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Recent Developments in International Taxation

Iceland

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Recent highlights

Income tax

At the beginning of 2020, several tax changes entered into force, for both individuals and companies.

The tax rate for individuals was decreased when a three-stage tax bracket system was introduced with a new and lower primary bracket. The current tax rates after the amendments are 35.04 per cent, 37.19 per cent and 46.24 per cent.

Payroll tax for companies was also decreased from 6.60 per cent to 6.35 per cent.

Finally, copyright payments to authors and/or other individuals as rights holders is no longer taxed as personal income tax (35.04–46.24 per cent), but as capital income tax (22 per cent) without deduction.

Country-by-country reporting

In 2019, a new regulation concerning delivery of country-by-country reports and an act amending the Income Tax Act, regarding country-by-country reports, entered into effect. Three main changes were made in the amending act.

First, an amendment was made to the reference amount for the obligation to file a country-by-country report. The reference amount is now displayed in euros (€750m) rather than Icelandic krona.

Second, an amendment was made regarding the obligation of domestic entities that are not part of a multinational group. In accordance with the Organisation for Economic Co-operation and Development's (OECD's) recommendations, such entities can be obliged to file a country-by-country report when there are no agreements between competent authorities that stipulate an automatic exchange of country-by-country reports on tax returns. The same can apply if the Directorate of Internal Revenue has informed the Icelandic entity that a systematic failure exists in the parent entity's country of domicile, which results in Icelandic tax authorities not receiving country-by-country reports.

Third, a new paragraph was added on surrogate parent entities. A surrogate parent entity is a constituent entity within a group of multinational enterprises that has been appointed as a substitute ultimate parent entity and is responsible for filing country-by-country reports in its country of domicile on behalf of the group of enterprises.

Incentives for innovative companies

At the beginning of May 2020, the Icelandic Government raised the deduction of expenses incurred in research and development projects, which have received confirmation from Icelandic authorities. Innovative companies are now entitled to a special deduction from their levied income tax in 2021 and 2022, that amounts to 35 per cent of the aforementioned expenses for small and medium-sized enterprises (SMEs) and 25 per cent for large enterprises. The maximum expenses for calculating the deduction was also raised to ISK 1.1bn. These changes were part of Iceland's economic countermeasures due to the economic impact following the outbreak of the coronavirus pandemic.

Base erosion and profit shifting (BEPS)

In September 2019, Iceland deposited its instruments of acceptance for the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the 'Multilateral Instrument' or MLI) which entered into force in January 2020. The MLI modified all existing bilateral tax treaties between Iceland and states in which the MLI has entered into force to implement the tax treaty measures developed during the BEPS Project. According to Iceland's instrument of acceptance, 35 double taxation agreements are covered by the MLI. In addition, the Nordic countries signed a protocol amending the Nordic Convention for the avoidance of double taxation that introduced the MLI's minimum standard provisions.

VAT

In December 2019, a new regulation on VAT refunds to foreign undertakings entered into effect. The refunds are intended to balance the competitive position of domestic and foreign undertakings in trade between Iceland and other countries and domestic trade. The provisions of the regulation provide criteria for the refund of VAT to foreign companies regarding their purchases of goods and services domestically and importation of goods for their business activity abroad. The new regulation excludes purchases of goods and services for resale and final consumption in Iceland, which was not excluded in the previous regulation.

Last March, the VAT refund for residential and leisure housing builders was temporarily raised to 100 per cent of the VAT paid for labour work on construction sites over the period 1 March 2020 to 31 December 2020. The same applies for VAT paid for labour work for reconditioning and maintenance on residential and leisure housing, and car repairs and car painting on passenger cars. This was also part of Iceland's economic countermeasures due to the economic impact following the outbreak of the coronavirus pandemic.

Special tax on financial undertakings

In December 2019, a change was made to the act on special tax on financial undertakings. The tax rate was lowered from 0.376 per cent to 0.145 per cent of the tax base. However, it will not take effect until the assessment of the taxes in 2024 for the 2023 income year. The tax rate will decrease to 0.318 per cent for the 2020 income year, 0.261 per cent for the 2021 income year and 0.203 per cent for the 2022 income year.

Special tax on fish farming in the sea

In June 2019, a new act was adopted by Parliament that obliges fish farm operators to pay a special fee to the state treasury. This only applies to marine fish farms. The Directorate of Fisheries determines and publishes the amount of fees. The fee levied in accordance with the act is, inter alia, supported by the fact that operators of marine fish farms enjoy limited rights to utilise domestic natural resources, and the revenue from the fee can offset the cost of research for the benefit of fish farming, the cost of strengthening the administration and the cost of strengthening the communities that are affected by the fish farming operations.

Stamp duty

The liability to pay stamp duty on ships above a certain size was abolished from 20 May 2020.

Notable future developments: draft bills

Amendments on various acts: taxation of income from foreign legal entities

Several changes are still pending before Parliament, but have been delayed due to Covid-19 and other reasons. A few examples are as follows:

- Substantial changes have been suggested to the Icelandic controlled foreign corporation (CFC)-rule that would be more burdensome than the current provisions. These suggested amendments have been criticised by tax specialists and have been put on hold.
- Following comments from the European Free Trade Association (EFTA) Surveillance Authority, a bill has been proposed that allows two subsidiaries of a foreign parent company to file for joint taxation based on the Icelandic Income Tax Act.
- Amendments have been proposed to the criteria for tax incentives for expats. The amendments provide less and clearer requirements regarding the time that the foreign individual has been resident in Iceland.
- Following a ruling by the Internal Revenue Board, a new provision on the deduction of interest on equity feature loans has been proposed. In certain circumstances the deduction of interest is at the time of the payment of interest rather than on an accrued basis.
- An amendment has been proposed to the application of the existing thin capitalisation provision in the Icelandic Income Tax Act. The limitation of deduction will apply to interest deductions above ISK 100m rather than applying to all interest when the ISK 100m limit is exceeded.
- Changes have been proposed to the procedure for the investigation and prosecution of tax fraud. The changes relate to judgments issued by the European Court of Human Rights in relation to the requirements made on *ne bis in idem*.
- A proposal has been made to abolish the withholding of tax on capital gains realised by foreign tax residents from the sale of shares in Icelandic companies.