

Case No: 63644
Event No: 526126
Dec. No: 303/09/COL

EFTA SURVEILLANCE AUTHORITY DECISION

of 8 July 2009

on the scheme relating to maritime transport in the form of a tonnage tax scheme and a refund scheme for the employment of seafarers

(Iceland)

THE EFTA SURVEILLANCE AUTHORITY¹,

Having regard to the Agreement on the European Economic Area², 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 Justice³, in particular to Article 24 thereof,

Having regard to Article 1(2) of Part I and Articles 4(4), 6 and 7(5) of Part II of Protocol 3 to the Surveillance and Court Agreement⁴,

Having regard to the Authority's Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement⁵, and in particular the Chapter on Aid to Maritime Transport⁶,

Having regard to the Authority's Decision of 14 July 2004 on the implementing provisions referred to under Article 27 of Part II of Protocol 3⁷,

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 Hereinafter referred to as Protocol 3.

⁵ Guidelines on the application and interpretation of Articles 61 and 62 of the EEA Agreement and Article 1 of Protocol 3 to the Surveillance and Court Agreement, adopted and issued by the Authority on 19 January 1994, published in the Official Journal of the European Union (hereinafter referred to as OJ) L 231 of 03.09.1994 p. 1 and EEA Supplement No 32 of 03.09.1994 p. 1. Hereinafter referred to as the State Aid Guidelines. The updated version of the State Aid Guidelines is published on the Authority's website: <http://www.eftasurv.int/fieldsOfWork/fieldStateAid/guidelines/>

⁶ Hereinafter referred to as the Maritime Guidelines.

⁷ Decision 195/04/COL of 14 July 2004 published in OJ C 139 of 25.05.2006 p. 57 and EEA Supplement No 26 of 25.05.2006 p. 1 as amended by Decision 319/05/COL of 14 December 2005 published in OJ C 286 of 23.11.2006 p. 9 and EEA Supplement No 57 of 23.11.2006 p. 31.

Having called on interested parties to submit their comments pursuant to those provisions⁸,

Whereas:

I. FACTS

1 Procedure

By letter of 23 March 2007 (Event No 415003), the Icelandic authorities notified the Authority of planned aid to the maritime transport sector, pursuant to Article 1(3) of Part I of Protocol 3.

After various exchanges of correspondence⁹, by letter dated 19 December 2007, the Authority informed the Icelandic authorities that it had decided to initiate the procedure laid down in Article 1(2) of Part I of Protocol 3 in respect of the state aid to maritime transport in Iceland in the form of a tonnage tax scheme and a refund scheme for the employment of seafarers.

The Authority's Decision No 721/07/COL to initiate the procedure was published in the Official Journal of the European Union and the EEA Supplement thereto.¹⁰ The Authority called on interested parties to submit their comments thereon.

The Authority received no comments from interested parties.

2 Description of the proposed measures

The notification entailed two separate measures: a tonnage tax scheme and a special refund scheme for ship-owners. The two measures will be described here below.

2.1 Title and objective of the notified schemes

The scheme "*Ríkisstyrkur vegan kaupskipaútgerðar á Íslandi*", i.e., state aid to maritime transport in Iceland comprises both notified measures. The objective of the scheme is to support maritime transport in Iceland by giving advantages to ship-owners with a view to encouraging them to register in Iceland, rather than sailing under a convenience flag.

2.2 National legal basis for the notified measures

The legal basis for the above mentioned measures is Act 86/2007 on the Taxation of merchant vessel operations "*Lög um skattlagningu kaupskipaútgerðar*" (hereinafter the "Tonnage Tax Act"). This Act was adopted by Parliament on 17 March 2007 and published in the Official Law Gazette on 30 March 2007. According to Article 17 of the Tonnage Tax Act, it entered into force on 1 January 2008.

⁸ Published in OJ C96 of 17.04.2008 p. 37 and EEA Supplement No 20 of 17.04.2008 p. 17.

⁹ For more detailed information on the various correspondence between the Authority and the Icelandic authorities, reference is made to the Authority's Decision to open the formal investigation procedure, Decision No 721/07/COL, published in OJ C 93 of 17.4.2008 p. 37 and EEA Supplement No 20 of 17.04.2008 p. 17.

¹⁰ See footnote 8 for the OJ reference.

The Tonnage Tax Act needs to be seen in connection with Act 38/2007 *um íslenska alþjóðlega skipaskrá* on the Icelandic International Ship Register¹¹ (hereinafter the “IIS”) which entered into force on 1 January 2008.¹²

2.3 The tonnage tax

In Iceland, the standard corporate tax rate is 15%.¹³ The Tonnage Tax Act provides that, instead of applying directly the normal corporate tax of 15% on the profit generated by the shipping activities, shipping companies may benefit from a more favourable tonnage tax calculated on the basis of a notional profit per day depending on the actual tonnage of the ship concerned. If a shipping company wishes to remain subject to the normal corporation tax rules in order to calculate its profits, it may do so.

The notional profit obtained by applying a set rate to the actual tonnage is then subject to the standard corporate tax.

The tonnage tax regime thus exempts eligible companies from regular corporate tax on profits derived from shipping as long as the profits are retained in companies within the scheme. The exemption does not apply to interest, profits from net share trading, or income from other sources.

2.3.1 Eligible activities

Principal activities

The scheme covers ships registered on the IIS of at least 100 GT used for the transportation of people or cargo abroad and transportation of cargo domestically. Article 3 of the Tonnage Tax Act specifies that the transport of cargo or passengers is to be done by means of:

1. merchant vessels owned by the vessel operator;
2. merchant vessels leased without crew (bareboat charter);
3. merchant vessels leased with crew (time charter).

Merchant vessel operations do not include the leasing of bareboat charter for longer periods than three years. The Icelandic authorities have indicated that there is no particular rule regarding the proportion of merchant vessels that may be leased with or without a crew compared to those owned by the vessel operator.

¹¹ There is already an Icelandic Ship register which covers fishing ships, sailboats, ferries, etc. which will not be replaced by the newly introduced IIS. The two registers will run in parallel.

¹² The Icelandic authorities have indicated that the Icelandic Government had submitted a draft bill to the Parliament which was to postpone the entry into force of Act No 38/2007 until 1 January 2009. The bill of law was submitted to Parliament on 28 November 2007 and was discussed on 4 December 2007. The bill was however not agreed upon and was consequently never sent to the second reading in Parliament. Both Acts No 86/2007 and 38/2007 therefore entered into force on 1 January 2008.

¹³ At the time of the notification of the scheme the corporate tax rate was of 18%. This rate was changed to 15% by the Act of 7 June 2007 (“*Lög um breyting á lögum nr. 90/2003, um tekjuskatt, með síðari breytingum, og lögum nr. 86/2007, um skattlagningu kaupskipaútgærdar*”).

Article 4 of the Tonnage Tax Act provides that the following activities are not eligible under the Act: fishing, harbour constructions, diving, piloting and salvage, educational and schooling activities or other social activities, sports, entertainment and leisure activities including whale watching and passenger transport between ports within Iceland that are not ports of calls between countries.

The Icelandic authorities confirmed that towing and dredging are not eligible under the Act.

Ancillary activities

Article 3 of the Tonnage Tax Act provides that the following ancillary activities are eligible:

1. the use of containers in cargo transportations;
2. the operation of loading, unloading and maintenance facilities;
3. the operation of ticket sales and passenger terminals;
4. the operation of offices and management facilities;
5. the sale of consumer products on board merchant vessels.

2.3.2 Registration in the IIS and full tax liability

According to Article 1 of the Tonnage Tax Act,

“[l]imited liability companies and private limited companies, subject to taxation pursuant to item 1 of paragraph 1 of Article 2 of Act 90/2003 on Income Tax, and operating merchant vessels registered in the Icelandic International Ship register (IIS), may decide to pay taxes on their merchant vessels operations in accordance with this Act instead of Act No. 90/2003.”

In addition to the requirement regarding eligible activities, the Tonnage Tax Act stipulates that the two following conditions must be complied with:

- firstly, the vessels must be registered in the IIS. The Icelandic authorities argue that registration in the IIS is not considered to be a so-called flag link. No explicit flag link with Iceland *strictu sensu* is required. Indeed, according to Article 6 of Act No 38/2007 on the IIS “*a merchant vessel that is registered in the Icelandic International Ship Register is considered to be an Icelandic vessel and has the right to sail under the national flag of Iceland*”. The Icelandic authorities therefore describe the flag link as a right and not a condition for eligibility under the scheme.

A ship not flying the Icelandic flag could still have access to the tonnage tax as long as it is registered in the IIS. In that regard, Article 4 of the same Act prescribes that registration is open where the “*owner of the merchant vessel is an Icelandic citizen, a citizen of another State in the European Economic Area or the founding States of the European Free Trade Area, a citizen in the Faroe Islands or a legal entity registered in Iceland*”.

- secondly, limited liability companies and private limited companies must be subject to taxation pursuant to Article 2(1) subparagraph 1 of Act 90/2003 on Income Tax (hereinafter the “Income Tax Act”). That provision provides that companies domiciled in Iceland are liable in Iceland to tax on their global income (full liability). A legal person is considered to be domiciled in Iceland if it is registered in Iceland, if it considers Iceland as its residence according to its bylaw, or if it has the real seat of its administration in Iceland. Article 3 of the Income Tax Act provides that non-domiciled companies are liable in Iceland to tax on income originating in Iceland (source taxation). The Icelandic authorities have confirmed that the companies, in order to be eligible, need not be incorporated under Icelandic corporate law as Icelandic companies. Thus, companies incorporated under the company law of another EEA State would qualify for the tonnage tax scheme provided the additional requirements are met.

2.3.3 Establishment of the tax base

According to Article 6 of the Tonnage Tax Act, the tax base (notional profit) will be established as follows:

- Up to and including 25 000 NT – ISK 30 per 100 NT;
- From 25 001 NT – ISK 10 per 100 NT.

No deductions are permitted from the tax base.

2.3.4 Taxation under the Income Tax Act and separate accounting

Article 4 of the Tonnage Tax Act specifies that if a vessel operator is also engaged in other activities than the ones qualifying for tonnage tax, he should be taxed for those activities in accordance with the Income Tax Act.

Article 7 of the Tonnage Tax Act stipulates that income and costs of merchant vessel operations should be kept separate from the income and costs of other activities in proportion to the book value of assets used in merchant vessel operation on the one hand, and for other uses, on the other hand.

Article 9 of the Tonnage Tax Act stipulates that merchant vessel operation costs cannot be deducted from the income of the vessel operator subject to taxation under the Income Tax Act. Costs, other than financial costs, which relate at the same time to the acquisition of income in merchant vessel operations and the acquisition of other income, should be divided in proportion to the income. In the event that interest expenses, depreciation and exchange rate losses pursuant to Article 49 of the Income Tax Act relate at the same time to the acquisition of income in merchant vessel operation and the acquisition of other income, such financial costs shall be divided in proportion to the book value of assets used in merchant vessel operations, on the one hand, and for other uses, on the other hand. Costs which are considered to relate to the generation of other income than that from merchant vessel operation shall be governed by the Income Tax Act.

Article 11 of the Tonnage Tax Act provides that losses from merchant vessel operations should not be deductible with regard to taxation of other activities according to the Income Tax Act.

2.3.5 Duration of the scheme and lock-in period

The Icelandic authorities have indicated that the schemes are notified for an unlimited duration but that they are willing to re-notify after a period of time to be agreed with the Authority.

According to Article 2 of the Tonnage Tax Act, the tonnage tax scheme entails a lock-in period of three years. This means that a ship-owner opting for the tonnage tax has to stay within that scheme for three years.

2.4 Special refund for seafarers' income tax

The Icelandic authorities have also notified a gross wage support system for seafarers by which ship-owners may be paid grants amounting to 90% of the income tax calculated on the gross wages of the employed seafarers. In order to qualify for the grants the ship-owner must be a limited liability company or private limited company with full tax liability in Iceland, the vessels must be registered in the IIS and the ship-owner must employ seafarers who are eligible for taxation in Iceland.

Article 16 of the Tonnage Tax Act provides:

“Limited liability companies and private limited companies subject to taxation pursuant to item 1 of paragraph 1 of Article 2 of Act No 90/2003 on Income Tax, and which operate merchant vessels, cf. Article 3, registered in the Icelandic International Ship register (IIS), shall receive a subsidy which corresponds to 90% of the correctly determined amount of income tax and municipal income tax in withholding taxes on the wages of the crew of the merchant vessels in question, having taken into account personal tax allowances and seamen’s allowances. The withholding tax shall, in other respects, be so disposed of that 5% shall be paid to the Treasury and 5% shall be paid to the municipality of the crew member in question. This disposal shall replace the disposal of withholding tax and division according to the Act on Withholding Tax, the Act on Income Tax and the Act on Municipal Revenue base.

The Minister of Finance shall, by means of a regulation, specify the implementation of payments pursuant to Paragraph 1, including the form of subsidy applications, payment times and balancing against unpaid public levels.”

The Icelandic authorities have confirmed that there are no eligibility criteria on the level of the seafarer other than being employed with a merchant shipping company and having tax liability in Iceland. The refund is only given for the income tax, calculated on the seafarers' wages. It does not cover any social security contributions. The Icelandic authorities have also confirmed that the Icelandic nationality is not relevant in this respect. The seafarer does not need to have a residence in Iceland in order for the ship-owner to be able to qualify for the grant.

2.5 Aid recipients, budget, duration and entry into force of the notified measures

The Icelandic authorities have not submitted any exact figures regarding the reduction of State revenue that will follow from the application of the tonnage tax scheme as compared with the tax revenue that would have followed from the application of the standard corporation tax.

The Icelandic authorities have indicated that the cost of the notified measures would depend on the number of vessels registering in the IIS. They expected that 12 vessels for which the tonnage tax is assumed to be on average ISK 120 000, would register. The tonnage tax would then amount to ISK 1 440 000. However, the preliminary estimate does not indicate the amount of ordinary corporate tax these 12 vessels would otherwise have paid.

The Icelandic authorities have indicated that no requests for registration on the Icelandic Ship register have been made.

The Icelandic authorities have not limited the duration of the two schemes.

2.6 Cumulation

According to Section 11 of the Maritime Guidelines, a reduction to zero of taxation and social charges for seafarers and a reduction of corporate taxation of shipping activities in line with the schemes already approved in other EEA States is the maximum level of aid which might be permitted. To avoid distortions of competition, other systems of aid may not provide any greater benefit than this. The aid should not in any event exceed the total amount of taxes and social contributions collected from shipping activities and seafarers.

The Icelandic authorities have confirmed that cumulation of the two schemes with other support measures will be monitored by the Icelandic tax authorities and that the maximum aid intensities will be complied with.

2.7 Information on the expected macro-economic return on the maritime cluster

In conformity with Section 12(2) of the Maritime Guidelines, the Icelandic authorities carried out a cost effect analysis to establish the macro-economic return of the notified tax schemes. The analysis states that it is difficult to foresee the economic effects of the Tonnage Tax Act as it will depend on the number of ships registered on the IIS. On the estimate of jobs created or saved, the Icelandic authorities estimate that the effect of both support measures is that in the next six years 200 seafarers will be employed as new crew on qualifying merchant vessels.

3. Concerns in the opening decision

On 19 December 2007, the Authority decided to open the formal investigation procedure on the proposed state aid to maritime transport in Iceland in the form of a tonnage tax scheme and a refund scheme for the employment of seafarers.¹⁴

The Authority expressed doubts in the opening decision with regard to the tonnage tax scheme on the points concerning the requirement of registration of the vessel in the IIS thereby excluding from the tax scheme operations of ships registered in other EEA States and the requirement of full tax liability thereby excluding activities subject to source taxation from access to the tonnage tax.

The Authority had moreover concerns relating to the requirement that only legal entities registered in Iceland can register in the IIS, the treatment of ship-management companies,

¹⁴ For a detailed analysis of the concerns identified by the Authority, see Decision No. 721/07/COL, Section 3.

the establishment of the tax base and the duration of the period for which the ship-owner has to stay within the tonnage tax scheme (“the lock-in period”).

Regarding the refund scheme for seafarers, the Authority expressed doubts regarding the requirement to register in the IIS and to have full tax liability. Furthermore, regarding the scheduled passenger services between ports of the EEA, the Authority had doubts whether the aid would be given for the employment of EEA seafarers only.

4 Comments by the Icelandic authorities

The Icelandic authorities have provided the Authority with some comments regarding both the tonnage tax scheme and the scheme for refund for seafarers by way of a letter dated 15 February 2008 (Event No. 465550).

The Icelandic authorities have made the following comments:

- no ship-owner had come forward to apply for registration on the IIS;
- in order to be eligible, companies must be tax liable in Iceland but need not be incorporated under Icelandic company law as Icelandic companies;
- no specific rules apply regarding the ratio of ships that are owned by the ship-owner and those that are managed with a crew;
- vessels owned by legal entities in other EEA States with limited tax liability in Iceland are not eligible for registration in the IIS;
- Article 3 of the Tonnage Tax Act states that taxation pursuant to this Act includes the operation of all the merchant vessels that meet conditions for registration in the IIS. When opting for the tonnage tax regime, the company agrees to put all its eligible vessels and related activities under the tonnage tax (the so-called all or nothing rule);
- tax rates: the Icelandic authorities have argued that the tonnage tax rates are in line with those approved by the Authority in the Norwegian tonnage tax schemes approved;
- duration of the scheme: the Icelandic authorities have indicated that they are willing to re-notify the schemes as agreed with the Authority;
- cumulation: the Icelandic authorities have indicated that they will ensure that cumulation rules are complied with.

The Icelandic authorities did not make any comments regarding the length of the lock-in period.

II. ASSESSMENT

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.”

The individual criteria will be examined below.

1.1 Presence of state resources

The aid measure must be granted by the State or through state resources.

The application of the lower tonnage tax rather than the standard corporate tax leads to a loss of state revenues. The scheme regarding seafarers implies the same loss of state revenues as the State will be giving the ship-owners direct grants corresponding to 90% of the income tax which would have been due by the seafarer and paid by the ship-owner. As a result of those two schemes, the State renounces tax revenue which it would normally have received from the undertakings concerned. The absence of these funds represents a burden on state resources from charges that are normally borne from the budgets of the participating undertakings.¹⁵ A loss of tax revenue is equivalent to the consumption of State resources in the form of fiscal expenditure.¹⁶

1.2 Favouring certain undertakings or the production of certain goods

The two measures give ship-owners advantages by way of subsidies and tax concessions. The two measures are limited to the maritime sector and therefore favour only certain undertakings. They must consequently be viewed as selective within the meaning of Article 61(1) of the EEA Agreement.¹⁷

1.3 Distortion of competition and effect on trade between Contracting Parties

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

The ship-owners benefiting from the schemes carry out an economic activity in competition with ship-owners/companies from other EEA countries. The tonnage tax and the seafarers regime strengthen the ship-owners' position towards their competitors within the EEA and between Iceland and the other EEA States and third countries. Hence, the measures affect trade between the Contracting Parties.

¹⁵ Case C-156/98 *Germany v Commission*, [2000] ECR I-6857, paragraph 26.

¹⁶ See *inter alia* Section 3(3) of the State Aid Guidelines on the application of state aid rules to measures relating to direct business taxation.

¹⁷ Case C- 75/97 *Belgium v Commission* [1999] ECR I-3671, paragraph 33.

1.4 Conclusion

The Authority therefore takes the view that the notified support measures (tonnage tax scheme and seafarers scheme) constitute state aid within the meaning of Article 61(1) of the EEA Agreement.

Indeed, the Maritime Guidelines provide specifically that “*these tax relief measures which apply in a special way to shipping are considered to be state aid. Equally, the system replacing the normal corporate tax system by a tonnage tax is a state aid*”.

2 Procedural requirements

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

By submitting notification of the two support measures, forwarded with a letter from the Icelandic Mission to the European Union dated 23 March 2007 (Event No 415003), the Icelandic authorities have complied with the notification requirement.

However, the Icelandic authorities put the notified measures into effect before the Authority had taken a final decision thereon. The Authority therefore concludes that the Icelandic authorities have not respected their obligations pursuant to Article 1(3) of Part I of Protocol 3.

3 Compatibility of the aid

Under Article 61(3)(c) of the EEA Agreement, aid to facilitate the development of certain economic activities or of certain economic areas may be considered compatible with the functioning of the EEA Agreement where such aid does not adversely affect trading conditions to an extent contrary to the common interest. The Authority considers Article 61(3)(c) of the EEA Agreement together with the Maritime Guidelines to form the legal basis for assessing the compatibility of the notified measures.

The Maritime Guidelines at Section 1.2(c) paragraph 4 allow the EFTA States to support the maritime transport industry: “*maritime industries are inextricably linked to maritime transport. This association is a strong argument in favour of positive measures whose aim is to maintain a fleet dependent on EEA shipping. Since maritime transport is one of the links in the chain of transport in general and in the chain of maritime industries in particular, measures seeking to maintain the competitiveness of the European fleet have also repercussions on investments on land and maritime-related industries and on the contribution of maritime transport to the economy of the EEA as a whole, and to jobs in general*”.

The two notified measures concern operating aid, i.e. aid which is intended to relieve an undertaking of the expenses which it would normally have to bear in its day-to-day management of its usual activities. Operating aid should not normally be allowed unless it is explicitly authorised by the Authority’s State Aid Guidelines. The Authority’s Maritime Guidelines provide for the possibility to grant operating aid in the form of tonnage tax in Section 3.1 and in the form of a reduction in labour related costs in Section 3.2.

The Authority in its analysis has reviewed the conditions common to both the tonnage tax scheme and the seafarers scheme (3.1), and then the conditions specific to the tonnage tax scheme (3.2) and to the seafarers scheme (3.3).

3.1 Condition common to both the tonnage tax scheme and the scheme for refund to seafarers: requirement of registration of the vessel in the IIS, thereby excluding ships registered in other EEA States

The requirement in Article 1 of the Tonnage Tax Act that the vessels be registered in the IIS in order to have access to the tonnage tax scheme leads to the exclusion of vessels not registered in Iceland. This restriction applies even where the operation of such vessels is subject to Icelandic taxation. Thus, a ship-owner with two ships, one registered in the IIS and the other registered in another EEA State can be subject to taxation in Iceland on profits from the operation of both ships.¹⁸ Only the ship registered in the IIS will, however, be eligible to benefit from the tonnage tax.

It is well established that although direct taxation falls within the EEA States competence, they must nonetheless, exercise that competence consistently with EEA law.¹⁹ The right of establishment includes the right for nationals (natural and legal persons) of one EEA State to set up and manage undertakings in another EEA State under the conditions laid down by the law of the host State for its own nationals. The abolition of restrictions on the right of establishment applies to restrictions on the setting up of agencies, branches or subsidiaries.²⁰ Moreover, the prohibition on restrictions to the right of establishment also applies to tax provisions.²¹ Consequently, this includes the right of a company established in one EEA State, and having its seat, registered office, central administration or principal place of business within the EEA to pursue its activities in another EEA State through a branch or an agency, and be subject to the same tax treatment as companies established in that State. A difference in tax treatment can only be compatible with the provisions of the EEA Agreement if it concerns situations which are not objectively comparable or if it is justified by overriding reasons in the public interest.²²

Registration of a ship can constitute establishment where the ship constitutes an instrument for pursuing economic activity which involves a fixed establishment. Restrictions on registering ships in other EEA States can therefore be contrary to the right of establishment in Article 31 EEA.²³

¹⁸ Where double taxation agreements are in place, the right to tax will normally be given to the State where the place of effective management of the company is, including for operations which take place in other EEA States through a branch, etc. Hence, in the above given example, the taxation of a permanently established company in Iceland would be in Iceland, also for income generated outside the Icelandic territory. It would nevertheless only be the profits from the ship registered in the Icelandic International Ship register that would be subject to the tonnage tax regime. The profits from the operations of the other ship would be taxed according to the normal company tax scheme. The Icelandic authorities have confirmed this understanding.

¹⁹ Case E-6/98 *The Government of Norway v EFTA Surveillance Authority* [1999] EFTA Court Report, p. 74, paragraph 34; Case E-1/04 *Fokus Bank* [2004] EFTA Court Report p.11, paragraph 20.

²⁰ See for example, Case C-270/83 *Commission v France* [1986] ECR 273, paragraph 13, and Case C-311/97 *Royal Bank of Scotland* [1999] ECR -2651, paragraph 22.

²¹ Case C-471/04 *Keller Holding* [2006] ECR I-2017, paragraph 49.

²² Case 270/83 *Commission v France* [1986] ECR 273, paragraph 13; Case C-311/97 *Royal Bank of Scotland* cited above, paragraphs 23-31; and Case C-253/03 *CLT-UFA SA* [2006] ECR I-1831, paragraphs 14-17.

²³ Case C-221/89 *Factortame Ltd. And others* [1991] ECR I-3905, paragraphs 22-23.

As illustrated above, a ship-owner with full tax liability in Iceland and merchant vessels registered in another EEA State will be subject to a less favourable tax treatment than a ship-owner with full tax liability in Iceland and its merchant vessels registered in the IIS. The difference in treatment constitutes a restriction on the right of establishment as it deters ship-owners from having ships registered in other EEA States.

The Icelandic authorities have not presented any convincing overriding reasons in the public interest capable of justifying such a restriction on ship-owners establishment in other EEA States. Nor has the Authority identified any reasons as to why such a restriction on the freedom of establishment is necessary in order to pursue the objective behind the tonnage tax scheme, namely to improve the competitive conditions of ship-owners in Iceland vis-à-vis the conditions in non-EEA jurisdictions.

The Authority furthermore considers that the Icelandic registration requirement is not compatible with Section 3.1(7) of the Maritime Guidelines which stipulates that a tax relief scheme should require a link with an “EEA flag”. The Maritime Guidelines explain that such a rule exists to “*promote the competitiveness of the EEA fleets in the global shipping market*”. The wording “an EEA State” read in the light of this objective does not support the introduction of a requirement of registration in the specific EFTA State granting the aid. Rather, it supports the view that registration in any EEA State should be the criterion.²⁴

The Icelandic authorities have argued that they do not require what they call a “flag link” as each ship registered in the IIS still remains free to fly another flag. As explained above under Section 2.3.2, Article 6 of the Act 38/2007 on the IIS states that a merchant vessel that is registered in the IIS is considered to be an Icelandic vessel regardless of whether it sails Icelandic flag.

The Authority considers that the argument concerning the voluntary use of the Icelandic flag is not relevant as the restriction on the freedom of establishment, mentioned above, stems from the registration requirements. Thus, even if the ship-owner is allowed to fly a flag other than the Icelandic one, he is still obliged to register in the IIS in order to profit from the more favourable tonnage tax. Despite the requests made by the Authority, the Icelandic authorities have not presented any argument to justify why such a double registration requirement is necessary and proportionate in order to pursue the objectives of the tonnage tax scheme.

The Authority therefore concludes that the registration requirement is not compatible with the functioning of the EEA Agreement, in particular the right of establishment in Article 31 EEA and can therefore not be allowed under the EEA state aid rules.

In light of the above, the Authority does not consider it necessary to analyse in detail the concern it had raised in Decision 721/07/COL regarding the requirement of full tax liability in order to benefit from the tonnage tax scheme and the seafarers’ refund scheme. In any event, as mentioned above in footnote 18, EEA States’ double taxation agreements will normally entail that the activities of shipping companies will be taxed in the state where the place of the effective management of the company is. Thus, shipping companies

²⁴ As was the case in the Decision 755/08/COL of 3 December 2008 where the scheme provided that what was required was a link with the flag of one of the EEA States.

established in the EEA with limited tax liability in Iceland will normally be subject only to taxation in the EEA State of establishment.

3.2 Conditions specific to the tonnage tax scheme

3.2.1 Establishment of the tax base

Section 3.1(18) of the Maritime Guidelines provides that the Commission will only approve schemes giving rise to a tax load for the same tonnage “*fairly in line with the schemes already approved. Based on its experience, the Authority notes that instead of calculating virtual profits to which the ordinary corporate tax rate is applied, some States may decide to directly fix special tonnage tax rates. The Authority will likewise seek to keep an equitable balance in line with already approved schemes*”.

The Authority has compared the rates notified by the Icelandic authorities with rates applicable in schemes approved in other EEA States:

ICELAND	DENMARK	LITHUANIA	ITALY	NORWAY*
Every amount until 25 000 NT ISK 30 (EUR 0,17) per 100 NT	Until 1000 NT EUR 0,90 per 100 NT	Until 1000 NT EUR 0,93 per 100 NT	Until 1000 NT EUR 0,90 per 100 NT	No tax for the first 1000 NT
	From 1001 NT until 10 000 NT EUR 0,70 per 100 NT	From 1001 NT until 10 000 NT EUR 0,67 per 100 NT	From 1001 NT until 10 000 NT EUR 0,70 per 100 NT	From 1001 NT until 10 000 NT EUR 0,22 per 100 NT
	From 10 001 until 25 000 NT EUR 0,40 per 100 NT	From 10 001 until 25 000 NT EUR 0,43 per 100 NT	From 10 001 until 25 000 NT EUR 0,40 per 100 NT	From 10 001 until 25 000 NT EUR 0,15 per 100 NT
	More than 25 000 NT 10 ISK (EUR 0,06) per 100 NT	More than 25 000 NT EUR 0,30 per 100 NT	More than 25 000 NT EUR 0,27 per 100 NT	More than 25 000 NT EUR 0,20 per 100 NT

All the values are given per day

*In Norway, no notional profit is calculated. The tonnage tax is calculated directly by multiplying the tax rates with the actual tonnage. The rates for Iceland, Denmark, Lithuania and Italy are notional profits rates to which the domestic standard corporate tax is then applied. Therefore, despite the fact that the rates in Norway and in Iceland may appear very close, they lead to a very different level of tax effectively paid by the ship owner. Thus, as an example, a ship owner with a tonnage of 30 000 NT would pay a tonnage tax of approx. EUR 46 in Norway and of approx. EUR 7 in Iceland.²⁵

As can be seen from the table above, the Icelandic scheme operates with a tax base considerably lower than in the four other EEA States.²⁶

The Commission has accepted lower tax rates only in very specific circumstances.²⁷ The Icelandic authorities have not provided the Authority with any information regarding the existence of exceptional circumstances which would justify applying lower rates.

The Authority considers that the level of the Icelandic tax base is not in line with the rates applicable within the other EEA States as it is significantly lower and is accordingly not in line with Section 3.1(18) of the Maritime Guidelines.

3.2.2 Period for which the ship-owner must stay within the tonnage tax scheme

The period for which the ship-owner must stay within the Icelandic tonnage tax scheme is three years.

The Authority has taken the view that a ten year period should be applied within the EFTA States.²⁸

The Authority's approach is in line with that of the Commission. The minimum duration of that period in other EU tonnage tax regimes approved is ten years. The Commission stresses that by allowing diverging criteria for different tonnage tax schemes, a risk exists that unfair advantages are created and that there might be a competition between Member States on the level of tonnage tax schemes. Consequently, the Commission expressed doubts towards a Polish tax scheme which allowed for a minimal duration of five years, pointing out that this might lead to a harmful divergence between tonnage tax systems as it

²⁵ See further the Authority's decision on the Norwegian tonnage tax scheme, Decision 755/08/COL of 3 December 2008.

²⁶ The rates mentioned are those on the date of adoption of the Decision; they reflect the current currency rates. The Authority considers, however, that even before the financial crisis had an impact on the Icelandic króna, the level of the Icelandic tax base was not in line with the rates applicable within the other EEA States, cf. Decision 721/07/COL.

²⁷ See Commission Decision of 30 June 2004 concerning a series of tax measures which Belgium is planning to implement for maritime transport, OJ L 150, 10.06.2005, p.1. The Belgian authorities wanted to offer lower tax rates for larger ships which were going to be re-flagged. There was a reduced rate for the tranche above 40 000 tons in the Belgium case, which was accepted provided that the ship is new or have been registered under the flag of a third country during the five years preceding their entry into the Belgian system. The Commission's concern against this tax base divergence was that a low tax base might lead to a distortion of competition if it encourages non-Belgian ship-owners to transfer their ships from a Community register to the Belgian register.

²⁸ See Decision No 755/08/COL of 3 December 2008 on the notification of amendments to the Norwegian special tax system for shipping.

might make the Polish tax system more desirable and lead to re-flagging within the Community.²⁹

The Authority considers that this aspect of the notified scheme is not compatible with Article 61 EEA.

3.2.3 Treatment of ship-management companies

In its Decision 755/08/COL, the Authority had indicated that it had doubts concerning the compatibility of the notified scheme with the EEA Agreement regarding the treatment of ship-management companies.

The Icelandic authorities have not provided the Authority with any information eradicating the doubt raised.

In light of the above aspects concerning the incompatibility of the notified scheme with the EEA Agreement, the Authority does not consider it necessary to analyse in detail the concern it had raised in Decision 721/07/COL regarding ship management companies.

3.3 Conditions specific to the refund scheme for seafarers

3.3.1 Scheduled passenger services between ports of the EEA: aid should only be given to the employment of EEA seafarers

According to Section 3.2(2) of the Maritime Guidelines, support can be granted in the form of reduced rates of contributions for the social protection of EEA seafarers employed on board ships registered in an EEA State as well as reduced rates of income tax for EEA Seafarers on board ships registered in an EEA State. The Icelandic authorities have notified a support of the seafarer's contributions of which 90% can be re-funded to the ship-owner.

According to Section 3.2(2) of the Maritime Guidelines, EEA seafarers are defined as:

- citizens of the EEA States in the case of seafarers working on board vessels (including ro-ro ferries) providing scheduled passenger services between ports of the EEA;
- all seafarers liable to taxation in an EEA State in all other cases.

The Icelandic authorities have not submitted a written definition of the notion of seafarer in a legislative or administrative Act, but confirmed that nationality is not a requirement, neither is the residence of the seafarer. Third country nationals would also benefit from the scheme. The Authority had, in Decision 721/07/COL, indicated that according to Section 3.2(2) of the Maritime Guidelines, for passenger services between ports of the EEA, aid should only be given for the employment of EEA seafarers.

The Icelandic authorities have not provided the Authority with any information contradicting its assessment.

²⁹ Decision N 93/2006 – Poland.

On the basis of the information it has been provided with, the Authority therefore considers that this aspect of the scheme does not comply with the EEA Agreement.

4 Conclusion

On the basis of the foregoing assessment, the Authority considers the scheme relating to maritime transport in the form of a tonnage tax scheme and a refund scheme for the employment of seafarers to be incompatible with the state aid rules of the EEA Agreement.

The Authority understands that, despite the fact that passing the legislation in itself meant that the notification obligation referred to above had been triggered, no payments under the measures subject to formal investigation have been made and no recovery provisions will therefore be necessary.

HAS ADOPTED THIS DECISION:

Article 1

The scheme relating to maritime transport in the form of a tonnage tax scheme and a refund scheme for the employment of seafarers is incompatible with the functioning of the EEA Agreement within the meaning of Article 61(1) of the EEA Agreement.

Article 2

The Icelandic authorities shall inform the EFTA Surveillance Authority, within two months of notification of this Decision, of the measures taken to comply with it.

Article 3

This Decision is addressed to the Republic of Iceland.

Article 4

Only the English version is authentic.

Done at Brussels, 8 July 2009

For the EFTA Surveillance Authority,

Per Sanderud
President

Kristján Andri Stefánsson
College Member