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Ministry of Finance in Iceland

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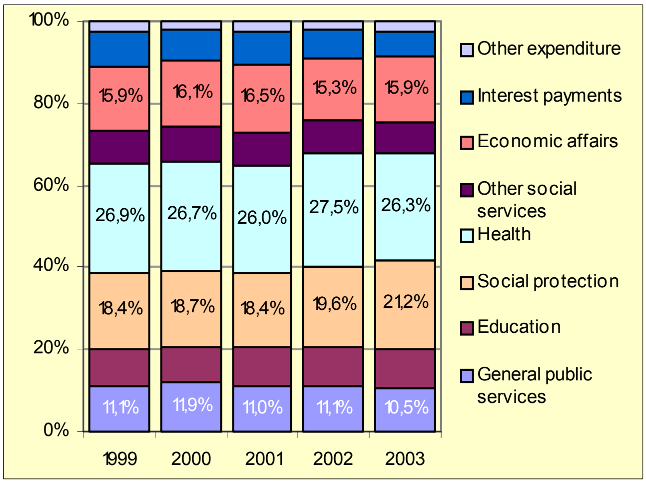
Treasury expenditure by government function

In the annual accounts and budget of the central government the expenditure is normally classified by ministry. However, it is also useful to do so according to the expenditure function.

The development of Treasury expenditure from 1999 – 2003 indicates substantial changes took place in the composition of expenditure during this time. This conclusion is based on the evolution of expenditure shares by function and by growth of expenditure in real terms. Pension liabilities and tax write-offs are not included because they are irregular items.

Treasury expenditure by purpose in per cent



The largest single expenditure group is health care, with a steady 26 – 27% of the total expenditure during this period. The second largest is social protection which has increased from 18% to 21% of the total over the period. This group registered the greatest increase over the five year period, or 40% in real terms. A large proportion of the increase is due to the Maternity fund introduced in 2002. Expenditure on education also increased, reaching around 10% of total expenditure in 2003.

Interest payments on the public debt decreased over the period, from 8.4% to 5.7%. In real terms, interest payments decreased by around 18%. This development is mainly due to the budget being in surplus for most of this time and it being used to draw down the debt. At the same time, interest rates continued to decline while also the exchange rate of the Icelandic króna strengthened.

Other general public services, which consist of executive and legislative organisations and foreign affairs (excluding law and order and safety), did not increase during the time period. On the contrary, the expenditure share dropped from 6.2% to 5.8%. In real terms, the increase was 13%.

The share of expenditure on economic affairs increased by 0.3% during the period. However, there was a transfer of expenditure within the group. The share of agriculture expenditure decreased, but transport and R&D expenditure increased. In real terms, agriculture and fishing expenditure increased by 6.5% and transport expenditure by 27%.

This confirms that the policy of the Government and Parliament has had a long term effect on public finances. The increase in government finances has mainly resulted in increased expenditure on social protection and education. The budget surplus has lead to a decrease in interest payments.

Double-taxation developments

The 18th August negotiations of a double taxation agreement between Iceland and Croatia where concluded. Iceland has now negotiated 30 treaties, thereof 22 that have entered into force.

The main purpose of double taxation conventions is to eliminate double taxation and to prevent fiscal evasion. The conventions give the contracting states right to give the taxpayer relief from taxes imposed according to domestic legislation.

The substance of double taxation conventions is a division of the right of taxation between the contracting countries. In this context there are three possibilities: 1. The country of residence has the right to tax. 2. The country of source has the right to tax. 3. The right to tax is divided between the contracting states.

Double taxation treaties largely cover the following categories of taxable income:

1. Business profits, i.e. profits that arise in one contacting state and are paid to a resident of the other contracting state, shall in principle be taxed in the country of residence of the recipient. The country of source can however tax as much of the profits as is attributable to a permanent establishment that is situated in that country. To decide which part of the business profits pertain to a branch, the profits are estimated as the same as if the branch involved were independent and not part of the same corporate structure. The term business profits does not include profits of limited liability companies or other corporations that are registered in one contracting state and owned by residents in the other contracting state.
2. Collective dividends, interest and royalties are profits from an ownership or rights in a business activity. The main principle is that such income is taxed in the recipient's country of residence but the principle has many exceptions.
3. Capital gains are in principle taxed in the country of residence of the owner, but the principle has many exceptions. Gains derived by a resident of a contracting state from the sale of real estate located in the other contracting state may be taxed in the latter state. The same exception applies to gains from the sale of movable property forming part of the business property of a permanent establishment which an enterprise of a contracting state has in the other contracting state.
4. The main principle is that income from employment is only taxable in the country of source. Exceptions are made if non-resident individuals derive income from employment during a temporary stay in the country of source that lasts for less than 6 months per year. I such cases the country of residence of the employee has the right to tax the income. The same exception applies to remuneration paid by an employer who is not a resident of the country of source and to directors' fees and income in respect of personal activities exercised by artists or athletes.

At the final stage of the treaty negotiations, the draft convention, which in most cases is in English, is initialled by the chairmen of the negotiation committees. After this the draft convention is translated into other treaty languages and thereinafter the treaty is formally signed. Double taxation treaties enter into force after ratification in both treaty countries. The governments of the contracting states shall notify each other of ratification. Each treaty decides the date of effect. Usually the have effect on the first day of January in the next calendar year following the year in which the later notice is given.

Treasury revenue. January-June

12-month changes %	2003-2004	2004-2005
Total tax revenue	14.8	18.7
Income taxes	18.2	15.5
Social security taxes	13.1	15.8
Asset taxes	18	56.8
Indirect taxes	13	18.6
Total revenue	2.3	23.9

Treasury expenditure. January-June

12-month changes %	2003-2004	2004-2005
Administration	6.1	3.6
Social affairs	13.2	6.9
Economic affairs	6.8	1.0
Interest	-15.7	64.7
Other	-2.5	14.3
Total expenditure	8.4	9.7

Treasury finances, January-June

Million krónur	2004	2005
Cash from operations	-2,243	15,536
Net financial balance	-858	25.915
Debt redemption	-28,604	-30,002
Gross borrowing requirem,	-33,212	-5,988
New borrowing	34,780	9,579
Overall cash balance	4,435	3,591

Economic indicators

12-month changes, %	2004	2005
Inflation - August	3.7	3.7
Core inflation - August	3.0	4.1
Wage index – July	5.1	6.6
Tot.turnov.Jan-April	11.3	7.1
Ret turnov.Jan-April	5.4	6.9
Unemploym.in % June	3.1	2.1

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