

1 July 2011

# Screening report

## Iceland

### Chapter 33 – Financial and budgetary provisions

**Date of screening meetings:**

Explanatory meeting: 7 March 2011

Bilateral meeting: 4 April 2011

## I. CHAPTER CONTENT

This chapter covers the rules concerning the financial resources necessary for the funding of the EU budget ('own resources'). These resources are made up mainly from so-called traditional own resources from customs duties and sugar levies, which are levied by the Member States on behalf of the EU; furthermore a resource based on value-added tax; and finally, a resource based on each Member State's gross national income. Member States must have appropriate administrative capacity to adequately co-ordinate and ensure the correct calculation, collection, payment and control of own resources. The *acquis* in this area is directly binding and does not require transposition into national law.

## II. COUNTRY ALIGNMENT AND IMPLEMENTATION CAPACITY

This part summarises the information provided by Iceland and the discussion at the screening meeting held on 7 March 2011.

Iceland indicated that it can accept the *acquis* regarding chapter 33, financial and budgetary provisions and does not expect any difficulties with implementing the *acquis* by accession. Iceland presented its current degree of alignment and its plans for further *acquis* alignment in the underlying policy areas as well as its plans for institutional and administrative capacity building to correctly apply and implement the EU's own resources rules.

### II.a. Traditional Own Resources

Iceland informed about its alignment with EU customs legislation, including the operational set-up of the customs administration and its implementing capacity. The Icelandic Customs Act No 88/2005 and the Customs Clearance Regulation No 1100/2006 are the main legal basis for the procedures concerning the collection of customs duties. Iceland indicated that while its legislation is to a large extent aligned in this area, significant further alignment is necessary in the areas of customs procedures, tariff classification and origin. Moreover, the rules on incurrence of a customs debt, temporary storage periods, deferred payments, the guarantee system before releasing goods in case of deferred payment, and the prescription period to re-assess import duties are also not fully in line with the *acquis*. These rules in particular have a direct effect on the establishment and collection of traditional own resources (TOR).

The use of IT in the customs administration is extensive. 97% of all customs declarations are submitted and cleared electronically and there is a direct link between the customs IT clearance system and the accounting system within the customs IT system. On release of the goods, calculated duties from the customs clearance processing system are automatically uploaded in the customs accounting system irrespective of whether they have been paid, guaranteed or contested. The customs accounting system is linked to the State revenue accounting system, run by the Financial Management Authority, which registers all revenue from the State. Customs issues are essentially covered by chapter 29: Customs union.

As regards the administrative conditions necessary for compliance with the traditional own resources rules as laid down in EU Regulation 1150/2000, Iceland stated that the existing accounting systems will have to be brought in line with EU requirements or a new system developed to allow for keeping A&B accounts and producing the related statements.

There are no sugar producers in Iceland. Therefore, no sugar production levies will have to be raised.

## **II.b. VAT resource**

Iceland focused its presentation on alignment with EU VAT legislation, including the organisational aspects of the VAT administration and its implementing capacity. Iceland's VAT Act is the main legal basis for the procedures concerning the collection of VAT. Iceland stated that this act is aligned to a large extent with the EU's VAT Directive (2006/112/EC), although some elements like definitions and rules applicable (i.e. VAT territory, taxable persons, taxable transactions, place of taxable transactions, chargeable events and chargeability) should be aligned with the EU *acquis*. In the same note, Iceland's exemptions and reduced rates, as well as some refund schemes – for example the scheme covering 60%<sup>1</sup> of the VAT incurred on labour costs in relation to owner occupied housing or another refund scheme applicable to supplies procured by state agencies and municipalities – are not in line with the *acquis*. These issues are essentially covered by chapter 16 Taxation. The various tasks related to the administration of VAT are under the responsibility of three different administrative bodies, which are all under the auspices of the Ministry of Finance. Thus, VAT collection is handled by the Customs administration; assessments and control activity are dealt with by the Directorate of Internal Revenue and the investigation of fraudulent behaviour is the responsibility of the Directorate of Tax Investigations.

Iceland indicated that it was aware that compensations will have to be calculated for own resources purposes to neutralise the budgetary impact of any derogations from the VAT *acquis* that might be agreed under chapter 16 Taxation.

Iceland also indicated it was aware of the need to calculate the Weighted Average Rate (WAR) as more than one VAT rate (a standard rate of 25.5% and a reduced rate of 7%) applies.

## **II.c. GNI resource**

Iceland informed about the administrative criteria related to the GNI own resource. In view of Iceland's EEA membership, the country has been a part of the EU system of GNI verification for many years. Statistics Iceland (SI) is involved in the work of the GNI Committee and the Icelandic national accounts are regularly checked by Eurostat for compliance with ESA 95 standards. Iceland recognised that further alignment is needed with regard to some aspects of the GNI calculations, as reflected in the reports from the GNI information visits to Iceland adopted by the GNI Committee in October 2009 and July 2010. These issues are essentially covered by chapter 18: Statistics.

## **II.d. Administrative infrastructure**

The Ministry of Finance coordinates preparations for full participation in the own resources system in the pre-accession period. Iceland is aware that a coordinating body will have to be set up in the short term to streamline and steer pre-accession preparations in the own resources field. Iceland stated that, from accession, a specific unit within the Ministry of Finance will be responsible for coordination activities necessary to ensure the correct calculation, forecast, collection, payment and control of own resources and reporting to the EU for implementation of the own resources rules.

The Treasury Department within the Financial Management Authority keeps the central government bank accounts with the Central Bank of Iceland. Therefore, the account in the name of the Commission to pay the own resources will be kept with the Central Bank applying SWIFT.

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<sup>1</sup> 100 % temporarily or until the end of 2011

### **III. ASSESSMENT OF THE DEGREE OF ALIGNMENT AND IMPLEMENTING CAPACITY**

Overall, Iceland has reached a good level of alignment with and capacity to implement the *acquis*. There are no significant divergences between the Icelandic and the EU system concerning the basic principles and institutions in the underlying policy areas linked to the application of the own resources system. In order to prepare for the full application of the *acquis*, Iceland needs to continue to align with the relevant *acquis* chapters, in particular customs union, taxation, statistics and financial control. Although the *acquis* in this area does not require transposition, Iceland will need to establish coordination structures and implementing rules so as to ensure the correct calculation, collection, forecast, payment and control of own resources and reporting to the EU for implementation of the own resources rules. Also, effective instruments are to be set up to combat customs duty and VAT fraud so that the financial interests of the EU can be protected.

The Commission will assess the budgetary impact of Iceland's accession at a later stage of the negotiations. The results of the impact assessment will be presented together with the financial framework for concluding the negotiations.

#### **III.a. Traditional Own Resources**

Legislative alignment in the customs field is significant (*dealt with under chapter 29, Customs union*). However, appropriate procedures and systems for accounting and making available of traditional own resources will have to be put in place. In particular, existing accounting systems will have to be brought in line with the EU requirements in order to ensure that separate accounts are kept to distinguish between recovered/guaranteed and outstanding debts as required by EU Regulation 1150/2000 (the so-called 'A' and 'B' accounts).

The Icelandic write-off system for irrecoverable debts needs to be amended in order to align it with Article 17(2) of Regulation 1150/2000, in particular for the established customs duties deemed irrecoverable in an automatic way after a certain time limit.

Post-clearance auditing at trader's premises needs further developing. Moreover, it remains to be established what types of independent internal and external control/audit will be performed on the collection, accounting and making available of TOR (e.g. management controls, controls by the internal audit service of the customs administration, etc.; *see also chapter 32 – Financial control*). OWNRES<sup>2</sup> working procedures will have to be set up to report cases of fraud and irregularities.

As Iceland has no sugar production, there is no need to set up the administrative and legal framework for sugar levies.

#### **III.b. VAT resource**

Iceland's VAT system follows the main structure of the legislation of the EU and the VAT Act is to a significant extent aligned with the EU VAT Directive (*dealt with under chapter 16, Taxation*). However, there are still some exemptions and reduced rates that will need to be aligned. The number of different bodies involved in the administration of VAT underlines the importance of solid coordination (see point III.d.) to ensure a structured and integrated approach to all own resources matters.

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<sup>2</sup> Web based application for notifying the Commission of cases of fraud and irregularities

Iceland will need to develop the capacity to calculate accurately the Weighted Average Rate, including the calculation of any compensations and corrections to offset the negative impact of possible derogations on the VAT resource base. Preliminary calculations of the VAT base suggest a ratio of 46 – 55% in proportion to GNI. Based on the latest estimates which are at the lower end of this scale, capping of the VAT base at 50%, as provided for in the Own Resources Decision (2007/436/EC), would not apply to Iceland.

### **III.c. GNI resource**

Iceland already widely implements the ESA 95 standards according to Council Regulation 2223/96 EC (*dealt with under chapter 18, Statistics*). Although the GNI calculation is not fully harmonised with ESA 95 standards, methodological work is on-going, in particular in the context of the GNI Committee. Iceland will need to continue aligning its statistics with ESA 95, particularly as regards the deficiencies identified during the GNI information visits carried out by Eurostat to Iceland in October 2009 and June 2010. Furthermore, Iceland should provide a detailed timetable for addressing the action points outstanding from those visits. Such points concern the need for improvements e.g. regarding exhaustiveness, estimates of reinvested earnings, consumption of fixed capital, changes in the inventory, etc.

### **III.d. Administrative infrastructure**

In addition to further strengthening administrative capacity in the underlying policy areas (customs, taxation, statistics, financial control), a fully operational coordination structure will be required so as to ensure the correct calculation, forecast, collection, payment and control of own resources and reporting to the EU for implementation of the own resources rules. Currently, preparations in the pre-accession period are managed and coordinated by the Ministry of Finance. This coordination structure will need to be strengthened and formally established. Besides steering and coordinating pre-accession preparations, the coordinating department will have to establish the organisational and procedural links between the various institutions involved in own resources; capacity building in view of the increased tasks post-accession needs to be ensured.

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