REPORT FOR THE HEARING
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 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 in the EEA and Article 40 EEA on free movement of capital.

I Introduction

1. By a letter dated 25 May 2007, registered at the Court on 30 May 2007, Stavanger tingrett made a request for an Advisory Opinion in a case pending before it between Seabrokers AS (hereinafter the "Plaintiff") and the Norwegian State, represented by the Directorate of Taxes (hereinafter the "Defendant").

II Facts and procedure

2. The case concerns a dispute on whether tax assessment on the basis of the rules set out in the Norwegian Act Relating to Tax on Assets and Income (the Tax Act) of 26 March 1999 No 14 (*lov 26. mars 1999 nr. 14 om skatt av formue og inntekt (skatteloven)*) and of 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 av 26. mars 1999 nr. 14; 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 an operator of a real estate business in Norway, developing and renting out its property there. All of the properties 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 (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 are operated separately both with regard to the nature and location of the business conducted.

6. The Plaintiff used the direct method in its accounts and tax declarations, meaning that tax-deductible expenses, both interest and group contributions, were entered in the country where the expense arose and was spent.

7. In the tax income year 2002, the Plaintiff paid the UK tax authorities GBP 235 375.20 in withholding tax on the profits calculated at the permanent place of operation in Aberdeen. In its Norwegian tax declaration for the same income year, the Plaintiff claimed a credit allowance of NOK 2 635 023, corresponding to the withholding tax paid in the UK.

8. The Stavanger Tax Assessment Office, by a 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 tax authorities, to NOK 1 667 373. The reduction was based on a calculation of the maximum credit allowance in accordance with the principle of net income taxation. In reaching its decision, the Tax Assessment Office applied an exception in Section 16–28–4 litra b FSFIN which has its legal basis in the Tax Act.

9. In its decision, the Tax Assessment Office apportioned debt interest and group contributions in accordance with the principle of net income taxation. In calculating the maximum credit allowance, interest expenses and group contributions paid are multiplied by the net income abroad and divided by the company’s total net income. The calculation was as follows, in NOK:

Global income before deduction of interest expenses abroad	14 787 889
Income abroad before deduction of interest expenses	9 430 482
Debt interest including interest expenses abroad	2 871 039
Group contributions paid	2 579 000

Debt interest share to be divided:
(9 430 482 x 2 871 039) / 14 787 889 = 1 830 909

Group contributions to be divided:
(9 430 482 x 2 579 000) / 14 787 889 = 1 644 671

Income abroad	9 430 482
- interest deduction	1 830 909
- group contributions	1 644 671
= Net income abroad	5 954 902

The maximum credit allowance is obtained by multiplying the net income abroad by the income tax rate in Norway: NOK 5 954 902 x 28% = NOK 1 667 373.

10. The Plaintiff appealed the decision on 9 March 2004. In the appeal, the following was alleged: 1) The Tax Assessment Office's decision entailed double taxation. The branch's income in the UK is fully taxed in the UK. Debt interest and group contributions which are exclusively related to the business in Norway are not considered deductible in the UK. By Norwegian tax assessment authorities nevertheless attributing a considerable part of these items to the UK, the tax base in Norway is increased correspondingly notwithstanding the tax paid in the UK. 2) The Tax Assessment Office's decision entails discrimination contrary to the EEA Agreement as well as the Double Taxation Agreement between Norway and the UK. Establishing a business in another EEA State shall not increase the total tax cost as compared to the business being established in Norway. 3) It is contrary to the regulations when the credit method is used such that the tax base is expanded in that tax paid in the UK is not deducted from Norwegian tax calculated on global income.

11. The assessment of the Tax Assessment Office was upheld by the Higher Assessment Appeal Board in Stavanger in a decision of 8 November 2004. In its ruling, the Appeal Board stated that expenses which cannot be attributed to a specific business shall be attributed to Norway or the UK in proportion to where the net income is otherwise attributed (the principle of net income taxation), cf. Section 16–28–4 litra b FSFIN. The Appeal Board did not find a basis for using an alternative apportionment of the group contributions in accordance with Section 16–28–4 litra c of the Regulation. The Plaintiff's plea that the taxation was contrary to the EEA Agreement was not considered.

12. The Plaintiff filed a lawsuit before Stavanger tingrett on 2 February 2005, claiming mainly the following: 1) That the decision of the Higher Assessment Appeal Board of 8 November 2004 be quashed. 2) Principally: that the new tax assessment be based on debt interest and group contributions being deducted in full 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 Aberdeen.

13. The Defendant countered in its defence with the claim that the action be dismissed.

14. Before Stavanger tingrett, the Plaintiff has pleaded that the decision by the Higher Assessment Appeal Board and the Norwegian rules on calculation of credit allowance in Section 16–28–4 FSIFN, cf. Sections 16–21 and 16–28 of the Tax Act, are contrary to the EEA Agreement's provisions 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.

III Questions

15. The following questions have been referred 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?

IV Legal background

National law

Rules on credit allowance under Norwegian law

16. 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), *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.*

17. 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,* reads:

> *(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.*

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

> *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.*
>
> *d. When spouses submit separate tax declarations it shall be held, when calculating the maximum tax deduction, that each spouse's tax be assessed in Class 1. Each spouse's debt interest which is deductible in Norway shall be apportioned according to his or her net income in Norway and abroad, respectively.*

Norway's double taxation agreement with the United Kingdom

19. 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 through 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. The rules of Article 28 of the DTA are implemented in Norwegian law by Sections 16–20 *et seq.* of the Tax Act.

20. 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.

21. Norwegian taxpayers are subject to the principle of global income taxation, meaning that they are taxed on income derived from Norway and abroad. 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;

(b) in the case of a dividend paid by a company which is a resident of Norway to a company which is a resident of the United Kingdom and which controls directly or indirectly at least 10 per cent of the voting power in the company paying the dividend credit shall take into account (in addition to any Norwegian tax for which credit may be allowed under the provisions of sub-paragraph (a) of this paragraph) the Norwegian tax payable by the company in respect of the profits out of which such dividend is paid.

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.

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.

V Written Observations

26. Pursuant to Article 20 of the Statute of the EFTA Court and Article 97 of the Rules of Procedure, written observations have been received from:

- the Plaintiff, represented by Thomas Smedsvig, Supreme Court 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 a member of its Legal Service, acting as Agent.

The Plaintiff

27. The Plaintiff maintains that the Norwegian rules on credit allowance and the way they have been practiced by the Norwegian tax authorities entail a restriction contrary to Articles 4, 31 and 40 EEA.

28. With respect to the factual background of the case, the Plaintiff explains that all of the company's interest expenses on real estate debt (NOK 2 778 369) incurred in Norway. The Plaintiff also explains that, within the limits of its net profit earned in Norway (NOK 2 579 000), it transferred the profit as group contributions to two daughter companies in Norway. The Norwegian tax authorities allocated the Plaintiff's deductible interest expenses (NOK 2 871 039) between the business in Norway and the UK, based on the proportionate share of the global income (Norway: 36.22834% and the UK: 63.77166%). The allocation had the effect that deductible interest expenses incurred on real estate properties in Norway was reduced (by NOK 1 830 909) and taxable income in Norway increased, based on the assumption that deduction should be granted abroad. Thereby, the net income before group contributions in Norway was increased (from NOK 2 579 038 to NOK 4 409 957) in spite of the fact that the Plaintiff could not deduct the reduced interest expenses in the UK. The deductible group contributions were also allocated in the same manner as the interest expenses, resulting in an increase of the net taxable income in Norway (by NOK 1 644 628), again based on the assumption that deduction should be granted abroad.

29. According to the Plaintiff, the Norwegian tax authorities assessed the total taxable income for the Plaintiff as follows (in NOK):

	Norway	UK	Global income
Profit before interest expenses	5 357 407	9 430 482	14 787 889
Interest:			
- interest expenses on taxes / bank charges	0	-92 670	-92 670
- interest expenses on real estate debt	-2 778 369	0	-2 778 369
Net income before group contributions	2 579 038	9 337 812	11 916 850
Group contributions	-2 579 000	0	-2 579 000
Net taxable income	**38**	**9 337 812**	**9 337 850**

30. The Plaintiff sets up the following table for the calculation of the net tax using the credit method (in NOK):

Calculation of Norwegian tax on global income

	Norway	UK	Global income	Paid taxes
Taxes in each country	0	2 635 023		2 635 023
Global income tax paid to Norway (28%)			2 614 598	2 614 598
Total taxes paid before credit allowance				**5 249 621**

Calculation of credit allowance

Total income UK	9 430 482
Credit allowance interest expenses (63.77166%)	-1 830 909
Credit allowance group contributions (63.77166%)	-1 644 671
Calculated net income attributed abroad	**5 954 902**

31. The Plaintiff next explains in figures the total tax it paid after the credit allowance had been granted. The tax calculated by Norwegian tax authorities on net income attributed abroad (to the UK) amounted to (NOK 5 954 902 x 28%) NOK 1 667 373 (the tax credit allowance), whereas the tax actually paid in the UK was NOK 2 635 023. The tax paid in Norway (28%) was NOK 2 614 598 - 1 667 373 = 947 225. Thereby the total tax paid by the Plaintiff amounted to NOK 2 635 023 + 947 225 = 3 582 248.

32. The Plaintiff points out that the tax paid in the UK is not influenced by the Norwegian tax authorities' calculation of the credit allowance. If the business in Norway had been the only activity, the Plaintiff would have owed no taxes. If the branch in the UK had been a subsidiary, the only tax for the activity there would be the UK tax (30% of UK net income). Thus, the tax cost is higher only because the Plaintiff conducts business both in Norway and through a branch office in the UK. If all business would have been conducted in Norway only, the total tax would have been NOK 2 614 598, not NOK 3 582 248. Therefore, in this instance, the result is an increased tax cost of NOK 967 650 which would have been avoided if the Plaintiff had not conducted any business in the UK.

33. In the view of the Plaintiff, the national court essentially asks whether, in circumstances such as those in question in the main proceedings, the provisions of the EEA Agreement relating to the freedom of establishment and the free movement of capital preclude legislation or practice of an EEA State which restricts the right of a company residing in that State to deduct for tax purposes expenses incurred by the company in respect of interest on debt in that State and group contributions to subsidiaries in that State, because the company also conducts business in another EEA State.

34. 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.[1]

35. According to the Plaintiff, Article 31 EEA grants to nationals of the EEA States freedom of establishment, which includes the right to take up and pursue activities and to set up and manage undertakings, under the conditions laid down for its own nationals by the EEA State where such establishment is effected. This entails, in accordance with Article 34 EEA, the right of companies or firms, formed in accordance with the law of an EEA State and having their registered office, central administration, or principal place of business within the EEA, to exercise their activity in the EEA State concerned, through a subsidiary, a branch, or an agency.[2] These provisions prohibit the State of origin from hindering the establishment of its nationals or companies incorporated under its legislation in another EEA State.[3] The Plaintiff stresses that the EEA Agreement makes no distinction with regard to whether business is conducted through agencies, branches or subsidiaries.

36. As regards the tax treatment in question, the Plaintiff states that, under Norwegian tax law, debt interest and group contributions paid in Norway are fully deductible towards income in Norway. The legislation and practice at issue in the main proceedings entail that debt interest and group contributions paid in Norway shall be allocated to the income abroad in proportion to the taxable income in the two States. Thus, unlike companies which conduct business only in Norway or 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 deduction. This entails a difference in treatment which results in a tax disadvantage. As a consequence of this difference, parent companies might be dissuaded from carrying on their activities through

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[1] The Plaintiff refers to Joined Cases C-397/98 and C-410/98 *Metallgesellschaft and Others* [2001] ECR I-1727, at paragraph 37; Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, at paragraph 29; Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995, at paragraph 40, Case C-347/04 *Rewe Zentralfinanz* [2007] ECR I-2647, at paragraph 21 and Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007], ECR I-2107, at paragraph 25.

[2] The Plaintiff refers to Case C-307/97 *Saint-Gobain* [1999] ECR I-6161, at paragraph 35; Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, at paragraph 30; Case C-471/04 *Keller Holding* [2006] ECR I-2107, at paragraph 29 and Case C-347/04 *Rewe Zentralfinanz* [2007] ECR I-2647, at paragraph 25.

[3] The Plaintiff refers to Case C-264/96 *ICI* [1998] ECR I-4695, at paragraph 21; Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, at paragraph 31 and Case C-347/04 *Rewe Zentralfinanz* [2007] ECR I-2647, at paragraph 26.

branch offices in other EEA States.[4] Accordingly, this tax treatment constitutes a restriction on freedom of establishment.[5]

37. The Plaintiff contests the arguments of the Defendant that the credit rules at issue do not affect the Plaintiff's right to income deduction in the company's global income due to the fact that it has received a full income deduction for debt interest and group contributions in relation to the assessment of the Norwegian tax on the company's global income. In its view, this is misleading and beside the point. In this regard, the Plaintiff argues that the Defendant disregards the fact that the UK tax is not affected by the deduction calculated in Norway. The Plaintiff also points out that it is not contested by the Defendant that the global tax is increased by the calculation of the tax claimed by Norwegian Tax Authorities. Moreover, and most importantly, the calculation of the credit allowance has resulted in a much higher tax for the Plaintiff compared to a company conducting the same business in Norway only, or through a subsidiary in the UK. Consequently, the Defendant's statement that the Plaintiff pays less tax than other taxpayers with corresponding income from business conducted exclusively in Norway is incorrect.

38. According to the Plaintiff, the fact that it does not receive a deduction in full for income tax paid in the UK cannot be explained by different tax rates in Norway and UK and/or the income from the permanent place of business being calculated differently in Norway and the UK, respectively. Firstly, the difference in rates (30% in the UK and 28% in Norway) constitutes an insignificant difference in this respect. Secondly, the marginal difference in tax rates is irrelevant as the difference in tax paid is caused solely by the allocation to the branch in the UK of a proportionate share of the expenses incurred in Norway. The Plaintiff refers to Case C-385/00 *de Groot*, according to which the Member States cannot deprive a citizen from the benefit of a tax deduction based on the assumption that he will receive a similar deduction in the other State where he performed work.[6] Moreover, in the view of the Plaintiff, the legal and factual circumstances in this case differ from Case C-336/96 *Gilly*, and therefore the Defendant cannot rely on that case.[7]

39. According to the Plaintiff, the Defendant has not claimed any justification for the tax treatment at issue. On the contrary, the Norwegian legislator has, in the Plaintiff's view, admitted that the relevant legislation may entail a restriction contrary to the EEA Agreement. The Plaintiff refers *inter alia* to the "Consultation memorandum on avoidance of international double taxation (*høringsnotat om*

[4] The Plaintiff refers to Case C-168/01 *Bosal* [2003] ECR I-9409, at paragraph 27.
[5] The Plaintiff refers to Case C-347/04 *Rewe Zentralfinanz* [2007] ECR I-2647, at paragraph 36.
[6] Case C-385/00 *de Groot* [2002] ECR I-11819, at paragraphs 85 and 87.
[7] Case C-336/96 *Gilly* [1998] ECR I-2793.

unngåelse av internasjonal dobbeltbeskatning)” issued by the Ministry of Finance in relation to a recent reassessment of the credit method.[8] In the view of the Plaintiff, the Ministry acknowledges in this memorandum that the current rules fail to meet Norway’s obligations under the EEA Agreement.

40. The Plaintiff points out, that despite recognising that the rules do not in practice prevent double taxation and thus discrimination, the Ministry chose to uphold the rules with respect to allocation of debt interest when amendments to the Tax Act and associated Regulations were adopted on 15 June 2007. In that regard, the Plaintiff quotes Odelsting Proposition No 20 (2006–2007), page 19. The Plaintiff maintains that when rules actually work in this fashion in specific cases, they must be set aside as being in violation of the EEA Agreement. The Plaintiff maintains that the reasons given for not amending the current rules are only technical in nature. It argues that obstacles to the freedom of movement of workers cannot be justified by arguments relating to the cohesion of the EEA State’s tax system or by the aim of simplifying and coordinating the collection of income tax or by technical difficulties.[9] As concerns group contributions, the Plaintiff notes that the Ministry proposed amendments to the current rules and thereby acknowledged, and acted upon, the fact that the practice of the earlier rules entailed discriminatory treatment against companies operating through cross-border divisions that violated the EEA Agreement.[10]

41. The Plaintiff also argues that there is a logical inconsistency in the legislative amendments as concerns the allocation of debt interest. In that regard the Plaintiff notes *inter alia* that an amendment was made for wage earners and pensioners, but not for businesses, with the result that taxpayers in the latter group are expressly treated differently from taxpayers that belong to the former group although they are in the same situation.

42. The Plaintiff suggests answering the questions as follows:

> *Question 1:*
>
> *Articles 31, 40 and 4 preclude rules and practice such as those at issue in the main proceedings, whereby a company forfeits, in the calculation of the income tax payable by it in its State of residence, part of the deductible debt interest and thereby part of the company’s tax advantage, because, during*

8 The Plaintiff quotes point 4.1 of the memorandum.

9 The Plaintiff refers to Case C-385/00 *de Groot* [2002] ECR I-11819.

10 The Plaintiff refers to page 21 of Ot.prp.No 20 (2006–2007). The Plaintiff also notes that the credit method will be dealt with by the ECJ in the pending Case C-298/05 *Columbus Container Services BVBA & Co.* The Plaintiff furthermore refers to the Opinion of the Advocate General in the same case, from 29 March 2007, who, in the view of the Plaintiff, came to the conclusion that the use of the credit method instead of the exception method to avoid international double taxation constitutes a violation of the freedom of establishment under the EC Treaty.

the year in question, the company also received income through a branch office in another Member State which was taxed in that State.

Question 2:

Articles 31, 40 and 4 preclude rules and practice such as those at issue in the main proceedings, whereby a company forfeits, in the calculation of the income tax payable by it in its State of residence, part of the deductible group contributions and thereby part of the company's tax advantage, because, during the year in question, the company also received income through a branch office in another Member State which was taxed in that State.

43. Should the Court not give affirmative answers to the questions above, the Court is requested in the third question to consider whether the answers will be different given the fact that the debt interest and the group contributions can only be linked to the business conducted in Norway and thus not deductible in the UK. In this case, the Plaintiff proposes that the questions should be answered as follows:

Question 1:

Articles 31, 40 and 4 preclude rules and practice such as those at issue in the main proceedings, whereby a company forfeits, in the calculation of the income tax payable by it in its State of residence, part of the deductible debt interest which is only incurred on its investments in this State and thereby part of the company's tax advantage, because, during the year in question, the company also received income through a branch office in another Member State which was taxed in that State and whose activity was not related to the investments in the State of residence.

Question 2:

Articles 31, 40 and 4 preclude rules and practice such as those at issue in the main proceedings, whereby a company forfeits, in the calculation of the income tax payable by it in its State of residence, part of the deductible group contributions which are only contributed to daughter companies in this State and thereby part of the company's tax advantage, because, during the year in question, the company also received income through a branch office in another Member State which was taxed in that State and whose activity was not related to the investments in the State of residence.

The Defendant

44. The Defendant maintains that the Norwegian legislation regarding maximum credit allowance is in conformity with the EEA Agreement.

45. The Defendant explains that Norwegian income tax is calculated according to the principle of global income taxation. Accordingly, the global income of the Plaintiff, including income derived from the permanent establishment in the UK, was taken into account. The Plaintiff then received a full income deduction for all global expenses, including debt interest and group contributions. According to the Defendant, this tax treatment is identical to the tax treatment of a company without foreign source income. Since the Plaintiff is also subject to taxation in the UK, it is entitled under Norwegian domestic law to a credit to be set against the tax payable to Norway. The credit was calculated in accordance with the rules of the FSFIN on maximum credit allowance. It is not disputed that the total global tax burden of the Plaintiff is higher than that of a company which conducts all of its business in Norway.

46. The Defendant maintains that the Plaintiff’s foreign tax was not fully credited for two reasons. First, 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 levied on foreign income. Second, the net income from the UK branch is calculated differently in the UK and in Norway. The Plaintiff did not receive any deductions for debt expenses or group contributions in the UK. However, Norway allocated a portion of the Plaintiff’s debt and group contribution expenses to the UK when calculating the Plaintiff’s foreign income. This is explained by the following table (in NOK):

Comparison with a company that conducts all of its business in Norway

	Plaintiff	A company that conducts all of its business in Norway
Ordinary Norwegian income tax	2 614 598	2 614 598
Norwegian credit allowance	- 1 667 373	Not applicable
Tax paid to Norway	= 947 225	2 614 598
Tax paid to the UK	+ 2 635 023	Not applicable
Global tax	= 3 582 248	2 614 598

47. With regard to the applicable EEA law, the Defendant argues that it follows from case law of the ECJ that when the rules on freedom of establishment apply,

the national measure is to be assessed under these rules, although the rules on free movement of capital in principle could apply. In the opinion of the Defendant, the principles of analysis are identical under both sets of rules.[11] Moreover, in the opinion of the Defendant, there is no differential treatment in the case at hand and hence Article 4 EEA is not applicable.

48. The Defendant argues that EEA States are free to tax the global income of resident companies.[12] This will result in juridical double taxation which obviously is an impediment to the establishment of a foreign branch. However, the EEA States are not obliged under the EEA Agreement to eliminate such double taxation. EEA law does not contain any rule on the question of which of the two States should prevent double taxation. The only remedies available are bilateral tax treaties and unilateral relief rules of the resident State.

49. In the view of the Defendant, it is clear from the case law of the ECJ that although eliminating double taxation is one of the purposes of the EC Treaty, cf. now Article 293 EC, it is not itself a multilateral tax treaty. It does not confer upon individuals any rights which they can invoke before their national courts.[13] Therefore, there is within the internal market an objective difference between a taxpayer staying at home and a taxpayer exposing himself to two tax jurisdictions. The Defendant also points out that the EEA Agreement contains no provision corresponding to the second indent of Article 293 EC. Therefore, elimination of double taxation or harmonisation of the tax base or tax rates in the EEA States is not one of the objectives of the EEA Agreement.

50. Since no obligation to give relief for double taxation can be established under the EEA Agreement, Norwegian credit rules cannot be deemed contrary to the Agreement on the grounds that not all foreign tax is credited. In that regard, the Defendant argues that while the EEA Agreement requires States to establish a level playing field for domestic and cross-border investments within its own tax jurisdiction, it does not impose on them the obligation to harmonise their tax bases and tax rates. If the EEA Agreement would be interpreted to the effect that all foreign tax should be credited in the State of residence (in this case Norway), the Agreement could in fact be regarded as a multilateral tax agreement. The State of residence would then no longer be free to determine its tax burden by defining its own tax base and tax rates.

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[11] The Defendant refers to the Opinion of Advocate General Geelhoed in Case C-513/04 *Kerckhaert* [2006] ECR I-10967, at paragraphs 14 and 15.

[12] The Defendant refers to Case C-336/96 *Gilly* [1998] ECR I-2793 and Case C-513/04 *Kerckhaert* [2006] ECR I-10967.

[13] The Defendant refers Case C-336/96 *Gilly* [1998] ECR I-2793, at paragraphs 14, 16, 17, 23 and 24; Case C-513/04 *Kerckhaert* [2006] ECR I-10967, at paragraphs 21 and 22; Case C-170/05 *Denkavit* [2006] ECR I-11949, at paragraph 43 and Case C-524/04 *Test Claimants in the Thin Cap Group Litigation* [2007] ECR I-2107, at paragraph 49.

51. The Defendant maintains that the Norwegian credit rules are not discriminatory. It is, in the view of the Defendant, not relevant to compare the global tax burden of the Plaintiff with the tax burden of a company that conducts all of its business in Norway. A taxpayer exposed to two tax jurisdictions is in another and objectively different situation than one that receives all his income in one State. The Defendant refers to the reasoning of the ECJ in *Kerckhaert* [14] and concludes 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. The credit rules do not affect the Plaintiff's right to income deductions in the company's global income. What distinguishes the Plaintiff from a company that conducts all of its business in Norway is that in addition to the income deductions, the Plaintiff receives a credit allowance for tax paid abroad.

52. The Defendant further points out in this regard that the Norwegian legislation does not make any negative distinction between domestic and cross-border situations. The Defendant argues that, therefore, several previous judgments regarding imputation tax systems and cross-border group contributions, from the ECJ and the EFTA Court, are not relevant to the case at hand.[15]

53. Finally, the Defendant contests that the reasoning of the ECJ in Case C-385/00 *de Groot* should apply in the case at hand. In that regard, the Defendant points out that the case concerns personal allowances and relates to case law of the ECJ concerning the obligations of the State of residence and the source State with respect to such allowances.[16] The deductions in question in this case are on the other hand interest expenses and group contributions, and there is no similar ECJ jurisprudence on such expenses. With regard to the foregoing, the Defendant suggests answering the questions as follows:

> *(1) It is not 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) It is not 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.*

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14 The Defendant refers to Case C-513/04 *Kerckhaert* [2006] ECR I-10967, at paragraphs 15–18.

15 Therefore, in the view of the Defendant, the judgments in Case C-35/98 *Verkooijen* [2000] ECR I-4071; Case C-315/02 *Lenz* [2004] ECR I-7063 and Case C-319/02 *Manninen* [2004] ECR I-7477 are not relevant to the case at hand. Further reference is made to Case E-1/04 *Fokus Bank* [2004] EFTA Ct. Rep. p. 11 and Case C-446/03 *Marks & Spencer* [2005] ECR I-10837.

16 The Defendant refers to Case C-385/00 *de Groot* [2002] ECR I-11819, at paragraphs 88–91.

> *(3) The answer to question 1 is the same even if the debt interest can only be linked to the business in Norway. The answer to question 2 is the same even if the group contributions can only be linked to the business in Norway.*

The EFTA Surveillance Authority

54. In the view of the EFTA Surveillance Authority (hereinafter "ESA"), the case in question, which concerns an alleged restriction to the establishment of a branch in another EEA State, should be assessed under Article 31 EEA only, because any restriction on the free movement of establishment could bring about restrictions on free movement of capital. Thus, an independent examination under Article 40 EEA is not justified.[17] Furthermore, Article 4 EEA only applies where specific provisions preventing discrimination do not apply.

55. In ESA's view, the questions referred to the Court may be reformulated as follows: 1) Does the allocation of deductible expenses to a foreign branch of a Norwegian company, for the purposes of calculating the credit allowance, constitute a restriction on the freedom of establishment when it applies to expenses that are not economically linked to the business in Norway? 2) Does the allocation of deductible expenses to a foreign branch of a Norwegian company, for the purposes of calculating the credit allowance, constitute a restriction on the freedom of establishment when it applies to expenses that are economically linked solely to the business in Norway?

56. ESA submits that as a general rule, tax systems of Member States are not covered by the EEA Agreement, but States must exercise their taxation power in a way that is consistent with EEA law.[18]

57. ESA maintains that juridical double taxation, with its inherent negative effects on the functioning of the EEA, is not contrary to any provision of EEA law, including Article 31 EEA. In that respect ESA recalls, firstly, that the EEA Agreement does not contain a provision equivalent to Article 293 EC, which calls for negotiations leading to the abolishment of double taxation. In any event, the ECJ has consistently held that this provision defines an objective and is not intended to lay down a directly applicable legal rule.[19] Secondly, according to case law of the ECJ, Community law in its current state does not lay down any general criteria for the attribution of areas of competence amongst the Member States in

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17 ESA refers to Case C-231/05 *Oy AA*, judgment of 18 July 2007, not yet published, at paragraph 24.

18 ESA refers *inter alia* to Case E-1/01 *Hörður Einarsson* [2002] EFTA Ct. Rep. 1, at paragraph 17; Case E-1/03 *EFTA Surveillance Authority* v *Iceland* [2003] EFTA Ct. Rep. 143, at paragraph 26 and Case C-319/02 *Manninen* [2004] ECR I-7477, at paragraph 19.

19 ESA refers to Case C-336/96 *Gilly* [1998] ECR I-2793, at paragraphs 15 and 16.

relation to the elimination of double taxation within the Community.[20] Consequently, it is up to the States to take measures necessary to prevent double taxation by applying, in particular, the apportionment criteria adhered to in international tax practice. Thus, the ECJ has recognised that the States are competent to conclude bilateral agreements to reduce or eliminate double taxation.[21] These conventions are designed to eliminate or mitigate the negative effect on the functioning of the internal market resulting from the coexistence of national tax systems.[22]

58. ESA submits that the EEA States are nonetheless obliged to comply with EEA law when it comes to the exercise of their taxation power, and cannot introduce discriminatory measures contrary to the fundamental freedoms.[23] ESA concludes that the rules on calculation of credit allowance must therefore not constitute discrimination or restriction on the freedom of establishment as laid down in Article 31 EEA.

59. ESA submits that the freedom of establishment which Article 31 EEA guarantees nationals of an EEA State entails, in accordance with Article 34 EEA, for companies or firms formed in accordance with the law of an EEA State and having their registered office, central administration or principal place of business within the EEA, the right to exercise their activity in another EEA State through a subsidiary, a branch or an agency. Even though the rules on freedom of establishment are mainly aimed at ensuring that foreign nationals and companies are treated in the host State in the same way as nationals of that State, they also prohibit the State of origin from hindering the establishment in another EEA State of one of its nationals or of a company incorporated under its legislation which comes within the definition contained in Article 31 EEA.[24]

60. ESA derives from the case law of the ECJ that, in the absence of harmonisation of national measures in this field, the difficulties ensuing for economic operators because of mere differences in tax regimes between States are outside the scope of the EEA Agreement.[25] Article 31 EEA prohibits restrictions on freedom of establishment, other than those that inevitably result from the fact that tax systems are national. Disadvantageous tax treatment that follows from

[20] ESA refers to Case C-513/04 *Kerckhaert* [2006] ECR I-10967, at paragraphs 22 and 23.

[21] ESA refers to Case C-336/96 *Gilly* [1998] ECR I-2793, at paragraph 23.

[22] ESA refers to Case C-513/04 *Kerckhaert* [2006] ECR I-10967, at paragraph 21.

[23] ESA refers to Case E-1/04 *Fokus Bank* [2004] EFTA Ct. Rep. p. 11, at paragraphs 20–21; Case C-385/00 *De Groot* [2002] ECR I-11819, at paragraph 94 and Case C-265/04 *Bouanich* [2006] ECR I-923, at paragraph 50.

[24] ESA refers to Case C-81/87 *Daily Mail and General Trust* [1988] ECR 5483, at paragraph 16 and Case C-200/98 *X and Y* v *Riksskatteverket* [1999] ECR I-8261, at paragraph 26.

[25] ESA refers to Case C-336/96 *Gilly* [1998] ECR I-2793, at paragraphs 47 and 48 and the conclusions of Advocate General Poiares Maduro in Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, at paragraph 23.

direct or covert discrimination resulting from the rules of one jurisdiction, rather than simply from disparities in or the division of tax jurisdiction between two countries' tax systems, infringes Article 31 EEA unless it can be justified.

61. ESA first assesses whether, in a situation in which debt interests and group contributions cannot be linked to any specific activity, either in Scotland or in Norway, the Norwegian credit rules constitute a restriction of the freedom of establishment.

62. ESA points out that the tax rules under examination aim to eliminate or mitigate the effects of double taxation, by granting a tax credit, limited to the tax in Norway that falls on the proportion of the income derived abroad. The logic behind this appears to be, in ESA's view, that differences in the overall tax burden stemming from the exercise in parallel by two EEA States of their fiscal sovereignty is not to be borne by Norway. As EEA States are not obliged to eliminate double taxation, they are not compelled by the EEA Agreement to grant full relief when they adopt methods intended to relieve double taxation

63. In the view of ESA, the fact that Norway does not grant tax deductions for expenses not connected with any specific income does not constitute a restriction on the freedom of establishment of Norwegian companies.

64. ESA remarks that the absence of full deduction could lead to a heavier overall tax burden for a Norwegian company with a branch in the UK, than for companies solely based in Norway if the costs attributed to the branch in the UK are not fully deductible there. However, in the given situation, such a difference would result from the differences in the two tax systems, as regards tax rate and rules on deduction.[26]

65. ESA concludes that when expenses not solely related to the activity in Norway are deducted from the income taxed abroad for the purposes of calculating the credit allowance, there is no restriction within the meaning of Article 31 EEA.

66. ESA next assesses the situation where debt interest and group contributions can be linked solely to the business in Norway. It submits that under such circumstances, the method for calculating the credit allowance would entail that a company with an establishment in another EEA State would derive from these expenses a lesser tax advantage than if it had operated solely in Norway. In the opinion of ESA, this amounts to differentiated tax treatment contrary to Article 31.

[26] ESA refers to Case C-513/04 *Kerckhaert* [2006] ECR I-10967, at paragraph 20, concerning a disadvantage resulting from the exercise in parallel by two States of their fiscal sovereignty.

67. ESA underlines that if certain expenses can be linked solely to the activity of the business in Norway, this means that even if the company had no branch (either in Norway or the UK) it would bear the exact same amount of expenses. Moreover, such expenses will not increase or decrease in proportion to the income of the branch. ESA also notes that such expenses will not be deductible from the income of the branch when calculating the tax payable in the UK.

68. In the given situation, the effect of the Norwegian tax rules is that expenses considered partially attributable to the branch in the UK are deductible from the tax payable in Norway only in proportion to the income of the Norwegian head office. This 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.[27] ESA remarks that if the expenses are intrinsically linked with 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 income derived in the territory of the branch.

69. ESA contends that a Norwegian company that establishes a branch abroad will suffer disadvantage since it will not be able to deduct from its income in Norway the same amount of expenses that it would have deducted had it not exercised its freedom of establishment. This disadvantage is, in ESA's view, not due to disparities between the tax systems of the two countries involved, but the manner in which the national tax provisions at issue treat expenses linked to the business in Norway. This is liable to discourage Norwegian companies from creating, acquiring, or maintaining a branch in another EEA State. The rules accordingly constitute a restriction on the freedom of establishment under Article 31 EEA.

70. ESA suggests answering the reformulated questions as follows:

> *1) Article 31 EEA does not preclude national tax provisions, such as those at issue in the main proceedings, whereby a portion of the deductible expenses that are not economically linked to the activity of the head office is allocated to a branch established in another Contracting Party for the purposes of calculating the maximum credit allowance.*
>
> *2) National tax provisions, such as those at issue in the main proceedings, whereby a portion of the deductible expenses that are economically linked solely to the activity of the head office is allocated to a branch established in another Contracting Party for the purposes of calculating the maximum*

[27] ESA refers to Case C-385/00 *de Groot* [2002] ECR I-11819.

credit allowance, constitute a restriction within the meaning of Article 31 EEA. It is for the national court to assess whether that restriction can be justified.

The Commission of the European Communities

71. With respect to the applicable EEA law, the Commission of the European Communities (hereinafter "the Commission") submits that the general prohibition of discrimination in Article 4 EEA does not need to be examined separately. Further, the relevant freedom is the freedom of establishment provided for in Article 31 EEA, whereas the free movement of capital protected by Article 40 EEA is only affected in a subsidiary manner.[28]

72. The Commission submits that as a general rule, the tax system of an EEA/EFTA State is not covered by the EEA agreement, but the States must however exercise their taxation power in consistency with EEA law.[29]

73. As concerns the freedom of establishment, the Commission states that its aim is to guarantee the benefit of national treatment in the host country by prohibiting any discrimination based on the place in which companies have their seat.[30] Equally, Article 31 EEA prohibits the EEA State of origin from hindering the establishment in another EEA State of one of its nationals or of a company incorporated under its legislation.[31]

74. In the present case, while a company doing business solely in Norway would enjoy a full deduction for the expenses in question, the Plaintiff has suffered double taxation by reason of the fact that part of its income is earned in another EEA State. Unless this difference in treatment corresponds to an objective and relevant difference in situation, it constitutes discrimination contrary to Article 31 EEA. Alternatively, if a company such as the Plaintiff is in a different situation from a company which operates solely in Norway, then any difference in treatment must correspond to that difference in situation.[32]

75. The Commission first examines the calculation of the maximum credit allowance in Norway in relation to expenses referred to in the first question, i.e.

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[28] The Commission refers to Case C-231/04 *Oy AA*, judgment of 18 July 2007, not yet published, at paragraphs 23–24.

[29] The Commission refers to Case E-6/98 *Norway* v *EFTA Surveillance Authority* [1999] EFTA Ct. Rep. 74, at paragraph 34; Case E-1/01 *Hörður Einarsson* [2002] EFTA Ct. Rep. 1, at paragraph 17 and Case E-1/03 *EFTA Surveillance Authority* v *Iceland* [2003] EFTA Ct. Rep. 143, at paragraph 26.

[30] The Commission refers to Case C-446/04 *Test Claimants FII* [2006] ECR I-11753, at paragraph 40.

[31] The Commission refers to Case C-264/96 *ICI* [1998] ECR I-4695, at paragraph 21 and Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, at paragraph 31.

[32] As concerns the concept of discrimination, the Commission refers to Case C-311/97 *Royal Bank of Scotland* [1999] ECR I-2651, at paragraph 26.

debt interest. In the Commission's view, if the interest expenses relate to financial obligations incurred for the company as a whole, then a proportional amount should indeed be attributed to the income earned in the UK. In that case, it would be up to the Plaintiff to make such a claim to the UK authorities. Whether or not the interest expenses relate solely to the business in Norway is, however, a question of fact for the national court. Therefore, the observations of the Commission are submitted on the hypothesis that the interest expenses in issue were incurred for the sole purposes of the Norwegian business operations of the Plaintiff.

76. The Commission holds that by attributing part of the interest expenses to the 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 rules on calculating the tax credit provide that debt interest expenses, which are deductible in Norway, must always be attributed to Norway or 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. The Commission is of the opinion that 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.

77. The Commission points out that Norway has recognised the disincentive against doing business in another country, inherent in (juridical) double taxation, by the laying down of rules in the DTA with the UK for the avoidance of such double taxation. Those rules allocate the taxing power, entitling the host State to tax the income of a permanent establishment, taking into account a proportionate amount of the general expenses of the taxpayer. The State of residence of the taxpayer is in return obliged to grant a credit in the amount of the tax paid, although not more than the amount it would charge on the same income.

78. The Commission contends that attributing interest expenses to the branch, in the manner laid down in the Norwegian legislation and applied in the case at hand, is contrary to the allocation of taxing power stipulated in the DTA. It disregards the rule that only expenses which are incurred for the purposes of the branch are deductible in the State where the branch is situated. This is also contrary to Article 31 EEA because it treats a company which makes use of its freedom of establishment less favourably than a company which operates solely in Norway, and may furthermore be considered contrary to that provision because it erects an important obstacle to cross-border business activity. There is no apparent justification for that obstacle, and none has thus far been pleaded by the Norwegian tax authorities.

79. In the Commission's view, the logic of the *de Groot* judgment,[33] relied on by the Plaintiff, is transferable to this case 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.

80. The Commission contends that the difference in tax rates between the two States involved cannot account for the large reduction made in the amount of the credit allowance. This difference clearly corresponds to the attribution of part of the interest expenses to the UK income. In so far as the interest expenses in question relate to a debt incurred solely for the purposes of the Norwegian business, the allocation of a part of them to the branch in Scotland in order to calculate the amount of credit for tax paid by the branch is contrary to Article 31 EEA.

81. With respect to the expenses referred to in the second question, i.e. group contributions, the Commission points out that even if the UK had a similar scheme of group contributions, it would not be obliged under Article 31 EEA to extend the scheme to a contribution made to a company in Norway.[34] That is, moreover, consistent with the scheme as laid down in the Norwegian legislation itself that applies solely to companies and to income taxable in Norway. Norway would not grant a deduction in respect of a group contribution to a company in the UK, nor can it expect the UK to grant such a deduction.

82. Accordingly, just as the attribution of a part of the specific expenses of the head office to the permanent establishment in another EEA State gives rise to discrimination contrary to Article 31 EEA, as described above, so is the attribution of a portion of the group contribution to the branch discriminatory, the Commission argues.

83. The Commission contends that such an attribution does not correspond to the situation of the taxpayer, as it disregards the fact that it is unable to deduct any part of the group contributions in the host State of the branch. By this, Norway has in effect re-appropriated, in an indirect manner, a portion of the tax base allocated to the UK under the DTA.

84. Further, the Commission submits that the attribution of part of the group contributions to the branch in the UK is contrary to the principle of fiscal cohesion, which serves to protect the "internal logic of national tax regimes", so

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[33] Case C-385/00 *de Groot* [2002] ECR I-11819.
[34] The Commission refers to Case C-231/05 *Oy AA*, judgment of 18 July 2007, not yet published.

long as they are not "arranged in such a way as to favour national situations or traders".[35]

85. The Commission argues that the principle of fiscal cohesion has in general been advanced by national tax authorities as a justification for measures which are unfavourable to taxpayers who do business across frontiers. Equally, it must be possible for the taxpayer to invoke the concept of cohesion in order to ensure that the tax rules are applied in a consistent manner and in accordance with the logic of the system. This approach can be seen in certain of the ECJ's judgments.[36]

86. In the Commissions' view, the group deduction scheme applied in the case at hand is based on a balancing which takes place solely at the national level in order to ensure there is no loss of tax base. The integrity of the tax base has been recognised as a legitimate interest.[37] EEA States may not artificially increase its tax base by, in effect, extending the group contribution scheme to cover income earned in another EEA State.

87. The Commission submits that consequently, the allocation in question of group contributions made by the Plaintiff is contrary to Article 31 EEA.

88. The Commission suggests answering the questions as follows:

> *1. Article 31 of the EEA Agreement precludes national tax provisions under which, in order to calculate the maximum credit allowance, a portion of the debt interest paid by a company is attributed to income earned through a foreign permanent establishment, in so far as the debt interest is not in reality attributable to the business activities of the foreign permanent establishment.*
>
> *2. Article 31 of the EEA Agreement precludes national tax provisions under which, in order to calculate the maximum credit allowance, a portion of the group contributions made by a company is attributed to income earned through a foreign permanent establishment..*

Thorgeir Örlygsson
Judge-Rapporteur

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35 The Commission refers to the Opinion of Advocate General Poiares Maduro in Case C-446/03 *Marks & Spencer* [2005] ECR I-10837, at paragraph 66.

36 The Commission refers to Case C-234/01 *Gerritse* [2003] ECR I-5933 and Case C-319/02 *Manninen* [2004] ECR I-7477.

37 The Commission refers to Case C-231/05 *Oy AA*, judgment of 18 July 2007, not yet published.