EFTA COURT

JUDGMENT OF THE COURT

7 May 2008*

(Freedom of establishment – double taxation agreement – calculation of maximum credit allowance for tax paid in another EEA State – debt interest and group contributions)

In Case E-7/07,

REQUEST to the Court under Article 34 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice by Stavanger tingrett (Stavanger District Court), Norway, in a case pending before it between

Seabrokers AS

and

The Norwegian State, represented by Skattedirektoratet (the Directorate of Taxes)

Concerning the interpretation of Article 4 of the Agreement on the European Economic Area (EEA) on prohibition of discrimination on grounds of nationality, Article 31 EEA on the freedom of establishment and Article 40 EEA on free movement of capital in the EEA.

THE COURT,

composed of: Carl Baudenbacher, President, Thorgeir Örlygsson (Judge-Rapporteur) and Henrik Bull, Judges,

Registrar: Skúli Magnússon,

---

* Language of the Request: Norwegian.

having considered the written observations submitted on behalf of:

– the Plaintiff, represented by Thomas Smedsvig, Attorney;

– the Defendant, represented by Amund Noss, advocate, Office of the Attorney General (Civil Affairs), acting as Agent;

– the EFTA Surveillance Authority, represented by Per Andreas Bjørgan, Deputy Director, Florence Simonetti, Officer, and Ida Hauger, National Expert, Department of Legal & Executive Affairs, acting as Agents;

– the Commission of the European Communities, represented by Richard Lyal, Legal Adviser and member of its Legal Service, acting as Agent,

having regard to the Report for the Hearing,

having heard oral argument of the Plaintiff, represented by its Attorney Thomas Smedsvig, the Defendant, represented by its Agent Amund Noss, the Government of Germany, represented by its Agent Christoph Blaschke, the EFTA Surveillance Authority, represented by its Agent Florence Simonetti, and the Commission of the European Communities, represented by its Agent Richard Lyal, at the hearing on 1 February 2008,

gives the following

Judgment

I Facts and procedure

1 By a letter dated 25 May 2007, registered at the Court on 30 May 2007, Stavanger tingrett has referred to the Court, under Article 34 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, three questions on the interpretation of Articles 4, 31 and 40 EEA.

2 Those questions have arisen in a case pending before Stavanger tingrett between Seabrokers AS (hereinafter the "Plaintiff") and the Norwegian State, represented by the Directorate of Taxes (hereinafter the "Defendant"). The case concerns a dispute on whether the Plaintiff's tax assessment for the income year 2002, on the basis of the rules set out in the Norwegian Act Relating to Tax on Assets and Income of 26 March 1999 No 14 (*lov 26. mars 1999 nr. 14 om skatt av formue og inntekt (skatteloven)*; hereinafter the "Tax Act") and in Regulation 19 November 1999 No 1158 Complementing and Implementing the Tax Act (*forskrift 19.*

november 1999 nr. 1158 til utfylling og gjennomføring mv. av skatteloven; hereinafter “FSFIN”) on maximum credit allowance for tax paid in a foreign State, is compatible with Articles 4, 31 and 40 EEA.

3 The Plaintiff is a Norwegian Private Limited Company which operates a real estate business in Norway through a mother company and five daughter companies there. It develops and rents out its properties, all of which are regulated as offices/industry. The properties are – or are in the process of becoming – developed with office buildings financed by loans guaranteed by mortgages on the properties.

4 The Plaintiff also has a branch in Aberdeen in the United Kingdom (the UK), whose only business activity is ship broking. Renting its office space, the branch has no investment in real property, with the exception of a detached house purchased for the use of employees. Since its only debts are due to operating expenses, the branch has low debt interest costs. Having registered it as a branch of a foreign enterprise in the UK, the Plaintiff has submitted tax declarations for the branch’s operations in the UK and has been charged tax on its operations there.

5 The two units, i.e. the real estate business in Norway and the ship broking business in the UK, are operated separately, both with regard to the nature and location of the business activities.

6 The Plaintiff used the direct method in its accounts and tax declarations, meaning that tax-deductible expenses, both debt interest and group contributions, were entered in the country where the expenses arose and were spent. Before deduction of debt interest expenses and group contributions, the Plaintiff’s net global income was NOK 14 787 889, of which the net income abroad was 63.77166%, i.e. NOK 9 430 482. Debt interest expenses, including interest expenses abroad, were NOK 2 871 039 and group contributions paid by the mother company to two of its daughter companies in Norway were NOK 2 579 000.

7 In the income year 2002, the Plaintiff’s net income from the branch in the UK was taxed there at a rate of 30%, and the Plaintiff paid GBP 235 375.20 in tax in the UK. In its Norwegian tax declaration for the same income year, the Plaintiff claimed a credit allowance of NOK 2 635 023, corresponding to the tax paid in the UK.

8 The Stavanger Tax Assessment Office, by decision of 13 February 2004, reduced the credit allowance for tax on income which the Plaintiff’s branch in Aberdeen had paid to the UK authorities, to NOK 1 667 373. In reaching its decision, the Tax Assessment Office applied an exception in Section 16–28–4 litra b of the FSFIN. Debt interest expenses and group contributions were apportioned in accordance with the principle of net income taxation.

9 In attributing the expenses in question to the Plaintiff’s branch in the UK in proportion to its income there, the interest expenses (NOK 2 871 039) and group

contributions (NOK 2 579 000) were multiplied by the net income abroad (NOK 9 430 482) and divided by the company's total net income (NOK 14 787 889). So calculated, debt interest expenses attributed to the UK branch were NOK 1 830 909 (2 871 039 x 63.77166%) and group contributions NOK 1 644 671 (2 579 000 x 63.77166%). Accordingly, the net income abroad after deduction of debt interest expenses and group contributions was NOK 5 954 902 (9 430 482 - (1 830 909 + 1 644 671)). In order to find the maximum credit allowance, the net income abroad so calculated was multiplied by the income tax rate in Norway (28%). Hence, the credit allowance was NOK 1 667 373 (5 954 902 x 28%).

10 It is undisputed between the parties to the main proceedings that the Plaintiff's global tax burden was higher than would have been the case had the Plaintiff conducted all its business activities in Norway. The Plaintiff paid NOK 3 582 248, including the UK tax not compensated by the credit allowance. Had the Plaintiff conducted all its activities in Norway, the tax would have been NOK 2 614 598. The latter figure corresponds to 28% of a total net income of NOK 9 337 850, i.e. 14 787 889 **-** (2 871 039 + 2 579 000).

11 The Plaintiff appealed the decision of the Tax Assessment Office on 9 March 2004 to the Higher Assessment Appeal Board which upheld the decision of the Tax Assessment Office in a decision of 8 November 2004.

12 The Plaintiff filed a lawsuit before Stavanger tingrett on 2 February 2005, claiming mainly: 1) that the decision by the Higher Assessment Appeal Board of 8 November 2004 be quashed. 2) Principally, that the new tax assessment be based on the deduction in full of debt interest and group contributions under the tax assessment in Norway. Alternatively, that the assessment be based on an apportionment of debt interest and group contributions in proportion to the apportionment of the Plaintiff's gross capital in Norway and the UK. The Defendant countered in its defence with the claim that the action be dismissed.

13 Before Stavanger tingrett, the Plaintiff has pleaded that the decision by the Higher Assessment Board and the Norwegian rules on calculation of credit allowance in Section 16–28–4 of the FSFIN, cf. Sections 16–21 and 16–28 of the Tax Act, are contrary to the provisions of the EEA Agreement on non-discrimination and the fundamental freedoms, referring to Articles 4, 31, 34 and 40 EEA. The Defendant has pleaded in its defence that the relevant tax rules under domestic law are not contrary to EEA law.

14 Stavanger tingrett has referred the following three questions to the Court:

1. *Is it contrary to Article 4, 31 or 40 of the EEA Agreement to attribute, according to the principle of net income taxation, debt interest to the income abroad when calculating the maximum credit allowance?*

2. *Is it contrary to Article 4, 31 or 40 of the EEA Agreement to attribute, according to the principle of net income taxation, group contributions to the income abroad when calculating the maximum credit allowance?*

3. *Will the answer to question 1 and/or 2 be the same if the debt interest and/or the group contributions can only be linked to the business in Norway?*

II Legal background – national law

15 In Norway, income tax is based on the principle of net income taxation. Moreover, taxpayers are subject to the principle of global income taxation, meaning that they are taxed on income derived from Norway and abroad. However, under Section 16–20(1) of the Tax Act, taxpayers may claim a credit allowance for income tax paid to foreign tax authorities. Section 16–20(1), first sentence, *Tax deductions for tax paid in a foreign State*, reads:

> *(1) A taxpayer as mentioned in Sections 2–1 and 2–2 who here in this Kingdom must pay tax on*
> *a. income from sources in a foreign State, or*
> *b. a capital in a foreign State,*
> *may claim deductions from Norwegian tax on conclusively assessed tax on income or capital or corresponding tax which is established as having been imposed on the taxpayer and paid in the relevant foreign State where the income has its source or the capital is located.*

16 Pursuant to Section 16–21(1) and (3) of the Tax Act, deductions can only be claimed for income tax paid to foreign tax authorities, within the maximum credit allowance. Section 16–21(1) and (3), *Limitations on the right to deductions – the maximum credit allowance*, read, at the relevant time:

> *(1) Deductions from Norwegian income tax under Section 16–20 may not exceed the portion of Norwegian tax on total taxable income, as calculated before the deduction, which proportionally falls on the income abroad. The deduction is also limited to the income tax which the taxpayer has paid in the source State on this income. Foreign income tax can only be deducted from Norwegian income tax.*
>
> *[…]*
>
> *(3) The terms "income abroad" and "capital abroad" refer to income from sources abroad and capital located abroad which are taxed abroad and which are included in the taxpayer's total income or capital which is taxable in Norway.*

17 A further elucidation of the maximum credit allowance calculation is provided for in Section 16–28–4 of the FSFIN, *Attribution of income and expenses when calculating a maximum tax deduction*, which read, at the relevant time:

When calculating the maximum tax deduction under Section 16–21 of the Tax Act, the following method is used:

a. Unless otherwise indicated below, income and expenses shall be attributed to Norway or abroad according to where the income is legitimately derived or the expenses are legitimately incurred.

b. Expenses which cannot be attributed to a specific business shall be attributed to Norway or abroad in proportion to where the net income otherwise is attributed. Debt interest which is deductible in Norway shall always be attributed in this way.

c. Expenses which cannot be attributed to a specific business may exceptionally be apportioned according to a different distribution key than what follows from the first sentence of [litra] b, if the taxpayer establishes that such a distribution key will provide a reasonable result in accordance with generally accepted commercial principles and generally accepted principles of corporate economics and the taxpayer establishes that such a distribution key is used consistently. This does not apply to debt interest.

[…]

18 The Kingdom of Norway and the United Kingdom signed a double taxation agreement (hereinafter the "DTA") on 12 October 2000, which has been effective in Norway since 1 January 2001. The DTA is incorporated into Norwegian law pursuant to Act No 15 of 28 July 1949 Relating to Authority for the King to Enter into Agreements with Foreign States for the Prevention of Double Taxation etc.

19 Article 7 of the DTA provides that Norway has the right to levy taxes on companies resident in Norway, and that in such cases the UK can only levy taxes on income derived from a permanent establishment in the UK. Article 7, Business profits, reads:

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph (3) of this Article, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including a reasonable allocation of executive and general administrative expenses incurred for the purposes of the enterprise as a whole, *whether in the Contracting State in which the permanent establishment is situated or elsewhere.*

4. *No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.*

5. *For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.*

6. *Where profits include items of income or capital gains which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.*

20 In order to avoid double taxation, Norwegian taxpayers have, according to the DTA, a right to credit allowance for income tax paid in the UK. Article 28 DTA, *Elimination of double taxation,* reads:

1. *Subject to the provisions of the law of the United Kingdom regarding the allowance as a credit against United Kingdom tax of tax payable in a territory outside the United Kingdom (which shall not affect the general principle hereof):*

    a. *Norwegian tax payable under the laws of Norway and in accordance with the provisions of this Convention, whether directly or by deduction, on profits, income or chargeable gains from sources within Norway (excluding in the case of a dividend, tax payable in respect of the profits out of which the dividend is paid) shall be allowed as a credit against any United Kingdom tax computed by reference to the same profits, income or chargeable gains by reference to which the Norwegian tax is computed;*

    […]

2. *Subject to the provisions of the laws of Norway regarding the allowance as a credit against Norwegian tax of tax payable in a territory outside Norway (which shall not affect the general principle hereof) –*

    a. *Where a resident of Norway derives income or owns elements of capital which, in accordance with the provisions of this Convention, may be taxed in the United Kingdom, Norway shall allow:*

        i. *as a deduction from the tax on the income of that resident, an amount equal to the United Kingdom tax paid on that income;*

        ii. *as a deduction from the tax on the capital of that resident, an amount equal to the United Kingdom tax paid on elements of capital;*

    Such deduction in either case shall not, however, exceed that part of the Norwegian tax, as computed before the deduction is given, which is attributable, as the case may be, to the income or the same elements of capital which may be taxed in the United Kingdom.

b. *Where in accordance with any provision of this Convention income derived or capital owned by a resident of Norway is exempt from tax in Norway, Norway may nevertheless, in calculating the amount of tax on the remaining income or capital of such resident, take into account the exempted income or capital.*

3. *For the purposes of paragraph (1) of this Article income, profits and capital gains owned by a resident of the United Kingdom which may be taxed in Norway in accordance with this Convention shall be deemed to arise from sources in Norway.*

21 When calculating the credit allowance to which a taxpayer is entitled under Article 28 of the DTA, Norwegian tax authorities apply the provisions of the Tax Act and the FSFIN on maximum credit allowance, cited above.

III Legal background – EEA law

22 Article 4 EEA reads:

Within the scope of application of this Agreement, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited.

23 Article 31(1) EEA reads:

Within the framework of the provisions of this Agreement, there shall be no restrictions on the freedom of establishment of nationals of an EC Member State or an EFTA State in the territory of any other of these States. This shall also apply to the setting up of agencies, branches or subsidiaries by nationals of any EC Member State or EFTA State established in the territory of any of these States.

[…]

24 Article 34 EEA reads:

Companies or firms formed in accordance with the law of an EC Member State or an EFTA State and having their registered office, central administration or principal place of business within the territory of the Contracting Parties shall, for the purposes of this Chapter, be treated in the same way as natural persons who are nationals of EC Member States or EFTA States.

'Companies or firms' means companies or firms constituted under civil or commercial law, including cooperative societies, and other legal persons governed by public or private law, save for those which are non-profit-making.

25 Article 40 EEA reads:

Within the framework of the provisions of this Agreement, there shall be no restrictions between the Contracting Parties on the movement of capital belonging to persons resident in EC Member States or EFTA States and no discrimination based on the nationality or on the place of residence of the parties or on the place *where such capital is invested. Annex XII contains the provisions necessary to implement this Article.*

26 Reference is made to the Report for the Hearing for a fuller account of the legal framework, the facts, the procedure and the written observations submitted to the Court, which are mentioned or discussed hereinafter only insofar as is necessary for the reasoning of the Court.

IV Findings of the Court

General

27 In its questions, the national court refers to Articles 4, 31 and 40 EEA. The Court notes that the case at hand concerns the situation where a company in one EEA State, the home State, establishes a branch in another EEA State, the host State, through which it runs a part of its business. Under such circumstances, the rules at issue in the main proceedings primarily affect the freedom of establishment. Therefore, they must be examined under Article 31 EEA. Should the rules have restrictive effects on the free movement of capital, those effects would be the unavoidable consequence of a possible obstacle to freedom of establishment, and do therefore not justify an independent examination under Article 40 EEA (see for comparison Case C-231/05 *Oy AA* [2007] ECR I-6373, at paragraphs 23 and 24). Furthermore, Article 4 EEA applies independently only where specific provisions preventing discrimination do not apply (see Case E-10/04 *Piazza* [2005] EFTA Ct. Rep. 76, at paragraph 31). Therefore, the Court will only address the questions referred to it under Article 31 EEA.

28 Freedom of establishment under the EEA Agreement entails a right for companies, formed in accordance with the law of an EEA State and having their registered office, central administration or principle place of business within the EEA, to pursue their activities in another EEA State through a branch established there, see Article 34 EEA. Even though according to its wording, Article 31 EEA is intended to secure, in particular, the benefit of national treatment in a host State, it also prohibits the home State from hindering the establishment in other EEA States of its own nationals or companies incorporated under its legislation (see for comparison Case C-298/05 *Columbus Container Services,* judgment of 6 December 2007, not yet reported (hereinafter "Columbus Container"), at paragraph 33, and Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, at paragraph 31). Therefore, the fact that the Plaintiff is a Norwegian company cannot prevent it from invoking the rules relating to freedom of establishment against Norway, since it has exercised its right of freedom of establishment in the UK.

29 Three questions have been referred to the Court. The first and the second one concern the same legal issue, i.e. attribution of expenses in accordance with the principle of net income taxation when calculating the maximum credit allowance for tax paid by a company in a foreign State. However, a distinction is made between the two types of expenses involved, namely debt interest and group contributions. In question three, an answer to the first and the second question is requested based on the assumption that the expenses involved are only linked to the company's business activities in Norway. Taking into account the subject matter of the case and the above described relationship between the questions, the third question will be answered together with the first and the second question respectively.

The first question – debt interest expenses

30 The first and the third question, read together, concern in essence the issue of whether it is contrary to Article 31 EEA for an EEA State, when calculating the maximum credit allowance for tax paid in another EEA State, to attribute debt interest expenses of a company to income earned through its branch in that State, and whether the answer depends on the expenses being linked solely to the business activities in the former State.

31 The Plaintiff maintains that while direct taxation falls within the competence of the Member States, this competence must nonetheless be exercised in a manner consistent with the EEA Agreement. Articles 31 and 34 EEA prohibit the home State from hindering the establishment in another EEA State of its nationals or companies incorporated under its legislation, and in that respect no distinction is made with regard to whether the business is conducted through agencies, branches or subsidiaries. Unlike companies which conduct business only in Norway and Norwegian companies which establish a subsidiary in another EEA State, Norwegian companies which perform business through a branch office in another EEA State are deprived of the benefit of full tax deductions. According to the Plaintiff, this entails a difference in treatment which results in a tax disadvantage.

32 The above mentioned difference in treatment cannot, according to the Plaintiff, be explained by different tax rates in Norway and the UK and/or the income from the permanent place of business being calculated differently in Norway and the UK. As a consequence, companies might be dissuaded from carrying on their activities through branches in other EEA States. Accordingly, this tax treatment constitutes a restriction on the freedom of establishment contrary to Article 31 EEA. The Plaintiff refers to Case C-385/00 *de Groot* [2002] ECR 1-11819 (hereinafter "*de Groot*") according to which the Member States cannot deprive a citizen of the benefit of a tax deduction based on the assumption that he will receive a similar deduction in another State where he has performed work. Moreover, in the view of

the Plaintiff, the legal and factual circumstances in this case differ from Case C-336/96 *Gilly* [1998] ECR I-2793 (hereinafter "*Gilly*"), and therefore the Defendant cannot rely on that case.

33 The Defendant argues that the EEA States are free to tax the global income of resident companies and refers in that respect to *Gilly*. The Defendant bases its observations on two main arguments. Firstly, that there is no obligation under the EEA Agreement to give relief for double taxation, and therefore the Norwegian tax rules at issue cannot be deemed contrary to the Agreement on the grounds that foreign tax is not fully credited. Secondly, that the difference in tax burden claimed by the Plaintiff is explained solely by the fact that the Plaintiff is exposed to income tax in two different tax regimes. In this regard, the Defendant points out that the tax rate in Norway is 28%, while the UK tax rate is 30%, and the tax credit is limited to the Norwegian tax rate applied to the foreign income. The Defendant also argues that the net income from the UK branch is calculated differently in the UK than in Norway.

34 According to the Defendant, the Norwegian tax rules at issue are not discriminatory. A taxpayer exposed to two tax jurisdictions is in another and objectively different situation than one who receives all his income in one State. Therefore, it is not relevant to compare the global tax burden of the Plaintiff with the tax burden of a company that conducts all its business in Norway. With reference to Case C-513/04 *Kerckhaert* [2006] ECR I-10967 the Defendant argues that tax paid to the UK should be disregarded when making a comparison between a company conducting all its business in Norway and the Plaintiff. Finally, the Defendant contests that the reasoning of the Court of Justice of the European Communities (hereinafter the "ECJ") in *de Groot* should be relevant, since that case concerns personal allowances and relates to the case law of the ECJ concerning the obligations of the State of residence and the source State with respect to such allowances.

35 The Defendant's view is essentially shared by the Government of Germany.

36 The EFTA Surveillance Authority (hereinafter "ESA") remarks that it is up to the EEA States to take measures necessary to prevent double taxation by applying, in particular, the apportionment criteria adhered to in international tax practice. Nonetheless, the States are obliged to comply with EEA law when exercising their taxation power, and cannot introduce discriminatory measures contrary to the fundamental freedoms. Therefore, the rules on calculation of credit allowance must comply with Article 31 EEA which prohibits restrictions on the freedom of establishment, other than those that inevitably result from the fact that tax systems are national.

37 According to ESA, disadvantageous tax treatment that follows from direct or indirect discrimination resulting from the rules of one jurisdiction, rather than simply from disparities in the applicable national tax provisions or the division of

tax jurisdiction between two countries' tax systems, infringes Article 31 EEA unless it can be justified.

38 If expenses are intrinsically linked to the business in Norway, the calculating method at issue would in ESA's opinion entail that a company with an establishment in another EEA State would derive from these expenses less tax advantage than if it had operated solely in Norway. This would amount to differentiated tax treatment contrary to Article 31 EEA. The application of the contested tax rules in the case at hand means that the tax base for the Norwegian head office increases with an amount equal to the deduction attributed to the UK branch. In ESA's view, this situation is comparable to that examined in *de Groot* and the considerations of the ECJ in that case are applicable in this case. If the expenses are intrinsically linked to the business in Norway, the State where the branch is established, exercising its limited tax competence in accordance with international tax practice, would not take those expenses into account due to the lack of cohesion between them and the income derived where the branch is established. This is liable to discourage Norwegian companies from creating, acquiring or maintaining a branch in another EEA State and accordingly, the rules constitute a restriction under Article 31 EEA.

39 On the other hand, when expenses not related solely to the activity in Norway are deducted from the income abroad for the purposes of calculating the credit allowance, ESA is of the opinion that there is no restriction on the freedom of establishment of Norwegian companies within the meaning of Article 31 EEA.

40 The Commission of the European Communities (hereinafter the "Commission") submits that by attributing part of the interest expenses to the Plaintiff's Scottish branch, the Norwegian tax authorities reduced the amount of tax that should be paid by that branch and hence the amount of the tax credit to be granted to the Plaintiff in Norway. The Commission argues that unless the difference in tax treatment in the case at hand between the Plaintiff and a company doing business solely in Norway corresponds to an objective and relevant difference in situation, it constitutes discrimination contrary to Article 31 EEA.

41 The Commission points out that the calculating rules at issue provide that debt interest expenses, which are deductible in Norway, must always be attributed to Norway and the foreign country in question in proportion to where the net income of the company is earned, irrespective of the purpose for which the debt was incurred. According to the Commission, such a calculation is discriminatory. Allocating debt interest expenses independently of the purpose for which the debt was incurred does not correspond to the situation of the taxpayer. This is contrary to Article 31 EEA. In the Commission's view, the logic of *de Groot* is transferable to the case at hand to the extent that it shows that a State cannot withdraw normal tax advantages where a taxpayer earns income which is taxed in another State.

42 If, on the other hand, the interest expenses relate to financial obligations incurred for the company as a whole, the Commission is of the opinion that a proportional amount should indeed be attributed to the income earned in the UK.

43 The Court notes that Norwegian income tax is, as explained earlier, based on the principle of net income taxation. An income tax of 28% is levied on resident taxpayers' net income, after deduction of such expenses as debt interest. In other words, this deduction of expenses works to the taxpayers' advantage by reducing the tax base.

44 Furthermore, resident taxpayers with income both in Norway and abroad are taxed, according to the principle of global income taxation, on their combined net income in Norway and abroad. When a resident taxpayer has income in another State (the host State) which taxes that income, the principle of global income taxation entails double taxation.

45 To relieve such double taxation, Norway grants a tax credit for tax paid in the host State, but only up to a maximum amount, cf. Section 16–21(1) and (3) of the Tax Act and Section 16–28–4 of the FSFIN. This amount is calculated as 28% of the taxpayer's net income in the host State after deduction of a portion of expenses such as debt interest, proportionate to the part of the global net income derived in the host State. This deduction of expenses when calculating the maximum credit allowance works to the taxpayer's disadvantage. Provided that the taxpayer has income taxable in the host State, every increase in debt interest expenses will reduce the maximum allowance granted to offset tax levied in the host State.

46 As a result, a taxpayer may, as in the case at hand, be left with having paid more tax in the host State than what Norway compensates in credit allowance. This is so if the host State does not allow deduction of the expenses in question when it calculates the base on which to tax the taxpayer's income. The effect may occur even if the tax rate in the host State is the same as, or lower than, in Norway. That depends on the amount of the expenses and the amount of the net income in the host State relative to the global net income.

47 In effect, this is the same as if Norway, for such taxpayers, would allow deduction only of a portion of expenses such as debt interest when calculating the global net income on which Norwegian income tax is assessed (cf. paragraphs 43–44 above). This means that the Norwegian rules on maximum credit allowance have the potential of leading to a more burdensome result for taxpayers with income earned through a branch in another EEA State than would have been the case had the taxpayers not exercised their freedom of establishment. After having been granted a credit allowance from the Norwegian global income tax, such taxpayers may not be able to enjoy, in effect, the same deduction of expenses as taxpayers with the same total income, but earned in Norway only. This places taxpayers with a branch in another EEA State in a less favourable position for the sole reason that they made use of their right of establishment under the EEA Agreement.

48 The EEA Agreement does not oblige the Contracting Parties to give relief for double taxation within the European Economic Area, nor does it lay down any criteria for the attribution of areas of competence between the Contracting Parties in relation to the elimination of double taxation. Consequently, the Contracting Parties have retained their competence to determine the connecting factors for the allocation of their fiscal jurisdiction, *inter alia* by concluding bilateral agreements. However, as far as the exercise of their taxation power so allocated is concerned, the EEA States must, as stated above, comply with EEA rules. In particular, such an allocation of fiscal jurisdiction does not permit the States to introduce discriminatory measures which are contrary to EEA rules (see for comparison, Case C-170/05 *Denkavit* [2006] I-11949, at paragraphs 43 and 44).

49 By the DTA, Norway and the UK have allocated their taxation powers. Norway exercises its taxation power, so allocated, by applying the provisions on maximum credit allowance of the Tax Act and the FSFIN. This exercise of taxation power must, as stated above, be in conformity with Norway's obligations under the EEA Agreement. Accordingly, the Defendant's argument that the tax rules at issue cannot be deemed contrary to the EEA Agreement since no obligation to give relief for double taxation can be established under that Agreement must be rejected.

50 Thus, it needs to be assessed whether rules limiting maximum credit allowance, such as the ones at issue in the main proceedings, restrict the freedom of establishment under Article 31 EEA. In that regard, it is recalled that all measures which are liable to hinder or make less attractive the exercise of freedom of establishment under the EEA Agreement must be regarded as constituting restrictions within the meaning of Article 31 EEA (see for comparison *Columbus Container*, at paragraph 34, and also Case E-2/06 *EFTA Surveillance Authority* v *Norway* [2007] EFTA Ct. Rep. 164, at paragraph 64).

51 The Court notes that a higher tax burden resulting from the fact that a taxpayer is subjected to two tax regimes is, as such, liable to dissuade companies from using their right of establishment under the EEA Agreement. However, it follows from what is stated in paragraph 48 above that obstacles to the freedom of establishment that are a consequence of a mere difference in tax regimes between States are outside the scope of the EEA Agreement (for comparison see also to that effect *Gilly*, at paragraphs 47 and 48).

52 Consequently, the difference between the Plaintiff's actual tax burden and the tax burden which the Plaintiff would have borne had all its operations been conducted in Norway, caused by the difference in tax rates under the two respective tax regimes (28% and 30%), does not constitute a restriction on the freedom of establishment. However, this explains only a fraction of the Plaintiff's additional tax burden, compared to what it would have paid, had all its business activities taken place in Norway, cf. paragraph 10 above. Most of the difference is caused

by the rules on apportionment of expenses when calculating the maximum credit allowance, see paragraphs 45–47 above. In order to determine whether such a disadvantage is the mere result of the application in parallel of two different tax systems, or a restriction on the freedom of establishment that falls under Article 31 EEA, it needs to be assessed whether a company with a branch in another EEA State is in a situation which is, with regard to those expenses, objectively comparable to the one of a company having all its business within the home State.

53 The parties to the main proceedings disagree as to whether the expenses in question relate solely to the Plaintiff's business activities in Norway or whether it is not possible to link them to any specific activity. It is for the national court to make that factual assessment.

54 In that regard, the Court notes that when expenses are linked to the income of a company's branch in another EEA State, apportioning them to the income from the business activities of that branch when calculating the maximum credit allowance corresponds to the situation of the taxpayer. These expenses arise solely as a result of the activities of the branch and are not linked to the income generated by the taxpayer in the home State. This means that such a taxpayer is not in a comparable situation to a taxpayer whose expenses are all incurred in the home State. When taxed in two separate fiscal jurisdictions, a taxpayer cannot expect the same tax treatment by the home State with regard to expenses related to the branch as with regard to expenses related to the taxpayer's activities in the home State. Consequently, to the extent the host State does not grant a deduction for expenses relating solely to the income of the branch when calculating the tax on the income of the branch, the resulting burden for the taxpayer is simply a consequence of the two States exercising their different tax regimes in parallel and does not constitute a restriction within the meaning of Article 31 EEA.

55 Similarly, when expenses cannot be linked to any particular business activities of a company conducting part of its business operations through a branch in another EEA State, the attribution of the expenses in proportion to the parts of the global net income earned in the home State and in the host State, respectively, corresponds to the situation of the taxpayer. Also in this case, the taxpayer is not in a comparable situation to a taxpayer whose expenses relate solely to the home State. If the host State does not grant a similar proportionate deduction for expenses when calculating the tax on the income of the branch, the resulting burden for the taxpayer is simply a consequence of the two States exercising their different tax regimes in parallel and does not constitute a restriction within the meaning of Article 31 EEA.

56 On the other hand, a company conducting all its business in its home State and having all its debt interest expenses linked to that State, and a company conducting its business in its home State and through a branch in another EEA State (the host State) but having all its debt interest expenses linked to the home State, are in a

comparable situation with respect to these expenses. Thus, they should get the same tax treatment in the home State with respect to these expenses. As described in paragraphs 46 and 47 above, the rules at issue do not guarantee this.

57 Consequently, the attribution of debt interest expenses related solely to a taxpayer's business in the home State to the income of a branch situated in another EEA State when calculating the maximum credit allowance constitutes a restriction within the meaning of Article 31 EEA.

58 In the request for an Advisory Opinion, Stavanger tingrett states that in case the calculation of the maximum credit allowance is found to be a restriction, the Defendant will plead that the restriction can be justified on grounds relating to the general interest. However, the request does not contain any information on what these grounds may be, nor have the parties commented upon them. Therefore, the Court is not in a position to assess such grounds and must confine itself to concluding that the Norwegian rules at issue constitute a restriction.

59 In light of the above, the answer to the first question is that an EEA State which attributes, in applying the principle of net income taxation, a portion of debt interest expenses of a company to income earned through its branch in another EEA State, when calculating the maximum credit allowance for tax paid in that State, restricts the freedom of establishment within the meaning of Article 31 EEA, insofar as the expenses can only be linked to the company's business in the former State.

The second question – group contributions

60 The second and the third question, read together, concern in essence the issue of whether it is contrary to Article 31 EEA for an EEA State, when calculating maximum credit allowance for tax paid in another EEA State, to attribute a portion of group contributions that are made between companies under its fiscal jurisdiction to income earned through a branch in the other EEA State.

61 The Plaintiff, the Defendant, the Government of Germany and ESA argue with regard to group contributions more or less in the same way as with regard to debt interest expenses, as described in paragraphs 31–39 above. ESA further notes that the objective behind the rules on group contributions is to allow companies within the same group to transfer profit from one company to another, normally for the purpose of covering losses incurred by the receiving company. To ESA's understanding, under Norwegian law group contributions at the outset are only available when both the donor and the recipient are Norwegian companies. As group contributions are only awarded in a situation where the transfer of funds takes place between Norwegian tax subjects, the overall logic of the system entails

that group contributions made by the Plaintiff will never be deductible in the UK where the necessary cohesion between the tax subjects is absent.

62 ESA is of the opinion that a Norwegian company which establishes a branch abroad will suffer a disadvantage if it is not able to deduct from its income in Norway the same amount of expenses that it could have deducted had it not exercised its freedom of establishment. Such a disadvantage results from the manner in which the national tax provisions at issue treat expenses linked to the business in Norway, i.e. as partially attributable to the branch. This difference in tax treatment is liable to discourage Norwegian companies from creating, acquiring or maintaining a branch in another EEA State and constitutes a restriction under Article 31 EEA.

63 According to the Commission, the provisions of the Norwegian Tax Act on group contributions apply solely to companies with income taxable in Norway. Norway would not grant a deduction in respect of group contributions made to a company in the UK, nor can it expect the UK to grant such a deduction. The Commission further maintains that the attribution of group contributions, as referred to in the second question, gives rise to discrimination contrary to Article 31 EEA in the same way as the attribution of debt interest expenses. Such an attribution does not correspond to the situation of the taxpayer and is contrary to the principle of fiscal cohesion, which serves to protect the internal logic of national tax regimes so long as they are not arranged in such a way as to favour national situations or traders. According to the Commission, it must be possible for a taxpayer to invoke this principle in order to ensure that tax rules are applied in a consistent manner and in accordance with the logic of the system. Furthermore, the EEA States may not artificially increase their tax base by, in effect, extending group contribution schemes to cover income earned in another EEA State.

64 The Court notes that in calculating the maximum credit allowance for the Plaintiff's tax paid in the UK, the Defendant applied Section 16–28–4 litra b of the FSFIN. Accordingly, a part of group contributions made from the Plaintiff to two of its daughter companies in Norway was apportioned to the income of the Plaintiff's branch in the UK. As a result of this, the Plaintiff was, in effect, not able to deduct, from its total taxable income, the same amount in group contributions as if it had conducted all its business in Norway. The Norwegian rules on maximum credit allowance work in the same way with regard to proportional attribution of group contributions as with regard to debt interest expenses. Reference is made to paragraphs 45–47 above.

65 In order to establish whether this constitutes a restriction on the freedom of establishment, it needs to be assessed whether a company with a branch in another EEA State is, with regard to group contributions as a cost factor, in a situation which is objectively comparable to the one of a company having all its business within the home State, see paragraph 52 above.

66 The request from the national court does not contain information on the conditions under Norwegian tax law for deducting group contributions for income tax purposes. However, according to written and oral observations submitted to the Court, group contributions seem to be deducted from the taxable income of the donor and added to the taxable income of the recipient, provided that both companies are subject to Norwegian fiscal jurisdiction. Such a system of intra group financial transfers generally serves the purpose of mitigating tax disadvantages within a group of companies, by allowing them to balance out their profits and losses. The logic behind not allowing deductions for group contributions made to companies abroad is generally to prevent companies from freely choosing the State in which profits are to be taxed.

67 When comparing two companies that make group contributions to daughter companies in their home State, the fact that one of the companies has a branch in another EEA State does not place it in a different position with regard to the group contributions. The existence of the branch abroad has no bearing on the possibility of the home State to tax the group contributions at the receiving companies. Both companies should thus get the same tax treatment with respect to the group contributions. As described in paragraphs 46 and 47 above, the rules at issue do not guarantee this.

68 In light of the above, attributing group contributions in circumstances such as in the case at hand to the income of a branch situated in another EEA State does not correspond to the situation of the taxpayer. Therefore, the Court concludes that it constitutes a restriction within the meaning of Article 31 EEA to attribute group contributions in a situation such as the one in the case at hand to the income of a branch situated in another EEA State when calculating the maximum credit allowance.

69 In the request for an Advisory Opinion, Stavanger tingrett states that in case the calculation of the maximum credit allowance is found to be a restriction, the Defendant will plead that the restriction can be justified on grounds relating to the general interest. However, the request does not contain any information on what these grounds may be, nor have the parties commented upon them. Therefore, the Court is not in a position to assess such grounds and must confine itself to concluding that the Norwegian rules at issue constitute a restriction.

70 In light of the above, the answer to the second question is that an EEA State which attributes, in applying the principle of net income taxation, a portion of a company's costs in the form of group contributions made to other companies under this State's fiscal jurisdiction to income earned through the company's branch in another EEA State, when calculating the maximum credit allowance for tax paid in that State, restricts the freedom of establishment within the meaning of Article 31 EEA.

V Costs

71 The costs incurred by the Government of Germany, ESA and the Commission, which have submitted observations to the Court, are not recoverable. Since these proceedings are a step in the proceedings pending before Stavanger tingrett, any decision on costs for the parties to those proceedings is a matter for that court.

On those grounds,

THE COURT,

in answer to the questions referred to it by Stavanger tingrett hereby gives the following Advisory Opinion:

1. **An EEA State which attributes, in applying the principle of net income taxation, a portion of debt interest expenses of a company to income earned through its branch in another EEA State, when calculating the maximum credit allowance for tax paid in that State, restricts the freedom of establishment within the meaning of Article 31 EEA, insofar as the expenses can only be linked to the company's business in the former State.**
2. **An EEA State which attributes, in applying the principle of net income taxation, a portion of a company's costs in the form of group contributions made to other companies under this State's fiscal jurisdiction to income earned through the company's branch in another EEA State, when calculating the maximum credit allowance for tax paid in that State, restricts the freedom of establishment within the meaning of Article 31 EEA.**

Carl Baudenbacher Thorgeir Örlygsson Henrik Bull

Delivered in open court in Luxembourg on 7 May 2008

Skúli Magnússon
Registrar

Carl Baudenbacher
President