The Norwegian tax system
- main features and developments

Chapter 2 of the budget proposal on taxes 2015
Oslo, 8 October 2014

2 The Norwegian tax system – main features and developments

2.1 Introduction

The tax system funds public welfare and serves as a redistributive tool. Taxes should be structured to promote high output and efficient resource allocation. The tax system should not impose unnecessarily high administrative costs on taxpayers and authorities. Taxes also have a counter-cyclical effect. The tax system contributes to automatic stabilisation of the economy as tax revenues increase during good times and decline during challenging times.

Figure 2.1 shows aggregate general government tax estimates for 2014. This chapter is based on the rules for 2014. The figure illustrates the data in Table 1.8[1] and shows that the main sources of tax revenues are tax on ordinary income, value added tax, employers' social security contributions and petroleum tax.

The various taxes can be classified as either direct taxes or indirect taxes.

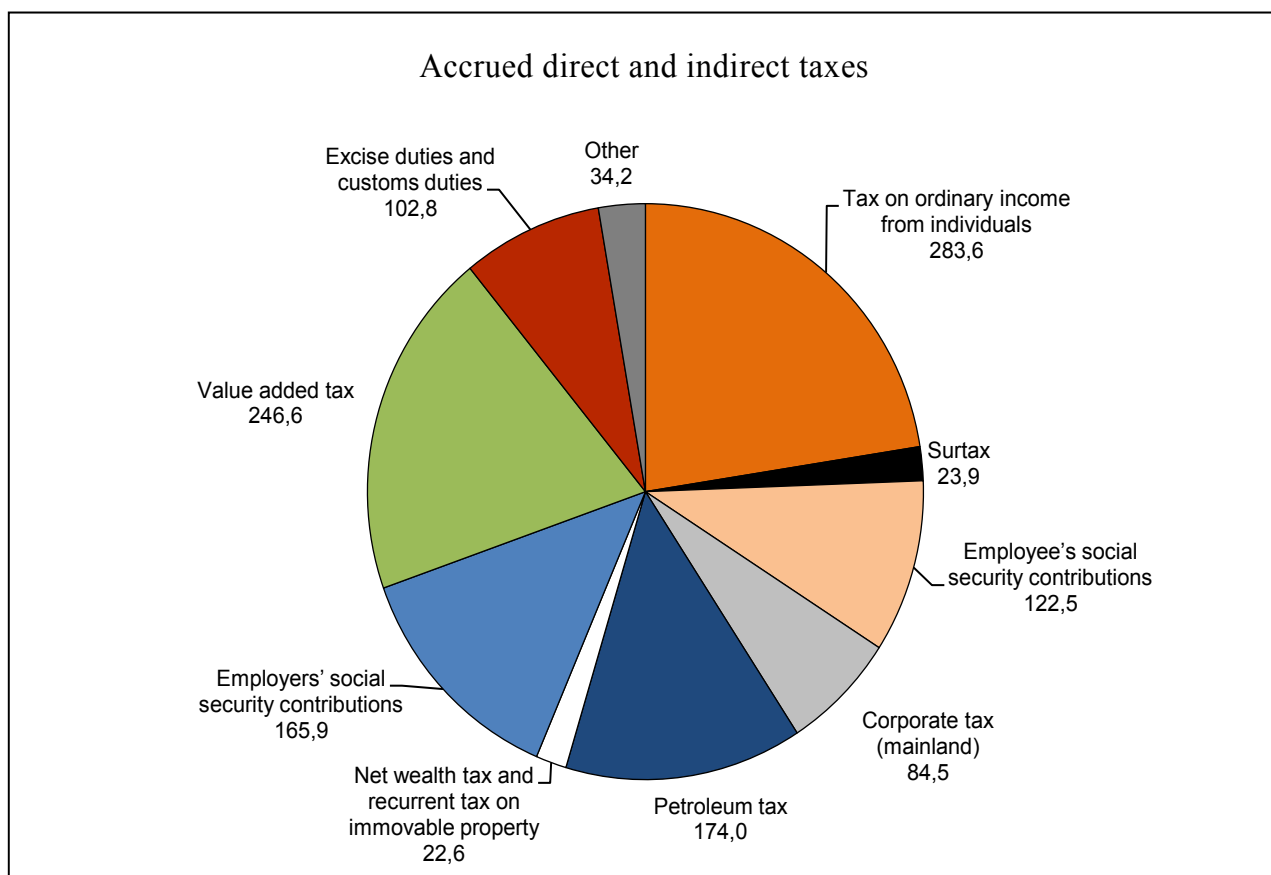Direct taxes include, *inter alia*, income tax from individuals and enterprises, net wealth tax

Accrued direct and indirect taxes

Figure 2.1 Accrued direct and indirect taxes. General government. Estimates for 2014. NOK billion

Source: Ministry of Finance.

[1] cf. the English translation of chapter 1 of the of the budget proposal on taxes 2015 (Prop. 1 LS (2014-2015)) «Main features of the tax programme for 2015»: http://www.statsbudsjettet.no/upload/Statsbudsjett_2015/dokumenter/pdf/chapter1_tax_budget2015.pdf.

and recurrent tax on immovable property. Direct taxes account for 72 pct. of overall tax revenues. 47 pct. of this is in the form of income tax from individuals, including employee's social security contributions and surtax, whilst 27 pct. is in the form of income tax from enterprises, including the petroleum industry. Tax revenues from mainland enterprises account for 8 pct. of tax revenues from Mainland Norway.

Indirect taxes include value added tax, excise duties and customs duties, and account for 28 pct. of overall tax revenues. Value added tax is the main source of revenues from indirect taxes, accounting for 20 pct. of overall tax revenues, whilst excise duties accounts for 8 pct. Customs duties are now a minor component of public revenues.

2.2 Guidelines for an efficient tax system

The tax system influences labour supply, consumption, savings and investments. It is therefore important for the tax system to be designed on the basis of some fundamental principles ensuring that resources are allocated as efficiently as possible in the economy. This can be achieved by:
– first make use of taxes that promote better resource utilisation (for example environmental taxes);
– thereafter employing neutral taxes that do not influence the choices made by producers and consumers (for example taxes on the economic rent in the petroleum and energy sector); and
– finally using distortionary taxes to achieve sufficient revenue to finance public goods and services and to realise redistribution objectives.

The economic costs resulting from distortionary 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 expenses. This reduces the costs of taxation, and is conducive to the equal treatment of taxpayers. Broad tax bases, covering 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 will result in improved distribution. The changes to the tax system resulting from the 1992 tax reform have, along with changes in subsequent years, extended the tax base, thus narrowing the gap between taxable income and actual income. The principle of broad

tax bases was again supported with the 2006 tax reform. This principle has also underpinned changes made to the net wealth tax in recent years.

Exemptions and special treatment in the tax system to support specific groups, industries or activities make the tax system less efficient and more administratively complex and challenging. Other taxes need to be increased in order to keep tax revenues at the same level, and the economic costs of taxation tend to increase more than proporsionally with tax rate increases. If it is desirable to support a specific activity or group in society, measures on the expenditure side of the budget are often less costly and more targeted.

In some cases, different tax objectives may conflict. Consequently, various considerations need to be balanced against each other when designing the tax system. In general, no single tax should target multiple objectives.

In Norway, public funding of extensive welfare programs makes it necessary to raise substantial tax revenues. However, some taxes are also intended to serve other important purposes beyond raising government revenues. This concerns in particular income redistribution and health and environmental considerations.

The tax system has a redistributive effect by way of, *inter alia*, the average tax burden increasing with income. Taxation of wage income will tend to reduce labour supply, but the tax system should, insofar as possible, promote good decisions with regard to labour force participation, education and career choices. Empirical research indicates that the labour supply of low-income groups is more sensitive to changes in economic framework conditions than is the labour supply of high-income groups.

People with the lowest incomes pay little or no tax. Consequently, changes to the tax system are of little significance to this group. Many people with a persistent low income are not working. The tax rules should as far as possible be designed to make work profitable. Moreover, for people who receive social security benefits to compensate for (temporary) loss of wage income as the result of health problems or unemployment, the interaction between benefits and tax rules has a major impact on incentives to return to work or to increase working hours. One of the tax and welfare policy challenges is balancing income protection considerations against work

Box 2.1 Work incentives depend on both the tax system and the benefit system

Work incentives are influenced by both tax rates on labour and any net transfers received by individuals. The Norwegian income protection system (primarily the National Insurance Scheme) comprises a number of transfer schemes that serve to provide people who, for various reasons, do not work. Examples are disability pension («disability benefits» from 2015) and unemployment benefits. Such benefits are often discontinued, in full or in part, when a person starts working, and hence these serve as an additional «tax» on labour. The effective average tax on labour is often calculated to illustrate the implications of this in terms of work incentives. The effective tax rates reflect both tax and the net transfers foregone when one starts working. Such rates are useful, but they need to be interpreted with caution. In general, these calculations only reflect transfer levels. Other aspects of these schemes, such as the extent to which benefits are subject to time limits and activity requirements for recipients, will also influence work incentives.

Figure 2.2 presents some average effective tax rates on labour when a person moves from unemployment to full employment in the Nordic countries (2012 data). The respective calculations are for a single parent 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 high. A single parent at 67 pct. of average earnings and with two children will in Norway in effect be taxed at about 89 pct. of gross wage income when the loss of unemployment benefit is taken into account.
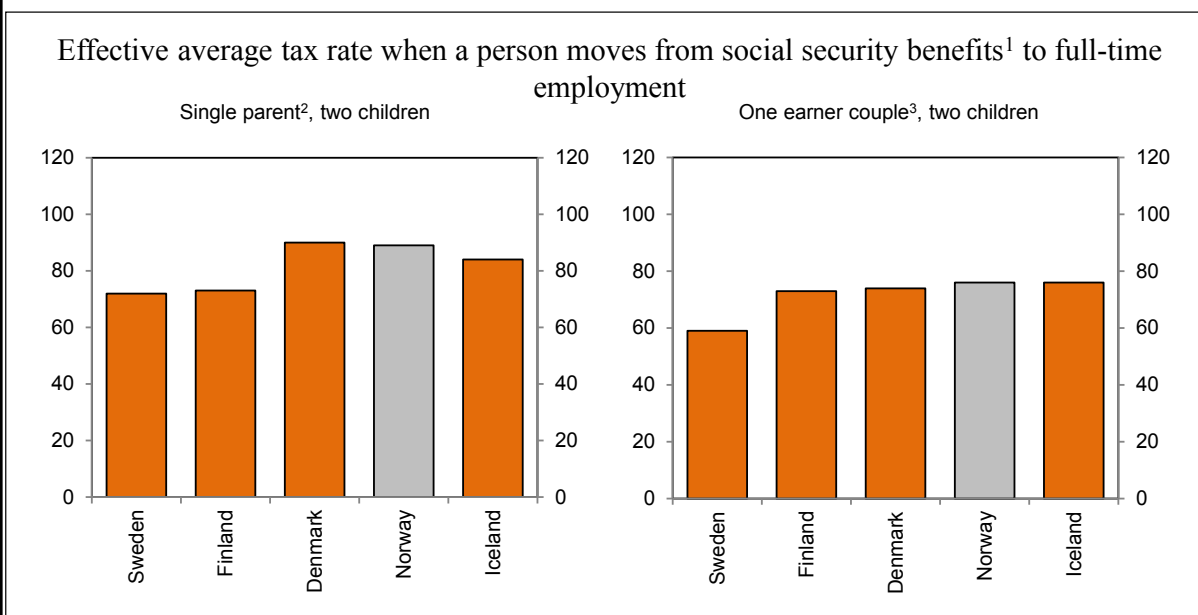
Effective average tax rate when a person moves from social security benefits[1] to full-time employment

Figure 2.2   Effective average tax rate when a person moves from unemployment benefits to full-time employment. 2012. Percent

[1] The calculations are based on unemployment benefits in the various countries as calculated in OECD Tax and Benefit 2012. The benefit level is that paid in the first year of unemployment.
[2] Based on 67 pct. of the average wage in the various countries, in calculating both the benefits and the amount of the wage income from full employment.
[3] Based on 100 pct. of the average wage in the various countries, in calculating both the benefits and the amount of the wage income when moving into full employment. The spouse/cohabitant is assumed to stay at home in both cases.
Sources: OECD and the Ministry of Finance.

incentive considerations. This is illustrated in Box 2.1, showing that there may in some cases be little financial gain from working rather than claiming social security benefits.

Environmental taxes contribute to more appropriate pricing of environmentally-harmful ac-

tivities and motivate individuals and enterprises to more environmentally-friendly behaviour. Moreover, the use of environmental taxes is consistent with the polluter pays principle. Revenues from environmental taxes can be used to strengthen welfare schemes and public services or to reduce

other taxes.

Business taxation should principally focus on raising government revenues, without impeding sound commercial activity. Making the taxation of all actual incomes as consistent and uniform as possible makes resource allocation less susceptible to, for example, tax-motivated investments. Taxed profits should correspond to actual profits. This also entails a broad tax base, thus enabling tax rates to be kept lower.

Business and capital taxation must also focus on predictability. Instability may impair business investment and reduce profits.

Industries exploiting natural resources may generate extraordinary profits in the form of economic rent. It is important to ensure that society receives a large proportion of such extraordinary profits. This is the rationale behind the special taxation of profits from the petroleum industry and hydropower plants. The petroleum tax system and the State's Direct Financial Interest (SDFI) channel a large proportion of the high income from the continental shelf to the State, without preventing economically profitable investments from being made. SDFI functions as a cash flow tax on each field, but its income is not formally classified as tax revenues.

Figure 2.3 compares the tax revenues of various countries as a percentage of their gross domestic product (GDP) and provides a rough indication of differences in the size of their public sector. The tax burden will vary somewhat depending on, *inter alia*, the extent to which public pension and social security payments are classified as taxable income. The figure shows that Norway and the other Scandinavian countries have a relatively high overall tax level. This reflects, *inter alia*, comprehensive public welfare schemes. Norway has a highly unusual industrial structure, characterised by considerable production in the petroleum sector. For purposes of international comparisons, the tax level in the mainland economy is the most relevant parameter for Norway. Although a major part of the revenues from the petroleum activities accrue to the State, the overall tax level for the economy as a whole is nonetheless somewhat lower than in the mainland economy. The reason for this is that the revenues from SDFI accrue directly to the State, and hence are not subject to taxation.

Since 1985, tax revenues in Norway have amounted to between 41 and 45 pct. of GDP. In Sweden, the tax to GDP ratio has ranged from 45 to 53 pct., whilst it has been between 41 and 51 pct. in Denmark. Over the same period, the average OECD tax revuenue share has varied be-
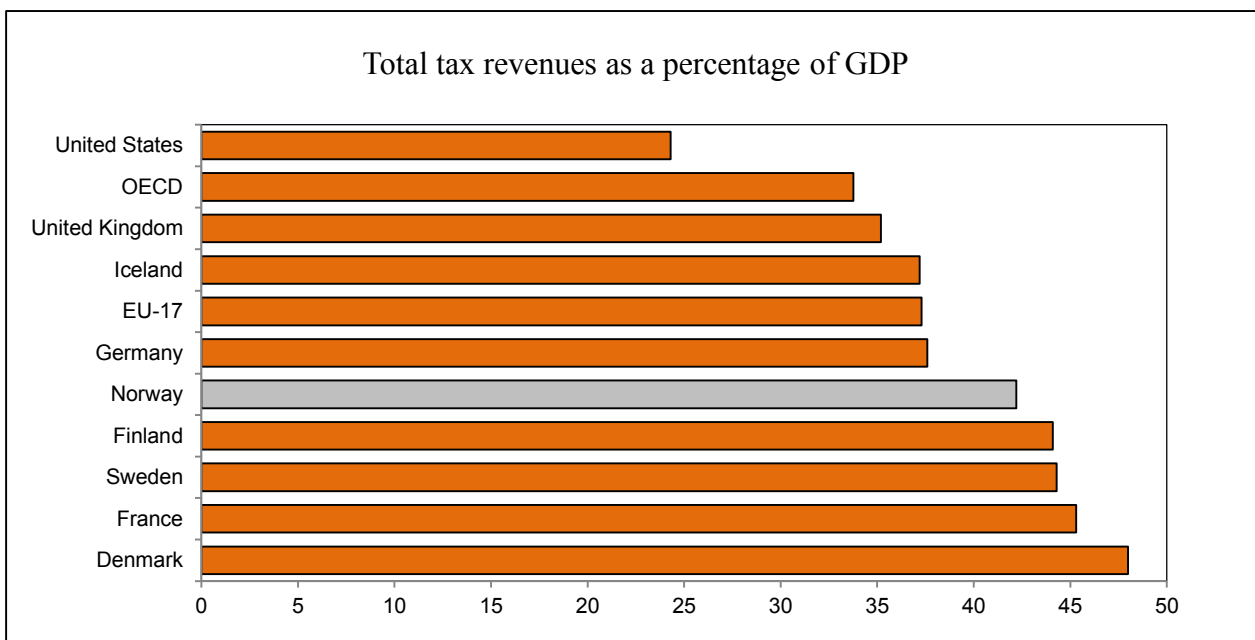

Figure 2.3 Tax revenues as a percentage of GDP in selected countries; EU-17[1] and OECD.[2] 2012. Percent

[1] The euro zone.
[2] Data for the OECD are from 2011.
Sources: OECD Revenue Statistics and Taxation Trends in the European Union.

tween 30 and 36 pct. of GDP.

The greater mobility of capital, goods and services implies that the significance of different taxation between countries may increase. Norway needs good general tax rules to retain and attract business activities and capital. However, location decisions depend on more than tax. Political stability, good infrastructure, access to highly qualified manpower, well-functioning financial markets, property rights, as well as a stable and predictable regulatory framework, are also important determinants of the overall framework conditions for doing business.

2.3 Direct taxes

2.3.1 Income tax for individuals

Rate structure and tax base

The income tax for individuals is calculated on two different bases. Firstly, a flat rate tax of 27 pct. is paid on «ordinary income» less the personal allowance and certain special allowances. Ordinary income comprises all taxable income (wages including taxable benefits in kind, pensions, net income from self-employment, taxable income from shares and other capital incomes), less the basic allowance, deductible losses and expenses such as debt interest, etc., parental allowance and other allowances. Levying a flat tax

rate on a net tax base ensures that all deductions are of equal tax value and makes the taxation of capital symmetric, i.e. income (gains) and expenses (losses) are taxed at the same rate.

Secondly, employee's social security contributions and any surtax are paid on so-called «personal income», which comprises gross wage income and pension income, without deductions of any kind. Imputed personal income for self-employed is also included in «personal income».

People with high personal incomes pay a larger proportion of tax on their incomes than do people with low personal incomes. Such progressivity is achieved through minimum allowances and surtax. It is estimated that about 950,000 people will be paying surtax in 2014. Box 2.2 shows how marginal and average tax rates increase with higher wage income. The highest marginal tax rate on wage income, excluding employers' social security contributions, is 47.2 pct. If employers' social security contributions are included, the highest marginal tax rate reaches 53.7 pct. Figure 2.4 shows that Norway was around the mean in terms of the highest marginal tax rate on wage income amongst the countries included in the figure.

Since the 2006 tax reform, it has been an important property of the tax system that the highest marginal tax rates on wage income, income from shares and income from self-employment
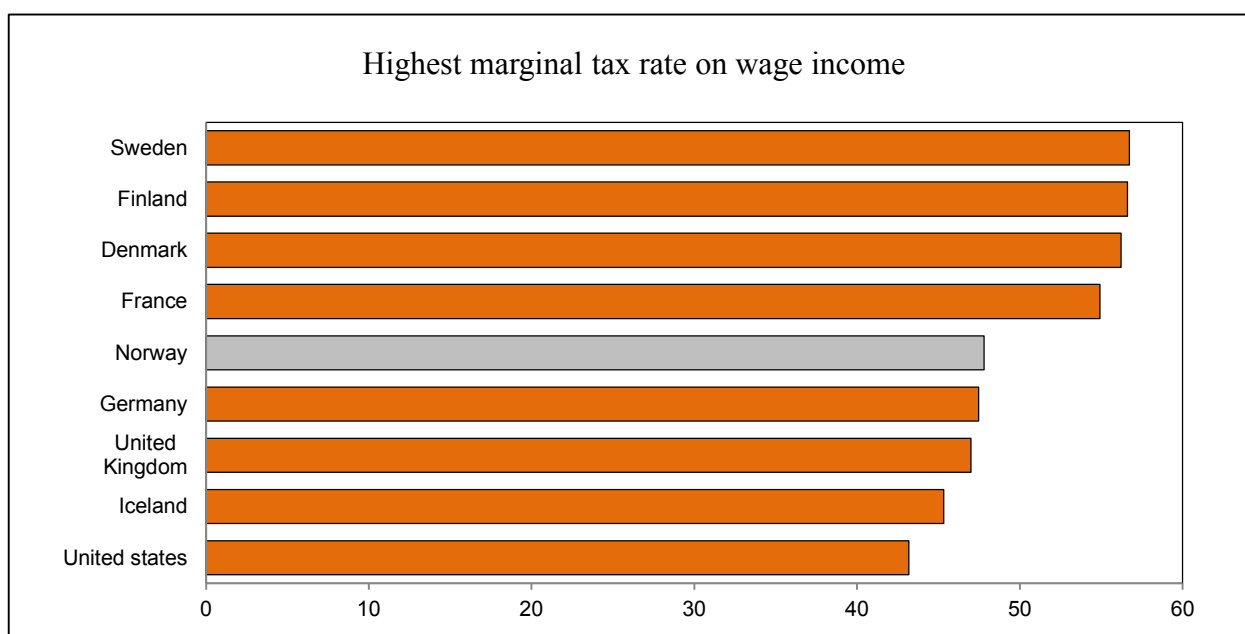

Figure 2.4   Highest marginal tax rate on labour income. Selected countries in 2013. Percent

Source: OECD Tax database.

Box 2.2   Calculation of tax on wage income

The marginal tax rate is the tax rate applicable to the last krone earned by a taxpayer. The marginal tax rate influences his or her choices with regard to how much to work. A high marginal tax rate may weaken employees' incentives to work more. Such labour supply distortions imply that resources are allocated less efficiently. The higher the tax rates, the greater are these distortions.

Average tax is tax as a proportion of taxable income. Under a tax system characterised by basic allowances, as well as other allowances and a progressive rate structure, the marginal tax rate is always higher than the average tax rate for the same income level, and those with the highest incomes pay the largest proportion of their income in tax.

The figures below show marginal tax rates and average tax rates, respectively, on wage income under the 2014 rules.

Figure 2.5 shows that the marginal tax rate varies with the income level. The tax rate is nil up to the tax-free threshold. Employee's social security contribution is thereafter paid at a levelling rate (25 pct.). The levelling rate is used until it becomes financially more attractive to pay employee's social security contribution at the general rate of 8.2 pct. on the total wage income. If wage income exceeds the sum of the personal allowance and the basic allowance (43 pct. of income), the taxpayer will pay tax on ordinary income (27 pct.), which results in a marginal tax rate of 23.59 pct. (8.2 pct. + 27 pct. * (1 − 0.43)). If the taxpayer has a sufficiently high income to obtain the maximum basic allowance, the marginal tax rate will be 35.2 pct. (8.2 pct. + 27 pct.). Upon reaching the surtax thresholds, the marginal tax rate increases to 44.2 pct. at level 1 and 47.2 pct. at level 2, respectively.
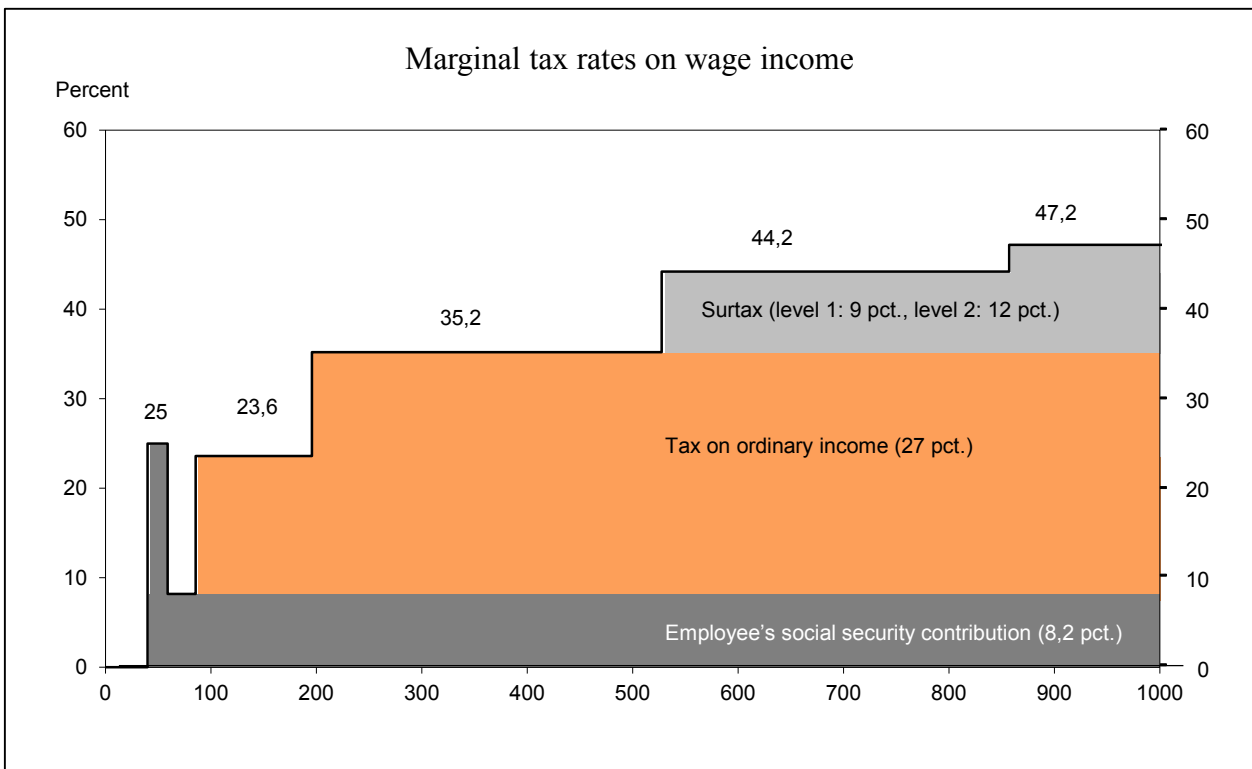

Figure 2.5   Marginal tax rate on wage income (excluding employers' social security contribution). 2014 rules for a wage earner in tax class 1 with only wage income and standard reliefs. NOK thousands

Source: Ministry of Finance.

shall be about the same. When the difference in marginal tax rates between ownership income and wage income is small, there is little to gain from presenting what is actually gained through work as income from shares in order to reduce tax. This type of income shifting was a considerable problem before 2006.

Box 2.2 continues

Figure 2.6 shows that the average tax rate is considerably lower than the marginal tax rate.
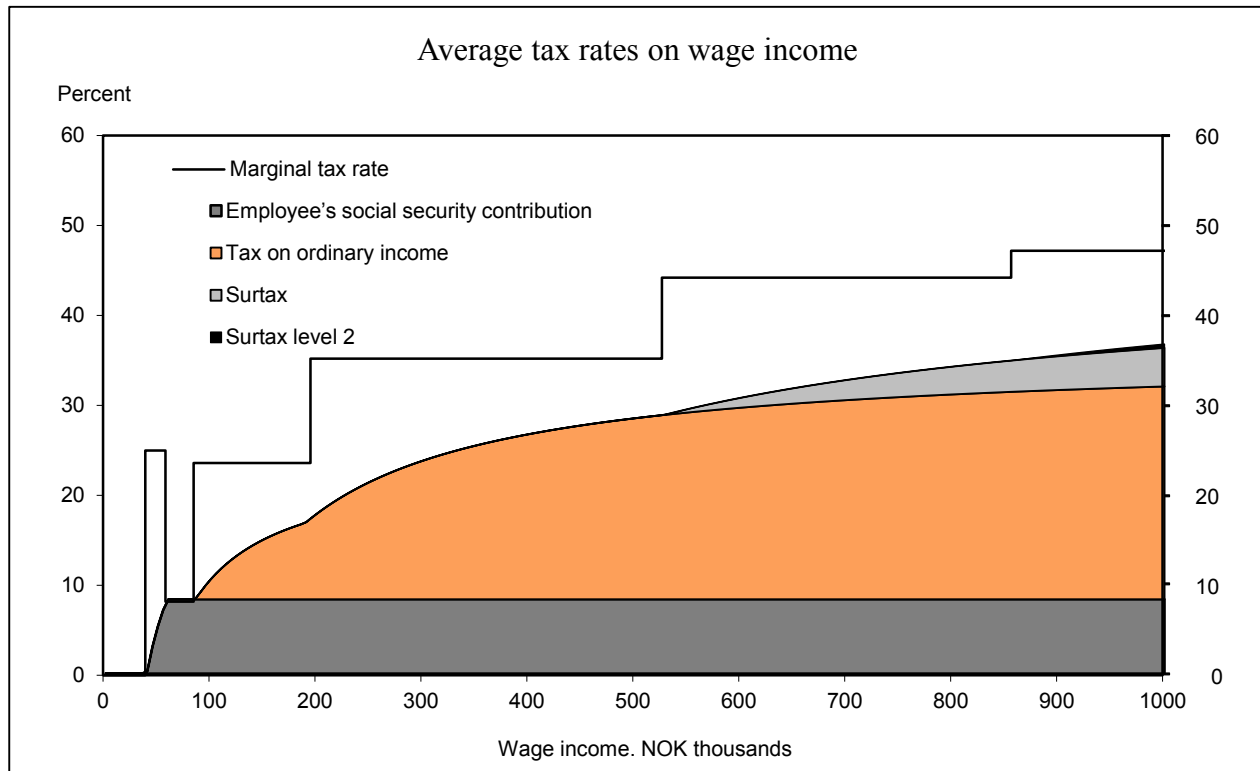

Figure 2.6   Average tax rate on wage income (excluding employers' social security contribution). 2014 rules for a wage earner in tax class 1 with only wage income and standard reliefs. NOK thousands

Source: Ministry of Finance.

Tax on pension income

Special tax rules mean that pensioners and recipients of some 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 lower for pension income than for wage income.

A special non-refundable tax credit for pension income is granted to those on contractual early retirement pension (AFP) and ordinary retirement pension, which results in no tax being paid on any pension income up to the minimum state pension, and in less tax being paid on pension income than on wage income above that level. The tax credit is reduced with regard to pension income in excess of the minimum state pension, thus implying that the difference between the tax on pension income and the tax on wage income declines as the pension income increases.

Disability pension recipients are in 2014 grant-ed a special disability allowance against ordinary income. Moreover, a tax limitation rule applies to disability pension recipients who are more than two thirds disabled and to recipients of certain means-tested benefits. The rule implies that income around the level of the minimum state pension is tax-exempt. Income in excess of that level, including a net wealth supplement, is taxed at a rate of 55 pct., thus implying that the preferential tax treatment is scaled back until it becomes financially more attractive to pay tax under the ordinary tax rules. The Storting has decided to introduce a new disability benefit from 2015. The new disability benefit will be taxed as wage income, and hence the special disability allowance and the tax limitation rule for the disability benefit recipients will be abolished.

Figure 2.7 shows calculated tax on pension income under the 2014 rules for single recipients of contractual early retirement pension (AFP)/ ordinary retirement pension and single disability
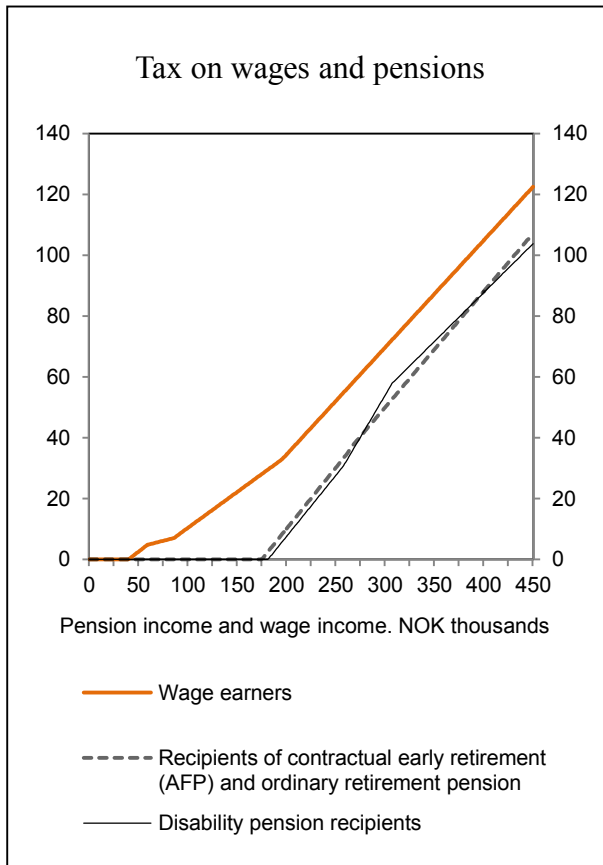
Tax on wages and pensions

Figure 2.7   Tax at various income level for wage earners, recipients of contractual early retirement pension (AFP) and ordinary retirement pension, as well as disability pension recipients, respectively, under the 2014 rules[1]. NOK thousands

[1] It has been assumed that the taxpayers are singles and taxed in class 1, that they have no other income than wage income and pension income, respectively, and that they can claim no other deductions than the standard reliefs.

Source: Ministry of Finance.

pension recipients, respectively, as compared to tax on wage income for wage earners in class 1. It has been assumed that taxpayers have no other income than wage income and pension income, respectively, and that disability pension recipients do not have net wealth exceeding NOK 200,000. It is also assumed that the taxpayers can claim no other deductions than the standard reliefs . The tax on a NOK 250,000 retirement pension represents NOK 30 200 and will be about NOK 21,900 less than the tax on a corresponding wage income.

Tax on income from shares earned by individuals

Dividends and capital gains on shares earned by shareholders who are natural persons are taxed under the shareholder model. This implies that income from shares in excess of a risk-free return allowance is taxed as ordinary income on the part of the owner. In general, the risk-free return allowance is calculated as the cost price of the share multiplied by a risk-free rate of return. The risk-free rate of return shall reflect the return after tax on a risk-free investment. Hence, dividend tax is levied on any return in excess of the return available through an alternative risk-free investment.

If the income from the share is less than the risk-free return allowance, any unused risk-free return allowance is added to the risk-free return base for the subsequent year. In practice, this means that any unused risk-free return allowance is carried forward with interest. Unused risk-free return allowance is specific to each share, and is not deductible against income from other shares.

It is, for practical reasons, the owner of a share as at 31 December who is granted the risk-free return allowance calculated for the relevant year. Upon selling the share, the seller can deduct any previously unused risk-free return allowance from any capital gains. In the event of a loss, the entire loss is deductible against ordinary income. A new risk-free return allowance is calculated for the new owner, representing the new cost price multiplied by the risk-free rate of return.

Tax on income from self-employment

Owners of sole proprietorships are taxed under the self-employment model, whilst those holding ownership interests in entities assessed on a partnership basis (general partnerships, limited partnerships and others) are taxed under the partnership model. Both of these models are based on the same premise as the taxation of income from shares, i.e. that income not exceeding a risk-free return on the invested capital (which income corresponds to the risk-free return allowance), shall only be taxed as ordinary income. This has contributed to a high degree of uniformity in the taxation of different types of business entities.

The profits of entities assessed on a partnership basis are taxed as ordinary income on the
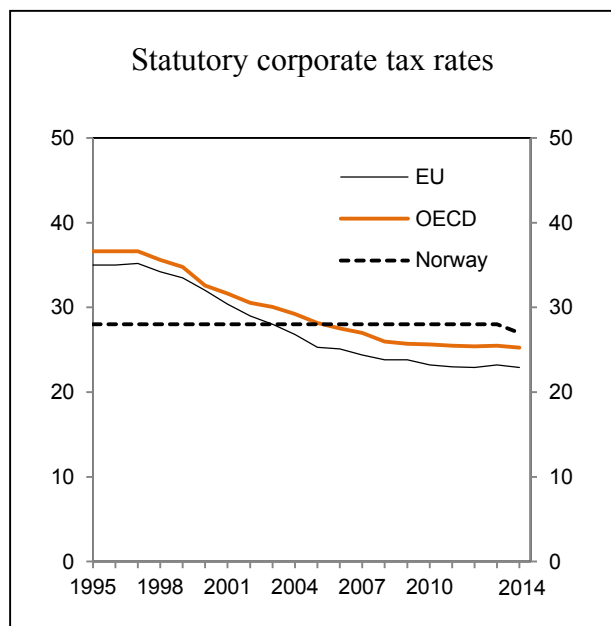
Statutory corporate tax rates

Figure 2.8 Statutory corporate tax rates in Norway, the EU and the OECD.1 1995 – 2014. Percent

1 Non-weighted average for the EU and the OECD. The EU data encompass the countries that were members as of 1 July 2013 (EU-28).

Sources: OECD, Eurostat and the Ministry of Finance.

part of the owners as they accrue. In addition, any distributed partnership profits in excess of the risk-free return allowance are taxed anew as ordinary income on the part of owners who are natural persons.

Income from a sole proprietorship in excess of the risk-free return allowance is taxed as imputed personal income and is subject to surtax and employee's social security contribution. Hence, the imputed personal income is taxed continously. Income from shares, on the other hand, is not taxed as ordinary income until the time of dividend payment or realisation. This difference has to do with sole proprietorships not being separate legal entities. Consequently, the distribution of funds will only represent a transfer of funds within the owner's own financial sphere. The self-employed pay a higher social security contribution than do wage earners on their income from self-employment. On the other hand, the self-employed do not pay employer's social security contributions on their personal income. However, in some cases the self-employed receive lower social security benefits than wage earners. Self-employed fishermen pay employee's social security contributions at a medium rate

(like wage earners), but are also subject to a product tax.

2.3.2   Corporate taxation

Company profits are taxed as ordinary income at a flat rate of 27 pct. Losses can be carried forward and deducted from subsequent profits. The corporate tax system puts a special emphasis on the principles of equal treatment of different investments, forms of funding and types of legal entities, as well as the symmetrical treatment of income (gains) and expenses (losses). This implies, *inter alia*, that taxable profits should, to the extent possible, match actual company profits. «Durable and significant» assets shall be capitalised under various asset groups and depreciated at rates intended, in principle, to reflect the expected annual depreciation.

The exemption method implies, as a main rule, that companies are exempted from the taxation of dividends and gains on shares, etc. Mirroring this, there is no right to deduct corresponding losses. The purpose of the exemption method is to prevent chain taxation in the corporate sector, i.e. that dividends and gains on shares held by companies are taxed several times.

Employers in both the private sector and the public sector are required to pay employers' social security contributions on wage costs. The rate of employers' social security contribution depends on where the enterprise is located.

Figure 2.8 shows that the corporate tax rate in Norway was significantly below the average statutory corporate tax rate in both the OECD countries and the EU member states in 1995. While the corporate tax rate remained at the same level in Norway until 2014, other countries reduced their rates. The average statutory corporate tax rates in OECD and EU are hence now somewhat lower than in Norway.

The effective taxation of companies will also depend on the tax base. The effective average tax rate is paid tax as a proportion of a company's actual profits. This is lower than the statutory tax rate if investments are tax relieved, for example through generous depreciation rules. The effective average tax rate is the key variable when a company decides which country to invest in for tax reasons. The effective marginal tax rate is the key variable when a company decides the level of investment.

Table 2.1 shows statutory tax rates and calcu-

Table 2.1   Statutory and calculated effective corporate tax rates in 2013. Percent

Country	Statutory tax rate	Effective average tax rate	Effective marginal tax rate
Ireland..	12.5	14.4	13.2
Switzerland	21.2	18.6	12.4
Sweden	22.0	19.4	14.5
United Kingdom	23.0	24.2	26.5
Finland	24.5	22.3	17.3
Austria.......................................	25.0	23.0	18.4
Denmark	25.0	22.0	14.7
The Netherlands	25.0	22.3	15.7
Greece..	26.0	24.1	19.8
Canada	26.5	24.9	24.0
Norway.......................................	28.0	26.5	23.3
Portugal	30.0	27.1	20.8
Germany	31.0	28.2	22.5
Italy	31.3	25.1	11.2
Belgium	34.0	26.5	5.9
Spain	35.3	33.7	34.8
France	37.1	34.3	29.6
United States	37.9	36.5	34.3
Japan..	38.6	40.1	42.1

Sources: European Commission and ZEW Mannheim (TAXUD/2013/CC/120).

lated effective average and marginal tax rates in selected countries in 2013. Effective tax rates are calculated on the basis of a hypothetical investment offering a fixed return, etc., and take into account both statutory tax rates and key parts of the tax base (depreciation rates, etc.).

Company profits are also taxed on the part of their owners, by way of dividend and capital gains taxation, cf. Section 2.3.1. Figure 2.9 shows the total marginal tax rate on dividends on the part of companies and their owners in selected countries in 2014.

Petroleum taxation

There is a considerable extraordinary profit (economic rent) associated with the extraction of oil and gas. Income from petroleum extraction is therefore subject to a special tax of 51 pct. on top

of the ordinary tax on profits.

In principle, petroleum taxation is based on the rules governing ordinary corporate taxation. However, the tax base for income from the sale of crude oil is determined using administratively determined norm prices, i.e. tax benchmark prices. All relevant operating costs are deductible, and exploration costs are expensed as incurred. The special tax base is calculated by deducting a so-called uplift (investment-based extra depreciation) from the ordinary tax base. If the company incurs a loss, such loss and any unused uplift can be carried forward with interest. If a company never earns a sufficient taxable profit, the State will refund the tax value of loss when the company terminates activities on the Norwegian shelf. Consequently, the system is designed to give companies full certainty with regard to the utilisation and value of their tax allowances. Certain
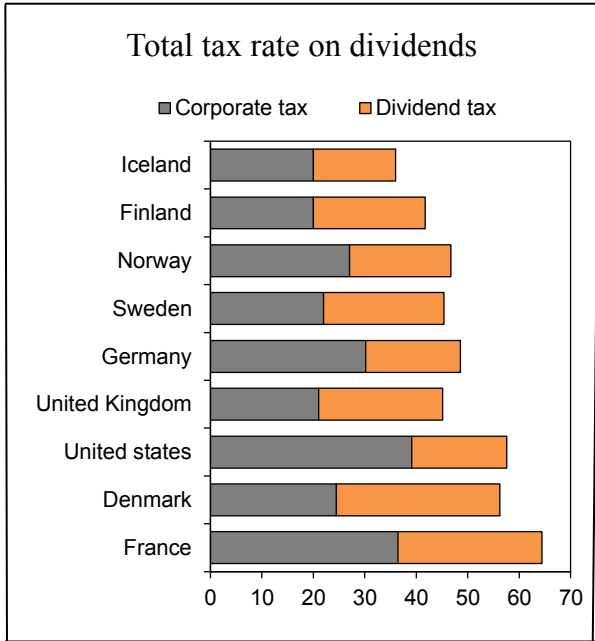
Total tax rate on dividends

Figure 2.9 Total marginal tax rate on dividends on the part of companies and their owners in selected countries in 2014. Percent

Source: OECD.

future tax allowances shall be valued using a risk-free rate, net of ordinary tax. Valued at a risk-free rate of interest, the value of the investment based allowances (depreciation, uplift and interest allowances) exceeds the investment costs, cf. Prop. 150 LS (2012–2013) section 5.4. Hence, the investment allowances are too high compared to a neutral resource rent tax.

SDFI, through which the State takes a direct financial interest in licences, is also an important source of State revenues from the continental shelf. SDFI has the similar characteristics as a field-specific cash flow tax. The State coveres its portion of investments and operating costs on an ongoing basis and receives the same portion of the income.

Figure 2.10 shows the composition of central government revenues from petroleum activities. All else being equal, higher oil prices will result in higher profits for oil companies, and thus in higher revenues for the State. Correspondingly, government revenues from the petroleum industry will decline considerably when prices are low. Revenues have also increased over time as the result of higher production.

Power plant taxation

The profits of power generators are taxed as ordinary income, in the same manner as for other enterprises. In addition, hydropower plants are subject to a 31 pct. central government tax on economic rent. Power plants with generators below 5,5 MVA are exempted from economic rent tax under the current rules.The economic rent is calculated as a standardised market value of the
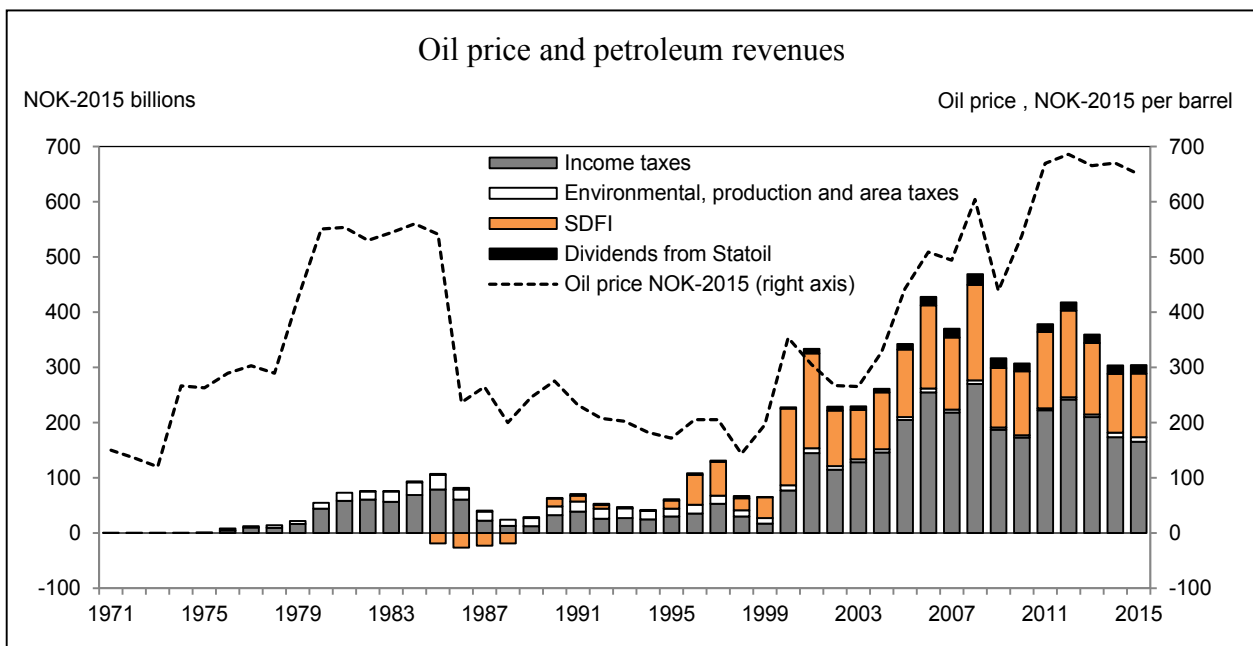
Oil price and petroleum revenues

Figure 2.10 Oil price and total net central government revenues from the petroleum sector. NOK-2015 prices

Source: Ministry of Finance.

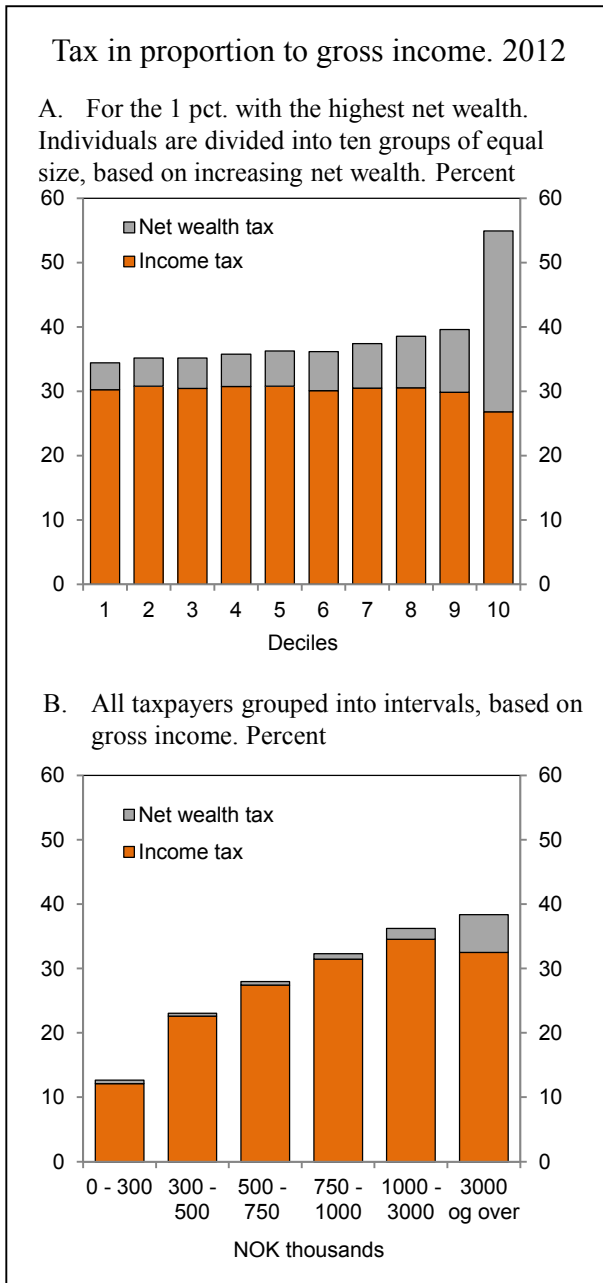## Tax in proportion to gross income. 2012

A. For the 1 pct. with the highest net wealth. Individuals are divided into ten groups of equal size, based on increasing net wealth. Percent

Legend: Net wealth tax, Income tax

X-axis (Deciles): 1, 2, 3, 4, 5, 6, 7, 8, 9, 10

B. All taxpayers grouped into intervals, based on gross income. Percent

Legend: Net wealth tax, Income tax

X-axis (NOK thousands): 0 - 300, 300 - 500, 500 - 750, 750 - 1000, 1000 - 3000, 3000 og over

Figure 2.11 Tax as a proportion of gross income in 2012. Percent

Sources: Statistics Norway and the Ministry of Finance.

power generated (actual power generated multiplied by spot market prices), less operating expenses, licence fees, recurrent tax on immovable property, depreciation and uplift. The uplift is calculated as the risk-free return on the written-down value of the operating assets. The investment allowances under the economic rent tax are fully secured. Negative economic rent income in one power plant can be coordinated with positive economic rent income in other power plants within the same consolidated tax group. Moreover, any negative economic rent income following coordination between power plants is paid out. Consequently, the risk-free rate is sufficient to shield the opportunity return and ensure that the economic rent tax does not make profitable projects unprofitable after tax.

Power generators are also subject to a natural resource tax (paid to local and regional government) of 1.3 øre per kWh. Natural resource tax is deductible against the company's assessed central Government tax. In addition, power generators pay a licence fee and (normally) a recurrent tax on immovable propertyto the municipalities hosting them, and also have to yield power to such municipalities under special licence conditions.

Taxation of shipping companies

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

2.3.3 Taxation of assets

Net wealth tax

Individuals pay net wealth tax at a rate of 1 pct. on their taxable net wealth, i.e. gross wealth less debt, in excess of a basic allowance of NOK 1 million in 2014. Spouses are granted one basic allowance each. The net wealth tax supplements income taxation and gives the tax system as a whole a more progressive effect on individuals. This is illustrated by Figure 2.11.

As a general rule, the taxable value of assets is equal to their market value. Homes and other immovable properties are valued well below market value. On average, commercial property other than power plants, agricultural property and forestry property is valued at about 60 pct. of market value in 2014 for wealth tax purposes. The taxable value of a primary residence (the home in which one lives) averages 25 pct. of market value, whilst it is 60 pct. for second dwellings (homes other than the primary residence, which are not commercial property or holiday homes). A safety valve is intended to ensure that no primary residence or holiday home has a taxable value in ex-
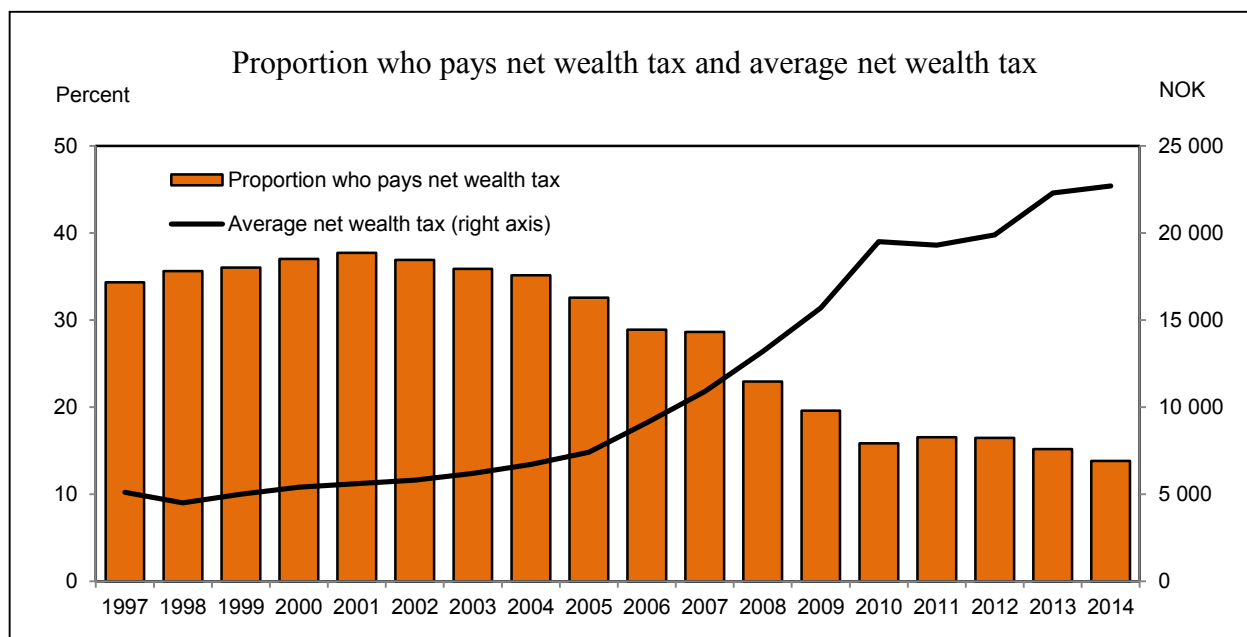
Figure 2.12 Proportion of people (resides in Norway and 17 years or older) paying net wealth tax[1] and average net wealth tax. 1997–2014. Estimates for 2013 and 2014

[1] Net wealth tax before possible reductions following the socalled 80-porcentage rule (only relevant in the periode 1997-2008).

Source: Statistics Norway.

cess of 30 pct. of the market value documented by the taxpayer. The safety valve for commercial property and second dwellings is 72 pct.

The proportion of people paying net wealth tax has been reduced in recent years due to increases in the minimum allowance, but the average amount of tax on the part of those who pay net wealth tax has increased. It is estimated that about 14 pct. of taxpayers will pay net wealth tax in 2015 (2014 rules extrapolated into 2015), cf. Figure 2.12.

Recurrent tax on immovable property

The introduction of a recurrent tax on immovable property is left at the discretion of each municipality. All property tax revenues accrue to the relevant municipality. The property tax rate, if any, shall be between 0.02 and 0.07 pct. of the valuation basis, to be determined by valuation every tenth year. In the valuation of homes, municipalities may from the 2014 property tax year choose to use the net wealth tax bases. Municipalities may choose to apply a discount in their valuation of properties. They may also apply a minimum allowance to reduce the valuation basis of homes, including holiday homes. Recurrent property tax on power plants is governed by spe-

cial valuation rules based on production value, subject to minimum and maximum limits.

As per 2014, 341 of 428 municipalities had introduced some form of recurrent tax on immovable property, of which 211 levied the tax on homes in all or part of the municipality. Total tax revenues were about NOK 8.9 billion in 2013.

Tax on property internationally

Box 2.3 provides an overview of property tax revenues in the OECD countries.

2.4 Indirect taxes

2.4.1 Value added tax

Value added tax is a general tax on the domestic consumption of goods and services, intended to raise revenues for central government. Value added tax is collected and paid by the businesses that sell goods and services subject to value added tax. Value added tax is charged at all levels in the chain of distribution. Businesses collecting and paying value added tax qualify for tax deduction of tax on their inputs and have to collectvalue added tax on their own sales. The tax decution on inputs prevents the tax from being charged on taxable businesses throughout the chain of distri-

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Box 2.3 Revenues from taxes on property in the OECD countries

The OECD tax statistics provide an overview of revenues generated by different types of taxes. Taxes on property include taxes pertaining to the use, ownership and transfer of real estate. Capital gains taxation is not included. In the case of Norway, municipal recurrent property tax, net wealth tax, inheritance tax and stamp duty will all be included.

For some countries, there may be a difference between the gross and net tax on property. This applies to, for example, the US, where many taxpayers can deduct any local property tax paid from their income tax base. The OECD figures are based on non-weighted averages of gross taxes.

Figure 2.13 shows revenues from taxes on property in selected OECD countries. Norway derives 2.9 pct. of its tax revenues from property, which is well below the OECD average. As mentioned, this estimate includes aggregate revenues from net wealth tax and inheritance tax, etc., and thus also includes tax on assets such as shares, etc.

Revenues from tax on immovable property probably account for less than 2 pct. of overall tax revenues. In addition, Norway stands out internationally in granting unlimited deductibility of debt interest.
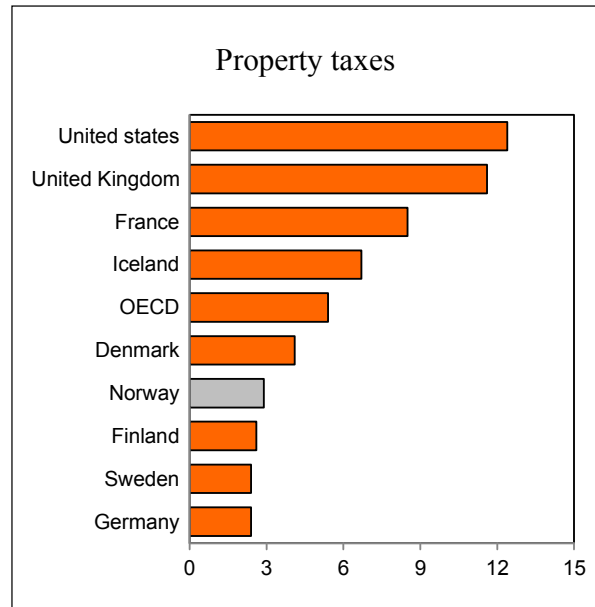

Figure 2.13 Property taxes. Percentage of total tax revenues. 2011

Source: OECD Revenue Statistics.

bution, thus making VAT a tax on the final consumption of goods and services. When the tax is charged on final consumption only, it does not result in production distortions. A general value added tax encompassing all goods and services at a uniform rate will not affect the composition of consumption. Such a value added tax would be simple to collect and entail relatively low administrative costs on the part of businesses.

The standard rate of value added tax in Norway is 25 pct. Denmark and Sweden also apply a standard rate of 25 pct. The rates in the Scandinavian countries are high by way of international comparison. Only Hungary (27 pct.) and Iceland (25.5 pct.) apply higher standard rates. In Norway, value added tax revenues as a proportion of GDP are higher than the OECD average, but somewhat lower than in Denmark and Sweden.

Although the current value added tax is, as a main rule, a general tax on consumption, it is subject to various exemptions and reduced rates. In Norway, foodstuffs are subject to a reduced rate of 15 pct., whilst a number of services are subject to a reduced rate of 8 pct. Certain goods are exempted by way of so-called zero-rating, which implies full deductibility of value added tax on goods and service inputs, whilst no value added tax is charged on sales. A number of services fall outside the scope of the value added tax system, including, *inter alia*, financial services, health services and teaching. Businesses outside the value added tax system are granted no deductions in respect of any value added tax on goods and services procured by them.

The introduction of reduced rates and exemptions means that one moves away from a simple, general system with a uniform rate on all consumption of goods and services. Value added tax will thereby influence the composition of consumption and production, as well as the choice between internal production and external deliveries in sectors exempted from value added tax. In addition, the administrative costs are higher. The value added tax system is not well suited for attending to distributional considerations, for supporting specific causes or for moving consump-

Box 2.4 Value added tax rates and bases in OECD countries

Value added tax has been introduced in more than 160 countries worldwide. On average, value added tax revenues account for one fifth of the overall tax revenues of the OECD countries.

OECD has compared the value added tax systems of its member countries, and the ability of such systems to raise revenues. This was done by comparing the actual value added tax revenues for a country with what such revenues would have been if all consumption, both private and public, had been subject to the standard rate applied in that country. If all consumption is taxed at the standard rate of value added tax, the value added tax revenues as a proportion of consumption will also be equal to the value added tax rate. A number of factors may cause the revenue proportion to be lower than such standard rate. This may partly be the result of how the system is designed , with the revenue proportion being lowered by the use of reduced rates and exemptions. The revenue proportion may also be influenced by other factors like the effectiveness of tax collection and compliance, including the extent of tax planning, evasion and fraud. Although such an indicator needs to be interpreted with caution, and a loss of value added tax revenues may be caused by a number of factors, it may serve to illustrate how effectively the value added tax system works. Besides, the abolition of reduced rates and exemptions would mean that the same level of government revenues could be raised at a lower tax rate.

Figure 2.14 presents the standard value added tax rates for Norway, the OECD average and a selection of other countries. The figure also presents value added tax revenues as a proportion of consumption. The standard rate of value added tax is as high in Norway as in Denmark and Sweden, but value added tax revenues as a proportion of consumption is nonetheless somewhat lower. New Zealand has a very broad value added tax base with one uniform rate and few exemptions. Consequently, virtually all consumption is taxed at the standard rate, including public sector consumption.

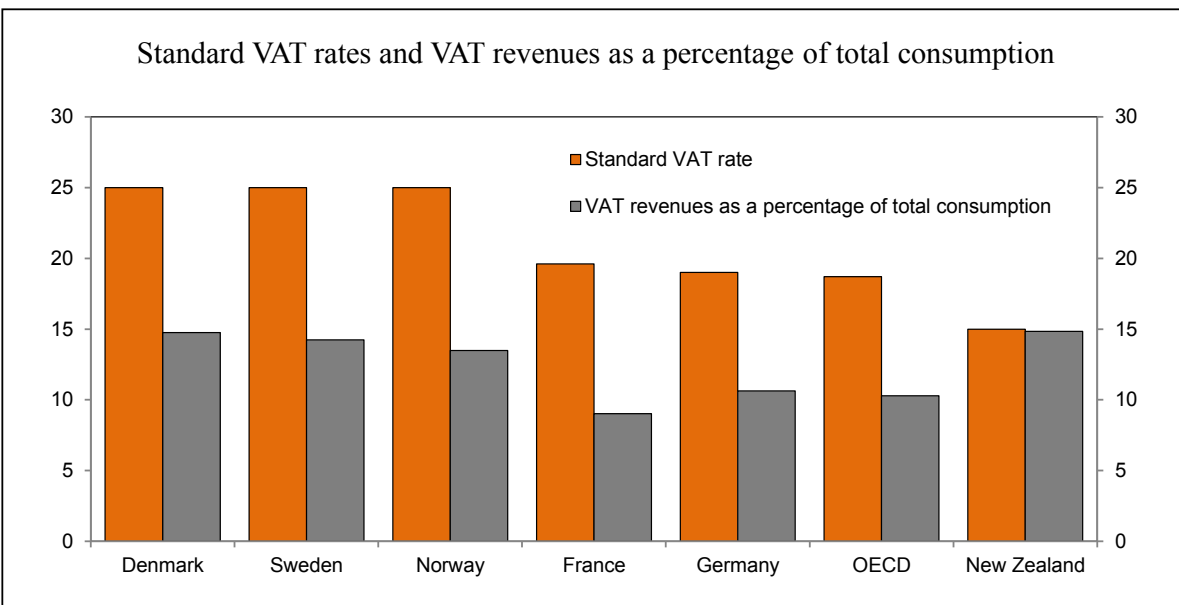Standard VAT rates and VAT revenues as a percentage of total consumption

Figure 2.14 Standard value added tax rates and value added tax revenues as a percentage of total consumption. 2012

Sources: OECD (2012) Consumption Tax Trends and the Ministry of Finance.

tion in a desired direction. If, for example, one intended to reduce the consumption of goods that are harmful to individuals and to society, it will be more effective to use excise duties.

2.4.2 Excise duties

Excise duties are intended to fund government expenditure, but are also used as instruments for the pricing of the social costs of using products that are environmentally harmful or hazardous to health.

Excise duties on specific products will, in contrast to general taxes on consumption, shift consumption away from taxed products. Hence, excise duties are suitable policy instruments for re-

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Box 2.5   Relationship between taxes and emission allowances

Environmental taxes put a price tag on the costs imposed on society by environmentally harmful activity. This makes it financially attractive for those involved to take steps to reduce emissions, by scaling back production, by changing production methods or by introducing abatement measures that cost less than the tax. By imposing a tax, the authorities put a price tag on polluting emissions, but do not directly control emission volumes. Under a cap-and-trade system, on the other hand, the authorities put a cap on emission volumes, whilst emission prices are determined in the market. The cost of the implemented abatement measures will nonetheless be determined by the emission allowances price established in the emission allowance market, and will depend on the supply of, and demand for, emission allowances.

An environmental tax and a cap-and-trade system will deliver the same emission reductions when the emission allowance price equals the tax. If the emission allowances are auctioned, such allowances can generate the same government revenues as the tax. This is because the residual emissions will correspond to the total volume of emission allowances. Hence, market participants will be willing to pay an emission allowance price equal to the tax. If the emission allowances are allotted free of charge, the authorities will forfeit these revenues and thus forgo the opportunity to reap further economic gains by reducing other taxes.

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ducing the social costs associated with the use of products that are environmentally harmful or hazardous to health. Some excise duties are solely intended to raise central government revenues. Examples of such taxes are the stamp duty on sales of immovable properties and the re-registration tax on motor vehicles and trailers. Other exercise duties are also intended to influence consumption or behaviour. This applies, first and foremost, to the environmental taxes and to the taxes on alcohol and tobacco.

The purpose of a tax has a bearing on its design. In order to limit the social costs of taxation, fiscally motivated taxes should not be levied on manufactured intermediate goods. Environmental taxes intended to put a price tag on an environmental problem should, on the other hand, encompass all sources of such environmental problem, and the tax rate should reflect the environmental damage.

Environmental taxes

Norway's first environmentally motivated tax was the tax on the sulphur contents of mineral oil, which was introduced in 1970. The use of environmental taxes did not become more widespread until the late 1980s/early 1990s. Environmental taxes have subsequently been introduced in a number of areas.

Environmental taxes make market prices reflect the social costs of environmentally harmful activities to a greater extent. This helps reducing such environmentally harmful activities. The revenues from environmental taxes can be used to reduce other distortionary taxes.

The use of environmental taxes is consistent with the polluter pays principle. This principle implies that those using environmental goods should also pay the costs their environmentally harmful activities impose on society.

The cost of reducing emissions from environmentally harmful activities may vary between different sectors of the economy, and the authori-
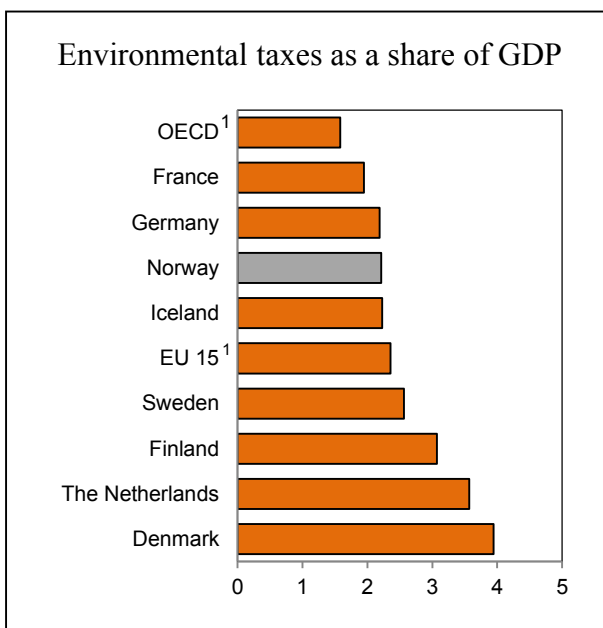

Figure 2.15 Revenues from environmental taxes as a proportion of GDP in different countries. 2012. Percent

[1] Weighted average.
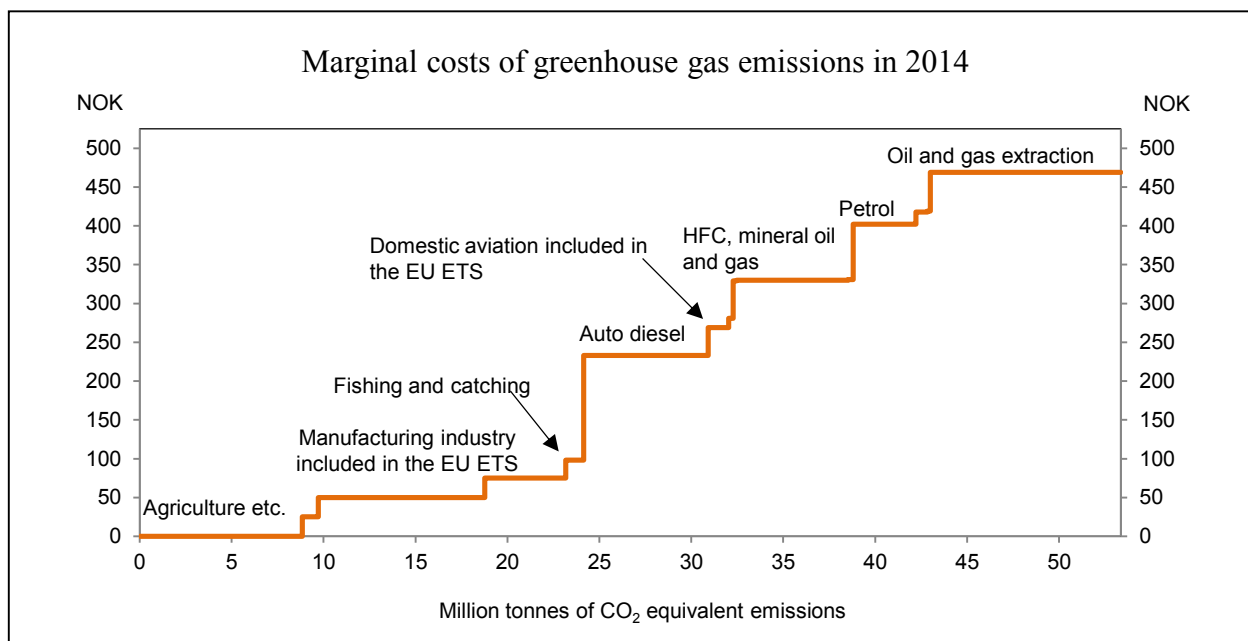Sources: Ministry of Finance and OECD.

Marginal costs of greenhouse gas emissions in 2014

Figure 2.16 Price of greenhouse gas emissions in various sectors. Tax level in NOK per tonne of CO_2 equivalents in 2014 and an emission allowance price of NOK 50 per tonne of CO_2. Emission data for 2011

Sources: Statistics Norway, the Norwegian Environment Agency and the Ministry of Finance.

ties do not have complete information as to the magnitude of such costs for different enterprises and households.

A correctly designed environmental tax will, for example, include all emission sources at one uniform rate. This facilitates decentralised decision-making that delivers environmental gains at the lowest possible social cost. Emission allowances are another cross-sectoral policy instrument that can have effects similar to those of environmental taxes. Emission allowances and taxes are discussed in further detail in Box 2.5.

When environmental taxes work as intended, they contribute to a reduction in environmentally harmful activity. This will reduce government revenues. This may explain some of the decline in revenues from environmental taxes in recent years. If environmental taxes are replaced by emission allowances that are not sold (free emission allowances), such revenues will decline further. Reduced revenues from environmental taxes may imply that other taxes need to be increased in order for tax revenues to be kept stable. Figure 2.15 compares environmental tax revenues in selected countries.

There may be various reasons why environmental taxes or cap-and-trade systems are not designed in a cost-effective manner. The reason is often a desire to protect particular groups or

industries. Figure 2.16 shows the marginal cost of greenhouse gas emissions in various sectors in Norway. Having diverging prices for greenhouse gas emissions increases the overall cost of reducing national emissions.

Environmental taxes on energy products are often additional to taxes that put a price on other social costs of such energy use. The environmental effect will reflect the aggregate level of taxes. The road usage tax on fuel also serves to curtail the consumption of petrol and diesel, and hence to reduce emissions of, inter alia, CO_2. The base tax on mineral oil serves to prevent an environmentally undesirable transition from electrical heating to the use of heating oil.

There are, in addition to environmental taxes and energy taxes, other taxes that are fiscally motivated, whilst also serving environmental objectives. This applies to, for example, the motor vehicle registration tax, which is differentiated on the basis of, *inter alia*, CO_2 and NO_X emissions. Taxes on fuels and motor vehicles account for a large portion of the environmental taxes.

Taxes reflecting health considerations and social considerations

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

that are not reflected in their market prices. This is exemplified by the consumption of alcoholic beverages and tobacco products. The taxes on alcoholic beverages and tobacco products raise revenues for central government, but also mean that the prices of these products include, to a greater extent, the costs imposed on society when consuming them. These costs relate to the health expenses imposed on the public sector, as well as the negative external effects of smoking and alcohol consumption on others than those who consume these products.

In addition, there are costs associated with consumers themselves failing to pay sufficient attention to the long-term effects of their consumption, or ignoring undesirable effects. A high level of tax 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.

2.4.3   Customs duties

Customs duties serve to protect domestic producers against international competition. Import duties normally result in more expensive goods for consumers and higher production costs for businesses. Besides, customs duties reduce trade volumes and prevent countries from fully utilising their comparative advantages in the production of goods and services. Trade in goods and services has enabled Norway to draw on its competitive advantages. Norway is currently one of the countries in the world with the lowest customs barriers for manufactured goods. Certain clothes and textiles are the only manufactured goods subject to customs duties.

Customs protection of agricultural goods is an important part of Norwegian agricultural policy. Import protection contributes to, *inter alia*, ensuring that Norwegian agricultural goods are sold at prices stipulated in the Agricultural Agreement. Customs protection is an important aspect of the overall support given to Norwegian agriculture. The customs duty rates for agricultural goods are highly variable, depending on the need for protection.

Maximum customs duty rates are laid down in international agreements. Norway has committed to reducing customs duty rates through several rounds of GATT/WTO[2] negotiations, most recently under the WTO 1994 Agreement. Apart from a certain reduction in customs duties on manufactured goods, the WTO Agreement entailed commitments with regard to market access, domestic subsidies and export subsidies for agricultural goods. Like other industrialised countries, Norway grants preferential customs treatment to developing countries under the GSP (Generalized System of Preferences) scheme. The scheme involves individual industrialised countries granting developing countries improved market access for their goods. GSP is a unilateral scheme, and can in principle be revoked or amended.

2.5   Fees and sectoral taxes

In 2006, the Ministry of Finance laid down general guidelines on central government fees and sectoral taxes. Fees shall cover, in full or in part, the cost of services addressed to a specific user, whilst sectoral taxes are normally levied to fund services provided by government for a specific industry or group. The guidelines entered into effect immediately with regard to the introduction of any new fees and sectoral taxes. Existing schemes were required to comply gradually over time. Changes to the bases and rates of overpriced central government fees and all changes to sectoral taxes are considered part of the tax programme.

Follow-up of the guidelines has thus far been much focused on eliminating overpricing, but various funding arrangements have also been straightened out. A number of arrangements that were previously labelled fees or reimbursements are now highlighted as sectoral taxes in the fiscal budget. New guidelines on cost calculation for chargeable local government services will enter into effect in 2015. The Government proposes a reduction in certain overpriced fees in 2015, and will initiate a review of public sector funding via fees and sectoral taxes, with a view to revising the guidelines, cf. the discussion in Chapter 9 of the white paper on taxes and customs duties 2015.

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[2] WTO (World Trade Organization) was established in 1995, replacing the former General Agreement on Tariffs and Trade (GATT) from 1947.

Box 2.6 Consumption opportunities and equivalent income

A person's consumption opportunities are determined by, *inter alia*, such person's income after tax, net wealth, access to government-provided goods and services, as well as home production. Ideally, analyses of resource distribution across a population should be based on overall consumption opportunities. In most cases, distribution analyses are nonetheless based on income, because of measurement difficulties.

Using taxable gross income as the income concept and the basis for classification into income groups does not fully convey how tax changes are reflected in altered consumption opportunities and welfare. A person's consumption opportunities are influenced by the household to which he or she belongs. People who live together can share fixed costs, for example on housing, cars and electricity (economies of scale), and people with no income of their own can nevertheless have consumption opportunities if they belong to a household in which others have an income.

To take account of economies of scale and different family compositions, each member of the household is allotted an income based on the aggregate income of the household. Such income is higher than the household's actual income per person. This allotted income is often termed «equivalent income». This term is intended to represent the income a household member would have needed as a single person in order to have the same consumption opportunities that he or she has as part of the larger household. A person may, for example, have a low equivalent income because her own gross income is low, or because she supports financially other household members without income.

There are different methods or «scales» to adjust income in this manner. Norway often uses the EU scale, the OECD scale and the square-root scale. The square-root scale implies that each household member is allotted an income equal to the total household income divided by the square root of the number of persons in the household. This implies, for example, that a four-person household only needs twice the gross income of a single-person household to have the same consumption opportunities. The EU and OECD scales use slightly different weights, thus implying that the economies of scale adjustments differ somewhat. However, all scales are based on the same underlying principle.

The examples in Table 2.2 show the calculation of equivalent income for a four-person household and a two-person household using the square-root scale.

Table 2.2 Examples of calculated equivalent income for a four-person household and a two-person household, respectively, using the square-root scale

Example 1: Couple with two children		*Example 2: Childless couple*	
	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
Equivalent income per person (800,000/√4)	400,000	Equivalent income per person (800,000/√2)	565,685

Source: Ministry of Finance.

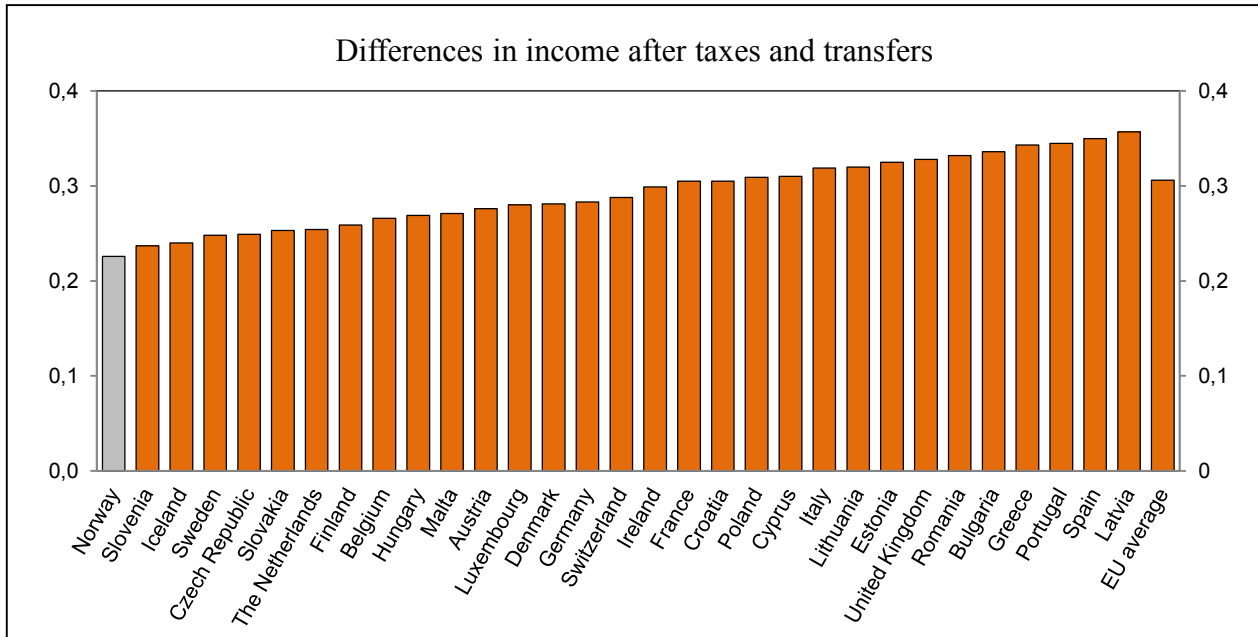## Differences in income after taxes and transfers

Figure 2.18 Gini coefficients for countries in Europe. 2011 tax year.

Source: Eurostat.

2.6 Distribution effects of the tax system

2.6.1 Distribution in Norway

Income distribution

No single indicator provides all relevant information with regard to income distribution, whether over time, between groups or between countries. The Gini coefficient is a frequently used measure of the degree of income inequality in a country. If everyone has the same income, the Gini coefficient will be 0, whilst it will be 1 if one
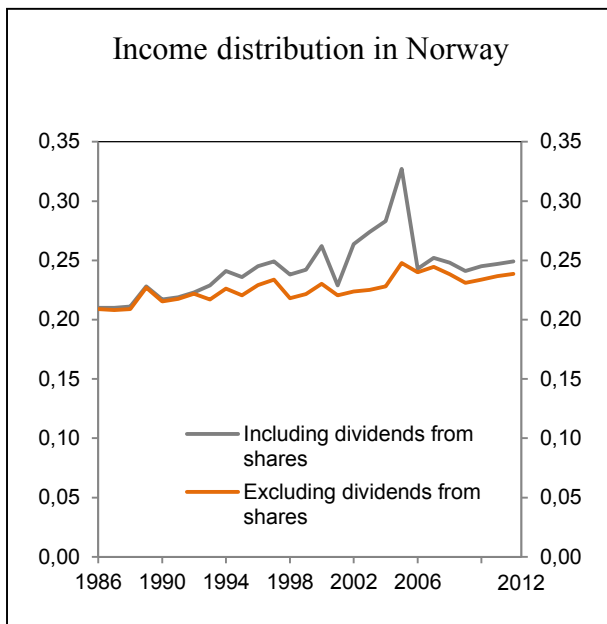
Figure 2.17 Income inequality developments in Norway as measured by the Gini coefficient. Equivalent income after tax (square-root scale). 1986-2012
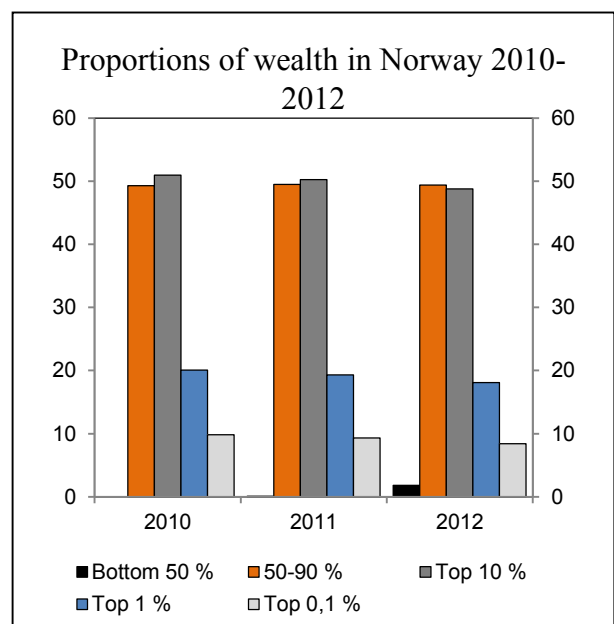
Source: Statistics Norway.

Figure 2.19 Proportions of estimated gross wealth in Norway 2010–2012 held by various groups, classified by the amount of such wealth
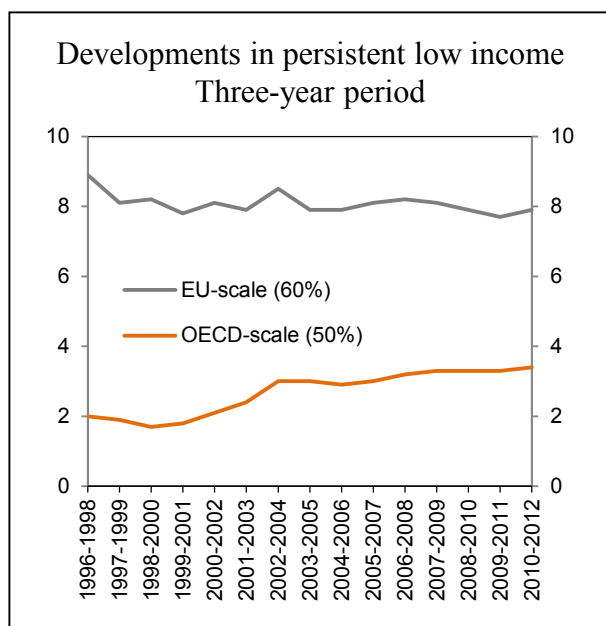
Source: Statistics Norway

Figure 2.20 Proportion of the Norwegian population on a persistent low income. Three years-period. Percent
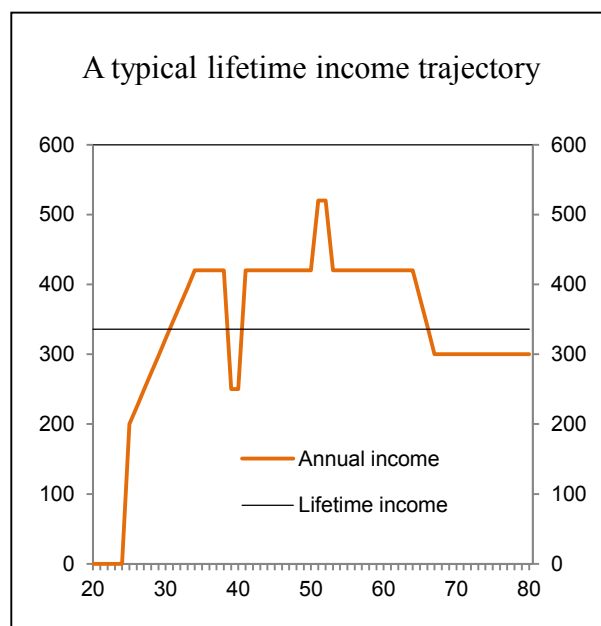
Source: Statistics Norway.

Figure 2.21 Illustration of hypothetical developments in income, with corresponding lifetime income. NOK thousands

Source: Ministry of Finance.

person or household gets all the income in society. The income concept used includes all household income after taxes and transfers. The income is adjusted to facilitate comparison of the income and consumption opportunities of people belonging to households of different family compositions . The method for adjusting income to so-called equivalent income is described in Box 2.6.

Income inequality in Norway has been fairly stable over the last 25 years, as measured by developments in the Gini coefficient, cf. Figure 2.17. This is particularly striking when looking at income exclusive of dividends from shares. A weak trend towards increasing inequality appears to have come to a halt or been reversed since 2005. The relatively large fluctuations in the Gini coefficient based on total registered income have to do with capital income becoming more visible in the statistics after the 1992 tax reform. The major change around 2005 has to do with taxpayers receiving large extraordinary dividends prior to the introduction of dividend tax in 2006.

Figure 2.18 shows income distribution as measured by the Gini coefficient in most European countries in 2011. According to these calculations from Eurostat, Norway was the country with the most equal income distribution in Europe in 2011. Greece, Spain, Portugal, Latvia and

Bulgaria are amongst the countries with the largest income differences.

Wealth distribution

Wealth is much more unequally distributed across the population than income. This is commonly the case in other countries as well. Figure 2.19 shows the proportion of wealth held by various groups, classified by the amount of such wealth. The 10 pct. with the highest wealth held about 50 pct. of all net wealth in Norway over the period 2010–2012. The one percent with the highest wealth held about 18 pct., whilst the richest 0.1 pct. of households (about 2,200 households) held 8 pct. of all wealth in 2012. The distribution of wealth has become somewhat more equal in recent years, and is more equal in Norway than in countries like France, the United Kingdom and the United States.

Persistent low income

The incidence of, and developments in, low-income households are of relevance to income distribution analysis. The OECD defines low income as income below 50 pct. of the median income (when all incomes are ranged in ascending order, the middle income), whilst the EU puts the low-income threshold at 60 pct. of the median in-

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come. There are also certain other differences between the EU and the OECD measures, cf. Box 2.6. The incidence of low annual incomes is low in Norway and the other Scandinavian countries, when compared to other countries.

The indicator persistent low income, here defined as low average income over a three-year period, is used to prevent the data from being overly influenced by people who have low incomes for only a short period of time. Figure 2.20 shows that the measures for persistent low income used by the EU and the OECD, respectively, suggest both different levels and different developments over time when applied to Norwegian data. Under the EU definition, the proportion on a persistent low income has remained fairly stable, at around 8 pct., since the late 1990s, whilst it has increased from 2 pct. to just over 3 pct. under the OECD definition.

The composition of the persistent low income group has changed over time. This reflects changing family patterns, with more sole providers and single-person households. Increases in the minimum state pension mean that fewer elderly people are on low incomes, whilst high immigration has added to the number of low-income households. Immigrants and Norwegian-born children of immigrants are overrepresented in the persistent low income group. Families with children

constituted the single largest group of people with a persistent low income over the three-year period from 2010 to 2012.

Distribution across the lifecycle

Analyses covering a three-year period may exaggerate the actual incidence of low incomes and income inequality. Income will be more equally distributed over time. The bottom of the income distribution scale, in particular, will include many people who do not actually belong to low-income groups, but nonetheless fall in this group when looking at short time periods. Income will vary quite significantly over the lifecycle for the vast majority of people, cf. the illustration in Figure 2.21. Hence, distribution analysis based on lifetime income can be a useful supplement to traditional one-year analysis.

The Ministry of Finance has developed, in cooperation with Statistics Norway, a model for analysing income distribution throughout the lifecycle. The model generates fictive lifecycle developments in income, wealth, etc., for about 7,500 persons based on Norwegian data for about 386,000 persons. This enables distribution analysis to be based on lifetime income.

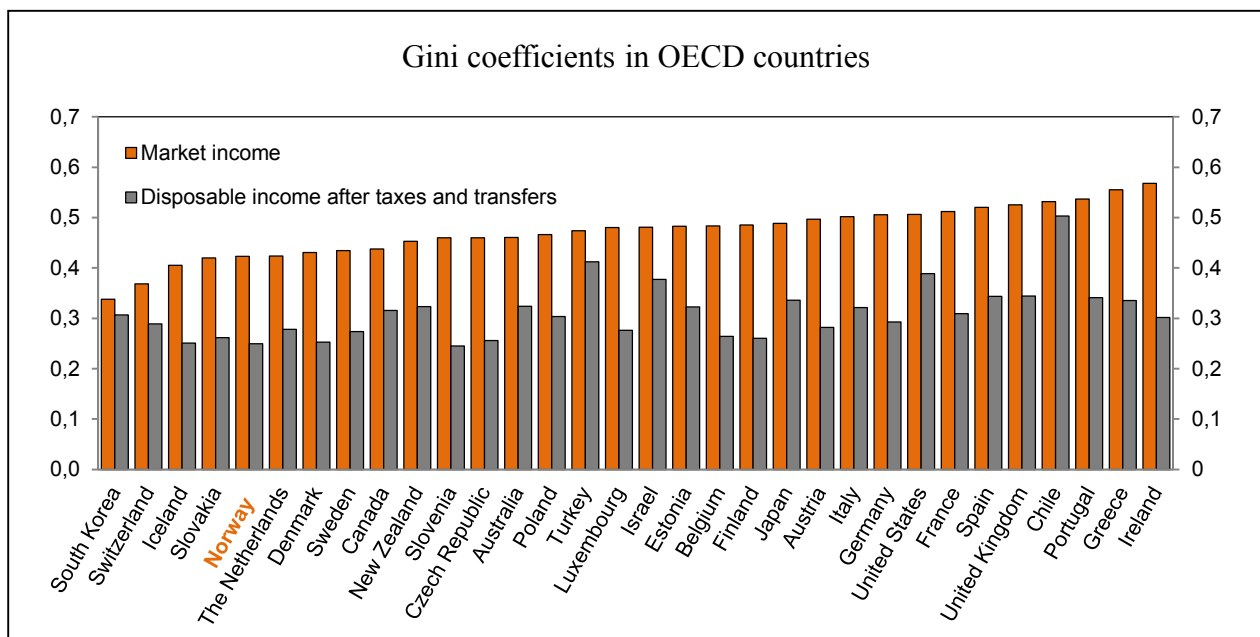Calculations show that the Gini coefficient declines from 0.294, based on annual income, to

Figure 2.22 Gini coefficients for market income and disposable income after taxes and transfers. 2012 or most recent available year
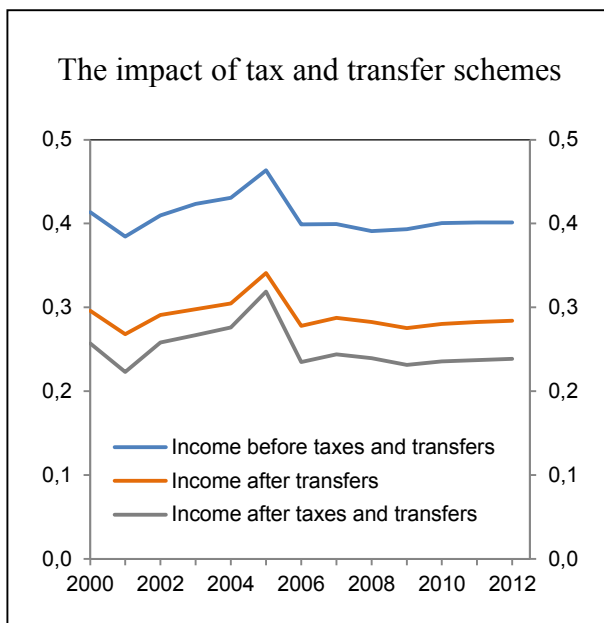
Source: OECD.

Figure 2.23 The impact of tax and transfer schemes on income distribution, as measured by the Gini coefficient. 2000-2012

Source: Statistics Norway.

Figure 2.24 Average assessed tax as a proportion of gross income

Source: Statistics Norway.

0.154, based on lifetime income. This is a decline of about 48 pct. The decline is brought about by examining the average of all annual incomes over a lifecycle, thus smoothing out individual years of very high or very low income. These differences are even larger for the low-income measures. Only 0.1 pct. of the population has a lifecycle income of less than 50 pct. of the median income, whilst about 10 pct. of the population has an annual income of less than 50 pct. of the median income.

2.6.2 Distributional implications of the tax system

Income distributional implications of the taxation of individuals

High labour force participation, low unemployment and a releatively important element of centralized wage determination are some of the reasons why Norway has small income differences, even before taking into account the redistribution taking place through taxes and transfers, cf. Figure 2.22.

Redistribution via taxes and transfer schemes is significant in Norway, cf. Figure 2.23. Major government transfer schemes provide protection against the loss of income due to illness, disability, old age and unemployment. These schemes
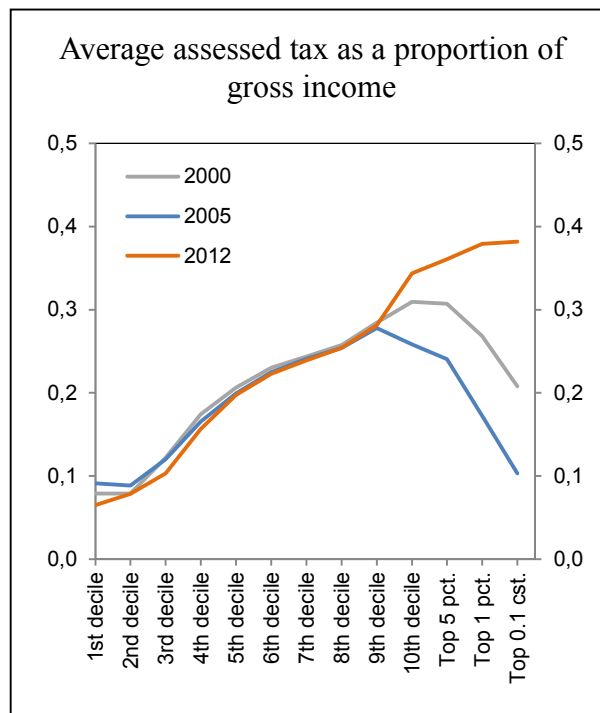
reduce the Gini coefficient by about 30 pct. in Norway. Government transfers and taxes as a whole reduce the Gini coefficient by more than 40 pct. in Norway. Hence, the key redistribution contribution of the tax system is via its funding of welfare benefits and income protection schemes.

The tax system contributes, at the same time, to a redistribution of the financial burden. Figure 2.24 shows average assessed tax as a proportion of gross income for different income groups. The progressivity of the tax system is clearly illustrated by the fact that average tax as a percentage of income increases with the income level. In 2000 and 2005, those with the very highest incomes paid a lower percentage of their income in tax than did other high- and medium-income groups. This has been changed, especially after the introduction of the dividend tax under the 2006 tax reform. Besides, the average percentage of income paid in tax has been reduced somewhat for the 10% of the population with the lowest incomes.

An extensive government-funded education system and a comprehensive student loan and grant scheme contribute as well to reduce income differences and the importance of parents' income for the income level of their children.
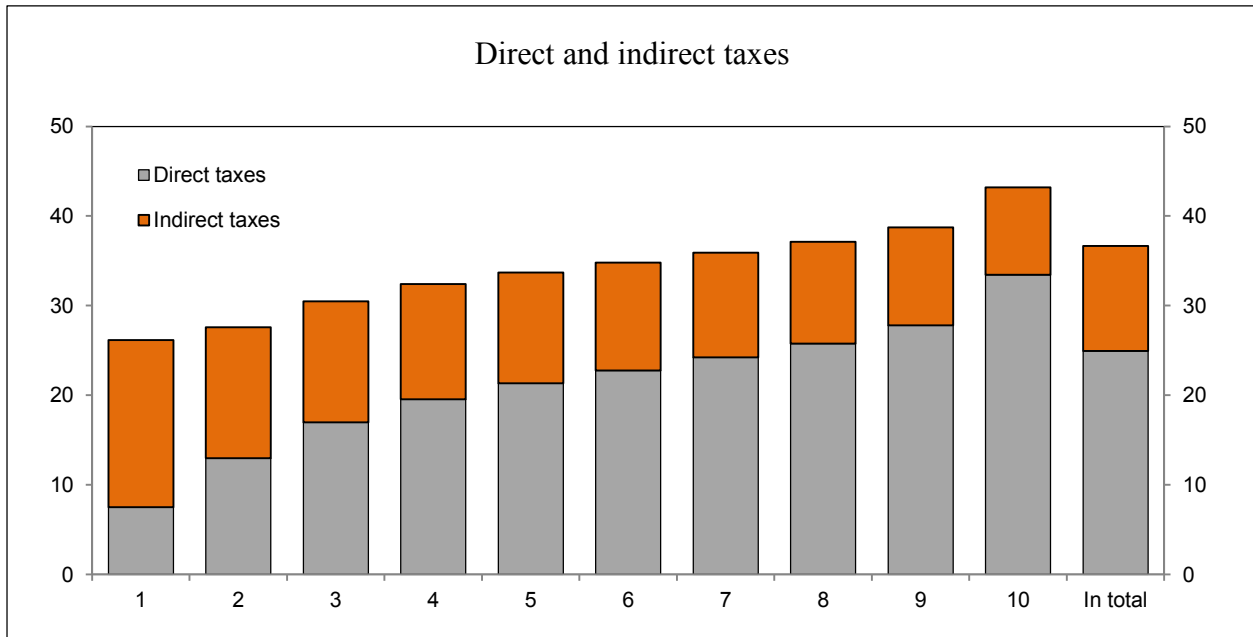
Figure 2.25 Direct and indirect taxes per person as a percentage of equivalent income. Wage- and price-adjusted 2014 rules. Percent

Sources: Statistics Norway and the Ministry of Finance.

Income distributional implications of indirect taxes

When examining how the tax system influences household consumption opportunities and welfare, it may be relevant to take into account the fact that indirect taxes also influence consumption opportunities. Such computations are made on the Statistics Norway models LOTTE-Skatt and LOTTE-Konsum.

In Figure 2.25, the entire population has been ranked in ascending order on the basis of equivalent income (cf. Box 2.6), into ten groups of equal size (income deciles). Correspondingly, everyone has been allotted a share of the direct and indirect taxes paid by their household.

The figure shows that people with low consumption opportunities have a lower tax burden than people with high consumption opportunities. At the same time, indirect taxes contribute to weakening 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 do persons with low gross income, and thus have a smaller proportion of their income available for consumption. It is income after tax (as well as savings) that can be consumed, and thus be subject to indirect taxes. Consequently, indirect taxes will constitute a smaller proportion of the gross income of a person with high gross income than that of a person with a low gross income. If the calculations were based on income after tax (disposable income), this tax burden would have been fairly equal across the various income groups.

2.7 Estimated tax expenditures and tax sanctions

The tax system is sometimes used as an instrument for realising political objectives. This can result in exemptions and special arrangements that reduce government revenues, and consequently represent subsidies for specific groups and activities. The estimated subsidies are labelled tax subsidies or tax expenditures. Examples are special arrangements for single parents and for the self-employed within agriculture. Correspondingly, the tax system may feature tax sanctions, i.e. that some taxes are higher than would be implied by a general and uniform regulatory framework. Such additional taxation also reflects political priorities. One example is fiscal taxes on production inputs in the business sector.

Unlike the corresponding measures funded via the expenditure side of the budget, the Storting does not decide the level of tax expenditures
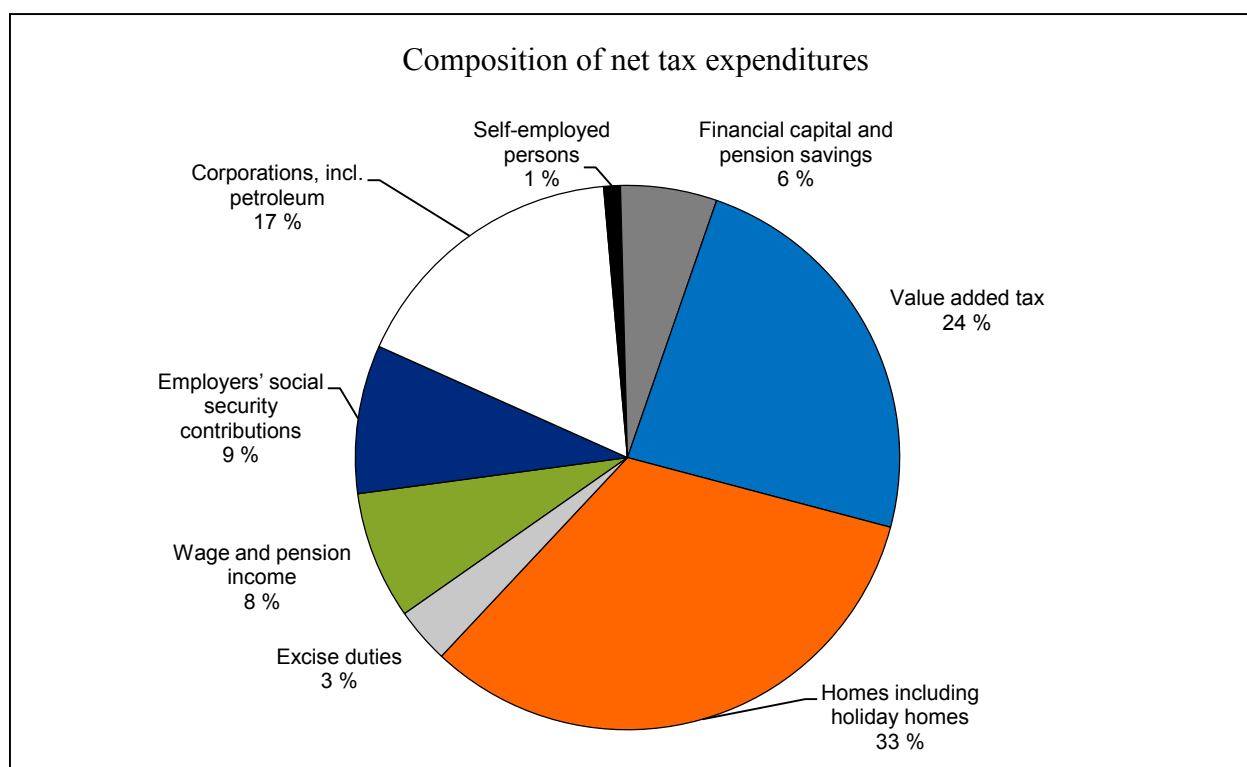
Figure 2.26 Net tax expenditures in 2014 by source of tax. Percent

Source: Ministry of Finance.

and sanctions in the annual budgets. This chapter is therefore intended to provide supplementary information concerning the various policy measures and tools incorporated into the current tax provisions. The overview does not purport to be complete. Appendix 1 of the white paper on taxes and customs duties 2015 provides a detailed overview of the tax expenditures and tax sanctions as calculated by the Ministry, as well as a more detailed analysis of tax expenditures.

The magnitude of tax expenditures and tax sanctions depends on how the benchmark system is defined. As a main rule, the general tax provisions are applied. In some areas one applies the main principles underpinning the design of the tax system, as established by, *inter alia*, 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. the tax expenditures are estimated as the tax revenues foregone by government as the result of more lenient provisions than would be implied

by the benchmark system. The calculations do not take behavioural changes into account. Consequently, the calculations will in many cases not represent a realistic estimate of the actual revenue losses caused by tax expenditures.

Figure 2.26 shows the distribution of net tax expenditures in 2014 across different sources of taxation. The figure illustrates that the taxation of homes, including holiday homes, is the largest tax expenditure. This represents about 33 pct. of overall tax expenditures[3]. Tax expenditures relating to financial capital and pension savings account for about 6 pct. of the total. Exemptions under the value added tax system represent 24 pct., whilst the regionally differentiated employers' social security contributions and tax expenditures relating to wage income and pension income account for 9 and 8 pct., respectively.

2.8   Revenue estimation methods

Changes to the tax rules will normally have an impact on government tax revenues. These revenue effects need to be distinguished from tax rev-

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[3] Stamp duty on the sale of freehold apartments is deducted from tax expenditure relating to homes.

enue changes caused by other developments, including business cycle fluctuations. A sound basis for decision-making needs to include information on the revenue effects of proposed changes to the tax rules.

The Ministry of Finance estimates the revenue effects of tax changes by a number of different methods. The methods vary from sophisticated models to simple estimates based exclusively on statistics. Which method is used depends on which models have been developed, which data are available and the deadline by which the estimates have to be prepared.

The Ministry of Finance publishes an annual report describing the calculation methods used to estimate the revenue effects of changes to the tax rules[4]. The calculation methods are summarised briefly below.

2.8.1 Benchmark system and tax revenue benchmark

Benchmark system for tax rules

The revenue effects of changes to tax rules in a fiscal year are estimated by reference to a benchmark system for tax rules. The benchmark system is characterised by taxes being kept unchanged in real terms from the year prior to the relevant fiscal year. This means that nominal thresholds and rates[5] under the tax rules are adjusted annually in line with estimates for the relevant growth factor, for example growth in retail prices, wages, pensions or asset values.

The benchmark system for *direct taxes* is based on the tax rules applicable in the current year, with allowances and income thresholds under the general rate structure for personal taxation being, as a main rule, adjusted in line with estimated wage growth. A taxpayer who only qualifies for standard reliefs and whose ordinary income and personal income increase in line with estimated wage growth, will thus pay approximately the same average income tax under the benchmark system as in the current year. Correspondingly, the wealth tax threshold in the benchmark system is adjusted such as to make a person with an average net wealth composition pay the

same net wealth tax under the benchmark system as in the current year, measured as a proportion of net wealth. Special allowances and some other personal taxation thresholds are adjusted in line with estimated inflation.

Under the benchmark system for *excise duties*, all quantitative rates are adjusted in line with estimated inflation (changes in the retail price index). Hence, the tax burden under this benchmark system remains unchanged in real terms. The benchmark system for *value added tax* is based on the current value added tax regulations.

Tax revenue benchmark

The tax revenues that would be generated if all taxes remained unchanged in real terms may be labelled the *tax revenue benchmark*. The tax revenue benchmark is determined by the benchmark system for the tax rules and by estimated tax base developments. Tax base projections are based on, *inter alia*, estimated macroeconomic developments.

2.8.2 Revenue calculations not incorporating behavioural effects

The most basic form of revenue calculation assumes that the tax change does not influence the behaviour of households or businesses. In such case, the revenue effect will only reflect the direct effect on the tax revenues. The revenue effect of a tax rate change will, for example, be calculated as the tax base multiplied by such tax rate change.

Revenue calculations that include only direct effects will in many cases provide a good approximation of the revenue effects in the fiscal year in which the tax rule is changed. Such is the case where there is little reason to assume that the change to the tax rules will occasion major behavioural changes in the short run, and where the change will have only a minor impact on other tax bases.

2.8.3 Revenue calculations incorporating behavioural effects

Changes to taxes and certain government ex-

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[4] The report is available on the following webpage: http://www.regjeringen.no/nb/dep/fin/tema/skatter_og_avgifter/metoder-for-provenyberegninger.html?id=717071

[5] Percentage rates, such as for example the value added tax rate and the employee's social security contribution rates, remain unchanged from the previous year under the benchmark system.

penditure items may influence government finances beyond the immediate, direct budgetary effect. This is because such changes may influence the behaviour of businesses and households. An increase in an excise duty will, for example, normally result in an increase in the price of the relevant goods, and thus a reduction in demand for that good.

It is reasonable to assume that it will take time for changes to the taxation of wage income and pension income to induce behavioural changes with a permanent impact on labour supply. Many people have fixed working hours and are therefore unable to change these without finding a new job or renegotiating their existing employment agreements. In most cases it will, for such reasons, be of most relevance to incorporate the revenue effects in the budget without behavioural changes.

However, in some cases it may be relevant to include behavioural effects already in the first year. In general, financial adaptations occur quite swiftly, whilst adaptations in the real economy take more time. Dividends were, for example, more than halved from 2000 to 2001 as a result of the temporary dividend tax in 2001. Changes to indirect taxes may also have a fairly rapid impact on consumption. As a main rule, the Ministry therefore incorporates behavioural effects in the budget estimates for indirect taxes. In some cases it may also be appropriate to assume fairly swift adaptations to certain changes in the income tax for individuals. One example is the restructuring of pensioner taxation in 2011, which the Ministry assumed would have some impact on labour supply in the first year.

In some cases the adaptations may happen before the tax change has entered into effect. One example is the dividend tax introduced as part of the 2006 tax reform. Many shareholders who were natural persons adapted their behaviour to the announced dividend tax by arranging for the distribution of large tax-exempted dividends before the reform entered into effect. The extraordinary dividends distributed prior to the reform where to a large extent channelled back to the companies in the form of loans and new equity. This meant that shareholders converted retained profits, which would have become taxable upon distribution after the reform, to loans and new equity that could still be distributed without dividend taxation after the reform. An-

other example is the restructuring of the motor vehicle registration tax. When the budget proposal was made public in October 2006, it became evident that cars with low CO_2 emissions would be subject to lower registration tax after 1 January 2007, whilst cars with high CO_2 emissions would be subject to higher registration tax. This resulted in purchases of car types that would become subject to lower tax being deferred, whilst purchases of car types that would become subject to higher tax were accelerated.

A revenue calculation incorporating behavioural effects will normally only include the direct effect on tax revenues of the tax base being directly affected . The revenue calculation will thus take into account both such regulatory change and how the resulting behavioural changes on the part of households and businesses will influence the tax base.

In some cases one should take into account the fact that changes to one tax base will have behavioural effects that also influence other tax bases. The change to the tax regulations will in such cases have an indirect effect on tax revenues via a tax base that is not directly affected by such regulatory change. An increase in the tax on spirits, for example, will not only increase the price of spirits, and thus reduce demand for spirits. Such increase may also shift alcohol consumption away from spirits and towards wines and beers. Consequently, an increase in the tax on spirits may increase the revenues from the tax on wines and beers.

Permanent effects

The permanent effect of a tax change includes all long-term effects of such tax change. How long time it takes for all adaptations to work themselves out will depend on which tax is being changed.

2.8.4 Effects of expansionary fiscal policy

All tax reductions need to be financed, sooner or later. This can be achieved by increasing other taxes, by reducing expenditure or by paying interest costs on government debt (or foregoing interest revenues as a result of lower net government assets). The funding of a tax reduction may also influence tax bases, as in the case of a reduction in government expenditure.

A tax reduction that is not financed may result in an increase in disposable income in the short

run[6]. Higher private sector incomes may increase demand and economic activity. This will also result in higher tax revenues, thus reducing the initial weakening of the fiscal budget. The impact on activity will depend on, *inter alia*, the amount of spare capacity in the economy. The impact on activity will be minor during an economic boom, but may be major in times of recession. In any case, tax reductions need to be paid for over time, through higher taxes or reduced expenditure. This will, when taken in isolation, reduce demand for goods and services, thus counteracting the impact of the initial tax reduction on the activity level and the budget balance. A short-term demand increase resulting from unfinanced tax re-

ductions should not be confused with permanent effects from behavioural changes. What needs to be measured for purposes of examining whether a tax change is making the tax system more efficient or not is any permanent behavioural changes. The impact of any expansionary fiscal policy on activity will normally be taken into account in the Ministry's model computations for the entire fiscal budget.

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[6] Increasing social security benefits will, correspondingly, also increase private sector disposable income. Hence, demand effects are general implications of an expansionary fiscal policy, and are not specific to tax policy.