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Recent Developments in International Taxation

Iceland

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1. Corporate tax

Joint taxation of group companies

Rules on joint taxation and joint utilization of operating losses between group companies were changed following comments from the EFTA Surveillance Authority (“ESA”), as former rules were thought to possibly violate the free movement of capital within the Internal Market.

A parent company, registered in one member state of the European Economic Area or in the Faroe Islands, may request joint taxation with one or more subsidiaries registered in Iceland, provided that all conditions for joint taxation under the Icelandic Income Tax Act are otherwise met. The same applies to a domestic parent company which requests limited joint taxation with one or more subsidiaries registered in a member state.

Minimum pension-contribution raised

Changes to Icelandic Act on compulsory insurance of pension rights and the activities of pension funds, no. 129/1997 led to increase of the minimum pension contribution from 12% to 15.5%. A minimum 15.5% contribution to pension funds is thus mandatory, and the minimum insurance coverage increases from 1.4% to 1.8% of the annual pension premium.

Reimbursement of VAT to entities on Public Welfare Register

Legal entities, acting for the public good, can obtain registration on the Public Welfare Register (icel. *almannaheillaskrá*). Such legal entities shall receive reimbursement of 100% of VAT paid of labour of construction workers on site, in relation to refurbishments or constructions on real properties owned by the respective legal entity. The reimbursement covers VAT charged for work performed in the period 1 January 2022 to 31 December 2025.

Customs duties on goods from Ukraine

Customs on goods imported to Iceland and originating entirely in Ukraine were abolished until 31 May 2023, as political and economic support to Ukraine. Thus, no import customs are charged on goods imported from and originating in Ukraine.

Innovative companies

Stock options in innovation companies (tax on personal income from stock option)

In order to support the development of innovative companies, a new provision was implemented, as Article 10.a. of the Icelandic Income Tax Act. The exemption provides for capital gain taxation on income from stock option in innovative companies, provided to employees, board members and specialized consultants of the company, instead of taxation as general income (up to 46% taxation). Thus, taxation on income deriving from such stock options, amounting to the difference between the

purchase price and market value of the respective shares, is brought down from up to 46% income tax rate down to 22% capital gains tax rate. Further conditions must be met.

Innovation companies – definition

Innovation companies under the provision, are legal entities conducting research or development in accordance with Icelandic Act on support for innovative companies, no. 152/2009.

For a legal entity to be considered an innovation company, the number of employees cannot exceed twenty-five and the annual turnover cannot exceed ISK 650 million. The company must also work on a specific research or development project, which has obtained approval from the Icelandic Centre for Research (*Rannís*).

Further conditions

Firstly, the innovation company must have been confirmed by the Icelandic Centre for Research, before the stock option agreement was entered into. Further the work contribution of the respective employee/board-member/consultant, receiving the stock option, must be directly related to the innovative project which the Icelandic Centre for Research has approved.

Secondly, the respective stock option holder must hold the option for a minimum of 18 months prior to exercising the option right.

Thirdly, the purchase price of the stock option agreement cannot be lower than the market price at the time of the agreement.

Fourthly, the stock option cannot be transferable and may not extend beyond six years.

Tax deduction

Legal entities that have received a confirmation from the Icelandic Centre for Research are entitled to a deduction from income tax, as per Act on support for innovative companies no. 152/2009. A special deduction was implemented in 2020, which in the year 2022 was extended. Following this, innovative companies can receive tax deduction, pending further conditions, throughout the year 2025. For small and medium-sized companies, the deduction amounts to 35% of expenses incurred in relation to innovation projects, and 25% in the case of large companies.

Withholding tax of British companies on dividends from Icelandic companies

Following BREXIT – the exit of the UK from the European Union – and given the scope of the EEA partnership, dividend payments received by UK companies from Icelandic companies were subject to withholding tax in Iceland. A double taxation treaty between the states generally caps the tax rate on such dividend payments at 5%, however, similar payments to companies in EU or EEA countries are subject to full deduction, resulting in no taxation on such payments. A new temporary provision to the Icelandic Income Tax Act provides for a similar exemption for companies in UK, effective for such payments as from 2021, resulting in full tax deduction on dividend payments from Icelandic entities to UK entities.

Merger or liquidation - commencement date and approval with regards to transfer of tax-rights

Annual tax assessment is generally based on income of the previous calendar year and income shall generally be recognized as such within the year in which it is generated. Same applies to recognition of costs generated. Icelandic tax law is thus based on the principle that income and expenses, that tax assessment will be based on, must have arisen in the respective year subject to assessment, and this was believed to apply equally to the transfer of tax-rights and obligations that transfer due to a merger or liquidation/division of companies.

The Income Tax Act was amended, as to emphasize the above principles with regards to mergers or liquidation. According to the amendment, tax-rights and obligations upon merger or liquidation, which belong to the acquired or liquidated company, do not transfer to the acquiring company until the merger or liquidation has been approved in all respective companies and the acquired company has been dissolved within that same income year.

Longer redetermination period in the case of bribery offences

As to respond to recommendations of the Organization for Economic Co-operation and Development's (OECD) working group on combating bribery in international trade, statute of limitation was extended from six years to ten in cases where bribery offences are committed. Under circumstances, where bribery offence is committed, the tax authorities can thus reassess taxes up to ten years following.

2. Personal income tax**Incentives to accelerate energy exchange**

In 2022, several changes were made to Icelandic tax law and related acts, as to increase private investment in energy exchange and environmentally friendly assets and properties. The amendments include granting of incentives to residential real estate owners, encouraging energy exchange. The incentives amount to 50% of cost of purchasing of equipment which leads to environmentally friendly energy generation and/or improved energy efficiency in residential heating, according to Icelandic Act on subsidizing heating costs for, no 78/2002. The incentives can amount to a maximum of ISK 1.3 million, excluding VAT.

3. Case law***Dividend payments as incentives – ruling of the Internal Revenue Board no. 55/2022***

The Internal Revenue Board (board of appeal, at administrative level, in tax matters) ruled on an incentive scheme of a financial institution. An employee of the financial corporation received subscription rights to class D shares in the company. Class D shares had limited rights compared to general rights linked to shareholding. However, the class D shares were accompanied by preferential rights to dividends linked to profits deriving from activities of the division where the respective employee worked.

Tax authorities had assessed dividend payments, deriving from shareholding of class D shares, as general income, as employment-related benefits, rather than dividend income from shareholding. This resulted in much higher tax rate of the income. The Internal Revenue Board agreed with the tax authorities on this conclusion. The conclusion was based on the fact, that the granting of the subscription rights had many characteristics of employment-related benefits and productivity-motivating bonuses, such as being personal and subject to individual employees and non-transferable. Further, the Board recognized a significant difference between the employees' financial risk from the purchase of the rights and the possible profits.

VAT registration of operator of servers in data centre – ruling of the Internal Revenue Board no. 39/2023

VAT registration of an Icelandic company was denied, as tax authorities considered its operation, which consisted of providing service to the company's foreign parent company, as exempt from VAT, due to the connection between the services of the two companies. As the operation of the foreign parent company would have been exempt from VAT under Icelandic law, and the operation of the Icelandic subsidiary was considered greatly intertwined with operation of the parent company, the subsidiary's operation was deemed exempt from VAT.

The foreign parent company operated a mining operation for cryptocurrencies. Under Icelandic tax law, such activity was considered as exempt from VAT as sales or facilitation of financial services. The Icelandic subsidiary had the sole purpose of providing services to the parent company, consisting of data processing on servers owned by the subsidiary. The Icelandic subsidiary argued that the service it provided was not materially intertwined with the mining of cryptocurrency, but rather involved purchasing of supplies and equipment to service the parent company.

The Internal Revenue Board ruled that the service provided by the subsidiary was intertwined with the operation of the parent company, resulting in the services of the subsidiary forming a fundamental material element of the operation of the parent company. No recognizable material difference was between the two scenarios, where on the one hand the parent company would conduct the operation of the subsidiary itself, or on the other hand the subsidiary would service the parent company.

In conclusion, the services of the subsidiary were considered a part of the operation of the parent company. As the operation of the parent company were of such nature, of being exempt from VAT, the services of the subsidiary were also considered exempt from VAT and VAT registration denied.

Share capital purchase between related parties - ruling of the Internal Revenue Board no. 37/2022

The Internal Revenue Board confirmed a ruling of the Icelandic Tax Authorities, where sales profits from sale of share capital were increased. The case concerned an individual, shareholder of a company, which in the year 2018 sold all issued share capital in the respective company to another company, which was also solely owned by himself. The purchase price was ISK 40,54 per share. Mid 2019, the share capital was sold to an unrelated party at the rate ISK 352,46 per share.

The tax authorities argued that no accurate documents or information could confirm that the former sale took place in 2018, rather than midyear 2019. Also, the terms for purchase in the former transaction, between related parties, were considered to be abnormal and not in line with terms which would have been agreed on by unrelated parties. Thus, tax authorities determined that the former transaction took place at the same time or around the same time as the latter transaction. As the transaction was between related parties the transactions were deemed as scheme to avoid taxation of sale profits from the share capital – as companies generally receive full deduction of sale profits of share capital, contrary to tax treatment of such profits with individuals which do not receive such deduction.

Tax authorities, as confirmed by the Internal Revenue Board, increased the sale price in the former transaction, in line with the terms in the latter transaction, increasing the sale profits of the individual and increasing the tax liability generated by the former transaction.

Taxation of foreign exchange gains – ruling of the Internal Revenue Board no. 74/2022

Tax authorities taxed the transfer of funds from a foreign currency account to another such account in the same currency, as exchange gain. The respective taxpayer contradicted the tax-assessment, as no currency exchange had taken place. The Internal Revenue Board found the currency of withdrawal irrelevant, i.e., the exchange gain realizes regardless of whether withdrawal is made in ISK or not – or any other currency for that matter. The Board stated that the exchange gain realizes from a two-part instrument, i.e., on the one hand, a withdrawal from a foreign currency account, and on the other hand, a payment by deposit into the counterparty's foreign currency account. Thus, exchange gain realizes upon withdrawal, regardless of the withdrawn currency.

Taxation of advertisement income from YouTube – ruling of the Internal Revenue Board no. 9/2023

The Internal Revenue Board ruled that income from advertisements placed on a YouTube-channel, operated by an Icelandic resident individual, were subject to taxation in Iceland. The taxpayer – a retiree – argued that the income was not subject to taxation in the country of origination, the United States. The Internal Revenue Board ruled that the income was not exempt from taxation in Iceland. Double taxation treaty between Iceland and the US does not specify tax treatment of income deriving from advertisements, and thus Article 20 of the agreement, on *other income*, should apply and thus the income should be taxable in Iceland, as the state of residency of the beneficial owner of the income.