SUMMARY PROJECT FICHE

1. BASIC INFORMATION

1.1 Title: Development of the VAT Service through a Reform and Modernization programme to apply and enforce the Acquis.

1.2 Code: CY0001.02.02

1.3 Sector: Indirect Taxation - VAT

1.4 Location: Ministry of Finance, Department of Customs and Excise, Central Offices of VAT Service, Nicosia, Cyprus.

2. OBJECTIVES:

2.1 Wider Objective:

The strengthening of the administrative capacity of the VAT Service to apply the Acquis and to collect and control the VAT revenue in compliance with the EU required standards.

2.2 Immediate Objectives:

2.2.1 Harmonisation of the Cyprus VAT legislation and development of the administrative capacity to apply the Acquis especially in the areas of the taxation of immovable property, the special scheme for farmers and the refund of VAT to EU and third country traders.

2.2.2 Strengthen administrative capacity in the area of revenue registration, assessment, collection and enforcement through the promotion of taxpayers’ voluntary compliance, the introduction of a user friendly system for the electronic submission of the tax returns and the direct payment of the tax, the improvement of the effectiveness and capacity of the Enforcement and the Internal Audit sections of the VAT Service.

2.2.3 Strengthen administrative capacity in the area of VAT control through the development of an IT- based intelligence system for the risk-based selection, execution and monitoring evaluation of the audit visits.

2.3 Accession Partnership and NPAA priority

Effective implementation of these activities will ensure the systematic strengthening and transformation of the legal, institutional and administrative capacity of the VAT Service to apply and enforce the Acquis, within the context of the Single Market at the point of EU accession.

Accession Partnership

The following text is extracted from the Accession Partnership

Taxation: pursue VAT harmonisation diminishing the zero-rate extension and abolishing special VAT regime for off-shore companies;

Medium term
Taxation: complete the alignment of VAT system to EU norms.”
3. **DESCRIPTION:**

3.1. **Background and justification:**

The VAT Service established its own Unit for EU matters with effect from the 1st September 1997. The Unit has drafted a bill, regulations, orders and notices for a new harmonized VAT system. A small number of divergences, namely the taxation of immovable property, the special scheme for farmers and the level of the tax rates are not covered by the Bill and will be covered by separate bills in 2001 and 2002. The exact timing will depend on the decisions of the Government. There is however an urgent need for technical assistance in the form of expert assistance and study visits in order to be able to apply the Acquis in the above areas.

Regarding the revenue collection process, VAT return forms are printed by the VAT computerised system and send out to taxable persons every three months. The taxable persons pay the tax due at the banks and submit their tax returns (either in person or by ordinary mail) to the VAT Service. The data of the tax returns are keyed into the computerised system and the return data are automatically reconciled by the system. All the information is made available on-line to all VAT officers. If a tax return is not submitted on time, a reminder is issued and thereafter an estimated assessment of the tax is raised and compliance measures are taken (legal action, seizure and forfeiture etc.). Although the level of compliance in submitting tax returns and paying the tax seems satisfactory, in reality investigation has shown that for a significant proportion of the returns the tax due is underdeclared. There is a need to further promote voluntary compliance through taxpayers’ education programmes, improved taxpayer services, as well as through the introduction of a user friendly system for the electronic submission of tax returns and the direct payment of tax.

The main efforts and resources of the local VAT offices are focused on the control visits at the taxable persons premises. The taxable persons to be controlled are selected on a basic and manual risk-based approach. The VAT control officers are high calibre employees and adequately experienced, but they need further training in the light of planned improvements in overall VAT management control policy. It is vital to establish the full range of Audit Control techniques, including computer based systems audit which is required to support the implementation of the VAT legislation (L.246/90). The VAT legislation provides a VAT control officer with the power to enter and inspect the premises of the business, to examine the books and records and to require any information regarding the business. For the assessment of the tax due various methods are used such as the "profit margin", the "parts to total" etc. However, during the accession negotiations the EU officials were concerned with the small number of control visits executed per year and suggested immediate enhancement of the capacity in this area. Since then, the VAT Service has recruited additional 53 tax officers thus increasing its control officers by almost 150% and is providing training to both the existing and the new staff.

Technical assistance is required more generally for staff development training and more specifically for the development of an IT-based intelligence system which will facilitate risk-based selection, execution and monitoring evaluation of the audit visits. In addition, the capacity will be improved by the establishment of specialised audit teams, the development of a management information system for establishing and updating risk/trade profiles, the training of the control officers on Computer Aided Audit Techniques (CAATs) and the enhancement of the effectiveness of the VAT Fraud Investigation section.

Concerning Administrative Cooperation and Mutual Assistance, the VAT Service has been committed to have all necessary systems, especially VIES, operational six months before accession. There is therefore an urgent need to develop a Central Liaison Office and to design and implement the necessary infrastructure to ensure interconnectivity and interoperation of the VAT computerised system with the EU exchange information systems.

The following extracts from the screening results, the position paper and the progress report provide further evidence of the administrative gaps which the VAT Service is obliged to resolve prior to accession.

**CYPRUS SCREENING RESULTS** *(CHAPTER 10 – TAXATION)*

The following text is extracted from the Cyprus screening results.

"Cyprus will introduce harmonised legislation on the VAT Information Exchange System (VIES) and develop the existing infrastructure to apply this system. Cyprus already disposes of a computerised system for the collection and processing of VAT returns. A Central Liaison Office will be created and officials will be trained. Risk-analysis methods will be introduced."
Cyprus will introduce harmonised legislation six months before accession and will develop the necessary infrastructure for mutual assistance for the recovery of claims. A system for the recovery of claims already exists in Cyprus. No particular problems are envisaged in this area although Cyprus does not have any experience in mutual assistance with other countries on VAT matters.

Nevertheless, in order to be able to meet the new demands concerning administrative cooperation and mutual assistance under Directive 77/799 (mutual assistance), Regulation 218/92 (VIES) and Directive 767308 (recovery of claims), Cyprus will have to further reinforce its tax administrative structures and control procedures."

**CYPRUS POSITION PAPER  (CHAPTER 10 – TAXATION)**

The following text is extracted from the Cyprus position paper.

“Capacity to Implement the Acquis Communautaire

Cyprus generally has the capacity to apply the acquis in the field of Administrative Cooperation and Mutual Assistance. The VAT Service, as explained above, is a well organised administrative unit and will be allocated all necessary resources in order to meet the enhanced, due to the abolition of fiscal frontiers, requirements for VAT control and for administrative cooperation and mutual assistance.

All necessary infrastructure will be operational before accession. Especially regarding VIES the necessary software and hardware will be acquired at the beginning of year 2002 in order to have the whole system operational for a trial period of six months before accession.

The capacity of the VAT Service in the crucial field of VAT control will be further strengthened by:

- the recruitment, well before the end of 1999, of 56 VAT control officers, thus increasing the VAT personnel by 65% and the VAT control officers by more than 150%
- the providing of extensive training to all its control officers and
- the purchase of a computerised system for control visits”

**Regular Report from the Commission on Progress towards Accession ; CYPRUS – October 13, 1999**

Extract from the Regular Report

“In the area of VAT control, there will be considerable new recruitments by the end of 1999 which will increase VAT personnel by 65% and VAT control officers by 150%. Furthermore, a computerised system for control visits will be purchased and extensive training of control officers will continue.”

**3.2. Linked activities**

A number of short-term expert assignments have been requested from TAIEX. These assignments are complementary to the activities listed in this project fiche and no duplication of effort is envisaged. In addition no other request for assistance have been requested from the Commission or other donor agencies.

**3.3. Results**

Overall, a planning and control environment will be created, under the direction of the Project Steering Committee (PSC), and operationally through a Departmental Project Implementation Team (DPIT) which will ensure the effective, timely, and quality delivery of the project components. This will result in the readiness of the VAT Service to apply the Acquis and to collect and control VAT revenue up to the standards required by the EU.

A break-down of the specific results to be achieved in relation to each objective is detailed as follows:

*Harmonisation of the Cyprus VAT legislation and development of the administrative capacity to apply the Acquis especially in the areas of the taxation of immovable property, the special scheme for farmers and the refund of VAT to EU and third country traders.(Objective 2.2.1)*

- Harmonisation of the Cyprus VAT legislation finalised.
- Current VAT system enhanced to meet changes resulting from the adoption of the harmonisation Bill
Strengthen administrative capacity in the area of revenue registration, assessment, collection and enforcement through the promotion of taxpayers’ voluntary compliance, the introduction of a user friendly system for the electronic submission of the tax returns and the direct payment of the tax, the improvement of the effectiveness and capacity of the Enforcement and the Internal Audit sections of the VAT Service. (Objective 2.2.2)

- Increased VAT revenue.
- Improved relations with taxpayers.
- Increased taxpayers’ voluntary compliance.
- Design and development of the first phase of a user friendly system for the electronic submission of tax returns and the direct payment of tax.
- More effective Enforcement and Internal Audit sections.

Strengthen administrative capacity in the area of VAT control through the development of an IT-based intelligence system for the risk-based selection, execution and monitoring evaluation of the audit visits.

- Enhanced effectiveness in the area of control visits.
- Design, development and operation of the first phase of an IT-based intelligence system for the risk-based selection, execution and monitoring evaluation of audit visits.

3.4. Activities

In order to meet the specific objectives and to produce the results indicated in 3.3 the project will address two main areas, namely, development of a) Business Support Systems and b) Administrative Capacity. The two components are in fact the part of a logical grouping of associated activities which have been derived from a rigorous process of Gap Analysis and Needs Analysis, for each VAT function, based upon the European Commission’s Fiscal Blueprints.

Development of Business Support Systems

The development of the Business Support Systems component is necessary to ensure that the VAT Service can fully function as well as meet the requirement of interconnectivity and interoperation with the EU systems.

The activities which are required to be implemented under this component are as follows:

- Enhancement of the current VAT system to meet changes resulting from the adoption of the Harmonisation Bill.
- Expert assistance for the design and development of the first phase of an IT-based intelligence system for the risk-based selection, execution and monitoring evaluation of the audit visits.
- Expert assistance for the design and development of the first phase of a user friendly system for the electronic submission of the tax returns and the direct payment of tax.

Development of Administrative Capacity

The development of the Administrative Capacity component is necessary to improve the policy, structure, procedures and overall performance which is required in order to ensure that the Cyprus VAT Service can fully function in the context of a Single Market.

The activities which are required to be implemented under this component are as follows:

- Development of managers and staff responsible for implementing the special scheme for farmers through e.g. study visits.
- Expert and technical assistance for the taxation of new buildings and building land.
- Expert assistance for the designing of infrastructure and the drafting of procedures for the refund of VAT to EU and third country traders.
• Development of managers and staff responsible for implementing optimised and modern working practices for the electronic submission of tax returns and the direct payment of tax, through e.g. study visits
• Seminar to familiarise staff with these new practices
• Educational seminar for tax practitioners
• Development of managers and staff responsible for implementing methods and procedures followed in the field of VAT Enforcement, through e.g. study visits
• Expert assistance to provide training to the staff of the VAT Enforcement section.
• Expert assistance to provide training to the staff of the Internal Audit section
4. **INSTITUTIONAL FRAMEWORK**

Value Added Tax was introduced in Cyprus on the 1st July 1992.
The tax is administered by the VAT Service, which is an independent structure within the Department of Customs and Excise, where the Director of Customs and Excise is also the VAT Commissioner. The administrative system of control of VAT is based on central administration with local control.
The VAT Central Office is divided in four sections, as follows:
(a) Liability, Control Policy and Training Section.
(b) Processing of Tax Returns / Electronic Data Processing (EDP) Section
(c) Investigation and Compliance (Enforcement) Section.
(d) Internal audit, Administration and Insolvent Businesses Section.
There are currently four Regional Offices, one in each major town of Cyprus. They are responsible for providing information to traders, registering taxable persons and carrying out control visits. They are all linked to the central computer mainframe.

The Customs and Excise Department is under the Ministry of Finance.
The Planning Bureau is responsible for the coordination of the accession process and the relations with the European Union.
5. DETAILED BUDGET (MILLION EURO)

<table>
<thead>
<tr>
<th>COMPONENT</th>
<th>Commission support Investment support</th>
<th>Institution Building**</th>
<th>Total Commission support (=I+IB)</th>
<th>National co-financing***</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>I. Development of Business Support Systems</td>
<td>0</td>
<td>0.83</td>
<td>0.83</td>
<td>0.55</td>
<td>1.38</td>
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<tr>
<td>II. Development of Administrative Capacity</td>
<td>0</td>
<td>0.17</td>
<td>0.17</td>
<td>0.18</td>
<td>0.35</td>
</tr>
<tr>
<td>TOTAL</td>
<td>0</td>
<td>1.00</td>
<td>1.00</td>
<td>0.73</td>
<td>1.73</td>
</tr>
</tbody>
</table>

(*) In relation to infrastructure, equipment, software, related developments, installation, testing and documentation
(**) In relation to changes in management, procedures, legislation, enforcement, training and general activities and services as result of investments.
(***) In relation to the running costs of the project, the infrastructure, the purchase of computer hardware and other equipment etc.

6. IMPLEMENTATION ARRANGEMENTS

The programme will be implemented in a decentralised manner according to the procedures established by the Commission.

7. IMPLEMENTATION SCHEDULE


8. EQUAL OPPORTUNITY

Article 28 of the Constitution safeguards the right of all persons to equality before the law, the administration and justice and of equal protection thereof and treatment thereby. Any direct or indirect discrimination against any person on the grounds, inter alia, of his sex, is prohibited.

Furthermore, the prevailing legislation with respect to equality of treatment for men and women is partly in conformity with the Acquis Communautaire. The following laws currently in force cover equality issues: the Equal Pay between Men and Women for Work of Equal Value Law (Law 158/89), the Protection of Maternity Law of 1997 (Law 100(1)/97), the Termination of Employment Law 1967 (Law 24/67) as amended, and the Commissioner for Administration Law 1991 (Law 3/91) as amended. Cyprus has ratified by Law 39/62 the European Convention for the Protection of Human Rights and Fundamental Freedoms. Various international Conventions which guarantee equal rights between men and women have also been ratified.

Harmonised legislation is under preparation and full compliance with the acquis communautaire will be achieved gradually by 1.1.2003.

The VAT Service (Customs and Excise Department) which is the implementing agency for this project is an equal opportunity employer. Its human resources in terms of qualified personnel comprise of 63 men and 73 women. The total number of the personnel employed by the VAT Service is 200 consisting of 74 (37 %) men and 126 (63 %) women.

9. CONDITIONALITY AND SEQUENCING:

EU financing is granted provided that the necessary national co-financing will be provided from budgetary resources of the Government of the Republic of Cyprus.

If the conditions are not in place for decentralisation (adequate structures as per the Commission “Guidance note on Cyprus and Malta” not in place or operational, Memorandum of Understanding on the establishment of the
National Fund not yet signed), the Commission reserves the right to implement the programme in a centralised manner.

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ANNEXES
1. Logical framework matrix in standard format
2. Detailed implementation time chart in standard format
3. Contracting and disbursement schedule by quarter for full duration of programme.
## LOGFRAME PLANNING MATRIX

**Programme name:** Development of VAT service and number: CY0002  
**Date of drafting:** 3.3.2000  
**Contracting period expires:** 31 December 2002  
**Disbursement period expires:** 31 December 2003  
**Total Budget 2000**  
1,73 MEURO  
**EU contribution 2000**  
1,0 MEURO

### Development of the VAT Service through a Reform and Modernization programme to apply and enforce the Acquis.

**Project Number** CY00.02.02

<table>
<thead>
<tr>
<th>Wider Objective</th>
<th>Indicators of Achievement*</th>
<th>How, When and By Whom Indicators Will Be Measured</th>
<th>Assumptions and Risks</th>
</tr>
</thead>
</table>
| Strengthening of the administrative capacity of the VAT Service to apply the acquis and to collect and control the VAT revenue in compliance with the EU required standards | • Readiness of VAT Service to apply the Acquis and to collect and control VAT revenue up to the standards required by EU  
• Annual review of Blueprints through the gap and needs analysis process | • Increase of VAT revenue  
• Reduction of tax evasion  
• Departmental Project Implementation Team planning and progress reports  
• Commission evaluation reports  
• Annual operational Business Change Management Plan | • Political commitment towards EU continued.  
• Adequate resource (external & internal) availability  
• Absorption capacity of VAT Service to ensure sustainability |

<table>
<thead>
<tr>
<th>Immediate Objectives</th>
<th>Indicators of Achievement*</th>
<th>How, When and By Whom Indicators Will Be Measured</th>
<th>Assumptions and Risks</th>
</tr>
</thead>
</table>
| Harmonisation of the Cyprus VAT legislation and development of the administrative capacity to apply the Acquis especially in the areas of the taxation of immovable property, the special scheme for farmers and the refund of VAT to EU and third country traders. | • Full harmonisation of the VAT legislation achieved.  
• VAT system enhanced to meet the changes resulting from the adoption of the Harmonisation Bill | • Departmental Project Implementation Team progress reports  
• Screening reports  
• National Programme for the Adoption of the Acquis (NPAA) reports  
• Project evaluation and post implementation report | • Political commitment towards EU continued.  
• Policy change decision within the remit of the MoF |
| Strengthen administrative capacity in the area of revenue registration, assessment, collection and enforcement through the promotion of taxpayers´ voluntary compliance, the introduction of a user friendly system for the electronic submission of the tax returns and the direct payment of the tax, the improvement of the effectiveness and capacity of the Enforcement and the Internal Audit sections of the VAT Service. | • Increased VAT revenue.  
• Improved relations with taxpayers.  
• Increased taxpayers’ voluntary compliance.  
• Design and development of the first phase of a user friendly system for the electronic submission of tax returns and the direct payment of tax, operational.  
• Effective Enforcement and Internal Audit sections. | • Annual performance report of the VAT Service  
• Special survey to be conducted by VAT Service and EU expert to measure taxpayers’ voluntary compliance | • Ability to undertake benchmarking study visits  
• Responsiveness of the taxpayers to promotion programme. |
| Strengthen administrative capacity in the area of VAT control through the development of an IT- based intelligence system for the risk-based selection, execution and monitoring evaluation of the audit visits. | • Enhanced effectiveness in the area of control visits.  
• Design and development of the first phase of an IT-based intelligence system for the risk-based selection, execution and monitoring evaluation | • Operational IT-based risk management system  
• The results of the control visits are closely monitored by the Control Policy section of VAT Service. The higher productivity and | • Adequate resource (external & internal) availability  
• Timely development and procurement plan  
• Effective support by the Department of |
<table>
<thead>
<tr>
<th>Outputs</th>
<th>Indicators of Achievement*</th>
<th>How, When and By Whom Indicators Will Be Measured</th>
<th>Assumptions and Risks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Development of Business Support Systems</td>
<td>Enhance current VAT system to meet the changes resulting from the Harmonization Bill</td>
<td>Current VAT system enhanced to meet the changes resulting from the harmonization Bill</td>
<td>Timely availability of adequate resources</td>
</tr>
<tr>
<td></td>
<td>Design and development of the first phase of a user friendly system for the electronic submission of tax returns and the direct payment of tax designed and developed</td>
<td>First phase of a user friendly system for the electronic submission of tax returns and the direct payment of tax operational</td>
<td>Effective monitoring of progress reports</td>
</tr>
<tr>
<td></td>
<td>Design and development of the first phase of an IT-based intelligence system for risk based selection, execution and monitoring evaluation of the audit visits</td>
<td>First phase of an IT-based intelligence system for control visits operational</td>
<td>Ability to select and recruit appropriate experts</td>
</tr>
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<td>Development of Administrative Capacity</td>
<td>Development of managers and staff responsible for implementing the special scheme for farmers through e.g. study visits</td>
<td>Implementation of the special scheme for farmers</td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>Expert and technical assistance for the taxation of new buildings and building land.</td>
<td>Taxation of new buildings and building land operational</td>
<td>- if each indicator is achieved and how;</td>
</tr>
<tr>
<td></td>
<td>Expert assistance for the designing of infrastructure and the drafting of procedures for the refund of VAT to EU and third country traders.</td>
<td>System for refund of VAT to EU and third country traders operational</td>
<td>- if each indicator is not achieved including appropriate corrective actions</td>
</tr>
<tr>
<td></td>
<td>Development of managers and staff responsible for implementing optimised and modern working practices for the submission of tax returns and the direct payment of tax through e.g. study visits</td>
<td>Practices of other Member States for the submission of tax returns and the payment of tax observed</td>
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<tr>
<td></td>
<td>Seminar to familiarise staff with these new practices</td>
<td>Staff trained in new practices</td>
<td></td>
</tr>
</tbody>
</table>

The Project Steering Committee will approve and monitor budgets and approve the results of each of the listed activities. The Departmental Project Implementation Team (DPIT) will monitor and evaluate the delivery of each of the listed activities and report to the Project Steering Committee accordingly. The DPIT progress report will include:
- if each indicator is achieved and how;
- if each indicator is not achieved including appropriate corrective actions.
<table>
<thead>
<tr>
<th>Inputs</th>
<th>Indicators of Achievement*</th>
<th>How, When and By Whom Indicators Will Be Measured</th>
<th>Assumptions and Risks</th>
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<tbody>
<tr>
<td>Financial</td>
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<td>National Budget approved</td>
<td>Support from Ministry of Finance</td>
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<tr>
<td></td>
<td>EU contribution: 1.0 M Euro</td>
<td>EU financing approved</td>
<td>Full commitment of management and staff</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>Budgets approved and available.</td>
</tr>
<tr>
<td>Education seminar for tax practitioners</td>
<td>Tax practitioners trained</td>
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<tr>
<td>Development of managers and staff responsible for implementing methods and procedures followed in the field of VAT Enforcement through e.g study visits</td>
<td>Methods and procedures for VAT enforcement followed by other Member States reviewed.</td>
<td>Ministry of Finance and Commission Services</td>
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<tr>
<td>Expert assistance to provide training to the staff of the VAT Enforcement section.</td>
<td>Staff trained in Enforcement methods and techniques</td>
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<tr>
<td>Expert assistance to provide training to the staff of the Internal Audit section</td>
<td>Staff trained in Internal Audit methods and techniques</td>
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<tr>
<td>The Project Steering Committee will approve and monitor budgets and approve the results of each of the listed activities.</td>
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<tr>
<td>The Departmental Project Implementation Team (DPIT) will monitor and evaluate the delivery of each of the listed activities and report to the Project Steering Committee accordingly.</td>
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<tr>
<td>The DPIT progress report will include:</td>
<td>- if each indicator is achieved and how;</td>
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<td>- if each indicator is not achieved including appropriate corrective actions</td>
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<td>National contribution: 0.73 M Euro</td>
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<td>EU contribution: 1.0 M Euro</td>
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<td>Financial</td>
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<td>Budgets approved and available.</td>
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<tr>
<td></td>
<td>EU contribution: 1.0 M Euro</td>
<td>EU financing approved</td>
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### SUMMARY DETAILED TIME IMPLEMENTATION CHART FOR THE PROJECT

**Title:** Development of the VAT Service through a Reform and Modernization programme to apply and enforce the Acquis (CY00.02.02)

<table>
<thead>
<tr>
<th>COMPONENT</th>
<th>2000</th>
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<tr>
<td></td>
<td>J</td>
<td>A</td>
<td>S</td>
</tr>
<tr>
<td>1. Development of Business</td>
<td>D</td>
<td>D</td>
<td>D</td>
</tr>
<tr>
<td>Support Systems</td>
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<td></td>
<td></td>
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<tr>
<td>2. Development of Administrative</td>
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<td>D</td>
<td>D</td>
</tr>
<tr>
<td>Capacity</td>
<td></td>
<td></td>
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</tbody>
</table>

D = Design  
C = Contracting  
I = Implementation  
X = Closure
**ANNEX 3**

**CUMULATIVE CONTRACTING AND DISBURSEMENT SCHEDULE OF EU FUNDING**

Title: Development of the VAT Service through a Reform and Modernization programme to apply and enforce the Acquis (CY00.02.02)

<table>
<thead>
<tr>
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<td>DISBURSEMENT</td>
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All figures in million Euro