Tax expenditures in Norway

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1. Introduction

Tax expenditures are financial benefits provided through the tax system. The common perception is that the tax system represents the revenue side of the national budget, and that the expenditure side gives a comprehensive overview over public spending. The obvious task of the tax system is thus to raise public revenue. This is not, however, entirely true. A lot of public spending is happening on the revenue side as well in the form of deviations from the normal tax system. The concept of calculating and reporting tax expenditures is to unveil this form of public spending through the tax system.

Norway has reported tax expenditures annually since 1999. In the period 1999-2010 tax expenditures were reported in the national budget (Meld. St. 1 Nasjonalbudsjettet). From 2011 the description of tax expenditures were moved to the annual white paper to the Parliament on the government's tax programme (Prop. 1 LS Skatter, avgifter og toll). The main purpose of reporting tax expenditures is to make political priorities more transparent and illustrate to what degree the tax system supports specific groups or activities. Tax expenditures (tax sanctions) are defined as exemptions from the general rules in the tax system that make the tax revenue lower (higher) due to a more gentle (stricter) taxation of certain groups or activities.

Norway has for the most part chosen a pragmatic approach by using the general rules in the tax system as the reference system, instead of choosing a more theoretical norm. The pragmatic approach implies that tax expenditures should be interpreted as "subsidy indicators" more than "efficiency indicators". This is probably one of the reasons why the issue of tax expenditures receives only moderate attention in Norway. There are however a few exceptions where more theoretical norms are used to formulate the benchmark. For example is the imputed income from owner-occupied housing and the "true" economic surplus within companies included in the reference tax system.

Most tax expenditures have clear subsidy elements, and many of these could easily have been replaced by direct spending programs. There are also a few examples of tax incentives, such as special deductions for R&D expenses and tax-favoured saving schemes.

2. Reference tax system

In the white paper to the Parliament on the government's tax programme (Prop. 1 LS Skatter, avgifter og toll) the reference tax system is described as a system based on the general rules in the tax system where equal persons, activities and goods etc. are taxed according to the same principles and at the same rates. Exemptions from the reference tax system are regarded as tax expenditures or tax sanctions.

Hence, Norway employs the general tax system as a benchmark and does not operate with a normative tax system in order to identify tax expenditures. The general tax system is heavily influenced by the low rate/broad base approach and the fundamental principles of equality, neutrality and symmetry. This implies that all types of income and all assets should be taxed, and the tax base should be as close to real values as possible. The definition of tax rules and tax bases that constitutes the reference tax system is based on clearly identifiable tax rules and a straight forward definition of (otherwise taxable) income. The general and descriptive approach has made tax expenditures a subject of very little controversy in Norway, but at the same time also led to a minimal awareness in the public of what the tax expenditures actually express.

2.1 Direct taxes

The Norwegian tax system is based on the concept of the dual income tax with a broad base / low rate foundation. The personal income tax is split between two tax bases: personal income and ordinary income. Personal income is defined as income from labour and pensions. Personal income is a gross income base from which no deductions are made, and are subject to a progressive rate schedule. Ordinary income is subject to a flat rate of 28 pct. and applies to all taxpayers (including corporations). Ordinary income includes all types of taxable income less any deductions or allowances. The reference tax system includes all personal gains from working, including benefits in kind, and all other types of personal and corporate income.

Personal income is subject to a social security contribution from the employee at 4.7 pct. and 7.8 pct. on pension and labour income respectively. Contributions from self-employed are equal to 11 pct. of personal income from labour. Personal income for self-employed is a net income where costs directly related to the income generation are deducted. Deviations from these rates are regarded as tax expenditures. For example is the lower rate for fisheries (7.8 pct.) seen as a tax expenditure. Employer's social security contribution of 14.1 pct. of wage costs is also included in the reference tax system. This contribution is geographically differentiated with lower rates outside the central parts of southern Norway. These lower rates are considered as tax expenditures. Personal income above a threshold (490 000 NOK in 2012) is subject to surtax. The progressive tax structure, which includes the surtax, is integrated in the reference tax system.

Ordinary income is taxed at a rate of 28 pct., and this is the benchmark for personal income, capital income, dividends and corporate income. There are several accessible deductions and allowances in the computation of tax on ordinary income. Except for costs directly linked to the income generation, these deductions and allowances are generally regarded as tax expenditures. The standard allowances in income, which contribute to a progressive tax structure, are on the other hand considered as parts of the reference tax system.

The benchmark for corporate and capital income taxation is that the true (nominal) profit of an investment is taxed as ordinary income. This benchmark income is not defined clearly, but should correspond to true economic values as far as possible. In the corporate income taxation all deviations from the ordinary tax rate of 28 pct. are regarded as tax expenditures. Dividends and capital gains to persons are taxed according to the shareholder model, where dividends or capital gains exceeding a risk free rate of return is taxed as ordinary income. The (risk free) rate of return allowance is considered as a part of the reference tax system, and so are interest rate deductions as they ensure neutrality in the capital taxation.

Wealth above a threshold (750 000 NOK per person in 2012) is taxed annually at a rate of 1.1 pct. In the computation of the wealth tax base, assessment values should be as close to real values as possible. Deviations from this principle are regarded as tax expenditures. The low assessment value on housing property is one of the largest tax expenditures in Norway.

In the inheritance tax each recipient is granted a tax free allowance of 470 000 NOK in relation to both gifts and inheritance from each donor/deceased. There is also an annual tax free allowance for gifts of about 40 000 NOK. The tax rate for the amount below 800 000 NOK is 6 pct. for children and parents and 8 pct. for other recipients. The tax rate for the amount exceeding 800 000 NOK is 10 pct. for children and parents and 15 pct. for other recipients. The allowances and the different tax rates in the inheritance tax are included in the reference tax system. The tax base is the assumed sales value of the inherited assets. Lower assessment values are regarded as tax expenditures. However, due to technical difficulties these tax expenditures in the inheritance tax are not calculated.

2.2 Indirect taxes

Each excise duty is treated separately, which means that a reference rate is made for each tax. Deviations from the standard rate are either regarded as sanctions (if it is higher than the standard rate) or expenditures (if it is lower). Produced factors of production should in accordance with theory of optimal taxation not be taxed unless the purpose of the tax is to price an externality. These factors are not taxed in the reference tax system for fiscal taxes. Excise duties on production factors will hence normally be treated as sanctions. Stamp duty is seen as an additional tax on property and is not included in the reference tax system. The stamp duty is therefore registered as a tax sanction.

For the calculation of tax expenditures and tax sanctions related to taxes on climate gases (CO2- and HFC/PFC) the benchmark is set at the expected emission quota price in the EU Emission Trading System (EU ETS). CO2-tax levied on sectors that are covered by the EU ETS will therefore be regarded as tax expenditures. For road usage tax on diesel and petrol the tax level per energy content of petrol is chosen as benchmark. For other environmentally related taxes the general rates will constitute the reference tax. Only explicit exemptions and reduced rates are considered, hence products/gases not taxed at all, will not be considered.

The benchmark for the VAT is the standard rate of 25 pct., and any deviation (reductions) from the standard rate is calculated as tax expenditures. Also zero-rated sectors and sectors outside the VAT system are normally treated and calculated as tax expenditures. The calculation of tax expenditures from reduced rates, zero-rated areas and sectors outside the VAT system, is based on the difference between levying reduced rates, zero-rates and exemptions instead of the reference system with the standard rate of 25 pct.

As the definition of the reference system for indirect taxes depends on the objectives of the tax, one of the major challenges is to decide how to treat taxes with both fiscal and environmental objectives. In cases where there are several objectives, the Ministry of Finance has chosen a pragmatic approach by assuming one main objective for the different taxes. This main objective then decides how the reference system for the different taxes is defined.

2.3 Changes in the reference tax system

The general features of the reference tax system for direct taxes have been fairly stable since 1999. One major change is that the shareholder model is included in the reference tax system since the 2006 tax reform. Another change is that the definition of income and the reference tax system is stricter, so that more exemptions and allowances are regarded as tax expenditures. As the reference tax system is based on the general rules in the tax system, the reference tax system changes when the general rates change and when the tax system undergoes reforms. In 2011 both stamp duty and custom duty went from being included in the reference tax system to be seen as a tax sanctions.

3. Methods

Similar to most other countries Norway employs the revenue foregone method when calculating tax expenditures. This means that the tax expenditure is set equal to the revenue loss for the government as a consequence of more gentle tax treatment of certain tax payers or activities than in the reference system. Only tax expenditures in the general government taxation are calculated, although the revenue loss will also affect local government income as tax revenue from tax on ordinary income is divided between central and local government.

The calculated revenue foregone does not necessarily represent the potential revenue gain by eliminating the tax expenditure, both since the revenue foregone method normally does not consider possible behavioural responses to a change in the tax expenditure and since it does not take into account potential interaction effects between different tax expenditures.

In addition to the revenue foregone method, Norway employs a present value method to calculate some tax expenditures. This method takes into account that some tax arrangements involve a deferred taxation or involve future tax credits. Some examples of such arrangements are the occupational pension schemes and excessive depreciation rates on certain capital components. All present value calculations assume a nominal discount rate of 6.6 pct. This discount rate is based on the "normal real interest rate" of 4 pct. from the government's manual on cost-benefit analyses (Finansdepartementet 2005) and an assumed long-term inflation of 2,5 pct.

The actual calculation of tax expenditures in direct taxation is for the most part performed by Statistics Norway, but some tax expenditures are calculated by the Ministry of Finance. Statistics Norway uses a micro simulation model called LOTTE-Skatt when calculating revenue effects from changes in direct taxation and tax expenditures. This model is based on tax returns from a selection of households. Tax expenditures are calculated by calculating tax revenue when one deduction or allowance is removed compared to a reference system where all existing tax expenditures are included.

LOTTE-Skatt calculates most of the tax expenditures in personal income taxation and in taxation of capital income and wealth. Tax expenditures that cannot be calculated by LOTTE-Skatt are calculated by the Ministry of Finance. A limited number of tax expenditures are not calculated because the calculations are too uncertain to provide a meaningful estimate. Tax expenditures related to indirect taxes are not calculated by models, but by ad hoc methods based on sectoral statistical information and information from tax administration systems.

4. Reporting

The tax expenditures are reported annually to the Parliament, prior to 2011 in the national budget (Meld. St. 1 Nasjonalbudsjettet) and from 2011 in the annual white paper to the

Parliament on the government's tax programme (Prop. 1 LS Skatter, avgifter og toll). Tax expenditures have been reported since 1999, when tax expenditure figures for 1998 were presented. The first report did not contain a complete list of tax expenditures, and only a few were calculated. In the following year more tax expenditures were reported and calculated, and several deductions and allowances that previously were not regarded as tax expenditures were included. In the first report the tax expenditures were classified according to purpose. Since 2000 the tax expenditures in direct taxation have been classified according to taxable base. Expenditures in indirect taxation are classified according to both the tax type (VAT, excises) and objectives (fiscal, environmental/health). Today the report contains a short description of all exceptions and deviations from the reference system, and the revenue effect is calculated when possible. The description is neutral and the tax expenditures are not justified in any way.

The decision making process for new tax expenditures is the same as for direct transfers, which requires a majority in the Parliament. But once the tax expenditures are in place they are not subject to the same scrutiny. All the tax expenditures are permanent, and as opposed to direct transfers, where block grants are common, tax expenditures are always open-ended, which make them more difficult to project and control. However, tax expenditures reflect political priorities, just as direct transfers do, cf. paragraph 6.1 below. By publishing the tax expenditures the amount of governmental support to different groups becomes more evident.

5. Tax expenditure figures

In 2011 Norway had 63 calculated tax expenditures and 9 calculated tax sanctions. The actual number of tax expenditures and tax sanctions is higher, as there are several tax expenditures that are not calculated due to technical difficulties. The tax expenditures in 2011 add up to almost 150 bn. NOK. This corresponds to approximately 12 pct. of total tax revenue and 7 pct. of mainland GDP (petroleum sector excluded). It should be stressed that these numbers must be interpreted with care as neither behavioural effects nor interaction effects are taken into account.

5.1 Direct taxes

The main tax expenditures in the personal income tax include additional personal allowance for one-income families and sole parents, childcare expense deduction and tax allowance for commuters' daily work travels and visits to main residence. All these tax expenditures are calculated by LOTTE-Skatt and are estimated to about 2.0 bn. NOK, 2.1 bn. NOK and 1.6 bn. NOK respectively in 2011.

The main tax expenditures in capital income taxation include deductions for employee premiums and contributions to occupational pension schemes, low income taxation of owner-occupied housing and vacation homes and low assessment values on housing and vacation homes in the wealth tax. The tax expenditure related to pension premiums is calculated as if the deposit had been paid out as wage income and saved in a bank. The disbursement will be taxed as pension income, and this is taken into consideration when calculating the present value of the tax savings. This tax expenditure is estimated to 14 bn. NOK in 2011. The tax expenditure on the low income taxation of owner-occupied housing and vacation homes is estimated to 37.8 bn. NOK in 2011. A low assessment value of housing property and vacation homes is estimated to create a tax expenditure of 21.4 bn. NOK in 2011. These estimates regarding housing and vacation homes are based on the precondition that housing on average provides the owner with an annual rate of return equal to the average annual yield on 10 year Norwegian government bonds (estimated to be 3.3 pct. in 2011 at the time of calculation). The market values of housing property are estimated by employing the valuation system in the wealth tax. The assessment values of vacation homes are multiplied by five to simulate market values.

5.2 Indirect taxes

The Norwegian VAT reform from July 2001 broadened the VAT base substantially by including services in the VAT base on a general basis. Since the establishment of the Norwegian VAT-system in 1970, services in general were not inside the scope unless if specifically listed in the VAT-law. A low VAT rate on food was also introduced as a result of the reform in 2001. Several sectors have been included in the VAT-base since 2002, e.g. accommodation, travel agencies, transportation of passengers and some cultural services. These sectors have been included in the system with a reduced rate, of 8 pct. in 2011, and are therefore still a source to tax expenditures.

The main tax expenditures in the VAT arise because some sectors are
(i) outside the VAT-system,
(ii) inside the system with a lower rate, or
(iii) inside the system with a rate equal to zero (zero-rate).

The tax expenditures calculated for sectors outside the VAT-system are estimated to about 1.7 bn. NOK in 2011. The tax expenditures calculated for sectors with a lower rate are estimated to about 20 bn. NOK the same year. The bulk of this expenditure is due to the reduced rate on food (15 pct. in 2011 vs. the general rate of 25 pct.). The tax expenditures due to zero-rated areas are estimated to about 5.1 bn. NOK. This is mainly related to zero-rates on newspapers, books and periodicals.

Tax expenditures from excise duties sum up to about 15.8 bn. NOK in 2011. The main sources are the excise tax on energy consumption, taxes on alcohol and tobacco, and a lower tax rate on diesel fuel than petrol.

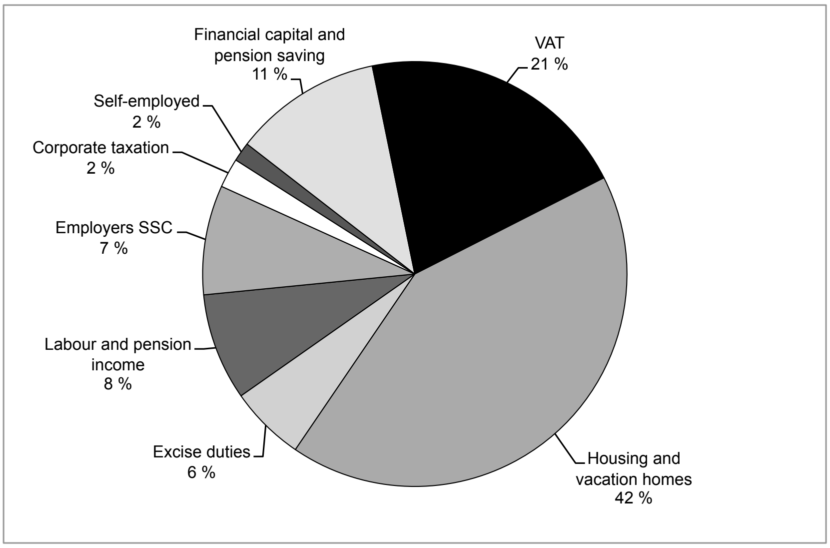
There are also calculated tax sanctions related to excise taxes of about 14.4 bn. NOK in 2011. The largest sanctions are the stamp duty, customs and the CO2-tax on petroleum related activities that are simultaneously covered by an emission quota-regime. In addition to taking account of alternative measures, corrections are done for other reasons, for instance for activities that can be deducted from the special tax on petroleum activities, and that part of the CO2-tax is paid by the governmental institution that manages the ownership of the Norwegian state. This illustrates the complexity of calculations and the numbers of consideration linked to tax expenditures/sanctions.

5.3 The composition and development of tax expenditures

Figure 1 shows the composition of net tax expenditures (tax expenditures minus tax sanctions) in 2011. The net tax expenditures add up to 130 bn. NOK in 2011. As illustrated in the figure, the biggest tax expenditure by far is the tax expenditure on owner-occupied housing and vacation homes, with a share of 42 pct. of the total net tax expenditures. Tax expenditures concerning financial capital and pension saving constitute 11 pct., while VAT exceptions constitute 21 pct.

Differentiated social security contributions from employers and tax expenditures on the taxation of labour and pension income constitute 7 and 8 pct. respectively.

Figure 1: The composition of net tax expenditures in Norway in 2011. Pct.



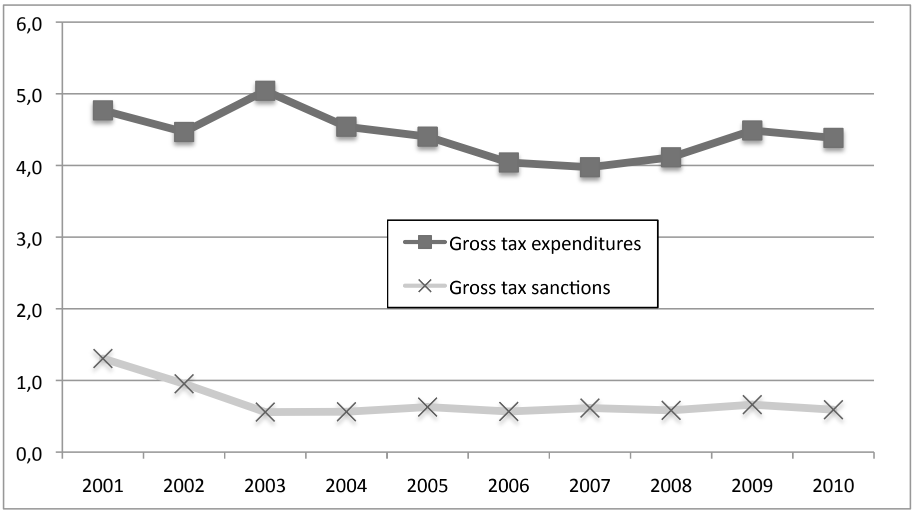
Source: The Ministry of Finance.

Figure 2 shows the development of *gross* tax expenditures and *gross* tax sanctions, as a percentage of mainland GDP, since 2001. The tax expenditures related to housing and vacation homes are excluded from the time series. The main reason for this is that the calculation method has changed over time and that old estimates are not reliable. It is difficult to reproduce the old estimates with the new calculation method.

Figure 3 shows the development of *net* tax expenditures (tax expenditures minus tax sanctions) for different categories, as a percentage of mainland GDP, since 2001. For the same reason as above the tax expenditures related to housing and vacation homes are excluded from the analysis. For pension saving the tax expenditures are only calculated from 2004 due to technical difficulties.

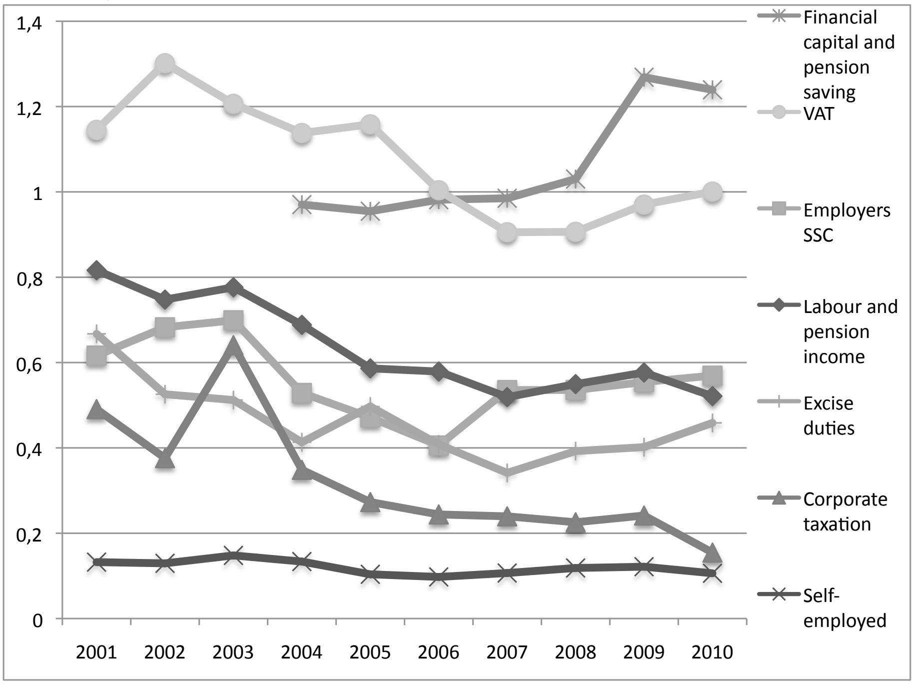
The figures 2 and 3 should be interpreted with care. The methods for calculating tax expenditures have changed over the years. So has the definition of tax expenditures. For example has some allowances (childcare expenses, daily work travel expenses etc.) switched from being included in the reference tax system to be seen as tax expenditures. It is difficult to calculate tax expenditures properly several years back in time based on new definitions and calculation methods. Such recalculations are for this reason only made when the recalculations are assumed to affect the results greatly.

Figure 2: The development of gross tax expenditures (housing and vacation homes excluded) and gross tax sanctions in the period of 2001-2010. Pct. of mainland GDP



Source: The Ministry of Finance.

Figure 3: The development of net tax expenditures for different categories in the period of 2001-2010. Pct. of mainland GDP



Source: The Ministry of Finance.

As can be seen from figure 2 the *gross* tax expenditures as pct. of mainland GDP have not changed much since 2001. The decline from 2003 to 2006 can partly be explained by a temporary phase-out of the differentiated social security contributions from employers. The phase-out was reversed in 2007. Tax sanctions have also been fairly stable, although the gradual abolishment of the investment tax in 2002-2003 contributed to a significant drop in tax sanctions from 2001 to 2003.

6. Evaluation of tax expenditures

6.1 Tax expenditures compared to direct spending

Tax expenditures can often be seen as alternatives to direct spending programs. Norway operates with a balanced budget rule, which is formulated as a structural non-oil central government budget deficit. This deficit is supposed to correspond to the expected real return, estimated to be 4 pct., on the Government Pension Fund – Global (the former Petroleum Fund) over time. Fiscal policy is however allowed to be used actively to counter fluctuations in economic activity. The balanced budget rule implies that the government has a direct choice between tax expenditures and direct spending as policy instruments. It also implies that increased tax expenditures imply less revenue to be distributed on the spending side of the budget.

With direct spending the government's priorities become more transparent than with tax expenditures. The tax expenditures are for the most part not published side-by side with direct spending in the budget and are less likely to undergo rigorous review and repeal. The only exception is a section in the National Budget (Meld. St. 1 Nasjonalbudsjettet) where direct transfers and tax transfers intending to support different industries are reported together under the heading "industry support".

Thus, from a democracy perspective it is desirable that the government first and foremost support specific groups through direct spending. Special exemptions, tax credits etc. are also typically more costly to administrate for tax authorities than direct spending. The Tax Committee (NOU 2003: 9), appointed by the Government in order to evaluate the objectives and principles applicable to the tax system prior the tax reform of 2006, pointed out that the tax system is in general not well suited to support specific groups compared to direct spending programs as long as the groups cannot be perfectly identified by their taxable income. Since some social benefits are tax exempt and there exist basic allowances in the tax system, many individuals with low income do not pay much tax in the first place. The standard of living for those individuals can therefore not be improved greatly through changes in the tax system. The Tax Committee concluded that direct spending programs in general are more efficient tools to support specific groups than tax expenditures.

Hence, based on the above arguments, the government should preferably support specific groups or activities through direct spending, and not through tax expenditures. In Norway the government has recently made a change towards this principle. As a part of the work of modernising and simplifying the tax system, the government started to phase out the special tax allowance for high expenses due to illness in 2012. The main reasons given by the government were that the allowance does not harmonise well with health professionals' assessments and priorities, excludes weak groups who do not pay tax, and inflicts disproportionately high costs on the Tax Administration for assessment and control of requirements relating to special allowances. The resources that are freed up are used to strengthen existing health subsidies on the expenditure side of the budget. For example are The National Insurance Administration's reimbursement rates for dental treatment increased and the Diabetes Association's work with motivation groups and early detection of diabetes strengthened in the 2012 budget.

The Norwegian R&D tax credit scheme, introduced in 2002 to stimulate R&D activities in the business sector, could also have been converted into a direct spending scheme. However, the majority of the Hervik Committee (NOU 2000: 7), who was appointed to evaluate different measures to stimulate R&D activities in the business sector, recommended a tax credit scheme. The committee argued that investors would see a tax credit scheme as more stable and reliable. The stability of the scheme was seen as important for it to have a distinct effect on R&D investment over time. The committee's minority emphasised on the other hand that it was important to keep the tax system simple and transparent. The minority argued that public spending in general did not belong on the revenue side of the budget, but on the expenditure side, although the spending itself could lead to increased productivity and increased tax revenues. Based on a resolution from the Parliament, the Government did however propose the scheme as a tax credit scheme, in line with the recommendations from the committee's majority.

6.2 Previous evaluations

There has not been a tradition for regular and systematic evaluation of tax expenditures in Norway. Even though the purpose of reporting tax expenditures is to obtain a greater degree of transparency regarding political priorities and financial support to different groups or activities, not many attempts have been made to assess whether the targeted groups of the tax subsidies really are the beneficiary, or if the tax incentives alter behaviour in the desired direction. This is probably due to the fact that tax expenditures do not receive much public attention in Norway.

However, there are a few examples of more thorough evaluations of some of the tax expenditures. The Norwegian R&D tax credit scheme, Skattefunn, was evaluated by Cappelen et al. (2008) based on observations in 2002-2006. Skattefunn's goal is to stimulate R&D activities in the business sector. Enterprises can deduct a share of costs for approved R&D projects directly from assessed tax (both intramural R&D and approved purchases). If the calculated credit exceeds the assessed taxes of the company, the difference is refunded as part of the tax assessment. The evaluation concludes that Skattefunn mainly has the intended effects. Skattefunn is cost-effective and is used by a large number of firms. It stimulates these firms to invest more in R&D, and, in particular, the effect is positive for small firms with little R&D experience. The R&D stimulated by Skattefunn does not however seem to create innovations of a kind that can be expected to have large external effects. The returns of the R&D investments supported by Skattefunn are positive and do not in general differ from the returns on other R&D investments. The evaluation found indication of what can be interpreted as tax motivated adjustments to the scheme, but to some extent this must be accepted as a cost to subsidy and support schemes intended for use by a large number of economic agents. This is particularly so when attempts are made to keep administrative costs and control routines at a low level.

The VAT reform of 2001 included most services in the VAT system, abolished the investment tax, introduced a reduced VAT rate on foodstuffs and reduced the overall VAT revenue. The reform has previously been evaluated from a distributional point of view by Åvitsland and Aasness (2004). Åvitsland and Aasness combines a multisectoral growth model with a micro simulation model. In the study they test the response to a 1,5 percentage point increase in the ordinary VAT rate to keep the revenue unchanged (relative to the VAT system prior to the reform). The study shows that the new reform, with a reduced VAT rate on foodstuffs, leads to a higher degree of equality (based on the Gini coefficient) compared to the old VAT system without such reduced rates. An alternative reform is also tested, where all services are included in the VAT system, the investment tax is abolished and the ordinary VAT rate is increased with 1 percentage point to keep the revenue unchanged (relative to the VAT system prior to the reform), but no reduced VAT rate on foodstuffs is introduced. This alternative reform is estimated to leave the degree of equality unchanged compared to the old VAT system. Hence, the results indicate that a reduced VAT rate on foodstuffs contributes to more redistribution. Other empirical evidence has also shown that taxes on food indeed have regressive effects. This was for example shown by the committee appointed to evaluate excise duties in Norway (NOU 2007: 8). However, none of these reports considered whether a reduced VAT rate on foodstuffs is an efficient tool to increase redistribution within the tax system. Most probably they are not.

The tax expenditures in connection with regional policy (for Finnmark county and regions of Troms county) have also previously been evaluated. Based on reports from external research institutes the government concluded in a white paper from 2003 (St. meld. nr. 8 (2003-2004)) that the tax expenditures in general have contributed to increased settlement and employment in the respective areas, and that the system with differentiated social security contributions from employers has been the most efficient policy instrument to increase employment. On the other hand, they concluded that exemption from excise duty on electricity consumption has been a rather inefficient policy instrument, both since it is difficult to say whether the exemption actually has affected the consumer prices on electricity and since the exemption probably has not contributed much to employment in the region.

Finally, the Tax Committee (NOU 2003: 9) also looked into tax expenditures, but with a more general approach. The committee's recommendation was to abolish a wide range of tax expenditures in order to secure a broad tax base and horizontal equality of taxation (with equal taxation of persons with the same tax liability).

7. Legal issues

7.1 Preparatory drafts

The term "tax expenditure" is not a legal concept and is thus not defined in Norwegian tax legislation. The term is also rarely used in preparatory works when new legislation is introduced. However, the objective of the new legislation is normally made clear, and the revenue effect is always calculated. If the new legislation involves new tax expenditures, they are added to the list of tax expenditures reported to the Parliament.

The issue of tax expenditures has implicitly been addressed in previous preparatory works. This was for example the case when preparing the 1992 tax reform. The reform resulted in the abolishment of a wide range of incentives, special allowances and provisions designed to favour various causes and groups. Such measures were necessary to construct a tax system based on the principles of equal treatment, broad tax bases, low rates, neutrality and symmetry.

The Government can in some cases appoint committees to thoroughly assess new tax legislation prior to introduction. Such committees evaluate the effects of the proposed legislation and make recommendations for action. Tax expenditures have indirectly been discussed in some of these committees. This was for example the case with the committee appointed to evaluate the current tax regime for shipping companies (NOU 2006: 4). The committee discussed whether Norway should continue with a special tax regime for shipping companies or tax shipping companies according to the general tax system. The majority of the committee recommended to tax shipping companies according to the general tax system. The dissenting minority recommended an improved special tax regime for shipping companies. The final outcome was that the Government proposed a new special tax regime for shipping companies, in order to secure equal conditions for competition between the Norwegian shipping sector and the shipping sectors of the other EEA countries. The new regime was introduced with effect from 2007.

In some other cases the tax expenditures are less thoroughly assessed and appear more as a consequence of administrative challenges. The taxation of imputed rent on owner-occupied housing and vacation homes was abolished in 2005. It appears from the preparatory works that the amendments were partly motivated by political reasons and partly by valuation problems. The Government considered the imputed rent from housing as an inappropriate tax base. It was also emphasised that the rules had arbitrary implications, and it would be most difficult to design a valuation system without any unreasonable implications.

7.2 Constitutional problems

In two cases constitutional questions regarding changes in tax expenditure legislation have been raised for the Norwegian Supreme Court. In both cases the question was whether the transitional rules accompanying the changes were in conflict with the constitutional prohibition against giving new legislation retroactive effect.

In 2008 the new special tax regime for shipping companies where introduced with effect from 2007. The old regime offered a postponed taxation of profits derived from the operation of ships, until untaxed dividends were distributed to shareholders, or the company resigned from the special tax system. This regime was replaced by a final exemption regime. According to the transitional regulations two thirds of the calculated untaxed income from the old regime should be entered as income with a 10 per cent linear depreciation. The Supreme Court concluded that the transitional regulations entering previously untaxed profits as income had unlawful retroactive effect, and thus were in breach with the constitutional prohibition of giving new legislation retroactive effect (Rt. 2010 s. 143).

The other case was related to a change in the VAT system. From 2002 driving schools were exempted from the VAT system. In the transitional rules given in December 2001 the deduction for input VAT on learner cars bought before the exemption was introduced, were limited. Also in this case the Supreme Court concluded that the transitional regulations were in breach with the constitutional prohibition of giving new legislation retroactive effect (Rt. 2006 s. 293).

7.3 EEA law

Norway is not a member of the EU. However, the four freedoms and the state aid rules apply to Norway as a result of the EEA agreement.

Regulations that involve tax expenditures might cause problems towards EEA law and in particular the State Aid rules. In the late nineties the EFTA court concluded that the regionally differentiated social security system was incompatible with the EEA Agreement. There are also some examples of changes to the legislation subsequent to an assessment made by the EFTA Surveillance Authority (ESA). Furthermore, there is one example of new legislation not entering into force because of ESA 's conclusion that it would be incompatible with the EEA agreement. These cases will be further commented upon in the following.

In 1999 the Norwegian system of regionally differentiated social security contributions from employers was brought before the EFTA Court (Case E-6/98). The contributions levied on employers were calculated on the basis of the individual employee's gross salary income. A system of regionally differentiated contribution rates ranging from 0 to 14.1 per cent was in place, with the contribution rate depending on the zone in which the employee had his or her registered permanent residence. The Court concluded that the Norwegian system involved State aid and was incompatible with the EEA Agreement.

Based on the court decision the scheme was changed with effect from 2000. However, this scheme was assessed by ESA once more in 2000-2003 and found to be incompatible with the EEA agreement. The scheme was changed again in 2004, based on the new assessment. On the background of changes in the guidelines on National Regional Aid, Norway notified in 2006 a new system of regionally differentiated social security contribution from employers. The notified system was found by ESA to be compatible with the new guidelines and entered into force from 2007.

Another example of legislation that has been amended on the basis of an assessment made by ESA is the provisions concerning deductions for donations to non-profit organisations with their seat of administration in Norway. In this case ESA concluded in a reasoned opinion that the rules were in conflict with the EEA agreement because of the requirement that the organisation had its seat of administration in Norway for the donations to be deductible. On the basis of the reasoned opinion the scope of the provisions was extended to donations to organisations with a seat of administration within the EEA states.

In 2006 a special tax deduction scheme for cooperative societies was adopted. According to the scheme cooperative societies fulfilling certain requirements would be entitled to a special form of tax deduction. The deduction could be made for allocations to cooperative share capital. The tax deduction was limited to 15 percent of the year's income. The Government considered the tax deduction scheme to be a non-aid measure. However, notification was carried out for reasons of legal certainty. Based on the assessment of the special tax deduction scheme, ESA considered the notified tax exemption to be state aid incompatible with the EEA agreement. The scheme was therefore not put into force.

7.4 Problems of interpretation

Special tax schemes or systems that involve tax expenditures may cause administrative problems and problems regarding interpretation. As part of the tax assessment it is often necessary to decide if certain tax subjects, activities and/or objects are comprised by the scheme in question. As mentioned above the reason for abolishing the special tax allowance for high expenses due to illness was the high cost on the Tax Administration in connection with the assessment and the control of whether the specific requirements were fulfilled. In the preparatory works it was also emphasised that the difficulties connected to the assessment and control involved a risk of discriminatory treatment.

Another example is the Norwegian VAT system. Tax expenditures in the VAT system are mainly caused by the fact that some sectors are outside the VAT system and some sectors are inside the system, but with a lower or a zero rate. In practice the exemptions from the main VAT system cause problems of interpretation. In particular is this the case for companies involved both in a sector outside the VAT system (or with reduced/zero rates) and in a sector with ordinary rates. This leads to administrative burdens for the taxpayers as well as the Tax Administration. It also leads to many disputes (and court cases) between the Tax Administration and the taxpayers.

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