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Decision No 225/17/COL

Ministry of Trade, Industries and Fisheries
PO Box 8090 Dep
0032 Oslo
Norway

Subject: **Employee share option tax scheme**

1 Summary

(1) The EFTA Surveillance Authority (the "Authority") informs the Norwegian authorities that, having assessed the "employee share option tax scheme" (the "measure" or "the new tax scheme"), it considers that the measure constitutes state aid, and decides not to raise objections[1] to the measure, as it is compatible with the functioning of the EEA Agreement, pursuant to Article 61(3)(c) of the EEA Agreement.

(2) The Authority has based its decision on the following considerations.

2 Procedure

(3) The Norwegian authorities notified the measure by letter of 18 October 2017. The Norwegian authorities updated the notification on 4 December 2017. The Norwegian authorities provided further clarifications by e-mail of 6 December 2017.

3 Description of the measure

3.1 Objective

(4) The measure is aimed at enabling young and small companies to recruit and retain employees. Such companies may not have the same access to capital as older and larger companies. Hence, young and small companies may find it more challenging to finance competitive wages. Moreover, such companies may have difficulties in obtaining external financing. Also, employees are often risk-averse and may consider a young and small company an uncertain employer. Young and small companies may therefore find it difficult to recruit and retain employees.

(5) One way of addressing this challenge is to delay the tax burden for employees when they are offered share options. A share option is a right for the employees to buy shares in the company they are employed in. This will decrease the tax costs and liquidity issues for the employer associated with offering the employees share options.

(6) The measure is granted in the form of deferred taxation of employees' income when they are offered employee share options. Under the new tax scheme, employees will be taxed at

([1]) Reference is made to Article 4(3) of Part II of Protocol 3 to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice.

the moment of realisation[2] of the shares and no longer already when the shares are purchased[3]. The employer's liability for corresponding social security contributions will also be deferred. For example, if the share value decreases between purchase and realisation of the shares, the taxation of the employee will be lower than it would have been under the general system. Consequently, the employer may pay lower social security contributions than under the general system if the share value decreases. If the share value increases, the employer will only be liable for social security contributions up until the amount of the option benefit. The option benefit is the difference between the market value and the price paid by the employee for the share.

3.2 Description of the new tax scheme

3.2.1 Current taxation of employees

(7) Under the current tax rules, benefits granted by an employer to an employee as remuneration for the employee's work are taxed as employment income. A share option granted to the employee at a lower rate compared to the market value of the share is regarded as a taxable benefit. Share options granted to the employee on market value are not considered remuneration for the employee's work. In such cases, the employee is not granted a benefit, and there will be no benefit to tax.

(8) A share option is taxed on the employee's side as part of his personal income when the option is exercised – that is, when the employee uses his right pursuant to the option to buy the shares at the predetermined price. The taxable gain is the difference between the market value of the shares at the time of exercising the option and the agreed price of the option (the "exercise price"), with the deduction of the option premium,[4] if any. Any subsequent increase in value of the shares after purchase and until realisation (i.e. sale of the shares) is taxed as share capital gain (any gain derived from the exercise of the option and taxed as employment income is added to the input value of the shares to avoid double taxation). Any loss at the realisation of the shares may be deducted from general income.

(9) In Norway, taxable income consists of income from employment, capital, business and pensions. All taxable income (subject to certain exceptions and special regulations), regardless of its source, is taxed at a rate of 24%, after deductions.

(10) Employment income is in addition taxed as personal income, which is a gross tax consisting of a progressive bracket tax[5] and social contributions[6]. The highest marginal tax rate on personal income is 22.7%. Thus, the highest marginal tax rate on personal income is 46.7%.

(11) For natural taxpayers, capital gains obtained by the sale of shares are taxed as general income at the rate of 24%, subject to deduction of a shielded amount[7] and an upward adjustment of 1.24%.[8]

3.2.2 Current taxation of the employers

(12) The employer is liable for social security contributions on any benefit granted to the employee as remuneration for the employee's work. As stated above, a share option

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([2]) "Realisation" means the sale of the shares, or taxation after a specified time period has passed.
([3]) "Purchase" means the time at which an employee uses their right to buy shares.
([4]) The option premium is the price paid to hold the option as such.
([5]) Norwegian: *trinnskatt.*
([6]) Norwegian: *trygdeavgift.*
([7]) Norwegian: *skjermingsgrunnlag.*
([8]) Norwegian: *oppjusteringsfaktor.*

granted to the employee at a lower rate compared to the market value is regarded as a benefit that is subject to social security contributions. The employer is liable for social security contributions when the share option is taxed on the employee's side – that is, when the option is exercised. The current social security contribution rate is 14.1% of the remuneration.[9]

3.2.3 The new tax scheme

(13) Under the new tax scheme, the benefit of the option will be taxed when the share is sold, or after a specified time period has passed (the "realisation date", see section 3.2.4 below). For the employee, the benefit will be taxed partly as employment income and partly as a share capital gain, depending on how the value of the shares has evolved, see below.

(14) At the realisation date, any gain accrued by the employee on the shares is taxed as employment income, up to and including the amount of the option benefit. Any gain above the option benefit will be taxed as a share capital gain. If the actual gain is lower than the option benefit, the taxation on the employee's hand is limited to the amount of the gain. If there is no gain at all, there will be no taxation.

(15) The scheme requires that the value of the option benefit is calculated on the date of exercise, and that the records of the calculation is kept until the later time of taxation. The employer will handle the calculation of the option benefit and keep records of the respective amount.

(16) The employer will be liable for social security contributions at the realisation date. The contributions will be calculated on the value of the option benefit, which is the amount subject to employment tax on the employee. Any gain on the employee's side above the option benefit is not subject to social security contributions.

(17) At the time of exercising the option, the employer will calculate the benefit that would, in accordance with the general rule for taxation of employee share options, be taxed as employment income on the employee's side (the option benefit). This is the market value of the shares with deduction of the actual price paid for the shares (including any paid option premium, i.e. the price for the option as such). The market value will be based on recent share transactions made within the company, if any. Individual aspects of the share option will also be taken into account, such as lock-in clauses, restrictions on further sales etc. If the real sales value cannot be established with reasonable certainty, the value of a share may be set as equal to the share's *pro rata* part of the total valuation of the company's assets.

(18) Further, provided that the option is connected to the purchase of shares under a general share-purchase-program available for all employees of the company, the calculated market value of the share(s) at the time of exercising the option can be reduced by up to 20%, though with a maximum accumulated reduction of NOK 3 000.

3.2.4 Taxation events

(19) If an employee's contract ends while still holding an option, or if the employee moves abroad, the option benefit will be taxed.[10] The calculation will be based on the market

([9]) Lower rates apply for companies located outside of densely populated areas. This differentiated social security contribution system constitutes a regional aid scheme that was approved by the Authority in its Decisions No 225/14/COL and No 094/17/COL.

([10]) If the employee moves abroad, the general exit taxation rules found in the Norwegian Tax Act 10-70 will apply. This means that the employee will have the right to postpone the taxation on further conditions set out in the same section.

value of the shares at the time the employment ends. Following taxation, the input value of the shares will be adjusted with the option benefit taxed as employment income, and any further gains on the later sale of the shares will be adjusted with the option benefit taxed as employment income.

(20) Pursuant to the Norwegian Accounting Act[11], the employer has a general obligation to keep accounting information, including information on employment salary. Hence, the employer is not obliged to keep the information on the calculated option benefit for more than five years after the option is exercised. In order to ensure coherence with the employer's general duty to keep accounting information, the employment income part of the option benefit, including payment of social security contributions, shall be taxed if the shares have not been realised within five years. The calculation will be based on the market value of the shares at this date. Following taxation, the input value of the shares will be updated, and any gains on the later sale will be taxed as share capital gain.

3.3 Eligibility criteria

(21) In order to benefit from the scheme, the employer, the employee and the option must fulfil certain eligibility criteria.

3.3.1 Companies

(22) The company whose shares are subject to the tax scheme must fulfil the following criteria:

a) It must be a Norwegian private limited liability company[12] or a corresponding foreign company with a permanent establishment in Norway, which originates from a state within the European Economic Area.
b) It cannot be listed on a public market.
c) It must employ fewer than ten full-time equivalent employees.
d) The company's annual turnover and balance sheet cannot exceed NOK 16 million.
e) The requirements related to the company's size in *litra* c) and d) must be fulfilled on average during the fiscal year preceding the granting.
f) The company cannot be older than six years. This means that at the time of the granting of the option, the company cannot have been incorporated for more than six years.
g) The company cannot be controlled by a public body at the time of the granting of the option, i.e. that 25% or more of the shares or voting rights of the shares of the company cannot be directly or indirectly controlled by one or more public bodies.
h) The company cannot be active in the coal or steel sector. Nor can the company engage in merely passive capital investment.[13]
i) The company must not be a company in difficulty within the meaning of the Guidelines on State aid for rescue and restructuring non-financial undertakings in difficulty.[14]

(23) The companies eligible for the measure correspond to the definition of "micro enterprises" in Annex I to the Commission Regulation (EU) No 651/2014 of 17 June 2014 declaring

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([11]) The Norwegian Accounting Act of 19 November 2004 no. 73 (Norwegian: *bokføringsloven*).
([12]) Norwegian: *aksjeselskap*.
([13]) According to the State Budget for 2018 (Prop. 1 S (2017-2018), passive capital investment means capital placement in banks, funds, securities, renting out capital goods or static functions, for instance obtaining return on intellectual property rights. The Norwegian authorities have excluded this sector from the scheme as the sector does not contribute to industrial and commercial development to the same extent as other sectors.
([14]) Guidelines on State aid for rescuing and restructuring non-financial undertakings in difficulty, OJ L 271, 16.10.2015, p. 35 and EEA supplement No 62.

certain categories of aid compatible with the internal market in application of Articles 107 and 108 ("GBER").[15]

(24) If the grantor company is a member of a group of companies, the eligibility requirements set out in this section should, as a general rule, be fulfilled for the group as a whole.

3.3.2 Employees

(25) The employee eligible to receive the share option must be employed by the grantor company at the time of the granting and for three years from that point. The option must at the latest be exercised within ten years after the date of the granting.

(26) The option holder will only be eligible for the scheme if he or she was employed by the grantor after 1 January 2018.

(27) The employee must be employed by the grantor for a minimum of 25 hours per week during the option period, calculated on an annual basis.

(28) The employee and his or her near relatives cannot, in the year of the granting of the option and the two preceding years, own or control more than 5% of the shares in the company.

3.3.3 Options

(29) The maximum option benefit under scheme is limited to NOK 30 000 per employee throughout the employee's period of employment.

3.4 National legal basis and aid granting authority

(30) The legal basis of the scheme is section 5-14 of the Norwegian Tax Act[16] and a complementary administrative regulation that will be adopted by the Norwegian authorities. The aid granting authority is the Ministry of Finance.

3.5 Budget and duration

(31) The revenue loss is expected at NOK 200 million 2018. The long-term budget is estimated at NOK 350 million annually.

(32) The Norwegian authorities have notified the scheme for ten years, starting on 1 January 2018.

3.6 Cumulation

(33) The Norwegian authorities have confirmed that aid granted under the scheme is not related to any costs that could be eligible for other state aid. The Authority approved the differentiated social security contribution system ("SSC scheme") in Decisions No 225/14/COL[17] and No 094/17/COL.[18] The system provides a lower social security contribution rate for undertakings in very sparsely populated areas. The new tax scheme will also lower the social security contributions for eligible undertakings. The Authority notes that the Guidelines on regional state aid for 2014-2020[19] contains no maximum cap on aid. The social security contribution scheme and the new tax scheme subject to this decision also address different market failures.

([15]) OJ L 187, 26.6.2014, p. 1. Incorporated into Article 1j of Annex XV of the EEA Agreement.
([16]) Norwegian: *Lov om skatt av formue og inntekt (skatteloven) av 26. mars 1999 no. 14*.
([17]) OJ C 344, 2.10.2014, p. 14.
([18]) Not yet published in the Official Journal.
([19]) OJ L 166, 5.6.2014, p. 44.

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(34) The Norwegian authorities have submitted information showing the amount of aid that will be possible to obtain under the new tax scheme. The amount of aid obtained under the new share option scheme will depend upon the performance of the eligible undertakings:

Company examples (10 employees, NOK 500 000 average wage, option benefit NOK 500 000 per employee): SSC-scheme zone	Aid in NOK - reduced SSC	Aid in NOK – employee share options scheme	
		Success	Failure
1 – rate 14.1 per cent	0 (No aid)	14 120	82 550
2 – rate 10.6 per cent	175 000	10 610	61 830
3 – rate 6.4 per cent	385 000	6 410	37 300
4 – rate 5.1 per cent	450 000	5 110	29 750
4 a – rate 7.9 per cent	310 000	7 910	46 080
5 – rate 0 per cent	705 000	0 (No aid)	0 (No aid)

(35) The Authority also notes that section 6-53(4) of the Norwegian Tax Act does not allow investors under the "Investor tax incentive scheme for start-up undertakings" (GBER/31/2017/SME)[20] to be employed in the companies eligible for aid under this GBER scheme. Furthermore, if shareholders that have received a tax deduction under this GBER scheme are subsequently employed by companies covered by the measure, the measure and the GBER scheme will not cover the same eligible costs.

4 Presence of state aid

(36) State aid is defined in Article 61(1) of the EEA Agreement as:

"[…] *any aid granted by EC Member States, EFTA States or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods* […] *in so far as it affects trade between Contracting Parties* […]"

(37) The qualification of a measure as aid within the meaning of this provision therefore requires the following cumulative conditions to be met: (i) the measure must be granted by the state or through State resources; (ii) it must confer an advantage on an undertaking; (iii) favour certain undertakings (selectivity); and (iv) threaten to distort competition and affect trade.

4.1 Presence of state resources

(38) The measure must be granted by the State or through state resources.

(39) The measure involves state resources, as the deferred and possibly reduced social security contributions constitute foregone revenues of the State which would, absent the scheme, be due. The deferred and possible reduced taxation on the employee's side also constitutes foregone revenues for the State. The notified measure is also imputable to the State as it is introduced through a legislative act.

(20) http://www.eftasurv.int/media/esa-docs/physical/GBER-31-2017-SME.pdf

4.2 Advantage on undertakings

(40) The measure must confer on undertakings an advantage that relieves them of charges that are normally borne from their budgets.

(41) The deferred and possibly lower taxation on the employee's hand only concerns employees who are private individuals. Private individuals do not constitute undertakings. Article 61(1) of the EEA Agreement therefore does not apply to them.

(42) However, the measure confers an advantage on the eligible companies. The companies would, under the current legal framework, pay full social security contributions at the time of the exercise of the share option. Under the new scheme, the companies will be liable for the social security contributions at a later point in time, i.e. the realisation of the option. If the value of the share is reduced between the exercise and the realisation, the employer will pay lower social security contributions. The deferred and possible reduced social security contributions confer direct advantages to these companies, as they may mitigate charges which are normally included in their budget.

4.3 Selectivity

(43) The measure must be selective in that it favours *"certain undertakings or the production of certain goods"*.

(44) The proposed measure benefits only young and small companies as defined. Older or larger companies are de jure excluded from the tax scheme. The measure only favours certain undertakings and is therefore selective.

4.4 Effect on trade and distortion of competition

(45) The measure must be liable to distort competition and to affect trade between the Contracting Parties to the EEA Agreement.

(46) The aid granted will strengthen the position of the eligible companies compared with that of its competitors. Furthermore, at least some of the eligible companies are active in markets that are open for EEA-wide competition and trade. The Authority therefore concludes that the measure is liable to distort competition and to affect trade between the Contracting Parties.

4.5 Conclusion

(47) In light of the above, the Authority concludes that the measure constitutes state aid to eligible companies within the meaning of Article 61(1) of the EEA Agreement.

5 Procedural requirements

(48) Pursuant to Article 1(3) of Part I of Protocol 3 to the Agreement between the EFTA States on the Establishment of a Surveillance Authority and a Court of Justice ("Protocol 3"): "*The EFTA Surveillance Authority shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. .... The State concerned shall not put its proposed measures into effect until the procedure has resulted in a final decision*."

(49) The Norwegian authorities have submitted a notification of the measure and have not let the new tax scheme enter into force yet. They have therefore complied with the obligations under Article 1(3) of Part I of Protocol 3.

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6 Compatibility of the aid measure

(50) The Authority can declare state aid compatible with the functioning of the EEA Agreement under Article 61(3)(c), provided that certain compatibility conditions are fulfilled.

(51) In this case, there are no existing state aid guidelines applicable to the measure at hand. The Authority will therefore assess the measure directly under Article 61(3)(c) of the EEA Agreement.

(52) The Authority's assessment is based on the following common assessment principles:

- contribution to a well-defined objective of common interest;
- need for state intervention;
- appropriateness of state aid as a policy instrument;
- existence of an incentive effect;
- proportionality of the aid amount (aid limited to minimum necessary);
- avoidance of undue negative effects on competition and trade; and
- transparency.

6.1 Objective of common interest

(53) State aid must aim at a well-defined objective of common interest that has been recognised by the Contracting Parties.

(54) The objective of the measure is to increase market efficiency by facilitating the efficient matching of labour resources to the economic needs of young and small companies, in order to increase their value added.

(55) The Norwegian authorities have explained that young and small companies often face difficulties in recruiting and retaining employees. Such companies often do not have enough capital or financial resources to compete with older, more established companies.

(56) Moreover, the European Commission has recognised that shortage of skilled employees adversely impacts innovation and growth, by restricting small companies' abilities to explore the productive potential of innovation and ideas.[21]

(57) The European Commission has also emphasised the importance of employee share options as a mechanism for attracting and retaining employees to small growth companies and in fostering entrepreneurship.[22]

(58) The Authority understands that the measure aims at facilitating the efficient matching of labour resources to the economic needs of young and small companies in order to increase

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([21]) Communication from the Commission to the European Parliament, the Council, the European economic and social Committee and the Committee of the Regions, *Entrepreneurship 2020 Action Plan, Reigniting the entrepreneurial spirit in Europe*, COM (2012) 795 final of 9.1.2013, available here: https://ec.europa.eu/transparency/regdoc/rep/1/2012/EN/1-2012-795-EN-F1-1.Pdf.

([22]) *Employee Stock Option: the legal and administrative environment for employee stock options in the EU*, European Commission, DG Enterprises, June 2003, p. 20.

their productivity and growth, and their value added. This will again foster the level of overall innovation, job creation and value added to the economy. The possibility for young and small companies to develop ideas and grow is a fundamental condition for growth in the economy at large.

(59) Accordingly, the measure contributes to a well-defined objective of common interest.

6.2 Need for state intervention

(60) In order to assess whether state aid is effective to achieve the identified objective of common interest, it is necessary to identify the problem the aid is to address. State aid should be targeted towards situations where aid can bring a material improvement that the market alone cannot deliver, for example by remedying a market failure or addressing an equity or cohesion concern.

(61) According to the Norwegian authorities, the market failure, which is the rationale for this new tax scheme, stems both from capital and labour market failures. Young and small companies in Norway face challenges when competing in the labour market to attract and retain qualified personnel, because the companies have difficulties providing competitive remuneration. Potential employees may also find a young and small company less attractive, as such companies may be perceived as riskier compared to employment at a larger, well-established company. These challenges may adversely affect the overall level of innovation, productivity, growth, job creation and value added in the economy.[23]

(62) Young and small high growth companies are often at a competitive disadvantage compared to larger companies in terms of their ability to offer an economically efficient level of remuneration. Young and small companies tend to have cash constraints and have limited assets or reserves to offer competitive remuneration to employees. The Authority has no reason to doubt the information it has received to this effect.

(63) The Norwegian authorities have further submitted data showing that access to qualified labour is a greater challenge for small companies compared to larger companies.[24] The survey also shows that small companies, to a greater extent than larger companies, express that access to capital constitutes a challenge.

(64) The Norwegian authorities have explained that employee share options are less often used by young and small companies due to a number of challenges.[25] Firstly, the general rules on taxation of employee share options may create liquidity challenges for the employees. When options are exercised, employees both have to pay taxes on gains on options and pay for the shares. This challenge will in some cases be reinforced by difficulties selling shares that might not be liquid. A deferred taxation may remedy this and increase the attractiveness of such options.

(65) Moreover, employees who accept remuneration in the form of share options make an investment decision, similar to an equity investment, because the benefit of the share options does not materialise immediately (compared to cash-based remuneration), but rather maybe in the future if there is growth in the share value. Investing in young and small companies may be risky, and the future value of the option is more uncertain than options in larger, more established companies. It is difficult to estimate the market value

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([23]) M Institute's "*Empowering Medium Enterprises*" 2006, D.J Storey, *"Understanding the Small Business Sector"*, Routledge, London, 1994. Pages 155-156. M Institute's *"Empowering Medium Enterprises"* 2006.
([24]) The data comes from a survey conducted by NHO, the Confederation of Norwegian Enterprise.
([25]) According to the Norwegian authorities, less than 5 percent of SMEs in the EU use employee share options.

of shares in such companies because they are not listed on a stock exchange. The employee must primarily rely on expectations of future profitability and dividends when assessing the value of such share options. According to the Norwegian authorities, employees hired by such companies therefore tend to be less inclined to accept share options as a form of remuneration. The Authority has no reason to doubt this assessment.

(66) Furthermore, according to the Norwegian authorities, young and small companies may face difficulties in obtaining funding compared to larger companies. This is *inter alia* the case where funding is sought for purposes other than tangible assets, such as employees. Due to an asymmetry of information, it is difficult for the external finance providers to estimate additional productivity improvements from remunerating employees.

(67) As capital and funding may be more costly to young and small companies, projects that might have been profitable in larger companies are not necessarily so in smaller companies. This may result in situations where projects that could have increased economic value added, are not undertaken. By reducing liquidity challenges, the scheme will, according to the Norwegian authorities, contribute to shrinking such differences, thereby contributing to economic value added.

(68) The Norwegian authorities have also highlighted the information asymmetry between the employee and the employer. Employees are typically risk-averse and find it hard to assess the future prospects of a young and small, risky employer, even if its prospects are positive. This may deter them from considering opportunities in any younger and smaller, high risk businesses. Economic theory indicates that employees are significantly more likely to choose large employers, and young and small companies may therefore face disproportionate staff shortages.[26] Larger and older companies are usually more well known, offer more opportunities for a career and more attractive remuneration packages, as well as job security. Working for a young and small company inherently involves a greater risk to job security, which is likely to increase the size of the remuneration package necessary to attract and retain key employees.

(69) Finally, the Norwegian authorities have highlighted that there are costs connected to hiring and laying off employees. According to the Norwegian authorities, these costs are higher for young and small companies compared to larger companies. First, young and small companies have less staff to undertake these tasks and the administrative costs are more of a burden to them relative to larger companies. Second, young and small companies perform hiring processes less often. It is therefore likely that the process is less efficient. Third, these companies will usually have fewer opportunities to shift resources internally. Finally, the risk of hiring and laying off employees are higher for young and small companies. This is especially the case for companies eligible for the proposed measure, as these companies have fewer than ten employees.

(70) The Authority has no reason to doubt this information. Considering the above, the Norwegian authorities have demonstrated the existence of a market failure that prevents an efficient matching of labour resources to the economic needs of young and small companies. In this context, younger and smaller companies are unable to offer competitive remuneration and normal job security to employees.

([26]) G. Akerloff, *"The Market for Lemons: Quality Uncertainty and the Market Mechanism"* The Quarterly Journal of Economics, 84, 1970, pp. 488-500.

(71) Public intervention both at company level and employee level is thus needed in order to allow young and small companies in Norway to offer competitive remuneration to employees compared to larger well established ones.

6.3 Appropriateness of state aid

(72) State aid must be an appropriate instrument to address the identified objective of common interest. An aid measure is not compatible with the functioning of the EEA Agreement if the same positive contribution to the common objective is achievable through other less distortive policy instruments or other less distortive types of aid instruments.

(73) The proposed measure addresses the eligible companies' specific problem of attracting, recruiting and retaining qualified employees. The Norwegian authorities acknowledge that other instruments can be appropriate to tackle the general problems of lack of capital. However, other measures would, according to the Norwegian authorities, not address the nature of the problems underpinning the recruitment and retention issues faced by young and small companies and their employees. A fiscal scheme aimed at addressing access to finance for small and medium sized enterprises would not be sufficiently focused and concentrated on the eligible companies' specific problem of attracting, recruiting and retaining qualified employees.

(74) The Norwegian authorities are also of the opinion that a general regulatory measure would be less effective and therefore cause, in economic terms, so-called "deadweight losses" (i.e. losses of economic efficiency), as such a measure would address all companies and not target specifically those young and small companies with problems of attracting, recruiting and retaining personnel. The proposed scheme is specifically targeted at young and small companies.

(75) In addition, the scheme may reduce liquidity issues for the eligible companies. Use of performance-based instruments, such as employee share options, paid on top of a fixed cash salary, may form part of the overall remuneration and decreases the necessity of, for example, granting cash bonuses, which may be an issue for young and small companies. The scheme will make employee share options more attractive for the employees, thereby increasing the possibility of the eligible companies using options as a form of remuneration, which does not impose any immediate cash constraints.

(76) Finally, the Norwegian authorities highlight that the new tax scheme will have additional advantages compared to other aid measures. Share options have an effect on retaining employees, since they are motivated to create share value, as the benefits of exercising the option materialise upon the growth in share value. The potential future value of the share options may reduce a potential salary differential between young and small companies and larger, more established companies.

(77) Academic literature also indicates a positive relation between the use of share-based remuneration and productivity when used as part of a wider package of measures.[27]

(78) In conclusion, state aid is appropriate to remedy the market failure identified above. Further, the type of aid chosen is coherent with the market failure that the aid measure aims to address. As the new tax scheme better focuses on young and small companies' problem of recruiting and retaining key employees, the Authority considers it is an appropriate state aid instrument.

([27]) A. Bryson, R. Freeman, "*Doing the Right Thing? Does fair share capitalism improve workplace performance?*" WERS 2004 Grants Fund. DTI, Employment Relations Research Series No. 81.

6.4 Incentive effect

(79) State aid is only compatible with the functioning of the EEA Agreement if it has an incentive effect. An incentive effect occurs when the aid induces the beneficiary to change its behaviour to further the identified objective of common interest, a change in behaviour which it would not undertake without the aid.

(80) The Norwegian authorities indicate that the scheme increases the liquidity for young and small companies. Therefore, the companies may offer their employees a higher remuneration. Remuneration through share options will thus be a more attractive option for both the employee and the employer. Share options provide an incentive for employees to remain in young and small companies, and work to increase the value of the underlying shares.

(81) The Norwegian authorities explained that while the potential benefits arising from options only materialise if an employee ultimately exercises their option and only if there has been market growth in the value of the shares between grant and exercise, nevertheless granting the options *per se* gives incentives to the employees. Besides, given that the deferred tax advantages are lost on employee resignation and termination, the employee has an incentive to remain in the company.

(82) The Norwegian authorities also explained that the new tax scheme will have an incentive effect on the eligible companies. The new tax scheme will reduce the amount of underlying shares under the option that a company would have to provide to give the same post-tax reward to employees. The new tax scheme thus enables the company to provide a more competitive overall remuneration package that otherwise would have only been possible through the provision of greater shareholding value under the option.

(83) The Authority considers that the measure makes employee share options economically attractive both for employees and young and small companies, which addresses both the labour and capital market failure. The scheme will increase the amount of post-tax reward available to an employee and thereby provides an incentive to join or stay with the company. Furthermore, by reducing the value of the options that a company would have to issue to attract a given employee, it enables companies to provide a more competitive remuneration package.

(84) The scheme thus provides incentives to the beneficiary companies to recruit and retain employees, by improving the economic attractiveness of employee share options granted by young and small companies in Norway to their employees. It is also an incentive to employees to join or stay with the companies, which addresses the market failures and contributes to the achievement of the common objectives.

6.5 Proportionality

(85) State aid is proportionate if the aid amount per beneficiary is limited to the minimum needed to achieve the identified objective of common interest.

(86) The Norwegian authorities have explained that the measure contains safeguards to limit the aid granted to the companies.

(87) First, the scheme merely provides a deferred taxation on option gains for eligible young and small companies and their employees, in addition to a preclusion of the risk for such companies and employees to pay income tax/social security contributions on options that do not end up with any gain upon realisation of the shares. The advantage from the

scheme materialises only from the exercise of employee share options, which happens only where the share price exceeds the agreed exercise price.

(88) Second, the amount of options awarded is the result of bargaining between companies and their (prospective) employees, with opposite motives, which will contribute to the proportionality of the aid. Both independent economic actors will have to negotiate on the exercise price, the premium and the amount of share under option to be awarded. While employees will have preferences for greater remuneration, employers will have an incentive to minimise the costs.

(89) Third, the scheme is only granted to young and small companies and their employees, which means that large companies which do not suffer from the previously described market challenges in Norway, will not benefit from the scheme.

(90) Finally, the scheme also caps the total value of employee options that a company may issue and the total value of the employee options each option holder may hold, and the cap is low. There are also a number of qualifying criteria for companies, employees and options, which also provide safeguards that the measure targets the above identified market failures, while still limiting the aid to the minimum.

(91) The Norwegian authorities have also submitted information showing that any cumulation with the differentiated social security contribution system is limited, see section 3.6 above.

(92) The aid granted with the notified measure is therefore proportionate, as it provides for a number of safeguards ensuring that any aid is limited to the minimum necessary to achieve the objectives.

6.6 Avoidance of undue negative effects on competition and trade

(93) For state aid to be compatible with the functioning of the EEA Agreement, the negative effects of the aid measure in terms of distortions of competition and impact on trade between Contracting Parties must be limited and outweighed by the positive effects in terms of contribution to the objective of common interest.

(94) The measure is targeted at a well-defined restricted set of companies which typically face difficulties in recruitment and retention of key employees. Larger, well-established companies do not suffer from the market failure to the same extent, and would be able to compete successfully in the labour market by offering competitive remuneration packages without the aid. Therefore, the measure is unlikely to discourage investments by larger companies.

(95) By increasing the ability of young and small companies to offer competitive remuneration packages to employees, the scheme has the potential to promote competition in the labour market and help to improve the efficient matching of labour resources to productive economic activities. This may increase competition, since it will give companies greater potential to develop, market and commercialise their products and services, and may therefore lead to growth in overall economic productivity.

(96) Given that the maximum aid amount is limited, the limited size of the eligible companies and that the aid is targeted to a well-defined purpose, it is unlikely to have any measurable negative effects on competition and trade.

(97) The distortions of competition and negative effects on trade due to the measure will thus be limited.

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6.7 Transparency

(98) According to the general transparency requirement, only aid granted in a transparent manner can be approved on the basis of Article 61(3)(c) of the EEA Agreement. The Norwegian authorities have committed to publish information about the aid granted in accordance with the general transparency requirement. The Norwegian authorities will publish the full text of the aid scheme and make the necessary disclosures on a central website.[28]

7 Conclusion

(99) The employee share option tax scheme constitutes state aid with the meaning of Article 61(1) of the EEA Agreement. Since no doubts are raised as to its compatibility with the functioning of the EEA Agreement pursuant to its Article 61(3)(c), the Authority has no objections to the implementation of that measure.

For the EFTA Surveillance Authority, acting under Delegation Decision No 068/17/COL,

Yours faithfully,

Sven Erik Svedman President	Carsten Zatschler Director

This document has been electronically signed by Sven Erik Svedman, Carsten Zatschler.

([28]) The information will be available on the following website: https://data.brreg.no/rofs/