

26 March 2007

Screening report

Croatia

Chapter 33 – Financial and budgetary provisions

Date of screening meetings:

Explanatory meeting: 6 September 2006

Bilateral meeting: 27 September 2006

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 and agricultural 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 Croatia and the discussion at the screening meeting.

Croatia indicated that it can accept the *acquis* regarding chapter 33, financial and budgetary provisions. Croatia indicated that it does not expect any difficulties with implementing the *acquis* by accession. Croatia 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

Croatia focused its presentation on alignment with EU customs legislation, including the operational set-up of the Customs Directorate within the Ministry of Finance and its implementing capacity. The main legal basis for the procedures concerning the collection of customs duties are the Customs Act, Customs Tariff Act, Customs Service Act, regulations adopted on the basis of these legal acts and a series of international agreements; both bilateral and multilateral. 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 Regulation 1150/2000, Croatia indicated that appropriate procedures for accounting and making available of traditional own resources would be put in place well before accession, including necessary administrative and IT infrastructure. Croatia indicated that there are currently no separate accounts to distinguish between recovered/guaranteed and outstanding debts. Only paid and secured debts are accounted for (cash accounting). However, outstanding debts (mainly ex-post duties) can be identified in the existing IT system at any time. Any outstanding debt has an identification which makes it possible to recognise the actions undertaken for the collection of the debt in the analytical records.

Provisions of Article 119 and Article 135 of the General Tax Act lay down the conditions for the write-off of tax debt. Since the provisions of the Customs Duty Act do not prescribe any special procedure for writing off customs debt, provisions of the General Tax Act are applied for the write-off of customs debt. The system for writing off customs debt, according to the provisions of the General Tax Act, is not fully in line with EU rules. However, at the date of accession to the European Union, Croatia will directly apply the provisions of Regulations 1150/2000/EC and Regulation 2028/2004/EC for writing off customs debt.

No sugar production levies are charged in Croatia. There are four sugar producers. A quota system is not applied. Croatia will set up the necessary administrative and legal framework

for sugar levies, taking into account changes in the Common Market Organisation for sugar. Sugar levies will fall under the responsibility of the Ministry of Agriculture, Forestry and Water Management.

Croatia recognised the need to further develop post-clearance control at trader's premises, carried out by the Department for Examination within the Customs Control Service. In 2005, there were 1,736 control procedures for which an order for inspection control was issued. Total value affected amounted to HRK 1,480,631 in customs duties, HRK 100,210 in excise duties and HRK 7,436,666 in VAT. The post-clearance control involves 57 inspectors country-wide.

II.b. VAT resource

Croatia focused its presentation on alignment with EU VAT legislation. The VAT Act forms the main legal basis for the procedures concerning the collection of VAT. The Tax Administration within the Ministry of Finance is the responsible institution for collection of the tax within the country and the Customs Directorate for the collection of VAT at importation. This issue is essentially covered by chapter 16: Taxation.

Croatia indicated it was aware that compensations will have to be calculated for own resources purposes to neutralise the budgetary impact of any derogations allowing continued taxation or exemptions based on annexes E and F of the 6th VAT directive. Croatia does not apply the special taxation scheme for farmers and the graduated tax relief scheme, both of which are optional schemes. Registration as a taxpayer is optional for firms with an annual taxable turnover of less than 85,000 Kuna (ca. 11,675 €).

Croatia also indicated it was aware of the need to calculate the Weighted Average Rate (WAR) as a multiple rate structure (22%, 10% and 0%) applies. It also indicated, as discussed under the chapter 18 – Statistics screening, the need for improved statistics and in particular the further elaboration of the Use and Supply Table (started in 2006) so that the WAR can be calculated with accuracy.

Croatia's preliminary estimate of the VAT base suggests a ratio of 57.2% in proportion to the preliminary estimate of GNI in 2006. In this regard, Croatia indicated that increases in GNI expected as a result of statistical harmonisation had been taken into account. The VAT base was calculated by dividing the expected 2006 VAT revenue by 0.22 (the maximum VAT rate). If the lower WAR had been applied, this would have resulted in a higher VAT base and accordingly a higher ratio in proportion to the preliminary estimated GNI.

II.c. GNI resource

Croatia focused its presentation on alignment with ESA 95 standards. This issue is essentially covered by chapter 18: Statistics.

Components for the calculation of GNI in Croatia are compiled by the National accounts department of the Croatian Bureau of Statistics (GDP) and the Research and Statistics Department of the Croatian National Bank (balance of payments). The Croatian Statistical System has widely implemented the ESA 95 according to Council Regulation 2223/96 EC. Although components for the GNI calculation are not fully harmonised with ESA 95 standards, methodological work is on-going.

Further alignment is needed as regards the exhaustiveness of national accounts, FISIM (Financial intermediation service statistics indirectly measured) and accounting of dwelling services. Croatia estimated that the impact of these adjustments would be an increase of about 15%-17% of GDP, mainly due to exhaustiveness. Croatia plans to achieve full alignment following the completion of the on-going project on the exhaustiveness of national accounts.

II.d. Administrative infrastructure

Croatia indicated that the Bureau for Macroeconomic Analysis and Planning (BMAP) headed by an assistant minister within the Ministry of Finance will operate as the coordinating body for the preparation and establishment of the own resources system in the pre-accession period. From accession, this unit will then take over 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.

Croatia indicated that this coordination unit is expected to be established by the end of 2006. This unit was subsequently formally established by the Regulation on the Amendments to the Regulation on Internal Organisation of the Ministry of Finance adopted by the Croatian Government on 14 December 2006. This unit will also be responsible for own resources forecasting in cooperation with the National Bank and the Croatian Bureau of Statistics.

The Croatian Treasury within the Ministry of Finance will open an account in the name of the Commission with the Croatian National bank. The latter applies SWIFT. The Treasury will provide the BMAP with reporting statements.

III. ASSESSMENT OF THE DEGREE OF ALIGNMENT AND IMPLEMENTING CAPACITY

Overall, Croatia has reached a good level of alignment with and capacity to implement the *acquis*. There are no significant divergences between the Croatian 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*, Croatia 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, Croatia will need to establish coordination structures and implementing rules so as to ensure the correct calculation, collection, 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 Croatia'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

As indicated under chapter 29 – Customs union, legislative alignment in the customs field is very high. However, appropriate procedures and systems for accounting and making available of traditional own resources will have to be put in place. In particular, separate accounts to distinguish between recovered/guaranteed and outstanding debts as required by Regulation 1150/2000 (the so-called 'A' and 'B' accounts) will need to be established. The Croatian 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 control 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 traditional own resources. This issue will also be followed-up in the framework of chapter 32: Financial control.

Croatia will need to create the legal and the administrative framework for sugar levies.

III.b. VAT resource

As indicated under chapter 16: Taxation, Croatia's VAT system follows the main structure of the legislation of the EU and the VAT Act is to a large extent aligned with the 6th VAT Directive. However, there are still a large number of discrepancies and further alignment is required inter alia as regards a wide range of exemptions in Articles 13-15, free zones, and zero-rates for certain products. Croatia will need to develop capacity to calculate accurately the Weighted Average Rate, notably through improved statistics and to calculate the compensations and corrections to offset the negative impact of possible derogations on the VAT resource base. While Croatia's first estimate of the VAT base suggests a ratio of 57.2% in proportion to the preliminary estimate of GNI in 2006, it is not evident that the capping at 50% provided for in the Own Resources Decision will apply, taking into account the need for improvements in the GNI calculation, in particular the exhaustiveness of national accounts.

III.c. GNI resource

As indicated under chapter 18: Statistics, the Croatian Statistical System has widely implemented the ESA 95 according to Council Regulation 2223/96 EC. Although the GNI calculation is not fully harmonised with ESA 95 standards, methodological work is on-going. Croatia will need to continue aligning its statistics with ESA 95, particularly as regards the exhaustiveness of national accounts. Alignment with accounting of dwelling services will have only limited impact on the own resources contribution. The calculation of FISIM is in any case excluded for own resources purposes. Based on the work-plan of an on-going twinning project, Croatia plans to achieve full alignment by the first quarter of 2008. In terms of GNI growth forecasts, the Commission's (DG ECFIN) forecasts have been used already in Croatia since 2004.

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. It is positive that Croatia already established a coordinating unit within the Ministry of Finance in December 2006. This unit will initially be responsible for preparations in the pre-accession period. Capacity building in view of the increased tasks post-accession is foreseen.