 totals NOK 1.395 per litre or Euro 0.181 per litre.[55] The exemption from general CO_2 tax by reference to ETS means that the tax burden is reduced (except for the paper and pulp industry and the petroleum production industry) to the tax rate of heating oil for 2008 of NOK 0.845 per litre or NOK 845 per 1000 litre, that is, Euro 109.92 per 1000 litre. This is above the Community minimum level set out in the Energy Taxation Directive.

As for the petroleum production sector the total tax burden on the use of mineral oil as of 1 January 2008 totals NOK 1 per litre or Euro 0.13 per litre.[56] The exemption from general CO_2 tax means that the total tax burden is brought down to the level of the specific CO_2 tax for 2008 which is NOK 0.45 per litre or NOK 450 per 1000 litre, that is, Euro 58.54 per 1000 litre. This is also above the Community minimum level set out in the Energy Taxation Directive.

Reduced heating oil tax rate in favour of pulp and paper sector

The pulp and paper industry receives an additional reduction in the overall tax burden in the form of a reduced heating oil tax rate. The reduced heating oil tax rate in favour of the pulp and paper sector reduces the overall tax burden of this sector to the reduced level of the heating oil tax. This additional reduction must also be in compliance with the Energy Taxation Directive.

Article 17(1)(a) of the Energy Taxation Directive provides that taxes on the consumption of energy products for heating purposes and electricity may be reduced down to the minimum levels fixed by the Directive in favour of energy intensive businesses where the purchases of energy products and electricity amount to at least 3% of the production value. According to the Norwegian authorities the energy costs of the paper and pulp industry

[51] This consideration does in no way prejudice the assessment of the Norwegian national allocation plan under Directive 2003/87/EC, OJ L 275, 25.10.2003, p. 32.
[52] The European Commission has approved tax reductions by reference to Article 17(1)(b) in case 2006/640/EC of 23 November 2005, OJ L 286, 27.9.2006, p. 19.
[53] Article 9 and Table C of the Energy Taxation Directive.
[54] Source www.ssb.no.
[55] See table above.
[56] CO_2 tax of NOK 0.55 per litre and specific CO_2 tax of NOK 0.45 per litre totalling NOK 1/Euro 0.13 per litre.

amounted in 2006 to approximately 8.5% of the production value.[57] This is considerably higher than the threshold stated in the Energy Taxation Directive. On this basis the Authority considers the pulp and paper industry to be energy intensive within the meaning of the Energy Taxation Directive.

This therefore means that if, following the reduction in the tax burden for the paper and pulp industry, the minimum level set forth in the Energy Taxation Directive is respected the conditions set forth in Article 17(1)(a) of the Energy Taxation Directive are fulfilled.

With respect to the pulp and paper industry the tax burden is reduced down to NOK 0.12 per litre or NOK 120 per 1000 litre, that is, Euro 15.61 per 1000 litre. This rate is also above the minimum level set forth in the Energy Taxation Directive.

Conclusion on compliance with Energy Taxation Directive

The proposed exemption from general CO_2 tax for ETS covered undertakings and the proposed reduced heating oil tax rate in favour of the pulp and paper sector are taxes which correspond to taxes which have been harmonised by the Energy Taxation Directive. Based on the tax rates applicable for 2008 the proposed measures comply with the conditions set forth in the Energy Taxation Directive.

3.2 Duration

According to the Environmental Guidelines aid in the form of tax reductions and exemptions from such taxes which correspond to environmental harmonised taxes within the Community is considered to be compatible with the functioning of the EEA Agreement for a period of 10 years provided the beneficiaries pay at least the level corresponding to the Community minimum tax level set by the relevant applicable Directive.[58]

The Norwegian authorities have notified the proposed measures for an approximate period of 10 years, that is, until 31 December 2017, counted from 1 January 2008.[59] Since it has already been concluded that the proposed measures respect the minimum taxation levels in the Energy Taxation Directive the Authority considers that a duration until 31 December 2017 is acceptable.

4. Conclusion

On the basis of the foregoing assessment, the Authority considers therefore that the proposed measures consisting of an exemption from general CO_2 tax for ETS covered undertakings and a reduced heating oil tax rate in favour of the pulp and paper sector meet the conditions set out in the Environmental Guidelines and are therefore compatible with the functioning of the EEA Agreement within the meaning of Article 61 of the EEA Agreement. This assessment is based on the applicable rates of heating oil tax and specific CO_2 tax for 2008. Any reduction in any of the relevant tax rates, compared to 2008 levels,

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[57] Total production value of the paper and pulp industry amounted in 2006 to NOK 18 930 million; source "*nasjonalregnskapet*" http://www.ssb.no/emner/09/01/nr/tab-06.html. The total energy costs of the paper and pulp industry in 2006 amounted to NOK 1 614 million of which electricity costs accounted for NOK 1 151 million whereas the costs of petroleum products (excluding transport) amounted to NOK 386 million; source: http://www.ssb.no/emner/10/07/indenergi/tab-2007-06-22-04.html.

[58] Paragraph 153 of the Environmental Guidelines.

[59] At which date the reduced heating oil tax rate entered into force.

may therefore change the outcome of the assessment and must therefore be notified to the Authority.

The Norwegian authorities are also reminded that any other plans to modify the proposed measures must be notified to the Authority.

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

HAS ADOPTED THIS DECISION:

Article 1

The Authority considers the notified measures of (i) exemption from general CO_2 tax for ETS covered undertakings; and (ii) reduced heating oil tax rate for the pulp and paper sector to be compatible with the functioning of the EEA Agreement and has thus decided not to raise objections. This assessment is based on the applicable rates of heating oil tax and specific CO_2 tax for 2008 and such tax levels form therefore an integral part of the conditions for considering the notified measures as compatible with the functioning of the EEA Agreement.

The Authority considers the notified measures to be compatible until 31 December 2017.

Article 2

The implementation of the notified measures are accordingly authorised.

Article 3

This Decision is addressed to the Kingdom of Norway.

Article 4

Only the English version is authentic.

Done at Brussels, 16 July 2008

For the EFTA Surveillance Authority,

Per Sanderud
President

Kristján Andri Stefánsson
College Member