SUPREME COURT OF NORWAY

J U D G M E N T

given on 28 May 20202 by the Supreme Court composed of

Justice Magnus Matningsdal
Justice Kristin Normann
Justice Henrik Bull
Justice Wenche Elizabeth Arntzen
Justice Espen Bergh

HR-2020-1130-A, case no. 19-177162SIV-HRET
Appeal against Borgarting Court of Appeal's judgment 26 September 2019

A/S Norske Shell	(Counsel Jan Birger Jansen)
v.	
The State represented by The Petroleum Tax Office	(The Office of the Attorney General represented by Anders Flaatin Wilhelmsen)

(1) Justice **Bergh:**

Issues and background

(2) The case concerns the validity of an administrative decision from the Petroleum Tax Appeal Board (the Appeal Board) regarding the assessment of A/S Norske Shell for the financial years 2007–2012. A final ruling has been issued by the Court of Appeal establishing a basis for an estimated (*skjønnsmessig*) supplement to the company's income under section 13-1 of the Taxation Act, since costs for research and development (R&D) in Norway should have been shared with other Shell companies. The Supreme Court is to consider whether this supplement may comprise the portion of the costs charged to A/S Norske Shell's co-licensees (*lisenspartnere*) in production projects on the Norwegian continental shelf.

(3) The Shell group is one of the world's largest oil and gas companies, with activities worldwide. A/S Norske Shell (Norske Shell) is a wholly owned subsidiary in the group. The company's activities include exploration and production (E&P) of petroleum on the Norwegian continental shelf and are thus taxable under the Norwegian Petroleum Taxation Act. Norske Shell is licensee and operator in several major Norwegian E&P projects.

(4) The E&P projects are carried out by several petroleum companies jointly. The relationship between the various licensees is regulated by a fixed set of regulatory agreements, including a Joint Operating Agreement and an Accounting Agreement.

(5) Shell Technologies Norway AS was previously a wholly owned subsidiary of Norske Shell. The R&D activities concerned in the case at hand were largely run through this company. However, the parties agree that the case at hand gives no cause to distinguish between the two companies. When I in the following refer to Norske Shell, it may therefore include Shell Technologies Norway AS.

(6) The Shell group carries out extensive research activities, of which the main part related to E&P is placed in the Dutch company Shell International Exploration and Production B.V. (SIEP). The costs for applied research are shared among the various E&P companies according to a distribution formula reflecting each company's expected benefit. The cost sharing principles are laid down in a separate agreement – the SIEP Agreement. In accordance with this agreement, Norske Shell has for the period 2007–2012 paid an annual amount between NOK 46 and 100 million for participation in the SIEP system. This corresponds to five to six percent of the total SIEP costs.

(7) Norske Shell participates in a number of projects involving research cooperation connected to Norway – many of which are conducted by the Research Council of Norway. During the period in question, the research in Norway was funded by Norske Shell without cost sharing among various Shell companies according to the distribution formula in the SIEP agreement or otherwise. The research in Norway is nonetheless comprised by the SIEP cooperation in the sense that the results thereof are available to companies in the Shell group and considered an integrated part of the SIEP system.

(8) In connection with the tax assessment for the income years 2007–2012, Norske Shell deducted all R&D costs that had not already been carried through special on-demand research. In addition, the company deducted its share of the Shell group's joint research costs

under the SIEP agreement. The annual deducted R&D costs in Norway were in the interval of NOK 81 to 111 million.

(9) In connection with a reassessment by the Petroleum Tax Office for the financial years 2007 and 2008, and the assessment for the income years 2009–2012, deduction was refused for the company's R&D costs in Norway. The reason for such refusal was that the costs should have been shared within the Shell group according to the formula in the SIEP agreement. However, the company's deduction of its share of the SIEP costs was accepted. Norske Shell appealed the Petroleum Tax Office's reassessment to the Petroleum Tax Appeal Board.

(10) On 12 December 2016, the Appeal Board issued an order, concluding unanimously that the conditions for estimation under the provisions on transfer pricing in section 13-1 of the Taxation Act had been met. In connection with the estimation, the Appeal Board agreed with the Petroleum Tax Office that it was correct to take as a starting point the aggregate costs for the relevant R&D projects in Norway. The cost sharing within the Shell group would take place without any reduction for the part of these costs that had been charged, in accordance the Accounting Agreement, to Norske Shell's co-licensees in the various E&P projects.

(11) The Appeal Board found that it could not rule out circumstances implying that the research in Norway to some extent gives Norske Shell larger economic benefits than those obtained by Shell companies in other countries. However, the Appeal Board disagreed on the significance of this. Based on these benefits, the majority stipulated a ten-percent reduction in the cost base.

(12) Following the Appeal Board's reassessment, the remaining costs were shared according to the formula used by Shell within the SIEP system. As mentioned, Norske Shell's share constitutes five to six percent. This entailed that the tax assessment was based on an estimate that around 85 percent of the total R&D costs in Norway were to be distributed amongst Shell companies in other countries.

(13) Norske Shell brought the reassessment from the Appeal Board before Oslo District Court for a judicial review. On 23 March, the District Court ruled as follows:

> "1. The District Court finds in favour of the State represented by the Petroleum Tax Office.
>
> 2. A/S Norske Shell will pay costs of NOK 224 750 to the State represented by the Petroleum Tax Office within two weeks of the service of this judgment."

(14) Norske Shell appealed the judgment to Borgarting Court of Appeal, which, on 26 September 2019, ruled as follows:

> "1. The appeal is dismissed.
>
> 2. A/S Norske Shell will pay costs in the Court of Appeal of NOK 146 450 – onehundredandfortysixthousandfourhundredandfifty – to the State represented by the Tax Office within – 2 – weeks of service of this judgment."

(15) Both the District Court and the Court of Appeal heard all parts of the Appeal Board's reassessment. Norske Shell challenged both the authority to estimate (under section 13-1 of the Taxation Act) and the procedure by which the estimation was done.

(16) Norske Shell appealed the Court of Appeal's judgment to the Supreme Court. The appeal concerned the judgment as a whole and covered both the findings of fact and the application of the law.

(17) The Supreme Court's Appeals Selection Committee has granted leave to appeal "as concerns the question whether R&D costs shared among A/S Norske Shell's co-licensees under the Accounts Agreement are to be included in the stipulation of the company's loss of income under section 13-1 of the Taxation Act (the 'gross/net issue')". Apart from that, leave to appeal has been refused.

(18) The case has been dealt with as a remote hearing in accordance with Temporary Regulations of 27 March 2020 No. 459 on simplifications and measures within the Judiciary to mitigate the effects of the Covid-19 outbreak and Temporary Act of 26 May 2020 No. 47 on adjustments to the procedural set of rules as a consequence of the Covid-19 outbreak.

The parties' contentions

(19) The appellant – *A/S Norske Shell* – contends:

(20) Section 13-1 of the Taxation Act does not permit estimates with the effect that the share of R&D costs covered by Norske Shell's co-licensees are also included as costs in the cost sharing based on the SIEP Agreement.

(21) First, the Appeal Board's decision is based on factual errors. No transaction has taken place transferring material and intellectual property that can be evaluated.

(22) Also, the application of the law is wrong. The estimate is incompatible with the arm's length principle in section 13-1 of the Taxation Act and the OECD guidelines referred to in section 13-1 subsection 4. The costs charged to the co-licensees are not costs for Norske Shell to be included in the SIEP cost sharing system.

(23) Alternatively, the contributions from the co-licensees may constitute income for Norske Shell that must be subject to the cost sharing in the same way as costs and other SIEP income.

(24) Furthermore, the reassessment entails double taxation, which means that the same income – the costs carried by the co-licensees – are taxed twice.

(25) A/S Norske Shell invites the Supreme Court to pronounce the following judgment:

> "1. The assessment of A/S Norske Shell for the financial years 2007 to 2012 is set aside. In a new assessment, no income is to be stipulated for A/S Norske Shell from the Shell group for the R&D costs charged to the company's co-licensees.
>
> 2. A/S Norske Shell is awarded costs in District Court, Court of Appeal and the Supreme Court."

(26) The respondent – *the State represented by The Petroleum Tax Office* – contends:

(27) In its estimate, the Appeal Board has stipulated the consideration in the same way as the Shell group prices access to R&D results, i.e. so that the price to be paid by each company is stipulated as a part of the aggregate costs. This estimate is valid.

(28) It is not correct that the charging under the Accounting Agreement entails that Norske Shell's R&D costs are actually reduced, and that this means that fewer costs remain for distribution within the Shell group. The costs for Norske Shell remain unchanged both by the charging under the Accounting Agreement and by the further sharing within the Shell group.

(29) Legally, there is no reason why, in connection with the pricing of the benefit the other Shell companies receive, only the "net cost" that is distributable. The purpose of the act is to estimate what the parties would have agreed had they been independent. Here, there is no room for reducing the consideration because one of the parties has an advantage from a different transaction.

(30) No double taxation has taken place. The taxation is this place relates to income from various transactions.

(31) The State represented by the Petroleum Tax Office invites the Supreme Court to pronounce the following judgment:

> "1. The appeal is dismissed.
>
> 2. The State represented by the Petroleum Tax Office is awarded costs in the Supreme Court."

My opinion

The starting points

(32) With the Court of Appeal's judgment, it has been finally decided that Norske Shell's R&D activities in Norway have been beneficial to other Shell companies, and that the Norwegian company in this context – had the group community not existed – would have demanded consideration or compensation from the foreign companies. It has thus been established that Norske Shell's income may be estimated in accordance with section 13-1 of the Taxation Act. Subsection 1 of this provision reads:

> "Discretionary assessment may be applied if the wealth or income of the taxpayer has been reduced as the result of a direct or indirect commonality of interest with another person, company or undertaking."

(33) The Appeal Board's estimate is based on distribution of R&D costs in Norway between the group companies in proportion to how beneficial this activity has been to the various companies. According to the reassessment, Norske Shell's right to deduction is limited to the part of the costs that are deemed to correspond to the benefit acquired by this company. The Appeal Board has taken as its starting point the distribution formula used by the group itself for costs comprised by the SIEP Agreement, and thus assumed that Norske Shell's share of the costs amounts to five to six percent. As the case stands before the Supreme Court, the use of this distribution formula is not in dispute.

(34) Before the distribution among the group companies, the Appeals Board's majority reduced the cost base by ten percent since Norske Shell's R&D is considered somewhat more valuable to Norske Shell than to the other group companies. The size of this reduction is not at issue before the Supreme Court.

(35) The question for the Supreme Court to answer is whether it should be possible, when calculating the R&D costs to be shared with group companies in other countries, to include costs that are charged to Norske Shell's co-licensees partners on each of the E&P projects. Therefore, I will start by considering the licence partnership on the Norwegian continental shelf and the coverage of costs within this cooperation.

The relationship between the operator and other licensees on the Norwegian shelf – coverage of R&D costs

(36) Production of petroleum on the Norwegian shelf takes place in accordance with a production licence granted by the King in Council under section 3-3 of the Petroleum Act. A production licence for a field is generally granted to several licensees jointly. In such cases, one of the licensees is appointed operator, see section 3-7 of the Petroleum Act. The case at hand concerns costs related to a field on which Norske Shell is operator.

(37) As mentioned, the relationship between the licensees, which jointly constitute a joint operation, is as mentioned regulated by the Joint Operating Agreement and the Accounting Agreement. According to article 3.1 of the Joint Operating Agreement, the operator is to carry out and administer the day-to-day management of the joint venture activities. It is also set out that the operator is neither to have profit nor loss through the execution of its duties, unless otherwise provided in the Joint Operating Agreement. According to article 8.1, the parties are obliged to provide sufficient funds to cover all expenses relating to the activities of the joint venture.

(38) The subject of dispute in the case at hand are costs relating to activities described in the Accounting Agreement as "General Research and Development". According to article 1.1 (d) this is:

> "[p]rojects (in accordance with the definition of "Research and Development" adopted by the Research Council of Norway) that are carried out by or under the direction of the Operator. The projects shall be beneficial to the upstream operations and be charged to the Operator."

(39) The operator's costs may be charged to the so-called Joint Account and thus the other licensees in proportion to their share. Each year, it must be documented that the costs relate to activities that have "a beneficial effect for the Norwegian Continental Shelf". The parties have trusted that around 40 percent of Norske Shell's general R&D have been charged to the other licensees. This implies that Norske Shell itself has covered around 60 percent.

The tax rules

(40) I have already reproduced section 13-1 subsection 1 of the Taxation Act. As the case stands before the Supreme Court, it has been clarified, as mentioned, that the basic requirements of the law have been met by Norske Shell's income being reduced due to the community of

interests with the other group companies. Thus, it is clear that the Appeal Board was entitled to estimate the income. The question before the Supreme Court is whether the Appeal Board has exercised its authority to estimate correctly when stipulating the size of the supplement made to Norske Shell's income.

(41) The estimation procedure is regulated as follows in section 13-1 subsection 3 of the Taxation Act:

> "The discretionary assessment shall determine the wealth or income as if there was no commonality of interest."

(42) It is clear that it concerns international factors, which gives application to section 13-1 subsection 4, which states that

> "… the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations adopted by the Organisation for Economic Co-operation and Development (OECD) shall be taken into consideration when determining whether wealth or income has been reduced within the meaning of subsection 1"

(43) Subsection 4 was added by Act of 29 June 2007 No. 72. It was also assumed in former case law that the OECD Transfer Pricing Guidelines were relevant for the interpretation of section 13-1 of the Taxation Act. The amendment was made due to the desire to implement these guidelines more formally into Norwegian law, see Proposition to the Odelsting No. 62 (2006–2007) page 14. On page 15 of the Proposition, it is also stated that the OECD guidelines are still intended as guidelines, rather than mandatory rules. However, it is also stated on page 14 that the guidelines "are relevant when interpreting section 13-1". This implies that the guidelines may be relevant when applying section 13-1 subsection 3 as a legal framework for further estimation of income or costs.

(44) The courts' jurisdiction to review the authority to estimate in section 13-1 subsection 3 of the Taxation Act is compatible with the general administrative law rules on the use of estimates in administrative decisions, see the Supreme Court judgment Rt-2012-1025 paragraph 68. Norske Shell holds that the estimate in this case is based on incorrect facts and an incorrect application of the law. This is within the courts' jurisdiction to examine.

(45) Section 13-1 subsection 3 of the Taxation Act describes the so-called arm's length principle. The aim is to establish how independent parties would have arranged matters in a similar situation. In section 1.119 of the OECD guidelines, it is emphasised that an accurate analysis

> "… will have identified the substance of the commercial or financial relations between the parties, and will have accurately delineated the actual transaction by analysing the economically relevant characteristics".

(46) Hence, an individual analysis of the transaction must be made with focus on the aspects therein that are commercially relevant in a commercial context.

The Appeal Board's application of the law

(47) The Appeal Board's reassessment is based on the group companies' recent access internationally to research obtained through R&D in Norge. It is a question of sharing the

results, rather than transferring them with the effect that Norske Shell assigns its rights or the group companies acquire exclusive rights.

(48) A central starting point for the reassessment is that the research carried out by Norske Shell in Norway is taxable in the same manner as the activities carried out by Shell internationally through the SIEP system. This system is based on a cost sharing principle, which implies that it is the actual costs, without being supplemented with any form of profit, that are to be shared proportionally between the group companies based on each company's benefit. The Appeal Board's reassessment must be interpreted to mean that one accepts that the SIEP cooperation is established to align with the arm's length principle.

(49) In an intra-group document named "Operating Model Documentation", the cost sharing within the SIEP cooperation is described as follows in section 1.4:

> "The Operating Model operates within the context of a cost sharing system, where services are made available 'at cost' (i.e. without any element of profit) and shared proportionally amongst each of the companies benefiting from the activities for which the costs were incurred."

(50) Next, it follows form the same set of rules that when calculating costs, a deduction must be made for income earned in connection with the R&D activities. This is expressed as follows:

> "From the said cost shall be deducted all such amounts (…) as in the year concerned shall have been received by SIEP in consideration of the granting of any licences or other rights of use in respect of patented and unpatented technical knowledge and information in the said fields."

(51) In Proposition to the Odelsting No. 62 (2006–2007) issued in connection with the adding of section 13-1 subsection 4 to the Tax Act in 2007, the Ministry discussed the content of the OECD Transfer Pricing Guidelines. Item 5.9 of the Proposition presents the guidelines relating to Cost Contribution Arrangements (CCAs) as follows:

> "A CCA is a contractual framework for sharing of costs and risks connected to development, production or acquisition of assets, services or rights. The participants seek to obtain an expected advantage through their contribution to the CCA. Under a CCA, each participant will have a right to exploit its interests in the CCA as actual owner thereof, and the participants will thus not be liable for any royalty or other compensation towards any other party for the exploitation of its interests within the system. The most common CCA are systems for joint development of intellectual property, but CCAs are also established for other purposes."

(52) The way I see it, the Appeal Board has observed the arm's length principle under section 13-1 of the Taxation Act and the OECD guidelines, when taking as its starting point for the reassessment that the joint venture between Norske Shell and the group companies involves cost sharing. Here, no assets are being transferred in return for a consideration to be estimated based on the commercial principles applicable in an ordinary acquisition of goods, services or rights.

(53) This means that the tax authorities' estimate must comply with the CCA principles that may be derived from section 13-1 of the Taxation Act interpreted in light of the OECD guidelines. In section 8.12 the following is provided on the application of the arm's length principle in such a context:

> "For the conditions of a CCA to satisfy the arm's length principle, the value of participants' contributions must be consistent with what independent enterprises would have agreed to contribute under comparable circumstances given their proportionate share of the total anticipated benefits they reasonably expect to derive from the arrangement."

(54) Thus, the crucial point is, also here, which contribution would have been agreed between independent parties, but in light of the expected benefits to be received under the relevant arrangement. Proposition to the Odelsting No. 62 (2006–2007) section 5.9 describes it likewise.

(55) The Appeal Board states the following on the significance of a share of Norske Shell's R&D costs being charged to the co-licensees:

> "The payment from the parent company and the company's onward charging to the partners are to separate transactions. The Appeal Board cannot see that there is a connection between these two transactions implying that they should nonetheless be assessed jointly in accordance with section 13-1 of the Taxation Act."

(56) From what I have pointed out, the Appeal Board has not taken the correct legal starting point. What the Board states must be naturally understood to imply that it finds that a transaction – a sale – has taken place between Norske Shell and the foreign group companies. The correct assumption would be that an agreement exists regulating a cost sharing system.

(57) A correct application of the arm's length principle suggests that one must assess what foreign Shell companies – as part of a cost contribution arrangement between independent parties – would have accepted to pay bearing in mind the expected benefit from accessing the results of the R&D activities in Norway. In my view, it would then be correct to base it on the actual costs incurred by Norske Shell, which has the effect that costs covered by others are not to be included.

(58) Importance cannot be attached to whether the coverage obtained through the charging to the co-licensees, from Norske Shell's perspective, appears as cost sharing or as payment for access to the results of R&D projects. The crucial factor is nonetheless that Norske Shell and the foreign Shell companies participate in a cost sharing system under which the actual costs incurred by Norske Shell are to be distributed in proportion to each company's benefit. The portion of the R&D costs charged to the co-licensees may not in this regard be considered a cost for Norske Shell.

(59) Against this background, I conclude that the Appeal Board's reassessment is based on an incorrect interpretation of the arm's length principle as described in section 13-1 of the Taxation Act and in the OECD guidelines.

(60) The Appeal Board's administrative decision must thus be set aside. It follows from what I have pointed out, that with the Appeal Board's reassessment, the portion of the R&D costs charged to Norske Shell's co-licensees partners, cannot be included in the estimated income. The conclusion of the judgment may thus be modelled on Norske Shell's request for relief.

Costs

(61) Norske Shell has contended during the entire case, also in the appeal to the Supreme Court, that there was no basis at all for applying section 13-1 of the Taxation Act in the case at hand. The result after the Supreme Court's judgment is that although estimation is possible, the income must be estimated lower than in the Appeal Board's reassessment. This implies that neither party has been successful either in the whole or in the main, see section 20-2 of the Dispute Act.

(62) Both parties have succeeded to a significant degree, see section 20-3 of the Dispute Act. However, I see no reason why any of them should be awarded costs in the District Court or in the Court of Appeal.

(63) In the Supreme Court sitting as a division, the case has been limited to the question whether the share of the costs charged to the co-licensees are to be included in the estimated income. On this point, the Supreme Court finds in favour of Norske Shell. Thus, there are factors clearly suggesting that Norske Shell should be awarded costs in part in the Supreme Court, see section 20-3 of the Dispute Act.

(64) In my opinion, Norske Shell should be compensated for necessary costs incurred after leave to appeal was granted, in addition to the court fee. For work carried out after the appeal was submitted, Norske Shell has demanded compensation for legal fees of NOK 378 505. Costs constitutes NOK 21 396, and the court fee NOK 31 050 kroner. A total of NOK 430 951 is thus awarded.

Conclusion

(65) I vote for this

J U D G M E N T :

1. The order issued by the Petroleum Tax Appeal Board 12 December 2016 is set aside. A new tax assessment is not to include income for A/S Norske Shell from other companies in the Shell group for the share of R&D costs carried by the company's co-licensees.

2. Costs in the District Court and the Court of Appeal are not awarded.

3. The State represented by the Petroleum Tax Office will pay costs in the Supreme Court of NOK 430 951 – fourhundredandthirtythousandninehundredandfiftyone – to A/S Norske Shell within 2 – two – weeks of service of this judgment.

(66) Justice **Arntzen:** I agree with Justice Bergh in all material respects and with his conclusion.

(67) Justice **Normann:** Likewise.

(68) Justice **Bull:** Likewise.

(69) Justice **Matningsdal:** Likewise.

(70) Following the voting, the Supreme Court gave this

J U D G M E N T :

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