## Article

# Constitutional issues in tax law (Norway)

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political constitution; tax system; tax principles; human rights; constitutional jurisprudence.

ABSTRACT:

In Norway, constitutional issues play a rather modest role in tax policy and praxis. There are few and rather insignificant procedural rules for tax rules, the most important being that rules on state taxes are valid only for one year. Judicial review is important, primarily concerning whether a tax assessment is within the tax laws. Courts can also decide on whether tax rules are within the Constitution. Such constitutional review is particularly important concerning the issue of retroactive tax rules; therefore, this is dealt with in some detail. Court can also decide on whether tax rules are in harmony with tax treaties, the European Economic Area Agreement and the European Convention on Human Rights.

PALABRAS CLAVES:

constitución política; sistema tributario; principios tributarios; derechos humanos; jurisprudencia constitucional.

RESUMEN:

En Noruega, las cuestiones constitucionales juegan un papel más bien modesto en la política y praxis tributaria. Hay pocas y bastante insignificantes reglas de procedimiento para las reglas tributarias, siendo la más importante que las reglas sobre impuestos estatales son válidas solo por un año. La revisión judicial es importante, principalmente con respecto a si una determinación de impuestos está dentro de las leyes fiscales. Los tribunales también pueden decidir si las normas fiscales están dentro de la Constitución. Tal revisión constitucional es particularmente importante en relación con el tema de las normas tributarias retroactivas; por lo tanto, esto se trata con cierto detalle. El tribunal también puede decidir si las normas fiscales están en armonía con los tratados fiscales, el Acuerdo sobre el Espacio Económico Europeo y el Convenio Europeo de Derechos Humanos.

MOTS CLES :

constitution politique; régime fiscal; principes fiscaux; droits humains; jurisprudence constitutionnelle.

RESUME :

En Norvège, les questions constitutionnelles jouent un rôle plutôt modeste dans la politique et la pratique fiscales. Il existe peu de règles de procédure et plutôt insignifiantes pour les règles fiscales, la plus importante étant que les règles sur les impôts d'État ne sont valables que pour un an. Le contrôle judiciaire est important, principalement pour déterminer si une cotisation fiscale est conforme aux lois fiscales. Les tribunaux peuvent également décider si les règles fiscales sont conformes à la Constitution. Cette révision constitutionnelle est particulièrement importante en ce qui concerne la question des règles fiscales rétroactives ; par conséquent, cela est traité en détail. Le tribunal peut également décider si les règles fiscales sont en harmonie avec les conventions fiscales, l'accord sur l'Espace économique européen et la convention européenne des droits de l'homme.

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**1 INTRODUCTION**

## 1 INTRODUCTION

The Kingdom of Norway is a constitutional monarchy. The King, however, has only ceremonial functions. The executive power is with the Government and the legislative power is with the Parliament ("Stortinget"). Norway has a parliamentary system, which means that the Government has to have a certain degree of support in the Parliament.

The Norwegian Constitution is from 1814, which means that it is one of the oldest constitutions still in force. Of course, it has been amended several times.

Legislation and the levying of taxes have to be decided by the Parliament, under an ordinary majority rule.

Norway does not have administrative courts and no special constitutional court. Therefore, all tax cases are decided by the ordinary courts where the judges are legal all-rounders and not specialists in tax law or in constitutional law.

Generally, there is little tradition for Norwegian courts to discuss constitutional issues in their decisions in tax cases and, consequently, taxpayers seldom invoke arguments based on constitutional rules. There are a few exceptions to this; thus, the principle of legality is often invoked and in particular, the issue of retroactive tax legislation has been dealt with in several Supreme Court cases.

## 2 BASIC PRINCIPLES OF TAXATION

Basic principles of the Norwegian tax rules are the ability-to-pay principle, the principle of equality and the principle of economic efficiency.

The ability to pay principle applies primarily to individuals and is mainly taken care of by the income tax and the net wealth tax (the inheritance tax was abolished as from 1. January 2014). The income tax is progressive with a top marginal tax rate of 46.4 percent (2021). This marginal rate is applicable for income exceeding approximately one million NOKs (2021) (10 NOK equals approximately 1 US dollar). The net wealth tax is proportional but there is a tax-free amount of 1.5 million NOK. The tax rate is 0.85 percent.

For income taxation of companies, the principle of economic efficiency dominates. For this reason, the tax base is broad. The company tax rate is 22 percent (2021). In addition, also for other taxes (in particular the value added tax, a payroll tax, special turnover taxes) the principle of economic efficiency dominates.

The principle of equality requires that income should be taxed the same way regardless of its form. Therefore, income in kind is in principal taxed in the same way as income in cash and different kinds of capital income are generally taxed according to similar rules. One important feature is that the combined tax on company income and tax on distributed income in combination is at the same level as the highest marginal tax rate for income from labour. Therefore, there is not much tax to save by incorporating a business activity.

However, the principle of equality is severely challenged by the so-called Nordic dual income tax system, which is still generally applicable in Norway. Individuals' capital income is generally taxed at a rate of 22 percent (there are special rules for dividends and capital gains from shares), whereas earned income is taxed progressively with rates up to 46.4 percent as explained above.

## 3 PROCEDURAL CONSTITUTIONAL ISSUES

There are three rather insignificant special procedural rules for the levying of taxes compared with ordinary legislation. Firstly, the levying of state taxes requires only one decision in the Parliament whereas other legislation (including legislation concerning other taxes than state taxes) requires two (with three days between the decisions).

Secondly, ordinary legislation requires the consent of the King whereas decisions on taxes do not; but the King's consent is today a pure formality.

Thirdly, and somewhat more important, decisions on the levying of state taxes is valid only for the coming year, which means that the Parliament has to decide on the levying of each tax, tax rates etc. every year (the Constitution sec. 75 litra a). In practice, this is done in connection with the budget process, taking place right before the income year starts (normally in December with effect from the following January 1).

These rules, however, applies, as already indicated, only to state taxes, not taxes to the municipality and not for the social security contribution (which is often regarded as part of the income tax).

## 4 TAX TREATIES, THE EEA AGREEMENT

Treaties are entered into by the Government. However, the consent of the Parliament is required for treaties of special importance and for treaties, which requires new legislation. Tax treaties are incorporated into Norwegian law and as *lex specialis* they shall be applied by courts and tax authorities when they make exceptions from domestic law. Therefore, the Parliament has to give its consent to the entering into of tax treaties. A simple majority is sufficient; in practice, these consents are almost always unanimous and very seldom triggers a debate.

Because tax treaties are incorporated into Norwegian law at the same level as legislation enacted by the Parliament treaty override is in principle possible but does not happen in practice.

Norway has tax treaties with some 90 countries. By far most of them are based on the OECD tax treaty model or – for treaties with developing countries – the UN model.

The Agreement on the European Economic Area (the EEA Agreement) includes the EU Member States and three EFTA countries: Iceland, Liechtenstein and Norway; the fourth EFTA country, Switzerland, opted to stay outside (EFTA: the European Free Trade Area). The EEA Agreement extends the internal market of the EU to include also the three EFTA countries, except for agriculture and fisheries. This means that the so-called four freedoms −free movement of goods, persons (including the freedom of establishment), services and capital – apply also in the three EFTA countries and so do rules on the ban on state aid. The EEA Agreement does however, not cover taxation. Nevertheless, Norwegian tax legislation has to comply with the rules on the four freedoms and the state aid rules, because they are embedded in the EEA Agreement itself. This means that the case law of the Court of Justice of the European Union (CJEU) is directly relevant in Norway. Both the CJEU and EFTA Court (which interprets the EEA Agreement with effect for Norway, Iceland and Liechtenstein) have decided that the four freedoms in the EEA Agreement shall be interpreted in the same way as these freedoms in the EU treaties are interpreted. On the other hand, EU regulations and directives on taxes are not binding for Norway; thus, the Norwegian VAT is not harmonized with the EU VAT rules and the directives on company tax (for instance the Parent-Subsidiary and Merger directives) are not binding.

The EEA Agreement has had considerable impact on Norwegian tax law. The most well-known example internationally is probably the Focus Bank case (2004) in which the

EFTA Court struck down the Norwegian rules on withholding tax on dividends in force at that time.

## 5 LEGALITY, EQUALITY, JUDICIAL REVIEW

The Constitution contains some rules with general applicability but which are also important in tax law. The most important is the ban on retroactive legislation, which is dealt with separately in the next section.

Of course, the principle of *legality* applies in tax law. All taxation have to have its basis in tax rules enacted by the Parliament. However, this is not understood as a prohibition on the delegation of the power to enact tax rules, typically to the Government or, more often, the Ministry of Finance. Most often, such delegation concerns rather technical or insignificant rules but there are also examples of substantial tax rules enacted by delegation. One example is the rules concerning the incorporation of a business with so-called tax continuity (meaning that the incorporation does not trigger income tax). There is no prohibition in the constitution against enacting substantial and important rules by delegation but such practice is sometimes criticized.

In connection with the principle of legality, it should be mentioned that Norwegian courts apply a rather pragmatic and purpose-oriented interpretation style. Of course, in accordance with the principle of legality the wording of the tax rules in question is the point of the departure and have great weight in the interpretation process. However, important are also the preparatory works, the context of the rules, what can be induced from the purpose of the rules, and even the quality of the results are taken into account. This rather pragmatic approach made it possible for the courts (the Supreme Court in particular) to deal with tax avoidance schemes even without the support of a statute based general anti avoidance rule (a GAAR) (a statutory GAAR was introduced as from 1. January 2020).

The principle of *equality* has recently been written into the Constitution. As already mentioned, equality in taxation must be regarded as a basic principle in tax law. Nevertheless, it is very seldom that the argument of equality is successfully invoked in court cases. For instance, rather unequal value assessments for wealth tax purposes have not been successfully challenged and the Supreme Court has accepted very unequal valuations of dwelling houses for income tax purposes (Supreme Court case 2001). It remains to be seen whether the inclusion of the equality principle in the Constitution will have an impact on this.

The principle of *judicial review*, which applies to all fields of administrative law, is very important in tax law and is considered as a corner stone of taxpayers' rights. The judicial review applies on two levels. The courts can, as part of decisions in concrete cases, decide whether a rule in a tax statute is contrary to the Constitution, the European Convention of Human rights or the EEA Agreement. Further, and that is more important in practice, the courts can decide whether a tax assessment is consistent with the tax statutes (including whether the assessment has sufficient basis in a tax rule) or rules in the tax treaties.

There is a restriction in the principle of judicial review as regards concrete assessments, which are based more on economic, technical etc. than legal considerations. Thus, in a heavily criticized decision some years ago the Supreme Court decided that the tax administration's concrete valuation in transfer pricing could not be tried by the courts (Supreme Court case 2012). Later Supreme Court cases indicate, however, that the courts can try not only the administration's general interpretation of the transfer pricing rules but also whether the OECD Guidelines on transfer pricing have been correctly applied (Supreme Court case 2020).

## 6 RETROACTIVITY

The most important constitutional issue in tax law in Norway is probably the question of retroactivity of tax legislation. The Constitution sec. 97 contains a general rule, which according to its letter forbids all kinds of retroactivity in all fields of law. The doctrine agree that the rule cannot be understood literally. Thus, it is clear that the rule does not prohibit retroactivity that is favorable for the citizens. Even for legislation that is unfavorable for the citizens the rule is understood literally only in criminal law. There is also an issue what retroactivity actually means.

In tax law, several Supreme Court cases have dealt with retroactivity, starting early in the 20. Century. The Court early established that taxes, which are levied in connection with a transaction – or more generally a particular action or incident – could in general not be levied on incidents which occurred before the tax rule in question was enacted. Already in 1910 the Supreme Court made this clear concerning inheritance tax: Inheritance rules enacted on 27. April in one year could not be applied for calculating inheritance tax on the inheritance after a person who died on 14. April that same year (Supreme Court case 2010) (the inheritance tax is abolished in Norway as from 1. January 2014).

Much later, in 2006, the Supreme Court, in a plenary session, made a similar reasoning for the value added tax: As from 1. July 2001 driving schools became taxable for VAT. After a change of political majority in a general election, the taxability for VAT for driving schools was repealed as from 1. January 2002. Of course, during these six months some schools had acquired new cars, and they had obtained a deduction for input VAT on these cars in due course. When the tax was repealed, these deductions were partly reversed in a transitory rule (based on an assumption that the cars would be in use for three years). The Supreme Court turned down this rule. The reversal of the deduction for input tax was regarded as similar to levying of a new tax burden and it found the transitory rule to run against the prohibition of retroactive legislation in the Constitution sec. 97 (Supreme Court case 2006).

In 1925, the Supreme Court, also in a plenary session, had taken another view regarding income taxes. In the leading case, the taxpayer had sold shares with a capital gain in February on year. Under the rules at that time, the capital gain was tax-free. However, in May that same year a new rule made such gains taxable, and that rule should apply as from 1. January of that year. Therefore, the capital gain was taxed and the taxpayer lost the court case (Supreme Court case 1925). The core of the reasoning of the Supreme Court was that the income tax is at tax on the net income of the taxpayer each year and not a tax on income of each transaction or incident, even if such transaction or incident actually triggers the taxable income. Therefore, the taxpayer has to be prepared that changes in the tax rules during the year can be applicable for the whole year. The reasoning can certainly be questioned.

Over the years, in non-tax cases, the Supreme Court developed its view on what should amount to a retroactivity in conflict with sec. 97 of the Constitution. A distinction was drawn between what was referred to as direct or real retroactivity on the one side and indirect or non-real retroactivity on the other. Direct or real retroactivity refers to cases where new legislation levies heavier burdens on transaction carried out or incidents having taken place before the rule was enacted (as in the cases concerning inheritance tax and value added tax mentioned above). Such retroactivity can, however, be accepted (outside criminal law) but only if strong public interest reasons support it.

Indirect or non-real retroactivity refers to cases where the new rule restricts an established position, without directly levying heavier burdens on earlier incidents. In such cases, according to the Supreme Court, the rule would be unconstitutional only if the

application of the new rule amounted to a clearly unreasonable or inequitable retroactivity. For instance, stricter rules on depreciation allowances on fixed assets can normally be applied also to assets that are acquired before those stricter rules were enacted. It turned out in practice that the test of unreasonable or inequitable retroactivity is almost impossible to pass.

In the VAT case from 2006, the Court picked up the differences between "action taxes" (as inheritance tax and VAT) and income taxes. Adhering to the development in non-tax cases, the Court was of the view that in general the application on new unfavorable rules on action taxes would be unconstitutional unless strong public interest reasons supported applying the rules. As for income taxes, however, the application of a new unfavorable rule would be acceptable unless that would amount to a clearly unreasonable and inequitable retroactivity. This view had, in fact, been applied in Supreme Court case from 1976. There the taxpayer had sold assets in September 1970 with a capital gain, which at that time was tax free. Parts of the price should be paid in 1971 and according to rules applicable at that time this amount should be taxed in 1971 if it was at all taxable. Such capital gains were made taxably by a law enacted in June 1971 and the new rules should apply as from the beginning of the income year of 1971. The Supreme Court accepted the taxation of that part of the price that was paid in 1971 and i.a. argued that the new rule had been long expected and for that and other reasons it was not unreasonable to apply it.

In the VAT case of 2006, the Court stated that there was no sharp dichotomy between the two groups of tax rules and that tax law was not in the core of the retroactivity prohibition in the same way as criminal law. Nevertheless, the majority of the Court found that the new VAT rule, reversing parts of the deduction for input VAT, could be accepted only if strong public interest reasons supported it, and the majority found that this was not the case. The minority (four of 15 judges) pointed out that action taxes could be rather different and, therefore, that strong public interest reasons could not always be required. The minority pointed out i.a. that the damage to the taxpayers was small and that the rule in question was essentially reasonable.

This set the scene for the for the most well-known Norwegian retroactivity tax case in recent years – the shipowner case from 2010, which was also decided in a plenary session of the Supreme Court. In 1996, Norway introduced a tonnage tax regime for taxing shipping business. Shipping income should not be taxed under the ordinary tax rules; instead, a very modest so-called tonnage tax was levied. However, the shipping income was not tax free; instead, the tax liability was postponed as long as the income was kept within the shipping company and the company was part of the tonnage tax regime. Thus, the company would be taxed if and when the profits were distributed to the shareholders or if and when the company the left the tonnage tax regime. No time limit applied as to how long this postponement could last and in principle the taxpayer had control of when, if ever, the tax liability should be triggered.

However, most tonnage tax regimes in other countries were based not a postponement of the tax liability but on a definitive tax freedom for shipping income. The shipping companies lobbied for introduction of a similar system in Norway and in 2006 they eventually succeeded. A transitory rule dealt with the profits from shipping earned but not yet taxed since 1996: Two thirds of this income should be taxed over ten years (one tenth each year); the remaining one third of the income would be tax free provided that an amount equal to the tax on that income (calculated at the corporate income tax rate at that time: 28 percent) was used for environmental purposes. These rules implied that the taxpayers lost control of if and when tax liability on income earned since 1996 should be taxed and they contended that this was unconstitutional retroactivity (Zimmer, F., 2016, 583).

In a deeply split Supreme Court, a majority of six out of 11 judges stated that this was not a clear-cut case of either direct/real or indirect/non-real retroactivity but something in between. Nevertheless, the majority found that the case had much in common with the VAT case on driving schools of 2006. In this case, as well, the rules in question implied that earlier incidents and actions were taxed more heavily because of the new rules. Therefore, accepting the rules should require strong public interest reasons, and such reasons were not found.

A minority of five judges were of the opinion that this was a case of indirect or non-real retroactivity and found that the retroactivity was not clearly unreasonable or inequitable. The minority also invoked the importance of freedom for the Parliament to legislate in tax matters and the fact that the majority of the Parliament had clearly stated that the rules were not unconstitutional.

The majority's emphasis on the parallel to the VAT case can be discussed. However, the result of the majority can be defended with reference to the fact that the main purpose of the postponement rules of 1996, which was the postponement of the tax liability and that the taxpayer had control of the length of the postponement. In addition, future losses in the company would reduce or eliminate the tax liability. Thus, the transitory rules in effect removed these effects and therefore undermined the core of the 1996 rules.

The shipowner case could, of course, not be decided with reference the old Supreme Court cases concerning income tax rules enacted during the year but applicable the whole year. In the shipowner case the retroactivity applied to income earned up to 11 years before the new rules were enacted. At the same time, the shipowner case did set not aside this old practice. However, both the VAT case and the shipowner case seems to play down the difference between action taxes and income taxes. Therefore, the question has been raised as to whether the Supreme Court would now be prepared to set aside its practice from the 1920s regarding retroactivity within the same year and consider this as possible unconstitutional retroactivity.

## 7 CONSTITUTIONAL LIMITS TO TOTAL TAXATION?

The question of whether there are limits to the total amount a taxpayer may have to pay in taxes and, in case, where that limit goes, has not been tested before the Supreme Court.

Some decades ago, there was a "roof" as to the total effect of a taxpayer's income and wealth taxes: the sum of these taxes for a given year, as a main rule, could not exceed 80 or 90 percent of the net income of the taxpayer. These rules were controversial, and with the lowering of tax rates in recent years, this issue is now not very practical. Consequently, there is not discussion of reintroducing such rules for the time being.

Oil and gas producing companies pay up to 78 per cent of their income in income taxes. The companies have not challenged this taxation under the constitution.

Further, as a point of departure there is no constitutional limits as to what kind of taxes that can be levied. However, taxes may treat taxpayers so unequally that it conflicts with the Constitution's requirement of equal treatment of subjects.

Taxes have to be levied according to general rules. Otherwise, it may amount to an expropriation, which as a main rule trigger a right to compensation.

## 8 RIGHTS AND DUTIES FOR TAXPAYERS

Most rights and duties of the taxpayer is embedded in administrative law rather than the Constitution. Thus, the duty to file a tax return and to answer questions from the tax office

is regulated in a special tax administrative act. The same applies for instance to rules on professional secrecy, the right to obtain an advance ruling, the right to be informed of planned deviations from the tax return and the right to appeal the case to a special appeals body. In addition, this act contains rules on additional taxes (a penalty tax) in cases where the taxpayer has not fulfilled his reporting obligations. Criminal punishment for tax fraud is embedded the criminal act.

## 9 INTERNATIONAL HUMAN RIGHTS

The European Convention on Human Rights has been incorporated into Norwegian law. The Convention has had some impact on tax law. Admittedly, the important rule on fair trial in Art. 6 does not apply to substantial tax cases, according to case law by the European Court of Human Rights. However, it applies when there is a criminal charge. The Supreme Court has decided that additional tax (the penalty tax) levied by the tax administration when taxpayers do not fulfill their reporting duties amounts to a criminal charge under the Convention, and therefore Art. 6 applies. This has raised several cases in Norwegian law. In many decisions, the penalty for tax fraud has been reduced due to the tax administration and/or the police having used too long time in handling the case. In addition, the burden of proof has been sharpened for additional taxes, in particular in cases of serious information neglect. In the last-mentioned cases, the burden of proof is similar to the burden of proof in ordinary criminal cases.

In particular, the right not to be tried or punished twice for the same offence (the so-called double jeopardy), which is embedded in Protocol no. 7 to the Convention, Art. 4, has had an impact on Norwegian law. Under domestic law a tax offence can be sanctioned both by additional taxes according to rules in the tax administrative act and punishment levied by the courts under rules in the criminal act. Through several cases the Norwegian Supreme Court has decided that the subsequent use of both these remedies are against the right embedded in Protocol 7 Art. 4, regardless of the order of the administrative and criminal reaction. However, the European Court of Human Rights has decided, in a case from Norway, that this prohibition does not apply in case of parallel application in time of the levying of an administrative additional tax and the court sentence in a criminal case concerning the same offence (A and B v. Norway, 2016).

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