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# EFTA SURVEILLANCE AUTHORITY

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Ref. No: SAM030.02.002  
Dec. No: 171/02/COL

EFTA SURVEILLANCE AUTHORITY DECISION  
of 25 September 2002  
regarding tax deduction for expenses of research and development  
(NORWAY)

THE EFTA SURVEILLANCE AUTHORITY,

HAVING REGARD TO the Agreement on the European Economic Area<sup>1</sup>, 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<sup>2</sup>, in particular to Article 24 and Article 1 of Protocol 3 thereof,

HAVING REGARD TO the Authority's Guidelines<sup>3</sup> on the application and interpretation of Articles 61 and 62 of the EEA Agreement,

WHEREAS:

## I. FACTS

### 1. The notification

By letter of 15 April 2002 from the Mission of Norway to the European Union, received and registered by the Authority on 17 April 2002 (Doc. No. 02-2800 A), the Norwegian authorities notified, pursuant to Article 1(3) of Protocol 3 to the Surveillance and Court Agreement, a new aid scheme entitled: "§16-40 of the Tax Law, Tax deduction for expenses for research and development (R&D) and Regulation relating to § 16-40 of the Tax Law" ("Skatteloven § 16-40 Skattefradrag for kostnader til forskning og utvikling (FoU-fradrag)" and "Forskrift til skatteloven § 16-40").

By letter of 16 May 2002, the EFTA Surveillance Authority acknowledged the receipt of the notification and asked the Norwegian authorities for additional information and clarification. The Norwegian Government responded by letter of 24 June 2002, received and registered by the Authority on 25 June 2002 (Doc. No. 02-4798-A).

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<sup>1</sup> Hereinafter referred to as the EEA Agreement.

<sup>2</sup> Hereinafter referred to as the Surveillance and Court Agreement.

<sup>3</sup> Procedural and Substantive Rules in the Field of State Aid (State Aid Guidelines), adopted and issued by the EFTA Surveillance Authority on 19 January 1994. Published in Official Journal L 231, 03.09.1994. The Guidelines were last amended 26 July 2002 (not yet published).

By letter dated 28 June 2002, received and registered by the Authority on 28 June 2002 (Doc. No. 02-4929-A), the Norwegian authorities submitted amendments to the Regulation relating to § 16-40 of the Tax Law (“Forskrift til skatteloven § 16-40”) concerning tax deduction for expenses of research and development.

By letter of 2 July 2002 (Doc. No. 02-4716-D), the Authority acknowledged the receipt of the letter dated 28 June 2002 from the Norwegian authorities and considered the notification to be complete.

In a letter dated 22 July 2002 (Doc. No. 02-5498-D), the Authority sought additional clarification concerning the aid intensity of the proposed aid scheme.

By letter of 22 August 2002 (Doc. No. 02-6081-D), the Authority asked the Norwegian authorities to agree to an extension of the preliminary examination phase by one month. The Norwegian Ministry of Trade and Industry agreed to an extension by letter dated 23 August 2002, received and registered by the Authority on 23 August 2002 (Doc. No. 02-6089 A).

By letter of 9 September 2002, received and registered by the Authority on 9 September 2002 (Doc. No. 02-6407-A), the Norwegian Government communicated amendments to the proposed aid scheme.

## **2. The contents of the amended proposed aid measure**

### **2.1 Background and legal basis**

The provision in § 16-40 of the Tax Law (“Skatteloven § 16-40 Skattefradrag for kostnader til forskning og utvikling”) is a new R&D grant scheme, which the Norwegian Government proposed to establish in its Fiscal Budget for 2002<sup>4</sup>. The scheme is implemented by a new paragraph in the Tax Law and a regulation to this paragraph. In addition, the Research Council of Norway will adopt internal regulations concerning the process of application and evaluation of projects. The Authority has received draft guidelines.

The Research Council of Norway (Norges Forskningsråd) and the Ministry of Finance will administer the aid scheme.

This aid scheme will replace the aid scheme “Research and Development (R&D)-projects in enterprises” (FUNN-ordningen), which was approved by the Authority by decision of 18 July 2001<sup>5</sup>. According to the notification, the main differences between “FUNN-ordningen” and the tax deduction scheme are:

- the tax deduction scheme allows in-house R&D;
- all tax subjects that meet the criteria will be granted tax reductions;
- the aid is given through the tax assessment; and
- the scheme is primarily directed at small and medium-sized Enterprises (SMEs).

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<sup>4</sup> “Ot.prp. nr. 1 (2001-2002) Skatte-og avgiftsopplegget 2002 – lovendringer”, chapter 5.

<sup>5</sup> Dec. No. 249/01/COL.

The amendment of the Tax Law came into force on 1 January 2002 and the aid scheme applies to the fiscal year 2002 and onwards. The law will not, however, be effectively implemented until the Authority has approved the aid scheme. Furthermore, expenses related to R&D may not be deducted until the assessment on tax of the enterprises has been carried out. For the fiscal year 2002, assessments will not be concluded until the summer or autumn 2003, depending on the category of the company involved. The aid scheme will remain in force until the Norwegian Parliament decides otherwise.

The annual loss in tax revenue is estimated to be approximately NOK 510 million (approximately EUR 70 million).

## **2.2 Objectives**

The overall objective of tax deduction for expenses of research and development is to stimulate enterprises to increase their efforts regarding R&D. The aid scheme supports both internal R&D projects and the purchase of such services from R&D institutions.

Section 16-40-4 in the Regulation deals with the Research Council's approval of R&D projects benefiting from the tax deduction. The Norwegian authorities have assured the Authority that one of the criteria for the approval is that the aid serves as an incentive for firms to undertake R&D activities in addition to their normal day-to-day services. The Research Council will adopt guidelines for assessing the incentive effect of the projects to ensure compliance with Chapter 14.7 of the Authority's State Aid Guidelines. The Authority has received draft guidelines.

The aid scheme is not limited to specific sectors. The Norwegian Government has by letter dated 24 June 2002 given a confirmation that sector specific rules, as mentioned in Annex XV to the EEA Agreement, cf. Article 63 EEA and Part V of the Authority's State Aid Guidelines, in particular the specific notification requirements, will be respected in relation to this scheme.

## **2.3 Eligible R&D activities**

According to the notification, the stages of R&D benefiting from the aid scheme are industrial research and precompetitive development activity. In the proposed legislation, the stage of R&D benefiting from the aid is described as limited projects aimed at the acquisition of new knowledge, the objective being that such knowledge may be useful for the undertaking in developing new or improved products, processes or services. By letter of 28 June 2002, the Norwegian authorities informed the Authority that the Regulation was amended to include precompetitive activity as well. The Regulation describes this stage to be the shaping of the results of industrial research into a plan, project or design for new, improved products, processes or services, including the creation of an initial prototype which could not be used commercially.

Eligible R&D costs are, according to the Regulation § 16-40-5 (3), calculated on the basis of the Research Council's guidelines for projects where the user defines the scope of the R&D. According to these guidelines, eligible costs are as follows:

- personnel costs (researchers, technicians and other supporting staff employed solely on the research activity);
- cost of instruments, equipment and land and premises used solely and on a continual basis (except where transferred commercially);
- cost of consultancy and equivalent services used exclusively for the research activity, including the research, technical knowledge and patents, etc. bought from outside sources;
- other operating expenses (e.g. costs of materials, supplies and similar products) incurred directly as a result of the research activity.

The scheme has no expressed international aspects. Foreign R&D-institutions are not excluded from approval.

Enterprises will own the results of the R&D-projects and are supposed to use the knowledge in their innovation activities. Enterprises can also license the results to other enterprises.

R&D-institutions' use of the R&D-results is to be regulated in contracts between the enterprises and the R&D-institutions in question.

The projects and expenses will be controlled by the Research Council and by the Tax authorities through the yearly tax assessment. The provisions §§ 16-40-4, 16-40-7, 16-40-8 and 16-40-9 in the Regulation will ensure that tax deduction only will be given to projects that meet the criteria in the Tax Law and the Regulation. The Research Council approves the R&D project in advance. The approval shall be enclosed in the tax return when the taxpayer claims tax deduction for R&D expenses, and the Tax authorities assess whether or not the conditions for tax deduction are met in each case. In addition, the Research Council may require that the undertaking reports on the development and the achieved results of the projects.

As the aid is granted by a tax deduction, there is no repayment arrangement. However, the assessments may be altered if the expenses have not been incurred or if the actual expenses are not in accordance with the tax returns. By the Norwegian tax assessment act "Ligningsloven 13. juni 1980 nr. 24" Chapter 9, wrongful assessments can be altered.

## **2.4 Aid measures**

The aid is granted by a tax deduction. To qualify for deduction, expenses must also be deductible from taxable income. The aid may be deducted from the income tax, wealth tax and national insurance tax to the State.

The scheme implies a tax deduction of 18 per cent of the actual R&D expenditure for the approved R&D project, limited to expenses not exceeding NOK 4 million (approximately EUR 550 000) for each project per year if it is an internal project. If the expenses are related to the purchase of services from an R&D institution, the limit is NOK 8 million (approximately EUR 1.1 million). Enterprises that meet the criteria for being a small and medium-sized enterprise in the meaning of Chapter 10 of the Authority's State Aid Guidelines are entitled to a tax deduction of 20 per cent.

The scheme includes projects carried out in co-operation with several firms. In case projects involve more than one enterprise, the limits for eligible costs are divided between the participants. The shares are calculated on the basis of the enterprises' contribution to the project. This is laid down in paragraph 16-40 (3) of the Tax Law.

The tax deduction may be combined with other governmental programs. According to the provision in paragraph 16-40-5 (5) of the Regulation, the total aid received by each taxpayer must not exceed the maximum applicable thresholds as prescribed in Chapter 14.5 of the Authority's State Aid Guidelines. By letter dated 28 June 2002, the Norwegian authorities informed the Authority that the Regulation is amended to include a reference to the Authority's State Aid Guidelines on this point. The auditor of every enterprise with an approved project is responsible for the compliance with this provision.

## **2.5 Aid beneficiaries**

Enterprises from all sectors are eligible, but the aid scheme is limited to undertakings that fulfil two of the three following conditions:

- annual sales income is less than NOK 80 million (approximately EUR 11 million);
- the enterprise has less than NOK 40 million (approximately EUR 5.5 million) on the annual balance sheet total;
- the enterprise has less than 100 employees.

The aid is accorded automatically once the taxpayer meets the criteria laid down in the Tax Law and the Regulation.

The number of recipients is estimated to be 1500 to 2000 per year. This number is calculated on the basis of R&D-statistics from 1999, and does not include enterprises with fewer than 10 employees.

## **II. APPRECIATION**

### **1. The presence of State aid and notification formalities**

The notified aid is being funded by State resources and will favour certain undertakings in the meaning of Article 61(1) of the EEA Agreement. The benefiting enterprises are actually or potentially in competition with similar undertakings in Norway and other EEA States. The proposed aid affects trade and distorts or threatens to distort competition. Consequently, the scheme constitutes State aid in the meaning of Article 61(1) of the EEA Agreement.

The Norwegian authorities have, by notification dated 15 April 2002 (Doc. No. 02-2800 A), fulfilled their obligation under Article 1(3) of Protocol 3 to the Surveillance and Court Agreement to notify plans to grant or alter aid. Consequently, the Authority is obliged to assess whether any of the derogations in Article 61(2) or (3) are applicable in order to exempt the aid measures from the general prohibition in Article 61(1) of the EEA Agreement.

## **2. Application of the relevant State aid rules**

### **2.1. Article 61(3) (c) EEA**

Where it satisfies the requirements in Article 61(1) EEA and therefore has to be examined by the Authority, aid granted to firms for *i.a.* R&D may be regarded compatible with the functioning of the EEA Agreement by virtue of one of the derogations provided for in Article 61(2) or Article 61 (3). The relevant derogation in question is contained in Article 61(3)(c) of the EEA Agreement.

To qualify for the derogation in Article 61(3)(c), a State aid measure must in the first place be of the nature of an incentive: it must under no circumstances have the sole effect of continuously or periodically reducing the costs which the enterprise would normally have to bear, while otherwise leaving the status quo untouched, as in the case of operating aid, and it must be necessary in order to achieve objectives which market forces alone would not secure. The objectives pursued must be in the common interest of the Contracting Parties to the EEA Agreement. Lastly, the aid must be proportionate to the handicaps which have to be overcome in order to secure the socio-economic effect deemed to be desirable on grounds of the common interest: the positive effect must outweigh the damaging effect which State aid has on competition and trade.

### **2.2 Objectives**

In the letter of 24 June 2002, the Norwegian authorities stated that the stages of R&D benefiting from aid under the new scheme are industrial research and precompetitive development activity.

Chapter 14 of the Authority's State Aid Guidelines, Aid for Research and Development, is relevant for assessing the new scheme. The State Aid Guidelines draw a distinction between fundamental research, industrial research and precompetitive development activity (Chapter 14.2.1 of the State Aid Guidelines).

By industrial research is meant planned research or critical investigation aimed at the acquisition of new knowledge, the objective being that such knowledge may be useful in developing new products, processes or services or in bringing about a significant improvement in existing products, processes or services. By precompetitive development activity is meant *i.a.* the shaping of the results of industrial research into a plan, arrangement or design for new, altered or improved products, processes or services, whether they are intended to be sold or used, including the creation of an initial prototype which could not be used commercially.

The definitions in the implementing Regulation of the benefiting stages as industrial aid and precompetitive activity correspond to the Authority's State Aid Guidelines in Chapter 14.2.1.

### **2.3 Aid intensities**

According to Chapter 14.5.1 (5) of the State Aid Guidelines, as a general rule, the gross aid intensity for industrial research must not exceed 50 per cent of the eligible costs of the project. For precompetitive development activities, the gross aid intensity must not exceed 25 per cent, cf. Chapter 14.5.1 (7).

According to the State Aid Guidelines Chapter 14.5.3 (1), an extra 10 percentage points are added to the maximum level of aid intensity mentioned in Chapter 14.5.1 if the aid is to be given to SMEs in the sense of Chapter 10 of the Guidelines. This implies that the maximum level allowed for precompetitive activity is 35 per cent if the receiver is an SME.

The proposed aid intensity is in general 18 per cent. As the aid is granted by a tax deduction, the 18 per cent is a *net* grant. With a company tax rate at 28 per cent, the proposed net aid intensity implies a gross aid intensity at 25 per cent.

Enterprises that fulfil the criteria for being an SME in the meaning of Chapter 10, Aid to small and medium-sized enterprises (SME), of the Authority's State Aid Guidelines, are, however, entitled to a tax deduction of 20 per cent. The proposed net aid intensity corresponds to a gross aid intensity of 27,8 per cent.

The Authority finds that the proposed maximum aid intensity for the aid scheme is in accordance with the permissible maximum aid intensities set out in the State Aid Guidelines in Chapter 14.

#### **2.4 Eligible costs**

Rules on eligible costs are set out in Chapter 14.6 of the Authority's State Aid Guidelines. According to these rules, the following costs will be regarded as eligible:

- personnel costs (researchers, technicians and other supporting staff employed solely on the research activity);
- cost of instruments, equipment, and land and premises used solely and on a continual basis (except where transferred commercially) for the research activity;
- cost of consultancy and equivalent services used exclusively for the research activity, including the research, technical knowledge and patents, etc. bought from outside sources;
- additional overheads incurred directly as a result of the research activity;
- other operating expenses (e.g. cost of materials, supplies and similar products) incurred directly as a result of the research activity.

The eligible costs of the aid scheme correspond to the rules in Chapter 14.6. The Authority therefore finds that the proposed eligible costs of the aid scheme are in accordance with the State Aid Guidelines.

#### **2.5 Incentive effect**

According to Chapter 14.7 of the Authority's State Aid Guidelines, State aid for R&D should serve as an incentive for firms to undertake R&D activities in addition to their normal day-to-day operations. If the recipient is a small or medium-sized enterprise (SME) within the meaning of the definition laid down in the Authority's State Aid Guidelines, Chapter 10, the Authority may assume that the aid provides a necessary incentive, cf. Chapter 14.7 (5).

As mentioned under item I point 2.2 above, the Norwegian authorities have assured the Authority that one of the criteria for the approval of R&D projects is that the aid serves as an incentive for firms to undertake R&D activities in addition to their normal day-to-day services. The Research Council will adopt guidelines for assessing the incentive effect of the projects to ensure compliance with Chapter 14.7 of the

Authority's State Aid Guidelines. Draft guidelines have been forwarded to the Authority, see item I point 2.2 above. As indicated under item I point 2.5 above, the scheme is basically oriented towards SME's as defined in Chapter 10 of the Authority's State Aid Guidelines.

Based on this information, the Authority finds that the proposed aid scheme is in compliance with the Authority's State Aid Guidelines on this point.

### **3. Cumulation of aid<sup>6</sup>**

Grants from the aid scheme "Skatteloven § 16-40 Skattefradrag for kostnader til forskning og utvikling" can, according to the notification, be combined with other grants or other relevant support schemes from other resources.

The Authority has previously argued that it is appropriate that guidelines (or regulations) for new aid schemes contain rules on cumulation of aid to ensure that the cumulative aid intensity of aid granted under different schemes is within the maximum aid limits.

The Regulation on the scheme contains rules on cumulation of aid that ensure that the cumulated aid intensities do not exceed the maximum applicable aid thresholds. According to the letter of 28 June 2002 from the Norwegian Government, the rules have been amended to include a reference to the maximum applicable aid thresholds laid down in the Authority's State Aid Guidelines on this point.

The Authority therefore finds that the aid scheme contains rules that ensure that the cumulative aid intensity of aid granted under different schemes is within the maximum aid limits laid down in Chapter 14.5 of the State Aid Guidelines.

### **4. Conclusion**

The criteria and the intensities foreseen for the aid scheme "Skatteloven § 16-40 Skattefradrag for kostnader til forskning og utvikling" reflect the requirements set out in the State Aid Guidelines, Chapter 14, for aid under Article 61(3) (c) of the EEA Agreement. It is therefore concluded that the new scheme "Skatteloven § 16-40 Skattefradrag for kostnader til forskning og utvikling" qualifies for exemption under Article 61(3) (c) of the EEA Agreement.

The Authority reminds the Norwegian Government that, under point 8 of Chapter 14.4 of the Authority's State Aid Guidelines, they are required to notify individually any research project costing more than 25 million euros and for which it is proposed to provide aid with a gross grant equivalent of more than 5 million euros.

## **HAS ADOPTED THIS DECISION:**

1. The Authority has decided not to raise objections to the proposed new aid scheme "Skatteloven § 16-40 Skattefradrag for kostnader til forskning og utvikling", as notified by the Norwegian authorities by letter dated 15 April 2002 (Doc. No. 02-2800).

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<sup>6</sup> Cumulation of aid is defined as the application of more than one aid scheme to a given investment project. See Chapter 13 of the State Aid Guidelines.



2. The Norwegian authorities are obliged to submit a separate simplified annual report to the Authority on the application of the scheme “Skatteloven § 16-40 Skattefradrag for kostnader til forskning og utvikling” (in accordance with Chapter 32 and Annex IV of the State Aid Guidelines).

Done at Brussels, 25 September 2002

For the EFTA Surveillance Authority

Einar M. Bull  
President

Hannes Hafstein  
College Member