DET KONGELIGE
FINANSDEPARTEMENT

Royal Ministry of Finance

Prop. 1 LS

(2018 – 2019)

Proposition to the Storting (bill and draft resolution)

for the fiscal year 2019

Taxes 2019

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Recommendation from the Ministry of Finance of 28 September 2018,
approved in the Council of State on the same date.
(Solberg Government)

An unofficial English translation of Chapter 1 and 2
of Prop. 1 LS (2018-2019)

1 Main tax policy features

1.1 The tax policy of the Government

The Government will use the tax system to fund public goods and services, ensure social mobility, achieve more efficient resource allocation and improve conditions for Norwegian businesses. Private ownership shall be strengthened, and it shall be more profitable to work, save and invest.

The Government's main tax policy objective is to fund public goods and services in the most efficient manner. Furthermore, the Government will reduce the tax level to stimulate economic growth and to enhance the freedom of families and individuals. Taxes shall also stimulate more environmentally-friendly behaviour. Hence, improvements to the tax system form a key element of the economic policy of the Government, and are a principal policy instrument for promoting economic growth.

Broad tax bases, low tax rates and equal tax treatment across industries, businesses and investments will contribute to resources being utilised in the best possible manner. These principles have been guiding the design of the tax system since the tax reform of 1992. The reform provided Norway with a more growth-promoting tax system. Tax bases were better aligned with actual corporate profits and returns on investments increased. The Storting has endorsed these fundamental principles through its deliberation of Report No. 4 (2015–2016) to the Storting; *Better Taxation – A Tax Reform for Transformation and Growth* (the Tax Report).

The competitiveness of Norway depends on the ability of our economy to change and to utilise resources in the best possible manner. This is achieved by ensuring that the general business framework makes it attractive to invest in Norway. Special arrangements and exemptions in the tax system will often channel resources into less productive uses.

Key achievements in the Government's tax policy

The Government has reduced overall taxes by about NOK 24 billion accrued since it took office. The Government has implemented, among others, the following changes as of 2018:

- Income tax has been reduced for individuals and corporations. The lowering of the tax rate on ordinary income for individuals and corporations from 28 to 23 percent serves to stimulate savings and investments and strengthens the growth capacity of the economy. The reduction of marginal tax rates for individuals and the abolition of tax class 2 strengthen work incentives. By also increasing the basic allowance for wage income, social benefits and pension income, broad groups of the population have benefited from the tax reductions.
- Net wealth tax has been reduced by about NOK 6.1 billion. The reductions stimulate savings, the inflow of Norwegian equity, as well as investments in the business sector. The tax rate has been reduced from 1.1 to 0.85 percent, and the basic allowance has been increased from NOK 870,000 to NOK 1.48 million. A valuation discount of 20 percent has been introduced for shares and operating assets and associated debt. The taxable valuation of commercial properties has, at the same time, been increased from 50 to 80 percent of estimated market value, the valuation of secondary dwellings has been increased from 50 to 90 percent, and the valuation of holiday homes has been increased by 10 percent. This has resulted in more equal valuation of different assets.
- The Skattefunn research and development (R&D) tax incentive scheme for stimulating R&D in businesses has been expanded considerably. The maximum deductibility basis (cap) for internal R&D costs has been increased from NOK 5.5 million to NOK 25 million, whilst the cap on the sum total of internal R&D and R&D outsourced to approved research institutions

has been increased from NOK 11 million to NOK 50 million. In addition, the maximum hourly wage rate for internal personnel has been increased from NOK 530 to NOK 600.
- Taxes on businesses, including corporate tax, have been reduced by about NOK 8.8 billion.
- The inheritance tax has been abolished. This eases the liquidity strain of generational change and represents a major simplification.
- There has been a clear shift towards environmentally related taxes.
- Car taxes have been reduced by a total of about NOK 1.9 billion.
- The motor vehicle registration tax has been changed in an environmentally-friendly direction, and the engine power component has been phased out. This has served to increase the number of new zero- and low-emission cars. The average motor vehicle registration tax for a new passenger car (including electric cars) has been reduced by more than NOK 40,000 from 2013 to the first half of 2018.
- The marine engine tax, the annual tax on caravans and the motor vehicle registration tax on vintage cars and amateur-built vehicles have been abolished.

1.2 Main features of the tax proposal for 2019

The outlook for the Norwegian economy is positive, cf. the discussion in Meld. St. 1 (2018–2019) *National Budget 2019*. The expansionary fiscal policy and a forward-leaning tax policy with broad tax reductions for businesses and individuals have paid off.

The Government will continue to give priority to tax changes that strengthen the growth capacity of the economy, facilitate structural adjustment and create new jobs.

A lower tax rate on ordinary income for individuals and corporations is especially growth inducing. Along with further increases to the valuation discount for shares and operating assets for net wealth tax purposes, this makes it more profitable for Norwegian owners to invest in Norway.

The Government is also making a number of proposals that will expand tax bases and improve the tax system.

Total new tax reductions in 2019 as the result of the Government's proposal are about NOK 1.1 billion accrued and NOK 1.7 billion booked. Dynamic effects of the tax proposal for 2019 are discussed in Section 1.3.

Direct taxes

The Government is committed to following up the tax reform in line with the parliamentary tax agreement. This involves, inter alia, considering additional corporate tax reductions in view of international developments. Norway currently has the highest corporate tax rate in the Nordic region. In Sweden, parliament has decided to reduce the rate from 22 percent in 2018 to 20.6 percent in 2021. It is proposed that the tax rate on ordinary income for corporations and individuals be reduced from 23 to 22 percent in order to reflect international developments. The petroleum tax and the tax on resource rent from hydropower are adjusted without any net effect on tax revenues. This involves increasing the special tax on petroleum income by
1 percentage point to 56 percent and reducing the rate of uplift (investment-based extra depreciation) from 5.3 to 5.2 percent per year. The tax on resource rent from hydropower production is increased by 1.3 percentage points to 37.0 percent. The upwards adjustment factor for dividends, etc., in ordinary income is increased from 1.33 to 1.44, thus implying that the overall marginal tax rate on dividends is maintained at about the current level when considering corporate tax and personal dividend tax as a whole. The tax rate on profits in the financial industry will be maintained at 25 percent.

The corporate tax rate reduction is recouped by expanding tax bases, including, inter alia, by changing the rules on the taxation of insurance and pension undertakings. Targeted measures are also implemented to prevent base erosion and profit shifting, including, inter alia, changes to the interest limitation rule and the tax rules determining when a company is deemed to be tax resident in Norway (the tax residency rules).

New accounting standard reduces the total valuation of banks' credit portfolios. It is proposed that this reduction can be deducted in its entirety in the year 2018.

It is proposed that the marginal tax rate on wage income be reduced for the vast majority of wage earners. This is achieved by increasing the rates applicable under the bracket tax by less than the reduction in the rate of tax on ordinary income. The rates under the bracket tax are increased by between 0.5 and 0.9 percentage points.

The Government is also proposing to increase the valuation discount for shares and operating assets in the net wealth tax from 20 to 25 percent and to increase the basic allowance of the net wealth tax to NOK 1.5 million (NOK 3 million for married couples).

Changes that will simplify the tax system are proposed. These include, inter alia, the introduction of a joint threshold amount in the travel allowance for travel inside and outside the EEA, respectively. It is proposed that tax limitation for taxpayers with low taxability be closed to new users to maintain work incentives for young social security benefit recipients and to preserve the effects of the disability reform.

The Government is proposing that employers be required to report, withhold taxes and pay employer's social security contributions on wages in the form of gratuities. Gratuities are taxable income, but have been subject to inadequate tax reporting.

It is proposed to increase the pension savings allowance against ordinary income for the self-employed.

The Government proposes a number of changes to the property tax rules for residential properties and holiday homes. The maximum rate will be reduced from 0.7 to 0.5 percent, and municipalities will be required to use the net wealth tax bases for property tax purposes. The mandatory discount applied to reduce the tax base will be 30 percent of estimated market value for both residential properties and holiday homes. The changes enter into effect from 2020.

Indirect taxes

The Government is proposing a number of changes to improve the climate and environmental impetus of the tax system. Air passenger tax will be given an environmental profile through the introduction of distance-based differentiation with a higher rate outside Europe. It is intended for this to enter into effect on 1 April 2019. Further environmental differentiation of the motor vehicle registration tax for motorbikes is also proposed. The Government is proposing the introduction of a vehicle scrap deposit duty for lorries, motorbikes, mopeds and caravans. It is proposed to abolish the preferential treatment in the CO_2 component of the motor vehicle registration tax for taxis. This provides a stronger incentive to acquire more environmentally-friendly cars for taxi operations as well.

It is proposed to postpone transition to a new measurement method for the calculation of emissions from new cars (WLTP) to 2020 because insufficient information is available on emission values under the new measurement method.

Furthermore, the Government is proposing to reduce the tax on chocolate and sugar products to its (price-adjusted) 2017 level.

It is proposed to reduce the electricity tax by NOK 0.01 per kWh relatively to the price-adjusted rate. Thereby, electricity bills are reduced for, inter alia, households, services industries and municipalities.

Other proposed tax changes

The Government is also proposing a number of other changes to the tax rules, with revenue effects in 2019:

- The tax-exemption rates for domestic daytrip food allowances will be reduced.
- The personal allowance will be adjusted in line with wage growth.
- Certain limits will remain nominally unchanged. This applies, for example, to the trade union subscription allowance, the kilometre rates of the travel allowance, the parental allowance, the tax-exempted net income and the net wealth supplement under the tax limitation rule, the special allowance in Finnmark and North Troms, the agricultural allowance, the fishermen's and seamen's allowances, as well as the maximum annual savings under the home investment savings scheme for people below the age of 34 years (BSU).
- Tax-exempted employee discounts will be capped at NOK 7,000 and tax-exempted overtime food will be capped at NOK 200.
- The share savings account scheme will be changed to extend deferred taxation to dividends on shares and fund units as well.
- The rate of product tax on sales of landed fish will be increased from 2.3 to 2.4 percent
- The biofuel sales requirement will be increased.
- The road usage tax on LPG will be increased to 40 percent of the road usage tax on petrol, in conformity with the Storting's plan for a gradual increase to full road usage tax by 2025.
- The reduced rate of electricity tax will be expanded to the production and transformation of energy products.
- Premium telephone number duty rates will be moved from the Numbering Regulations to the excise duty resolution and inflation adjusted from 2009 to 2019 as for other excise duties.
- Overpriced judicial fees will be reduced.
- A sectoral tax will be introduced for the controlling and tracing of tobacco products.

– The sectoral taxes for the Petroleum Safety Authority Norway and the Norwegian Communications Authority will be increased.

1.3 Dynamic effects

Lower tax rates may serve to improve resource allocation and stimulate economic growth. Part of the immediate loss of revenues will thus be offset by an expansion of the tax bases. The tax reductions may thereby be self-financing to some extent. An expansion of the tax bases may take place over many years. The associated increase in revenues can therefore not be included in the current fiscal year. The budgetary room for manoeuvre will increase as and when tax bases expand and the level of tax revenues increases.

Different taxes have different effects on resource allocation in the economy. Some taxes improve the allocation of resources, such as taxes that correct for damage caused to health and the environment. Other taxes, such as taxes on resource rents, are neutral. However, most taxes result in individuals and businesses changing their decisions in such a way as to utilise resources less efficiently. Taxes on labour will, for example, make it less profitable to work. Correspondingly, it becomes less profitable to repay debts and deposit money in the bank or invest them in shares if part of the return has to be paid in tax. Taxes on business profits result in fewer investments being profitable.

Most of the tax revenues need to come from taxes that have a negative impact on the economy. Relying more heavily on taxes that have little impact on the decisions of individuals and businesses, and having low tax rates on broad bases rather than higher rates on narrow bases, minimises such negative effects. High tax rates provide strong incentives to change behaviour and make it profitable to evade or avoid such tax. This inhibits economic growth.

Tax reductions may therefore serve to improve resource allocation and to stimulate economic growth. Some forms of tax reduction will have a more positive impact than others. Economic research indicates, for example, that lower tax rates on business profits and labour, in particular, may entail especially beneficial effects. The Tax Commission refers to international research and adopts the assumption that taxes on immovable property and on consumption have a less inhibiting effect on economic growth than other types of taxes, cf. the NOU 2014: 13 green paper; *Capital Taxation in an International Economy*. The Commission notes that traditional corporate tax and personal income tax (taxes on labour and capital income) have the strongest negative impact on economic growth.

The Government's tax proposal for 2019 is in line with economically well-founded recommendations as to which tax reductions will improve resource allocation and stimulate economic growth. The Government proposes to reduce the tax rate on ordinary income for corporations and individuals by 1 percentage point. This will strengthen the growth capacity of the mainland economy by stimulating increases in investment and labour supply over time. A lower corporate tax rate, in particular, is expected to have a positive effect. Estimates from the Tax Commission suggest that the degree of self-financing of the implemented corporate tax changes may be in the range of 20 – 40 percent over time.

A reduced tax rate on ordinary income for individuals, combined with a somewhat higher level of bracket tax, will reduce the marginal tax rate on both labour and savings. The overall marginal tax rate on labour will, under the Government's proposal, be reduced by between 0.05 and 0.5 percentage points for those who pay bracket tax (those with a personal income of no less than NOK 174,500 in 2019). Consequently, the proposal will stimulate work, and may involve an element of self-financing over time.

There is considerable uncertainty as to the degree of self-financing, but calculations made on the Statistics Norway simulation model LOTTE-Arbeid suggest that the degree of self-financing of the

combination of a lower tax rate on ordinary income, new bracket tax and other elements of the tax proposal that can be calculated in the model, is about 16 percent.

The Government's proposal for a reduction in the tax rate on ordinary income for individuals will, when taken in isolation, reduce the marginal tax rate on capital income by 1 percentage point. This will increase interest rates after tax, increase the value of interest income and reduce the value of the deductibility of interest. Empirical research indicates that the overall effect of a higher return after tax is to increase savings, but the magnitude of such effect is uncertain.

The proposed reduction in the valuation of shares and operating assets for net wealth tax purposes will also increase the return after tax from investing in shares and operating assets for those above the net wealth tax threshold. Furthermore, the preferential treatment of investments in primary dwellings and holiday homes, as compared to investments in business activities, for net wealth tax purposes is reduced. On the other hand, the preferential treatment of shares and operating assets, as compared to secondary dwellings, bank deposits and bonds, for net wealth tax purposes is somewhat increased. The proposal may serve to channel a larger portion of savings into investment in business activities. It may also serve to increase investment undertaken by businesses that rely on Norwegian equity to implement their projects. The Government's proposal for a net wealth tax reduction is assumed, against this background, to have a positive long-term effect on the Norwegian economy and Norwegian jobs.

The Ministry assumes that it will take time for dynamic effects of the Government's proposed changes to income and net wealth tax to influence tax revenues. The Ministry is therefore not including any dynamic effects of these changes in the 2019 budget. It is assumed, on the other hand, that changes in indirect taxes will affect prices and demand already in 2019. The estimated tax revenue from changes to most excise duties therefore takes into account that the tax base changes when the tax rates are changed.

1.4 Revenue effects of the proposed tax changes

Table 1.1 provides an overview of the revenue effects of the Government's proposals. The revenue effects of the tax proposal are calculated relative to the benchmark system for 2019. The benchmark system for 2019 is based on the 2018 rules with relevant adjustments, the most important being adjustments for estimated price, wage or wealth growth.

Allowances and limits, etc., in the general rate structure for personal taxation have largely been adjusted to the 2019 level using estimated wage growth of 3.25 percent. Special allowances and other limits in personal taxation have largely been adjusted in the benchmark system using an estimated consumer price growth rate from 2018 to 2019 of 1.5 percent. This means that a taxpayer who only qualifies for standard reliefs and whose ordinary income and personal income both increase by 3.25 percent will have about the same average income tax level in the benchmark system for 2019 as in 2018. In the benchmark system, all unit taxes have been adjusted by the estimated consumer price growth from 2018 to 2019. In real terms, the benchmark system thus entails no change in tax levels from 2018 to 2019.

Table 1.1 Estimated revenue effects of the tax proposal for 2019. Negative figures represent tax reductions. The estimates have been calculated relative to the benchmark system for 2019. NOK million

	Accrued	*Booked*
Income tax for individuals	**-619**	**-485**
Reduce the rate on ordinary income for individuals to 22 pct., incl. adjusted dividend tax[1]	-11,460	-9,170
Increase the bracket tax[2]	10,580	8,465
Reduce tax-exemption rates for domestic daytrip food allowances	80	65
Adjust the travel allowance. Tolls and ferry expenses to be included in the maximum amount	15	12
Close the tax limitation scheme for taxpayers with low taxability to new users	0	15
Require employers to report, withhold taxes and pay employer's social security contributions on wages in the form of gratuities	350	280
Cap tax-exempted employee discounts at NOK 7,000 and tax-exempted overtime food at NOK 200	-160	-128
Adjust the personal allowance in line with wage growth	-90	-75
Increase the maximum amount of tax-favoured pension savings for the self-employed	-80	-65
Maintain rates, limits and allowances unchanged in nominal terms, etc.	146	116
Net wealth tax	**-690**	**-550**
Increase the valuation discount for shares and operating assets (incl. commercial property) to 25 percent. Increase the basic allowance to NOK 1.5 million	-690	-550
Business taxation	**1,650**	**450**
Reduce the rate on ordinary income to 22 pct. for corporations	-2,700	0
Adjust the petroleum tax with no net effect on tax revenues[3]	0	0
Adjust the tax on hydropower with no net effect on tax revenues[4]	0	0
Increase the Financial Activity Tax by maintaining the tax rate on profits in the industry at 25 percent	700	0
Change the interest limitation rule	600	0
Change the tax residency rules	50	0
Tax insurance and pension undertakings	3,000	1,000
New accounting standard for banks and financial institutions from 2018 – increased deductions (non-recurring effect)	0	-550
Environmental taxes and car taxes	**295**	**271**
Increase the biofuel sales requirement	235	215
Increase the road usage tax on LPG	2	2
Abolish the preferential tax treatment of taxis in the CO_2 component of the motor vehicle registration tax	18	17

Restructure air passenger tax with no net effect on tax revenues	0	0
Restructure the motor vehicle registration tax for motorbikes in an environmentally-friendly direction	0	0
Introduce vehicle scrap deposit duty for lorries, motorbikes, mopeds and caravans	40	37
Other indirect taxes and customs duties	**-1,661**	**-1,397**
Reduce the tax increase on chocolate and sugar products to the (price-adjusted) 2017 level	-1,000	-900
Reduce the electricity tax by NOK 0.01 per kWh	-650	-490
Extend the reduced rate of the electricity tax to production and transformation of energy	-20	-15
Inflation-adjust premium telephone number duties	4	4
Improve preferential customs treatment for the second-poorest group of developing countries (the GSP+ countries)	0	0
Adjust reduced rates upwards due to Norwegian kroner exchange rate changes[5]	5	4
Sectoral taxes and overpriced fees	**-29**	**-26**
Reduce overpriced fees	-80	-77
Increase sectoral taxes for the Norwegian Communications Authority	29	29
Increase the sectoral tax for the Petroleum Safety Authority Norway	7	7
New sectoral tax – tracking and tracing of tobacco products	15	15
Aggregate new tax reductions in 2019	**-1,054**	**-1,737**
Effect of decisions relating to the National Budget 2018	-125	-2,157
Effect of decisions relating to the Revised National Budget 2018	-72	-63
Aggregate proposed and adopted tax changes in 2019	**-1,251**	**-3,957**

[1] The upwards adjustment factor for dividends is increased from 1.33 to 1.44.

[2] The bracket tax rates are put at 1.9 pct. in bracket 1, 4.2 pct. in bracket 2, 13.2 pct. in bracket 3 and 16.2 pct. in bracket 4. The tax credit for pensioners is adjusted to maintain the lower income tax threshold for pensioners.

[3] The change has no effect on the net present value of future tax revenues. Revenues are reduced by NOK 150 million accrued and NOK 75 million booked in 2019. Transfers to the Government Pension Fund Global are reduced correspondingly. Consequently, the room for manoeuvre in the budget for 2019 is not affected by this change.

[4] The increased rate of tax on resource rent will increase revenues by about NOK 305 million accrued in 2019, booked in 2020. It will have no net effect on tax revenues when considered in the context of the reduced rate of tax on ordinary income for the hydropower industry.

[5] Reduced rates shall not be lower than the minimum rates specified in the EU Energy Tax Directive measured in national currency on the first workday of October in the year before the fiscal year. Electricity tax is increased by about NOK 4 million accrued and NOK 3 million booked, base tax on mineral oils, etc., by about NOK 0.1 million and CO_2 tax on natural gas by about NOK 1 million accrued and booked.

Source: Ministry of Finance.

Table 1.2 presents estimated booked tax revenues for 2019, as well as estimates for 2018 and accounting figures for 2017, specified by chapter and item.

Table 1.2 Booked tax revenues specified by chapter and item. NOK million

Chapter	Item	Description	Accounts 2017	Budget estimate 2018 Balanced budget	Estimate NB 2019	Proposal 2019
5501		Taxes on wealth and income				
	70	Bracket tax, net wealth tax, etc.[1]	53,757	66,396	66,900	74,700
	72	Central government tax[1]	198,870	178,131	177,400	105,600
	74	Corporate tax	-	-	-	83,600
5502		Financial Activity Tax				
	70	Tax on wages	1,563	1,840	1,975	2,050
	71	Tax on profits	-	460	700	1,435
5506	70	Tax on inheritance and gifts	91	-	80	-
5507		Taxes on petroleum extraction				
	71	Ordinary tax on wealth and income	23,688	31,300	42,500	52,800
	72	Special tax on petroleum income	41,361	52,900	74,200	103,300
	74	Area fee, etc.	939	1,300	1,500	1,600
5508	70	Tax on the emission of CO_2 in petroleum activities on the continental shelf	5,182	5,600	5,400	5,600
5509	70	Tax on the emission of NO_X in petroleum activities on the continental shelf	7	5	2	2
5511		Customs revenues				
	70	Customs duties	3,271	3,200	3,430	3,000
	71	Auction revenue from customs quotas	227	250	310	300
5521	70	Value added tax	267,433	291,500	294,000	310,000
5526	70	Tax on alcoholic beverages	13,692	13,800	14,100	14,200
5531	70	Tax on tobacco products, etc.	7,027	7,100	6,600	6,600
5536		Tax on motor vehicles, etc.				
	71	Motor vehicle registration tax	16,227	15,935	15,000	14,600
	72	Traffic insurance tax	9,606	7,100	7,000	9,400
	73	Annual weight-based tax	339	350	340	350
	75	Re-registration tax	1,474	1,450	1,450	1,480
5538		Road usage tax on engine fuel				
	70	Road usage tax on petrol	5,575	5,100	5,600	5,700
	71	Road usage tax on auto diesel	9,850	9,900	10,600	10,900
	72	Road usage tax on natural gas and LPG	4	8	5	7
5541	70	Electricity tax	10,884	11,100	11,400	11,000

5542		Tax on mineral oils, etc.				
	70	Base tax on mineral oils, etc.	1,815	1,700	1,900	1,850
	71	Tax on lubricating oils, etc.	109	115	118	120
5543		Environmental tax on mineral products, etc.				
	70	CO_2 tax	7,093	7,939	8,600	8,700
	71	Sulphur tax	18	10	6	6
5547		Tax on chemicals that are harmful to health and the environment				
	70	Trichloroethene (TRI)	0	1	1	1
	71	Tetrachloroethene (PER)	1	1	1	1
5548	70	Tax on hydrofluorocarbons (HFC) and perfluorocarbons (PFC)	429	560	350	370
5549	70	Tax on the emission of NO_X	52	50	52	54
5550	70	Environmental tax on pesticides	39	65	65	65
5551		Tax relating to the minerals industry				
	70	Tax relating to subsea natural resources other than petroleum	1	1	1	1
	71	Tax relating to the right to explore and extract minerals pursuant to the Minerals Act	3	2	2	2
5555	70	Tax on chocolate and sugar products, etc.	1,411	2,520	2,200	1,500
5556	70	Tax on non-alcoholic beverages, etc.	2,091	3,170	2,900	3,050
5557	70	Tax on sugar, etc.	206	210	200	210
5559		Tax on beverage packaging				
	70	Base tax on disposable packaging	1,834	1,950	1,900	1,980
	71	Environmental tax on cartons	48	40	55	55
	72	Environmental tax on plastics	34	35	37	40
	73	Environmental tax on metals	9	10	11	10
	74	Environmental tax on glass	74	80	82	85
5561	70	Air passenger tax	1,813	1,850	1,950	2,040
5562	70	Parimutuel betting tax	-	135	135	135
5565	70	Stamp duty	9,259	9,300	9,300	9,700
		Sectoral taxes[2]	3,536	3,429	3,435	3,586
5583	70	Taxes on frequencies, etc.	292	294	293	302
5584	70	Abolished taxes	4	-	-	-
5700		National Insurance Scheme revenues				
	71	Employee's social security contributions	137,747	144,613	144,600	150,700

	72	Employer's social security contributions	175,773	182,205	183,100	191,800
Total taxes via the fiscal budget……..			1,014,754	1,065,010	1,101,787	1,194,587

[1] From 2019 taxes from personal taxpayers, before 2019 also including corporate taxes.
[2] This is a composite item for sectoral taxes under the different ministries, relevant to various chapters and items. See Table 15.1 for a detailed overview.

Source: Ministry of Finance.

Table 1.3 presents booked effects of new proposals for rule changes in 2019, specified by chapter and item.

Table 1.3 Estimated booked revenue effects of the tax proposal for 2019, specified by chapter and item. Calculated relative to the benchmark system for 2019. NOK million

Chapter	Item	Description	Change
5501		Taxes on wealth and income[1]	
	70	Bracket tax, net wealth tax, etc.	7,444
	72	Central government tax[2]	-8,663
	73	Tax on accumulated liabilities in shipping companies	0
	74	Corporate tax	414
5502		Financial Activity Tax	
	70	Tax on wages	0
	71	Tax on profits	36
5507		Taxes on petroleum extraction[3]	
	71	Ordinary tax on wealth and income	0
	72	Special tax on petroleum income	0
	74	Area fee, etc.	0
5508	70	Tax on the emission of CO_2 in petroleum activities on the continental shelf	0
5509	70	Tax on the emission of NO_X in petroleum activities on the continental shelf	0
5511		Customs revenues	
	70	Customs duties	0
	71	Auction revenue from customs quotas	0
5521	70	Value added tax	0
5526	70	Tax on alcoholic beverages	0
5531	70	Tax on tobacco products, etc	0
5536		Tax on motor vehicles, etc.	
	71	Motor vehicle registration tax	54

	72	Annual motor vehicle tax	0
	73	Annual weight-based tax	0
	75	Re-registration tax	0
5538		Road usage tax on engine fuel	
	70	Road usage tax on petrol	0
	71	Road usage tax on auto diesel	215
	72	Road usage tax on natural gas and LPG	2
5541	70	Electricity tax	-502
5542		Tax on mineral oils, etc.	
	70	Base tax on mineral oils, etc.	0
	71	Tax on lubricating oils, etc.	0
5543		Environmental tax on mineral products, etc.	
	70	CO_2 tax	1
	71	Sulphur tax	0
5547		Tax on chemicals that are harmful to health and the environment	
	70	Trichloroethene (TRI)	0
	71	Tetrachloroethene (PER)	0
5548	70	Tax on hydrofluorocarbons (HFC) and perfluorocarbons (PFC)	0
5549	70	Tax on the emission of NO_X	0
5550	70	Environmental tax on pesticides	0
5551		Tax relating to the minerals industry	
	70	Tax relating to subsea natural resources other than petroleum	0
	71	Tax relating to the right to explore and extract minerals pursuant to the Minerals Act	0
5555	70	Tax on chocolate and sugar products, etc.	-900
5556	70	Tax on non-alcoholic beverages, etc.	0
5557	70	Tax on sugar, etc.	0
5559		Tax on beverage packaging	
	70	Base tax on disposable packaging	0
	71	Environmental tax on cartons	0
	72	Environmental tax on plastics	0
	73	Environmental tax on metals	0
	74	Environmental tax on glass	0
5561	70	Air passenger tax	0

5565	70	Stamp duty	0
		Sectoral taxes and overpriced fees[4]	-26
5583	70	Tax on frequencies, etc.	4
5700		National Insurance Scheme revenues	
	71	Employee's social security contributions	134
	72	Employer's social security contributions	50
Total changes in taxes and revenues via the fiscal budget…….....			-1,737

[1] The effects apply to central government and local government. Reference is made to Section 5.8 for a discussion of local government tax rates.

[2] From 2019 this item applies to personal taxpayers.

[3] The adjustment of the petroleum tax has no effect on the net present value of future tax revenues. Revenues are reduced by NOK 150 million accrued and NOK 75 million booked in 2019. Transfers to the Government Pension Fund Global are reduced correspondingly. Consequently, the room for manoeuvre in the budget for 2019 is not affected by this change.

[4] Reference is made to Table 1.1 for a specification of which sectoral taxes are being changed.

Source: Ministry of Finance.

1.5 Distributional profile of the tax proposal

The tax system has a distributional effect as a result, inter alia, of average tax increasing with income. The dividend tax, which was introduced upon the tax reform in 2006, serves to increase average tax as a percentage of income for the highest income groups, cf. Section 2.6.

The Government's tax policy is characterised by growth-promoting reductions that have benefited large groups of the population. Distributional effects in the somewhat longer term, when the implications of the proposal have been fully phased in, are likely to differ significantly from distributional effects in the 2019 fiscal year. The analyses presented below quantify the very short-term distributional effects.

The Government's tax proposal for 2019 provides tax reductions for broad population groups. About 87 percent of taxpayers will experience lower or more or less unchanged tax under the proposal, whilst about 13 percent of taxpayers will pay more tax. The portion of individuals paying more tax is largest in the groups with the highest incomes, primarily as the result of higher tax on dividends. The calculations do not take the distributional effects of lower corporate tax into account. A large portion of individuals in the lowest income groups will experience more or less unchanged tax. This needs to be considered in the context that these individuals pay relatively little tax. Overall, it is estimated that about 1.3 percent of taxpayers will experience a tax increase in excess of NOK 2,000. Their average gross income is NOK 1.7 million and their average tax increase is just over NOK 8,800.

The calculations encompass all changes in the income and net wealth taxation of individuals which it is possible to include in the Statistics Norway tax model LOTTE-Skatt, representing total net tax reductions of NOK 1.5 billion accrued. The calculations on the effects of the tax proposal on various groups compare the tax implied by the Government's proposal with the tax implied by the benchmark system for 2019.

Some of the proposals concerning tax on income for individuals could not be included in the distributional calculations. This applies to changes in tax-exemption rates for food allowances, the travel allowance, closing of the tax limitation rule for tax payers with low taxability, capping of tax-exempted employee discounts, taxation of gratuities and tax-favoured pension savings for the self-

employed. These proposals increase net revenues by about NOK 0.2 billion accrued in 2019. Moreover, the effects resulting from changes in business taxation, indirect taxes, sectoral taxes and overpriced fees are not taken into consideration.

The calculations of distributional effects are made on current tax bases. The estimates must therefore be interpreted as the short-term effects. It is a challenge that the presentation of estimates which only encompass short-term distributional effects do not enable quantification of the effects of adjustments over time. A main objective of the Government's tax policy has been to make it more profitable to invest, work and save. A number of tax changes will result in adjustments of distributional relevance over time. There is a risk that measures whose effects can readily be calculated get too much attention, to the detriment of positive effects of a tax policy that expands investment and labour supply. Such effects will materialise gradually and are not as readily quantifiable.

There is thus a difference between distributional effects in the somewhat longer run, when the overall implications of a tax change have materialised, and in the very short run for any given fiscal year. Hence, tax changes that stimulate labour supply may promote increased equality. Lower marginal tax rates and closing of tax limitation for tax payers with low taxability to new users strengthen work incentives and will over time contribute to more equal distribution if more people enter the labour force. Corporate tax reductions will to begin with accrue to the owners, by way of an increase in profits. However, it is reasonable to assume that such corporate tax reductions will over time result in higher investment. Higher investment will contribute to making labour more productive, thereby resulting in higher real wages. Consequently, it is reasonable to assume that part of the corporate tax reductions will over time accrue to the employees.

Table 1.4 shows the average short-term impact of the changes to the taxation of individuals proposed by the Government for 2019 on various groups. About half of the tax reductions will accrue to individuals with a gross income of less than NOK 600,000.

The average tax reduction is about 0.1 percent of gross income. The average tax reduction, as measured in Norwegian kroner, is fairly similar for most income groups, but increasing for incomes in excess of NOK 750.000. The reductions for the topmost income groups are predominantly caused by the net wealth tax reductions.

The average tax reduction across all individuals is about NOK 300, of which the reduction in net wealth tax accounts for about NOK 200. Both the basic allowance of the net wealth tax and the valuation discount for shares and operating assets is increased under the proposal.

Table 1.4 Estimated distributional effects of changes to personal taxation for all individuals aged 17 years or more. Negative figures represent tax reductions. The estimates have been calculated relative to the benchmark system for 2019

Gross income. NOK	Number of taxpayers	Average tax under the benchmark system. Pct.	Average tax under the benchmark system. NOK	Average tax change. NOK	Change as a percentage of gross income	Of which: average net wealth tax change. NOK
0 – 150,000	541,700	4.8	2,800	0	0.0	0
150,000 – 200,000	227,700	5.7	10,000	-200	-0.1	0
200,000 – 250,000	296,100	8.6	19,300	-200	-0.1	0
250,000 – 300,000	329,200	13.0	35,800	-300	-0.1	0
300,000 – 350,000	350,800	16.4	53,400	-300	-0.1	0
350,000 – 400,000	331,200	18.9	70,900	-300	-0.1	-100
400,000 – 450,000	336,400	20.7	88,200	-300	-0.1	-100
450,000 – 500,000	317,400	22.0	104,600	-300	-0.1	-100
500,000 – 600,000	547,200	23.4	128,300	-300	-0.1	-100
600,000 – 750,000	487,600	25.6	170,100	-400	-0.1	-100
750,000 - 1 million	334,100	28.9	246,600	-700	-0.1	-200
1 million and above	270,800	34.9	572,500	-1,200	-0.1	-1,500
Total	4,370,200	24.5	118,300	-300	-0.1	-200

Sources: Ministry of Finance and the Statistics Norway tax model, LOTTE-Skatt.

The tax changes are favourable for the self-employed as a group. Aggregate tax reductions for this group will be about NOK 170 million. This represents an average tax reduction of about NOK 1,600, of which NOK 500 can be attributed to the net wealth tax reductions.

Aggregate tax reductions for wage earners as a group are estimated to be about NOK 925 million. This corresponds to an average tax reduction of NOK 400, of which about NOK 200 takes the form of net wealth tax reduction.

Those on retirement pension will obtain an aggregate tax reduction of about NOK 180 million. This corresponds to an average tax reduction of about NOK 200, of which almost 90 percent can be attributed to the net wealth tax reductions.

Recipients of social benefits will obtain an aggregate tax reduction of close to NOK 200 million. This corresponds to an average tax reduction of almost NOK 400, of which the net wealth tax reductions only account for a minor portion.

Some of the proposals pertaining to tax on income for individuals are not included in the distributional calculations, cf. the discussion above. These changes come to an average of about NOK 50 across all taxpayers over the age of 17 years, but said changes cannot be specified by gross income or socioeconomic group.

1.6 Tax rates and thresholds

Table 1.5 shows tax rates, allowances and thresholds in 2018 and the Government's proposals for 2019. The general allowances and thresholds are rounded after adjustment for estimated growth in wages, pensions or prices from 2018 to 2019. The increases may therefore deviate somewhat from the level of the various growth estimates. Wage growth is estimated at 3.25 percent, consumer price growth at 1.5 percent and growth in the ordinary retirement pension at 2.5 percent. Reference is also made to the proposed tax decisions in this report and to the overview of allowances and thresholds on the Ministry's website.

Table 1.5 Tax rates, allowances and thresholds in 2018 and proposals for 2019

	2018 rules	Proposal 2019	Change 2018 – 2019
Tax on ordinary income			
Individuals[1]	23 pct.	22 pct.	-1 pct. point
Corporations[2]	23 pct.	22 pct.	-1 pct. point
Tax on resource rent industries			
Petroleum (special tax)[3]	55 pct.	56 pct.	1 pct. point
Hydropower (tax on resource rent)	35.7 pct.	37.0 pct.	1.3 pct. points
Bracket tax			
Bracket 1			
Threshold	NOK 169,000	NOK 174,500	3.3 pct.
Rate	1.4 pct.	1.9 pct.	0.5 pct. points
Bracket 2			
Threshold	NOK 237,900	NOK 245,650	3.3 pct.
Rate	3.3 pct.	4.2 pct.	0.9 pct. points
Bracket 3			
Threshold	NOK 598,050	NOK 617,500	3.3 pct.
Rate[4]	12.4 pct.	13.2 pct.	0.8 pct. points
Bracket 4			
Threshold	NOK 962,050	NOK 993,300	3.3 pct.
Rate	15.4 pct.	16.2 pct.	0.8 pct. points
Employee's social security contributions			
Lower threshold for the payment of employee's social security contributions	NOK 54,650	NOK 54,650	-

Levelling rate	25 pct.	25 pct.	-
Rate			
Wage income	8.2 pct.	8.2 pct.	-
Fishing, hunting and childcare[5]	8.2 pct.	8.2 pct.	-
Income from other self-employment	11.4 pct.	11.4 pct.	-
Pension income, etc.	5.1 pct.	5.1 pct.	-
Rate on the gross income of foreign employees (withholding tax)	-	25 pct.	new
Employer's social security contributions			
Zone I	14.1 pct.	14.1 pct.	-
Zone Ia[6]	14.1/10.6 pct.	14.1/10.6 pct.	-
Zone II	10.6 pct.	10.6 pct.	-
Zone III	6.4 pct.	6.4 pct.	-
Zone IV	5.1 pct.	5.1 pct.	-
Zone IVa	7.9 pct.	7.9 pct.	-
Zone V	0 pct.	0 pct.	-
Maximum effective marginal tax rates			
Wage income, excl. employer's social security contributions	46.6 pct.	46.4 pct.	-0.2 pct. points
Wage income, incl. employer's social security contributions	53.2 pct.	53.0 pct.	-0.2 pct. points
Pension income[7]	43.5 pct.	43.3 pct.	-0.2 pct. points
Income from self-employment[8]	49.8 pct.	49.6 pct.	-0.2 pct. points
Dividends[8]	46.6 pct.	46.7 pct.	0.1 pct. points
Personal allowance	NOK 54,750	NOK 56,550	3.3 pct.
Basic allowance for wage income			
Rate	45 pct.	45 pct.	-
Lower limit	NOK 4,000	NOK 4,000	-
Upper limit[9]	NOK 97,610	NOK 100,800	3.3 pct.

Basic allowance for pension income			
Rate	31 pct.	31 pct.	-
Lower limit	NOK 4,000	NOK 4,000	-
Upper limit	NOK 83,000	NOK 85,050	2.5 pct.
Special wage income allowance[10]	NOK 31,800	NOK 31,800	-
Special allowance for single parents	NOK 51,804	NOK 51,804	-
Special tax credit for pensioners			
Maximum amount	NOK 29,950	NOK 30,000	0.2 pct.
Downscaling, bracket 1			
Threshold	NOK 193,250	NOK 198,200	2.6 pct.
Rate	15.3 pct.	15.3 pct.	-
Downscaling, bracket 2			
Threshold	NOK 290,700	NOK 297,900	2.5 pct.
Rate	6 pct.	6 pct.	-
The tax limitation rule			
Levelling rate	55 pct.	55 pct.	-
Tax-exempted net income			
Single person	NOK 147,450	NOK 147,450	-
Married person	NOK 135,550	NOK 135,550	-
Net wealth supplement			-
Rate	1.5 pct.	1.5 pct.	-
Single person	NOK 200,000	NOK 200,000	-
Married person	NOK 100,000	NOK 100,000	-
Special allowance in Finnmark and North Troms	NOK 15,500	NOK 15,500	-
Seamen's allowance			
Rate	30 pct.	30 pct.	-
Upper limit	NOK 80,000	NOK 80,000	-

Fishermen's allowance			
Rate	30 pct.	30 pct.	-
Upper limit	NOK 150,000	NOK 150,000	-
Special allowance for income from self- employment in agriculture, etc.			
Income-independent allowance	NOK 63,500	NOK 63,500	-
Rate applicable to amounts in excess of the income-independent allowance	38 pct.	38 pct.	-
Maximum overall allowance	NOK 166,400	NOK 166,400	-
Special allowance for high expenses due to illness[11]			
Lower limit	NOK 9,180	NOK 9,180	-
Maximum annual allowance for payments to individual pension schemes[12]	NOK 40,000	NOK 40,000	-
Allowance for travel between home and work			
Rate per km	NOK 1.56/0.76	NOK 1.56/0.76	-
Lower allowance limit	NOK 22,350	NOK 22,700	1.6 pct.
Maximum allowance for donations to charities..	NOK 40,000	NOK 40,000	-
Maximum value of tax-exempted employee discounts	-	NOK 7,000	new
Maximum allowance for paid trade union subscriptions, etc.	NOK 3,850	NOK 3,850	-
Home investment savings scheme for people below the age of 34 years (BSU)			
Tax deduction rate	20 pct.	20 pct.	-
Maximum annual saving	NOK 25,000	NOK 25,000	-

Maximum total savings in the scheme.....	NOK 300,000	NOK 300,000	-
Parental allowance for documented childcare expenses			
Upper limit			
One child.....	NOK 25,000	NOK 25,000	-
Supplement per additional child	NOK 15,000	NOK 15,000	-
Net wealth tax[13]			
Local government			
Threshold	NOK 1,480,000	NOK 1,500,000	1.4 pct.
Rate	0.7 pct.	0.7 pct.	-
Central government.....			
Threshold	NOK 1,480,000	NOK 1,500,000	1.4 pct.
Rate	0.15 pct.	0.15 pct.	-
Valuation discounts[14]			
Primary dwellings	75 pct.	75 pct.	-
Secondary dwellings (and associated debt)	10 pct.	10 pct.	-
Shares and operating assets (incl. commercial property) and associated debt.....	20 pct.	25 pct.	5 pct. points
Financial Activity Tax			
Financial Activity Tax on wages	5 pct.	5 pct.	-
Depreciation rates			
Asset group a (office equipment, etc.).....	30 pct.	30 pct.	-
Asset group b (acquired goodwill).....	20 pct.	20 pct.	-
Asset group c (heavy goods vehicles, lorries, buses, vans, etc.)[15].....	24/30 pct.	24/30 pct.	-
Asset group d (passenger cars, machinery and equipment, etc.).....	20 pct.	20 pct.	-
Asset group e (ships, vessels, rigs, etc.).....	14 pct.	14 pct.	-
Asset group f (aircraft, helicopters).....	12 pct.	12 pct.	-

Asset group g (facilities for the transmission and distribution of electricity and electrotechnical equipment in power companies)	5 pct.	5 pct.	-
Asset group h (buildings and installations, hotels, etc.)[16, 17]	4 (6/10) pct.	4 (6/10) pct.	-
Asset group i (office buildings)	2 pct.	2 pct.	-
Asset group j (technical facilities in office buildings and other commercial buildings).....	10 pct.	10 pct.	-

[1] The rate will be reduced from 19.5 pct. in 2018 to 18.5 pct. in 2019 for taxpayers in North Troms and Finnmark.
[2] Tax on ordinary income for undertakings subject to Financial Activity Tax is 25 pct. in 2018 and is maintained at the same level in 2019.
[3] The uplift in the special tax is reduced from 5.3 pct. in 2018 to 5.2 pct. in 2019.
[4] The rate in 2018 is 10.4 pct. in bracket 3 for taxpayers in North Troms and Finnmark, and will be increased to 11.2 pct. in 2019.
[5] Income from self-employment within fishing and hunting, as well as childminding in own home (children below the age of 12 years or with special care and nursing needs) is subject to an 8.2 pct. social insurance contribution. A lower social insurance rate for hunting and fishing has to do with the fact that these industries pay a product tax intended to, inter alia, make up the difference between the 8.2 pct. and the 11.4 pct. social insurance contribution rates.
[6] Employer's social security contribution shall be paid in Zone 1a at a rate of 10.6 pct. until the difference between the employer's social security contribution paid at this rate by the enterprise and what employer's social security contribution such enterprise would have paid at a rate of 14.1 pct. equals the *de minimis* amount. The rate of 14.1 pct. shall be applied to any contribution base in excess thereof. In 2019, the threshold amount is NOK 500,000 per enterprise. The threshold amount is NOK 250,000 for cargo transport by road in Zone 1a.
[7] For individuals who fall within the scope of the special tax credit for pensioners, the maximum effective marginal tax rate may be up to 46.6 pct.
[8] Includes corporate tax and upwards adjustment factor for dividends, etc. In 2018, the corporate tax is 23 pct. and the upwards adjustment factor for dividends, etc., is 1.33. In 2019, the corporate tax under the Government's proposal is 22 pct. and the upwards adjustment factor for dividends, etc., is 1.44.
[9] The sum of the basic allowance for wage income and the basic allowance for pension income shall not exceed the maximum basic allowance for wage income, i.e. NOK 100,800 for 2019.
[10] A taxpayer earning wage income only qualifies for the higher of the basic allowance for wage income and the special wage income allowance.
[11] The special allowance for high expenses due to illness will be continued as per the 2018 rules.
[12] A new tax-favoured individual pension savings scheme was introduced in connection with the Revised National Budget for 2017. The maximum deduction under this scheme is NOK 40,000. The old IPS scheme is continued with a maximum deduction of NOK 15,000 (coordinated with contributions under the new scheme, such as to cap the overall deduction at NOK 40,000) for those already saving under that scheme.
[13] The thresholds apply to single taxpayers. For married couples who are assessed jointly for joint assets, the threshold is twice the level specified in the table.
[14] The valuation discounts apply to assets owned directly by persons liable to pay net wealth tax.
[15] The ordinary depreciation rate for asset group c is 24 pct., with a higher rate of 30 pct. for vans that are exclusively running on electricity.
[16] Buildings with a design so simple that their economic life must be assumed not to exceed 20 years can be depreciated at a rate of 10 pct. The 10 pct. rate also applies to installations whose economic life must be assumed not to exceed 20 years.
[17] Agricultural buildings for livestock can be depreciated at a higher rate of 6 pct.

Source: Ministry of Finance.

Table 1.6 shows current rates of value added tax and excise duties, as well as rate proposals for 2019. Basically, all excise duties have been adjusted upwards by 1.5 percent to account for anticipated inflation. Minor deviations may be due to rounding of the rates. Reference is also made to the decision on indirect taxes in this proposition.

Table 1.6 Rates of indirect tax in 2018 and proposed rates for 2019

Tax category	2018 rules	Proposal 2019	Change in percent
Value added tax, pct. of sales value			
Standard rate	25	25	-
Reduced rate	15	15	-
Low rate	12	12	-
Tax on alcoholic beverages			
Spirits-based beverages in excess of 0.7 pct. alcohol by volume, NOK/pct. alcohol and litre	7.58	7.69	1.5
Other alcoholic beverages, from 4.7 to 22 pct. alcohol by volume, NOK/pct. alcohol and litre	4.94	5.01	1.4
Other alcoholic beverages, up to 4.7 pct. alcohol by volume, NOK/litre			
a) 0.0 – 0.7 pct. alcohol by volume	-	-	-
b) 0.7 – 2.7 pct. alcohol by volume	3.39	3.44	1.5
c) 2.7 – 3.7 pct. alcohol by volume	12.74	12.93	1.5
d) 3.7 – 4.7 pct. alcohol by volume	22.07	22.40	1.5
Tax on tobacco products			
Cigars, NOK/100 grams	259	263	1.5
Cigarettes, NOK/100 units	259	263	1.5
Smoking tobacco, NOK/100 grams	259	263	1.5
Snuff, NOK/100 grams	105	107	1.9
Chewing tobacco, NOK/100 grams	105	107	1.9
Cigarette paper, NOK/100 units	3.96	4.02	1.5
Motor vehicle registration tax			
Passenger cars, etc. Tax group a[1]			
Weight, NOK/kg			

first 500	0	0	-
next 700 kg	25.04	25.42	1.5
next 200 kg	62.41	63.35	1.5
next 100 kg	195.03	197.96	1.5
remainder	226.83	230.23	1.5
NO_X emissions, NOK per mg/km	72.06	73.14	1.5
CO_2 emissions, NOK per g/km			
first 70 g/km	0	0	-
next 25 g/km	929.34	943.28	1.5
next 30 g/km	1,041.42	1,057.04	1.5
next 70 g/km	2,728.96	2,769.89	1.5
remainder	3,505.00	3,557.58	1.5
allowance for emissions below 70 g/km, applies down to 40 g/km and only to vehicles emitting less than 70 g/km	952.20	966.48	1.5
allowance for emissions below 40 g/km, only applicable to vehicles emitting less than 40 g/km	1,120.29	1,137.09	1.5
Vans class 2. Tax group b,[2]			
weight, pct. of passenger car tax	20	20	-
NO_X emissions, pct. of passenger car tax	75	75	-
CO_2 emissions, pct. of passenger car tax	variable	variable	-
Campervans. Tax group c,[3]			
pct. of passenger car tax	22	22	-
Weasels. Tax group e,			
pct. of value tax base	36	36	-
Motorbikes. Tax group f,[4]			
Piston displacement tax, NOK/cm^3			
first 125 cm^3	0	0	-
next 775 cm^3	34.14	28.76	-15.8
remainder	74.86	63.06	-15.8
CO_2 emissions, NOK per g/km			
first 70 g/km (75 g/km in 2018)	0	0	-
next 60 g/km (65 g/km in 2018)	640.08	701.66	9.6

remainder	812.80	923.99	13.7
Snowmobiles. Tax group g			
Weight, NOK/kg			
first 100 kg	14.01	14.22	1.5
next 100 kg	28.02	28.44	1.5
remainder	56.02	56.86	1.5
Engine power, NOK/kW			
first 20 kW	22.50	22.84	1.5
next 20 kW	45.01	45.69	1.5
remainder	90.00	91.35	1.5
Piston displacement, NOK/cm^3			
first 200 cm^3	2.47	2.51	1.6
next 200 cm^3	4.94	5.01	1.4
remainder	9.85	10.00	1.5
Taxi. Tax group h,[5]			
weight, pct. of passenger car tax	40	40	-
NO_X emissions, pct. of passenger car tax	100	100	-
CO_2 emissions, pct. of passenger car tax	variable	100	-
Minibuses. Tax group j,[6]			
pct. of passenger car tax	40	40	-
Traffic insurance tax, NOK/day[7]			
Petrol vehicles and diesel vehicles with a factory-fitted particle filter	7.85	7.97	1.5
Diesel vehicles without a factory-fitted particle filter	9.15	9.29	1.5
Motorbikes	5.46	5.54	1.5
Tractors, mopeds, etc.	1.27	1.29	1.6
Annual weight-based tax, NOK/year	variable	variable	-
Re-registration tax	variable	variable	-

Road usage tax on engine fuel			
Petrol, NOK/litre[8]	5.17	5.25	1.5
Auto diesel, NOK/litre[9]	3.75	3.81	1.6
Bioethanol subject to the sales obligation, NOK/litre	5.17	5.25	1.5
Biodiesel subject to the sales obligation, NOK/litre	3.75	3.81	1.6
Natural gas, NOK/Sm^3	0	0	-
LPG, NOK/kg	2.23	2.98	33.6
Electricity tax, øre/kWh			
Standard rate	16.58	15.83	-4.5
Reduced rate	0.48	0.50	4.2
Base tax on mineral oils, etc.			
Mineral oils, NOK/litre	1.63	1.65	1.2
Mineral oil in the pulp and paper industry, production of dyes and pigments, NOK/litre	0.20	0.21	5.0
Tax on lubricating oils, NOK/litre	2.20	2.23	1.4
CO_2 tax			
Petrol, NOK/litre	1.16	1.18	1.7
Mineral oil			
standard rate, NOK/litre	1.33	1.35	1.5
domestic EU ETS aviation, NOK/litre	1.28	1.30	1.6
domestic aviation, NOK/litre	1.28	1.30	1.6
fishing and catching in inshore waters, NOK/litre	0.29	0.29	-
Domestic use of gas			
natural gas, NOK/Sm^3	1.00	1.02	2.0
LPG, NOK/kg	1.50	1.52	1.3
reduced rate for natural gas, NOK/Sm^3	0.057	0.060	5.3
Continental shelf			
mineral oil, NOK/litre	1.06	1.08	1.5

natural gas, NOK/Sm^3	1.06	1.08	1.5
natural gas emitted to air, NOK/Sm^3	7.30	7.41	1.5
Sulphur tax, NOK/litre	0.131	0.133	1.5
Tax on NOx emissions, NOK/kg	21.94	22.27	1.5
Tax on trichloroethene (TRI) and tetrachloroethene (PER), NOK/kg	72.29	73.37	1.5
Tax on HFC and PFC, NOK/tonne of CO_2 equivalents	500	508	1.6
Tax on chocolate and sugar products, etc., NOK/kg	36.92	20.82	-43.6
Tax on non-alcoholic beverages			
Finished products, NOK/litre	4.75	4.82	1.5
Concentrate (syrup), NOK/litre	28.91	29.34	1.5
Squash and syrup based on fruits, berries or vegetables, without added sugar, NOK/litre	1.70	1.73	1.8
Concentrate (syrup based on fruits, berries or vegetables), without added sugar, NOK/litre	10.32	10.47	1.5
Sugar tax, NOK/kg	7.93	8.05	1.5
Tax on beverage packaging, NOK/units			
Base tax, disposable packaging	1.19	1.21	1.7
Environmental tax			
a) Glass and metals	5.79	5.88	1.6
b) Plastics	3.50	3.55	1.4
c) Cartons and cardboard	1.43	1.45	1.4
Air passenger tax, NOK/passenger[10]	83	84	1.2

Parimutuel betting tax, pct. of gross turnover	3.7	3.7	-
Stamp duty, pct. of sales price	2.5	2.5	-

[1] Group a: Passenger cars, class 1 vans and buses shorter than 6 metres with up to 17 seats. Piston displacement is used as the tax component for vehicles whose CO_2 emissions are not specified.

[2] Group b: Class 2 vans. The highest level of the CO_2 component does not apply to group b, the second-highest level is 25 pct. of the tax on passenger cars and the other levels are 30 pct. of the tax on passenger cars.

[3] Group c: Camper vans. No NO_x component applicable.

[4] Group f: Motorbikes. Vehicles whose CO_2 emissions are not registered are taxed per unit and by engine power, in addition to tax on piston displacement.

[5] Group h: Taxis and vehicles for disabled persons.

[6] Group j: Buses shorter than 6 metres with up to 17 seats, of which at least 10 are forward-facing. The highest level of the CO_2 component does not apply to group j. No NO_X component applicable.

[7] The tax triggered by each insurance policy is calculated on the basis of the tax rates applicable upon commencement of the insurance. For insurance established or annually renewed before 1 March 2018, the 2017 rates shall apply. For insurance established or annually renewed from 1 March 2018 to 28 February 2019, the 2018 rates shall apply. For insurance established or annually renewed after 1 March 2019, the 2019 rates shall apply.

[8] Petrol with a sulphur content of 10 ppm or lower.

[9] Diesel with a sulphur content of 10 ppm or lower.

[10] It is proposed to restructure the tax from a date to be determined by the Ministry, with no net effect on tax revenues, by subjecting air travel to destinations outside Europe to a tax rate of NOK 200, and subjecting other air travel to a tax rate of NOK 75.

Source: Ministry of Finance.

1.7 Allocation of public sector tax revenues

Table 1.7 provides a general overview of the main groups of taxes and shows which part of the public sector receives the revenues from the different groups. In total, tax revenues are estimated at NOK 1,396 billion in 2018, of which about 85 percent accrue to central government, just over 13 percent to local government and about 2 percent to regional government.

Most of local and regional government tax revenues are in the form of income tax and net wealth tax on personal taxpayers. About 35 percent of central government tax revenues are in the form of value added tax, excise duties and customs duties. About 26 percent of central government tax revenues come from personal taxpayers, whilst about 23 percent come from non-personal taxpayers and employer's social security contributions in mainland Norway. About 13 percent of the central government revenues in 2018 are in the form of taxes from the petroleum sector. Other taxes, including the Financial Activity Tax, account for about 4 percent.

Table 1.7 Accrued taxes specified by tax creditors. Estimates for 2018. NOK billion

	Total	Central government	Local government	Regional government
Personal taxpayers	503.6	311.8	158.8	33.0
Tax on ordinary income	284.8	105.1	146.8	33.0
Bracket tax	60.5	60.5	-	-
Employee's social security contributions	143.7	143.7	-	-

Net wealth tax	14.5	2.6	12.0	-
Corporations (whose taxes are payable in arrears)	84.1	82.5	1.4	0.2
Income tax (including power plants).....	83.8	82.2	1.4	0.2
Net wealth tax	0.3	0.3	-	-
Financial Activity Tax.....	3.4	3.4		
Tax on wages.....	2.0	2.0		
Tax on profits	1.4	1.4		
Recurrent tax on immovable property (property tax)	14.0	-	14.0	-
Employer's social security contributions.....	186.0	186.0	-	-
Indirect taxes.....	410.3	410.3	-	-
Value added tax.....	300.0	300.0	-	-
Excise duties and customs duties	110.3	110.3	-	-
Petroleum.....	154.5	154.5	-	-
Tax on income.....	147.5	147.5	-	-
Tax on extraction, etc.	7.0	7.0	-	-
Other direct and indirect taxes	40.5	39.9	0.6	-
Social security and pension premiums, other central government and social security accounts[1]	27.1	27.1	-	-

Tax on dividends for foreign shareholders	3.3	3.3	-	-
Inheritance tax.....	0.0	0.0		
Other direct and indirect taxes[2]	10.2	9.6	0.6	-
Total direct and indirect taxes.....	1,396.4	1,188.4	174.7	33.2
Of which direct taxes.....	986.1	778.1	174.7	33.2

[1] Including the Norwegian Public Service Pension Fund.
[2] Including certain revenue items classified as tax revenues in the national accounts, but not classified as tax revenues in the fiscal budget.

Source: Ministry of Finance.

2 Main features of the Norwegian tax system

2.1 Introduction

Taxes may impede the efficiency of the economy, but are necessary to fund public services and transfers. The tax system should be structured to promote high output and efficient resource allocation. This will serve to minimise the economic loss from taxation. Furthermore, the tax system should not impose unnecessarily high administrative costs on taxpayers and authorities. The tax system serves to redistribute income. Taxes also have a counter-cyclical effect. The tax system contributes to automatic stabilisation of the economy as tax revenues increase during an economic upturn and decline in a downturn. Taxes that put a price tag on negative externalities, such as for example pollution, improve the utilisation of society's resources.

This chapter provides an overview of the main rules under the tax system. The description is based on the rules for 2018. There are also some exceptions from the main rules; so-called tax expenditures. The tax expenditures are discussed in Section 2.7 and outlined in further detail in Appendix 1. Figure 2.1 shows aggregate central, regional and local government tax estimates for 2018. The figure illustrates the data in Table 1.7 and shows that the main sources of tax revenues are tax on ordinary income from individuals, value added tax and employer's social security contributions.

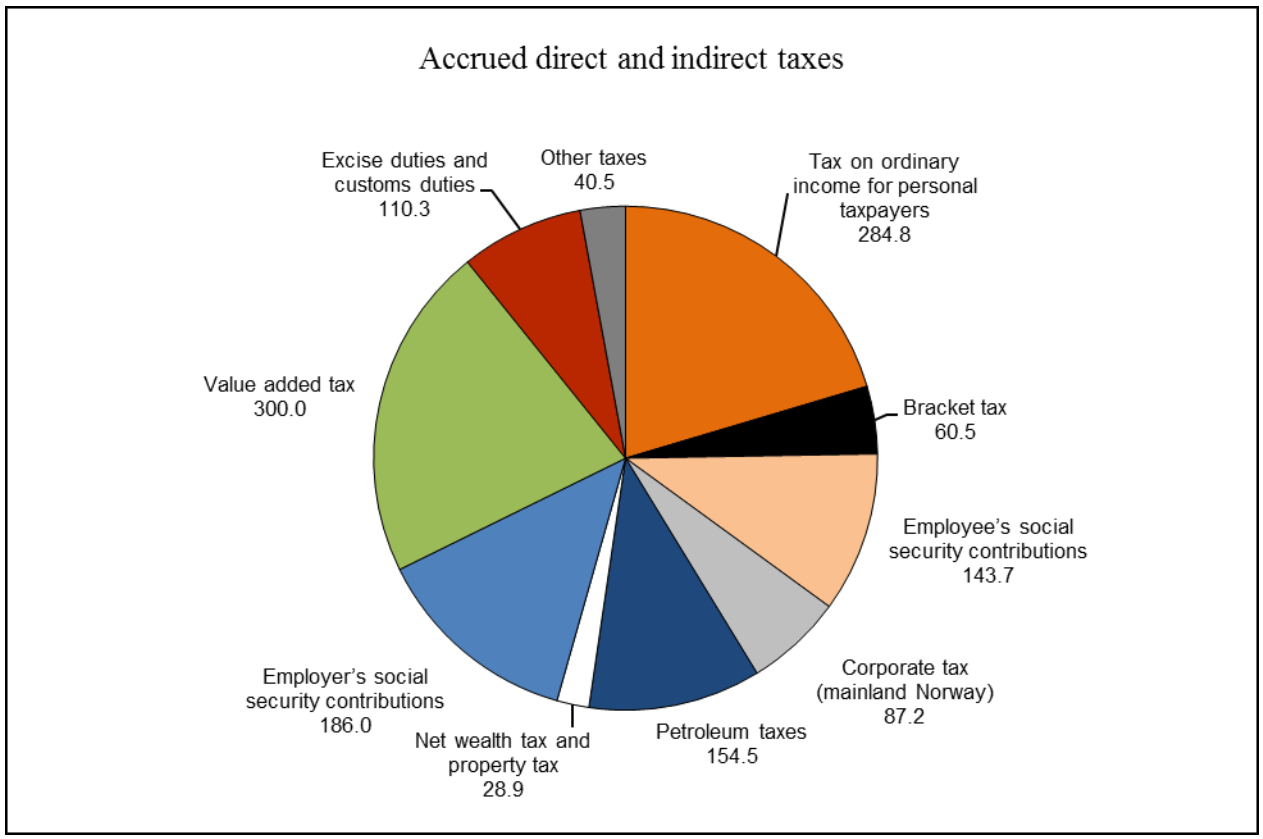

Figure 2.1 Accrued direct and indirect taxes. Central, regional and local government. Estimates for 2018. NOK billion

Source: Ministry of Finance.

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

Direct taxes include, inter alia, income tax from individuals and businesses, employer's social security contributions, net wealth tax and property tax. Direct taxes account for just over 70 pct. of overall tax revenues in 2018. Income tax from individuals, including employee's social security contributions and bracket tax, account for 36 pct. of overall tax revenues, whilst income tax and employer's social security contributions from businesses, including the petroleum industry and Financial Activity Tax, account for just over 30 pct. Tax revenues from mainland enterprises, including employer's social security contributions, account for 22 pct. of tax revenues from the mainland economy.

Indirect taxes include value added tax, excise duties, customs duties and sectoral taxes, and account for 30 pct. of overall tax revenues. Value added tax accounts for 21 pct. of overall tax revenues, whilst excise taxes account for 8 pct. Customs duties are a minor component of the public revenues.

2.2 Guidelines for an efficient tax system

The tax system influences labour supply, consumption, savings and investments. It is therefore important that the tax system is designed on the basis of a set of fundamental principles which enable resources to be allocated as efficiently as possible in the economy. This can be achieved by

- first making use of taxes that promote better resource allocation (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 hydropower sectors); and
- finally using distortionary taxes to achieve sufficient revenues 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 the progressivity of the tax system to actually result in redistribution. The changes to the tax system resulting from the 1992 tax reform and changes in subsequent years, extended the tax base, thus narrowing the gap between taxable income and actual income. The principle of broad tax bases and relatively low rates was maintained in the tax reforms of 2006 and 2016.

Exemptions and special schemes that deviate from the general rules make the tax system less efficient. These can also make the tax system more complex and challenging, for both taxpayers and the Tax Administration. 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 proportionally with tax rate increases. If it is desirable to support a specific activity or specific group, measures on the expenditure side of the budget are often less costly and more targeted. Revenues from individual taxes should, as a main rule, not be targeted for specific forms of expenditure. Such restrictions prevent efficient prioritisation of funds via the expenditure side of the budget.

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 programmes makes it necessary to raise substantial tax revenues. However, some taxes are also intended to serve other important purposes beyond raising government revenues. These include, in particular, income redistribution, as well as health and environmental considerations.

The tax system contributes to redistribution through, inter alia, an increase in the average tax burden as income increases. Taxation of wage income will tend to reduce labour supply, and 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 responsive to changes in hourly wages after tax 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 persistently low income are not working. The tax rules should as far as possible be designed to reduce disincentives to work. The interaction between benefits and tax rules has a major impact on incentives to return to work or to increase working hours for people who receive social security benefits as compensation for (temporary) loss of wage income resulting from health problems or unemployment. One of the tax and welfare policy challenges is balancing income protection considerations against work incentive considerations. This is illustrated in Box 2.1, showing that there may in some cases be little economic gain from working rather than claiming social security benefit.

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 do not work, for various reasons, with a subsistence income. Examples are disability benefits and unemployment benefits. Such benefits are often discontinued, fully or partly, when a person takes up a job, and hence such discontinued benefits 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 a person moves into employment. 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, for example 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 (2016 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 just under 80 pct. of gross wage income when the loss of unemployment benefit is taken into account.

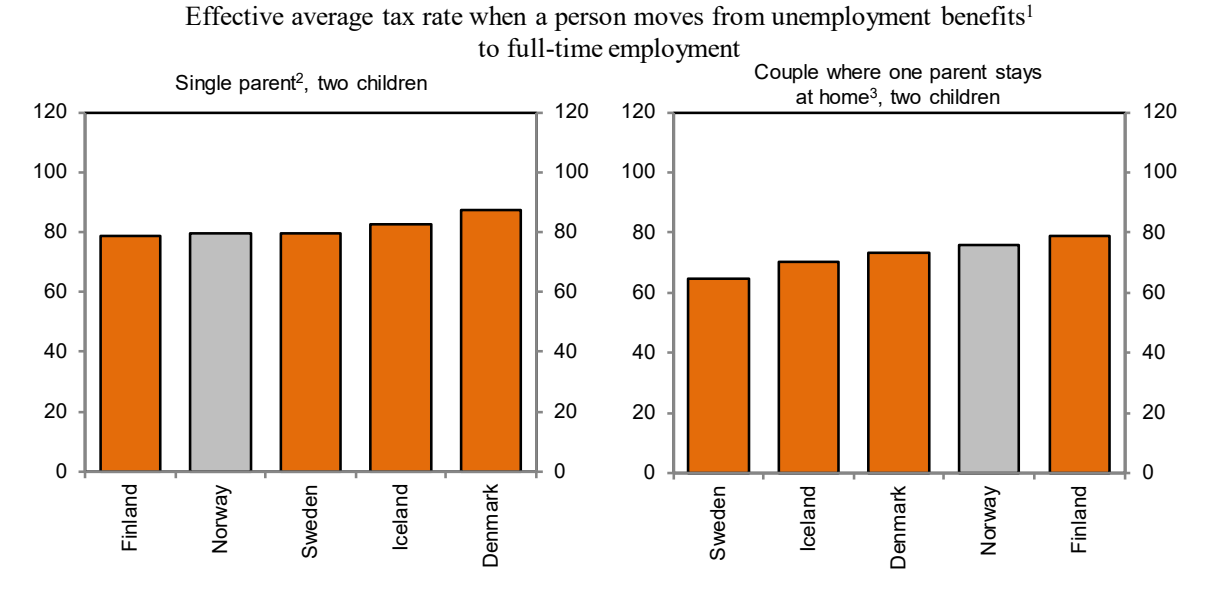

Figure 2.2 Effective average tax rate when a person moves from unemployment benefits to full-time employment. 2016. Percent

[1] The calculations are based on unemployment benefits in the various countries as calculated in OECD Tax and Benefit 2016. The benefit level reflects the payment 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.

Sources: OECD and the Ministry of Finance.

Environmental taxes contribute to more appropriate pricing of environmentally-harmful activities and motivate individuals and companies 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 income as consistent and uniform as possible makes resource allocation less susceptible to, for example, tax-motivated investments. Taxed profits should correspond to actual profits.

Predictability should also be emphasised in business and capital taxation. 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. Revenues for neutral taxes, such as taxes on economic rents, will, when taken in isolation, reduce the need for distorting taxes. Norway levies special taxes on 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 fields in which the State has retained an ownership stake, 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 sectors and differences in their overall tax levels. Such a comparison neither takes account of other revenue sources than tax, nor that the proportion of tax revenues will vary somewhat depending on factors such as the extent to which public pension and social security payments are taxable. The figure shows that the tax level in Norway is higher than the OECD average, but lower than in most other Nordic countries. In the EU, the tax to GDP ratio (weighted average) was more or less on a par with that of Norway in 2016. In Norway, part of the overall expenditure via government budgets is funded by petroleum revenues and fund returns from the Government Pension Fund Global. For 2018, this accounts for just over 13 pct. of overall expenditure via government budgets.

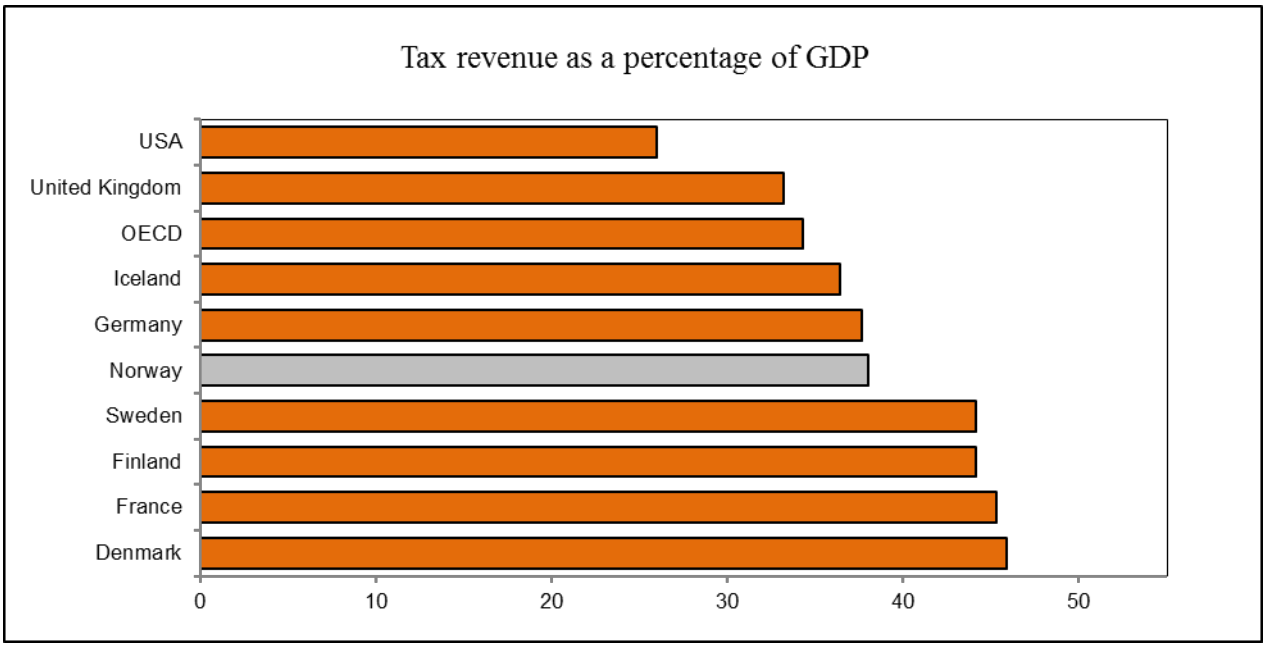

Figure 2.3 Tax revenue as a percentage of GDP in selected countries and the OECD.[1] 2016. Percent

[1] Non-weighted average for the OECD.

Source: OECD Revenue Statistics.

Since 1985, tax revenues in Norway have varied between 38 and 44 pct. of GDP. In Sweden, the tax to GDP ratio has ranged from 43 to 50 pct., whilst it has been between 44 and 51 pct. in Denmark. Over the same period, the average OECD tax revenue share has varied between 32 and 34 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 labour, 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.

Box 2.2 The EEA and tax

There is no obligation under the EEA Agreement to harmonise Norwegian tax rules with EU regulations and directives. Hence, Norway is not required to apply common tax rates with the EU, and we decide ourselves which incomes and transactions to include in our tax bases. The general provisions of the EEA Agreement requiring adherence to the four freedoms and the prohibition against state aid nonetheless place distinct limitations on the substance of Norwegian tax rules. Norway's compliance with these EEA obligations, also in relation to tax, contributes to safeguarding access to the internal market for Norwegian individuals and

corporations on a par with individuals and corporations in the other EEA states. The EFTA Surveillance Authority (ESA) in Brussels and the EFTA Court in Luxembourg have overarching responsibility for monitoring compliance with the EEA Agreement. The ESA may raise matters relating to Norwegian tax rules of its own accord or on the basis of complaints filed with the ESA by Norwegian or non-Norwegian individuals and corporations claiming that a Norwegian tax rule violates EEA law. In addition, the compliance of tax rules with EEA law is enforced through individual cases brought before the Norwegian courts.

The *four freedoms* – the right to free movement of goods, services, capital and persons/establishments – imply that Norway cannot, as a general rule, have rules treating cross-border movements and transactions between Norway and EEA states more restrictively than purely domestic movements and transactions. Such discrimination would be considered a barrier to the freedom of cross-border movement. In the area of indirect taxation, the rules on free movement of goods and services imply that such goods and services must be subject to the same VAT on the Norwegian market, irrespective of whether the goods are produced, or the service provider is established, in Norway or in another EEA state. In the area of direct taxation, the dividend taxation rules provide an example of Norwegian tax legislation having been amended as a result of the EEA Agreement. The free movement of capital and the freedom of establishment implied that Norway could not tax share dividends paid between Norway and other EEA states more heavily than corresponding dividend payments between taxpayers in Norway.

However, Norway may in some cases maintain or introduce rules that would, at the outset, entail an element of discrimination, if there are so-called *justification grounds.* It is primarily the European Court of Justice which has outlined, in case law, which legitimate considerations can justify tax rules that would initially be held to discriminate between domestic and cross-border movements. As far as taxes are concerned, it is especially the need to ensure a balanced allocation of tax revenues between states and to prevent tax avoidance that can justify a restrictive rule. Efficient tax collection is also a relevant consideration. This is conditional upon such restrictive tax rule being appropriate and necessary for purposes of catering to the relevant consideration, and does not go further than is justified by the said consideration.

Norway has for example invoked such justification grounds to tax shareholders who emigrate from Norway on such part of the gain on shares as has accrued whilst the taxpayer was living in Norway, despite the share not having been divested as at the time of emigration. Capital gains tax is, in other words, triggered by the actual cross-border movement in this case, whilst a taxpayer who relocates inside the borders of Norway would not be taxed on the capital gain until actual divestment. The reason why such discrimination is accepted under EEA law is the need to ensure a balanced distribution of the tax base between the EEA states and to prevent tax avoidance. However, although the Norwegian tax authorities may in such cases assess the potential capital gain upon emigration to another EEA state, they cannot automatically request *payment* of the tax at that point in time. The obligation to pay the assessed tax is deferred until the share is actually divested. This ensures that the restrictive tax rule does not go further than is justified by the need for appropriate allocation/prevention of tax avoidance.

Recently, the EU has adopted directives that not only permit, but also *require* member states to introduce tax rules that would generally be considered restrictive. This illustrates that free movement considerations must in certain cases give way to the need to prevent tax avoidance. As mentioned, the EEA Agreement does not require Norwegian rules to be harmonised with these tax directives, but the contents of such directives are important as an indication of how far the considerations behind the four freedoms reach when these come into conflict with the need to prevent tax avoidance.

The *prohibition against state aid* implies that Norway cannot apply tax rules that give individual undertakings, or categories of undertakings, more favourable tax treatment than these are entitled to under the main rule applicable to such undertakings. The background to this is that state aid may have unwanted effects on competition. The prohibition encompasses both preferential treatment of *individual undertakings* and preferential treatment of certain *sectors* or *geographical areas*. The prohibition applies even if state aid is given evenly to both Norwegian and non-Norwegian undertakings, and hence is not conditional upon discrimination.

The specific assessment of whether a tax rule constitutes state aid is performed according to an established procedure under EEA law. It is first assessed whether the tax exemption constitutes an economic advantage, thereafter whether such advantage is selective, i.e. favours certain undertakings or specific categories of undertakings. Furthermore, the advantage must distort competition and affect trade between the EEA states. The selectivity assessment will often turn out to be the most challenging aspect when considering tax rules. The selectivity assessment is conducted in three stages: 1) Identification of the reference system, i.e. what is the main rule? 2) Does the tax rule under assessment entail a derogation from the reference system? and 3) Even if the rule entails a derogation, can it be justified by the general scheme of the reference system?

Even if it is concluded, after such an assessment, that a tax rule represents state aid (i.e. constitutes a selective advantage, distorts competition and affects trade), the EEA Agreement offers scope for nonetheless finding such state aid to be lawful. This is termed «compatible aid». The European Commission and the ESA have laid down supplementary guidelines on what can be considered aid compatible with the EEA Agreement, including aid for regional development, environmental purposes, training purposes, research and development, as well as small and medium-sized enterprises. The guidelines tend to be very comprehensive and stipulate strict conditions and limitations for concluding that such aid can be considered compatible. The Norwegian authorities have to notify the ESA of any tax rules they hold to qualify as compatible aid, and the ESA needs to approve such aid before it can be implemented, pursuant to the guidelines or directly under the provisions of the EEA Agreement. In some cases the notification process may last for a few months, whilst it may take several years in more complex cases. Certain types of aid may, on specific conditions, be reported under a simplified procedure pursuant to the so-called General Block Exemption Regulation. In some cases, the aid may be permitted without notification/reporting, if the criteria for *de minimis* aid are met. Examples of tax rules that have been considered compatible aid are

differentiated employer's social security contributions (regional aid), grants for electrical vehicles (environmental aid) and tax incentives via the Skattefunn scheme for stimulating R&D in businesses (block exempted R&D aid).

Each year, the Ministry of Finance handles a number of tax matters for which the EEA Agreement is of relevance. We conduct meetings and correspondence with, inter alia, the ESA and the European Commission on a regular basis in this regard. This contributes to safeguarding Norway's interests as far as tax is concerned, whilst at the same time ensuring compliance with obligations under the EEA Agreement.

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 tax income bases. Firstly, a flat tax rate of 23 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, social security benefits, pensions, net income from self-employment, taxable income from shares and other forms of capital income), less the basic allowance, deductible losses and expenses such as debt interest, etc., parental allowance and other allowances.

Secondly, the employee's social security contributions and the bracket tax are paid on «personal income», which comprises gross wage income, social security benefits and pension income, without deductions. Imputed personal income for self-employed persons is also included in «personal income».

High-income earners pay a larger proportion of tax on their incomes than do low-income earners. Such progressivity is achieved through the lower threshold for the payment of employee's social security contributions, minimum allowances (basic allowance and personal allowance) and the rate structure of the bracket tax. The bracket tax comprises four brackets, with the rate being stepped up for each bracket tax threshold. Box 2.3 shows how marginal and average tax rates increase with higher wage income. The highest marginal tax rate on wage income, excluding employer's social security contributions, is 46.6 pct. in 2018. If employer's social security contributions are included, the highest marginal tax rate reaches 53.2 pct. of overall wage cost. Figure 2.4 shows the highest marginal tax rate on wage income in selected countries. Employee's social security contributions are included in the figure, whilst employer's social security contributions are excluded. The figure shows that the highest marginal tax rate in Norway is at a comparable level with the highest marginal tax rate in countries such as Germany and the United Kingdom, whilst some of the other Nordic countries have higher marginal tax rates on wage income.

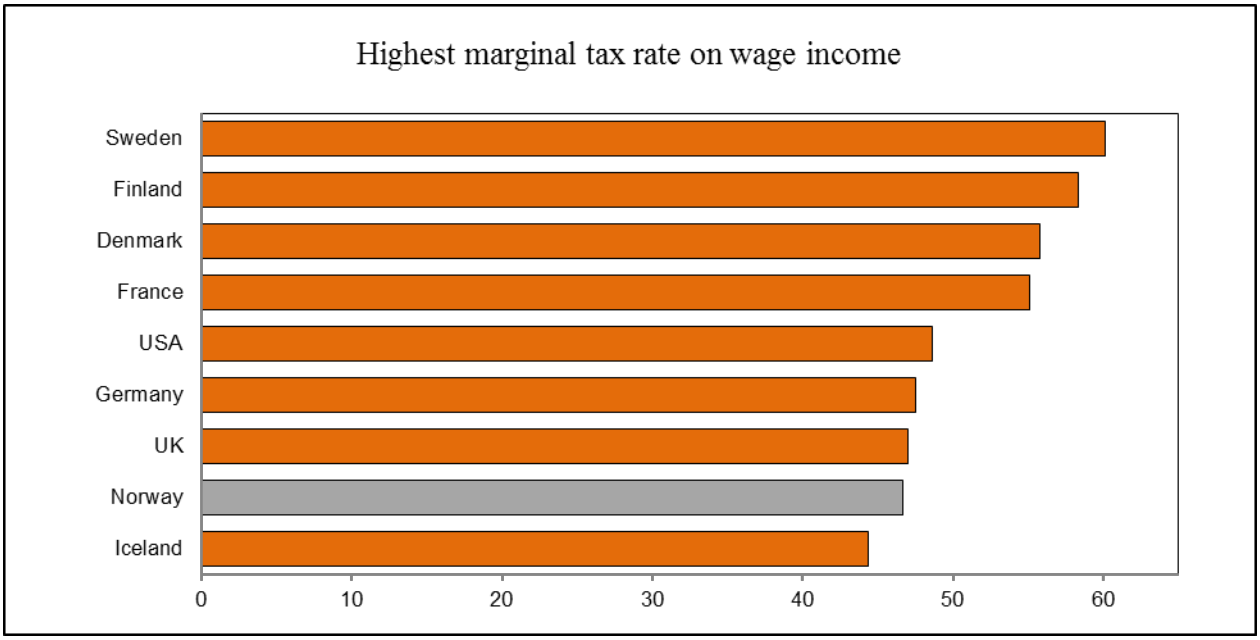

Figure 2.4 Highest marginal tax rate on wage income, excluding employer's social security contributions. Selected countries in 2017. Percent

Source: OECD Tax database.

Box 2.3 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 2018 rules.

Figure 2.5 shows that the marginal tax rate varies with the income level. The tax rate is nil up to the lower threshold for the payment of employee's social security contributions (i.e. the so-called tax-free threshold). Employee's social security contributions are thereafter paid at a levelling rate (25 pct.). The levelling rate is used until it becomes more beneficial to pay employee's social security contributions at the general rate of 8.2 pct. on total wage income. When wage income exceeds the sum of the personal allowance and the basic allowance (45

pct. of income), the taxpayer starts to pay tax on ordinary income (23 pct.). As long as the basic allowance is calculated as a rate of income and the income is below the first bracket tax threshold, the marginal tax rate is 20.85 pct. (8.2 pct. + 23 pct. * (1 – 0.45)). The rate in bracket 1 of the bracket tax increases the marginal tax rate by 1.4 percentage points to 22.25 pct. When the taxpayer has a sufficiently high income to obtain the maximum basic allowance, the marginal tax rate is 32.6 pct. (8.2 pct. + 23 pct. + 1.4 pct.). The marginal tax rate increases to 34.5 pct. in bracket 2, 43.6 pct. in bracket 3 and 46.6 pct. in bracket 4.

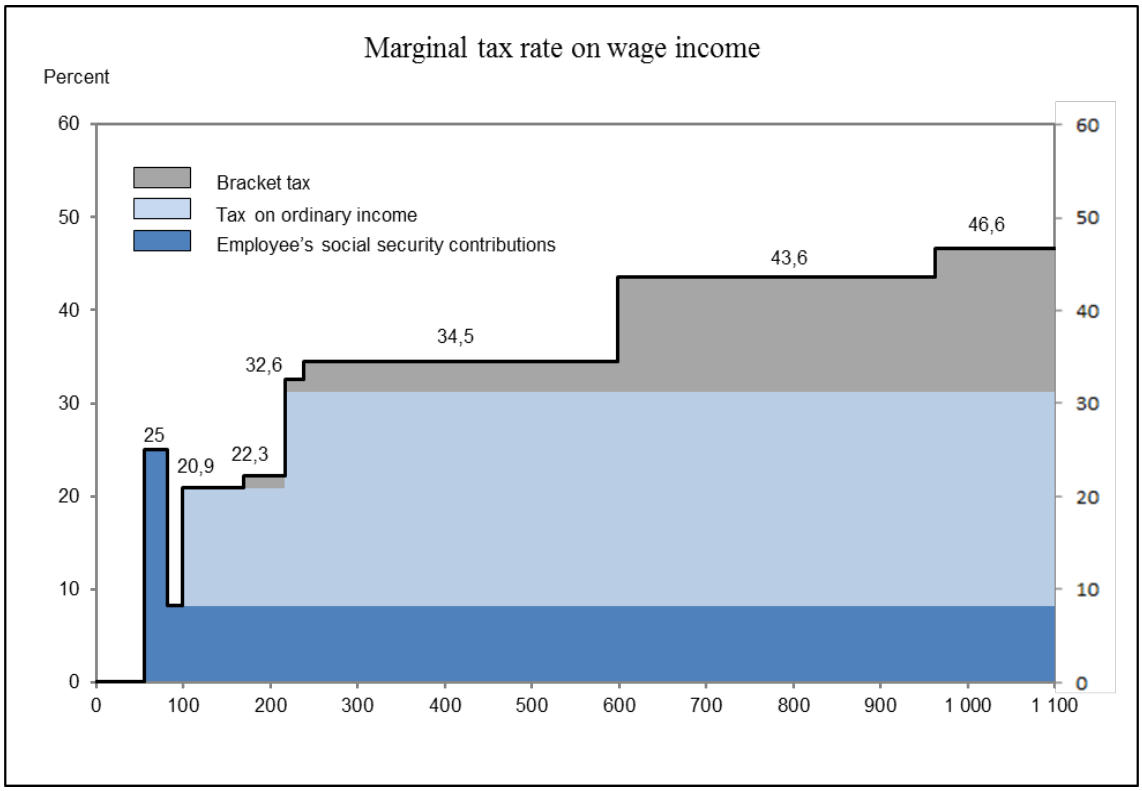

Figure 2.5 Marginal tax rate on wage income (excluding employer's social security contributions) under 2018 rules for a wage earner with only wage income and standard reliefs. NOK thousands

Source: Ministry of Finance.

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

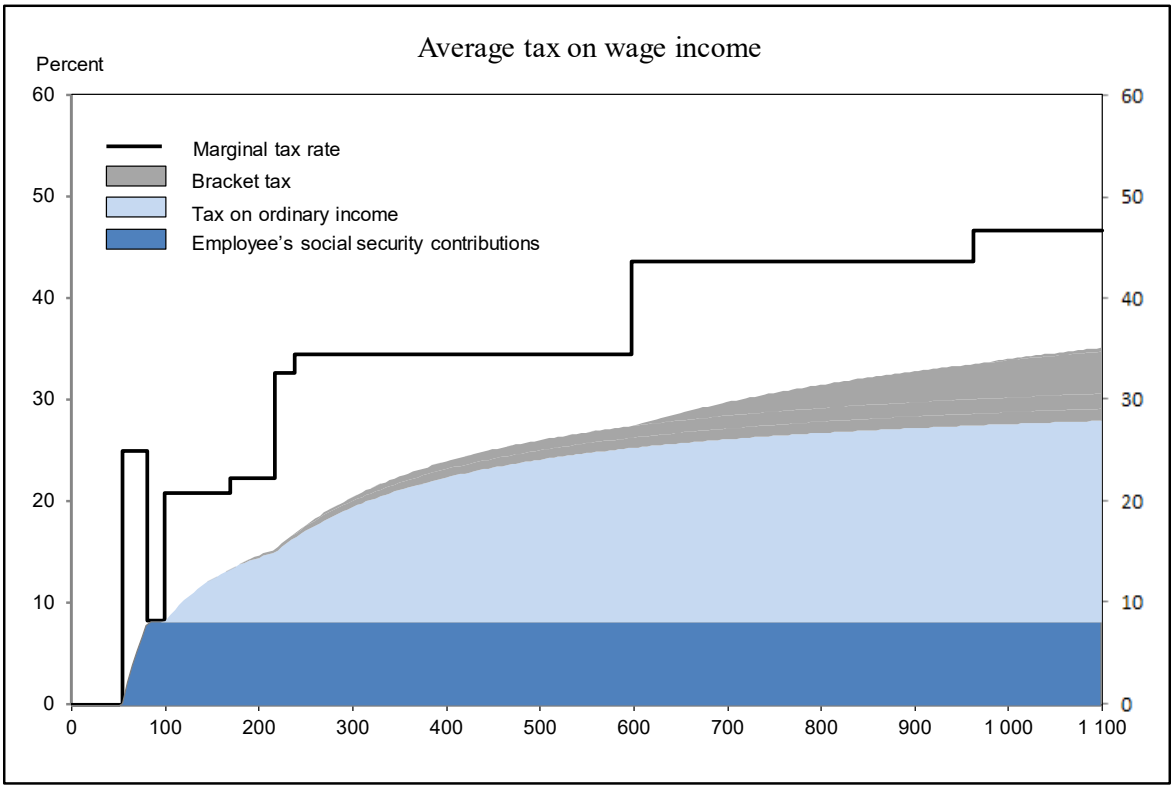

Figure 2.6 Average tax rate on wage income (excluding employer's social security contributions) under 2018 rules for a wage earner with only wage income and standard reliefs. NOK thousands

Source: Ministry of Finance.

Tax on pension income

Special tax rules for pensioners and recipients of some social security benefits result in lower tax payments for these groups than for wage earners. Social security contributions on pensions are lower than on wages. On the other hand, the basic allowance is somewhat lower against pension income than against 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. The tax credit results in no tax being paid on any pension income up to about NOK 197,700 in 2018, which is slightly above the level of the minimum state pension for singles. Total tax paid is lower on pension income than on wage income above that threshold. The tax credit is reduced with regard to pension income when it is above a level more or less corresponding to the minimum state pension, thus implying that the difference between the tax on pension income and the tax on wage income declines when the pension income increases.

Figure 2.7 shows tax, under the 2018 rules, as a proportion of pension income for recipients of contractual early retirement pension (AFP)/ordinary retirement pension and wage income for wage earners. It has been assumed that taxpayers have no other income than wage income and pension income, respectively. It is also assumed that the taxpayers can claim no other deductions than the standard reliefs. The tax on a NOK 300,000 retirement pension represents

13.7 pct. of the pension income, whilst tax as a proportion of the same amount of wage income comes to 20.5 pct.

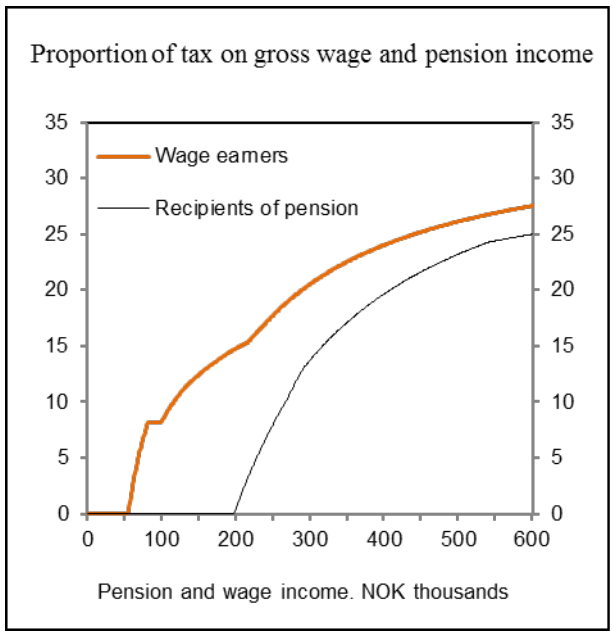

Figure 2.7 Proportion of tax at various gross income levels for wage earners and recipients of contractual early retirement pension (AFP) and ordinary retirement pension, respectively, under the 2018 rules[1]. Percent

[1] It has been assumed that the taxpayers 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.

Tax on income from shares earned by individuals

The shareholder model is intended to ensure that the difference between the highest marginal tax rates on wage income and income from shares is not too large. When the difference between marginal tax rates on income from shares and wage income is large, there is much to be gained from representing what is actually income from work as income from shares in order to reduce one's tax burden (income shifting). In 2018, the difference between the highest marginal tax rates on wages and share dividends is 6.6 percentage points; see Figure 2.8.

The shareholder model implies that income from shares in excess of a risk-free return allowance, earned by personal shareholders, is taxed on the part of the owner. Income from shares in excess of the risk-free return allowance is first multiplied by an upwards adjustment factor, and thereafter added to ordinary income. The upwards adjustment factor was introduced in 2016 to counteract the stronger incentives for income shifting caused when the tax rate on ordinary income was reduced from 27 to 25 percent. For 2018, the upwards adjustment factor is 1.33.

The main purpose of the risk-free return allowance is to prevent distortions in investments and financing decisions as the result of dividend taxation. The risk-free return allowance is calculated by multiplying the risk-free return base, which is the cost of the share plus any unused risk-free return allowance from previous years, by a risk-free rate of return. The risk-free rate of return is the interest rate on three-month Norwegian treasury bills plus 0.5 percentage points.

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 can be deducted against later dividends and gains on the share.

It is, for practical reasons, the owner of a share as at 31 December of any given year who is granted the risk-free return allowance for that 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. Any unused risk-free return allowance will lapse.

A share savings account scheme has been introduced with effect from 1 July 2017, under which gains upon the divestment of shares and fund units are not taxed on an ongoing basis, but only when the funds are withdrawn from the account. Any untaxed gains that are not withdrawn from the account are not included in the basis for the calculation of risk-free return allowance. Hence, the tax deferral is not a tax credit, but is mirrored by higher tax at the time of withdrawal. Share dividends are not deposited in the account, but are paid out on an ongoing basis and taxed directly on the part of the shareholder.

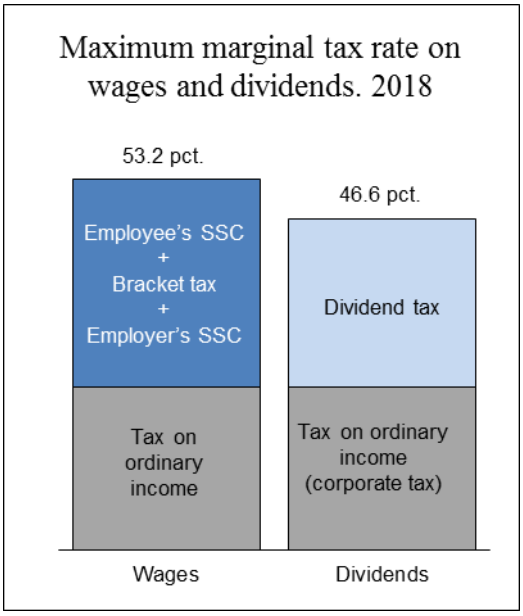

Figure 2.8 Maximum marginal tax rate on wages and dividends under 2018 rules. Percent

Source: Ministry of Finance.

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 the risk-free return allowance shall only be taxed once as ordinary income. This means that there is 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 part of the owners as these 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 bracket tax and social security contributions. Hence, imputed personal income is taxed on an ongoing basis. Income from shares, on the other hand, is not taxed as ordinary income until the time of dividend payment or divestment. 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 social security contributions at a medium rate (like wage earners), but are also subject to a product tax.

2.3.2 Corporate taxation

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

Company profits are taxed as ordinary income at a flat rate of 23 pct. in 2018. 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 costs (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 their 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.

The corporate tax rate in Norway remained unchanged at 28 pct. over the period 1992 – 2013. The rate was reduced to 27 pct. in 2014, thereafter to 25 pct. in 2016, 24 pct. in 2017 and again to 23 pct. in 2018. A corporate tax rate of 23 pct. is more or less in line with the OECD average, but somewhat higher than the average for Sweden, Denmark and Finland; see Figure 2.9.

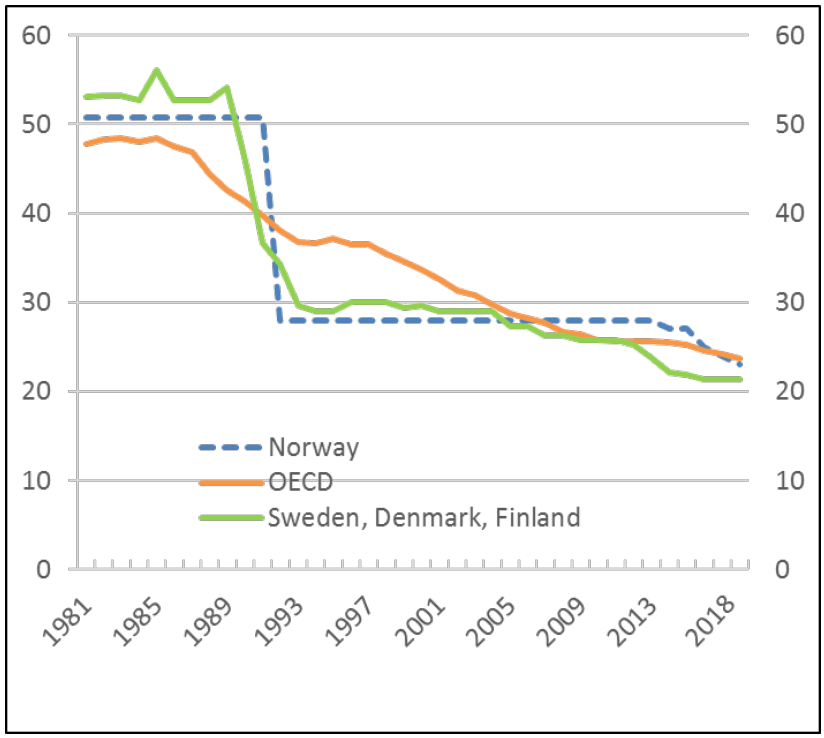

Figure 2.9 Statutory corporate tax rates.[1] 1981 – 2018. Percent

[1] Non-weighted average for Sweden, Denmark and Finland and for the OECD.

Sources: OECD and the Ministry of Finance.

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. The effective rate is lower than the statutory tax rate if there are tax credits on investment returns, 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 calculated effective average and marginal tax rates in selected countries in 2017. 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.). The calculation assumes a hypothetical investment across selected investment opportunities, with such investment being funded partly by equity and partly by debt.

Table 2.1 Statutory and calculated effective corporate tax rates in 2017. Percent

Country	Statutory tax rate	Effective average tax rate	Effective marginal tax rate
Ireland	12.5	14.1	12.3
United Kingdom	19.0	20.5	23.6
Finland	20.0	19.5	18.5
Switzerland	21.1	18.6	12.4
Sweden	22.0	19.4	14.5
Denmark	22.0	20.0	15.4
Norway	24.0	22.7	19.8
The Netherlands	25.0	22.5	16.8
Austria	25.0	23.1	18.8
Spain	25.0	30.1	36.0
Canada	26.7	24.2	21.8
Italy	27.8	23.5	14.8
Greece	29.0	27.6	24.7
Germany	29.8	28.8	23.0
Japan	30.0	34.2	38.2
Belgium	34.0	29.3	18.8
France	34.4	33.4	30.1
United States	38.9	36.5	34.3

Sources: OECD, Centre for European Economic Research (ZEW) (*TAXUD/2013/CC/120, Final Report 2017*).

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 2.10 shows the total statutory marginal tax rate on dividends on the part of companies and their owners in selected countries in 2017.

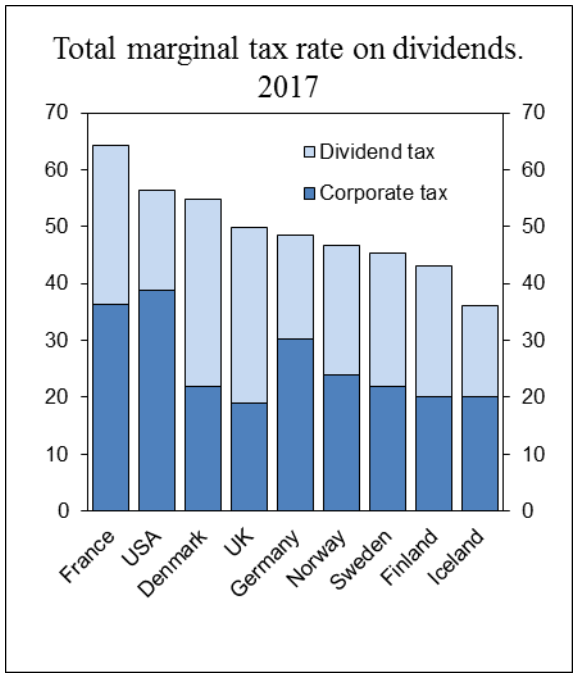

Figure 2.10 Total marginal tax rate on dividends on the part of companies and their owners in selected countries. 2017. Percent

Source: OECD.

Increased cross-border economic integration and investment have made it easier for multinational enterprises to shift profits between countries. A number of countries have introduced especially favourable tax schemes, for example for certain intangible assets, which imply that real effective tax rates can be much lower than indicated in Table 2.1. The OECD and the EU have prepared specific recommendations and plans to counter international tax planning. In follow-up of the tax reform, Norway introduced rule changes intended to prevent profit shifting, both by reducing the corporate tax rate and by targeted measures such as, for example, interest deductibility limitation and initiatives to facilitate the exchange of information with other countries.

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 on top of the ordinary tax on profits. The rate of special tax is 55 pct. in 2018.

In principle, petroleum taxation is based on the rules governing ordinary corporate taxation. However, petroleum taxation differs from ordinary corporate taxation in certain respects. Income from the sale of crude oil is valued at administratively determined norm prices, i.e. tax benchmark prices. Investments are depreciated over six years. In addition, uplift (investment-based extra depreciation) is deducted to determine the special tax base, and this is intended to compensate companies for the fact that the investment cost is not deductible immediately, but only gradually through depreciation. If a company incurs a loss, such loss and any unused uplift can be carried forward with interest. If the company never earns a sufficient taxable profit, the State will refund the tax value of the loss when the company terminates activities on the Norwegian continental shelf. Consequently, the system is designed to give companies certainty with regard to the utilisation of the full value of their tax allowances. Unconditional future tax allowances shall be valued using a risk-free rate of interest, net of ordinary tax. Valued at a risk-free rate of interest, net of ordinary tax, the

value of the investment-based allowances (depreciation, uplift and interest allowances against the special tax) is higher than under a neutral petroleum tax, cf. Appendix 1, section 3, and Prop. 150 LS (2012–2013), section 5.4.

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 same characteristics as a field-specific cash flow tax, inasmuch as the State covers its portion of investments and operating costs on an ongoing basis and receives the same portion of the income.

Figure 2.11 shows the composition of central government revenues from petroleum activities. The revenues of the State are based on the net profits from these activities, and hence tax revenues will automatically adjust to changes in oil prices and changes in industry profitability.

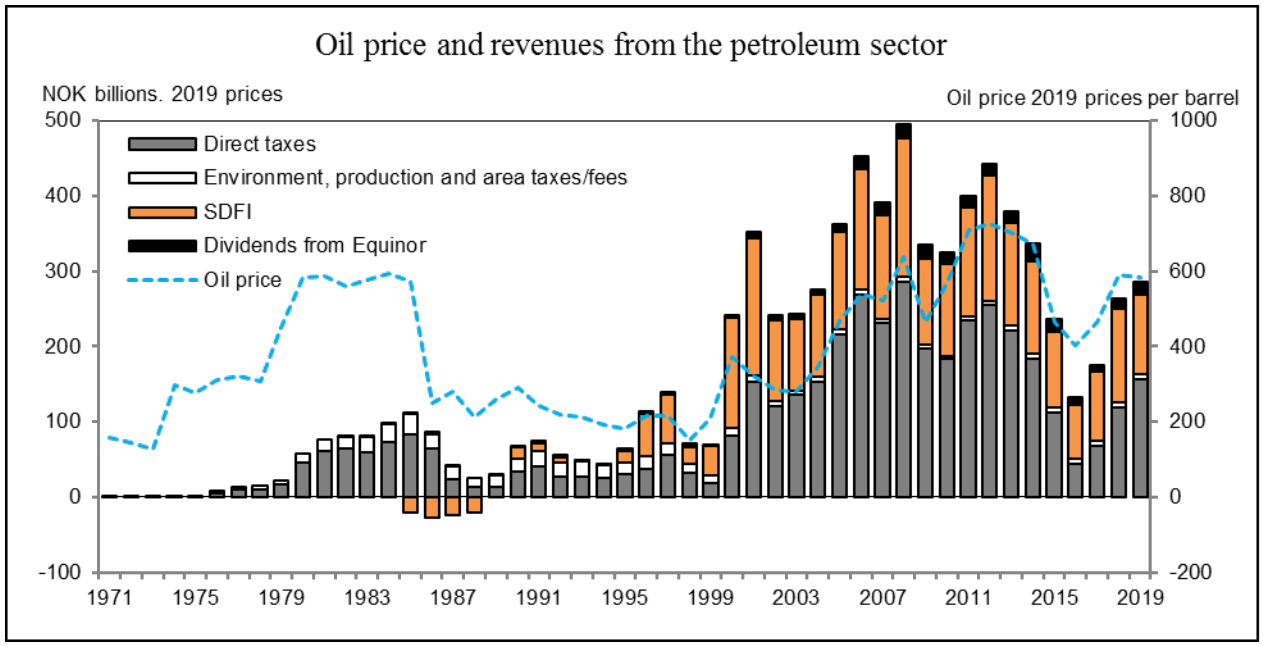

Figure 2.11 Total net central government revenues from the petroleum sector and oil price developments. NOK 2019 prices[1]

[1] Estimates for 2018 and 2019.
Source: Ministry of Finance.

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 central government tax on economic rent. The rate of the economic rent tax is 35.7 pct. for 2018. Power plants with generators below 10 MVA are exempted from the economic rent tax. The economic rent is calculated as a standardised market value of the power generated (actual power generated multiplied by spot market prices), less operating expenses, licence fees, property tax, depreciation and uplift. The uplift is calculated as the risk-free return on the written-down value of the operating assets. Companies have certainty that the full tax value of the investment allowances under the economic rent tax will be paid out. 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, the tax value of any negative economic rent income following coordination between power plants is paid out. Consequently, the uplift determined on the basis of a risk-free rate ensures that the net present value of

the tax deductions corresponds to the investment cost, and that projects which are profitable before economic rent tax are also profitable after economic rent tax.

Power generators are also subject to a natural resource tax (paid to local and regional government) of NOK 0.013 per kWh. Natural resource tax is deductible, krone by krone, against the tax assessed by central government. In addition, power generators pay a licence fee and (normally) property tax to the municipalities hosting them. They must also yield power to such municipalities under special licence conditions.

Taxation of shipping companies

Since the 2007 income 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.

Financial Activity Tax

A Financial Activity Tax on wages and profits was introduced in 2017 to compensate for the absence of value added tax in the financial industry. The sale and distribution of financial services is exempted from value added tax, primarily because it would be challenging to establish a suitable basis for calculating tax on margin-based services, for example the interest margins of banks. The Financial Activity Tax applies to financial undertakings and comprises a 5 pct. tax on wages (the basis for employer's social security contributions) and a tax on company profits inasmuch as the tax rate on ordinary income is two percentage points higher than for other undertakings.

2.3.3 Taxation of assets

Net wealth tax

Individuals pay net wealth tax at a rate of 0.85 pct. on their taxable net wealth, i.e. gross wealth less debt, in excess of a basic allowance of NOK 1.48 million in 2018. Spouses are granted a joint basic allowance of NOK 2.96 million. The net wealth tax makes the overall taxation of individuals more progressive than the income taxation in isolation. This is illustrated by Figure 2.12.

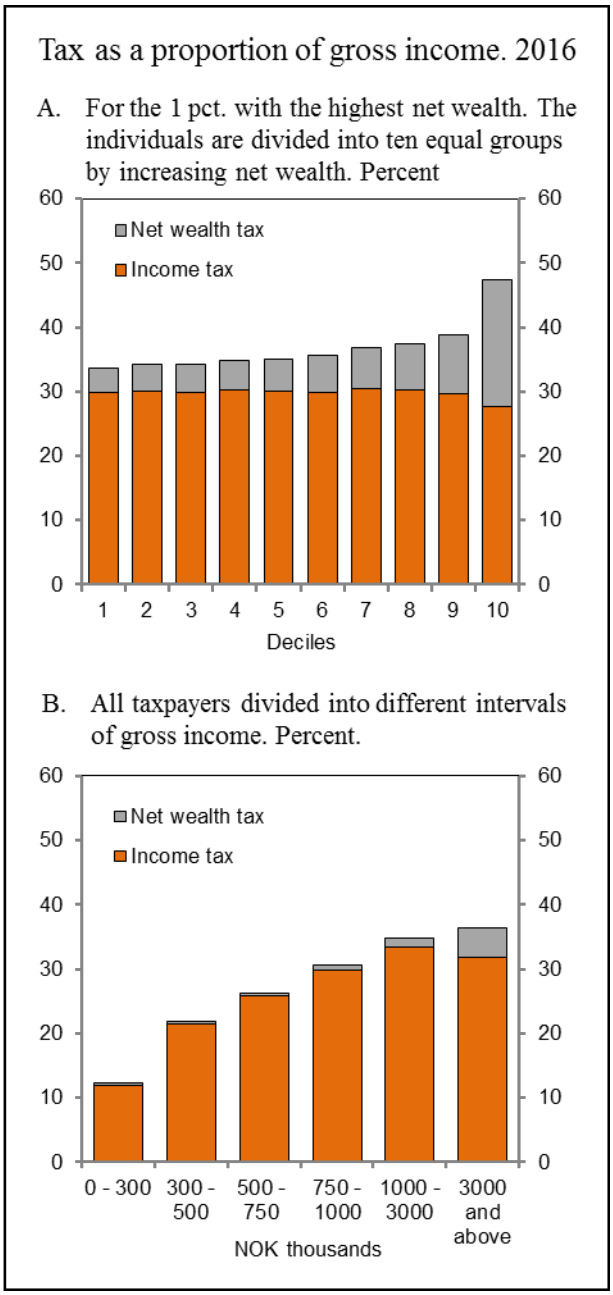

Figure 2.12 Tax as a proportion of gross income in 2016. Percent

Sources: Statistics Norway and the Ministry of Finance.

The taxable value of assets is in principle equal to their market value. However, a number of assets are, in part, valued well below market value. The taxable value of a primary dwelling (the residential property in which one lives) is 25 pct. of estimated market value, whilst it is 90 pct. for secondary dwellings (residential property other than the primary dwelling, which are not commercial property or holiday homes). A safety valve is intended to ensure that no primary dwelling or holiday home has a taxable value in excess of 30 pct. of the market value documented by the taxpayer. The safety valve for secondary dwelling corresponds to the documented market value. The valuation discount for shares and operating assets, including commercial property, is 20 pct. in 2018. The safety valve for commercial property is 96 pct. Debt is deductible for net wealth tax purposes. Debt attributed to primary dwellings, holiday homes, bank deposits, etc., is valued in full. Debt attributed to commercial property, secondary dwellings, shares and operating assets is valued

at the same statutory discount as the asset. Debt is allocated proportionally based on what portion of gross wealth is accounted for by the various assets (which allocation includes primary dwellings, commercial property, shares and operating assets without any statutory valuation discounts).

The proportion of people paying net wealth tax has declined in recent years due to increases in the minimum allowance. It is estimated that about 11.8 pct. of taxpayers will pay net wealth tax in 2018, cf. Figure 2.13. The average amount of tax on the part of those who pay net wealth tax has increased over the period.

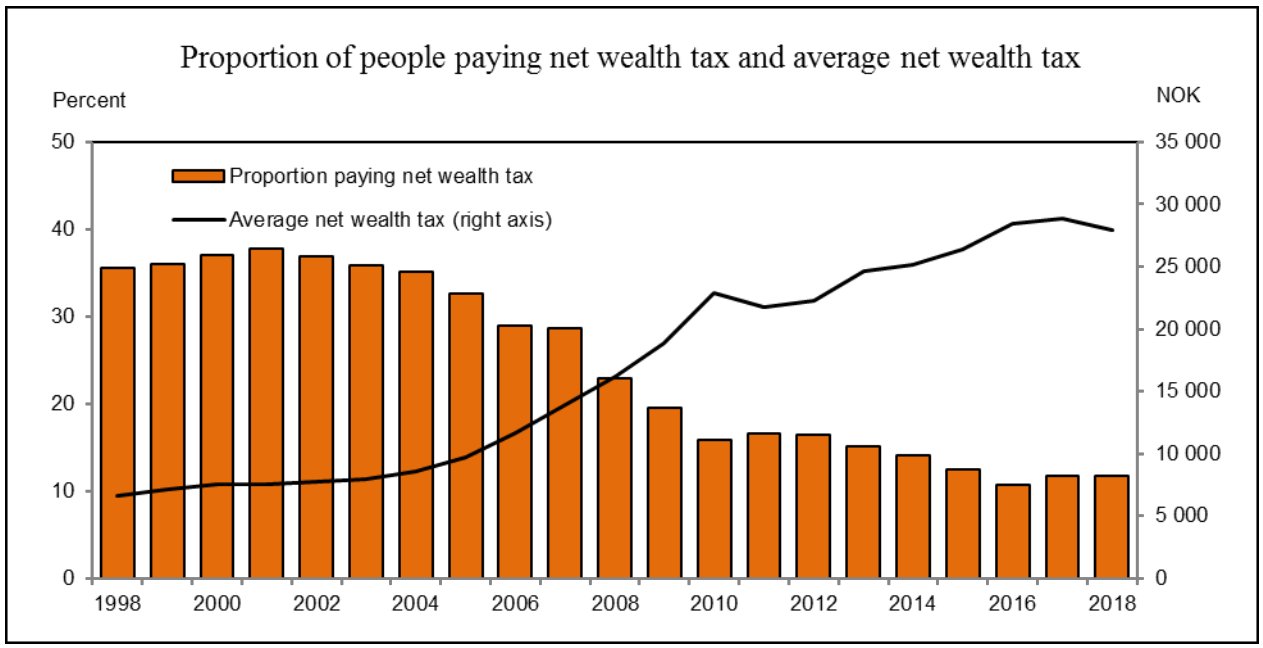

Figure 2.13 Proportion of people (resident in Norway and 17 years or older) paying net wealth tax[1] and average net wealth tax. 1998–2018. Estimates for 2017 and 2018. NOK 2018 prices

[1] Net wealth tax before any reductions as the result of the 80-percent rule (only relevant for the years 1998 – 2008).

Source: Statistics Norway.

Property tax

Property tax is levied by, and accrues in its entirety to, municipalities. Each municipality decides whether to levy property tax, within the limitations laid down in the Property Tax Act. The property tax rate, if any, shall be between 0.2 and 0.7 pct. of the valuation basis, to be determined by valuation every tenth year. The municipalities may alternatively choose to use the net wealth tax bases in their valuation of residential properties. 72 municipalities are exercising this option in 2018. Furthermore, 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 residential properties. From 2017, municipalities may opt for exempting holiday homes from property tax. Four municipalities are exercising this option in 2018. Property tax on power plants is governed by special valuation rules based on production value, subject to minimum and maximum limits.

As per 2018, 370 of the 422 municipalities had introduced property tax, of which 290 levied the tax on residential properties in all or part of the municipality. Total municipal property tax revenues were about NOK 13.6 billion in 2017, of which NOK 7.1 billion was property tax on residential property, including holiday homes. Figure 2.14 shows developments in overall municipal property tax revenues over the period 2005 – 2017.

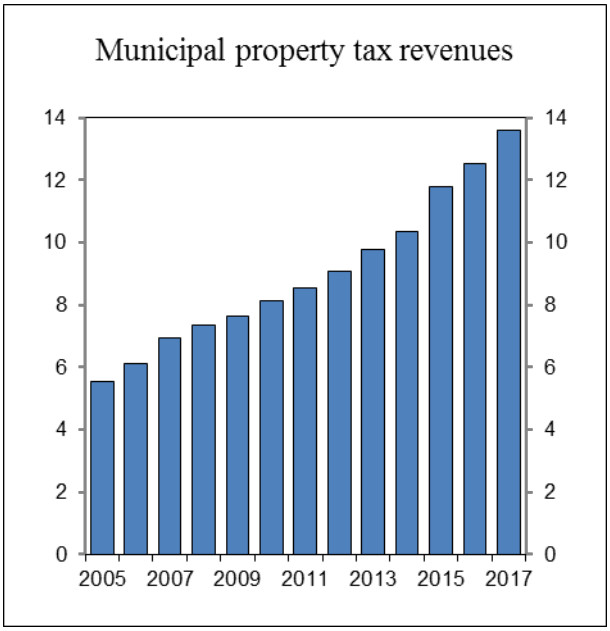

Figure 2.14 Municipal property tax revenues 2005 – 2017. Billion. NOK 2017 prices

Source: Statistics Norway (KOSTRA).

Tax on property internationally

Box 2.4 provides an overview of property tax revenues in the OECD countries.

Box 2.4 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 on the use, ownership and transfer of real estate. Capital gains taxation is not included. In the case of Norway, municipal property tax, net wealth tax and stamp duty are all 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 when calculating their federal income tax base. The OECD figures are based on non-weighted averages of gross taxes.

Figure 2.15 shows revenues from taxes on property in selected OECD countries. In Norway, tax revenues from property account for 3.2 pct. of overall tax revenues. This is well below the OECD average of 5.8 pct. As mentioned, the estimate for Norway includes aggregate revenues from net wealth tax, 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 in income tax.

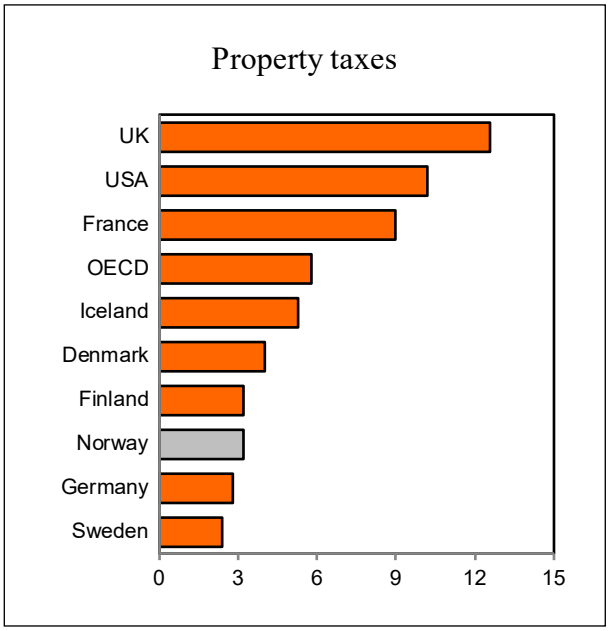

Figure 2.15 Property taxes. Percentage of total tax revenues. 2016[1]

[1] Figures for the OECD are for 2015.

Source: OECD Revenue Statistics Database.

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. The deduction of tax on inputs prevents the tax from being charged on taxable businesses throughout the chain of distribution, thus making value added tax 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.

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 international standards. 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. Box 2.5 compares value added tax regimes in various OECD countries.

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 12 pct. Certain goods and services are exempted by way of so-called zero-rating, which implies full deductibility of value added tax on 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 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 supplies 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 consumption in a desired direction. If, for example, one intended to reduce the consumption of goods that are considered harmful to individuals and to society, it would be more effective to use excise duties.

Box 2.5 Value added tax rates and bases in OECD countries

Value added tax has been introduced in more than 160 countries. On average, value added tax revenues account for 20 pct. of the overall tax revenues of the OECD countries.

The OECD compares the value added tax systems of its member countries, and the ability of such systems to raise revenues. This is done by comparing the actual value added tax revenues of 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. For example, the use of reduced rates and exemptions serves to lower the revenue proportion. The revenue proportion may also be influenced by factors relating to tax collection and compliance, including the extent of tax planning, evasion and fraud. Although the revenue proportion needs to be interpreted with caution as an indicator of effectiveness in the value added tax system, 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 2.16 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.

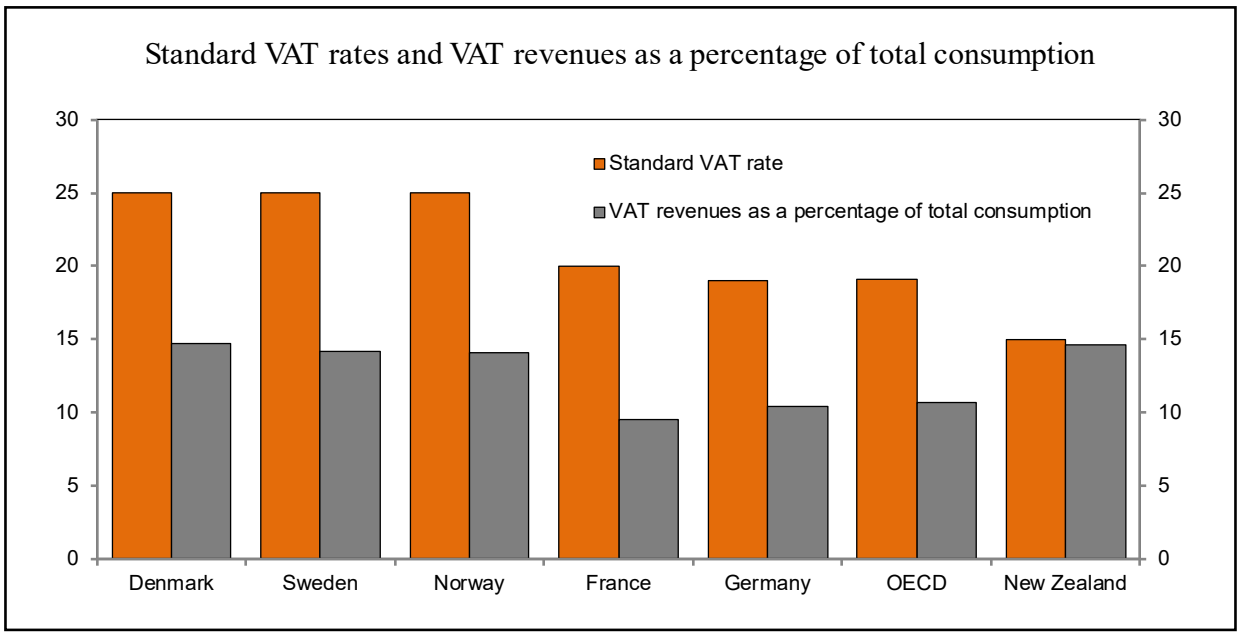

Figure 2.16 Standard value added tax rates and value added tax revenues as a percentage of total consumption. 2014

Sources: OECD (2016) *Consumption Tax Trends* and the Ministry of Finance.

2.4.2 Excise duties

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

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 reducing 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. An example of such a tax is the stamp duty on the sale of immovable property. Other excise 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 the 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 widespread until the late 1980s/early 1990s.

Environmental taxes ensure that market prices reflect the social costs of environmentally harmful activities to a greater extent. This serves to curtail 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 or other environmentally harmful activities may vary between different sectors of the economy, and the authorities do not have complete information as to the magnitude of such costs for different enterprises and households. A correctly designed environmental tax should subject all sources of a specific emission to one uniform tax rate. This facilitates emissions reduction at the lowest possible cost to society (cost effectiveness). 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 2.6.

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) or other policy instruments, government 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 2.17 compares environmental tax revenues in selected countries.

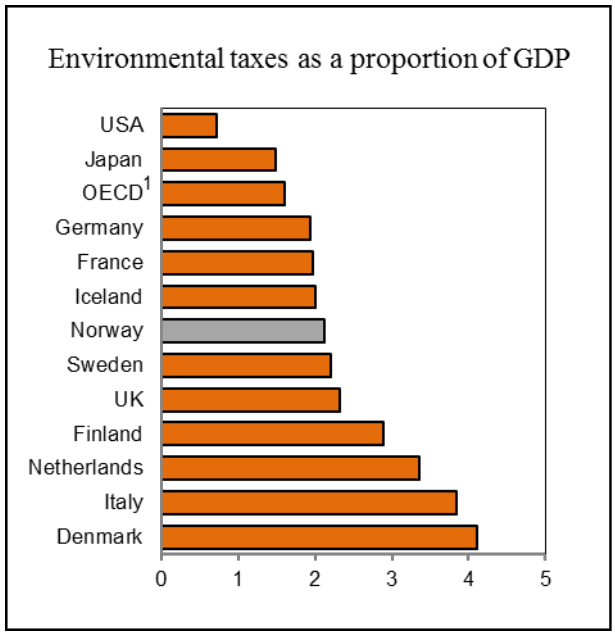

Figure 2.17 Revenues from environmental taxes as a proportion of GDP in various countries. 2014. Percent

[1] Weighted average.

Sources: Ministry of Finance and OECD.

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 2.18 shows the price of greenhouse gas emissions in various sectors in Norway. Having diverging prices for greenhouse gas emissions increases the overall cost of reducing national emissions.

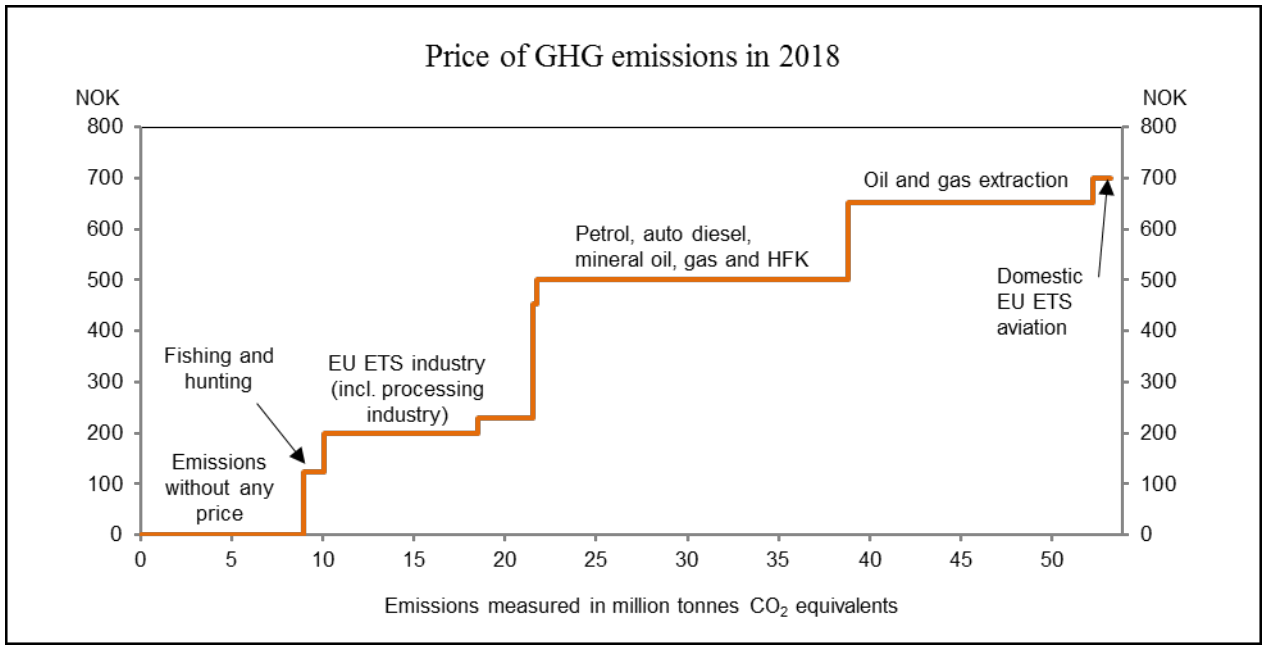

Figure 2.18 Price of greenhouse gas emissions in various sectors. Tax level in NOK per tonne of CO_2 equivalents in 2018 and an emission allowance price of NOK 200 per tonne of CO_2. Emission data for 2016

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

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 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 be circumvented by cross-border shopping, smuggling and illicit distillation of alcohol. The health effects of taxation must be weighed against the social costs of these activities.

Box 2.6 The 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 allowance 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.

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. In addition, customs duties may limit the range of goods available to consumers. 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 types of 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 ensuring that Norwegian agricultural goods are sold at prices stipulated in the Agricultural Agreement. Customs protection is a significant 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[1] negotiations, most recently

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

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

Central government service provision and execution of executive powers are normally funded by appropriations via the fiscal budget, but fees and sectoral taxes are used in some fields. In 2006, the Ministry of Finance laid down general provisions on central government funding by fees and sectoral taxes, which were revised in 2015. Fees may be introduced when the public sector performs a clearly defined service for those paying such fees, and payment is not made in respect of anything else or more. Consequently, the charging of fees that appropriately reflect costs is not classified as taxation. Fees that are charged at a rate in excess of the cost of producing and delivering the relevant service will, on the other hand, involve an element of hidden taxation.

Sectoral taxes serve a broader purpose as a source of funding, and changes to the base or rate of sectoral taxes are therefore classified as part of the tax proposal. The provisions call for considerable caution to be exercised in the introduction of sectoral taxes to fund central government expenditure. Sectoral taxes may nonetheless be used to fund joint measures targeting an industry or sector if such taxes are paid by parties belonging to or closely affiliated with the relevant sector. The operations of a number of supervisory bodies are, for example, funded in full or in part by sectoral taxes.

2.6 Distributional implications of the tax system

Inequality developments are influenced by numerous and complex factors. These factors include economic cycles and structural issues such as immigration, globalisation and changes in the household and age composition of the population. This section is primarily focused on the distributional implications of the tax system. Chapter 6 of the National Budget for 2019 on Norway's follow-up of the UN Sustainable Development Goals discusses Goal 10 on reducing inequality within and between countries.

Income distributional implications of the taxation of individuals

Figure 2.19 shows inequality as measured by the Gini coefficient based on both market income and disposable income for OECD countries. Expressed as a percentage, the Gini coefficient takes a value between 0 and 100; the higher the Gini coefficient, the more inequality there is. Calculation of the Gini coefficient is often based on the income concept of «equivalent income». This income concept takes account of some household members having no income, as well as the economies of scale associated with people sharing a home. The latter implies that each member of a multi-person household is allocated a higher income than the actual income per person of such a household. Such higher income is deemed to be «equivalent» to the income of a single person (although the actual income is lower).

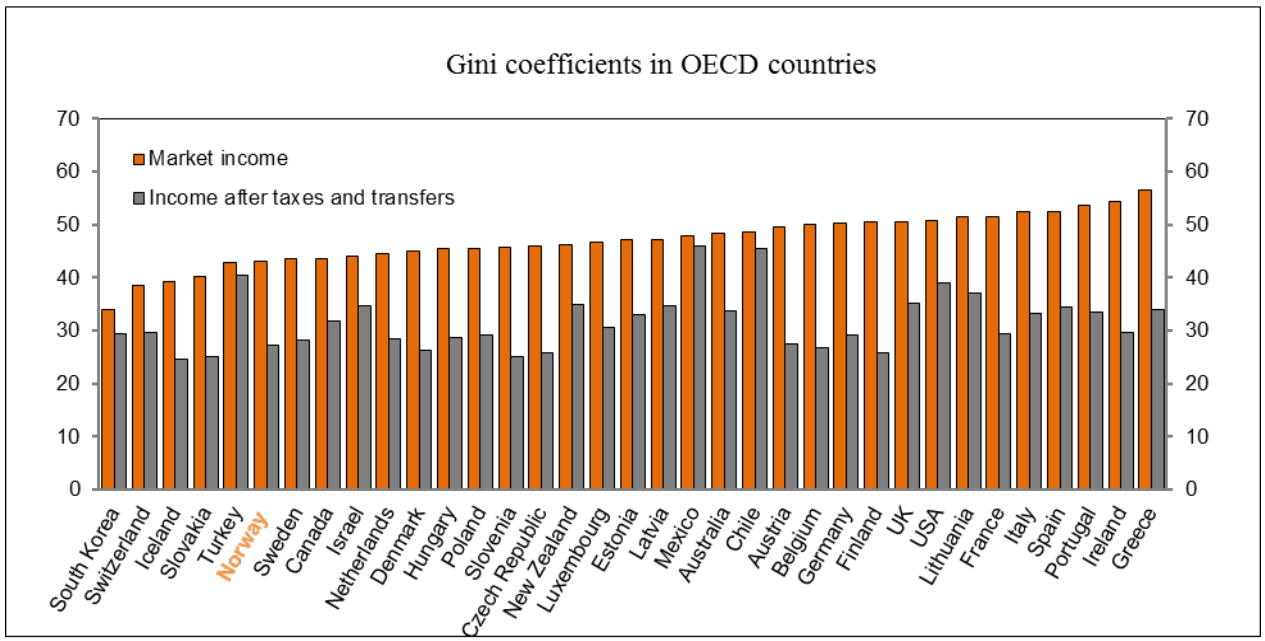

Figure 2.19 Gini coefficients for market income and income after taxes and transfers. Equivalent income (OECD scale). 2016 or most recent available year. Percent

Source: OECD.

Figure 2.19 shows that transfers and taxes serve to considerably reduce inequality in most countries. Norway is amongst the countries with relatively low inequality. High labour force participation, low unemployment and a large extent of centralised wage bargaining are some of the reasons why Norway has small income differences before taxes and transfers. A well-developed, government-funded education system also makes a key contribution to levelling social differences.[2]

Government transfer schemes provide protection against the loss of income due to illness, disability, old age and unemployment. Government transfers and taxes reduced the Gini coefficient by about 40 pct. in 2016, cf. Figure 2.20. The primary redistribution contribution of the tax system is via its funding of comprehensive and well-designed welfare benefits and income protection schemes. In addition, the tax system has a direct redistribution effect by sharing out the funding burden on the basis of income and wealth.

Figure 2.20 shows that income inequality as measured by the Gini coefficient has increased somewhat over the last 30-year period. A major portion of such increase took place early in that period. Fluctuations around the years 2000, 2005 and 2015 have to do with tax rule changes that have given rise to temporary tax adaptations. In 2005, changes in share taxation caused large share dividend distributions, which were subsequently returned to companies as equity. In 2015, major dividend distributions took place to avoid personal tax rate on dividends from 2016. Shifting income back and forth between a company and a personal shareholder has no effect on real income differences. It nonetheless shows up in the inequality measure (the Gini coefficient), which includes dividends paid to personal shareholders in their income, but not income accrued in companies. The redistributional significance of the transfer and tax system has remained relatively stable over this period. Redistribution via transfers and taxes has reduced income inequality by around 40 pct. in most years over the said period.

[2] OECD (2016) *In It Together. Why less Inequality Benefits All*. OECD Publishing, Paris.

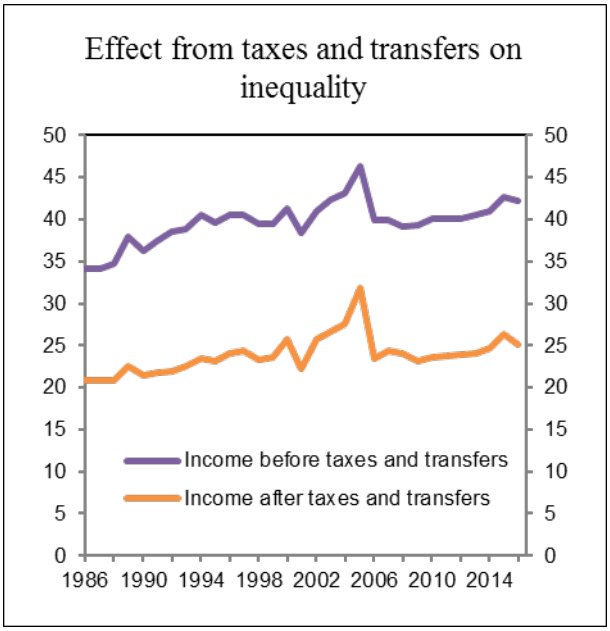

Figure 2.20 Gini coefficient for income before and after transfers and taxes. Percent. Equivalent income (EU scale). 1986 – 2016

Source: Statistics Norway.

Figure 2.21 shows average assessed tax as a proportion of gross income for different income groups in selected years. 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 1994 and 2004, those with the very highest incomes paid a lower percentage of their income in tax compared to other high- and medium-income groups. Average tax as a percentage of income has been increased for those with the highest incomes, most significantly through the introduction of dividend tax in the tax reform of 2006. Average tax as a percentage of income nonetheless declined somewhat with the income level for the top income group in 2016. This has to do with capital income accounting for a relatively large share of the income of high-income groups.

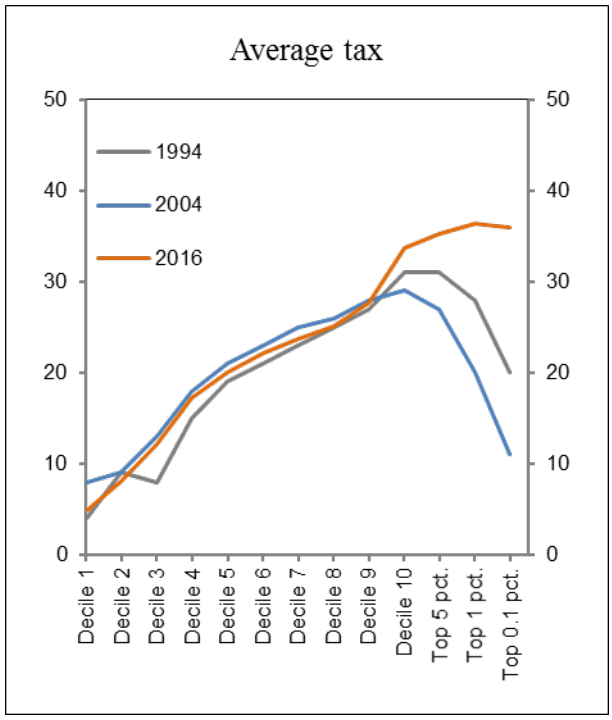

Figure 2.21 Average tax as a proportion of gross income. Percent

Source: Statistics Norway.

Figure 2.22 shows total tax in 2017 and tax reductions over the period 2013 – 2017. The figure shows that all income groups have been given tax reductions, and that the tax system is clearly progressive both before and after the tax reductions in the period. These tax reductions represent a small portion of the overall tax level for the various income groups and have limited effect on the progressiveness of the tax system. Figure 2.23 shows estimated total tax in 2018.

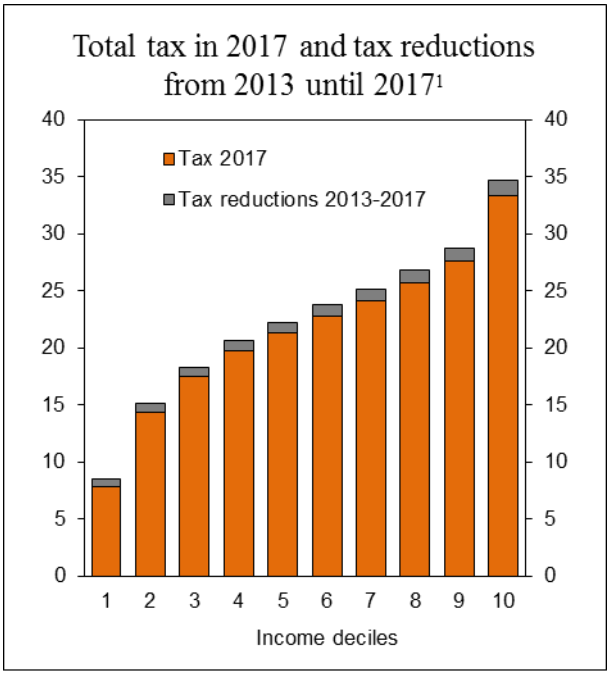

Figure 2.22 Total tax in 2017 and change in tax from 2013 until 2017 as a percentage of equivalent income, specified by income deciles. 2017 rules compared to 2013 rules projected into 2017

[1] The calculation encompasses tax changes that can be computed in the Statistics Norway tax model; LOTTE-Skatt, in a net amount of about NOK 21.5 billion. The computations have projected the tax rules from 2013 to the 2017 level to estimate what tax would have been charged in 2017 under the 2013 rules. This is then compared to the tax rules for 2017. The calculations use data from 2015. The calculations are more uncertain than the ordinary one-year analyses performed in connection with the budget proposals, but nonetheless provide an indication of the significance of the tax changes effected over the period 2013 – 2017.

Sources: Statistics Norway (LOTTE-Skatt) and the Ministry of Finance.

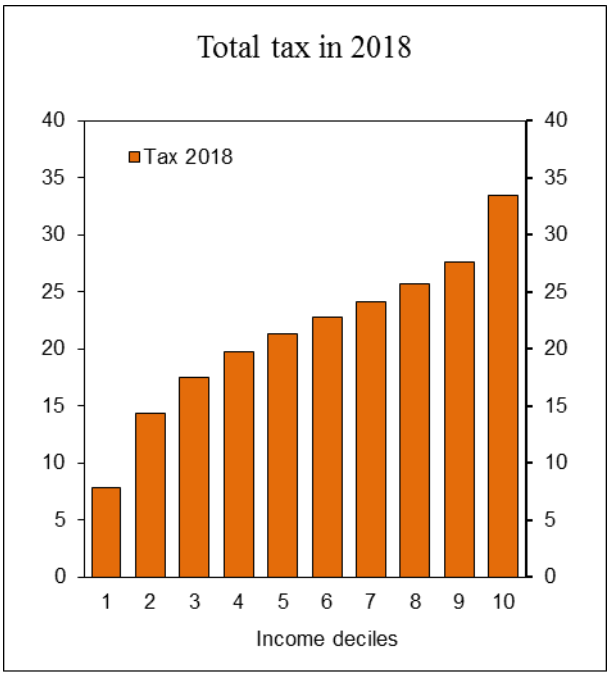

Figure 2.23 Total tax in 2018

Sources: Statistics Norway (LOTTE-Skatt) and the Ministry of Finance.

Income distributional implications of indirect taxes

When examining how the tax system influences household consumption opportunities and welfare, one should ideally take into account the fact that indirect taxes also influence consumption opportunities. Indirect taxes are not, unlike direct taxes, normally levied directly on consumers, but indirectly via producers and importers of the relevant goods and services. The extent to which the tax burden is reflected in the prices charged to consumers depends, inter alia, on the supply of, and demand for, the goods and services subject to such tax. However, no information is available that would show whether the tax burden is carried by individuals or businesses, respectively, or how such tax burden is allocated across various income intervals. The Ministry does not provide estimates for distributional effects of changes in any given indirect tax. The Ministry has in Figure 2.24 specified aggregated revenues from indirect taxes by income decile on the basis of the model Lotte-Konsum.

The figure ranks the entire population by ascending income (equivalent income) into ten groups of equal size (income deciles). Correspondingly, everyone has been allocated a share of the direct and indirect taxes paid by their household.

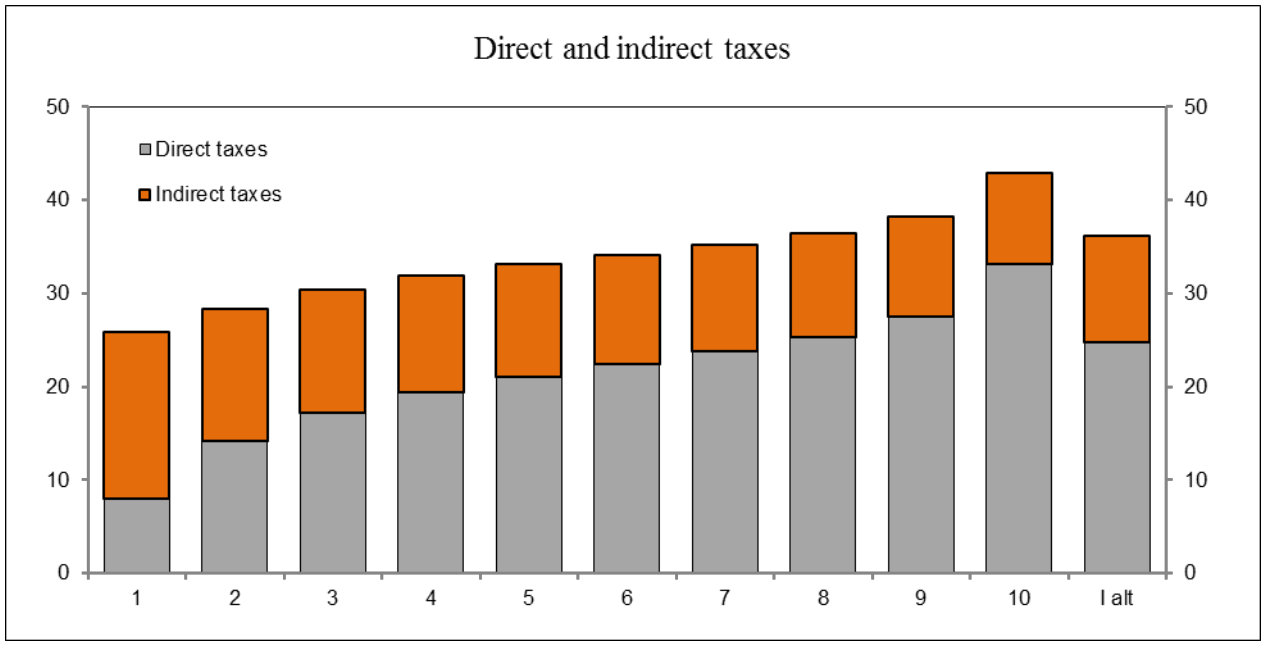

Figure 2.24 Direct and indirect taxes per person as a percentage of equivalent income. 2017 rules. Percent

Sources: Statistics Norway and the Ministry of Finance.

The figure shows that people on low incomes have a lower overall tax burden than people on high incomes. 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 income pay a larger proportion of their gross income in direct taxes than do persons with low gross income, and thus have a smaller proportion of their income available for consumption. It is income after direct tax 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 includes a number of exemptions and special arrangements which contribute to reducing government revenues. Compared to taxation in accordance with the ordinary rules, these exemptions and special arrangements represent an advantage to those falling within their scope.

The Norwegian tax system is based on the principle that all income and assets should be taxed, and that tax bases should correspond to real, underlying values. Deviations from these principles may reflect political priorities.

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 business sector inputs.

Unlike the corresponding measures funded via the expenditure side of the budget, the Storting does not decide the level of tax expenditures and tax sanctions in the annual budgets. This section is therefore intended to supplement the information incorporated into the current tax provisions. The overview of tax expenditures does not purport to be complete because, inter alia, it has not been

possible to quantify all tax expenditures. Appendix 1 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 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 precise estimate of the actual revenue losses caused by tax expenditures.

Figure 2.25 shows the distribution of net tax expenditures in 2018 across different sources of taxation. The figure illustrates that exemptions in the value added tax system are the largest tax expenditure, accounting for about 26 pct. of overall tax expenditure. Lower income tax on residential property accounts for about 19 pct. of overall tax expenditures, whilst net wealth tax discounts account for 15 pct. Tax expenditures associated with the corporate taxation of petroleum activities account for about 12 pct. Tax expenditures relating to financial capital and pension savings account for about 7 pct. of the total, whilst the regionally differentiated employer's social security contributions and tax expenditures relating to wage income and pension income account for 9 and 6 pct., respectively. Excise duties account for 5 pct. of overall net tax expenditures.

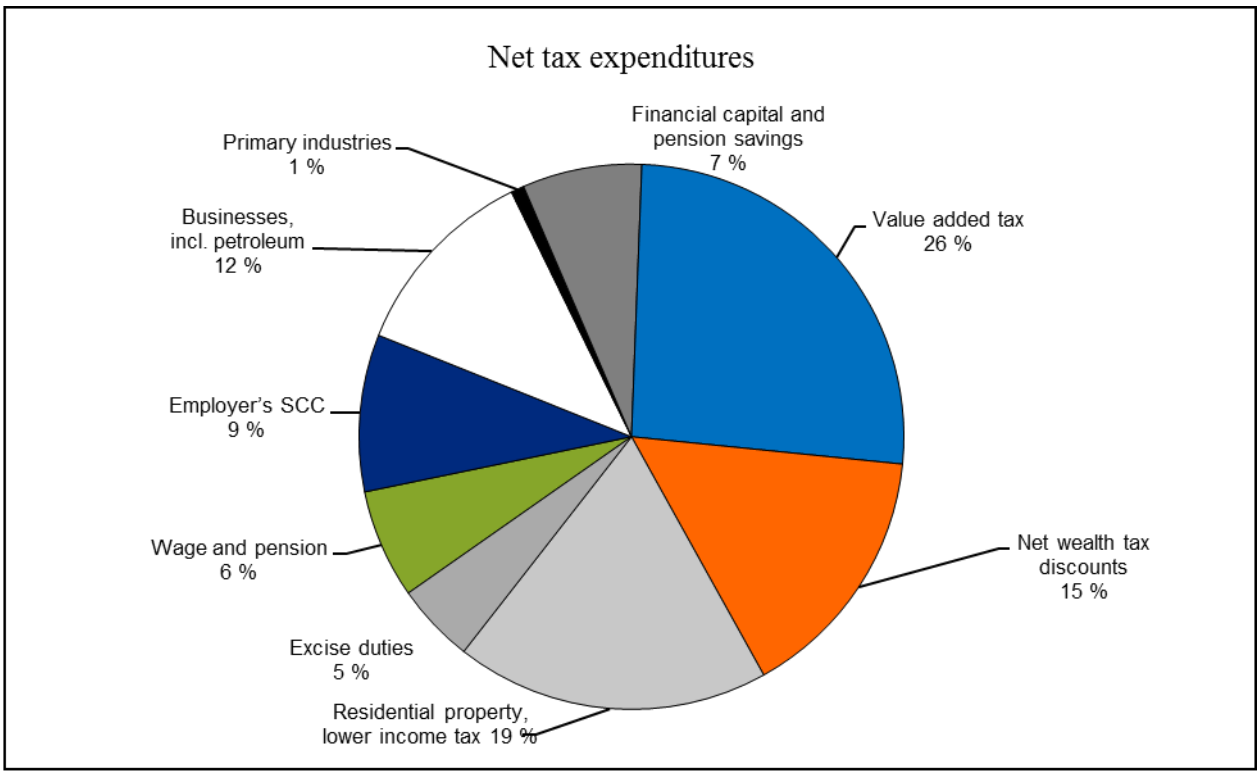

Figure 2.25 Net tax expenditures in 2018 by source of tax. Percent

Source: Ministry of Finance.

2.8 Revenue estimation methods

Changes to the tax rules will normally affect tax revenues. These revenue effects need to be distinguished from tax revenue 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, the data that are available and the deadline by which the estimates have to be prepared.

The calculation methods are summarised 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 tax system. 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[3] under the tax rules are adjusted annually in line with estimates for the relevant growth factor, for example growth in consumer 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 (personal allowance and basic allowance) 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 net 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 per unit rates are adjusted in line with estimated inflation (changes in the consumer 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 in turn based on factors such as estimated macroeconomic developments.

[3] 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.

2.8.2 Revenue calculations not incorporating behavioural effects

The most basic form of revenue calculation assumes that the tax change has no influence on the behaviour of households and businesses. In such case, the revenue effect will only reflect the *direct effect* on tax revenues. The revenue effect of a tax rate change will, for example, be calculated as the tax base multiplied by the tax rate change.

For the fiscal year in which a tax rule is changed, revenue calculations that include only direct effects will in many cases provide a good approximation of the revenue effects, especially if there is little reason to assume that the change will occasion major short term behavioural changes or appreciably affect other tax bases.

2.8.3 Revenue calculations incorporating behavioural effects

Changes to taxes and certain government expenditure 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 such goods.

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 contracts. 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 also in the first year. In general, financial adjustments occur quite swiftly, whilst changes 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. Dividends increased steeply in 2015 as a result of, inter alia, the announced increase in the dividend tax. 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 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 adjustments 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 personal shareholders adapted to the announced dividend tax by distributing large tax-exempted dividends before the reform entered into effect. The extraordinary dividends distributed prior to the reform were 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. Another 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 by the rule change. The revenue calculation

will thus take into account both such rule 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 rule change will in such cases have an indirect effect on tax revenues via a tax base that is not directly affected by such rule 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.

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 behavioural effects of tax reductions may serve to reduce long-term funding needs. 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.[4] 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 factors such as the amount of spare capacity in the economy. The impact on activity will be minor during high economic activity, but may be major in times of low economic activity. In any case, tax reductions need to be paid for over time, through higher tax revenues 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 reductions should not be confused with permanent effects from behavioural changes. It is the permanent behavioural change that is relevant when examining whether a tax change is making the tax system more efficient or not. The impact of any expansionary fiscal policy on activity will normally be taken into account in the Ministry's model forecast for the entire fiscal budget.

[4] Increasing social 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.