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EFTA SURVEILLANCE AUTHORITY

REASONED OPINION

delivered to the Kingdom of Norway in accordance with Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice finding that it has breached Article 40 of the Agreement on the European Economic Area and Article 1 of the Act referred to at point 1 of Annex XII to the EEA Agreement (Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty)

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REASONED OPINION

delivered to Norway in accordance with Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice due to a breach by that State of Article 40 of the Agreement on the European Economic Area and Article 1 of the Act referred to at point 1 of Annex XII to the EEA Agreement (Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty)

I. Introduction

In 2002, the Authority's Services carried out an examination of the tax legislation in Norway. One of the potential problems identified in relation to Norway's obligations under the Agreement on the European Economic Area (hereafter referred to as "the EEA Agreement") concerned the right for legal and natural persons to deduct donations to non-profit organisations from their taxable income.

The provisions concerning deductions on taxable income in respect of cash donations to non-profit organisations are laid down in section 6-50 of the Norwegian Tax Act, *lov av 26. mars 1999 nr. 14 om skatt av formue og inntekt* (hereafter mainly referred to as "the deduction rule"). Further rules are provided in a Regulation of 19 November 1999, *Forskrift til utfylling og gjennomføring mv. av skatteloven av 19. november 1999 nr. 1158.*

Those provisions allow deductions from taxable income of natural and legal persons only for donations to non-profit entities with a seat of administration in Norway.

II. Correspondence

On 6 March 2003, the Authority's Services sent a letter to Norway pointing out that the deduction rule appeared to be discriminatory and contrary to several of the fundamental freedoms enshrined in the EEA Agreement.

By a letter dated 8 May 2003, the Norwegian Government stated that it did not agree that the deduction rule was contrary to the EEA Agreement. As regards the requirement that a recipient non-profit entity must be seated in Norway in order to fall within the scope of the deduction rule, it was pointed out that it would be sufficient for such an entity seated abroad to have a branch in Norway. It was, furthermore, pointed out that, in order for donations to be deductible, a recipient non-profit entity was obliged to keep accounts of the received donations. These accounts must document that an amount corresponding to the funds received by donations has indeed been used for social activities as listed in the deduction rule. The accounts must, furthermore, be audited, and the non-profit entities are obliged to provide the tax authorities with certain information in machine-readable format.

It was submitted that it would be legally and practically difficult to determine that these requirements were met by non-profit entities seated abroad. Finally, it was submitted that, even if the donor would provide the tax authorities with information about the recipient non-profit entity, the entity itself would not be bound to follow the requirements laid down by the deduction rule, in particular those concerning accounting and auditing.

The issue was discussed at the Package meeting in Oslo in September 2003. At that meeting, the Norwegian delegation argued that the difference in treatment between non-profit entities with an administrative seat in Norway and similar entities seated abroad was necessary mainly as the auditing and accounting requirements applicable to non-profit entities donations to which are deductible, could not be imposed on entities outside Norwegian jurisdiction. The Authority's Services submitted that control concerns could, in general, be taken account of by requiring the tax payer himself to provide the tax authorities with the necessary information.

Being unconvinced by the Norwegian argumentation, the Authority, on 18 December 2003, sent a letter of formal notice to Norway. In this letter the Authority concluded that by maintaining in force Section 6-50 of the Tax Act Norway was in breach of Articles 4, 28 and 40 of the EEA Agreement, as well as Article 1 of Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty.

The Norwegian Government submitted its observations on the letter of formal notice to the Authority by a letter dated 16 April 2004.

The issue was, furthermore, discussed at the Package meeting in Oslo 15-16 November 2007.

Following the judgment of the Court of Justice of the European Communities (hereinafter "the Court of Justice") in case C-318/07 *Hein Persche* on 27 January 2009[1] the Norwegian Government was contacted by telephone and invited to reconsider its position. The Norwegian Government has not taken this opportunity to do so.

III. Relevant national law

According to paragraph 1 of the deduction rule, deductions on taxable income are granted to natural and legal persons, irrespective of nationality or state of registration, in respect of cash donations to companies, foundations and associations that do not have a commercial purpose (hereafter referred to as "non-profit entities") and are seated in Norway, provided that they pursue one of the social activities listed under lit. a)-f) of that provision.[2] However, it follows from paragraph 2 of the deduction rule that deductions are only granted in respect of donations made to non-profit entities that operate on a national basis ("countrywide") on 1 January of the year the donation took place. As far as donations to foundations are concerned, the grant of deductions furthermore presupposes that the foundation in question fulfils the requirements laid down in section 14 of the Act on Foundations, *lov av 25 mai 1983 nr. 11 om stiftelser mm.*

Pursuant to paragraph 4 of the deduction rule, the maximum deduction that can be granted a donor with reference to this provision is NOK 6.000, and only donations of NOK 500 and more are eligible for deduction.

Paragraph 5 of the deduction rule empowers the Ministry to issue further guidelines on the application of this provision and to impose conditions with regard to statutes, accounting, auditing and registration of non-profit entities in order for donations to it to be deductible.

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[1] Case C-318/07 *Hein Persche* v *Finanzamt Lüdenscheid*, judgment of 27 January 2009, not yet reported.

[2] E.g. work for the benefit of children, youth and elderly people, religious activities, charity work, work promoting human rights and development, work related to natural disasters and activities in order to prevent accidents and injuries, activities related to the promotion of culture and the protection of environment, nature and animals.

IV. Relevant EEA law

In light of the judgment in the *Persche* case, the Authority will only address the compatibility of the national legislation with the free movement of capital laid down in Article 40 EEA.

Article 40 EEA provides that, within the framework of the provisions of that 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.

Article 1 of the Act referred to at point 1 of Annex XII to the EEA Agreement, *Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty* (hereafter referred to as "Directive 88/361"), implements Article 40 of the EEA Agreement and obliges the EEA States to abolish restrictions on movements of capital taking place between persons resident in the EEA States.

Article 1 of Directive 88/361 refers to a non-exhaustive nomenclature in Annex I to the Directive, in which capital movement operations are classified. Gifts and endowments are mentioned under Heading XI "*Personal Capital Movements*", letter B of Annex I.

Article 4 of Directive 88/361 states that the Directive shall be without prejudice to the right of EEA States to take all requisite measures to prevent infringements of their laws and regulations, inter alia, in the field of taxation and prudential supervision of financial institutions, or to lay down procedures for declaration of capital movements for purposes of administrative or statistical information. However, according to the same provision, application of those measures and procedures may not have the effect of impeding capital movements carried out in accordance with EU law.

The EFTA Court and the Court of Justice have concluded that the rules governing the free movement of capital in the EEA Agreement are essentially identical in substance to those in the Treaty on the Functioning of the European Union ("TFEU").[3]

IV. The Authority's assessment

As already mentioned, Section 6-50 of the Tax Act allows deduction from taxable income only where donations are made to non-profit legal entities that have their seat of administration in Norway and fulfil certain additional requirements listed in that provision.

IV.I. Whether Section 6-50 of the Tax Act constitutes an impermissible difference in treatment in the meaning of EEA law

[3] Case E-1/04 *Fokus Bank ASA and the Norwegian State*, EFTA Court Report 2004, p. 22 paragraph 23; E-10/04 *Paolo Piazza* EFTA Court Report 2005, p. 100, paragraph 33; Case C-452 *Ospelt and Schlössle Weissenberg* [2003] ECR I-9743, at paragraph 28; C-521/07 *Commission of the European Communities* v. *Kingdom of Netherlands*, judgment of 11 June 2009 not yet reported, paragraph 33; C-562/07 *Commission of the European Communities* v. *Spain*, judgment of 6 October 2009 not yet reported, paragraph 67.

a) A breach of Article 40 of the EEA Agreement as implemented by Directive 88/361/EEC

It follows from Article 40 of the EEA Agreement that capital shall move freely between the EEA States. The EFTA Court has held that this provision encompasses all restrictions on the free movement of capital between the Contracting Parties.[4] It follows from the non-exhaustive nomenclature in Annex I to Directive 88/361, in which capital movement operations are classified, that personal capital movements are considered as capital movements within the meaning of Article 40 of the EEA Agreement and that Directive. In the Persche case, the Court of Justice recalled that gifts and endowments are specifically mentioned in the nomenclature in lit. B under Heading XI *"Personal Capital Movements"*.[5] Furthermore, donations made both in money and in kind must be considered to fall within the scope of the free movement of capital.[6]

Accordingly the Court of Justice stated in its judgment in *Persche* that *"[w]here a taxpayer of a Member State seeks the deduction for tax purposes of a sum reflecting the value of gifts to third persons resident in another Member State, it does not matter, in order to determine whether the national legislation in question is covered by the Treaty provisions on the movement of capital, whether the underlying gifts were made in money or in kind. [...] where a taxpayer claims, in a Member State, the deduction for tax purposes of gifts to bodies established and recognised as charitable in another Member State, such gifts come within the compass of the provisions of the Treaty relating to the free movement of capital, even if they are made in kind in the form of everyday consumer goods."*[7]

The Norwegian Government has pointed out that deductions are granted in respect of donations to large international organisations, such as the Red Cross and Save the Children, even though the funds these organisations receive from donations are also used outside Norway. This is due to the fact that these international organisations have a seat of administration in Norway. The Norwegian Government, furthermore, argues that, with regard to Article 40 EEA and the Capital Movements Directive, only the donor's *net* gift, *i.e.* minus the tax, can be considered to be covered by these provisions. The Government submits that there is no differential treatment depending on where the recipient organisation is seated as far as the *net* gift is concerned.

The Authority disagrees. It is clear from case law that the free movement of capital precludes a legislation which limits the deduction possibilities to donations made in favour of charitable bodies established in that State. In the *Persche* case the Court of Justice concluded that *"...since the possibility of obtaining a deduction for tax purposes can have a significant influence on the donor's attitude, the inability in Germany to deduct gifts to bodies recognised as charitable if they are established in other Member States is likely to affect the willingness of German taxpayers to make gifts for their benefit. [...] Such legislation constitutes, therefore, a restriction on the free movement of capital"*.[8]

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[4] Case E-1/00 *State Debt Management Agency and Íslandsbanki-FBA hf.* [2000] EFTA Court Report 8, paragraphs 25-28. See, in respect of the EC Treaty, Case C-439/97 *Sandoz GmbH* v. *Finanzlandesdirektion für Wien, Niederösterreich und Burgenland* [1999] ECR I-7041, paragraph 18.

[5] C-318/07 *Persche*, cited above, paragraph 24.

[6] C-318/07 *Persche*, cited above, paragraphs 25-27.

[7] C-318/07 Persche, cited above, paragraphs 25 and 30.

[8] C-318/07 *Persche*, cited above, paragraphs 38-39.

Consequently, the Authority maintains its view that Section 6-50 of the Tax Act is liable to dissuade Norwegian donations to charitable legal entities that are established in another EEA State. The provision, therefore, constitutes an obstacle to the free movement of capital.[9]

b) That the tax deduction constitutes state aid for the charitable institutions

The main argument put forward by the Norwegian Government is that the tax deduction rule in section 6-50 of the Tax Act is, in reality, an indirect state subsidy. Hence, by granting the donor a deduction from his taxable income, the State, in practical terms, subsidises the recipient non-profit entity with an amount equivalent to the tax which would have been due on the tax payer's hand, would the donor have donated taxed money. From the donor's and the recipient's point of view, it is submitted by Norway, the effects of this system are the same as those of a direct state subsidy system. Since direct state aid to non-profit entities is allowed under EEA state aid rules, the same must apply with regard to indirect state aid through tax deduction rules.

The Authority disagrees with this view. Although the result in terms of tax income for the Norwegian State may be the same regardless of whether non-profit entities are subsidised the one way or the other, the Authority holds that there is a significant difference from the perspective of the tax payer. As emphasised in the letter of formal notice, the Authority addresses the issue from the donor's perspective. A person who wishes to contribute to a non-profit entity would presumably, if possible, wish to benefit from the rule in Section 6-50 of the Tax Act. The average tax payer cannot be expected to take the Government's potential subsidy strategies into account. For the tax payer, the important issues are to support the charity of his choice and reduce his own tax base. Hence, the rule in Section 6-50 of the Tax Act is exactly the kind of provision that, according to settled case law by the Court of Justice, has effects that are liable to dissuade a person from donating funds to a non-profit entity that does not have an administrative seat in Norway.[10] Consequently, the argument of the Norwegian Government must be rejected.

c) That there is no appreciable effect from the differential treatment

The Norwegian Government has argued that the effects of the differential treatment are too indirect and minimal to amount to a restriction.

The Authority disagrees. It is sufficient to note that the Court of Justice has held on numerous occasions that the provisions of the TFEU on the free movement of goods, persons, services and capital are fundamental, and that any restriction, however minor, of these freedoms is prohibited.[11] Furthermore, reference is again made to the *Persche* case cited above where the Court of Justice stated *"As the Advocate General pointed out in paragraphs 47 and 48 of his Opinion, since the possibility of obtaining a deduction for tax purposes can have a significant influence on the donor's attitude, the inability in Germany to deduct gifts to bodies recognised as charitable if they are established in other Member States is likely to affect the willingness of German taxpayers to make gifts for their benefit."*[12] Accordingly, the argument of the Norwegian government must be rejected.

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[9] See, to that effect, case C-318/07 *Persche*, cited above; and Case C-484/93 *Svensson and Gustavsson* ECR [1995] I-3955, paragraph 10.

[10] C-318/07 *Persche*, cited above, paragraphs 38-39.

[11] See Case 49/89 *Corsica Ferries France v Direction générale des douanes françaises* [1989] ECR 4441, paragraph 8.

[12] C-318/07 *Persche*, cited above, paragraph 38.

Consequently, the Authority maintains that Section 6-50 of the tax Act constitutes an obstacle to the free movement of capital within the EEA.

IV.II Justification grounds submitted by Norway

The difference in treatment that stems from Section 6-50 of the Tax Act may, in principle, be justified on grounds of public policy, public security and public health. In this context, and in particular in relation to arguments submitted by Norway related to the financial effects of the donation rule, the Authority recalls that economic aims can never be considered a valid ground of justification.[13]

In its letter of 16 April 2004, the Norwegian Government invokes two justifications, both of which are considered by the Government to be in the public interest: (a) the importance of maintaining the independence of non-profit organisations, and (b) the effectiveness of fiscal supervision.

a) Independence of non-profit organisations

As regards the importance of maintaining the independence of non-profit organisations and securing their funding for social activities, the Authority assumes that the Norwegian Government refers to the aim that such organisations be independent from the State. According to the Norwegian Government *"A system of tax-deductible donations is a suitable measure for this purpose and must be considered as proportionate to the aim of ensuring independence for non-profit organisations."*

The Authority fails to see the link between the difference in treatment in Section 6-50 of the Tax Act and the wish to uphold the independence of non-profit entities. If private donations are considered an appropriate means to ensure funding of non-profit entities to support social activities, it remains unclear why the same rules cannot apply equally to donations made to non-profit entities irrespective of whether the entities have a seat in Norway.

b) Effectiveness of fiscal supervision

As regards the effectiveness of fiscal supervision, the Court of Justice has repeatedly held that that aim is legitimate provided that the measures taken to achieve that aim are proportionate. [14]

It is also clear from consistent case-law that this legitimate aim may be upheld with less restrictive measures than a difference in treatment.[15]

As the Norwegian Government has correctly noted in its letters, *Directive 77/799/EEC of 19 December 2007 concerning mutual assistance by the competent authorities of the*

[13] See, in particular, Cases C-352/85 *Bond van Adverteerders* [1988] ECR I-2085 paragraph 34; C-288/89 *Stichting Collectieve Antennevoorziening Gouda and others v Commissariaat voor de Media* [1991] ECR I-04007, paragraph 11; Case C-484/93 *Svensson and Gustavsson*, mentioned above, paragraph 15; C-265/95 *Commission v France* [1997] ECR I-6959, paragraphs 61-62; C-398/95 *Syndesmos ton Elladi Touristikon kai Taxidiotikon Grafeion v Ypourgos Ergasias* [1997] ECR I-3091, paragraph 23; C-39/04 *Laboratoires Fournier SA* v *Direction des vérifications nationales et internationales*, [2005] ECR I-2057, paragraph 31.

[14] C-318/07 *Persche*, cited above, paragraph 52.

[15] See Case C-422/01 *Skandia, Ola Ramstedt and Riksskatteverket* [2003] ECR I-6817, paragraph 44, Case C-136/00 *Rolf Dieter Danner* [2002] ECR I-8147, paragraph 51.

Member States in the field of direct and indirect taxation[16] is not part of the EEA Agreement. However, as the Court of Justice has repeatedly held, notwithstanding Directive 77/799/EEC, there is nothing to prevent the tax authorities concerned from requiring the taxpayer to provide such proof as they may consider necessary in order to determine whether the conditions for deducting contributions provided for in the legislation at issue have been met and, consequently, whether to allow the deduction requested.[17]

Following this line of case law the Court of Justice addressed this issue in detail in paragraphs 51 to 72 of its judgment of the *Persche* case. It confirmed that a Member State may apply measures enabling it to ascertain, including from the donor, in a clear and precise manner whether the body to which the donation is made meets the conditions imposed by national law in order to be entitled to the exemption and to monitor its effective management. It also held, however, that any administrative disadvantages arising from the fact that such bodies may be established in another Member State are not sufficient to justify a refusal on the part of the authorities of the State concerned to grant such bodies the same tax exemptions as are granted to national bodies of the same kind. The Court also held that nothing prevents the tax authorities of the State of the donor from refusing the deduction applied for if the evidence that they consider they need to effect a correct assessment of the tax is not supplied. It made clear that as regards charitable bodies in a country that is not a member of the EU it is legitimate, as a rule, for the State of taxation to refuse to grant such a tax advantage if, in particular, because that non-member country is not under any international obligation to provide information, it proves impossible to obtain the necessary information from that country.

The Authority does not dispute that Norway may lack jurisdiction over foreign non-profit entities as well as efficient means to oblige such entities without a seat in Norway to follow Norwegian accounting rules and to submit their accounts to Norway. However, it is clear from the *Persche* case and the other case law mentioned therein that all these concerns can be sufficiently addressed by requiring the donor to provide the Norwegian authorities with appropriate documentation about the recipient non-profit entity. If the tax payer fails to do so, the Norwegian tax authorities would be entitled to refuse the deduction of the donated amount.

Finally, it is recalled that similar issues were discussed by the Norwegian Government in the White Paper, Ot. prp.no 1 (2003-2004) with regard to the proposed changes of Section 5-20 and 5-21 of the Tax Act.[18] In this context, the Ministry of Finance observed that only Norwegian insurance companies could be obliged to submit accounts and statements to the tax authorities. Notwithstanding this fact, the Ministry proposed amendments to the relevant rules to the end that the tax subject, *i.e.* the insured person, would be required to provide the necessary information with regard to the insurance company established abroad.

Consequently, the Authority concludes that Norway has failed to provide sufficient arguments that could, in the given circumstances, justify the breach of Article 40 of the EEA Agreement and of Article 1 of Directive 88/361.

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[16] OJ 1977 L 336, p.15.

[17] See, e.g. Case C-204/90 *Bachmann,* mentioned above, [1992] ECR I-249, paragraphs 18 and 20, Case C-300/90 *Commission v. Belgium* [1992] ECR I-305, paragraphs 11 and 13, Case C-136/00 *Rolf Dieter Danner,* mentioned above, paragraph 50, Case C-422/01 *Skandia, Ola Ramstedt and Riksskatteverket,* mentioned above, paragraph 43.

[18] See Ot. prp nr. 1 (2003-2004), at p. 22-23.

EFTA SURVEILLANCE AUTHORITY

FOR THE ABOVE REASONS,

THE EFTA SURVEILLANCE AUTHORITY,

pursuant to the first paragraph of Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, and after having given the Kingdom of Norway the opportunity of submitting its observations,

DECLARES AS ITS REASONED OPINION

that the Kingdom of Norway, by maintaining in force provisions of national law that allow deductions from taxable income of natural and legal persons only for donations to non-profit entities with a seat of administration in Norway, such as Section 6-50 of the Tax Act *(lov av 26. mars 1999 nr. 14 om skatt av formue og inntekt)*, is in breach of Article 40 of the EEA Agreement and Article 1 of the Act referred to at point 1 of Annex XII to the EEA Agreement (Council Directive 88/361/EEC of 24 June 1988 for the implementation of Article 67 of the Treaty).

Pursuant to the second paragraph of Article 31 of the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice, the EFTA Surveillance Authority requires the Kingdom of Norway to take the necessary measures to comply with this reasoned opinion within *two months* following notification thereof.

Done at Brussels, 16 December 2009

For the EFTA Surveillance Authority

Xavier Lewis

Kurt Jaeger
College Member

Xavier Lewis
Director