Chapter 1
Mandate and summary

1.1 Mandate

On 15 March 2013, the Stoltenberg II Government appointed a commission to review corporate taxation in Norway in light of international developments. The Commission was given the following mandate:

"Background

Supporting the production capacity of the mainland economy is important. A broad range of measures must be employed to improve competitiveness and ensure the efficient use of resources. Norway has found that tax reforms can have a positive effect on the economy. Tax-system design and robustness play an important role. The closer integration of markets as a result of globalisation has motivated various countries to amend their tax rules. Internationally, there is a trend towards combining lower corporate tax rates with measures to prevent undesirable cross-border tax planning. The purpose of this review is to ensure that Norway maintains a robust tax system that is better equipped to deal with the international mobility of tax bases. The tax system must also contribute to the future financing of the welfare system and make it attractive to invest and create jobs in Norway.

The emphasis of the 1992 tax reform was on equal tax treatment, broad tax bases and low rates, with a particular focus on corporate and capital taxation. These guiding principles were also followed in the 2006 tax reform. The theoretical foundation and close integration of different parts of the tax system have produced a robust, stable tax system and reduced tax-adjustment incentives. The positive features of the tax system are believed to have helped Norway to maintain relatively high overall tax rates compared to other countries without incurring higher economic costs.

The 1992 reform followed an international trend of broadening tax bases and reducing tax rates. Norway went further than many other countries. The corporate tax rate was reduced from 50.8 per cent to 28 per cent. Distributional preferences were addressed particularly by the progressive taxation of labour and pension income and the retention of the wealth tax for individuals. In contrast, the main aim of the corporate and capital taxation design was to ensure efficient resource use.

The difference between the tax rates on capital income and labour income, and the opportunities available to transform business income into capital income, necessitated further tax reform. The 2006 tax reform introduced the shareholder model, the partnership model and the self-employed model. Today, ownership income above an estimated risk-free return on invested capital is taxed either as personal income (self-employed model), or as ordinary income when paid to business owners (shareholder model and partnership model for participants in a general partnership, limited partnerships etc.) An evaluation of the 2006 tax reform has indicated that the reform has been successful, and that tax arbitration through the shifting of labour income into capital income has largely been eliminated.

Reduced corporate taxes will make more investments profitable, but localisation decisions depend on many factors, including the government's ability to implement a sound economic policy, proximity to markets, the openness of trading systems, access to skilled workers, cost trends, the institutional framework, the administrative burden and available infrastructure. Globalisation and greater mobility of tax bases increase the relative importance of taxes in investment decisions. Norway is a small, open economy in which capital flows relatively freely across borders. The required return on investments will thus be determined by the international capital market.

The Norwegian corporate tax rate of 28 per cent has remained unchanged since 1992. At the same time, the average corporate tax rate in the EU27 has fallen from 35.3 per cent in 1995 to 23.5 per cent in 2012. The effective corporate tax rate (taxes paid as a percentage of the company's actual earnings), has also fallen, although not by as much because rate reductions have often been combined with base-broadening. Corporate tax as a share of GDP has fluctuated around 3 per cent in the EU27 in the same period.

Differences in corporate taxes between countries allow multinational enterprises (MNEs) to engage in profit shifting – using deductions and transfer pricing to shift profits from high-tax to low-tax countries. For example, the part of an MNE located in a high-tax country may take out a loan to finance other parts of the MNE, while equity is concentrated in countries with low corporate tax rates. Transfer pricing includes the pricing of services and intellectual property rights in transactions within MNEs. For tax purposes, the price should be set at the estimated market price, i.e. the price two independent parties would set (the arm's length principle), but this may be difficult to do in practice.

The corporate tax base has also changed in many countries. More countries are combining reduced corporate tax rates with measures to prevent the tax base from being undermined by the international activities of companies. Several countries have also shifted the tax burden from income taxes to consumption taxes.

"Tax Policy Reform and Economic Growth" (OECD 2010) discusses how shifting the tax burden between different taxes can promote increased growth and welfare. Subject to the proviso that the context of each country must also be considered, the study recommended that member states shift some of the tax burden from income taxation to less distortive taxes, such as taxes on consumption and property. The OECD argued that such a tax shift can be growth-enhancing in the long term. According to the report, it is first and foremost corporate taxes that are most harmful to economic growth.

Changes in international conditions make it necessary to consider the Norwegian tax rules in general, and corporate tax in particular.

Further details of what the Commission is to consider

Norway wishes to maintain a robust tax system that generates high revenues for the public sector. Accordingly, and given that the tax base is more mobile as a result of globalisation, the Commission is to consider potential changes in the area of corporate tax. The Commission is also to examine whether the taxation of companies is well adapted to international developments.

The Commission is to consider whether the corporate tax rate should be changed. A change in the corporate tax rate must be evaluated by reference to the rest of the tax system, in terms of both revenue and organisational structure. The different parts of the Norwegian tax system are tightly integrated, and the 28 per cent rate on ordinary income is applied in both personal and corporate taxation. The introduction of a uniform rate is believed to have reduced the possibility of tax avoidance associated with tax rate differences, and to have improved the stability of the tax system. A change in the corporate tax rate must be evaluated by reference to the tax system as a whole, and the relationship between personal and corporate taxation must be considered in context. In this connection, thought must be given to whether the systemic changes made through the 2006 reform (the exemption method, the shareholder model and the harmonisation of marginal tax rates for different types of income), can be maintained if the 28 per cent rate changes.

The Commission must consider the effects of the proposed solutions, whether they will be robust and how undesireable tax planning can be avoided.

The Commission is to consider the possibility of shifting income and deductions between countries in order to save tax, and assess measures to protect the Norwegian corporate tax base. The Commission must provide an overview of the measures that have been implemented in other countries.

The Commission must also consider whether the difference in the tax treatment of debt and equity held by foreign investors creates room for tax avoidance and, if so, consider counter-measures. The Commission is to examine the possibility of protecting Norwegian corporate taxation by treating debt and equity equally, either by removing the right to deduct interest expenses from corporate tax (referred to as Comprehensive Business Income Tax - CBIT), or by granting companies deductions for the alternative return on equity (referred to as Allowance for Corporate Equity - ACE). Belgium and Italy have introduced variants of ACE.

The exemption method excludes corporate dividends and gains from taxation. The exemption method does not apply to shares in companies registered in low-tax countries outside the EEA or portfolio investments outside the EEA. The Commission must consider whether the exemption method

offers possibilities for tax avoidance with respect to cross-border income from equity and, if so, consider the need for changes.

The Commission is requested to discuss whether greater emphasis should be placed on less mobile tax bases. The overall taxation of real property in Norway is low, both compared to the taxation of other capital and compared to the taxation of real property in many other countries. The purpose of the report is not to consider the taxation of real property. The Commission may refer to a scenario that includes increased taxation of real property, but the emphasis should be on alternatives that leave property taxation largely unchanged.

Guiding principles for the assessment

The main purpose of the tax system is to generate revenue. Tax policies should be designed so that the costs of taxation are low. The tax system should stimulate effective use of resources and good investment decisions. The tax base should capture actual income. This is important both for efficiency and redistributive reasons. It is also necessary that the tax system works satisfactorily as an automatic stabiliser of the economy.

The tax system, in combination with the social security system, must provide strong incentives to choose work rather than social security benefits. This consideration should also be emphasised.

Taxation, together with the social security system and an economic policy of full employment, helps to reduce income inequality. The Commission is to consider effects on income distribution, and discuss how its proposals meet redistributive aims.

The tax system should be as simple as possible, and the administrative costs to both taxpayers and the tax administration should not be too high. The Commission must discuss administrative consequences.

The Commission's proposals must take into account Norway's international obligations.

The Commission's proposals should be approximately revenue-neutral. The Commission is not requested to consider the special tax regimes for petroleum and hydropower companies, and can assume that revenue from these regimes will remain unchanged.

The Commission's report must present analyses of how changes to the tax system will affect economic decisions and thus resource use, employment, tax revenue and redistribution in both the short and long term. The Commission is to examine how the changes will affect production and growth. The Commission must give particular emphasis to empirical analysis of the proposals.

The Commission is to take into account developments in corporate tax theory, for instance by drawing on external expertise. The Ministry of Finance will establish a consultative forum of experts drawn from labour organisations, employer organisations and other institutions. The Commission is also to promote openness and debate, for instance by organising seminars.

The Commission shall submit its report by 15 October 2014."

On 8 November 2013, the Commission received a letter from the Minister of Finance containing a supplementary mandate from the Solberg Government. In the letter, the Commission was asked:

- To assess tax changes that, overall, result in tax reductions. This assessment is to be supplemented by at least one proposal which, overall is approximately revenue-neutral; see the mandate.
- To review and improve the system governing depreciation for tax purposes. The objective is strong correspondence between the depreciation rules and actual depreciation, although accuracy must be balanced with simplicity. A further review of actual depreciation relating to different types of assets is required.

1.2 The composition and work of the commission

The commission has had the following members:

- Managing director Hans Henrik Scheel (commission chair), Bærum
- Associate professor Annette Alstadsæter, Oppegård

- Director Legal Beate Bentzen, Oslo
- Attorney Joachim M. Bjerke, Bærum
- Attorney Aleksander Grydeland, Oslo
- Professor Guttorm Schjelderup, Bergen
- Justice of the Supreme Court Kristina Ståhl, Sweden
- Professor Peter Birch Sørensen, Denmark

The commission secretariat has comprised the following persons:
- Deputy Director General Ingrid Rasmussen, Ministry of Finance, chair
- Legal adviser Frode Kristiansen, Ministry of Finance
- Legal adviser Marius Pilgaard, Ministry of Finance
- Legal adviser Trude Steinnes Sønvisen, Ministry of Finance
- Legal adviser Martin Børresen, Ministry of Finance
- Senior adviser Marie Bjørneby, Ministry of Finance
- Senior adviser Thomas Klev, Ministry of Finance
- Senior adviser Kari Anita Syverud, Ministry of Finance
- Senior adviser Petter T. Solbu, Ministry of Finance
- Legal adviser Henriette Strandskogen Hjort, Ministry of Finance (from 25 September 2014)
- Senior adviser Øystein Bieltvedt Skeie, Ministry of Finance (until 31 August 2013)

The Commission held 15 meetings in the period 18 April 2013 to 24 November 2014. The Commission also hosted an open seminar at the Hotel Bristol on 29 November 2013.

Due to the expansion of the mandate, the submission deadline was extended from 15 October 2014 to 2 December 2014. Professor Peter Birch Sørensen (Commission member), Department of Economics, University of Copenhagen, and Statistics Norway have contributed annexes to the report.

The Ministry of Finance established a consultative forum of experts drawn from labour organisations, employer organisations and other institutions. The Commission met three times with the consultative forum, and additionally received written feedback from various other parties. The consultative forum consisted of:
- Diderik Lund, University of Oslo (chair)
- Norwegian Confederation of Trade Unions (LO) (Ellen Bakken/Maria Schumacher Walberg)
- Confederation of Vocational Unions (YS) (Helle Stensbak)
- Federation of Norwegian Professional Associations (Frode Lindseth)
- Unio (Erik Orskaug)
- Confederation of Norwegian Enterprise (Michael Riis Jacobsen and Ellen Mulstad)
- Virke (Camilla Forgaard Andreassen)
- Finance Norway (Jan Digranes)
- Norwegian Shipowners' Association (Lars Christian Tønder)
- Norwegian Association of Local and Regional Authorities (KS) (Helge Eide)
- Norwegian Association of Small and Medium-sized Enterprises (Hedvig Svardal)
- Norwegian Bar Association (Bettina Banoun)
- Norwegian Institute of Public Accountants (Rita Granlund)
- Norwegian Association of Authorised Accountants (Knut Høylie)
- Norwegian Tax Payers Association (Rolf Lothe)
- Tax Justice Network (Sigrid Klæboe Jacobsen)
- Ragnhild Balsvik, Norwegian School of Economics
- Frederik Zimmer, University of Oslo
- Øystein Dørum, DNB Markets
- Elisabeth Holvik, Sparebank 1
- Hugo Pedersen Matre, Advokatfirmaet Schjødt (law firm)
- Marianne Andreassen, Norwegian State Educational Loan Fund
- Bernt Sverre Mehammer, COWI

1.3 Delimitation of work

Although the mandate first and foremost concerns corporate taxation, it also permits assessment of many aspects of the tax system. The Commission has primarily assessed changes to corporate taxation, but also considered the economic connection between personal and corporate taxation and the need to ensure that this is taken into account in the Norwegian tax rules. The Commission has not reviewed all aspects of personal taxation, concentrating instead on the areas that are most relevant to its other proposals. As per the mandate, the Commission has not assessed the special tax regimes for hydropower and petroleum income.

The Commission considers it important that Norway has a tax system that provides maximum support for efficient resource use and economic growth. The Commission has therefore also considered changes to the composition of direct and indirect taxes. Reflecting the mandate, these assessments are of a general, largely undetailed nature. With the exception of value added tax, the Commission has not considered the composition of the indirect tax system.

The mandate directs the Commission to focus primarily on alternatives under which real property taxation remains approximately unchanged. The Commission has therefore not given detailed consideration to all aspects of property taxation, such as municipal property tax.

1.4 Summary and the Commission’s recommendations

1.4.1 Background and starting point

Norway is dependent on large tax revenues to fund public expenditure, e.g. the welfare state. Over the coming decades, public spending on pensions, health and care services will increase as the population ages, and tax revenues from the mainland economy will be the most important source of funding. However, a disadvantage to most taxes is that they have a negative impact on growth. To promote production, it is important to have a tax system that provides the greatest possible stimulus for efficient resource use.

The Commission is of the opinion that, generally speaking, Norway has a good tax system. The tax reforms of 1992 and 2006 helped to broaden tax bases and ensure more uniform taxation of different types of income. In particular, the 1992 reform led to more equal treatment of different capital incomes and gains, and thus reduced the opportunities for and profitability of tax planning. Lower tax rates also reduced the profitability of avoidance. The 1992 reform promoted better resource exploitation and economic growth without materially distorting the real income distribution. The 2006 reform resulted in more equal treatment of different forms of labour income, and ensured that labour income and particularly profitable investments are treated more uniformly. The reforms have given income taxation a principled foundation and logical consistency across different enterprises and persons. This has made the system relatively stable and predictable.

In the Commission’s view, it is important to build further on the principles which Norwegian income taxation is designed to protect:

- Neutrality. Equal treatment of, for example, different forms of ownership, forms of saving and investments.
- Symmetry. Income and associated costs should be treated equally.
- Uniform taxation of work income, whether taking the form of salary, business income or ownership income (dividends or gains).
- Continuity. The tax position of capital should not be altered in the event of inheritance, gift, merger, etc.
- Coordination. The equalisation of profits over time and between different enterprises (losses should be deductible from profits).
- Low tax rates to reduce efficiency losses in connection with taxation, the motivation to engage in tax avoidance and the profitability of tax planning.
- Broad tax bases corresponding to actual income. This promotes efficient resource use.

These principles have helped to build a tax system that has generally achieved tax revenue and redistributive aims in most areas, and that has had little negative impact on economic efficiency. The Commission considers that the principles also constitute good guidelines for the design of the future tax system,

given the challenges Norway will encounter. In accordance with the mandate, the Commission has primarily considered how corporate and capital taxation should be designed in response to the increased mobility of capital and ownership across national borders. In the context of capital taxation, the so-called residence principle has provided a basic starting point. The residence principle states that capital income must be taxed under the rules and rates applicable in the home country of the capital owner, irrespective of where the capital is invested. In principle, both individuals and companies resident in Norway must pay tax to Norway on their total income (global income). Further, the tax rules have been designed to treat Norwegians' domestic and foreign investments as uniformly as possible. One measure in this regard is the ability to deduct tax paid abroad from Norwegian tax (the credit method).

The Commission is of the opinion that a small, open economy should ideally apply the residence principle as consistently as possible. This would help to ensure that capital taxation in Norway does not reduce the returns on investments in Norway compared to investments in other countries. The residence principle should be the guideline for capital taxation. Nevertheless, administrative considerations indicate that capital taxation cannot be designed consistently enough to ensure absolute equality in the treatment of investments in Norway and investments abroad. In practice, several scenarios necessitate deviations from the residence principle in the design of the tax rules, particularly in the area of corporate taxation.

1.4.2 The main difficulties with corporate tax

The Commission considers that the following developments must be taken into account in the design of the tax system, and corporate tax in particular:

- Cross-border economic integration and investment has increased, and the impact of taxes on corporate investment, financing and ownership has changed. The opportunities for both legal and illegal cross-border tax planning have increased, and there are strong indications that taxpayers are exploiting these opportunities to a greater extent than before.
- Several tax bases are more mobile than before. Not only are both companies and persons more mobile in physical terms, but the increased digitalisation of the economy is also reducing the relevance of physical presence. Further, the EEA Agreement has made such cross-border transactions easier within the EEA, and limits Norway's opportunities to levy tax. Although increased mobility is positive for production, it represents a challenge in the context of taxation.
- Internationally, there is discussion of how national and international tax rules should be adjusted to protect the corporate tax base and counter the shifting of profits to low-tax countries, primarily through the legal exploitation of current rules. Studies indicate that the taxable profits of multinational companies do not correspond to their production levels and actual earnings. The G20 countries asked the OECD to study these issues and propose measures to prevent such erosion of tax bases. The OECD/G20 initiative focusing on this area is often referred to as the BEPS (Base Erosion and Profit Shifting) project. In 2013, the OECD presented an action plan comprising 15 action points and a timetable.
- Corporate taxation is changing in many countries. The average corporate tax rate in the OECD area has fallen from almost 50 per cent in the early 1980s to around 25 per cent today. Several countries have also implemented special cuts in the tax rate for selected types of income, such as profits on certain intangible assets (patent boxes). At the same time, ever more countries are introducing rules to counter the shifting of profits and erosion of the corporate tax base. For example, many countries are limiting deductions in respect of interest expenses.

Based not least on these international developments, the Commission has identified three primary challenges relating to corporate tax in Norway:

- Norway's relatively high effective tax rates give incentives to invest in countries with lower tax rates. This also applies to Norwegian taxpayers, because it is impossible to apply the residence principle consistently in the context of capital taxation. For example, the combination of the exemption method and the shareholder model breaches the residence principle.
- Corporate debt and equity are treated differently. Funding costs connected to debt financing (interest) are deductible, whereas costs connected to equity financing are not. In an open economy, such differ-

ential treatment will, in isolation, encourage companies to increase their gearing. Although this differential treatment is countered by Norway's personal taxation rules, this is of little relevance to the funding structures of businesses that secure funding in the international capital market. The differential treatment of debt and equity also facilitates legal profit shifting; see below.
- A relatively high statutory tax rate gives incentives for multinational enterprises to shift profits to other countries, for example through thin capitalisation or tax-motivated transfer pricing.

The impact of corporate tax on investment should not be exaggerated. Many other factors play a substantial, and sometimes greater, role with respect to the level of investment. Norway is rich in resources, has a large skilled workforce and stable political system, and ranks low in international corruption-prevalence surveys. Factors that make business in Norway attractive also raise wage costs. These factors are more important for investment than tax issues.

Nevertheless, tax may have a noticeable effect on the margin, particularly if the tax level differs significantly from the level in countries that are otherwise comparable to Norway. In a globalised world of free capital movement, investments in Norway will compete for the same capital as investments in many other countries. However, the most relevant competition is likely to arise between investments in Norway and investments in Norway's neighbours and countries with which Norway already has substantial economic interaction. This applies particularly to countries such as Sweden, Denmark, the United Kingdom, Germany, France, the Netherlands and the USA.

It may be reasonable to avoid having an effective corporate tax rate that is significantly higher in Norway than in these countries. The effective tax rates in Sweden and Denmark are of particular relevance, since these two countries are close to Norway both socially and geographically. Effective tax rates on investments, which take both tax rates and tax bases into account, are relatively high in Norway compared to the rates in the said countries.

One consequence of a high effective corporate tax rate is to increase the significance of the differential treatment of corporate debt and equity. Unlike dividends, companies may deduct interest expenses. Although, in isolation, the deduction of interest expenses reduces the cost of capital on debt-funded investments, the Commission is of the view that it is undesirable for corporate debt to be granted preferential treatment. The preferential treatment of debt is an important factor in profit shifting within multinational groups; see below. Such preferential treatment of debt may also encourage increased gearing by companies. This may result in a loss of efficiency, not least due to companies assuming a higher risk of bankruptcy. The differential treatment of corporate debt and equity may also mean that the corporate tax rate has a different impact on companies with access to debt financing than companies that depend on equity financing. Differential treatment of debt and equity may thus distort the investment composition. In an open economy, it will be impossible to compensate fully for the favourable treatment of debt in the context of corporate tax through the taxation of Norwegian investors. The corresponding favourable treatment of equity held by Norwegian personal taxpayers (tax on interest income and tax-free ownership income under the allowance for shareholder equity), can only partially counter the favourable treatment of debt, primarily in the case of investments that lack access to international funding and instead depend on Norwegian equity.

Norway not only has relatively high effective tax rates, but also a high statutory corporate tax rate. In 2014, the statutory corporate tax rate was 1.7 percentage points higher than OECD average, and 4.4 percentage points higher than the EU average; see Figure 1.1. In this average, large and small countries are weighted equally, and many large economies like the USA, Japan and Germany have relatively high rates exceeding that of Norway. The Norwegian corporate tax rate is higher than the tax rates of many countries with which Norway is often compared, including the other Nordic countries. Several countries have recently implemented or announced further reductions. It appears that the trend towards reduced corporate tax rates is continuing, and that even countries with high national debts are not raising corporate tax rates to strengthen public finances.

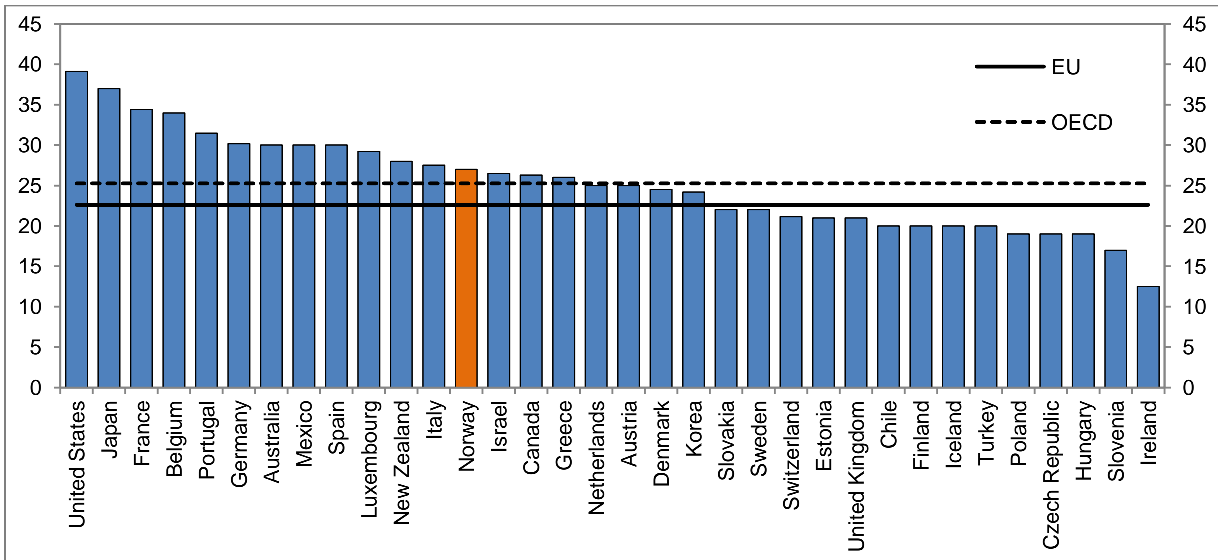

Figure 1.1 Statutory corporate income tax rates in OECD countries in 2014. Percentages.
Sources: OECD and KPMG Corporate Tax Rate Survey

One consequence of having a high statutory tax rate is that it makes the shifting of taxable profit out of Norway profitable. The term "profit shifting" describes transactions and allocations that reduce the tax burden in Norway but have little impact on the enterprise's investments and activity in Norway. Weaknesses in national and international rules allow multinational groups to shift taxable profits from group companies in Norway to group companies in countries with low or no taxes on income. Roughly speaking, profit shifting methods fall into three categories:

- Tax-motivated pricing of internal transactions between different group companies.
- High debt financing of companies in countries with high tax rates (thin capitalisation). This gives the interest deduction a high value.
- Avoidance of tax liability in respect of income or companies, including through exploitation of tax treaty networks and the use of hybrids.

In some countries, companies pay zero or almost no tax on their profits. As long as Norway has a positive statutory corporate tax rate, companies will have a motive to engage in profit shifting.

Research clearly indicates that groups employ both transfer pricing and financing structures to shift profits. This is also consistent with the experience of the Norwegian tax authorities.

The Commission is of the opinion that, over time, profit shifting may make it difficult to maintain the level of corporate tax revenues in Norway. Even if profit shifting does not represent a tax-revenue problem, it may nevertheless undermine the legitimacy of the tax system if some companies avoid or reduce their tax liabilities while other companies pay the full amount of tax. Profit shifting thus has an undesirable distorting effect on competition, since it favours companies with the opportunities and resources to engage in such tax planning.

In the Commission's view, the possibility of engaging in both legal and illegal tax planning challenges the tax system, and the Commission has therefore considered how the tax rules can be designed to limit such arrangements. The Commission has proposed several measures to reduce the opportunities for, and profitability of, tax planning. Although illegal arrangements must primarily be combated through the enforcement of the existing rules, the Commission has also proposed some changes to reduce the opportunities for and profitability of illegal arrangements. Further, the Commission has proposed changes to make enforcement more efficient.

1.4.3 General comments on the Commission's proposals

In compliance with the mandate and supplementary mandate, the Commission has made one proposal estimated to be approximately revenue-neutral and one proposal involving tax reductions. Although the supplementary mandate contained no guidance on the size of the tax reductions, the Commission has

proposed tax reductions totalling NOK 15 billion at its own discretion. This should provide sufficient scope to make important tax changes while still being realistic in a budgetary context.

Emphasis has been given to ensuring that the proposals as a whole promote a more robust and efficient tax system. A number of empirical and theoretical studies indicate that the overall harmful impact of the tax system could be reduced by placing less emphasis on corporate tax in relative terms. The Commission is of the view that strong emphasis should be given to broad tax bases, and that taxable income from business activities should correspond to actual profit. To avoid investment distortions and poor use of resources, depreciation rates should, as far as possible, correspond to actual depreciation. Corporate tax relief should therefore take the form of reductions in the tax rate rather than reductions in the tax base, for example through depreciation that exceeds actual economic depreciation. A lower corporate tax rate would also reduce undesirable distortion of corporate taxation, including favourable treatment of debt, and the profitability of shifting profits out of Norway.

Norway's corporate tax rate is high in an international context. Deciding how far to reduce the tax rate involves a difficult balancing act. The Commission has emphasised that the tax system, along with other economic conditions, needs to be able to compete for investment and business in an internationalised market. On the other hand, the Commission would advise Norway against taking the lead in an international tax competition in which countries compete to offer particularly low tax rates to companies, on certain types of business income or through patent boxes. Given corporate tax rates in other countries, particularly the Nordic countries, and the broad tax base recommended by the Commission, the Commission has proposed reducing the corporate tax rate to 20 per cent.

The Commission has reviewed different models of corporate taxation, but concluded that the best approach will be to build on the current system. However, the Commission is of the opinion that special measures are needed to counteract profit shifting and erosion of the corporate tax base.

The Commission suggests recovering some of the revenue lost by reducing the corporate tax rate by implementing more correct tax depreciations. The majority of the Commission also suggests that some of the revenue lost by reducing the corporate tax rate be recovered by introducing a stricter interest deduction limitation. The Commission also proposes a net tightening of the tax rules applicable to cross-border activities. Overall, the proposal implies net reductions in corporate tax and broadening of the tax base.

Some of the reductions in corporate tax can be recovered through increased taxes on the financial sector. The sector is currently under-taxed because most financial services are exempt from value added tax. The Commission has proposed, as a first step, introducing a tax on margin-based income and value added tax on services on which fees are payable.

In accordance with the mandate, the Commission has not assessed the special tax regimes for petroleum and hydropower companies, although it is assumed that a reduced corporate tax rate may be countered by increasing the special tax for petroleum companies and economic rent tax on hydropower.

The Commission has assessed how personal taxation should be adjusted in view of the reduced corporate tax rate. Not least to counteract tax avoidance, the Commission proposes the retention of a common rate on ordinary personal and corporate income. It therefore also proposes a reduction in the tax rate on ordinary personal income to 20 per cent. To recover the resulting revenue loss, a new, progressive tax on personal income is introduced; this would also replace the current surtax. Overall, the changes would mean lower marginal tax on labour income for most taxpayers. In the proposal involving overall net tax reductions, priority has been given to further cuts in marginal tax rates on labour income.

A reduced corporate tax rate necessitates increases in the tax levied on ownership income (dividends, gains, etc.), to avoid strong incentives to shift income (transfer labour income to ownership income). The Commission considers that it is undesirable for the tax system to encourage income shifting, and therefore proposes that tax on owners should be set so that the marginal tax on ownership income including corporate tax is approximately equal to the maximum marginal tax on wages including employer's national insurance contributions. In the net-reduction scenario, the tax rate on ownership income is increased a little less than in the revenue-neutral proposal, since the marginal tax on labour income has been reduced further. In combination with reduced corporate tax, higher tax on ownership income will make capital taxation more residence-based, i.e. the choice between investing domestically or abroad will be less influenced by tax than before. Further, refocusing from corporate tax onto tax on ownership income will

mean lower taxation of the opportunity cost of capital and higher taxation of economic rents (ownership income exceeding the allowance for shareholder equity).

The Commission has also proposed other changes to the personal income taxation, the wealth tax and value added tax. The Commission sees room for further improvement in several of these areas, but in view of the mandate and the time available, the Commission has restricted itself to providing guidance on a more efficient tax system.

The proposed adjustment of the wealth tax implies a more uniform valuation of different assets, by giving real property greater weight in the tax base. This reduces the distorting effects of the wealth tax. At the same time, the Commission has proposed reducing the effective tax rate and increasing the basic allowance so that the revenue generated by the wealth tax remains unchanged.

The Commission is of the opinion that there are good reasons for scaling down the favourable treatment of residential property in the context of income taxation. As a first step, the Commission proposes the repeal of the tax exemption for rental income of up to 50 per cent of the market value of private residences.

Further, there is significant room for improvement in the personal income tax base. The justification for several allowances is weak. The efficiency loss in connection with taxation increases more than proportionately compared to the tax rate. This suggests broad tax bases and low rates. However, in light of its mandate, the Commission has restricted itself to proposing the removal of only some allowances with a weak connection with the earning of income.

The value added tax system is largely unsuited to supporting distributional and other specific objectives. The Commission is of the opinion that the sole purpose of value added tax should be to generate tax revenue. The simplest and most efficient way of doing so is to have a single value added tax rate that is applicable to all consumption of goods and services. However, a change to a single rate would imply large increases in certain sectors, and this alternative should therefore be assessed in a wider context and potentially be introduced gradually over time. The Commission has therefore proposed a dual-rate value added tax system in which the general rate of 25 per cent is retained but the current zero rate and lowest rate are increased to 15 per cent, corresponding to the current rate on food. This change would generate increased revenues from value added tax.

Overall, the Commission's proposals involve giving less emphasis to corporate tax and personal income tax and greater emphasis to consumption taxes and taxes on real property. Such a shift in taxes is consistent with international recommendations for achieving a more efficient tax system. Since the overall effect of the proposal is to shift the tax burden towards taxes with relatively low economic costs while also expanding tax bases and reducing rates, the Commission expects the changes to have a positive impact on the growth potential of the economy.

The Commission's overall view is that the proposal would result in increased investment and labour supply, and promote better allocation of saving. This would promote increased labour productivity, a rise in real wages and higher returns on capital. In addition, the opportunities for profit shifting would be reduced. The Commission therefore anticipates that a considerable proportion of the immediate revenue loss linked to corporate and capital taxation would be compensated for by higher long-term tax revenues.

The various parts of the Commission's proposal are further elaborated on in 1.4.4.

Commission member Aleksander Grydeland is of the opinion that the current profit-based interest-limitation rule for companies should be repealed, and that it is sufficient for ownership income to be taxed at approximately the same level as in 2013, i.e. at approximately 48.2 per cent. Grydeland proposes that the revenue loss should be recovered by increasing the corporate tax rate to approximately 22 per cent, which is the same rate as in Sweden and Denmark (2016). Based on the Commission's assessments, Grydeland is also of the opinion that the tax rate on ordinary income at the personal level should be increased correspondingly. The new tax on personal income should be adjusted in view of the new rate so that, overall, the pay-taxation rate structure and the revenue effect of the changes to personal taxation are approximately the same as in the Commission majority's proposal. Alternatively, Grydeland supports the proposal of the Commission majority regarding a rate of 20 per cent on ordinary income.

1.4.4 Details of the Commission's assessments and proposals

1.4.4.1 The level and design of corporate tax

The Commission has assessed whether the current tax base should still be used in light of the challenges identified by the Commission. Based on the mandate, the Commission has assessed several alternatives to the current corporate tax system, I ncluding a cash flow tax, an allowance for corporate equity (the ACE model), or the abolition of the deduction of interest (the CBIT model).

Under a cash-flow tax, the tax base is the difference between inflows (receipts) and outflows (payments). The cash-flow tax functions as a tax on the present value of the net cash flow. Even if the State taxes a proportion of this net present value, the company still has incentives to maximise its pre-tax profits. A cash-flow tax has many attractive characteristics. It eliminates the current favourable tax treatment of debt in the context of corporate income tax, and does not distort marginal investment decisions. Nevertheless, the Commission does not recommend a general cash-flow tax for the entire corporate sector. Such a tax presents a range of practical challenges, including challenges related to cross-border investments, and would give incentives for tax planning.

A model that is much discussed in the international debate is based on a standard corporate income tax under which companies can deduct the opportunity cost of equity (ACE – allowance for corporate equity). A correctly designed ACE model would ensure that debt and equity are treated equally, and that all investment projects that are profitable pre-tax remain profitable post-tax. The Commission considers an ACE model feasible, but it will be difficult to design the model to prevent tax planning. For a given tax revenue, the model will require a higher tax rate than alternative models, and thus increase the incentives to engage in profit shifting. To prevent profit shifting through the deduction of interest costs, the ACE model could be modified by granting a deduction for the opportunity cost of all capital, both debt and equity (the ACC model). In this model, the deduction of interest is replaced with a standardised deduction for both debt and equity. This prevents profit shifting through interest deduction. Under an ACC model, financial sector taxation would have to be specially adapted, which in turn could trigger further tax planning strategies. Moreover, the ACC model presents challenges regarding integration with personal income taxation. In any event, the model should be combined with measures to prevent profit shifting through other types of deductions.

In a CBIT model, there are no deductions for funding costs, nor for interest costs. The company is thus taxed on the total return, irrespective of whether the investments are funded by debt or equity. On the one hand, the CBIT model raises the cost of capital for investments funded by debt. On the other hand, the model has a broader tax base that permits a lower tax rate, which reduces the cost of capital for equity-funded investments and the incentives to engage in profit shifting. The CBIT model raises many practical questions and problems, including the integration of financial sector taxation and personal taxation of capital income.

The Commission has examined the proposal of the Swedish corporate tax commission (SOU 2014:40) to abolish the net funding costs of companies. The Swedish proposal is largely a version of the CBIT model. The proposal would counter profit shifting, but at the same time present considerable challenges regarding the interaction between personal taxation and corporate taxation. The Commission cannot see that it is possible to avoid lock-in effects. Moreover, distortions would arise in the corporate sector through mergers and acquisitions involving companies with different interest rate positions. Equity-funded investments would be subject to lower tax as a result of the rate reduction (or capital deduction), while the model would increase the cost of capital of debt-funded investments.

Based on the above, the Commission would not recommend a CBIT model or the Swedish version of this model.

Based on an overall assessment, the Commission recommends keeping the current system for taxing companies. The Commission proposes that the corporate tax rate in Norway should be reduced from 27 per cent to 20 per cent. This rate cut will give Norway a corporate tax rate in line with the rates levied by its closest neighbours. A lower statutory tax rate will reduce the cost of capital in Norway, particularly for equity-funded investments. The different treatment of funding types would also be reduced somewhat by a

lower rate. Further, a lower corporate tax rate would, to some extent, make it less profitable to shift profits out of Norway.

A cut in the corporate tax rate on the scale proposed by the Commission will have a substantial impact on the tax system as a whole, with respect to revenue, redistribution and the design of personal taxation. The commission emphasises that the rate reduction must be combined with other measures to prevent profit shifting.

1.4.4.2 Taxation of cross-border income from shares

In principle, taxation in accordance with a consistent residence principle implies current taxation of Norwegian shareholders in respect of income earned by foreign companies. This would ensure the equal treatment of Norwegian investments irrespective of whether they are made at home or abroad. However, the Commission regards consistent residence taxation as rather unrealistic. It has therefore concluded that, in general, cross-border income from shares should continue to be taxed upon distribution or the sale of assets. Nevertheless, the Commission considers that there may still be reason to assess changes that promote more equal treatment of investments made by Norwegian owners abroad and at home and that will reduce the opportunities for profit shifting and erosion of the tax base.

A change that could help to ensure that Norwegian investments abroad are subject to at least the same level of taxation as investments in Norway is to replace the exemption method with a credit in respect of corporate tax paid abroad. A counter-argument is that the method would have to be limited and that this could mean weaker protection against chain taxation than under the exemption method. Further, a credit method would be more difficult to administer than the exemption method. It would also be difficult to design a practicable credit method for cross-border income from shares within the EEA. Overall, therefore, the scope for changes to the taxation of cross-border income from shares is very limited. The Commission would also point out that the exemption method is the most common method used internationally to avoid chain taxation of cross-border dividends.

The Commission has examined whether certain aspects of the current rules should be tightened up. In the case of share income from companies resident in low-tax countries within the EEA, the exemption method only applies if the company has been actually established and carries on genuine economic activity in its home country. One objective of the requirement for genuine economic activity, etc. is to prevent income earned in low-tax countries from being channelled through the EEA. The Commission would point out that the requirement must be interpreted in accordance with the case law of the European Court of Justice in this area. Further, the Commission has concluded that the Norwegian rules to prevent income earned in low-tax countries from being channelled through companies in EEA countries should be as strict as permitted under EEA law. The Commission has therefore asked the Ministry of Finance to monitor developments in EEA law on this issue and to consider whether there is scope for further measures to prevent income earned in low-tax countries from being channelled through intermediary companies without further taxation.

The Commission has also considered a number of simplifications to the exemption method. The exemption method applies to foreign companies equivalent to Norwegian companies covered by the exemption method. The assessment of whether a foreign company is equivalent to a Norwegian company can be complicated. The Commission has proposed that the ministry examine whether this assessment can be simplified by making companies whose owners have limited liability in respect of the company's liabilities subject to the exemption method. In the Commission's view, the requirement regarding the ownership percentage and ownership period in connection with investments in normal-tax countries outside the EEA is a further element that complicates the exemption method. In addition, the consideration of avoiding chain taxation may indicate that portfolio investments in normal-tax countries should be covered by the exemption method. The Commission therefore proposes the repeal of the ownership percentage and ownership period requirements.

The shareholder model applies in connection with the taxation of personal shareholders' income from equity irrespective of where the company is resident. The Commission has proposed that the shareholder model should not apply to income from equity from companies established outside the EEA. The Commission has also proposed that the shareholder model should only apply to income from equity from

companies established within the EEA if the company has been actually established and carries on genuine economic activity.

In the Commission's view, the NOKUS (CFC) rules have an important function in ensuring that residence-based taxation is not undermined by the opportunity to invest in low-tax countries. The Commission has therefore considered widening the scope of the NOKUS rules to make them more robust. However, the Commission recognises that the scope for such expansions is limited, particularly in view of the EEA Agreement and administrative circumstances. Nevertheless, it proposes raising the low-tax country definition threshold somewhat, from two-thirds to three-quarters of the Norwegian tax level. An increase in the threshold will help to ensure that Norwegian investments abroad are, to a greater extent, taxed at the same level as investments in Norway. The low-tax country definition should continue to be the same under the NOKUS rules and the exemption method.

The Commission is of the opinion that simplifications to the NOKUS rules should be considered. The application of the low-tax-country condition has proven difficult in several instances, indicating that simpler assessment criteria should be included in the rule. The Commission recommends that the system of black and white lists should be expanded and made more absolute. Administrative considerations, etc. may also indicate that a minimum-ownership-interest requirement should be introduced in respect of the individual participants before NOKUS taxation is carried out. The Commission also requests that the ministry consider whether the current distinction between active and passive income is appropriate.

The Commission has also examined the rules governing the levying of withholding tax on dividends paid by Norwegian companies to foreign shareholders. The Commission is of the view that the justification for levying withholding tax on dividends is weak, and has therefore proposed amending the rules so that withholding tax is only levied on shareholders resident in low-tax countries.

1.4.4.3 Measures to prevent profit shifting and erosion of the corporate tax base

A reduced corporate tax rate would, to some extent, make it less profitable to shift profits out of Norway. However, harmonisation of the Norwegian tax rate with tax rates in low-tax countries is unrealistic. The Commission proposes a tax rate of 20 per cent. Many countries have corporate tax rates lower than this, or favourable tax regimes for certain types of income. The incentives to engage in profit shifting will thus remain strong. The Commission therefore concludes that a rate reduction must be combined with other measures to counter profit shifting. However, the scope for adopting such measures is limited by Norway's international obligations, primarily under the EEA Agreement. Moreover, Norway's right of taxation will in some cases be limited by the approximately 90 tax treaties Norway has concluded with other countries. The Commission is nevertheless of the opinion that this should not prevent the introduction of rules that are deemed necessary, although the rules must take into consideration Norway's obligations under international law.

The prices charged for goods and services within a group must be set in accordance with the arm's length principle, i.e. as though the transaction had occurred between independent parties. The Commission has concluded that the arm's length principle should remain the fundamental principle governing the distribution of profits between countries, and that the fundamental transfer pricing principles must continue to be based on international agreement. The OECD/G20 BEPS project has examined possible clarifications of the arm's length principle to ensure that the distribution of the tax base mirrors where production occurs. The Commission is of the opinion that Norway should follow up any recommendations concerning the arm's length principle resulting from the BEPS project. However, in the Commission's view it is difficult to find good arm's length prices in certain areas – such as royalties, rental payments and interest – and so special rules should be considered.

The Commission proposes a withholding tax on royalties (including rental payments in respect of certain tangible assets). The Commission is of the opinion that there is a need for such a tax to counter profit shifting, prevent double non-taxation and safeguard Norway's right to tax such income. The Commission requests that the ministry assess whether bareboat vessel charters should be excluded from the Norwegian special tax regime for shipping companies so that a withholding tax could also apply to bareboat vessel charters that by definition fall under the Norwegian special tax regime for shipping companies. The withholding tax must be designed so that it does not conflict with EEA law.

The Commission has also proposed the introduction of a domestic rule authorising the levying of withholding tax on interest, as found in many other countries. The Commission would point out that a standardised interest-limitation rule, see section 1.4.4.4, will not necessarily cover all instances of undesirable profit shifting through interest deductions. A withholding tax could also be a measure to prevent profit shifting in special cases, for example through the use of hybrids.

The Commission has discussed whether to introduce a deduction limitation in respect of royalties, but has concluded that a general limitation is not a good solution. Nevertheless, the Commission is of the opinion that the Ministry of Finance should consider a deduction restriction for tax purposes in connection with certain types of rental payment, including for bareboat charters of vessels and rigs.

The rules on exit taxation are important to protect the Norwegian tax base. The rules are intended to ensure that revenues generated in Norway are also taxed here. However, EEA law offers little scope for tightening up the current rules applicable to companies that emigrate.

Anti-hybrid rules to prevent double deduction and double non-taxation have a central role in the BEPS project. The problem arises when countries classify financial instruments, etc. differently, with the result that taxpayers obtain a tax benefit. To counteract tax planning through the use of hybrid arrangements, the Commission proposes restricting the exemption method by excluding dividends where the distributing company has been granted a deduction in respect of the distribution. The Commission is also of the opinion that rules should be adopted to counter undesirable effects of hybrid entities more generally, for example by applying the classification of the home country in specified cases. Further proposals should also be examined, and consideration should be given to recommendations resulting from the BEPS project.

The Commission has assessed the non-statutory general anti-avoidance rule, and concluded that it is important to have a general rule to counter tax avoidance. The Commission proposes that the standard be made statutory, among other things to correct an undesirable development in case law and to strengthen the rule.

The rules governing where companies are deemed resident for tax purposes can be exploited to avoid general tax liability in Norway. To counteract this, the Commission proposes that companies registered in Norway should always be deemed resident here. The Commission anticipates that the proposal will have a limited effect in terms of countering profit shifting, etc., but that it will ensure that companies registered in Norway cannot become “stateless”.

The Commission is of the opinion that the development and growth of the digital economy will present challenges to the corporate tax base. The scope of domestic rules on the levying of tax on foreign activity in Norway should therefore be considered further. A key issue in this assessment will be international recommendations concerning taxation of the digital economy. In the Commission’s view consideration should be given to OECD recommendations concerning changes to the definition of permanent establishment, and to the need for consequential changes to the conditions under domestic law.

The Commission considers that the Norwegian tax authorities have wide powers under domestic law, tax treaties and information-exchange agreements to collect relevant information, including in cases involving cross-border arrangements. Nevertheless, more far-reaching rules should be introduced in some areas. The Commission is of the view that Norwegian taxpayers should have a duty to inform of foreign ownership in the tax return and, upon request, to submit information about other group companies located abroad. The electronic submission of tax returns would simplify the tax authorities’ risk assessments and control efforts, and streamline the procedure for taxpayers. The Commission is therefore of the opinion that a duty to submit tax returns electronically should be introduced in the corporate sector. Moreover, Norway should follow international developments in the area of information exchange for tax purposes, particularly as regards the automatic exchange of information.

1.4.4.4 Limiting the interest deduction to counter profit shifting

Multinational groups may have considerable incentives to reduce their tax bills by funding Norwegian group companies with debt. The manner in which the arm’s length principle is applied to related party loans may result in group companies deducting interest up to the maximum amount a company could have serviced if it were an independent company. However, in many cases an independent company will not utilise its maximum loan capacity. In addition, companies may deduct interest at market rates on related

party loans. This means that companies in Norway may be granted a deduction for a credit risk that does not exist. The current rules thus permit multinational enterprises legally to shift profits out of Norway through the interest deduction. The same applies to enterprises with owners who are not liable to pay tax on interest income, typically municipalities and foundations. This gives these entities a considerable advantage over independent companies.

The adoption of a group wide interest allocation rule (global approach) under which the starting point is a group's actual interest payments to independent lenders (external interest) would mean a stricter rule, and could in theory eliminate the opportunities to shift taxable profits out of Norway through interest deductions. If all countries were to introduce the same rule, multinational groups as a whole could not deduct interest exceeding their actual external interest costs. Such application of the arm's length principle would probably result in a large reduction in the interest deduction for group companies in high-tax countries. Further, it would contribute to more equal competition between standalone companies and multinational groups. However, the Commission does not anticipate an international agreement on a global rule in the foreseeable future. If Norway were to introduce a rule based on a global approach unilaterally, many questions would arise that would make the provision difficult to apply.

The Commission majority has instead recommended the retention of a profit-based rule against profit shifting.

The current rule only limits deductions on related party loans (intra-group interest). However, profit may also be shifted through interest payments to third-party lenders (external interest). The Commission majority has therefore proposed that the interest deduction limitations should be made applicable to all interest, including interest paid to third-party or independent lenders.

The Commission majority has also proposed making the rule stricter, to disallow a larger proportion of the interest deductions stemming from profit shifting. The Commission proposes a deduction limit of 45 per cent of earnings before interest and taxes (EBIT). The threshold amount for applying the rule should be reduced from NOK 5 million to NOK 1 million in net interest. Disallowing interest on third party loans while at the same time tightening up the deduction limit will mean that the rule will also affect interest deductions for companies without opportunities to engage in profit shifting. The Commission majority is of the view that having an effective rule against profit shifting is more important than protecting a few, highly geared companies. The Commission majority points out that debt is favourably treated in the context of corporate tax. Companies affected by the restriction will have a reduced motivation to employ debt financing. The majority would point out an unfortunate potential consequence of the rule: in isolation, it may have a negative impact on the investment incentives of these companies. However, a rule that primarily affects profit shifting will have a positive effect on overall investment returns due to a more level playing field for companies with and without opportunities to engage in profit shifting.

Commission member Aleksander Grydeland recommends that the current profit-based interest deduction limitation be abolished. In principle, Grydeland agrees that a general limit on interest deduction may constitute a sensible operationalisation of the arm's length principle. However, the current profit-based ratio has a number of negative consequences. Moreover, Grydeland cannot see clearly how an alternative rule could be designed in a suitable manner. The arm's length principle, with the clarifications made as part of the BEPS project, should therefore be sufficient to counter profit shifting.

1.4.4.5 Taxation of the financial sector

On the part of the individual company, corporate debt is treated more favourably than corporate equity. To the extent that this affects the solidity of companies, the financial sector may be particularly impacted. This is because excessively high gearing presents a risk not only to the companies themselves, but also to the financial system as a whole. A lower corporate tax rate will help to reduce the preferential treatment of debt in the context of corporate taxation. However, the Commission is of the opinion that other regulatory measures focusing on the financial markets are a more targeted means of promoting financial stability than changes to the tax system.

Activities in the financial sector may give rise to negative externalities. This applies particularly to risk accumulation in the economy. If this economic cost is not absorbed into the economic cost, market prices will not reflect the contributions of the various parties to the risk of a crisis. There may then be a risk of the

sector growing too large or of excessive risk-taking. The problem may be exacerbated if large individual parties can be said to enjoy an implicit state guarantee.

The consideration of financial stability is safeguarded through the regulation and supervision of financial institutions and financial markets. At the same time, contributions to the Norwegian Banks' Guarantee Fund support the build-up of capital in excess of minimum requirements. The Commission is of the opinion that – other than through this indirect tax – the financial sector should in principle be taxed in the same way as other industries.

In the context of value added tax, the financial sector is treated differently from other industries, since most financial services are exempt from the tax. This means that no tax is charged on the majority of sales by financial institutions, although – on the other hand – these institutions are not entitled to deduct value added tax paid on associated costs. Accordingly, under the value added tax system, the financial sector is taxed through input VAT instead of the difference between output VAT and input VAT. The value added tax exemption for financial services promotes an undesirable distortion of production and consumption towards such services and away from relatively more expensive, taxed goods and services. This contravenes the neutrality principle behind the design of the value added tax system. The exemption also means that the cost of financial services is higher for companies, and that households receive cheaper financial services than they would if value added tax applied generally. The value added tax exemption is estimated to cost approximately NOK 8.1 billion.

The Commission is of the opinion that the Ministry of Finance should continue its work on solving the problems associated with the current exemption of the financial sector from value added tax, see the description in the bill and draft resolution on direct and indirect taxes and customs duties in 2014 (Prop. 1 LS (2013–2014). The value added tax base should be expanded to encompass financial services provided in return for concrete payment in the form of fees, commission, etc., for example general insurance. Further, tax should also be levied on margin-based income in the financial sector. In principle, the Commission agrees that a tax on margin-based income from financial services should be designed to include as many of the neutrality characteristics of value added tax as possible. Neutral taxation requires the definition of a tax base that identifies the value added. However, further consideration should be given to whether margin-based income should be subject to value added tax at the ordinary rate, or whether account should be taken of the fact that a tax on interest margins may impact saving.

In the Commission's view, a tax on margin-based income should be introduced as soon as possible, even though it will not be possible to achieve all of the neutrality characteristics of value added tax in the short term. This step will eliminate a considerable proportion of the unfortunate distortions resulting from the current value added tax exemption. The Commission considers that the new distortions arising because the tax does not include all of the neutrality characteristics of value added tax are less serious than the distortions resulting from the current exemption. However, the Commission recommends that the Ministry of Finance continue its work on improving such a tax and develop a concrete proposal to shield the margin-based income of corporate customers.

As long as no distinction can be made between private and corporate customers, the Commission will not recommend recovering the full tax expense of NOK 8.1 billion. The consideration that the tax may function as a tax on saving, which may be more damaging than ordinary consumption taxes, also suggests that gradual implementation would be appropriate. The Commission has proposed introducing a tax on margin-based income and value added tax on services on which fees are payable. The basis for the tax on margin-based income comprises the reasons outlined in the bill and draft resolution on direct and indirect taxes and customs duties in 2014 (Prop. 1 LS (2013–2014)) (although the distinction between personal and corporate customers has not yet been incorporated).

In principle, it would be advantageous if services on which fees are payable were subject to value added tax at the ordinary rate. The simplicity of the value added tax system implies this. One argument against differentiating between a tax on margin-based income and value added tax on fee income is an undesirable shift away from services on which fees are payable and towards increased margins. On the other hand, it can be argued that consideration must be taken of the fact that a tax on interest margins may influence the choice between consumption and saving over time.

Overall, the Commission has proposed that a common rate be applied under the tax on margin-based income and value added tax on financial services on which fees are payable, producing additional revenue of NOK 3.5 billion. The Commission would point out that consideration can be given to using different rates under the tax on margin-based income and value added tax on services on which fees are payable, particularly if it is found that, in practice, it is difficult for financial institutions to replace fee income with margin-based income.

1.4.4.6 Depreciation

In the supplementary mandate, the Commission was asked to review and improve the system for depreciation for tax purposes. In the Commission's view, corporate tax should be designed to have the smallest possible impact on economic decisions, such as the scale of investment, what operating assets are invested in, and the replacement rate of operating assets. The Commission has therefore proceeded on the basis that tax deductions for depreciation should, to the greatest possible extent, correspond to actual economic depreciation. In practice, it is impossible to design a depreciation system where tax depreciation corresponds to the actual economic depreciation of every individual asset. Standardised depreciation should nevertheless be designed to have the smallest possible distorting effect on investment.

In the debate on depreciation rates for tax purposes, it has often been stated that other countries have higher depreciation rates and that depreciation rates in Norway should be increased to enhance competitiveness. The fact that other countries have higher depreciation rates is, in the Commission's view, not a weighty argument for higher depreciation rates in Norway. First, an isolated comparison of depreciation rates in different countries will not produce a correct picture of the tax-related investment conditions in different industries. Moreover, increased competitiveness in certain industries due to groundless increases in depreciation rates will reduce the country's overall competitiveness, since the favourable treatment of individual industries will create investment distortions.

The Commission is of the opinion that emphasis should not be given to the depreciation rules of other countries to improve the competitiveness of individual industries. A tax base that is broad and set as correctly as possible facilitates rate reductions, which in turn will help to boost the competitiveness of Norwegian trade and industry as a whole and the growth potential of the economy in the longer term. Rate reductions also have other benefits, including that they counteract incentives to engage in profit shifting and reduce the favourable tax treatment of corporate debt.

Different operating assets have different economic depreciation profiles. Empirical data may indicate that linear depreciation, under which equally large deductions are made every year over the lifetime of an asset, most correctly expresses economic depreciation across all groups. However, the Commission has proposed retaining declining balance depreciation as the general rule for depreciation for tax purposes. The declining balance system is well established, and has significant administrative advantages over, for example, linear depreciation.

The Commission has assessed depreciation rates based on the information available on economic depreciation. Although the economic-life estimates for many operating assets are uncertain, there is generally good agreement between current depreciation rates and economic depreciation. The available data appears to indicate that certain operating assets may have economic depreciation rates that imply that they should have a different depreciation rate. However, great uncertainty attaches to the estimates, and the considerations of predictability and simplicity suggest that a cautious approach should be adopted with regard to making changes on an uncertain basis. Nevertheless, certain groups deviate so markedly that there is reason to make changes. The Commission has proposed reducing the depreciation rate for the asset group comprising ships, rigs, vessels, etc. from 14 to 10 per cent, reversing the supplementary initial depreciation for the asset group comprising machines, equipment, etc., classifying private vehicles as a separate asset group with a depreciation rate of 15 per cent, repealing the higher rate for buildings for farm animals, and moving hotels, inns and restaurants into the office buildings asset group, with a depreciation rate of 2 per cent.

The basis for assessing depreciation on taxis is deficient. The Commission has therefore asked the ministry to examine this category of depreciation more closely based on market data and, if the current depreciation rate of 20 per cent and is found to be too low, to define taxis as a separate asset group with a

higher depreciation rate. Since 2012, it has been possible to depreciate industrial structures and facilities with an expected life span of less than 20 years at a higher rate of 10 per cent. The Commission is of the opinion that there may be grounds for increasing this threshold to 25 or 30 years. However, the rule is relatively new. The Commission requests that the ministry assess what a practical, manageable period would be once more experience has been gained of this exception in the building and construction asset group.

In the case of intangible assets, the Commission considers that the current depreciation rules largely produce a correct depreciation profile for tax purposes. No changes are proposed to the depreciation rules applicable to such assets.

Further, the Commission is of the view that no new rule should be introduced stating that in-house research and development (R&D) costs may be deducted on a current basis, but that the present rule requiring capitalisation should continue to apply.

The Commission has also assessed the threshold for direct deduction, which has remained unchanged since the 1992 tax reform. The threshold primarily exists for practical reasons, since it eliminates the capitalisation of a large volume of smaller operating assets and the administration of a large number of depreciation items relating to almost fully depreciated operating assets. The Commission cannot see that the administrative burdens imposed by capitalisation and depreciation have grown since 1992. Rather, the opposite appears true. The Commission has therefore proposed retaining the direct deduction threshold of NOK 15,000.

1.4.4.7 Changes to personal income taxation

Personal and corporate taxation are closely connected in economic terms, and the two sets of tax rules have been closely linked since the tax reforms of 1992 and 2006, including through the application of a common tax rate to ordinary income. Given the Commission's proposal to reduce the corporate tax rate to 20 per cent, the tax rate on capital income at the personal level should be reduced correspondingly. A special, lower rate for companies would incentivise transfers of capital from persons to companies and increase the differential treatment of different organisational forms. The Commission has therefore recommended retaining a common rate on capital income for both personal tax payers and companies.

The Commission has evaluated different solutions for adapting personal taxation to the new corporate tax rate. The Commission has concluded that the most sensible approach will be to retain ordinary income as the tax base and reduce the tax rate on ordinary income to 20 per cent, also at the personal level. Under this approach, different forms of income at the personal level remain connected through a single net tax base, as at present. An advantage of preserving ordinary income is that it is a familiar income term for taxpayers and that both taxpayers and the tax authorities will find it easy to adapt to the changes in technical terms.

A reduced tax rate on ordinary income will mean a large revenue loss from personal taxation. The Commission has proposed recovering the majority of the lost revenue through a new progressive tax on personal income, which will also replace today's surtax.

A lower corporate tax rate will reduce the overall tax levied on ownership income, and thus in isolation make it more profitable to convert labour income into ownership income (income shifting). Not least for this reason, the Commission considers that there is a need to increase the tax levied on ownership income (exceeding the allowance for shareholder equity). The Commission proposes making ownership income a separate tax base with a separate tax rate. The Commission is of the view that would be unfortunate if the tax system were to provide a motivation for income shifting. The C*ommission majority* therefore proposes setting the tax rate so that the marginal tax on ownership income (including corporate tax) is approximately equal to the maximum marginal tax on wages (including employer's social security contributions). *Commission member Aleksander Grydeland* considers it sufficient for ownership income to be taxed at approximately the same level as in 2013, i.e. at a rate of around 48.2 per cent.

Symmetry considerations indicate that it is important to maintain high certainty for taxpayers that they will be granted a deduction in respect of negative ownership income, for example resulting from losses on shares. The Commission has therefore recommended that negative ownership income should trigger a tax credit corresponding to the tax rate on ownership income multiplied by the ownership income. Such a tax

credit should be deductible from all other personal income taxes. It should also be possible to carry any unused tax credit forward.

The Commission is of the view that there is considerable room for improvement in the personal income tax base. The justification for several of the allowances is weak. The efficiency loss in connection with taxation increases more than proportionately compared to the tax rate. This suggests broad tax bases and low rates. The main tasks of personal income taxation should be to help generate public revenue, contribute to redistribution and ensure the most efficient use of resources possible. All of these considerations imply that the personal income tax base should be set so as to ensure the greatest possible correspondence between taxable income and the actual return on work and capital. The tax system should not be used to subsidise particular activities or to grant allowances in respect of expenditure that is not directly connected to the earning of income. Tax reductions should be granted through rate reductions rather than weakly justified allowances for individual groups.

Following an overall assessment, the Commission proposes the elimination of the following allowances:

- home savings scheme for young people (BSU)
- tax class 2
- allowance for seamen and fishermen
- allowance for gifts to voluntary organisations
- allowance for trade union contributions
- allowance for daily travel to work and home visits by commuters
- allowance for additional board and lodging costs of commuters
- parental allowance
- special tax rules in Nord-Troms and Finnmark (special income allowance, lower tax rate on ordinary income and lower rate in surtax band 1).

It is estimated that eliminating these allowances would increase revenue by approximately NOK 7.8 billion, assuming that the tax rate has already been reduced to 20 per cent. This would facilitate the reduction of income tax rates and restriction of the efficiency loss in connection with taxation.

The Commission sees room for further improvement and simplification through the elimination of allowances and reduction of personal income tax. However, the Commission has restricted itself to proposing the removal of some schemes with limited links with the earning of income.

Under the Commission's revenue-neutral proposal, the maximum marginal tax rate on wages (including employer's social security contributions), will be reduced to 52.8 per cent. The tax rate on ownership income in excess of the allowance for shareholder equity (including corporate tax at the rate of 20 per cent), will also be 52.8 per cent. Since personal income constitutes a gross tax base and excludes capital income, the new tax on personal income will not correspond entirely with the original rate reduction on ordinary income for individual taxpayers. The effect on individual taxpayers will depend on factors such as the size of deductions from ordinary income. The Commission refers to chapter 13 for a discussion of the redistributive effects of the overall proposal.

The Commission has been asked to evaluate both a revenue-neutral proposal and a proposal involving overall tax reductions. The Commission has emphasised the need to ensure that the restructured income tax system stimulates higher labour supply. The revenue-neutral proposal reduces marginal tax for most taxpayers. In the alternative scenario involving net tax reductions, the marginal tax on work is reduced further.

Increased tax on ownership income will make it more profitable than at present to avoid the additional taxation of ownership income, for example by converting ownership income into interest or by making loans from companies to shareholders. The Commission has considered whether special measures should be proposed to counter such avoidance in addition to the measures available under current rules. In the Commission's view, the rules on the additional taxation of interest on loans from personal taxpayers to companies should be retained by defining such interest income as ownership income. The rules currently exempt interest on loans linked to debentures, and the Commission considers that it should be clarified that this exception only applies to debentures that are traded in an organised market. The Commission has also proposed issuing special tax rules specifying that loans from companies to personal shareholders or

their close associates are to be regarded as dividends. This will remove the adjustment opportunities associated with loans from companies to shareholders. In addition, it will no longer be necessary to decide whether a loan from a company to a personal shareholder is genuine. This will simplify the system.

1.4.4.8 Tax on net wealth and property

As a result of the repeal of inheritance tax and the Commission's proposal to reduce tax on ordinary income, the role of net wealth tax in the tax system – and not least its function as an instrument of redistribution policy – is now highly topical.

At present, net wealth tax has a highly unfavourable design. The rate is relatively high, and assets are valued very differently. Net wealth tax distorts saving towards real property and other assets that are assigned lower values or are exempt from net wealth tax. The skewed valuations also weaken the contribution of net wealth tax to horizontal and vertical equality. However, in the Commission's opinion these factors do not constitute arguments for repealing net wealth tax, but rather for ensuring more uniform valuation and reducing the tax rate.

Provided that assets are valued more uniformly, the Commission considers that a special tax on net wealth can be justified in the interests of both efficiency and redistribution. Net wealth tax increases redistribution through the tax system, and a moderate, uniform net wealth tax carries modest economic costs. Net wealth tax primarily weakens incentives to save, and is expected to have little effect on the scale investment in Norway. The Commission is of the view that a reduction in corporate tax will be a more targeted measure for strengthening tax incentives to invest in Norway than cuts in net wealth tax. The Commission's proposal to reduce the corporate tax rate to 20 per cent would also reduce the profitability of corporate tax avoidance; see the Commission's assessments in chapter 5.

Real property constitutes a good tax base; see the Commission's assessments in chapter 3. Since real property is assigned a lower value for the purposes of net wealth tax and property is otherwise favourably treated in the Norwegian tax system, the Commission is of the opinion that real property valuations should be increased. Good standardised valuation systems have been developed for first homes, second homes and commercial property. The Commission sees no reason why these types of property should not be valued in the same way as other assets such as listed shares and bank deposits. If valuations are increased considerably, the effective tax rate on other assets can be reduced and the basic allowance can be increased.

As regards vacation properties, the Commission takes the view that valuations can be made more uniform. Many vacation properties are sold in Norway every year. Although some municipalities see few sales every year, most vacation properties in Norway are located in municipalities that record a substantial number of sales. The Commission is of the opinion that a standardised valuation system corresponding to the system for residential and commercial property can be introduced for vacation properties, and requests that the Ministry of Finance examine the optimal system design. The ministry should also assess whether the precision of the current valuation system for residential property can be improved. Pending an improved valuation system for vacation properties, the Commission considers that the tax assessment values of vacation properties should be increased.

The Commission would advise against a solution involving the exemption of "working" capital from net wealth tax. Such a change would reinforce the distorted features of today's net wealth tax and give rise to a number of practical and administrative problems, including the delimitation of "working" and "non-working" capital. Moreover, the Commission's proposal for a lower effective net wealth tax rate for most assets (other than real property) should reduce the need for such special rules.

Based on the above assessments, the Commission has proposed a concrete reorientation of net wealth tax within an unchanged revenue framework. The Commission is of the view that a net wealth tax within this revenue framework will not imply a major efficiency loss. However, such a net wealth tax has the potential to make a significant contribution to redistribution. The Commission's proposal is designed so that the different assets and debt are valued as uniformly as possible. The Commission proposes a solution under which all objects currently included in the net wealth tax base are valued at around 80 per cent of actual value. The Commission's specific proposed changes are:

- The tax assessment values of first homes, second homes and commercial property are increased to 80 per cent of estimated market value.
- The tax assessment values of vacation property are doubled pending a valuation system that is better at calculating market values.
- All other assets, including bank deposits and shares, and debt are valued at 80 per cent of current value.
- Given a revenue-neutral framework, this allows the basic allowance under net wealth tax to be increased to NOK 2,130,000.

The Commission sees good reasons for reducing the favourable treatment of residential property in the context of income taxation. As a first step, the Commission proposes repealing the tax exemption for rental income from letting up to 50 per cent of the market value of one's own home. Owners must then be permitted to deduct costs that are sufficiently connected with the lease relationship. This may give rise to difficult delimitation problems, and the Norwegian Tax Administration will face administrative challenges in checking such costs. The Commission therefore proposes that the ministry should examine potential rules on standardised deductions in respect of lease-related costs, including the use of a reduced rate or basic allowance. The Commission proposes a cautious introduction with the potential to generate annual revenue of approximately NOK 1 billion.

1.4.4.9 Changes to value added tax

The current value added tax system featuring reduced rates, exceptions and exemptions influences the composition of production and consumption. Based on economic theory, it can be argued that different tax rates should be applied to different goods and services, for example high rates on goods and services that complement leisure, that are price-insensitive or that carry particular socioeconomic costs. However, there are several reasons why, in practice, a single common value added tax rate should be applied to all goods and services. Among other things, reduced rates, exceptions and exemptions create delimitations that in turn impose considerable administrative costs on businesses and the tax authorities. The need for a differentiated tax structure should preferably be met by means of special taxes.

The value added tax system is largely unsuited to safeguarding distributional preferences, supporting individual groups, influencing the composition of consumption, etc. Other instruments will normally be more effective. For example, if the purpose of a low value added tax rate on food is to support families with children, an increase in child benefit will be more effective.

The Commission is therefore of the opinion that the sole purpose of value added tax should be to generate revenue for the State. The simplest and most efficient way of doing so is to have a single, common value added tax rate and make all consumption of goods and services taxable. This would allow value added tax to be collected in a simple manner and at a relatively low administrative cost. However, a change to a single rate would imply large increases in certain sectors, and this alternative should therefore be assessed in a wider context. Among other things, persons on low incomes would face a considerable increase in tax relative to income because they spend a greater proportion of their income on consumption, particularly food, which has benefited from a reduced rate since 2001.

The Commission has therefore proposed a dual-rate value added tax system in which the general rate of 25 per cent is retained but the current zero rate and lowest rate are increased to 15 per cent, corresponding to the current rate on food. It is estimated that, in isolation, this proposal will increase revenues by approximately NOK 5.7 billion.

The Commission recommends that the ministry consider a change to a single common value added tax rate. The Commission's calculations indicate that adopting a single common rate of just over 23 per cent on all goods and services that are currently covered by the value added tax system would generate approximately the same revenue as the Commission's proposal. Such a change to a single common rate would secure substantial simplification gains compared to the Commission's proposed dual-rate system. In a dual-rate system, considerable problems would remain with respect to distinguishing the ordinary rate and the low rate (for example service of food vs. sales of food, newspapers vs. weeklies, overnight accommodation including the service of food, etc.) The Commission is also of the opinion that the ministry should

give closer consideration to the possibility of including further areas that currently fall outside the value added tax system.

Table 1.1 The Commission majority's proposal

Tax on ordinary income Reduced tax rate of 20 per cent on ordinary income, at both the personal and the corporate level
The corporate income tax base Changes in the interest-limitation rule: the deduction limit set to 45 per cent of EBIT, third-party debt is limited and the threshold amount is reduced to NOK 1 million in net interest expenses. Changes in the depreciation rules: Initial depreciation is repealed for the asset group comprising machines, equipment, etc. Private vehicles are classified as a new asset group with a rate of 15 per cent (instead of 20 per cent). The rate applicable to the asset group comprising ships, rigs, etc. is reduced from 14 to 10 per cent. Hotels, inns and rooming houses are moved to the commercial buildings asset group, with a rate of 2 per cent (instead of 4 per cent). The rate applicable to livestock buildings in the agricultural sector in the building and construction asset group is reduced from 6 to 4 per cent.
Tax rules relating to cross-border activities Amend the definition of "resident" so that companies registered in Norway are always deemed resident here. Introduce a general withholding tax on interest. Introduce a general withholding tax on royalties (intangible assets and certain tangible assets). Limit withholding tax on dividends distributed to companies resident in low-tax countries. Repeal the exemption method's ownership percentage and ownership period requirement in the case of investments outside the EEA. Prohibit the use of the exemption method if the distributing company is granted a deduction in respect of the distribution/payment. Raise the low-tax country requirement in the NOKUS rules and the exemption method from two-thirds to three-quarters of the Norwegian tax level. Expand the system of white and black lists under the NOKUS rules. Changes in disclosure duties, etc.: introduce a duty to notify ownership of companies, etc. abroad, introduce power to demand information about other group companies (with associated penalties for breach of the disclosure duty), and introduce mandatory electronic submission of tax returns.
Financial sector Introduce value added tax on financial services provided in return for concrete payment (fee income, commission, etc.), and a special tax on margin-based income in place of ordinary value added tax.
Tax on personal ownership income Make ownership income a separate tax base.

In the revenue-neutral proposal: the tax rate is set at 41 per cent.

In the proposal involving net tax reductions: the tax rate is set at 37 per cent.

The exemption from additional tax on interest income shall only apply to debentures that are traded in an organised market within six months of issue.

Introduce tax rules stating that loans from companies to personal shareholders or their close associates must be deemed dividends.

The shareholder model shall not apply to income from shares in companies resident outside the EEA.

To be taxed under the shareholder model, companies in the EEA must be actually established and carry out genuine economic activity.

Tax on personal income

Introduce a new tax on personal income that also replaces the current surtax:

In the revenue-neutral proposal: 3 per cent above NOK 140,000, 6 per cent above NOK 206,000, 15 per cent above NOK 544,800 and 18 per cent above NOK 885,600.

In the proposal involving net tax reductions: 2 per cent above NOK 140,000, 5 per cent above NOK 219,000 kroner, 15 per cent above NOK 544,800.

The personal income tax base

Repeal allowances and special arrangements in the context of personal taxation:

Home savings scheme for young people (BSU)

Tax class 2

Allowance for seamen and fishermen

Allowance for gifts to voluntary organisations

Allowance for trade union contributions

Allowance for daily travel to work and home visits by commuters

Allowance for additional board and lodging costs of commuters

Parental allowance

Special tax rules in Nord-Troms and Finnmark (special income allowance, lower tax rate on ordinary income and lower rate in surtax band 1)

Tax on net wealth and real property

More uniform net wealth tax (revenue-neutral restructuring):

The tax assessment value of residential and commercial property is set at 80 per cent of estimated market value, the tax assessment value of leisure property is doubled, all other assets and debt are valued at 80 per cent of present value, and the basic allowance is increased to NOK 2,130,000.

Repeal the tax exemption on the letting of up to 50 per cent of the market value of private residences.

Value added tax

The current zero rate and lowest rate are increased to 15 per cent, corresponding to the current rate on food. The general rate is kept at 25 per cent.

1.4.5 Effects of the Commission's proposals

An important motivation for the Commission has been to reduce the economic costs of taxation. In the longer term, the proposals are expected to result in more efficient use of resources, increased investment and higher value creation. Over time, this is expected to raise household incomes. Accordingly, in the Commission's view, estimates of the short-term redistributive effects do not provide a full picture of the redistributive effects over time.

The Commission has nevertheless estimated the short-term redistributive effects of the proposals. The calculations indicate that the proposed changes to personal income taxes under the revenue-neutral proposal will, on average, mean approximately unchanged tax for all income deciles except the highest decile. Increased tax on ownership income will mean that the income group with the highest average income will, on average, face tax increases that in some cases will be considerable. The effect of increased tax on ownership income will be counteracted by the Commission's proposal to reduce the corporate tax rate, but for various reasons it is difficult to calculate the overall redistributive effects of the reduction in corporate tax. The changes to value added tax will involve approximately the same tax increase for all income groups when the tax change is calculated as a proportion of income. Under the alternative involving tax reductions, most deciles will face reduced average taxes as a result of the reductions in personal income tax. The highest decile will face, on average, a smaller tax increase than under the revenue-neutral proposal, both because tax on wages will be reduced most for high income groups and because tax on ownership income will increase by somewhat less than under the revenue-neutral alternative.

Generally speaking, the Commission's proposal involves shifting the tax burden from corporate tax, tax on saving and tax on labour to taxes on real property and consumption. This change is consistent with international recommendations to promote economic growth. The Commission's analyses and assessments support the view that such a change will have a growth-enhancing effect. Both theoretical and empirical research show that taxes on real property and consumption carry lower economic costs than taxes on company profits, saving and labour. Several of the proposals also involve expansion of tax bases and the reduction of rates. A broader, more correct base and lower rates in more areas will also reduce the total economic costs of taxation.

Overall, the Commission expects its proposal to reduce the corporate tax rate to 20 per cent, to implement more correct depreciation and to strengthen the interest-limitation rule to boost investment in Norway. The proposal will reduce both the marginal effective tax rate, which affects the investment level, and the average effective tax rate, which affects investment decisions such as location. The Commission's calculations show that the changes in corporate taxation may have substantial long-term effects. Some of the calculations show a relatively high degree of self-financing, although the results are based on a number of assumptions and must therefore be interpreted with caution. On an uncertain basis, the Commission assumes that, in the longer term, the degree of self-financing will total between 20 and 40 per cent if the reduced corporate tax rate, more correct depreciation and a stricter interest-limitation rule are implemented. The tax on margin-based income in the financial sector pulls in the opposite direction. The same applies to the increase in tax on ownership income, although the effects in this area are expected to be limited.

The Commission's proposal also to reduce the tax rate on ordinary income of personal taxpayers to 20 per cent will affect the rate of return on saving and thus the incentives to save. The effect on actual saving will differ in the case of borrowers and rentiers. Among borrowers, the proposal will result in increased saving, while the effect on rentiers is uncertain. Rentiers will receive higher returns on their net positive capital holdings, and thus have a reduced need to save for future consumption. However, since most households in Norway are net borrowers, the Commission assumes that the proposal will increase total saving.

The proposal to make valuations in connection with the net wealth tax more uniform considerably reduces distortions towards savings in real property. At the same time the effective taxation of other assets, including bank deposits and shares, will be reduced. Overall, this will result in higher returns on savings and have positive economic effects.

Increased investment as a result of reduced corporate tax will boost labour productivity, which in turn will increase employees' real wages. At the same time, the Commission has proposed changes to reduce

both the marginal tax and the average tax on labour. The Commission expects these proposals to increase labour supply.

The proposal to levy higher tax on ownership income is expected to have a low economic cost. This is because the higher tax on ownership income will have a limited impact on investments, since a large proportion of investors' opportunity cost of equity capital is exempt from taxation and since the tax is of little significance to investments in companies with access to international capital. The proposal to increase the value added tax rate is also expected to carry low costs. The proposal will contribute to more equal treatment of different product groups and reduce undesirable distortions towards certain consumables. Norwegian value added tax is generally thought to carry lower economic costs than taxes on labour and corporate tax.

Expanding the value added tax base to include financial services for which a fee is charged, and simultaneously introducing a tax on margin-based income in the financial sector, will eliminate some of the undesirable distorting effects of the present exemption from value added tax. The new distortions arising because the tax does not satisfy all of the neutrality characteristics of value added tax are considered to be less serious than the distortions resulting from the current exemption. Accordingly, the long-term effects of these changes in the taxation of the financial sector are also expected to be positive.

The Commission's overall view is that the proposal will result in increased investment, higher labour supply and more – and more correctly allocated – saving. In other words, the long-term economic effects on the Norwegian economy are expected to be positive. It is therefore assumed that a considerable proportion of the initial revenue loss from corporate and capital taxation will be compensated for by higher long-term tax revenues.

The Commission's proposal will have some administrative effects on taxpayers and the tax authorities. Among other things, the Commission's proposed changes to the interest limitation rule will mean some additional work for taxpayers and the tax assessment authorities. The rule can be difficult to apply in practice, and more loans will be affected if the provision is expanded to deny interest on third-party debt. Further, a reduction of the threshold amount to NOK 1 million will mean that more companies are affected by the rule. At the same time, not having to differentiate between related party and third-party interest will entail a simplification.

Other proposals may entail savings, such as the proposal to remove several existing allowances in personal income taxation.

Reference made to chapter 13 for a more detailed discussion of the economic and administrative effects of the Commission's proposal.