

# English translation of the Weekly Web Release



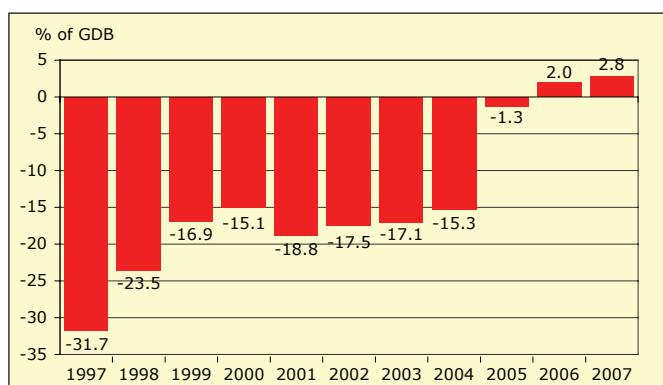
MINISTRY OF FINANCE IN ICELAND

November 2<sup>nd</sup> 2006

## Net financial position of the Treasury

As may be judged by the government's budget proposal for 2007, public finances in Iceland are on a very strong footing. The fiscal position of the Treasury has improved steadily during the past decade primarily because the central government operating performance and proceeds from privatisation have provided a significant net financial surplus, which, in turn, has been used for the most part to repay loans accumulated in the past. For this reason the gross debt of the Treasury has fallen from 46% of GDP in 1997 down to 17% of GDP in this year. In this context, it should also be noted that a considerable portion of the loans assumed by the Treasury are actually intended for re-lending to the Student Loan fund and other public entities; accordingly, claims on these entities accrue correspondingly. In addition, at the end of each year, the Treasury has outstanding a substantial amount of short-term claims that are mainly due to taxes levied during the fiscal year but not collected until the next year. Deducting these re-loans and claims from the gross debt gives the net debt, which provides a clearer picture of the Treasury's debt burden and how it has progressed. On this measure, the debt burden amounted to about 33% of GDP in 1997 but will decline to 4% at the end of this year, according to the budget estimates. Furthermore, the fiscal restraint applied in recent years has yielded ample surpluses which have enabled the Treasury to accumulate assets in the Central Bank that have grown in excess of 100 billion krónur, or around 10% of GDP. When these assets are taken into account by deducting them from net debt, what remains is the so-called net financial position. This balance was close to the net debt ratio in 1997, or around 32% of GDP; however, if plans proceed as expected, the net financial position will not only have reached the zero turning point at the end of this year but progressed beyond it to become a positive figure of around 2% of GDP.

Net financial position of the Treasury



In comparison to other OECD countries, Iceland has moved into a select league with regard to the debt burden. According to current estimates, the net public debt, including local governments, will be close to 47% of GDP on average in the OECD countries at the end of 2006 but only 9% in Iceland.

## Revenue from corporate income tax keeps increasing

The assessed corporate income tax for the 2005 income year amounts to 34.7 billion, increasing by close to 11 billion or 46 per cent from the previous year. The number of taxpaying legal entities is close to 15,000, an increase of 11 per cent from last year. The revenue from the tax has increased almost continuously from the time the tax was reduced to 18 per cent in 2002. The banks pay by far the highest income tax, although they pay considerably less than is listed in their annual reports. The difference is attributable to the fact that international accounting standards dictate that companies must list their assets at the market price. The difference between the market price and the purchase price can create a future tax commitment which

depends on the final profit when the asset is sold. Although the banks have operations in many countries, they pay most of their income tax here.

Payers of the corporate income tax can be divided into three groups, each paying about a third of the total taxes levied. The number of payers in each group is however, widely different. About 14,000 companies pay less than 5 million each, for a total of about 10 billion krónur. Companies that pay from 5 billion krónur up to one billion are 670 in number, paying a total of 13 billion krónur. The last group consists of three banks that pay a total of 11 billion in income tax. The ten largest corporate tax payers pay close to 40 per cent of the total and 70 taxpayers pay one-half of the total. It should also be noted that according to the database of the Internal Revenue Directorate, more than 12,000 companies pay no income tax in 2006.

## Treasury finances, January – September 2006

The current surplus of the Treasury amounted to 43.9 billion krónur in the first nine months of this year, 29.3 billion more than in the same period a year ago. Revenue exceeded last year's figure by 28.6 billion, excluding proceeds from the privatisation of Iceland Telecom, whereas expenditure remained constant. The net financial surplus amounted to 41.6 billion this year as against 59.7 billion last year.

Total revenue amounted to 277 billion krónur in the first nine months, an increase of 11.5 per cent from last year, again disregarding the sale of Iceland Telecom, and by 10.2 per cent after adjusting for the shift between months in the collection of the corporate income tax as of the turn of last year. Tax revenue, including social security contributions, increased by 12.4 per cent in nominal terms at the same time as the inflation was 6.5 per cent, leaving an increase of 5.6 per cent in real terms.

Taxes on income and profits amounted to 88 billion, increasing by 14 billion or 15.2 per cent. Revenue from the personal income tax rose by 12.1 per cent and from the corporate income tax by 69.6 per cent, adjusted for the shift in collection timing noted earlier. Revenue from the capital income tax declined by 2.4 per cent between years, in part due to a one-time payment of 5.6 billion in capital income tax in September of last year from the sale of Iceland Telecom. Excluding this item, revenue from the capital income tax rose by 46 per cent. Social security contributions rose by 16 per cent between years or by 6 per cent in excess of the rise in the wage index. The revenue from taxes on asset transactions amounted to 6.9 billion, 36.6 per cent less than last year. Of this amount, 5.4 billion came from the stamp tax, the collection of which has shrunk by 22 per cent from the previous year, in part because of a decline in debt conversion.

Indirect taxes yielded 132 billion in the first nine months, increasing by 14.1 per cent in nominal terms or 7.1 per cent in excess of the rise in consumer prices. Revenue from the value added tax rose by 16.3 per cent or 9.2 per cent in real terms. Due to the change in the due dates for the VAT and customs duties as of the beginning of this year, the meaning of a comparison with the previous year will depend on which periods are used for comparison. A moving average of several months indicates that the growth in real terms of indirect taxes peaked at the end of 2005. This year the growth has decelerated continuously. Indirect taxes other than the VAT amount to about a third of the total. These taxes have declined in real terms in recent months, based on a moving average.

Total expenditure amounted to 233.6 billion, remaining nearly unchanged as a whole from a year ago, although individual items fluctuate. Interest payments declined by 8.6 billion, mainly because a large issue of savings bonds matured in April of last year along with accumulated interest. Excluding interest payments and the capital income tax, expenditure increased by 14.7 billion or 6.5 per cent, of which 4.5 billion went to health and 2.9 billion to education. Payments for social security and welfare rose by 1.6 billion and for general public services by 2.6 billion. The cost of law enforcement rose by 1.3 billion and outlays in the category of economic affairs by 0.5 billion.

Treasury revenue January-September			Treasury expenditure January-September			Treasury finances January-September			Economic indicators		
12 month changes (%)	2005	2006	12 month changes (%)	2005	2006	Million krónur	2005	2006	12 month changes (%)	2005	2006
Total tax revenue	22.0	13.8	General public services	36.3	-24.8	Cash from operations	14,581	43,872	Inflation (October)	4.8	7.6
Taxes on income & profit	24.1	19.6	Health	6.0	7.6	Net financial balance	59,746	41,627	Core inflation (October)	4.9	7.2
Taxes on property	44.8	-36.6	Social security & welfare	4.4	3.1	Debt redemption	-47,939	-38,071	Wage index (September)	6.9	10.8
Taxes on goods & services	20.5	14.1	Economic affairs	-3.7	1.6	Gross borr. requirement	8,857	586	Total turnover (Jan. - June)	8.0	12.5
Social contributions	16.4	16.0	Education	14.8	12.5	Net borrowing	11,698	24,978	Retail turnover (Jan. - June)	6.4	5.1
Total revenue	51.8	-9.2	Total expenditure	9.7	0.0	Overall cash balance	20,555	25,564	Unemployment rate, sa (Sept.)	1.7	1.2