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The Norwegian tax system – main features and developments

Chapter 2 of the bill and draft resolution on taxes

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1 Introduction

Norway's tax and fiscal policies seek to secure public revenue, to contribute to just distribution of wealth, and to promote high value creation and efficient utilisation of society's resources. A further priority is to avoid that the tax system is imposing excessive administrative costs on taxpayers and the authorities. Direct and indirect taxes also play a role in counter-cyclical policy. The tax system contributes to the automatic stabilisation of the economy, because tax revenue rises during upturns and falls during downturns.

Figure 1 shows estimates of direct and indirect taxes in 2012. The figure shows, among other things, that the largest tax revenues come from tax on so-called ordinary income, value added tax, employer's social security contributions and petroleum tax.

The different types of taxes can be divided into direct taxes and indirect taxes.

Direct taxes include i.a. income tax for personal taxpayers and businesses, tax on net wealth and inheritance tax. Direct taxes account for 74 per cent of total tax revenue. 42 per cent of direct tax revenue comes from income tax from personal taxpayers, including social security contributions and surtax, while 36 per cent comes from income tax from businesses, including tax on petroleum activities. Tax revenue from mainland businesses accounts for 8 per cent of tax revenue

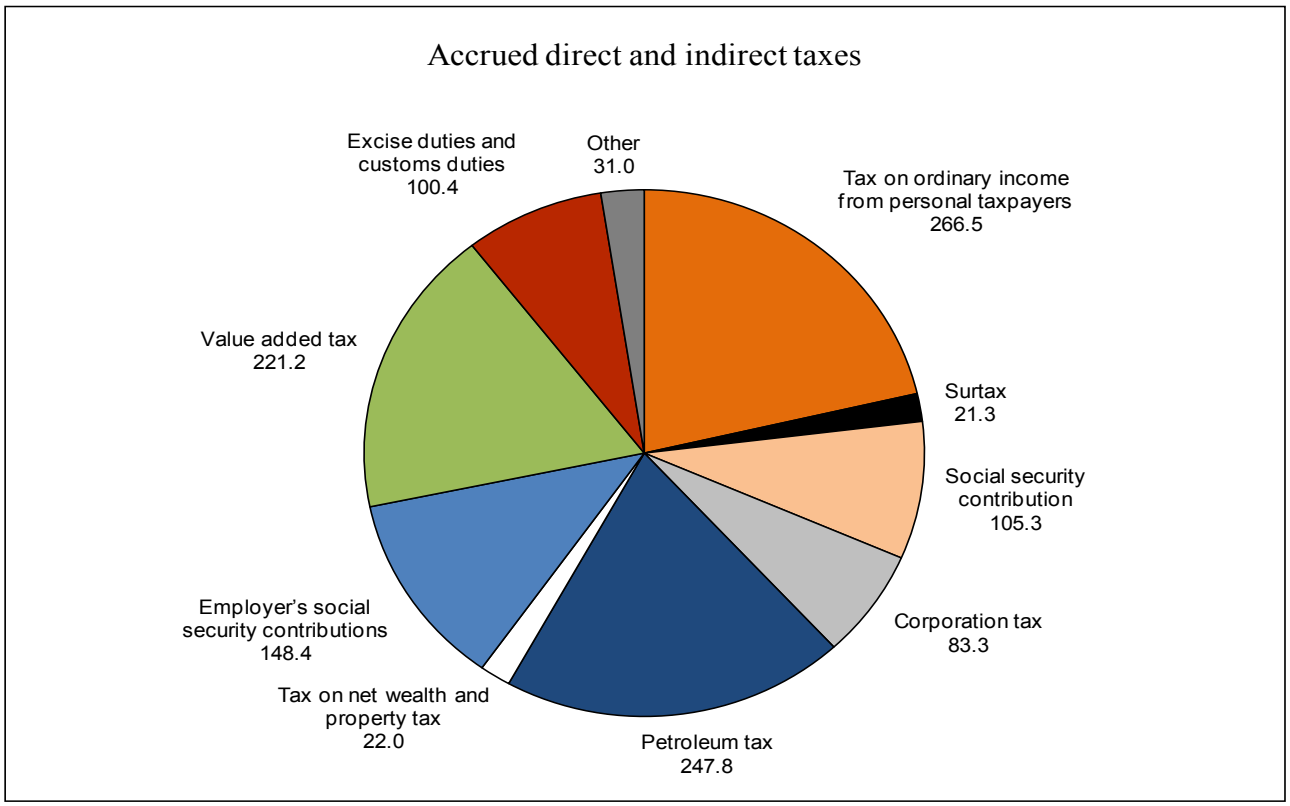

Figure 1 Accrued direct and indirect taxes. Estimates for 2012. NOK billions
Source: Ministry of Finance.

from mainland Norway.

Indirect taxes include value added tax, excise duties and customs duties. In total, indirect taxes account for just less than 30 per cent of total direct and indirect taxes. Value added tax is the largest source of revenue among indirect taxes, amounting to 20 per cent of total direct and indirect taxes, while excise duties total 10 per cent. Today, customs duties are a less significant component of public revenues.

2 Guidelines to ensure an efficient tax system

The tax system influences the supply of labour, consumption, saving and investment. It is therefore important that the design of the tax system is based on certain basic principles that ensure that society's resources are utilised in the most efficient manner possible. This can be achieved by:

- first employing direct and indirect taxes that promote better resource utilisation (such as environmental taxes);
- then using neutral taxes that do not influence the choices made by manufacturers and consumers (such as resource rent taxes in the petroleum industry and power industry);
- finally, using skewing taxes to achieve the desired tax level and redistribution objectives.

The socioeconomic costs that arise in connection with skewing taxation should be kept as low as possible. Since the 1992 tax reform, the tax system has been based on the principles of broad tax bases, low rates and symmetrical treatment of income and expenditure. This helps to keep the costs of taxation down and to ensure that taxpayers generally are treated equally. Broad tax bases, which cover all types of income, are a prerequisite for the equal taxation of persons with equal income, and for ensuring that the progressivity of tax rates results in better redistribution. The changes made to the tax system as part of the 1992 tax reform, along with changes made in subsequent years, have expanded the tax base and ensured better agreement between taxable income and actual income. The principle of broad tax bases was further strengthened in connection with the 2006 tax reform. This principle has also underpinned the changes made to tax on net wealth in recent years.

Introducing exceptions and special arrangements in the tax system to support particular groups, industries or activities makes the tax system less efficient and more complicated. Often, special arrangements will have undesired effects on redistribution, since they in practice are more used by high-income groups. Direct and indirect taxes then have to be increased to maintain tax revenues, and the socioeconomic costs of taxation normally increase disproportionately when tax rates are increased. When it is desirable to support a particular activity or group in society, measures on the expenditure side of the budget are often a less costly and more effective instrument, because they can be targeted.

In some cases, different objectives of the tax system may conflict. Accordingly, different interests have to be balanced when designing the tax system. In general, individual taxes should not target multiple objectives.

In Norway, public funding of extensive welfare tasks necessitates the maintenance of considerable tax revenues. However, certain direct and indirect taxes are also intended to meet other important aims beyond securing revenue for the state.

The tax system has a redistributive effect, not least because the average tax burden rises with income. Tax on wages implies a lower supply of labour, but the tax system should, insofar as possible, support the making of good decisions regarding participation in working life, education and career choices. Empirical research indicates that the supply of labour from low-income groups is influenced more by changes to economic framework conditions than the supply of labour from high-income groups. Lower taxes on low and middle wage incomes can therefore stimulate increased participation in working life while simultaneously making the income distribution more equal.

Persons with the lowest incomes pay little or no tax. Changes in the tax system are therefore of little significance to this group. Many people with permanently low incomes are not in work. The tax rules should be designed to ensure that it is profitable to work. Moreover, in the case of persons who receive social security benefits to compensate for (temporary) losses of wage income as a result of health problems or unemployment, the interaction between the social security rules and the tax rules is important as regards incentives for returning to work or increasing working hours. One challenge in the context of tax and welfare policy is to balance the consideration of protecting income with the consideration of providing incentives to work. This is illustrated in box 1, which provides an example showing that, in some cases, there may be little to be gained in financial terms from working rather than receiving social security benefits.

Box 1 Incentives to work depend on both the tax system and the social security system

Incentives to work are influenced both by the tax rates on labour and by any net transfers to individual recipients. Norway's income protection system (primarily the social security system) consists of various transfer schemes that ensure that persons who, for various reasons, are not working, have an income on which to sustain themselves. Examples include disability pensions and unemployment benefit. These social security schemes often lapse entirely or in part when a person starts working, and thus function as an additional "tax" on labour. To take this into account, a frequent approach is to calculate the effective average tax on labour. The effective tax rates take into consideration both tax and the net transfers lost when a person begins to work. Although such rates are useful for illustrating work incentives, they must be interpreted carefully. The calculations generally only take the level of the transfers into account. Other aspects of the schemes, such as time limits on benefit payments and activity requirements for recipients, will also influence incentives to labour.

Figure 2 shows some average effective rates of tax on labour when a person moves from unemployment to full employment (2010 figures for the Nordic countries). The respective calculations are for a sole provider with two children and a couple with two children, where one parent stays at home. The figure shows that the effective tax rate on labour can be considerable. A sole provider with two children will, in reality, be taxed around 90 per cent of gross wage income when the loss of unemployment benefit is included.

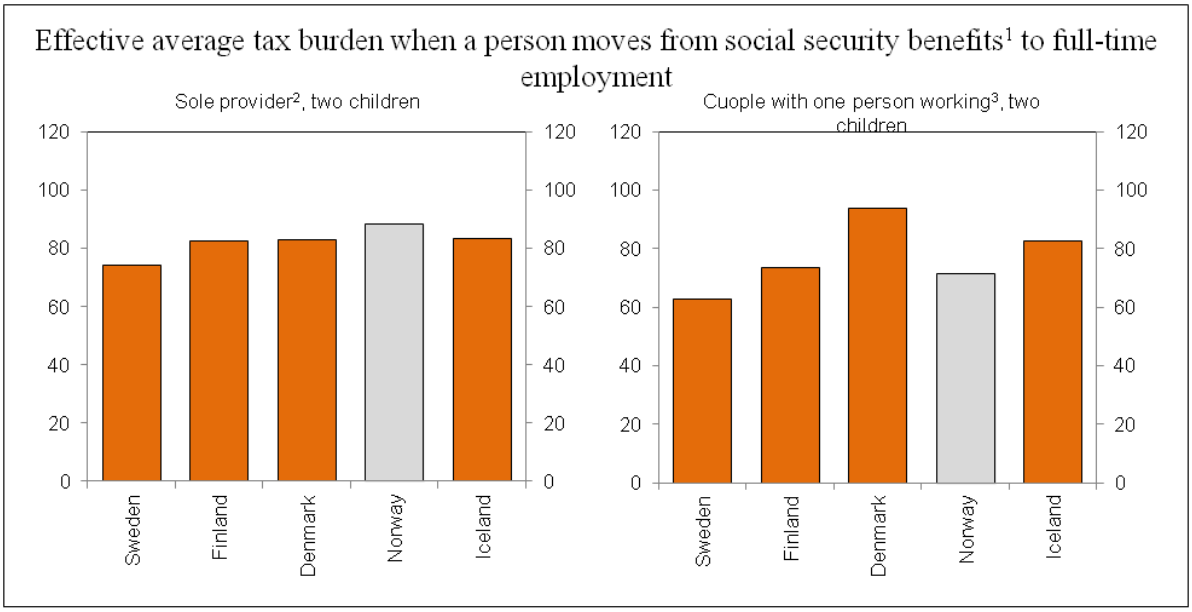

Figure 2 Effective average tax burden when a person moves from unemployment benefit to full-time employment. 2010. Per cent

1 The calculations are based on unemployment benefit in the different countries as calculated in OECD Tax and Benefit 2010. The level of the benefit is the level paid for the first year of unemployment.

2 Based on 80 per cent of average wages in the different countries, both as a basis for calculating the benefit and as the level of wage income from full employment.

3 Based on 100 per cent of average wages in the different countries, both as a basis for calculating the benefit and as the level of wage income upon the move into full employment. The spouse/cohabitant is assumed to stay at home in both cases.

Sources: OECD and the Ministry of Finance.

Environmental taxes and tradeable emissions quotas support the more correct pricing of environmentally hazardous activities, and motivate individuals and businesses to more environmentally friendly behaviour. The imposition of a uniform tax or quota price across different sectors will ensure that national emissions are reduced at the lowest possible cost to society, and is consistent with the principle that the polluter should pay. Revenue from environmental taxes and the sale of emissions quotas can be used to strengthen welfare schemes and collective benefits, or to reduce other direct and indirect taxes.

Taxes on businesses should primarily aim to secure revenue for the state, and should not hinder sound commercial activity. Ensuring that the taxation of all real income is as consistent and uniform as possible helps to ensure that resource utilisation is not influenced by, for example, tax-motivated investment. Taxed profits should correspond to actual value creation. This also expands the tax base, allowing the tax rate to be kept at a lower level than if the tax base were narrower.

Emphasis must also be given to foreseeability in the context of business and capital taxation. A lack of stability may influence business investment in an undesirable manner, weakening value creation.

In industries that exploit natural resources, an additional return may be generated in the form of resource rent. It is important to ensure that society receives a large proportion of this additional return. Accordingly, special taxes are levied on the profits generated by petroleum activities and in the hydropower sector. Through the petroleum tax system and the State's Direct Financial Interests (SDFI), the state secures a large proportion of the substantial revenues from the continental shelf without hampering investment which is profitable from a socioeconomic perspective. SDFI functions as a cash-flow tax, but the revenues are not treated as tax revenues.

Figure 3 compares the tax revenues of various countries as a percentage of gross national product, and provides a rough overview of differences in the size of the public sector between countries. The figure shows that Norway and the other Scandinavian countries have a relatively high level of taxation. Among other things, this reflects well-developed public social security schemes. Norway has a highly unusual industrial structure, which features considerable value creation in the petroleum sector. This makes it difficult to compare Norway's tax level directly with the tax levels of other countries.

Since 1980, tax revenue in Norway has totalled between 39 and 45 per cent of GDP. In Sweden, the proportion has been between 45 and 53 per cent, while the proportion for Denmark has totalled between 41 and 51 per cent of GDP. In the same period, the average tax level in the

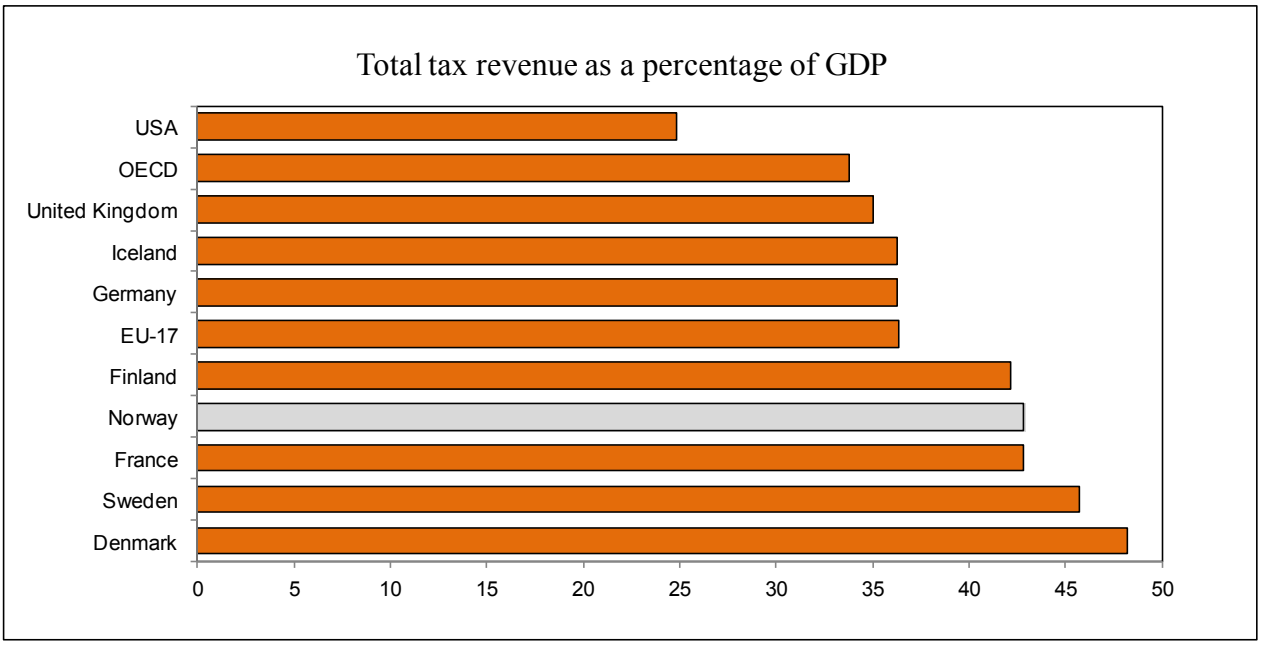

Figure 3 Tax revenue as a percentage of GDP in selected countries, EU-17[1] and OECD[2] 2010. Per cent

[1] The Euro area.

[2] Figures for the OECD are from 2009.

Source: OECD Revenue Statistics and Taxation Trends in the European Union.

OECD has fluctuated between 30 and 36 per cent of GDP.

Greater mobility of capital, goods and services may imply an increase in the significance of tax differences between countries. Norway needs to have good general tax rules in place to ensure that it can retain and attract commercial activities and capital. However, localisation decisions are based on more than tax. Political stability, good infrastructure, access to highly qualified labour, well-functioning financial markets, property law and a stable, foreseeable regulatory environment are also important framework conditions for business activity.

3 Direct taxes

3.1 Income tax for personal taxpayers

Rate structure and tax base

Income tax for personal taxpayers is calculated on two different bases. First, a flat rate tax of 28 per cent is paid on all taxable income (wages including taxable payments in kind, pensions, income from self-employment, taxable dividends and other capital income), less the tax-free allowances (basic allowance and personal allowance), deductible losses and expenditure such as debt interest, etc. Certain other allowances are also granted. This net tax base is called "ordinary income". Levying a flat tax rate on a net tax base ensures that all deductions have an equal tax value, and ensures symmetry in the taxation of capital, i.e. that income (gains) and expenditure (losses) are taxed at the same rate.

Second, social security contributions and any surtax are paid on so-called "personal income", which comprises gross wage and pension income without deductions of any kind.

Persons with high incomes pay a larger proportion of tax on their incomes than persons with low incomes. This progression is ensured through the tax-free allowances and the surtax. The number of surtax payers is estimated to total around 950,000 in 2012. Box 2 shows how marginal and average tax rates rise as wage income rises. The highest marginal rate of tax on wages, excluding employer's social security contributions, is 47.8 per cent. If employer's social security contributions are included, the highest marginal rate of tax increases to 54.3 per cent. Figure 4 shows that, in 2011, Norway's maximum marginal rate of tax on wage income was about average compared to selected countries.

Since the 2006 tax reform, an important principle of the tax system has been that the highest marginal rates of tax on wage income, on dividends and on personal income from business activities should be approximately equal. When the difference between the marginal tax rates on profit income and wage income is small, there is little to be gained by presenting profits that in reality derive from work as dividends to secure a lower tax burden. This form of income shifting was a considerable problem before 2006.

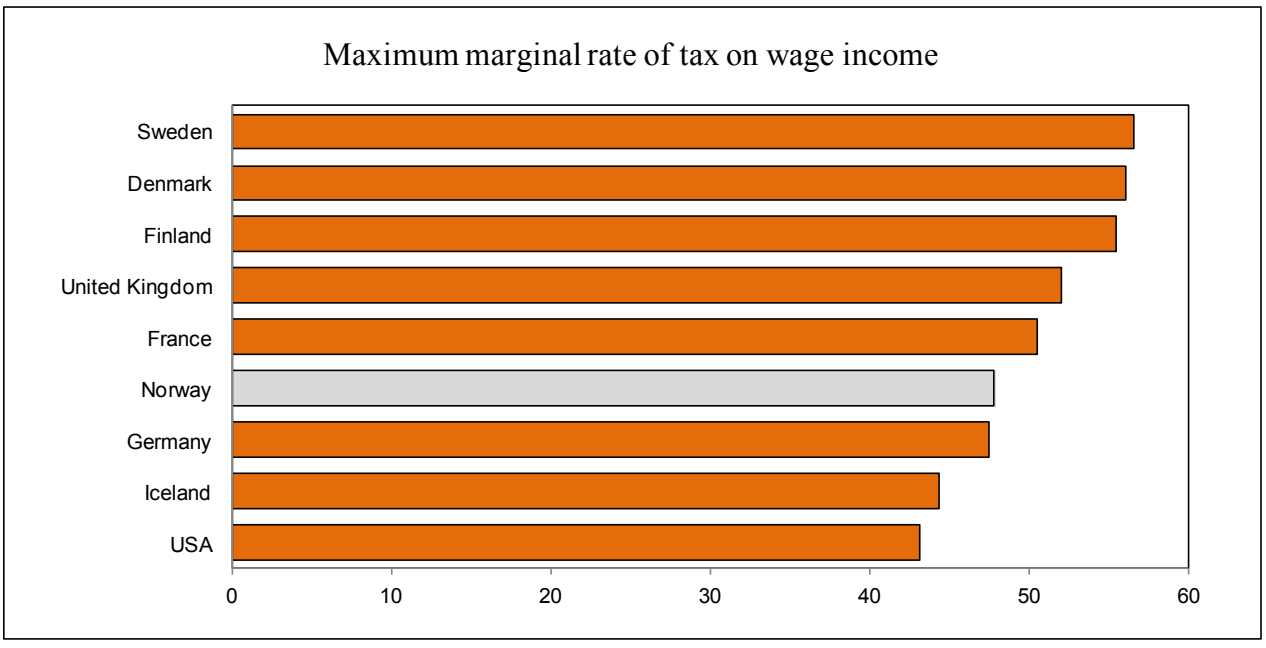

Figure 4 Maximum marginal rate of tax on wage income including employees' social security contributions. Selected countries in 2011. Per cent
Source: OECD Tax database.

Box 2 The calculation of tax on wage income

Marginal tax is the rate of tax applicable to the last krone earned by a taxpayer. The marginal tax rate influences the taxpayer's decision regarding how much or how little he or she wants to work. If the marginal tax rate is high, the motivation for employees to increase their work efforts may be weakened. Such distortions of the supply of labour have undesirable socioeconomic consequences, as resources are exploited less efficiently. The higher the tax rates, the greater these distortions.

Marginal tax must not be confused with average tax. In a tax system featuring tax-free allowances, other deductions and a progressive rate structure, the marginal tax rate will always be higher than the average tax rate for the same income level, and those with the largest incomes will pay the largest proportion of tax on income.

The figures below show marginal tax and average tax on wage income, respectively, under the 2012 rules.

Figure 5 shows that the marginal tax rate varies according to income level. The tax rate is zero up to the tax exemption limit. Social security contributions are then paid in accordance with a levelling rate (25 per cent). The levelling rate is used until it is worth paying social security contributions at the ordinary rate of 7.8 per cent of total wage income. If wage income exceeds the total of the personal allowance and the wage income allowance, the taxpayer starts to pay tax on ordinary income (28 per cent), resulting in a marginal tax rate of 35.8 per cent (0.078 + 0.28). When the basic allowance (38 per cent of income), exceeds the wage income allowance, the marginal tax rate falls to 25.16 per cent (0.078 + 0.28 * (1-0.38)). Once the taxpayer has reached the maximum basic allowance, the marginal tax rate again rises to 35.8 per cent. The marginal tax rate increases to 44.8 per cent at surtax threshold level 1 and 47.8 per cent at surtax threshold level 2, respectively.

Figure 6 shows that the average tax rate rises in line with income, although the average tax rate is substantially lower than the marginal tax rate in the case of wage income exceeding the total of the personal allowance and the earned income allowance.

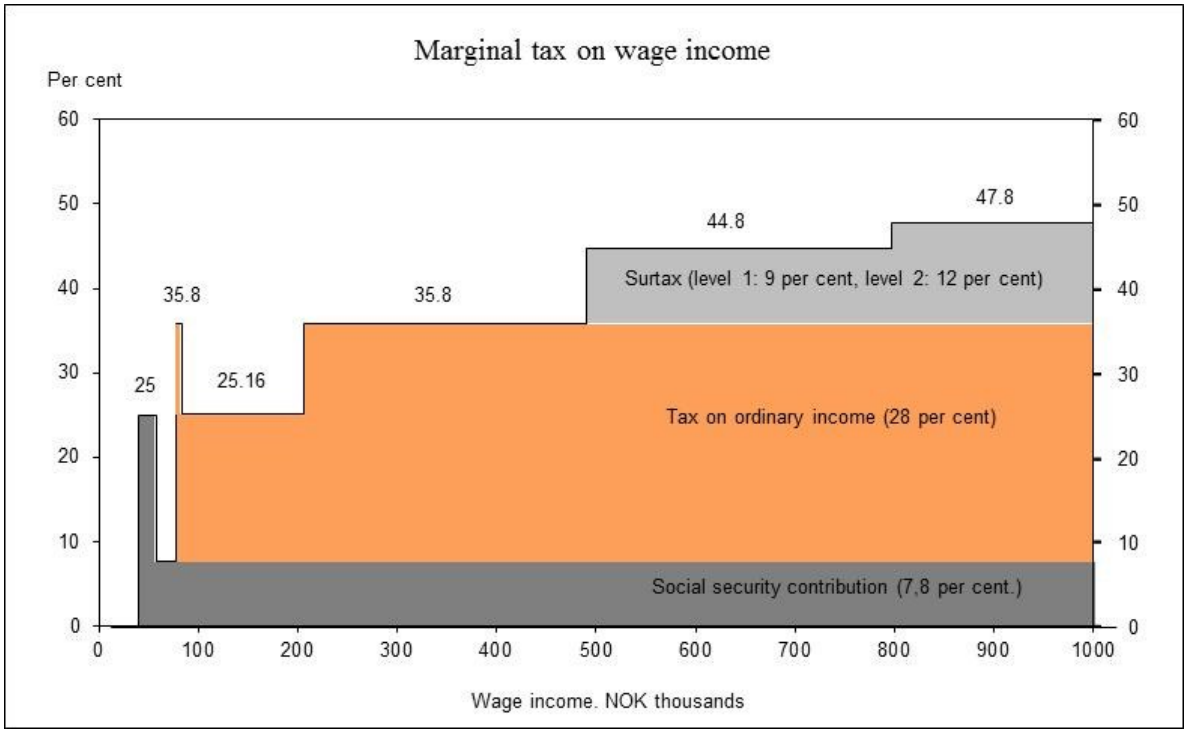

Figure 5 Marginal tax on wage income (excluding employer's social security contributions). 2012 rules for an employee in tax class 1 who only has wage income and standard allowances. NOK thousands

Source: Ministry of Finance.

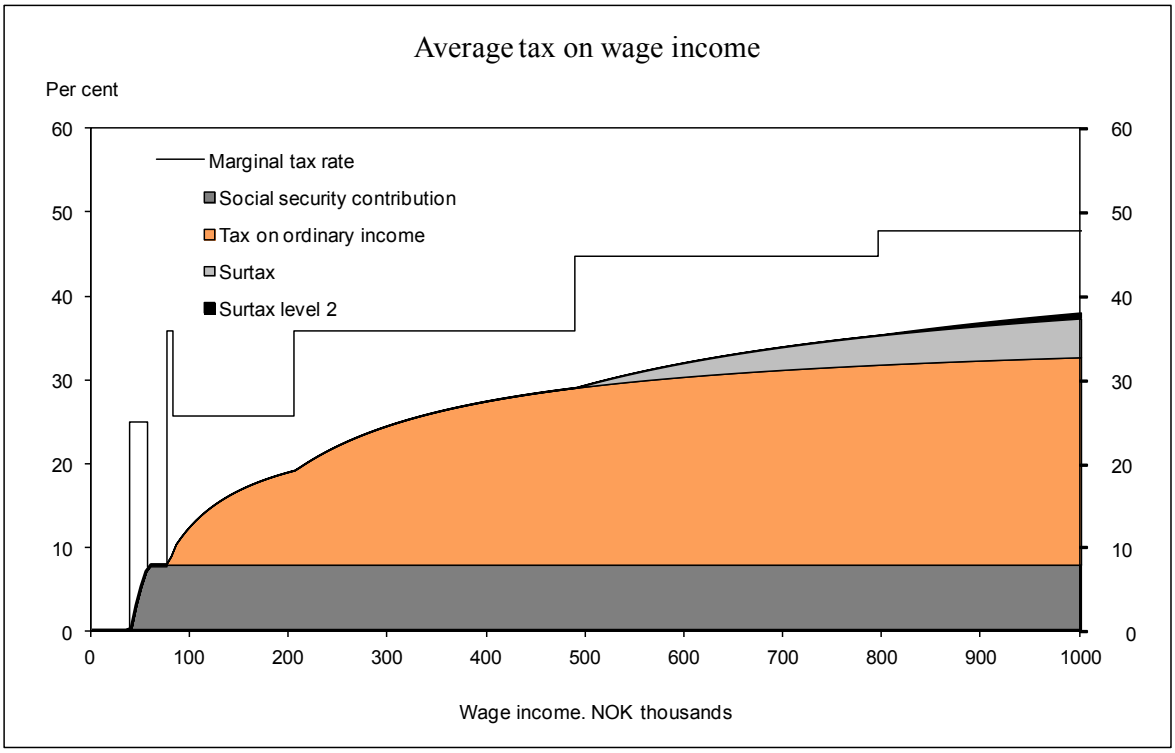

Figure 6 Average tax on wage income (excluding employers' social security contributions). 2012 rules for an employee in tax class 1 who only has wage income and standard allowances. NOK thousands
Source: Ministry of Finance.

Tax on pension income

Due to special tax rules pensioners and some recipients of social security benefits pay less tax than wage earners. Social security contributions on pensions are lower than on wages. On the other hand, the basic allowance is somewhat smaller in the case of pension income than in the case of wages.

A special tax allowance in pension income is granted to so-called AFP early retirement pensioners and to retirement pensioners to ensure that they do not pay tax on pension income corresponding to the minimum pension level, and that they pay less tax on pension income than on wage income above this level. The tax allowance is reduced for pension income exceeding the minimum pension level, so that the difference between tax on pension income and tax on wage income shrinks as pension income rises.

Disability pensioners are granted a special allowance in ordinary income in respect of disability. Further, a tax limitation rule applies for disability pensioners who are more than two-thirds disabled, and for recipients of certain means-tested benefits, including sole providers who receive transitional support. The rule means that income amounting approximately to the minimum pension level is tax free. Income above this, including a net wealth supplement, is taxed at a rate of 55 per cent, meaning that the advantage is reduced until it becomes worth while to be taxed in accordance with the ordinary tax rules.

Figure 7 shows calculated tax on pension income under the 2012 rules for unmarried AFP early retirement pensioners/retirement pensioners and unmarried disability pensioners, respectively, compared to tax on wage income for employees in class 1. It has been assumed that the taxpayers have no income other than wage income and pension income, respectively, and that the disability pensioners do not have net wealth totalling more than NOK 200,000. Nor do the taxpayers receive any allowances other than the standard allowances. The tax levied on a retirement pension of NOK 250,000 will be around NOK 20,000 less than the tax levied on a corresponding wage income.

Tax on dividends paid to persons

Dividends received, and capital gains made, by personal shareholders are taxed in accordance with the shareholder model. This means that dividends exceeding a shielding allowance are taxed as ordinary income for the owner. In principle, the

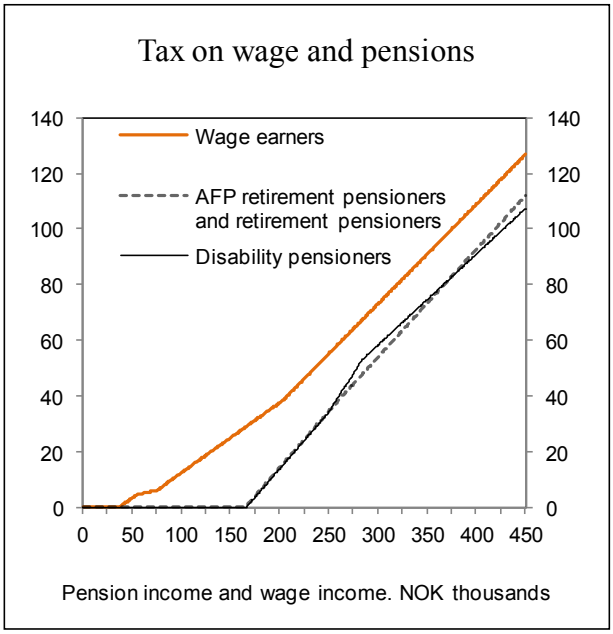

Figure 7 Tax at different income levels for wage earners, AFP early retirement pensioners and retirement pensioners, and disability pensioners under the 2012 rules. It has been assumed that the taxpayers are unmarried and assessed in class 1, that they receive only wage income or pension income, respectively, and that they do not receive allowances other than the standard allowances. NOK thousands
Source: Ministry of Finance.

shielding allowance is calculated as the cost price of the share multiplied by a shielding rate of return. The shielding rate shall reflect the return after tax on a risk-free investment. Accordingly, dividend tax is levied on the return that exceeds the return that can be achieved through an alternative, risk-free investment.

If the income from the share is lower than the shielding allowance, the unused shielding allowance is added to the shielding base for the next year. In practice, this means that the unused shielding allowance is carried forward with interest. The unused shielding allowance is attached to the particular share, and cannot be deducted from income received from other shares.

For practical reasons, it is the owner of the share on 31. December who receives the shielding allowance calculated for that year. When the share is sold, the seller may deduct any earlier, unused shielding allowance from any gain. If a loss is made, the full loss can be deducted from ordinary income. A new shielding allowance is calculated for the new owner, equal to the new cost price multiplied by the shielding rate of return.

Tax on income from self-employment

The owners of sole proprietorships are taxed according to the self-employed model, while partners in companies assessed on a partnership basis (general partnerships, limited partnerships and others), are taxed in accordance with the partnership model. The starting point for both of these models is the same as for the taxation of dividends, namely that income below a risk-free return on the invested capital (such income corresponds to the shielding allowance), shall only be taxed at a rate of 28 per cent. This has helped to ensure a high degree of equal tax treatment for different ways of organising businesses.

The profits of companies assessed on a partnership basis are taxed on an ongoing basis as ordinary income received by the partners. In addition, distributed company profits in excess of the shielding allowance are taxed again as ordinary income for the partners.

Income from a sole proprietorship in excess of the shielding allowance is taxed as calculated personal income, and surtax and social security contributions are levied on it. The calculated personal income is thus taxed on an ongoing basis, in contrast to, for example, dividends, which are taxed as ordinary income only once a dividend is paid or realisation occurs. The main reason for this difference is that sole proprietorships are not separate legal persons. A distribution of funds will thus only be a transfer of funds within the owner's own finances. Self-employed persons pay higher social security contributions than wage earners (11 per cent compared to 7.8 per cent) on their personal income from business. On the other hand, self-employed persons do not pay employer's social security contributions on their personal income. At the same time, self-employed persons receive lower social benefits than wage earners in a number of cases. Self-employed fishermen pay social security contributions at a rate of 7.8 per cent, plus a product tax intended, among other things, to make up the difference in social security contributions between 11 per cent and 7.8 per cent.

3.2 Business taxation

The profits of companies are taxed as ordinary income at a flat tax rate of 28 per cent. Losses can be carried forward and deducted from subsequent profits. In business taxation, particular emphasis is given to the principles of equal treatment of different investments, forms of funding and forms of organisation, and to symmetrical treatment of income (gains) and expenditure (losses). Among other things, this means that taxable profits must, insofar as possible, be set in

accordance with company profits. "Durable and significant" fixed assets must be capitalised in different asset groups and depreciated using rates which, in principle, should reflect the expected real depreciation.

The exemption method ensures that companies, in principle, are exempted from the taxation of dividends and gains on shares, etc. At the same time, the right of deduction is lost in respect of corresponding losses. The purpose of the exemption method is to avoid chain taxation in the company sector, i.e. that dividends and gains on shares owned by companies are taxed several times.

Employers in both the private and public sector are obliged to pay employer's social security contributions on wage costs. Employer's social security contributions are differentiated by region, and the tax rate depends on where the business is located.

Figure 8 shows that the average statutory corporate income tax rate has been reduced significantly in both the OECD countries and the EU countries in recent years. This trend is due partly to increased tax competition and partly to a desire to ensure more efficient domestic resource utilisation. Several countries have expanded their tax bases for corporate income tax and reduced tax rates. Norway was one of the first countries to implement a reform of this kind (the 1992 reform), and is among the countries which have gone furthest in implementing the principle of broad tax bases and low rates.

The effective taxation of companies will also depend on the tax base. The effective average tax rate is paid tax as a proportion of the company's real profits. It is lower than the statutory rate if tax credits are granted in connection with the investments, for example through generous depreciation rules. It is the effective average tax rate that is most relevant when a company is deciding in which country it wishes to invest based on tax considerations. The effective marginal tax rate is most relevant when a company is deciding the size of the investment.

Table 1 shows statutory tax rates and calculated effective average and marginal tax rates in selected countries in 2009. Effective tax rates are calculated based on an imaginary investment with a given return, etc., and take into account both statutory tax rates and key parts of the tax base (depreciation rates, etc.) In Norway, the effective average tax rate is currently at about the median level.

In addition, shareholders are taxed on profits through dividend and capital gains taxation; see section 3.1. Figure 9 shows the total marginal tax on dividends paid by companies and shareholders in selected countries in 2012.

Petroleum taxation

The extraction of oil and gas produces a considerable additional return (resource rent). A special tax of 50 per cent was therefore introdu-

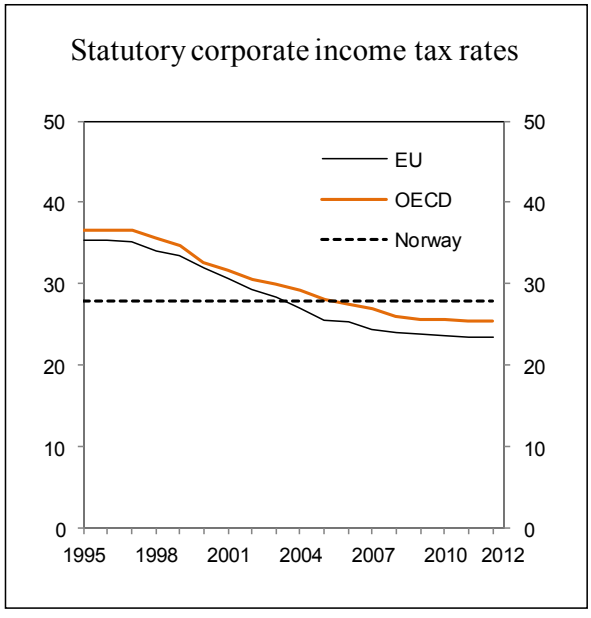

Figure 8 Statutory corporate income tax rates in Norway, the EU and the OECD.[1] 1995 – 2012. Per cent

[1] Non-weighted averages for the EU and the OECD. The EU figures relate to the countries which were members as at 1 January 2009 (EU-27).

Sources: OECD, Eurostat and the Ministry of Finance.

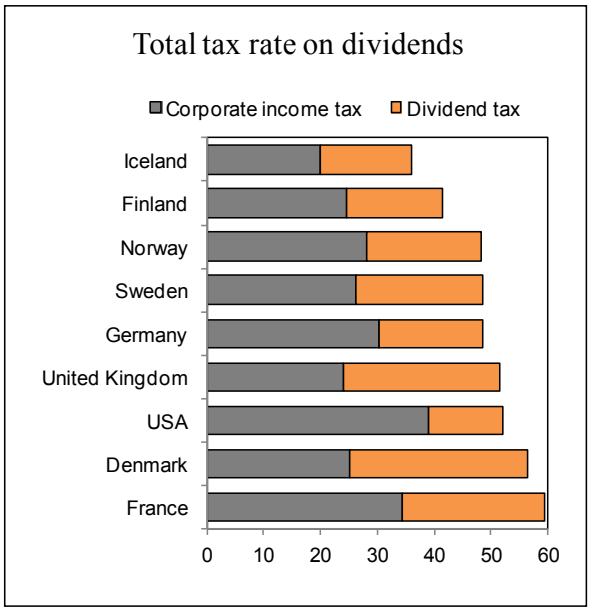

Figure 9 Total marginal tax on dividends paid by companies and shareholders in selected countries. 2012. Per cent

Source: OECD.

Table 1 Statutory and calculated effective corporate income tax rates in 2009. Per cent

Country	Statutory tax rate	Effective average tax rate	Effective marginal tax rate
Ireland	12.5	14.4	13.3
Switzerland	21.2	18.7	12.4
Greece	25.0	21.8	14.1
Austria	25.0	22.7	17.4
Denmark	25.0	22.5	16.7
The Netherlands	25.5	23.7	19.6
Finland	26.0	23.6	18.1
Sweden	26.3	23.2	17.4
Portugal	26.5	23.7	17.1
United Kingdom	28.0	28.3	28.9
Norway	28.0	26.5	23.3
Germany	31.0	28.0	21.7
Italy	31.1	27.4	20.8
Canada	33.0	32.9	32.8
Belgium	34.0	24.7	-5.1
France	34.4	34.6	34.9
Spain	35.7	32.8	33.4
USA	38.3	37.4	35.1
Japan	40.8	41.3	41.9

Sources: European Commission and ZEW Mannheim (TAXUD/2008/CC/099).

ced for income from petroleum extraction, in addition to the ordinary profit tax of 28 per cent. The marginal tax rate on the additional return in the petroleum sector is therefore 78 per cent.

The taxation of petroleum in Norway is generally based on the ordinary business taxation rules. However, the tax base for income from the sale of crude oil is determined using administratively set norm prices, i.e. tax reference prices. Deductions are granted for all relevant operating costs, and exploration costs may be directly recorded as expenses. An uplift (investment-based "supplementary depreciation") is deducted from the ordinary tax base to calculate the special tax base. If the company makes a loss, the loss and unutilised uplift can be carried forward, with interest. Moreover, a separate payout scheme has been introduced for companies which are not in a tax position, under which the tax value of the exploration costs is disbursed.

The State Direct Financial Interest (SDFI), through which the state participates in licences

with high potential, is also an important source of state income from the continental shelf. SDFI has the same properties as a cash-flow tax; the state covers its share of investments and operating costs on an ongoing basis and receives the same proportion of the income.

Figure 10 shows the composition of the state's income from petroleum activities. All else being equal, higher oil prices will result in higher profits for oil companies, and thus higher income for Norway. Correspondingly, the state's income from the petroleum industry will drop significantly during periods of low prices. When prices were high around 1980, the state's income was nevertheless relatively low. This is because production was considerably lower than when prices again rose to very high levels around 2008 and because many companies recorded substantial investment depreciations.

Hydro power taxation

The tax rules for hydro power companies are generally the same as for other companies. Among other things, this means that profits (ordinary income) are taxed at 28 per cent.

In addition, the state calculates tax at a rate of 30 per cent on the resource rent of hydropower plants. The resource rent is calculated as the standardised market value of the power produced (actual production multiplied by spot market prices), less operating expenses, depreciation and an uplift. The uplift is calculated as the risk-free return on the written-down value of working capital. If a hydro power company has a negative resource rent, the tax value is disbursed.

Power companies are also subject to a natural resource tax (paid to municipalities and county authorities), of 1.3 øre per kWh. The natural resource tax may be deducted from the company's tax on ordinary income. In addition, hydro power producers pay a license fee and (normally) property tax to their host municipalities, and have to yield power under licence conditions.

Taxation of shipping companies

Since 2007, companies taxed as shipping companies have been exempted from tax on shipping income, and pay only a tonnage tax. The tonnage tax is an annual tax calculated on the basis of the ships' net tonnage, and the rate varies according to different tonnage intervals. The rate may be reduced for ships, etc. that satisfies environmental requirements set by the Norwegian Maritime Authority.

3.3 Taxation of capital

Wealth tax

Personal taxpayers pay tax at a rate of 1.1 per cent of taxable net wealth, i.e. gross wealth less debt, on net wealth exceeding a tax-free allowance of NOK 750,000 in 2012. Spouses each have their own tax-free allowance. The wealth tax plays an important part in redistribution policy. It supplements income taxation and ensures that the tax system for personal taxpayers as a whole has a more progressive effect; see figure 11.

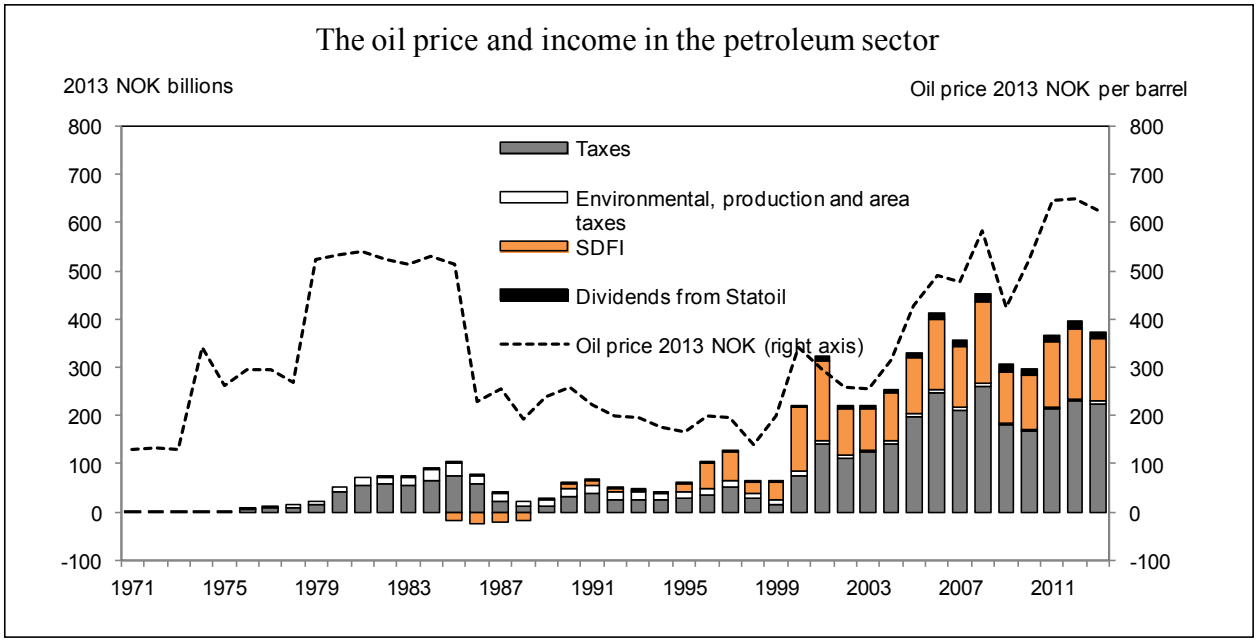

Figure 10 The oil price and total net income for the state from the petroleum sector. 2013 NOK
Source: Ministry of Finance.

In principle, the taxable value of assets is equal to their market value. However, homes and other real estate are valued much lower than market value. On average, commercial property other than hydro power plants, agricultural property and forestry property is valued at around 40 per cent of market value for the purpose of wealth tax. The average taxable value of a taxpayer's primary home (the home in which the taxpayer lives), is 25 per cent of market value, while the taxable value is 40 per cent in the case of second homes (homes in addition to the primary home which are not commercial or vacation properties). The taxable value of vacation properties is set at around 30 per cent of the cost of the new building and the land, and the taxable value can be updated using general percentage increases. A safety valve is intended to ensure that no primary home or vacation property has a taxable value higher than 30 per cent of the market value the taxpayer can document. The safety valve is 60 per cent for commercial property and second homes.

The proportion of persons who pay wealth tax has been reduced in recent years due to increases in the tax-free allowance. It is estimated that around 17 per cent of taxpayers will pay wealth tax in 2012; see figure 12.

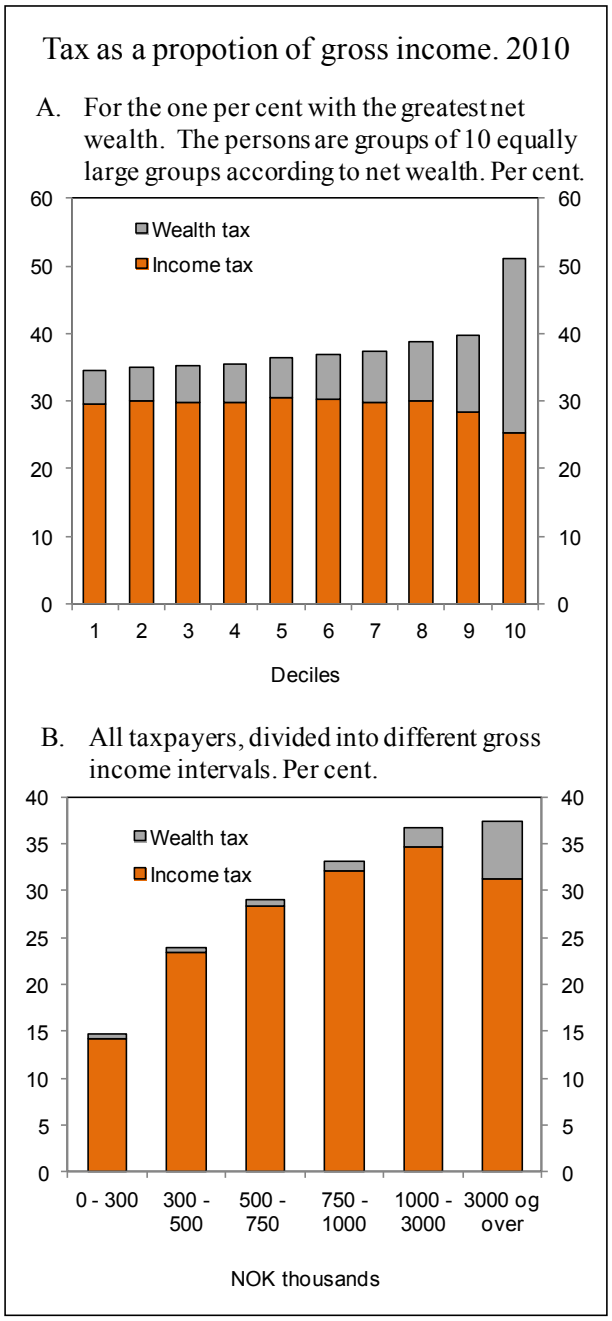

Figure 11 Tax as a proportion of gross income in 2010. Per cent
Sources: Statistics Norway and the Ministry of Finance.

Inheritance tax

In principle, all inheritances are subject to inheritance tax. In 2012, inheritances and gifts totalling up to NOK 470,000 are exempt from inheritance tax. In the case of inheritances and gifts to the testator's/donor's children, foster children (including step-children raised by the testator/donor), and parents, the tax rate is 6 per cent on inheritances/gifts totalling between NOK 470,000 and NOK 800,000, and 10 per cent on amounts exceeding NOK 800,000. The same thresholds apply to other beneficiaries/recipients of gifts, but the tax rates are 8 per cent and 15 per cent, respectively. Inheritances and gifts to spouses and cohabitants are not taxable.

Inheritance tax may be regarded as a suitable compensation for a lack of income and capital gains taxation. Recipients do not have to pay ordinary income tax on inheritances and gifts; nor are inheritances and gifts treated as a realisation that may trigger capital gains taxation of the estate or of the donor.

Among the recipients of inheritances and gifts, it is those with the highest incomes and highest net wealth who receive the largest values, and who consequently pay the most inheritance tax in absolute terms.

Property tax

The introduction of property tax is left to the discretion of the individual municipalities. All income from property tax falls to the municipality. The property tax rates must be between 0.02 and 0.07 per cent of the valuation basis, which must be established by conducting a property valuation every 10 years. Municipalities may choose to apply a reduction factor when valuing properties. In the case of homes and vacation properties, they may also use a tax-free allowance to reduce the valuation basis. Special valuation rules apply in the case of property tax on hydro power stations; these are based on the value of

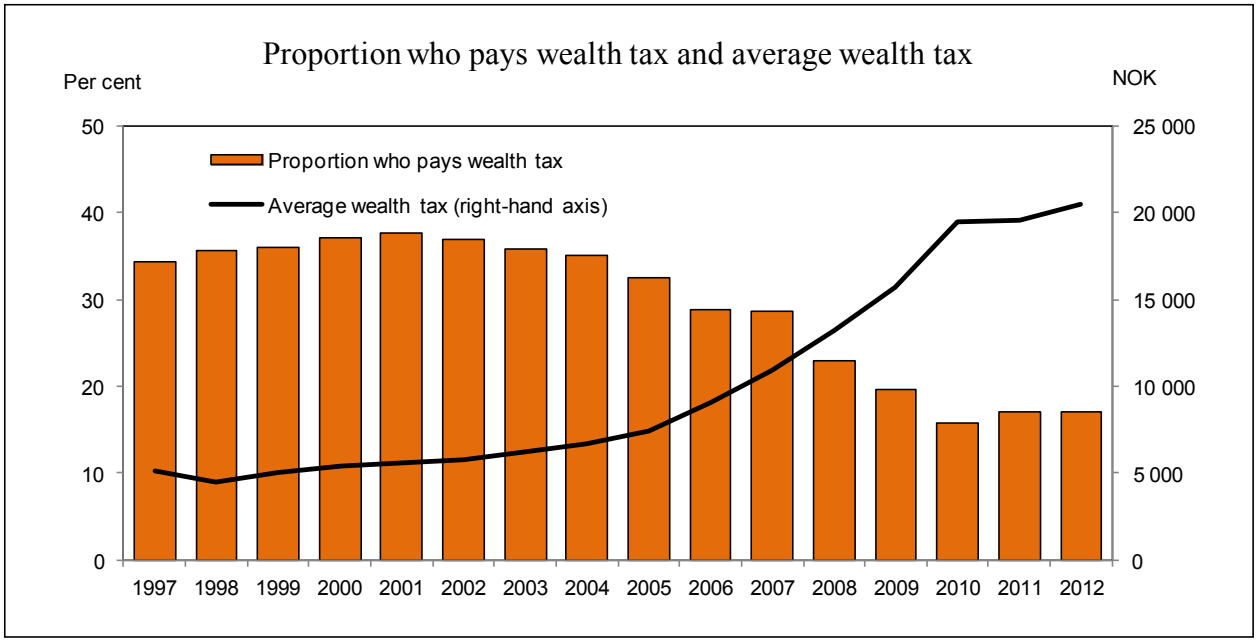

Figure 12 Proportion of persons who pay wealth tax and average wealth tax. 1997 – 2010. Estimates for 2011 and 2012
Source: Statistics Norway.

what is produced, subject to minimum and maximum limits.

Through 2011, 316 of 430 municipalities had introduced property tax in one form or another, and 193 had introduced property tax on homes and vacation properties in all or parts of the municipality. The municipalities' total income from property tax was about NOK 7.6 billion in 2011. Box 3 provides an overview of income from tax on property in the OECD countries.

In its draft budget for 2013, the government has proposed that municipalities should be permitted to use the net wealth bases to value homes for property tax purposes, starting in the property tax year 2014. An effect of the proposal is that the values of homes will fluctuate with the market prices.

4 Indirect taxes

4.2 Value added tax

Value added tax is a general tax on domestic consumption of goods and services, intended to generate income for the state. Value added tax is collected and paid in by businesses liable to value added tax. The general tax rate is 25 per cent.

When the value added tax system is designed to apply generally to all goods and services at a single rate, the tax will not influence the composition of consumption. Further, when the tax is only imposed on final consumption, it does not result in adjustments of production. This design also

Box 3 Income from tax on property in the OECD countries

The OECD tax statistics provide an overview of the income generated by different types of taxes. Tax on property includes taxes relating to use, ownership and the transfer of property. Capital gains taxation is not covered. In Norway's case, municipal property tax, tax on net wealth, inheritance tax and stamp duty will all be included.

In some countries, there may be a difference between the gross and net tax on property. This applies, for example, in the USA, where many taxpayers can deduct locally paid property taxes before income tax is calculated. The OECD figures are based on non-weighted averages of gross taxes.

Figure 13 shows that income from tax on property is generally relatively low. Norway receives only 2.9 per cent of its tax revenue from property, and lies well below the OECD average. This estimate includes the total income from tax on net wealth and inheritance tax, etc., and thus also includes tax on other assets such as shares, etc. The actual tax on real estate probably amounts to less than 2 per cent of total tax revenue. In addition, Norway is unusual in an international context in allowing an unlimited deduction in respect of debt interest.

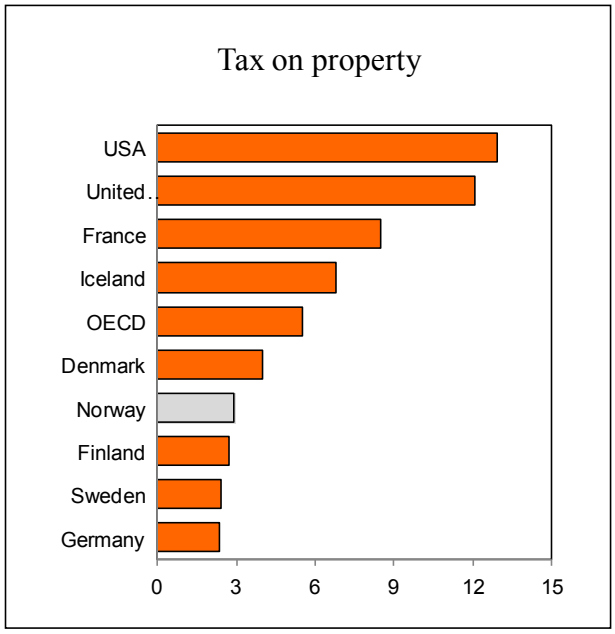

Figure 13 Tax on property. Percentage of total tax revenue. 2010[1]
[1] The OECD average relates to 2009 figures.
Source: OECD Revenue Statistics.

allows the value added tax to be collected in a simple manner, and at a relatively low administrative cost to businesses.

Although the current value added tax is, in principle, a general tax on consumption, there are various exceptions, exemptions and reduced rates. Several services are excluded from the value added tax system, including financial services, health services and teaching. This means that no value added tax is charged on the sale of these services, and businesses that produce the services cannot deduct the value added tax they pay on goods and services they purchase.

A reduced value added tax rate of 15 per cent applies to foodstuffs, and a low rate of 8 per cent applies to certain service areas such as passenger transport, accommodation, NRK's public broadcasting activities and access to cinemas, sporting events, amusements parks and adventure centres. Some goods are exempt from value added tax through a "zero rate". This means that the person liable to tax is entitled to deduct value added tax paid on goods and services for use in the business without charging value added tax on sales. This applies, for example, to books, newspapers and periodicals.

The general value added tax rate of 25 per cent is the same as in Sweden and Denmark, among others. Income from value added tax as a proportion of GDP is higher in Norway than the average for the OECD countries, but somewhat lower than in Denmark and Sweden.

4.2 Excise duties

Excise duties are intended to fund public expenditure, but are also used as an instrument for pricing socioeconomic costs linked to the use of products hazardous to health or the environment.

In contrast to general taxes on consumption, excise duties on certain products will shift consumption away from taxed products. Excise duties are therefore a suitable instrument for reducing the socioeconomic costs associated with products which are damaging to the environment or health. Some excise duties are motivated purely by fiscal considerations, i.e. the aim is to generate income for the state to fund public expenditure. Examples in this regard include stamp duty on the sale of real estate and the motor vehicle re-registration tax. Other taxes may be based on a fiscal motivation but are also assigned an environmental purpose. This applies, for example, to the motor vehicle registration tax, the design of which has increasingly been based on environmental considerations in recent years, and the electricity consumption tax, which is also intended to limit the consumption of electricity.

The objective of a tax influences the design of the tax. To limit the socioeconomic costs of taxation, fiscal taxes should not be charged on manufactured intermediate goods. On the other hand, environmental taxes which are intended to put a price on an environmental problem should be designed to cover all sources of the environ-

mental problem, at the same tax rate.

Environmental taxes

Norway's first tax with an environmental purpose was the tax on the sulphur content of mineral oil, which was introduced in 1970. The use of environmental taxes did not become more widespread until the late 1980s/early 1990s. In the last 20 years, environmental taxes have been introduced in various areas.

Environmental taxes ensure that market prices take greater account of the social costs of activities that are hazardous to the environment. This helps to reduce the scale of these environmentally harmful activities. Income from environmental taxes can be used to reduce other destortive taxes.

The use of environmental taxes is consistent with the principle that the polluter should pay. This principle states that those who use environmental goods should also pay the costs of the activity that is damaging to the environment.

The cost of reducing emissions from environmentally hazardous activities can vary between different economic sectors, and the authorities do not have complete information on how large these costs are for different businesses and households.

A correctly designed environmental tax will cover all emissions in all parts of the economy, at a single common rate. This allows decentralised decision-making that secures an environmental benefit at the lowest possible socioeconomic cost. Quotas are another cross-sectoral instrument that can have the same effect as environmental taxes. Quotas and taxes are discussed in more detail in box 4.

When environmental taxes function as intended, they help to reduce environmentally harmful activity. This in turn reduces the income of the state. This partly explains the drop in income from environmental taxes in recent years. If environmental taxes are replaced with emissions quotas that are not sold ("free quotas"), income falls further. A fall in the income from environmental taxes may mean that other direct and indirect taxes have to be increased to maintain a given level of tax revenue. However, Norway's income from environmental taxes remains relatively high compared to other countries; see figure 14.

Environmental taxes and quota systems may not have a cost effective design for various reasons. This is often due to a desire to protect particular groups or industries. Figure 15 shows the marginal cost of greenhouse gas emissions in different sectors in Norway. Having different prices for environmentally harmful emissions increases the total cost of reducing national emissions.

In addition to pure environmental taxes, taxes are levied on electricity consumption. The electricity consumption tax is motivated by fiscal considerations, but is also intended to help limit the consumption of electricity. In 2000, a base tax on mineral oil was introduced with the aim of preventing an environmentally undesirable transition from the use of electricity to the use of mineral oil for heating purposes.

There are also taxes other than environmental and energy taxes that are both motivated by fiscal considerations and have environmental objectives. This applies, for example, to the motor vehicle registration tax, which among other things is differentiated according to CO_2 emissions. Taxes on fuel and vehicles constitute a large proportion of the environmental taxes.

Health and social taxes

The consumption of goods other than environmental goods may also impose costs on society

Box 4 The connection between taxes and quotas

Environmental taxes put a price on the cost to society of environmentally harmful activities. It becomes financially profitable for stakeholders to implement measures to reduce emissions, either in the form of reduced production or through clean-up measures that cost less than the tax. In the case of a tax, the authorities put a price on polluting emissions, but do not control the volume of emissions directly. In a quota system, on the other hand, the authorities set the volume of emissions, while the price of emissions is determined by the market. However, the cost of the clean-up measures which are implemented will be determined by the price of the quotas as established in the quota market, and will depend on the supply of and demand for quotas.

An environmental tax and a quota system will secure the same emissions reductions when the quota price equals the tax. If the authorities auction off the quotas, the quotas will generate the same income for the authorities as the tax. This is because the residual emissions will correspond to the total volume of the quotas. Stakeholders will thus be willing to pay a price for the quotas equal to the tax. If the quotas are distributed free of charge, the authorities will lose the income and the opportunity to secure potential further socioeconomic gains by reducing other taxes.

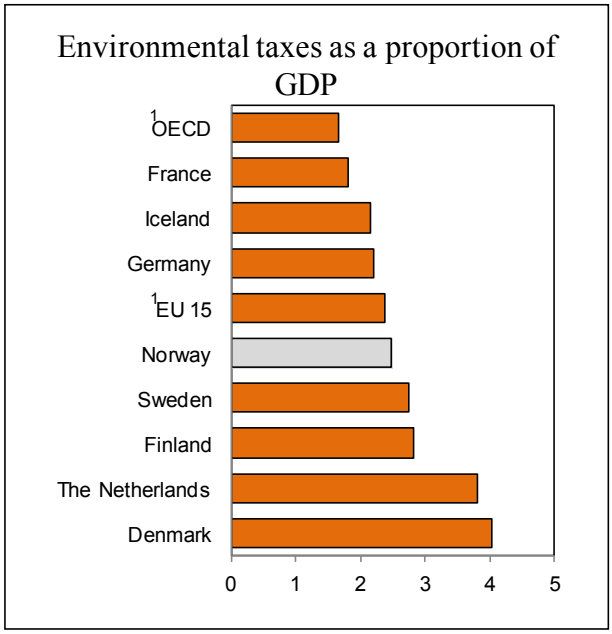

Figure 14 Income from environmental taxes as a proportion of GDP in different countries. 2010. Per cent
Source: Ministry of Finance and OECD.

which are not reflected in market prices. The consumption of alcohol and tobacco is an example of this. The taxes on alcohol and tobacco generate income for the state, but also help to ensure that the prices of these products include, to a greater degree, the costs which using them imposes on society. These costs relate to health expenditure which is covered by society and the drawbacks inherent in the fact that smoking and alcohol consumption may have negative effects on others than those who consume the goods. In addition, there are costs linked to the fact that consumers themselves do not take sufficient account of the long-term effects of consumption, or ignore undesirable effects. Health reasons have also been linked with the tax on chocolate and sugar products, and the tax on non-alcoholic beverages. A high level of taxes on consumer goods may increase the volume of cross-border shopping, smuggling and illicit distillation of alcohol. The health effects of taxation must be weighed against the social costs of such activities.

4.3 Customs duties

Customs duties have the objective of protecting domestic producers against competition from abroad. Import duties normally result in more expensive goods for consumers and higher production costs for businesses. Moreover, customs duties reduce the scope of trade and prevent different countries from fully utilising their relative advantages in the production of goods and services. Trade in goods and services have made it possible for Norway to utilise its competitive advantages. Today, Norway is one of the countries in the world with the least customs protection for manufactured goods. In the context of manufactured goods, only certain items of clothing and textiles are subject to customs

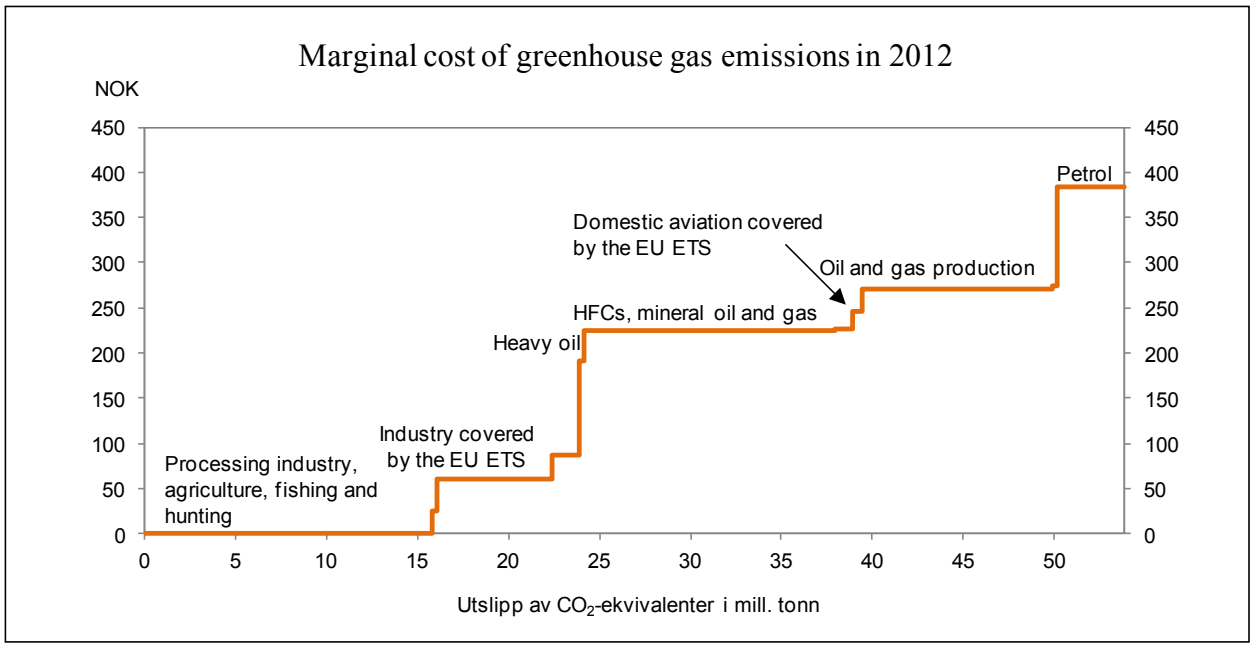

Figure 15 The level of taxes on greenhouse gases in different sectors. NOK per tonne of CO_2 equivalents in 2012 and a quota price of NOK 61 per tonne. Emissions figures for 2010
Source: Statistics Norway, Climate and Pollution Agency and the Ministry of Finance.

duties.

Customs protection of agricultural goods is a key part of Norwegian agricultural policy. Among other things, import protection helps to ensure trade in Norwegian agricultural products at prices set in the agricultural agreement. Customs protection is an important aspect of the overall support given to Norwegian agriculture, and constitutes the majority of Norway's border protection measures. Customs duty rates for agricultural goods vary considerably, depending on the need for protection.

Maximum customs duty rates have been set in international agreements. Norway has committed to reducing customs duty rates in several rounds of GATT/WTO negotiations, most recently in connection with the 1994 WTO agreement. The WTO agreement imposed not only a certain reduction in customs duties on manufactured goods, but also commitments regarding market access, domestic subsidies and export subsidies for agricultural goods. Like other industrialised countries, Norway grants preferential customs duty rates to developing countries through the GSP (Generalized System of Preferences) scheme. Under the scheme, individual industrialised countries grant developing countries improved market access for their goods. The GSP is a unilateral scheme, and can in principle be withdrawn or amended.

5 Fees and sectoral taxes

The state's exercise of authority is normally funded through ordinary allocations via the fiscal budget. However, in certain areas, the state's expenditure is covered entirely or partly by the collection of fees or sectoral taxes.

According to the Ministry of Finance guidelines, fees shall constitute payment for services provided by public bodies. Therefore, when a new fee is introduced, it cannot be set higher than the cost to the state of taking the action in question.

Sectoral taxes are earmarked for the funding of particular objectives. They can nevertheless be regarded as ordinary direct and indirect taxes, because their payment is not linked to direct reciprocal services from the state.

6 Distribution effects of the tax system

6.2 Income and net wealth distribution and the progressivity of the tax system

Taxation is one of several instruments for reducing income differences and improving the welfare of those with low incomes. Below, an overview is provided of the redistribution properties of the current tax system.

Different types of income and different assets are taxed differently. The composition of income and net wealth in the population is therefore important as regards how changes to the tax system influence distribution.

Figure 16 shows that persons with low incomes primarily receive wage and pension income, while income from self-employment and capital income are concentrated among persons with

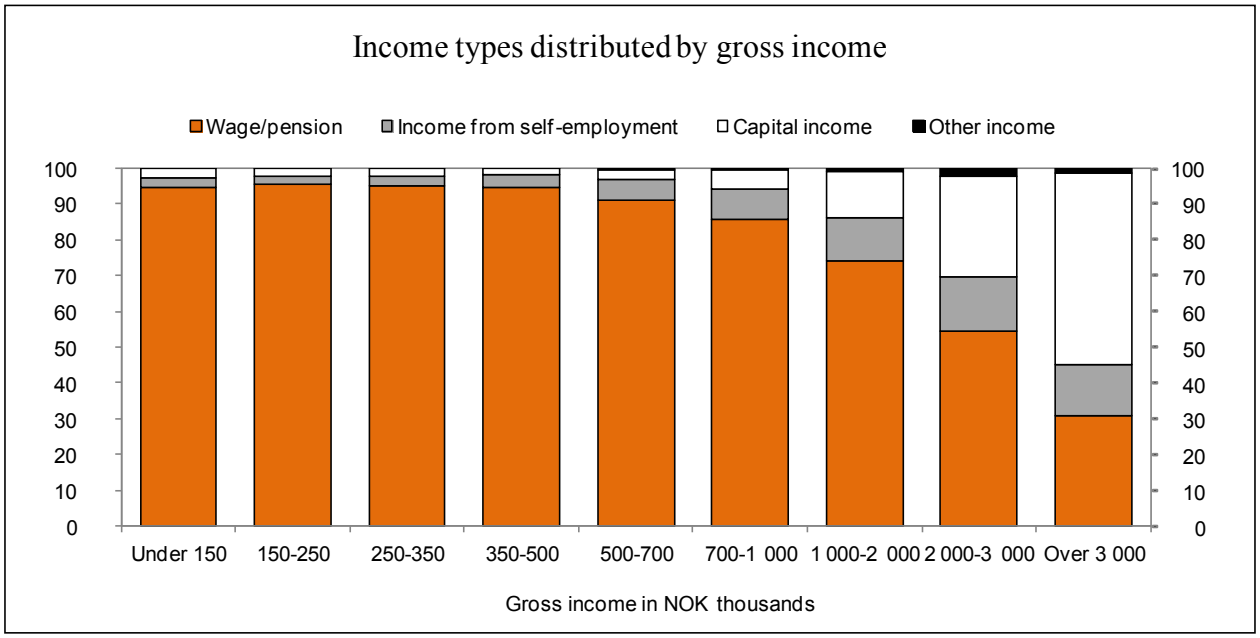

Figure 16 Income types distributed by gross income. 2010. Per cent
Source: Statistics Norway's tax statistics for personal taxpayers and the Ministry of Finance.

high incomes. In 2010, capital income accounted for around 53 per cent of the total income of persons with incomes of more than NOK 3 million.

Figure 17 shows the composition of net wealth at different income levels. Since taxable values are employed in this context, and these are lower than the real values in many cases, net wealth is underestimated. In particular, the assessment value of homes and other real estate is much lower than the market value. Low assessment values on commercial property also mean that many unlisted companies are valued far below their real value. It is nevertheless clear that securities comprise the largest net wealth component among the very wealthiest persons, while bank deposits and real estate dominate in the lower income groups.

Figure 18 illustrates how total tax is distributed among persons at different income levels. The figure shows that the tax system is progressive, i.e. the average tax increases in line with income. The tax and transfer system is more important, in relative terms, to the income distribution in Norway than in the OECD countries as a whole; see box 5.

6.2 The importance of the tax system for the welfare of households

When calculating the effects of the tax system, it is sometimes desirable to consider how the welfare and consumption opportunities of households, and not just actual incomes, are affected. Such calculations take account of total household income and the number of household members; see the detailed description in box 6. The calculations are performed using Statistics Norway's tax model, LOTTE-Skatt; see box 7 for a more detailed description of the model.

In figure 20, all members of the population have been assigned an income based on their household affiliation and then ranked according to rising income, in 10 groups of equal size (income deciles). The members of the household in example 1 in box 6 would be assigned to income group 8 in this figure, and the members of the household in example 2 would be assigned to income group 10. Correspondingly, all persons have been allocated a share of the direct and indirect taxes paid by their household. The figure shows that persons with low consumption opportunities have a lower tax burden than persons with high consumption opportunities.

As figure 20 shows, indirect taxes contribute to weaken the progressivity of the tax system. This is partly because the calculations are based on gross household income. Persons with high gross incomes pay a larger proportion of their gross income in taxes than persons with low gross incomes, and thus have a smaller proportion of income available for consumption. It is post-tax income (and savings) that can be consumed and from which indirect taxes are paid. Indirect taxes will thus constitute a smaller proportion of gross income in the case of a person with a high gross income than in the case of a person with a low gross income. If the calculations were to be based on post-tax income

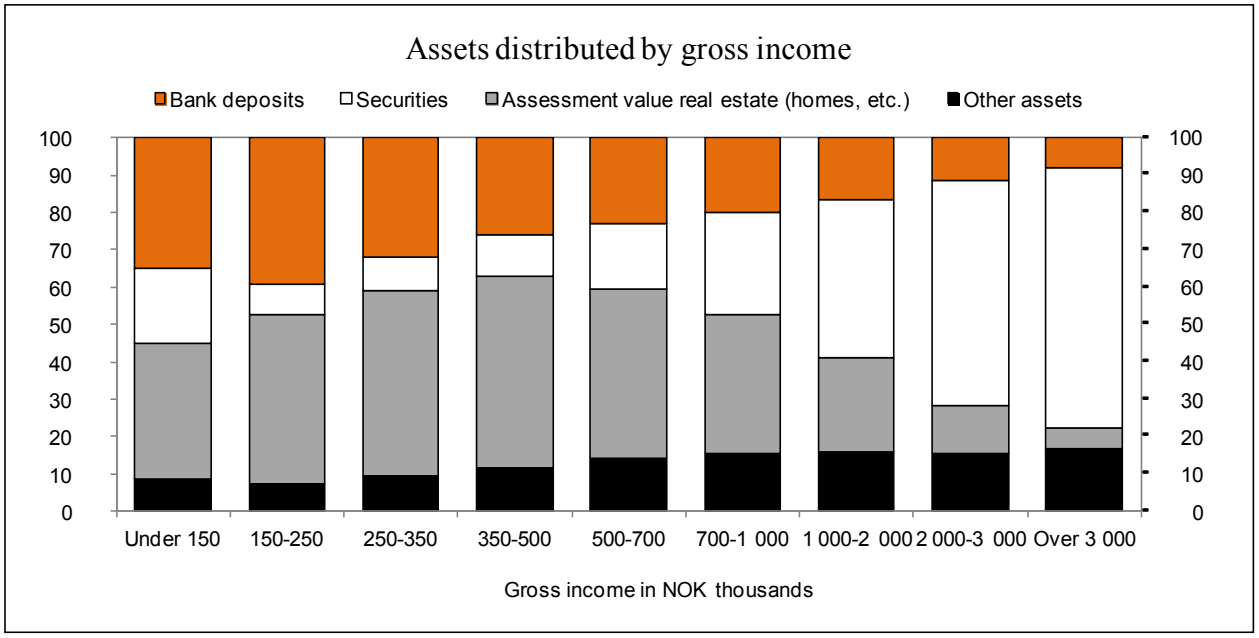

Figure 17 Gross wealth (taxable values) distributed by gross income. 2010. Per cent
Source: Statistics Norway's tax statistics for personal taxpayers and the Ministry of Finance.

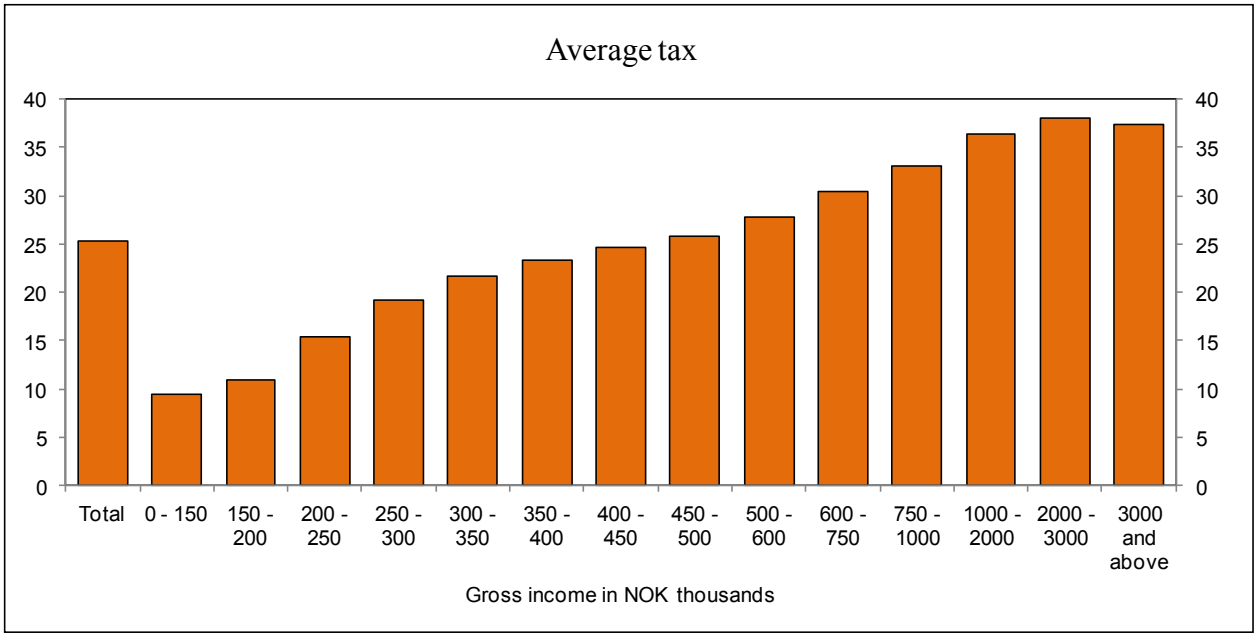

Figure 18 Tax as a proportion of gross income. 2010. Per cent
Source: Statistics Norway's tax statistics for personal taxpayers and the Ministry of Finance.

Box 5 Distribution effects of the tax and transfer system in Norway and other countries

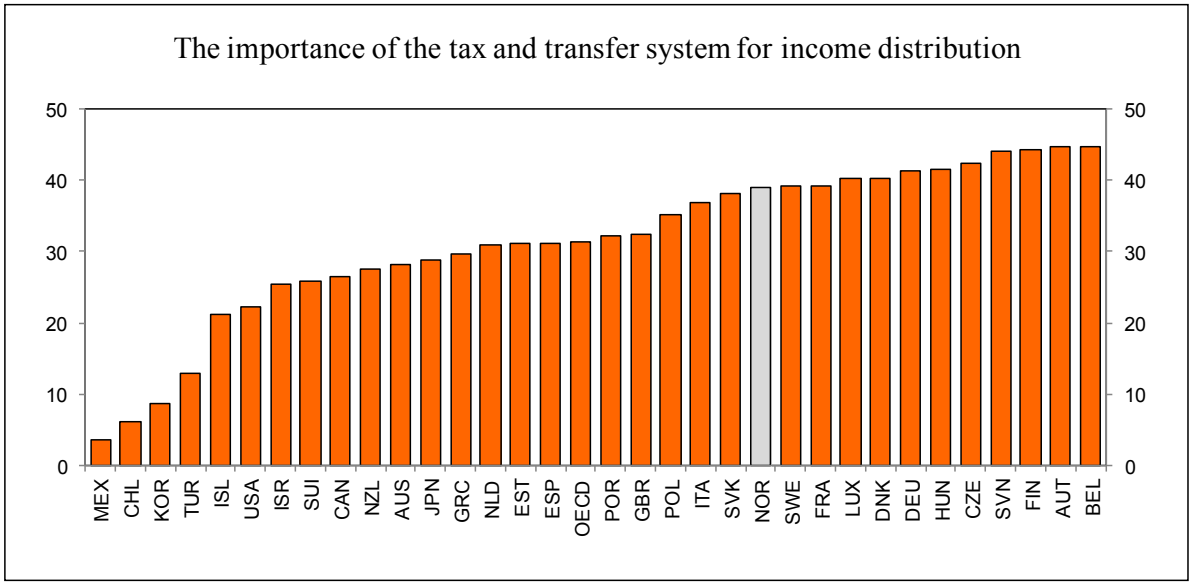

Figure 19 The importance of the tax and transfer system for income distribution. Percentage difference in inequality measured using the Gini coefficient before and after tax and transfers. End of the 2000s
Source: OECD. Social Expenditure Statistics.

Figure 19 shows how the tax and transfer system helps to reduce income differences in different OECD countries. The contribution of the tax and transfer system to redistribution is measured as the difference between income inequality (measured using the Gini coefficient) before taxes and transfers and income inequality after taxes and transfers. Compared to countries like Korea, Japan and the USA, Norway's tax and transfer system plays a much more substantial role in redistributing income.

Differences in the organisation of the tax system in different countries may result in differences in the degree of redistribution achieved through the tax system. For example, the tax system in a country that has placed greater emphasis on personal income tax than on employer's social security contributions will appear more redistributive, since employer's social security contributions are not included in the calculation of personal tax. This may explain why Denmark, which does not use employer's social security contributions, appears to have a more redistributive tax system than, for example, Norway, as Denmark's tax revenues must come from personal taxation to a greater degree. The OECD's calculations show that while the tax and transfer systems reduce the income differences in the OECD area by just over 30 per cent, the income differences in Norway are reduced by almost 40 per cent.

different income groups.

The calculations are static, and do not cover developments over time. Studies show that lifetime earnings are distributed much more evenly than annual income, and that the number of persons earning a very low income in one particular year is much higher than the number of persons earning a very low income for several years.

7 Estimates of tax expenditures and tax sanctions

The tax system is sometimes used as an instrument for achieving political aims beyond the main objectives mentioned in section 1. This results in exceptions and special arrangements that reduce the state's income and consequently constitute support for specific groups and activities. Such revenue losses are called tax subsidies or tax expenditures. Examples include special

Box 6 Consumption opportunities and adjusted income

A person's consumption opportunities are determined by the resources which the individual has at his or her disposal. These resources include post-tax income, net wealth, the value of public goods and services, and home manufacture. Ideally, analyses of resource distribution in the population should consider total consumption opportunities. Due to measurement difficulties, however, it is most common to base distribution analyses on income.

The use of taxable gross income as the definition of income and the basis for classification into income groups does not express fully how tax changes result in altered consumption opportunities and welfare. A person's consumption opportunities are influenced by the household of which he or she is a member. Persons who live together can share fixed costs, for example linked to the home, motor vehicles and electricity (economies of scale), and persons without a personal income can nevertheless have consumption opportunities if they belong to a household in which others have an income (provider responsibility).

To take account of economies of scale and provider responsibility, each member of the household is allocated an adjusted income ("equivalent income"), which is larger than the household's actual income per person. The adjusted income expresses the income a household member would have to have as a single person in order to have the same consumption opportunities he or she has as part of the larger household. For example, a person may have a low adjusted income because her own gross income is low, or because she has provider responsibility for other members of the household who do not have incomes.

There are different scales for adjusting income in this manner. The calculations in this chapter employ the "square-root scale", which has been used, for instance, in a number of official reports. Individual household members are allocated an income equal to the total household income divided by the square root of the number of persons in the household. This means, for example, that a household of four persons only needs double the gross income of a single-person household to have the same consumption opportunities.

The examples in table 2 show the calculation of adjusted income for a household of four and for a household of two.

Table 2 Examples of calculated adjusted income for households of four and two persons, respectively

Example 1: Couple with two children		*Example 2: Couple without children*	
	Income (NOK)		**Income (NOK)**
Adult with income	450,000	Adult with income	450,000
Adult with income	350,000	Adult with income	350,000
Child	0		
Child	0		
Total	800,000	Total	800,000
Adjusted income per person (800,000/√4)	400,000	Adjusted income per person (800,000/√2)	565,685

Source: Ministry of Finance.

arrangements for sole providers and for agricultural and industrial businesses. Correspondingly, the tax system may feature tax sanctions, i.e. in certain cases a direct or indirect tax is imposed that is higher than it would be under a general, uniform set of rules. Such extra taxation also expresses political priorities. One example is indirect fiscal taxes on businesses' factor inputs.

In contrast to corresponding measures funded via the expenditure side of the budget, the Storting (the Norwegian parliament) does not decide the level of tax expenditures and tax sanctions in the annual budgets. This section is therefore intended to provide supplementary information about the different measures and instruments which are incorporated into the current direct and indirect tax rules. The summary is not intended to be complete.

The size of the tax expenditures and tax sanctions depends on how the benchmark system is defined. Usually the general direct and indirect tax rules are applied. However, in some cases, the main principles for the design of the tax system are applied, as established by, for instance, the 1992 and 2006 tax reforms. Examples include depreciation rates, the taxation of housing and certain indirect taxes. As in most other countries, the Ministry uses the revenue foregone method, i.e. tax expenditures are set equal to the tax revenues which the public sector loses due to the use of more generous rules than indicated by the benchmark system.

Estimated gross tax expenditures will amount to about NOK 130 billion in 2012. Figure 21 shows the distribution of net tax expenditures in 2012 across different areas. As shown in the figure, by far the greatest tax expenditure relates to the taxation of housing. This amounts to approximately 40 per cent of total tax expenditures. Tax expenditures related to financial capital and pension savings amount to about 7 per cent of total tax expenditures. Exceptions in the value added tax system account for 22 per cent, while regionally differentiated employer's social security contributions and tax expenditures on wages and pensions amount to 7 and 10 per cent respectively.

8 Revenue estimation methods

8.1 The benchmark and the tax revenue reference

The benchmark

The revenue effects of changes to the tax rules are calculated by reference to a benchmark. The benchmark is characterised by the fact that direct and indirect taxes are kept unchanged in real terms. This means that limits and rates under the tax rules are adjusted annually in line with growth in prices, wages, pensions and net wealth.

The benchmark is based on tax rules for the current year. Deductions and income thresholds in the general rate structure for personal income taxation are generally adjusted in line with estima-

Box 7 The LOTTE-Skatt and LOTTE-Konsum tax models

Statistics Norway's LOTTE-Skatt tax model is used to calculate the effects on tax revenues and distribution of amending the personal taxation rules. The model consists of a set of tax rules and a set of data. The set of data is based on a representative sample of taxpayers taken from Statistics Norway's income statistics for households for 2010, extrapolated to 2013. These statistics include tax information from the tax return and tax assessment registers and information about tax-free income like scholarships, housing benefits and social security benefits.

To allow the effects of amending the tax rules in 2013 to be studied, the tax rules for 2012 are extrapolated to 2013. The extrapolated rules are called the benchmark system for 2013, because they define the real unamended tax rules. Deductions and limits relating to the general rate structure for personal taxation are primarily extrapolated using estimated wage growth for an ordinary man-year. This means that a wage earner whose wage growth equals estimated wage growth (and who is not entitled to any special deductions), will pay approximately the same amount of tax as a percentage of income in the benchmark system as the year before.

Deductions and limits that are not linked to the general rate structure for personal taxation are extrapolated using the development of consumer prices. The tax-free allowance in the tax on net wealth is extrapolated so that a person with a net wealth composition equal to the average will pay approximately the same amount of tax on net wealth as a percentage of net wealth as in the previous year. A corresponding method is used to extrapolate the inheritance tax thresholds.

Since 2011, pensions have no longer been adjusted according to wage growth, but rather according to wage growth less 0.75 percentage points (for ordinary pension income), and according to wage growth adjusted downwards in view of increasing life expectancy (minimum pension level). This will be reflected in the benchmark system. Starting in 2013, the tax allowance in pension income will be extrapolated using (primarily) growth in the minimum pension level, the upper limit of the basic allowance will be extrapolated using growth in pension income and the personal allowance will be extrapolated using a weighted average of wage growth and growth in pension income. The said limits were previously wage-adjusted in line with the benchmark system, but this would imply a tax relief from 2013.

LOTTE-Konsum is used to calculate how household consumption expenditure on different groups of goods varies between income groups. By linking consumption taxes (VAT and excise duties) with groups of goods, it is possible to calculate how consumption taxes, or changes to these taxes, are distributed between income groups. Such calculations are only performed for taxes on goods and services that are charged to households directly, not for taxes charged to other sectors, even though these also affect households through consumer prices. The benchmark alternative for taxes in 2013 comprises estimated booked revenue for each individual tax in 2011 extrapolated using price and volume growth in the period to 2013.

The calculations performed using LOTTE-Skatt and LOTTE-Konsum are uncertain, not least because they are based on a sample, and in the case of LOTTE-Konsum due to uncertainity in the calculations of price effects. In addition, the data is extrapolated to 2013 on a discretionary basis. The models are static, i.e. they do not take into account any adjustments over time resulting from proposed rule changes. Further, the tax returns on which the calculations are based do not cover all income and other sources of consumption. Accordingly, there may be differences between a person's actual consumption opportunities and what the statistics express.

ted wage growth. A taxpayer who only receives standard allowances and experiences growth in both ordinary income and personal income equal to estimated wage growth will thus pay approximately the same average income tax under the benchmark tax rules as in the current year; see the detailed discussion in box 7. Correspondingly, in the benchmark, the tax-free allowance in the tax on net wealth is adjusted so that a person with an average net wealth composition pays the same amount of tax on net wealth under the benchmark system as in the current year, measured as a proportion of net wealth. Special deductions and certain other limits related to personal income taxation are adjusted in line with estimated price growth. In the benchmark for indirect taxes, all quantitative rates are adjusted in line with estimated price growth. Accordingly, the indirect tax burden under the benchmark tax rules remains unchanged in real terms.

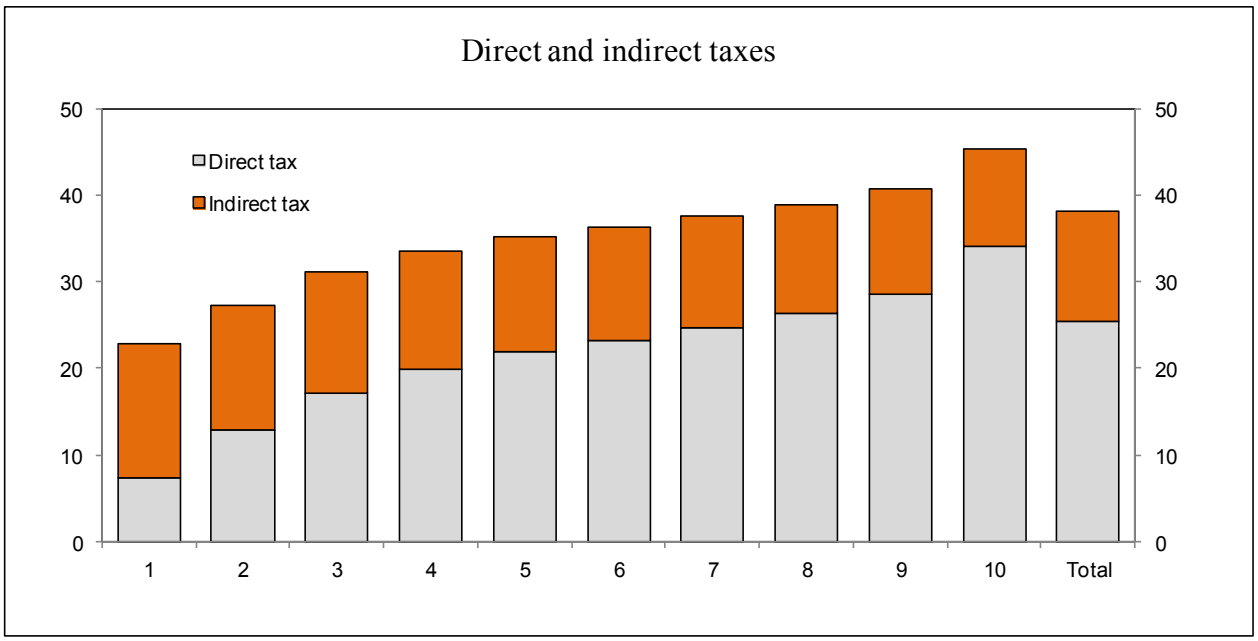

Figure 20 Direct and indirect taxes per person as percentages of adjusted income. Wage and price-adjusted 2012 rules. Per cent
Source: Statistics Norway and the Ministry of Finance.

The tax revenue reference

The revenues resulting from the benchmark for the tax rules are often described as the tax revenue reference. The tax revenue reference is thus determined by the benchmark and the estimated development of the tax bases. The extrapolation of the tax bases is based on estimates of macroeconomic developments.

8.2 Static revenue estimation

When the short-term revenue effect of a rule change, such as the effect in the budget year, is to be estimated, it is often reasonable to assume that there are no initial behavioural responses from the taxpayers. This is particularly the case if there is little reason to believe that the tax change will influence their behaviour to any notable degree, or that behaviour changes takes time.

The revenue effect of a change in the tax rate will in such cases be the tax base multiplied by the change in the tax rate. This can be illustrated using the example of a change in the annual motor vehicle tax. Around three million motor vehicles are registered in Norway. An increase in the annual motor vehicle tax of NOK 100 per motor vehicle can be estimated to increase revenue by around NOK 300 million. Such an increase in the annual motor vehicle tax is unlikely to affect the number of motor vehicles in the short term.

8.3 Behavioural effects

Changes to direct and indirect taxes, and certain public expenditure changes, may influence public finances beyond the immediate, direct budget effect. This is because the changes may influence the behaviour of businesses and households.

When assessing the economic effects of tax changes, it is important to distinguish between the permanent behavioural effects and the demand effects of a tax change that is not revenue neutral.

Permanent behavioural effects

The long-term, permanent effect, often referred to as the structural effect, of a tax change on public budgets depends on the design of the tax change. For example, reduced tax on wage income will partly increase real post-tax income (income effect), and partly leave a worker with more money after tax for each additional hour worked (substitution effect). In addition, the tax change may motivate some individuals to enter the labour market (participation effect). The income effect tends to reduce labour supply (increase consumption of leisure), while the substitution effect and the participation effect tends to increase labour supply. The effects vary with different tax changes, and depend, among other things, on the size of the income, substitution and participation effects for individuals at different income levels. However, there is great un-

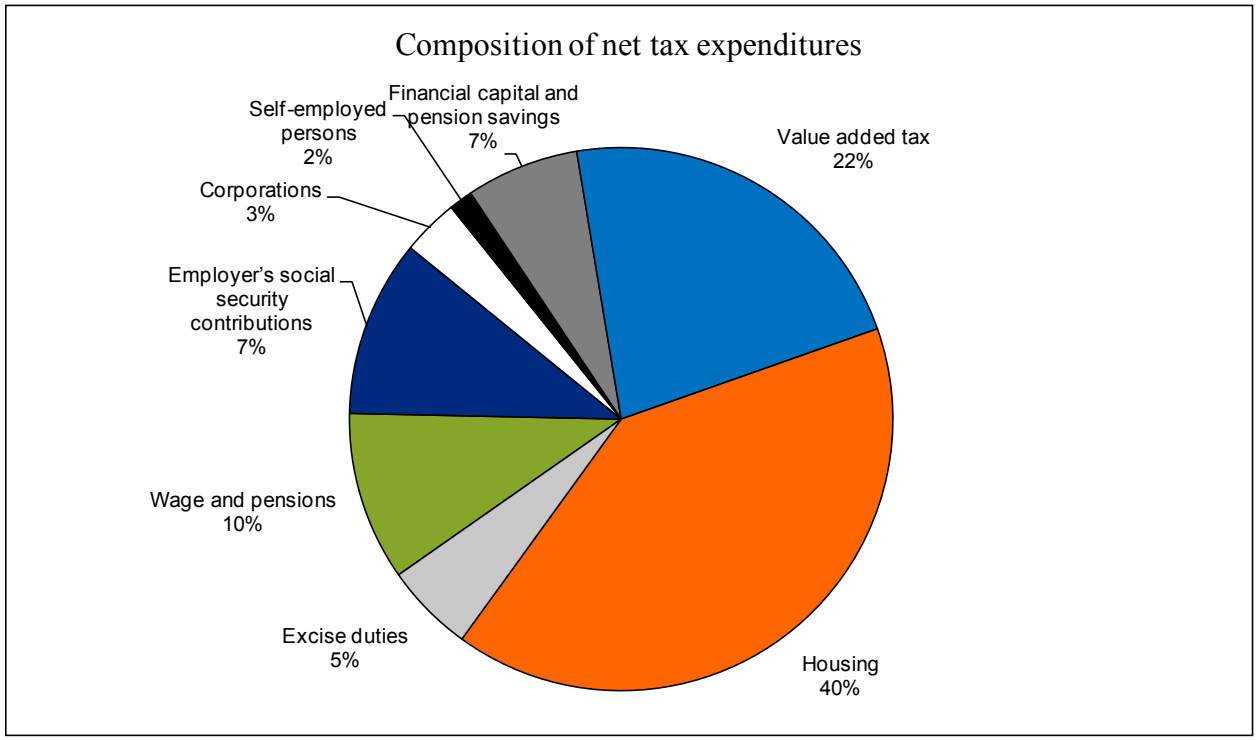

Figure 21 Net tax expenditures in 2012 distributed across different areas. Per cent
Source: Ministry of Finance.

certainty about both the size of the effects and how quickly they arise.

As a rule, a tax change will form part of a balanced budget proposal. A tax reduction in one part of the tax system will often be funded by tax increases in other parts of the tax system. It is therefore reasonable to assume that the income effects will largely counteract one another, leaving the substitution and participation effect.

The substitution effect and the participation effect express the degree to which resource utilisation in the economy improves or worsens as a result of different tax changes. The behavioural effect of an unfunded tax change thus only provides partial knowledge about the total effect on resource utilisation. A complete picture requires analysis of the change within a balanced budget, including analysis of the measures that fund the tax change. This will often be difficult. In connection with large tax reforms, it is nevertheless desirable, subject to the limitations of the estimation methods, to prepare overall analyses of the total effect of a revenue-neutral change on resource utilisation.

In general, there is reason to believe that tax reductions that reduce the tax base have a negative effect on the overall efficiency of the tax system. On the other hand, reductions that reduce marginal tax on work, saving, etc. help to improve resource utilisation.

Some behavioural responses to a tax change may occur quickly, while others take more time. Generally speaking, financial behavioural responses may occur relatively quickly, while responses in real terms take longer. For example, dividends fell by more than half from 2000 to 2001 as a result of the temporary personal dividend tax introduced for 2001, while the introduction of the personal dividend tax with a rate of return allowance from 2006 onwards reduced dividends by over 90 per cent from 2005 to 2006. On the other hand, it will take time, for instance, for changes to depreciation rates to influence investment. It is also reasonable to assume that it will take time for changes to labour income taxation to result in permanent changes in labour supply. As a rule, therefore, the Ministry's best estimate of the effect of a change in income tax on the supply of labour is zero in the first year.

A change in indirect taxes will influence the prices of goods and services relatively quickly, in turn affecting demand for the taxed goods and services fairly rapidly. This adjustment is included in the Ministry's revenue estimates.

Not all tax reductions will trigger positive behavioural responses. A tax change that exempts income or increases the difference between the taxable income and the actual economic income may lead to undesirable behavioural responses, for example to distort investment from socially

profitable projects to socially unprofitable projects. A tax change of this kind will weaken the growth of the economy and thus weaken the tax base in the longer term.

Demand effects

A tax reduction which is not funded through increases in other taxes or cuts to expenditure will increase the disposable income of the private sector and will weaken the public sector budget balance. In the short-term, increased income in the private sector will increase total demand and economic activity. This will also increase tax revenues, and the initial weakening of the fiscal budget will be moderated. The effect on activity levels will depend, among other things, on the amount of free resources in the economy. During an upturn, the effect on activity levels will be small, while it may be large during a downturn.

However, over time, all tax relief must be funded through increased taxes or reduced public expenditure. In isolation, such measures will reduce demand for goods and services, and thus counteract the positive effect of the initial tax reduction had on activity levels and the budget balance. Over time, a tax reduction which is "unfunded", and thus permitted to affect the public sector budget balance, will cause the public sector to incur higher interest costs or reduce its capital income.

Incorporation of behavioural effects

The Ministry of Finance takes into account that tax changes may influence the behaviour of businesses and households in cases where the behavioural changes are substantial and are expected to occur quickly. This is particularly relevant in the case of major changes to the tax rules.

In the annual budget proposals, the demand effect of the proposal is incorporated into the macroeconomic estimates. The short-term effects of tax reductions on activity levels in the economy will thus generally be included in the estimate of the oil-adjusted deficit in the budget.