

# English translation of the Weekly Web Release



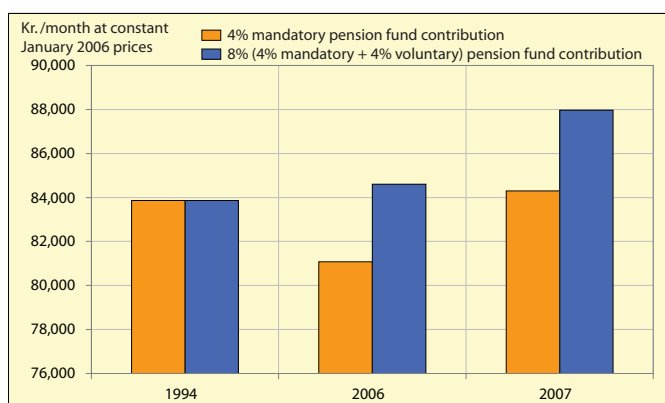
MINISTRY OF FINANCE IN ICELAND

February 2, 2006

## What is the income threshold for taxation?

In the public debate on taxation of the last few weeks the difference between the tax credit on the one hand and the income threshold of taxation has sometimes been unclear. The tax rate in 2006 is 36.72 per cent (23.75% state income tax + 12.97% average local authority income tax). According to the Act on income taxation the tax credit this year amounts to 348,348 krónur per year or 29,029 krónur a month. The tax is calculated by first subtracting the tax rate from the tax base and then the tax credit is subtracted from the calculated tax. If the calculated tax is a lower amount than the tax credit no tax is levied. This means that the tax base can amount to 79,055 krónur a month before there is any tax payment. The income threshold for taxation therefore depends both on the tax rate and the tax credit. If the tax rate is lowered the threshold rises and it does so also if the tax credit is raised. Since the present PAYE system was initiated changes have been made both in the tax rate and the tax credit with corresponding changes in the income threshold for taxation. This however is not the whole story although it is for those who are not paying into a pension fund. For others the income threshold is higher. The difference is caused by the fact that the 4 per cent mandatory pension fund contribution is tax free. This was not the case at the beginning of the PAYE system. This raises the tax free income to 82,349 krónur a month. If an employee pays into a voluntary pension system a further deduction up to 4 per cent is added raising the tax free income to 85,929 krónur a month. At the beginning of next year the state income tax rate will be lowered from 23.75% to 21.75%. This causes the income threshold for taxation to rise by 5.8 per cent. When the raising of the tax credit by 2.25% is considered as well the tax free income threshold will rise nominally by 8.1 per cent.

The income threshold for taxation 1994-2007



When this situation is looked at from the point of view of the Treasury it is revealed that even if a person does not pay any tax as long as his income is below the tax free threshold the local authority where he is registered receives its tax rate from his total income. The state pays his local authority income tax as long as the income is below the tax free threshold. The local authority is a case of a flat tax rate with no tax free threshold. When income rises above the threshold the person starts to pay the local tax but does not pay any tax to the state until he pays all of his local tax himself. This year this limit is 122,227 krónur a month. If one considers the mandatory pension contribution the limit for state taxation is an income of 127,390 krónur a month but this can rise up to 132.855 krónur a month with voluntary pension contributions.

## Treasury finances, January-December 2005

The cash flow statement of the Treasury for all of 2005 is now at hand.

Net cash flow from operating activities of the Treasury amounted to 32 billion krónur in 2005, 32 billion more than last year. There are no cases of a better outcome in prior decades. The net cash inflow before financing amounted to 82 billion, compared to 22 billion a year ago. The change from the previous year is largely explained by the 56.8 billion krónur capital gain from the privatisation of the national telephone company, Landssíminn, and a 5.6 billion krónur capital income tax from the sale, treated both as expenditure and revenue. Financial transactions yielded a surplus of 50 billion, including 66 billion from the sale of Iceland Telecom, 32 billion of which was placed on special deposit with the Central Bank.

Treasury revenue amounted to 399.3 billion, an increase of 118.6 billion or 42.2 per cent over the previous year and is in line to what was anticipated. Total tax revenue amounted to 314.8 billion, an increase of 20.7 per cent, compared with 4 per cent inflation, which leaves an increase of 16.1 per cent in real terms. This increase is in line with the revised economic forecast of the Ministry, published last month, where total national expenditure is estimated to have increased by 14 per cent in real terms last year.

Taxes on income and profits amounted to 102.2 billion, increasing by 18.9 billion. Revenue from the capital income tax rose by 8 billion, most of which is due to the sale of Iceland Telecom. Revenue from the personal income tax rose by 6.4 billion and income from the social security tax increased by 16.2 per cent, compared to the increase in the wage index of 6.8 per cent. Receipts from taxes on net wealth and asset transactions amounted to 14.9 billion, increasing by 23.7 per cent or 19 per cent in real terms. Most of the increase came from the stamp tax where revenue increased by 42.9 per cent. This increase is due to changes in the residential mortgage market in 2004 which led to an acceleration in real property transactions and refinancing of mortgage credits, both of which subject to the stamp tax. Other current revenue amounted to 25.2 billion, increasing by 6.1 billion, the bulk of which comes from a dividend payment from Iceland Telecom and from fines levied on oil companies.

Indirect taxes, particularly the value added tax, tend to reflect the state of general demand in the economy. Revenue from indirect taxes rose by 20.3 per cent from the previous year or by 15.6 per cent in real terms. Receipts from the value added tax rose by 22.1 per cent in nominal terms and 17.4 per cent in real terms. The import excise duty on motor vehicles is the main item amongst other current revenues, increasing by 68.8 per cent.

Treasury expenditure amounted to 308.4 billion krónur, increasing by 28 billion of which 5.6 billion is due to a payment of capital gains tax by the Treasury to itself on the profit from the sale of Iceland Telecom. Another 4.6 billion can be attributed to the payment of interest on a savings bond that matured in April along with accumulated interest. Excluding these two items, expenditure rose by 17.8 billion or 6.7 per cent.

Expenditure on health and social affairs took up about two-thirds of total outlays, 195.7 billion, an increase of 12.6 billion or 7 per cent between years. Health costs rose by 5.2 billion and education by 4.2 billion or 15.7 per cent. Payments for social security rose less, by only 1.5 billion. Other expenditure rose less, except that the payment of privatisation proceeds concerning the Agriculture Credit Fund to the Farmers Pension Fund results in an increase of 2.6 billion in payments to agriculture.

Financial transactions. Debt repayments amounted to 62.3 billion, increasing by 90 per cent. Of this amount, 47.7 billion went to repay foreign debt and 14.6 billion to redeem maturing domestic savings bonds. New borrowing amounted to only 10.2 billion, all domestic. In addition, 5.5 billion was paid to the Government Employees Pension Fund in order to reduce future commitments of the Treasury to the Fund. Cash at hand rose by 24.3 billion within the year.

Treasury revenue, January-December	2003-2004	2004-2005
12 month changes (%)		
Total tax revenue	13.1	20.7
Income taxes	10.7	22.7
Social security taxes	11.1	16.2
Asset taxes	38.8	23.7
Indirect taxes	13.4	20.3
Total revenue	8.1	42.2

Treasury expenditure, January-December	2003-2004	2004-2005
12 month changes (%)		
Administration	3.7	7.9
Social affairs	6.4	6.9
Economic affairs	2.6	4.7
Interest	-12.5	35.2
Other	3.2	49.3
Total expenditure	4.3	10.0

Treasury finances, January-December		
Million krónur	2004	2005
Cash from operations	-292	32,014
Net financial balance	22,408	81,888
Debt redemption	-32,477	-62,305
Gross borr. requirement	-17,569	14,101
Net borrowing	25,867	10,234
Overall cash balance	8,298	24,335

Economic indicators		
12 month changes (%)	2004-2005	2005-2006
Inflation (Jan. '06)	4.0	4.4
Core inflation (Jan. '06)	4.0	4.3
Wage index (Dec. '05)	6.0	7.2
Total turnover (Jan. - Oct. '05)	10.0	9.5
Retail turnover (Jan. - Oct. '05)	4.5	5.2
Unemployment rate (Dec. '05)	2.7	1.7