Working paper

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The impact of the prohibition of discrimination and restriction granted under EC treaty to non EU States, such as Switzerland and Norway

This paper aims at answering the following question :

"Through the European Economic Area Treaty and bilateral treaties, the prohibition of discrimination and restriction also apply to several non-EU states such as Switzerland and Norway.

To what extent have the freedoms of movement, as granted under the EC treaty and interpreted by the EC Court of Justice, and extended to third countries under the European Economic Area Treaty (e.g. Norway) or under bilateral agreements (such as Switzerland) influenced the domestic (tax) law of such third countries."

Outline

Part I Switzerland

A Bilateral Agreement on the free movement of persons
1. General characteristics
2. Free movement of persons
3. Non-discrimination clause
4. Taxation aspects

B Influence on Swiss tax legislation
1. Influence on Swiss tax law
2. Possible breaches contained in domestic tax law

Part II Norway

A EEA Agreement
1. Aim
2. Dynamic
3. Non-discrimination
4. Taxation aspects

B Influence on Norwegian tax law
1. Obligation of notification
2. Infringement proceedings
3. Judgements
4. Modifications to Norwegian tax law
5. Possible breaches contained in domestic tax law

Conclusion

Introduction

1. EU-law in the field of taxation

In principle, the EU Member States have sovereign national tax regimes. At the same time, they are expected to fully apply the four basic freedoms of movement, which form the basis of the European internal market[1].

Clashes between national tax legislation and the principles prohibiting discrimination and restriction relating to the basic freedoms, have lead to a continuously growing case law from the European Court of Justice (ECJ). It is quite clear that national sovereignty cannot generally be invoked in order to avoid applying the rules relating to the basic freedoms.

The principle of non-discrimination is a general principle of EC law, which seeks to ensure national treatment for nationals of any EU State inside any other EU State. In the field of taxation this means that non-resident taxpayers cannot be discriminated against when in a situation comparable to that of resident taxpayers. Resident and non resident taxpayers in a similar situation must be given a similar treatment.

The principle of non-restriction is a market integration principle, which aims at keeping the internal market free from any obstacles affecting cross-border intra-community trade. Any domestic rule, which is considered to have the same effect as a trade obstacle at the border, will be condemned by the ECJ.

2. Influence of EU-law on the domestic tax law of third countries

The principles of prohibition of discrimination and restriction in the integrated European internal market also apply to certain third countries, such as Switzerland through the bilateral Agreements and Norway through the E.E.A. Agreement.

This paper will attempt at describing the extent to which these principles relating to the European internal market actually apply in Switzerland and Norway through the respective Agreements, and examine this status with regard to taxation.

Thereafter the focus will shift to the effective application in these two States of the EC principles, and the adjustments they have undertaken to this end in respect of their domestic tax legislation and practice.

[1] As defined by the Single European Act, Official Journal L 169 of 29 June 1987.

Part I SWITZERLAND

A The bilateral Agreement on the free movement of persons [2]

The seven sector specific bilateral agreements between the EC and its Member States on the one hand, and Switzerland on the other, were signed on 21 June 1999. They entered into force on 1 June 2002.

1. General characteristics of the bilateral Agreements

The bilateral Agreements can be classified in three categories; five liberalisation Agreements (technical barriers to trade, public procurement, free movement of persons, transport by land and agriculture), one co-operation Agreement (research) and one partial integration Agreement (air transport). The seven Agreements are administered by joint committees in which the parties make decisions by one accord. The joint committees have limited decision-making power. Each Contracting Party is responsible for the correct application of the Agreements on their own territory. The principle of parallelism between the Agreements ensures that either all Agreements are in force, or none (except for the research Agreement on scientific co-operation). Otherwise, the Agreements are distinct and their existence is based on different legal provisions.

In the following we will concentrate on the Agreement relating to the free movement of persons, as it is the most relevant to this presentation.

1.1. The administration of the Agreement

The Agreement is in principle based on classical intergovernmental co-operation. It is administered by a joint committee within which decisions are taken by one accord (by unanimity). The decisions are then carried out by the parties according to their own rules. The joint committee does not have the power to impose new obligations on the parties to the Agreement. A decision on new obligations must be taken and approved of by each party according to their respective procedures, as is equally the case for substantial modification to the provisions in the Agreement itself.

The joint committees have the task of ensuring the good functioning of the Agreements and they are there to facilitate exchange of information and consultation between the parties. They are furthermore supposed to attempt at settling disputes when asked to do so by one of the parties.

1.2. The application of the Agreements and the surveillance of the application

Each Contracting Party shall take all necessary measures in order to ensure the fulfilment of the obligations under the Agreement. Each party is to this end responsible for the correct implementation of the Agreement in its own territory.

1.3. Development of law under the Agreement

The parties have kept their autonomy as regards decisions. There is moreover no transfer of legislative competence to a supranational body. The Agreements is based on the recognition of the parties' legislation.

The parties have committed themselves to taking the necessary measures in order to apply the rights and obligations equivalent to those contained in the secondary community legislation to which the Agreement refers, in the relations between them.

In as much as the Agreement is based on the recognition of the parties' legislation or on the *acquis communautaire*, useful procedures have been foreseen for the exchange of information or for consultation in the event that one of the parties contemplates modifying its rules in a subject area covered by the Agreement.

Considering the sector specific and non-global character of the seven Agreements and the fact that they do not completely reproduce the *acquis communautaire* (except for the Agreement on air transport), Switzerland has

[2] Information in this section is drawn from the Message du Conseil Fédéral relatif à l'approbation des accords sectoriels entre la Suisse et la CE du 23 juin 1999, FF 1999 5440.

accordingly not the possibility to participate fully in all the community committees administrating this *acquis*. However, by way of a declaration of the EC Council, Switzerland has obtained the rights for its representatives to participate as observers at meetings of important committees in the fields of research, air transport, social security and recognition of diplomas. The Swiss representatives have a right to speak but not to vote. Moreover, in the fields where the Swiss legislation is equivalent to the *acquis communautaire*, the Commission shall consult Swiss experts in the same manner as it consults experts of the Member States whilst preparing propositions for rules or measures.

2. The Agreement on the free movement of persons ("the Agreement")

The free movement of persons will come about gradually and not automatically. As from the entry into force of the Agreement in 2002, national treatment was accorded to EU nationals in Switzerland and to Swiss nationals in the EU. The right to obtain a permit was introduced as from the entry into force of the Agreement, it was nevertheless from the start subject to a quota, to priority of native workers and to the control of salary and working conditions. After two years (2004), the priority for native workers and the discriminatory control of employment contracts are abolished. Simultaneously, full freedom of movement applies to Swiss nationals on EU territory. During a transitory phase of five years (until 2007), Switzerland will determine quotas as concerns EU nationals. From the sixth year onwards, Switzerland will abolish the quota for EU nationals. A safeguard clause, which can be set off unilaterally will allow Switzerland to avoid a massive increase in immigration. Switzerland will in fact for the following six years (until 2012) have the possibility to reintroduce quotas should the immigration exceed a determined limit. In this case, Switzerland or the EU can, if serious problems persist, call for an agreement on the safeguard clause or altogether give up the Agreement.

The principles of the free movement of persons, as they are already applied within the EU, will equally apply to Switzerland after the transitory period. The free movement of persons includes employed workers and free-lance or self-employed workers. The EU nationals can freely choose their place of work and stay within the Union and enjoy the same rights as the nationals in the state they stay in. The right to stay is however subject to the condition of actually <u>working</u>, either as an employee or through self-employment. Unemployed people may not benefit from the freedom of movement (exports of unemployment benefits are allowed up to three months).

The free movement of *employed* workers implies the obligation of equal treatment and the prohibition of any discrimination as concerns the workers from the signatory states. It requires the abolition of all differences in treatment based on nationality in relation to employment, remuneration and other working conditions. Workers from the other Member States benefit from the same welfare benefits and tax concessions as the nationals, the same rights to education and the same priority on the employment market. They also have the right to be joined by their family.

Self-employed workers who establish themselves in a Member State or who provide cross border services also enjoy the freedom of movement. The freedom of establishment includes the right to set up and to practice a self-employed activity, to create and administer companies in the conditions defined by the legislation of the State of establishment for their own nationals. The self-employed workers equally enjoy the right to be reunified with their family.

The freedom to provide services applies to cross border services provided temporarily in another signatory State. Services include inter alia commercial and craftsmen activities and the liberal professions. The service providers are authorised to cross the borders and to stay in the other State for the duration of the provision of services. The Agreement limits however the freedom to provide services to cross border personal services and does not foresee the full freedom to provide services as defined through the *acquis*.

The free movement for persons without employment activities has only been regulated in the EU since 1 July 1992. It applies to pensioners, students and other non-active persons. Persons in these categories have the right to stay, with their family, in whichever Member State on the condition of having sickness insurance and sufficient financial means at their disposal so as not to become a burden for the social security.

Exceptions to the free movement of persons may on certain conditions be admitted on grounds of public security, public order and public health. Furthermore, employment in the public sector will often fall outside the scope of the rights relating to the free movement, especially as activities linked to the exercise of public power or intended to safeguard the general interests of the State or other public organisations are concerned.

The developments in this area since 1992 (when the Agreement on the European Economic Area was rejected by the Swiss people), i.e. the Maastricht Treaty (Treaty of the Union) and the Amsterdam Treaty – in particular the removal of border control designed by the Schengen agreements – do not form part of the bilateral Agreement and will consequently not be taken up at the end of the transitional period.

3. Non-discrimination clause

The preamble to the Agreement states that the Contracting Parties are resolved to bring about the free movement of persons between them *on the basis of the rules applying in the European Community*.

The *non-discrimination principle* is provided for in Article 2 of the Agreement, and it prohibits any discrimination on grounds of nationality to nationals of one Contracting Party lawfully resident in the State of the other Contracting Party.

Article 16 paragraph 2 ensures that where concepts of Community law are involved regarding the application of the Agreement, the case-law of the European Court of Justice prior to the date of the signature (21 June 1999) shall be taken account of.

Swiss authors generally acknowledge that it is the non-discrimination principle from Article 12 EC Treaty, as interpreted by the ECJ, that has been reproduced in Article 2 of the bilateral Agreement[3].

Article 9 in Annex I to the Agreement[4] repeats the principle of equal treatment, presumably inspired by Article 39 of the EC Treaty. It emphasises the non-discrimination principle especially as concerns the free movement of workers.

4. Taxation aspects of the agreement

Article 21 of the Agreement deals with the effect of its provisions on tax law. According to *paragraph 1*, the provisions of the double taxation conventions (DTC) concluded between Switzerland and the EU States remain unaffected by the Agreement, nor does it affect the definition in the DTC of "frontier workers".

This means that the definitions of frontier workers as found in Annex 1 to the Agreement in Articles 7, 13, 28 and 32 are only applicable as regards the regulation of the free movement of persons and their rights to stay, and not at all to taxation. The tax law will, as it has up to now, rely on its own definitions of frontier worker. In the case where a DTC omits defining the frontier worker, the definition shall not be left to Annex 1 of the Agreement. This question shall be solved within the framework of the DTC concerned. The enlargement of the definition of frontier worker through the Agreement (to an employed worker returning weekly to his country of residence, according to Annex 1) has no repercussion on taxation.

Paragraph 2 ensures that when applying their tax laws, the Contracting States may still distinguish between taxpayers whose situations are not comparable, especially as regards their place of residence.

It thus contains the *principle of equality of treatment*, and prohibits the Contracting States from operating with distinctions, when they apply the relevant provisions of their tax legislation, between taxpayers who are in *comparable* situations, in particular in the EU as concerns their place of residence. All the DTC concluded between Switzerland and the EU States contain an equality of treatment clause. This clause stipulates the inadmissibility of differential treatment of nationals of the Contracting States in cases where these persons, especially as regards their residence, are in *identical* situations. The non-discrimination clause of Article 21 in the Agreement is hence stricter than the clauses provided for in the DTC, as it must be observed already where two taxpayers are in comparable situations as regards their residence (it is not necessary that it be effectively identical).

Through *paragraph 3*, the primacy of the Contracting States' tax legislation is repeated as concerns the adoption and application of measures to ensure the imposition, payment and effective recovery of taxes or to forestall tax evasion under their national tax legislation or agreements aimed at preventing double taxation.

Furthermore, paragraph 2 of Article 9 in Annex I reads as follows: "An employed person and the members of his family referred to in Article 3 of this Annex shall enjoy the same tax concessions and welfare benefits as national employed persons and members of their family."

<u>B Influence of the bilateral Agreement on Swiss tax legislation and practice</u>

[3] See Xavier Oberson, « Précis de droit fiscal international », 2nd edition, Berne 2004, p. 211; Pascal Hinny, « Die bilateralen Verträge und ihre Auswirkungen auf unser Steuerrecht », Der Schweizer Treuhänder, 10/2000, p. 1149 ; Jean-Marc Rivier, « L'égalité devant l'impôt des travailleurs suisses et étrangers », Archives de droit fiscal suisse 71, N° 3, 2002, p. 116 and 119.
[4] Annex I on Free Movement of Persons, Official Journal L 114/16 of 30 April 2002.

A number of Swiss legal acts were modified or passed upon the approval of the bilateral Agreement on the free movement of persons[5].

1. Influence of the bilateral Agreement on Swiss tax law

No direct modifications have so far been made to the Swiss legislation in the field of taxation, following the entry into force of the Agreement. It does not mean that EU law, as such, did not have an impact on the Swiss tax system[6].

2. Possible breaches of the bilateral Agreement currently contained in the Swiss tax legislation

2.1. Source taxation of EU nationals resident in Switzerland[7]

The Swiss Federal Tax Act[8], provides in its fourth part rules concerning source taxation (Articles 83 to 101). There is also an Order[9] from the Federal Ministry of Finance on source taxation within the framework of the Federal Tax Act. These texts basically subject certain categories of people to source taxation:

- foreign workers resident in Switzerland holding a residence permit (type B) [10] valid for either one or five years depending on the duration of the employment contract ;

- workers, artists, sportsmen, lecturers and certain other non-residents in Switzerland, regardless of nationality[11].

The latter category hardly creates any controversy as regards equality of treatment in relation to source taxation, as they are all subject to limited tax liability in Switzerland whether they are foreigners or of Swiss nationality. They are all non-residents.

The situation is more delicate regarding the former category, as the criterion for subjecting them to source taxation is firstly their nationality, and secondly the type of permit that they are entitled to obtain from the Swiss authorities. This has given rise to discussions among Swiss authors.

This source taxation is collected at federal, cantonal and communal levels, on the basis of the gross salary (Article 84). Levied by the *employer*, it generally deprives the taxpayer of the right to submit a tax declaration to the Swiss tax authorities (except in cases where there is no employer to levy the taxes, such as for income from real estate owners or stock holders). It substitutes the ordinary federal tax (Article 87), and is subject to a separate procedure (Articles 136 to 139).

The source tax has a progressive rate, which is fixed according to the rate scales applicable to the ordinary tax (Article 85). According to the Federal Tax Act (Article 86, first paragraph), several deductions are taken account of[12], whereas

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[5] Adaptation of the following Acts: Loi fédérale sur le séjour et l'établissement des étrangers (LSEE) du 26.3.1931, Loi fédérale sur l'acquisition d'immeubles par des personnes à l'étranger (Lex Koller) du 16.12.1983, Loi fédérale concernant l'exercice des professions de médecin, de pharmacien et de vétérinaire dans la Confédération suisse du 19.12.1877, Loi fédérale sur l'assurance-vieillesse et survivants (LAVS) du 20.12.1946, Loi fédérale sur l'assurance-invalidité (LAI) du 19.6.1959, Loi fédérale sur les prestations complémentaires (LPC) du 19.3.1965, Loi fédérale sur la prévoyance professionnelle (LPP) du 25.6.1982, Loi fédérale sur l'assurance-maladie (LAMal) du 18.3.1994, Loi fédérale sur le libre passage (LFLP) du 17.12.1993, Loi fédérale sur l'assurance-accidents (LAA) du 20.3.1981, Loi fédérale sur les allocations familiales dans l'agriculture (LFA) du 20.6.1952, et Loi fédérale sur l'assurance-chômage obligatoire et l'indemnité en cas d'insolvabilité du 25.6.1982.
Accompanying measures by distinct Orders: Loi fédérale sur les conditions minimales de travail et de salaire applicables aux travailleurs détachés en Suisse et les mesures d'accompagnement du 8.10.1999.

[6] See in particular, Markus Reich, « Einfluss des EU-Rechts auf das schweizerische Steuerrecht », Steuer Revue/Revue fiscale, n° 3, 2000, p. 150-160 ; Locher Peter/Cadosch Roger, « Auswirkungen eines Beitritt der Schweiz zur Europäischen Union », in : Der Beitritt der Schweiz zur Europäischen Union, Zurich 1998 p. 765 following; Xavier Oberson, « Influence of EC Tax Rules on the Swiss Tax System », Archives de droit fiscal suisse 65, 1996/1997, p. 239 following.

[7] Jean-Marc Rivier, « L'égalité devant l'impôt des travailleurs suisses et étrangers », Archives de droit fiscal suisse 71, no. 3, 2002, p. 97-123 ; Pascal Hinny, « Die bilateralen Verträge und ihre Auswirkungen auf unser Steuerrecht », Der Schweizer Treuhänder 10/2000, p. 1147-1156.

[8] Loi fédérale sur l'impôt fédéral direct (LIFD) - Federal Act on direct federal tax - of 14 December 1990, no. 642.11.

[9] Ordonnance sur l'imposition à la source dans le cadre de l'impôt fédéral direct (OIS) of 19 October 1993, no. 642.118.2.

[10] Article 83 of Act on direct federal tax.

[11] Article 91 following, of the Act on direct federal tax.

[12] Such as notably professional expenses, insurance premiums, family charges.

other deductions are only possible through the ordinary taxation (Article 33)[13]. The tax base could hence risk being more substantive for source taxation than for ordinary taxation.

If the gross annual income subject to source taxation exceeds the amount of CHF 120,000.-, an ordinary taxation procedure will take place afterwards, and the taxes already perceived at the source will be deducted from the ordinary income tax[14].

The Swiss Federal Council estimated in its Message relating to the approbation of the sector Agreements between Switzerland and the EC[15] (Message) that an adaptation of the tax legislation regarding source taxation was not necessary, but nevertheless admitted that this regime raised questions with regard to the principle of equality of treatment.

The Message first stated that the clause of non-discrimination of Article 21 paragraph 2 of the Agreement could pose a problem, since only non-Swiss nationals living in Switzerland are subject to this source taxation. It then went on to examine the case law of the ECJ, but still concluded that the Swiss source taxation is compatible with EC law, since it takes account of, during the taxation procedure, all family aspects of the taxpayer. Furthermore the source taxation rates correspond approximately to the scales, which are applied to 'ordinary procedure' taxation and not only professional expenses but also social deductions are taken account of. In conclusion it stated that the Swiss system of source taxation hence corresponded, approximately, to the requirements of the ECJ in the field of equality of treatment.

Several Swiss authors in the field of taxation have questioned the compatibility of this source taxation of EU nationals with the bilateral Agreement on the free movement of persons and the Annex thereto.

Hinny in his article finds that source taxation of EU-nationals residing in Switzerland is not in line with the general requirements of equal treatment, but can still be justified. He considers that Article 21, third paragraph, can be invoked in order to justify keeping this system of source taxation of foreign workers, as it has a function of guarantee for the perception of the income tax. For as long as the source taxation can be seen as a guarantee for the perception, then the "stricter" non-discrimination principle contained in the Agreement is no longer applicable. He nevertheless proposes certain changes to the legislation to inter alia ensure that restitutions of amounts already taxed at the source (i.e. in cases where the gross annual salary exceeds the threshold mentioned above) will be paid including interest, which is not the case today. He also proposes that an ordinary taxation procedure takes place after the source taxation (including interest) for everybody.

Rivier on the contrary considers the source taxation as definitive, a taxation which substitutes the ordinary taxation and therefore excludes it. And thus the source taxation of resident EU-nationals is in breach of Switzerland's international obligations.

In a nutshell we tend to consider that, at least, the possibility of being taxed according to the ordinary procedure should be offered to EU-citizens non-resident in Switzerland who obtain the essential part of their income in Switzerland[16]. This is in line with the case *Schumacker* in which the ECJ ruled that a non-resident taxpayer who draws the essential part of his income from a State is in a comparable situation to the resident taxpayers of that State, and should therefore not be treated differently from them.

2.2. Other issues

The agreement is too recent to evaluate at large its impact on other tax aspects of the Swiss tax system. It appears however clear that the field of company taxation is not covered by the agreement which only applies to individuals.

[13] Such as interests, allowances, alimonies and contributions to the 3rd pillar pension scheme.
[14] Order, paragraph 2 of Appendix.
[15] Message du Conseil Fédéral relatif à l'approbation des accords sectoriels entre la Suisse et la CE du 23 juin 1999, FF 1999 5440.
[16] See Oberson Xavier, Précis de droit fiscal international, 2nd ed., Bern 2004 p. 215.

Part II NORWAY

A The European Economic Area Agreement[17] ("the Agreement")

The EEA Agreement between the EC, the ECSC and their Member States on the one hand, and Austria, Finland, Iceland, Norway, Sweden and Switzerland on the other, was signed on 2 May 1992. Switzerland voted in a referendum against EEA membership the same year. The Agreement entered into force 1 January 1994, and in 1995 Liechtenstein became a member, whilst Austria, Finland and Sweden left the European Free Trade Area (EFTA) to become EC Members.

There current EEA members are thus the 15 EC Member States, and 3 of the EFTA States; Iceland, Liechtenstein and Norway.

1. Aim of the Agreement

The aim of the Agreement is to create a homogenous European Economic Area; an internal market governed by the same basic rules. It substantially reproduces the EC law in the field of the four freedoms of movement as well as for conditions of competition, public procurement and state aid, and its objective is that the Contracting Parties arrive at, and maintain, a uniform interpretation and application of the Agreement and the provisions of EC law that it contains.

2. Dynamic of the Agreement

The four fundamental freedoms of the EC internal market, as well as a wide range of accompanying EC rules and policies, are extended to the EFTA EEA States through the Agreement. This has been done by drafting the basic provisions of the EEA Agreement in terms resembling as closely as possible the corresponding provisions of the EC Treaty, on the free movement of goods, persons, services and capital, on competition, state aid and public procurement, and in certain "horizontal" areas relevant to the four freedoms, such as labour law, health and safety at work, environment, consumer protection and company law.

Secondary legislation (regulations, directives, decisions) of the EC in areas covered by the EEA Agreement is adopted into the Agreement by direct reference to them in the relevant annexes to the Agreement.

The EEA Agreement supposes the coexistence of two different legal systems:
1. the *EEA Agreement* to the relations between a) the 3 EFTA EEA States, and b) the 3 EFTA EEA States and the EC States;
2. the *EC law* to the relations between the EC Member States.

It has been described as being an international treaty *sui generis* containing a distinct legal order of its own, having less profound effects than EC law, but going further than a classical international treaty.

The principle of homogeneity underlies the EEA Agreement and requires uniform interpretation and application of provisions relevant to the two systems. Subsequently, the Agreement establishes not only procedures for integrating new EC law into the Agreement, but equally foresees mechanisms to ensure the fulfilment of obligations under the Agreement, including judicial control.

2.1. Extension of new EC legislation to the EEA

The EEA Joint Committee, which consists of representatives of the Contracting Parties, is established according to Articles 92 - 94 of the Agreement. The EEA Joint Committee has the task of taking the decisions to amend the annexes to the EEA Agreement to ensure that they contain new relevant EC legislation "with a view to permitting a simultaneous application of the latter as well as of the amendments of the Annexes to the Agreement" (Article 102, paragraph 1).

Preceding this decision-making of the EEA Joint Committee, the EC Commission is obliged to inform the EFTA States whenever it drafts new legislation in a field covered by the Agreement and to seek advice from experts from the EFTA EEA States in the same way as it seeks advice from EC experts. If one of the Contracting Parties so wishes, an exchange of views on the draft legislation takes place within the EEA Joint Committee (Article 99).

[17] Information in this section is based on EFTA Surveillance Authority Annual Report 2002.

2.2. Mechanisms to ensure the fulfilment of obligations under the Agreement

Whereas the adoption of new legislation within the EEA is entrusted with a joint body, the surveillance and control mechanisms take place within two parallel systems.

a. Surveillance

For the EC Member States, the surveillance of the implementation and application of the EEA Agreement, is carried out by the European Commission (Article 109, paragraph 1), whereas the EFTA EEA States has created a parallel institution (through Article 108, paragraph 1) the "EFTA Surveillance Authority" (ESA) to ensure the fulfilment of the obligations under the Agreement of the EFTA EEA States.

These two institutions, the European Commission and the EFTA Surveillance Authority, can to this end act on their own behalf by monitoring the implementation and application of the Agreement by the Contracting Parties, or they can examine any complaints they receive. The EFTA Surveillance Authority has extended competence in the fields of competition, public procurement and state aid (just like the European Commission).

The surveillance activities comprise on the one hand to ensure that the provisions of the Agreement are properly implemented into the national legal orders of the States concerned, and on the other hand to check that the provisions are correctly applied by the national authorities.

There are procedures foreseen to ensure the uniform surveillance in all the EEA States. These provide for co-operation, exchange of information and consultation between the two surveillance bodies (Article 109, paragraph 2 EEA).

The surveillance procedures are more closely defined in the Surveillance and Court Agreement[18] (ESA/Court Agreement). Article 5 paragraph 1 lists the tasks of the EFTA Surveillance Authority in relation to the general aim of ensuring the proper functioning of the EEA Agreement, as ensuring the fulfilment by the EFTA States of their obligations under the EEA Agreement and the Surveillance and Court Agreement, ensuring the application of the rules of the EEA Agreement on competition, and monitoring the application of the EEA Agreement by the other Contracting Parties to that Agreement. Paragraph 2 specifies the means through which the EFTA Surveillance Authority shall act; by taking decisions, formulating recommendations, delivering opinions and issuing notices or guidelines, carrying out co-operation, exchange of information and consultations with the European Commission, and carrying out the specific functions that relate to Protocol 1 of the EEA Agreement.

Article 31 of the ESA/Court Agreement specifies the procedural steps in an infringement case[19].

b. Judicial control

The ECJ has the competence to judge on cases involving the fulfilment of the obligations in the EEA Agreement on behalf of the EC States. The EFTA States have created the EFTA Court to have the same functions (as well as to judge on disputes between two or more EFTA States) by way of Article 108 paragraph 2.

To preserve the homogenous interpretation of the Agreement, the EEA Joint Committee has the obligation to keep under constant review the development of the case law of both judicial bodies (Article 105, paragraph 2). It is equally responsible for setting up a system of exchange of information concerning judgements from the European Court of

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[18] The Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, Official Journal No L 344, of 31 December 1994, p. 1.
[19] They can briefly be summarised as follows:
i. The EFTA Surveillance Authority may initiate a case on its own initiative, or on the basis of a complaint.
ii. The Authority Directorate concerned will often at first attempt at resolving the issue through informal means, as the overwhelming majority of problems are solved as a result of less formal exchanges of information and discussions between the Authority's staff and representatives of the EFTA States. The Authority may send an informal letter to the EFTA State in question, inviting it to adopt the measures necessary to comply with the relevant EEA rule or to provide the Authority with information on the actual status of implementation into the national legal order.
iii. The EFTA State may submit its comments.
iv. If the Authority receives no reply , or is not pleased with the reply from the EFTA State, it will deliver a reasoned opinion. This reasoned opinion will define the Authority's final position on the matter, state the reasons on which that position has been based, and request that the Government take the necessary measures to bring an end to the infringement.
v. The EFTA State may reply to the opinion.
vi. Should the Government fail to comply with the reasoned opinion, the Authority may decide to defer the matter to the EFTA Court.
vii. If proceedings are brought before the Court, its judgement shall be binding.

Justice, the EFTA Court and the Courts of last instance of the EFTA States, in order to ensure as uniform an interpretation as possible of the EEA Agreement (Article 106).

The Surveillance and Court Agreement provides more detailed information as to the tasks and the functioning of the EFTA Court. The EFTA Court has jurisdiction in the following cases:

- *infringement proceedings*: where the EFTA Surveillance Authority brings a matter before it considering that an EFTA State has failed to fulfil an obligation under the EEA Agreement and has not complied with the reasoned opinion within the determined period (Article 31 ESA/Court Agreement), or, where an EFTA State brings action against the EFTA Surveillance Authority to have the infringement of failing to act established (Article 37 ESA/Court Agreement);

- *settlement of disputes*: in actions concerning the settlement of disputes between two or more EFTA States regarding the interpretation or application of the EEA Agreement, the Agreement of a Standing Committee of the EFTA States or the ESA/Court Agreement (Article 32 ESA/Court Agreement);

- *advisory opinions*: to give advisory opinions on the interpretation of the EEA Agreement to a court or a tribunal in an EFTA State which requests the EFTA Court to give such an opinion (Article 34 ESA/Court Agreement);

- *annulment proceedings*: in actions brought by an EFTA State against a decision by the EFTA Surveillance Authority on grounds of lack of competence, infringement of an essential procedural requirement, or infringement of the ESA/Court Agreement, the EEA Agreement or any rule of law relating to their application, or misuse of powers. Natural or legal persons may also institute proceedings before the EFTA Court against a decision of the EFTA Surveillance Authority addressed to that person or against a decision addressed to another person, if it is of direct and individual concern to the former (Article 36 ESA/Court Agreement).

3. Non-discrimination and the four freedoms

The non-discrimination clause is contained in Article 4 of the Agreement, and it prohibits, within the scope of the Agreement, any discrimination on grounds of nationality.

Article 28 repeats the non-discrimination principle as regards the free movement of workers, Article 31 prohibits restriction on the freedom of establishment, Article 34 provides for the non-discrimination of companies, Article 36 prohibits restrictions on the freedom to provide services and the non-discrimination of service providers is ensured through Article 37.

4. Taxation aspects of the Agreement

4.1. Indirect taxation

There are certain provisions on indirect taxation in Part II of the Agreement relating to the free movement of goods, prohibiting restrictions on or discrimination of products through taxation measures (Articles 14 and 15). Customs duties of fiscal nature are also prohibited between the Contracting Parties (Article 10).

Otherwise, indirect taxes are outside the scope of the Agreement, and the directives and regulations in this field are thus not binding on Norway. The Norwegian value added tax, to take an example, is not fully harmonised with the EU system.

4.2. Direct taxation

a. EEA Agreement

Direct taxation is excluded from the fields of co-operation of the EEA. The Agreement does therefore not, *a priori*, apply to Norwegian direct tax measures. However, social security is part of the Agreement, and EU secondary legislation in this field also apply to Norway[20]. Social security contributions fall under domestic income tax rules.

b. Secondary legislation

[20] Such as Council Regulation 1408/71.

Some secondary EC tax legislation has been adopted through the Agreement[21], and some has not[22], depending on whether the provision serving as a legal basis for it is found in the EEA Agreement.

c. ECJ rulings

Article 6 ensures that the provisions of the Agreement which are identical in substance to EC provisions shall, in their implementation and application, be interpreted in conformity with the relevant case law of the ECJ prior to the date of signature of the Agreement.

All the fundamental freedoms, as well as the general prohibition of discrimination contained in Article 12 of the EC Treaty, as interpreted by the ECJ, have been made part of the EEA Agreement.

Norwegian direct tax measures should therefore not be contrary to the case law of the EC on the basic freedoms up to the signature of the Agreement. The principle of homogeneity after the signature is provided for in the procedures of Articles 105 - 107 of the Agreement.

There is an issue as to which extent domestic courts should be considered bound by ECJ rulings after 1992. Norwegian courts are strictly speaking not formally bound by these later rulings by the ECJ but it is now generally accepted that they should be regarded as very important sources of law. Hence, in practice, there is no or only very little difference in the way the ECJ practice prior to or subsequent to 1992 is taken into consideration.

B Influence of the EEA Agreement on Norwegian tax legislation and practice[23]

Norway has a *dualistic* system for making international treaties legally effective (as opposed to Switzerland, which has a classical continental *monist* tradition). It is simply not sufficient that the Agreement itself is ratified - all the acts to which the Agreement refers must be incorporated into the national legislation, through an act of Parliament or by delegation of legislative power to the King. Thousands of EC acts have thus been adopted into Norwegian acts.

1. Obligation of notification from the EFTA EEA States

The EFTA Surveillance Authority has extended powers in the fields of public procurement, competition and state aid. Certain taxation measures risk falling under the definition of state aid, and Norway has been implied in proceedings in this area. State aid is covered by Articles 61-64 in the EEA Agreement.

The EEA Agreement requires the EFTA Surveillance Authority to keep all systems of existing aid in the EFTA States under constant review, and to propose to the EFTA States appropriate measures to ensure their compatibility with the Agreement.

Norway, as an EFTA State, has the *obligation to notify new aid or modifications to existing aid* to the Surveillance Authority before it is given effect. The Authority then carries out a preliminary examination of the notified aid measure. If it considers the aid compatible with the EEA Agreement, it will approve the aid. If, however, it concludes that the aid is not in conformity with the Agreement, it decides that the EFTA State concerned shall abolish or modify the measure. If the EFTA State in question does not follow the Authority's decision, the latter may bring the matter before the EFTA Court.

Protocol 3 to the ESA/Court Agreement, on the functions and powers of the EFTA Surveillance Authority in the field of state aid, specifies the different procedures applicable to the various categories of state aid (notified aid, unlawful aid, misuse of aid, and existing aid schemes).

[21] Article 7 of the Council Regulation 1612/68 on the free movement of workers, and Article 40 of the Council Regulation 2137/85 on European Economic Interest Groupings.
[22] The EC Merger Directive (90/434/EEC) and the EC Parent-Subsidiary Directive (90/435/EEC).
[23] Of general literature on this subject, there is in Norwegian « EØS-avtalen og norsk skatterett » (The EEA Agreement and Norwegian tax law), by Dajani, Leegaard, Nordby and Ongre, published by Universitetsforlaget, Oslo, 2003. There is also an article in English by Thor Leegaard, « Impact of the European Economic Area Agreement on Direct Taxation: A Norwegian Perspective », IBFD Bulletin 2002, p. 110-117.

The EEA Agreement provides for the co-operation between the Authority and the European Commission relating to the individual cases in this field. The decisions of the EFTA Surveillance Authority are published in the Official Journal.

2. Infringement proceedings and complaints

Infringement proceedings against Norway in 2003 concerned a variety of fields, including taxation and state aid.

2.1. During 2003

a. Tax measures

On 18 December 2003, the EFTA Surveillance Authority sent a letter of formal notice to Norway[24] concerning the difference of treatment with regard to tax deductions[25]. Norway has tax rules that limit the right to deduct donations from a person's taxable income to the cases in which a recipient charitable or non-profit organisation is seated in Norway. The deductible amount is NOK 6,000.- (approx. € 750.-).

The Authority considers that the Norwegian rules work to the detriment of foreign workers or self-employed people, as these are more likely to wish to donate money to an organisation seated abroad. Hence, the tax rules give rise to an impermissible difference of treatment within the meaning of Article 28 EEA and - for other migrant persons than workers - within the meaning of Article 4 EEA. The tax rules are in addition liable to dissuade donations to entities that are established in another EEA State and hence constitute an obstacle to the movement of capital. Norway is requested to submit its observations within three months.

b. State aid based on tax measures

In 2003, all the notified taxation measures constituting state aid were cleared by the EFTA Surveillance Authority.

i. Amendment to a scheme offering tax deduction for research and development expenses of enterprises[26]

The original aid scheme was limited to smaller enterprises. The amendment implied that all enterprises could benefit from the scheme, irrespective of their size.

The Authority found that the extension of the scope of the scheme to include all enterprises did not change the scheme's compatibility with the state aid provisions in the EEA Agreement.

ii. Amendment to "Norwegian Special Tax Regime for Shipping Companies"[27]

Since the initial authorisation, the so-called "tonnage tax" had been doubled twice, after which a sliding scale for environmentally based reductions up to 25% and subsequently a general reduction of 30% of the tax rates were adopted. In addition, some of the ring-fencing mechanisms had been subject to modifications.

In the view of the Authority, these amendments did not alter the assessment regarding the compatibility of the aid scheme, and it was cleared under Article 61(3)(c) of the EEA Agreement.

iii. A tax refund scheme for offshore vessels and shuttle tankers registered in the Norwegian shipping register[28]

The Norwegian authorities introduced a special tax refund scheme whereby offshore vessels and shuttle tankers registered in the ordinary Norwegian shipping register are reimbursed for collected seafarers' income tax and social security contributions levied on seafarers and on employers.

The aid scheme allows a reimbursement of the contributions in relation to seafarers who are liable for taxation in Norway. Refunds are not to be granted to ships qualified for other public subsidies. The ships eligible under the special refund

[24] And to Liechtenstein on the same issue.
[25] EFTA Surveillance Authority press release no. PR(03)39 of 19 December 2003.
[26] Decision no. 171/02/COL regarding tax deduction for expenses of research and development. Official Journal C 10, 16 January 2003.
[27] Decision of the EFTA Surveillance Authority, 16 July 2003. Press release no. PR(03)17.
[28] EFTA Surveillance Authority press release no. PR(03)30.

scheme have to be engaged in all year traffic on a scheduled regular basis and will not benefit from any regional aid schemes. The ships must carry out maritime transport and be engaged in petroleum activities.

The scheme came into effect as from 1 July 2003. The amount allocated for the operation of the special refund scheme in 2003 is NOK 150 million (approx. € 17,5 million). The refund scheme is not limited in time and is subject to the annual budget appropriation decided by the Norwegian Parliament.

The scheme was notified to the Authority and it was assessed under the state aid provisions of the EEA Agreement. The Authority found that companies benefiting from the scheme certainly receive state aid, but that the aid was compatible with the Agreement and complied with the principles outlined in the Authority's Guidelines on state aid to maritime transport.

2.2. During 2002

a. Tax measures

On 5 August 2002, the EFTA Surveillance Authority delivered a reasoned opinion to Norway concluding that Norway's legislation concerning taxation of lottery prizes breached the EEA fundamental freedom on provision of services[29]. According to the Norwegian Tax Act[30], lottery prizes are considered as taxable income. §5-50 of the Tax Act allows income tax exemption of lottery prizes above NOK 10,000.- (approx. € 1,250.-) won in the national lotteries in Norway. The tax exemption does not apply to prizes won by taxpayers in Norway in similar lotteries organised in other EEA States.

The Authority maintained that although direct taxation falls primarily within the competence of the EEA States, this competence shall be exercised consistently with EEA law. The exemption from income tax of lottery prizes won in Norwegian lotteries provided for in the Norwegian Tax Act constituted discrimination based on the place of establishment of the provider of lottery services contrary to Article 36 of the EEA Agreement. Such a discriminatory measure may only be justified by the list of limited non-economic grounds provided by Article 33 of the EEA Agreement, namely public policy, public security or public health aims. Even if a less rigid interpretation of the obligation placed on an EEA State was to be permitted, the Authority would in any case come to the conclusion that the discriminatory tax regime was neither truly apt nor necessary to promote those aims. Norway had not, in the Authority's opinion, demonstrated that its national measure was justified. Norway was given three months to take the measures necessary to comply with the reasoned opinion. See point 4. 1. c. for the proposed change to the national legislation.

b. State aid based on tax measures

i. Derogation from environmental taxes in Norway[31]

In May 2001, the EFTA Surveillance Authority adopted new Environmental Guidelines, and it proposed to the Norwegian Government to bring all existing aid schemes, which would fall under these guidelines, in line with the new guidelines before 1 January 2002. The Norwegian Government gave its agreement to this in June 2001.

The Surveillance Authority monitored the implementation of this obligation through informal discussions with the Norwegian Government. After having been informed about the tax measures in place, the Authority regarded several of the exemptions of environmental taxes as not being in compliance with the new Environmental Guidelines. It requested concrete proposals as concerned the meeting of the requirements set out in the Guidelines. Based on the information submitted and the arguments presented by the Norwegian Government, the Authority carried out a preliminary assessment of the tax measures at issue and came to the conclusion that there were doubts as to the compatibility of these tax measures with the EEA state aid rules. It therefore decided to open a formal investigation procedure.

ii. Regionally differentiated social security taxation[32]

The EFTA Surveillance Authority proposed appropriate measures to Norway with regard to state aid in the form of regionally differentiated social security taxation. The Norwegian authorities had to take the necessary measures to eliminate any state aid resulting from the system of regionally differentiated social security tax, or to render such aid compatible with the EEA Agreement.

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[29] EFTA Surveillance Authority press release no. PR(02)15.
[30] Lov om skatt av formue og inntekt (skatteloven) nr. 14, av 26. mars 1999.
[31] EFTA Surveillance Authority press release no. PR(02)14.
[32] EFTA Surveillance Authority press release no. PR(02)20.

3. Judgements from the EFTA Court

Taxation measures in respect of state aid rules have been subject to a judgement of the EFTA Court[33], in a case which opposed the Norwegian Government to the EFTA Surveillance Authority.

The Norwegian legislation provided for a regionally differentiated social security taxation, in an attempt to give more favourable conditions to certain remote or under developed regions. This was by the EFTA Surveillance Authority decided to be state aid which was not compatible with the EEA Agreement. The Norwegian Government sought the decision annulled[34].

The application for annulment of the decision of the EFTA Surveillance Authority was dismissed.

4. Modifications to Norwegian domestic tax law following the obligations under the EEA Agreement

4.1. Change to rules as of 1 January 2004

The Norwegian Ministry of Finance has published an overview of changes to tax rules, effective as from 1 January 2004[35]. Among these, three out of around 25 expressly refer to the obligations under the EEA Agreement. They are explained in detail in the published proposition to the Parliament[36].

a. Tax deductions for young people with special savings account

This arrangement is provided for by §16-10 in the Norwegian Tax Act, and it aims at relieving young taxpayers (up to 34 years old) from a part of their tax burden while they save money with the purpose of acquiring property. The young taxpayer may deduct 20% of the amount saved on a special savings account (called a BSU[37] account) from his taxes every year until 33 years of age. A maximum of NOK 15,000.- (approx. € 1,900.-) is allowed for savings per year and the maximum of total savings is fixed at NOK 100,000.- (approx. € 12,500.-).

The condition for deductibility of savings on a BSU account was that the amount would be transferred to a domestic (i.e. Norwegian) bank, co-operation or permanently organised domestic savings association. The EFTA Surveillance Authority asked the Ministry of Finance to justify this provision, and the Ministry subsequently proposed to change it as it realised that it could not be maintained as it was without entering into conflict with Norway's obligations under the EEA Agreement. The application of this arrangement has therefore been extended to similar savings accounts in other EEA States. This means that taxpayers in Norway can deduct 20% of the allowed savings amount deposited in banks in other EEA States.

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[33] Case E-6/98 of the EFTA Court, of 20 May 1999.

[34] Point 34 "The Court notes first that, as a general rule, a tax system of an EEA/EFTA State is not covered by the EEA Agreement. In certain cases, however, such a system may have consequences that would bring it within the scope of application of Article 61(1) EEA. It is established case law of the ECJ that the fiscal nature of a measure does not shield it from the application of Article 92 EC (now after modification Article 87 EC).
Point 38 "The Court thus finds that the system of regionally differentiated social security contributions must be seen as favouring certain undertakings within the meaning of Article 61(1) EEA, unless it can be shown that the selective effect of the measures is justified by the nature or general scheme of the system itself. Any direct or indirect discrimination which is to be considered justified must derive from the inherent logic of the general system and result from objective conditions within that general system. In the opinion of the Court, these criteria are not satisfied in the present case, where differentiation is based on regional criteria alone."
Point 40 "With regard to the pleadings of the Applicant on the demarcation of the powers of the institutions set up under the EEA Agreement, the Court observes the following: the provisions of the EEA Agreement shall be interpreted in conformity with the relevant rulings of the Court of Justice of the European Communities (hereinafter "ECJ") given prior to the date of signature of the EEA Agreement, cf. Article 6 EEA; rulings given subsequent to the date of signature of the EEA Agreement shall be duly taken account of by the EFTA Surveillance Authority and this Court in the interpretation and application of the Agreement, cf. Article 3(2) of the Surveillance and Court Agreement."
Point 43 "The Government of Norway has, by its membership in the European Economic Area, accepted to adhere to the framework established under the EEA Agreement. The Government has also agreed to amendments to these rules at later stages. The Court finds that the EFTA Surveillance Authority has not, in its Decision now under scrutiny, acted beyond its competence or wrongly applied the rules on State aid. It follows from the foregoing that the Norwegian social security contribution scheme constitutes State aid within the meaning of Article 61 EEA. The first part of the first submission of the Applicant must therefore be dismissed as unfounded."

[35] Internet site of Ministry of Finance; "Regelendringer (changes of rules) fra 1. januar 2004": http://www.odin.dep.no/fin/norsk/skatter_avgifter/006071-210074/index-dok000-b-f-a.html.

[36] Odelstingsproposisjon no. 1 (2003-2004); chapters 6, 7 and 8.

[37] BSU - boligsparing for ungdom (saving for property for young people).

There will still be a difference in treatment as regards the declaration of the amount transferred to the account during the year, depending on whether the institution is in Norway or in another EEA State. In Norway, the banks are responsible for declaring to the tax authorities any moves on the account, or any breaches to the conditions for this special account. As Norwegian tax authorities do not have the competence to oblige foreign banks to submit information of this kind, taxpayers in Norway with "BSU" accounts in another EEA State will themselves have to declare whatever information the tax authorities need to allow the tax deduction. In order to avoid abuse, the regulations relevant to this type of account will be supplemented with more detailed rules on the duty of declaration and consequences of breaching the duty.

b. Taxation of domestic and foreign life insurance

§§ 5-20 and 5-21 of the Norwegian Tax Act define the income which is to be taxed as capital income. As concerns life insurance, the rules provide that the annual yield on the savings part of a life insurance in a Norwegian company (capital insurance) is considered as an advantage of capital for the insured. The annual yield of the savings part in a foreign life insurance is on the contrary not considered to be taxable capital income. Payment of life insurance (capital insurance) is not considered as income unless the payment is made from a foreign insurance company.

The main reason for distinguishing between domestic and foreign life insurance, is the concern for control. In order to enable taxation on current annual income from a savings product, information and documentation accompanying the tax declaration is indispensable. Norwegian insurance companies are obliged to assess the annual yield on savings products and to report this assessment to the taxation authorities, thus facilitating the tax assessment of the yield. The fact that it is possible to tax the current annual yield is also the reason why payments of life insurance held in Norwegian companies are not taxed (Tax Act §5-21).

Norwegian authorities may not oblige foreign insurance companies to assess the annual yield or to report this to them. It thus becomes difficult to control if the assessed yield is correct, to ensure that the correct amount is taxed. Hence, the whole amount has been taxed once paid, i.e. upon entry of the amount into Norway. In this way one avoids having to take up a position on whether the taxpayer (or the foreign insurance company) reports the correct yield of the life insurance upon payment of the foreign amount of insurance. This "once and for all" taxation is a *gross* taxation, without deduction of paid premiums. This is applied even if there are no rights in Norway to deduct paid premiums for such a life insurance. This solution is not seen as very satisfactory. However, neither a *net* taxation (of paid insurance amount minus paid premiums) would make up a satisfactory solution. It would have comprised a tax credit not applying to domestic life insurance, hence favouring foreign companies before domestic ones.

As the provisions of §§5-20 and 5-21 distinguishes between life insurance drawn up in Norwegian and foreign insurance companies, the EFTA Surveillance Authority has claimed that these rules could be conflicting with Norway's obligations under the EEA Agreement. The Ministry of Finance has found that by obliging taxpayers with life insurance in foreign insurance companies to supply justifying documents, Norwegian and foreign life insurance may be treated equally for tax purposes.

Obliging the taxpayer to owe taxes on current annual yields and provide documentation thereto, raises several questions. One of them is how this is to be solved for taxpayers moving to Norway having a current life insurance abroad. The Ministry has not made research as to how life insurance is taxed in EEA countries, but supposes that it can vary from state to state as in other tax issues. The best thing would therefore be to find a solution which is not dependent on the tax regime in the EEA State concerned where the life insurance is subscribed to. The most appropriate will thus be the ordinary subjection to taxes in Norway. The obligation to tax should in these cases be related to the years the taxpayer has been a subject to Norwegian taxation. In consequence, a taxpayer moving to Norway with life insurance in another EEA State may have his life insurance paid tax-free in Norway, provided he has informed about and has been taxed on the annual yield of the insurance the years he has been subject to taxation in Norway. Equally, a Norwegian citizen with life insurance abroad may have this paid tax-free if he reports and is taxed on the annual yield of the insurance. Another question is which consequences should the non-reporting of annual yields from the foreign insurance by the taxpayer for one or more years have. The Ministry proposes that if the taxpayer does not report the annual yield of a foreign life insurance, the yields shall be fixed by discretion according to the ordinary rules on taxation by estimation provided for by the Tax Assessment Act[38]. In practice this means that the taxation authorities can determine the basis of the taxation by discretion when they find that the taxpayer has not produced the necessary documentation relating to the yields of the insurance. There will be rules on the transition to this regime.

c. Tax exemption of foreign lottery prizes

[38] Lov om ligningsforvaltning (ligningsloven) nr. 24, av 13. juni 1980.

According to §5-50, first paragraph, of the Norwegian Tax Act, lottery prizes are taxable income if the prize exceeds NOK 10,000.- (approx. € 1,250.-). The second paragraph, however, contains certain exceptions to the first paragraph, which in practice has the result of exempting prizes from Norwegian lotteries, whereas foreign lottery prizes are still subject to taxation.

The EFTA Surveillance Authority sent on 5 August 2002 a reasoned opinion to Norway claiming that the Norwegian rules on taxation of lottery prizes are in conflict with the EEA Agreement. The Norwegian authorities replied that it does not agree with the Surveillance Authority. The reason for the distinction between Norwegian and foreign lotteries for tax purposes is that the Norwegian lotteries in reality are subject to a different form of taxation. The Norwegian lotteries and betting games are required to use a part of their turnover for specific causes. Furthermore the Norwegian authorities may keep the Norwegian lotteries under surveillance, and control their activity in a way they cannot with foreign lotteries. The taxation authorities have the possibility to obtain necessary information to check whether the prize was won from a legal or illegal lottery. On top of that, the prizes in Norwegian lotteries have so far been rather modest in comparison with certain foreign lotteries, and this has enabled the authorities to control and limit more easily the social problems related to lotteries and other betting games.

The Norwegian authorities nonetheless envisaged a revision to change these rules. On certain conditions, prizes from foreign lottery games (within the EEA) comparable to the lotteries that are allowed in Norway may be exempt from taxes. The basic idea is that the foreign lotteries will be subject to the same requirements as the Norwegian ones, in order to benefit from the same tax exemption. Only forms of games allowed in Norway will be comprised by the exemption, the game must have a legal base and be ran according to authorisation from public authorities, and must be subject to rules and control by public authorities. Such criteria will be appropriate to delimit the application against purely commercial games, in which the profit part will be considerable and in which natural persons will be left with the profit from the game. Subsequently, prizes from inter alia casinos will still be taxed as they are today. The aim of the change in legislation was to treat equally the taxation of prizes from foreign games which are of the same kind as those allowed to operate in Norway, and where public authorities keep the game under surveillance and control. The burden of proof for the fulfilment of the conditions for tax exemption rests with the prize taker. Norwegian authorities do not have the same possibility to collect information from foreign lottery companies as they have for domestic ones. If there are no requirements as to documentation from the prize taker, there is a certain danger that income which in reality might have its source elsewhere could be disguised as a prize from a foreign lottery game. If there are doubts as to whether a prize originates from a game which fulfils the criteria for exemption of taxes, the prize taker will have to produce adequate and relevant documentation about the game to justify the basis of a possible tax exemption. Since Norway is party to the EEA Agreement, the tax exemption will be limited to foreign games in the EEA, albeit the Ministry of Finance did not agree with the EFTA Surveillance Authority that the tax rules in this field were in conflict with the EEA Agreement. The Ministry hence saw no reason for extending this tax exemption beyond the EEA. Subsequently, all prizes of at least NOK 10,000.- from countries not party to the EEA Agreement remain fully taxable in Norway.

The Ministry anticipates certain difficulties relating to the definition of the foreign games which would be comprised by the tax exemption and which documentation to require from the prize taker, and therefore contemplates leaving some of these considerations to "Lotteritilsynet"[39].

As regards the entry into force of this change in legislation, the Ministry proposed to wait for the outcome of the case C-42/02 *Diana Elisabeth Lindman v. Finland* which was pending at the time before the European Court of Justice for a preliminary ruling concerning the question of whether differentiated taxation of lottery prizes based on nationality is in conflict with the EC Treaty. If the Court should find that such treatment is not contrary to the EC Treaty, the Ministry of Finance would consider an eventual reverse of these new rules on tax exemption for foreign lottery prizes. Should the Court reach the opposite solution, the new rules could to a certain extent be given a retroactive effect.

The Court delivered the following answer: "Article 49 EC prohibits a Member State's legislation under which winnings from games of chance organised in other Member States are treated as income of the winner chargeable to income tax, whereas winnings from games of chance conducted in the Member State in question are not taxable".

The change to the Norwegian legislation is therefore in force and it provides that gains from lotteries now are fully tax free (also for prizes up to NOK 10,000.-).

4.2. Changes to rules in previous years

[39] "Lottery Watch", an independent surveillance body for lotteries.

A proposition to the Parliament in 2001 on changes to the tax legislation suggested the elimination of an Article in the Tax Act (§6-14) on rights of deduction for seminars abroad, which the Ministry considered incompatible with the EEA Agreement[40].

Costs relating to seminars, courses, meetings etc., aimed at maintaining knowledge and following developments of professional or technical nature, may give right to deductions at the tax assessment, according to §6-1 of the Tax Act. This applies both to employed workers and to self-employed workers, who, when they have paid the costs themselves, can subtract the costs in their tax declaration. If the employer assumed the costs, he may subtract the costs in his accountability. The decisive issue concerning the right of deduction is that the costs are seen to cover further education or professional updating. For the employer, the costs of travelling for the employees are always deductible anyway, but a report of salary for the employee could be an issue if the travelling takes on a too private character.

§6-14 of the Tax Act gave a particular rule for costs relating to seminars, courses, meetings etc. held *abroad*. This rule also applied to study trips. Where the course would have an "unreasonable element of non-professional character or give a holiday-like impression", the deduction could be reduced or no longer apply at all. The provision had significance on its own, in that it through a legal basis could reduce the right to deduction based on geographical criteria. The Ministry considered this distinction rather inopportune, especially regarding Norway's obligations under the EEA Agreement, and the judgement in the case *Vestergaard*[41], and suggested the Article be abolished. The costs incurred through courses, seminars, meetings, etc. abroad may now be deducted to the same extent as costs incurred through participation in domestic seminars, courses etc.

There will however still be limits to the right of deduction. Such limits will apply in cases where there are trips combining a professional purpose, which gives right to deduction, and other activities which do not give right to deduction, such as holidays. In such cases the extent of the right to deduct will depend on the main purpose of the trip. If the main purpose is of professional character, only the expenses covering non-deductible activities could be denied the right to be deduced. If the main purpose of the trip is holiday, only the expenses related to the professional part of the trip could be deduced. In cases of doubt, importance could be attached to whether the information sought obtained, could have been acquired in a different and less expensive way, and whether the costs are in reasonable proportions to the yield of the trip. Indirectly, the fact that trips abroad are often more expensive and time consuming than domestic trips implies a more important reduction to the right of deduction for trips abroad than for domestic flights. The criteria for assessing whether the trip is deductible will however be the same for trips abroad and inland.

5. Possible breaches of the EEA Agreement currently contained in Norwegian tax legislation

5.1. Tax deductions of donations to organisations seated in Norway

This case was raised by the EFTA Surveillance Authority in the formal notice of 18 December 2003, and is pending reaction from the Norwegian authorities (see page 15).

5.2. Other matters

Norwegian authors[42] have identified several provisions in the Tax Act as questionable. Those not already treated above can be listed as follows[43]:

a. §8-81; special deduction for age

This deduction is subject to a residence requirement, and could hence be contrary to the judgement *Schumacker*[44] assuring equal treatment for non-residents where these obtain the essential part of their income from Norway, and therefore are in a comparable situation with residents.

b. §6-82; special deduction for disability

Same reasoning as for a.

[40] Odelstingsproposisjon no. 94 (2000-2001), chapter 2, point 2.3.
[41] C-55/98.
[42] See foot note n° 22.
[43] a. to c. concern taxation of persons, d. to l. company taxation.
[44] ECJ C-279/93.

c. §6-32; general minimum deduction

What is offered to non-residents with limited tax liability is only a part proportionate to the duration of stay in Norway.

d. §§10-2 – 10-4; group relief for companies

The rule is that a company may get a deduction for contributions paid to another company within the same group. In order to be in the same group, one company must own directly or indirectly 90% of the stocks in the other company, or both companies must be directly or indirectly owned at 90% by another company.

Both companies must be resident in Norway for tax purposes, but there is no requirement that the mother company must be resident. However, the rules do not apply to contributions to and from permanent establishments of a foreign company. The Ministry of Finance has expressed that in practice, through the double taxation agreements, Norwegian law is practiced in line with the law of other EC Member States. However, this only concerns contributions from a permanent establishment to a subsidiary. The contribution the other way around (from a subsidiary to a permanent establishment) is not covered so the treatment of permanent establishments of a company resident in another Member State may turn out to be less favourable than the treatment of a Norwegian company.

e. §§10-20 – 10-25; deduction of contributions from the shareholder to the company

The right to deduct capital contributions from a shareholder to the company, during its first four years of existence, to cover debts, is subject to the residence criterion. Furthermore, the receiving company must be “Norwegian”.

f. §11-21; relating to the transfer of assets within a group of companies

The transfer of assets between companies in the same group (the 90% rule) may be done with tax neutrality. However this is subject to the same condition as for intra-group contributions – the companies must be resident in Norway.

g. §11-20; transformations and restructuring of companies

This provision is not applicable for permanent establishments of foreign companies wishing to incorporate their activity in Norway. If such a permanent establishment wishes to become a Norwegian limited company, it will be subject to taxation as if the foreign company cedes its activity in Norway (including on latent reserves of the company). This might be seen as an obstacle for the foreign company to incorporate the activity it runs through the permanent establishment, which could possibly be contrary to EEA law.

Concerning mergers and scissions, §11-11 provides tax exemption for as long as all the companies involved are resident in Norway. The Ministry of Finance may however allow for exceptions, and apparently the practice more or less resembles the provisions in the Merger Directive.

h. §13-1; capital requirements imposed on subsidiaries of foreign banks

Subsidiaries of foreign banks are subject to a capital requirement in Norway, which in practice means that they are subject to double requirements (also in the State of residence). This is presumably contrary to EC Directive 89/646 on the recognition of credit institutions through authorisation in the State of residence. Furthermore, limits on the right to deduct interest could be contrary to the freedom of establishment.

i. §10-12(3); imputation of taxes on dividends for the shareholder

In general in Norway, there is taxation of the company’s profits, and then imputation on the income of the shareholder receiving dividends of that taxed profit.

There is a residence requirement for the company, so that dividends from companies in the EEA to taxpayers in Norway are not comprised by the deduction. Thus Norwegian taxpayers investing in a limited company in another EEA State are taxed more on their investments than those investing in companies resident in Norway.

The outcome of the pending *Manninen* case will be crucial in this respect[45].

j. §§16-20 following; tax credit rules on dividends

If there is source taxation in the distributing company's State of the dividends, then this can normally be credited against the Norwegian taxation. Thus the juridical double taxation is avoided, but the economic double taxation still exists. These rules are only applicable to domestic taxpayers, but should probably be extended to permanent establishments, according to the *St. Gobain* case.

The main rule in Norway is that there is no relief for avoiding double economic taxation for income with its source outside of Norway.

§§16-30 following contain exceptions to this, under certain specific conditions. The shareholder must be a company owning more than 10% of the distributing company. According to some double taxation conventions, this threshold can be even lower. A deduction of taxes may also be offered to a company owned by the daughter company if the former is detained with a participation of at least 25%.

k. Winnings from stocks in foreign companies

In order to avoid double economic taxation there is a requirement for the company of residence in Norway.

The so-called "RISK" rules on computation of capital gains on shares (which essentially give shareholders the right to add non distributed profit to the cost price of the shares, in order to avoid double taxation at the capital gains level) apply to shares in Norwegian companies only. This is probably a non justifiable discrimination, but the case has so far not appeared before the courts.

l. §10-13; dividends from a Norwegian company to foreign shareholders

Foreigners have in principle no right to imputation at all, even though they pay Norwegian source taxation on the dividends. The Norwegian taxes that the State of the shareholder might give relief for, are the taxes on the company's profits and the taxes on dividends (up to 25% at the source).

Some double taxation conventions provide for a right to be credited the source tax.

The district court of Oslo decided in November 2003 that the Norwegian rules were invalid since they are not in conformity with EU rules. There is taxation at source and then the foreign shareholders have no right to a credit, unless it concerns a permanent establishment that the shares are connected to. The decision has been appealed and it has furthermore been decided to ask for a preliminary ruling from the EFTA court on the matter.

This is not an exhaustive list of discriminating provisions contained in Norwegian tax legislation, but an indication of some of the matters under discussion.

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[45] ECJ C-319/02. The opinion of the Advocate General, Ms Kokott, was published on 18 March 2004 and concludes that the imputation of taxes on dividends distributed by domestic companies only, is contrary to Article 56, first paragraph, letter a) and Article 3 of the EC Treaty, and can not be justified by invoking the coherence of the national tax system.

Conclusion

The bilateral Agreements between Switzerland and the EC (and its Member States) have been in force for scarcely two years. They do not provide for a full participation in the internal market.

If an EU national in Switzerland considers that Swiss tax law is in breach of the non-discrimination principle as provided for in the Agreement on the free movement of persons, he will have to seek remedy from the Swiss Courts on this question, as there is no independent surveillance or control body provided for under the Agreement.

The EEA Agreement has been in force for a decade, and it approaches full internal market participation for the EEA EFTA States.

Certain modifications to the Norwegian tax legislation have taken place, but the majority of these seem to have come about through the pressure form the EFTA Surveillance Authority.

In the quest of integration, it seems that independent surveillance institutions are useful in the prevention of discriminatory tax rules.

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