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Global Legal Group

The International Comparative Legal Guide to: Corporate Tax 2012

A practical cross-border
insight to corporate tax work

Published by Global Legal Group with
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Email: info@glgroup.co.uk
URL: www.glgroup.co.uk

Cover Design

F&F Studio Design

GLG Cover Image Source

Stock.XCHNG

Printed by

Information Press Ltd
October 2011

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ISBN 978-1-908070-11-1
ISSN 1743-3371



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Iceland



LOGOS legal services

Bjarnfredur Olafsson

1 General: Treaties

1.1 How many income tax treaties are currently in force in Iceland?

Iceland has 32 tax treaties in force, one which is a multilateral treaty between the Nordic countries, to which Iceland, Sweden, Norway, Finland, Denmark and the Faroe Islands are parties. The Ministry of Finance aims at building an even more extensive treaty network and is therefore negotiating with new treaty partners.

1.2 Do they generally follow the OECD or another model?

Icelandic Tax treaties generally follow the OECD model. All new treaties follow the OECD model except the new Icelandic-US treaty.

1.3 Do treaties have to be incorporated into domestic law before they take effect?

Icelandic law provides the government of Iceland with the authority to negotiate, and enter into, tax treaties with other countries. Once the treaty has entered into force, according to its provisions and after the treaty has been published in the Official Gazette of Iceland (in Icelandic; *stjórnartíðindi*), it is, according to practice, in force in Iceland.

1.4 Do they generally incorporate anti-treaty shopping rules (or "limitation of benefits" articles)?

In general, Iceland has not incorporated anti-treaty shopping rules or limitation of benefits articles, except in the new Iceland-US treaty, which incorporates a limitation of benefits clause. Each treaty should always be reviewed individually. There is also a new general CFC legislation in force in Icelandic domestic tax legislation.

1.5 Are treaties overridden by any rules of domestic law (whether existing when the treaty takes effect or introduced subsequently)?

No, they are not.

2 Transaction Taxes

2.1 Are there any documentary taxes in Iceland?

Stamp duty is levied on: bills of exchange (0.25%); deeds on immovable property, vessels, etc. (0.4%); formation fund of limited partnership (0.5% or 1.5%); issued shares of public companies (0.5%); loan documents, bonds, etc. (1.5%); and the formation fund of partnerships (2%).

2.2 Do you have Value Added Tax (or a similar tax)? If so, at what rate or rates?

Iceland has a VAT system, as per the Value Added Tax Act, no. 50/1988, under which VAT is levied at all levels of supply of goods and services. There are two rates of VAT:

- the standard rate of VAT is 25.5% (this rate applies to any supply of goods or services which is not exempt or subject to the reduced rate of VAT); and
- a reduced rate of VAT which is 7% (this rate applies for example to food, rental of hotel rooms, CDs, books and magazines, electricity and water for heating).

2.3 Is VAT (or any similar tax) charged on all transactions or are there any relevant exclusions?

Certain transactions are excluded from VAT, most importantly:

- financial and banking services;
- insurance services;
- health services, social services, education, libraries, art, sports, passenger transport and postal services; and
- rental of real property.

2.4 Is it always fully recoverable by all businesses? If not, what are the relevant restrictions?

Input tax is only recoverable by a taxable person, i.e. a person who is required to be registered for VAT. If the Input tax, in any settlement period, exceeds the output tax, the taxable person is entitled to a refund. Any person excluded from registration would not be entitled to such recoveries.

2.5 Are there any other transaction taxes?

No, there are no other transaction taxes levied (*lagðir á*) in Iceland.

2.6 Are there any other indirect taxes of which we should be aware?

Excise duties are levied on various goods. Custom and excise duties may apply.

3 Cross-border Payments

3.1 Is any withholding tax imposed on dividends paid by a local resident company to a non-resident?

Foreign individuals and legal entities are subject to a withholding tax on dividends. The applicable withholding rate for individuals is 20%, and the applicable rate for legal entities is 18%. If the recipient is a foreign limited company in a jurisdiction which is a member of the European Union or the European Economic Area, the withholding tax can be refunded after a tax assessment. Accordingly, the net result can be 0% for EEA/EU limited companies if they file for a refund. However, it should be noted that such refund will be permitted only to the extent that carryover losses have first been settled.

Alternatively, the applicable withholding tax rate can be reduced in accordance with an applicable tax treaty that Iceland has entered into.

3.2 Would there be any withholding tax on royalties paid by a local company to a non-resident?

In the absence of a tax treaty, royalties paid by resident companies to non-resident companies are subject to taxation. The application of withholding tax is unclear as the tax liability is net-based.

Royalties paid to non-resident companies are subject to a withholding tax of 20%.

3.3 Would there be any withholding tax on interest paid by a local company to a non-resident?

Icelandic tax law provides for withholding tax on outbound interest payments from Iceland. However, the applicable rate will depend on whether the recipient is an individual or a legal entity. The applicable rates are:

- 20% if the recipient is an individual. However, withholding tax shall not apply to income from interest up to the amount of ISK 100,000 in each taxable year.
- 18% if the recipient is a legal entity. The withholding tax might however be reduced depending on each individual Tax Treaty that Iceland has ratified.

3.4 Would relief for interest so paid be restricted by reference to "thin capitalisation" rules?

Iceland does not yet have any thin capitalisation rules in force.

3.5 If so, is there a "safe harbour" by reference to which tax relief is assured?

This is not applicable in Iceland - see question 3.4.

3.6 Would any such "thin capitalisation" rules extend to debt advanced by a third party but guaranteed by a parent company?

This is not applicable in Iceland - see question 3.4.

3.7 Are there any other restrictions on tax relief for interest payments by a local company to a non-resident?

No, there are not, however, any interest charges between related parties would need to be at arm's length.

3.8 Does Iceland have transfer pricing rules?

No. However, the Icelandic tax law provides for a general arm's length rule, which requires that business terms should generally be decided on at an arm's length basis.

4 Tax on Business Operations: General

4.1 What is the headline rate of tax on corporate profits?

The general corporate income tax is 20%.

4.2 When is that tax generally payable?

Companies are required to make advance income tax payments on the first day of each month of the tax year until the assessment is completed, except in January and the month in which the assessment is completed. The instalments are determined as a percentage of the previous year's tax liability, i.e. 8.5% per month for 10 months. Any tax liabilities remaining when the final tax has been assessed must be paid in monthly instalments during the rest of the tax year.

4.3 What is the tax base for that tax (profits pursuant to commercial accounts subject to adjustments; other tax base).

In general terms, the tax follows the commercial accounts subject to certain tax adjustments. Resident companies are taxable on their worldwide income and expenses incurred in acquiring, securing and maintaining taxable income are generally deductible.

4.4 If it otherwise differs from the profit shown in commercial accounts, what are the main other differences?

Timing of income and costs can differ.

4.5 Are there any tax grouping rules? Do these allow for relief in Iceland for losses of overseas subsidiaries?

Group tax consolidation is permitted in Iceland. With consolidated treatment one company's losses, within the group, can immediately be set off against other companies' profits, within the group. Resident companies may elect group consolidation if one company owns 90% of the shares in another company, or if 90% of the shares in the latter company are owned by a number of companies that are all members of the same jointly taxed group. Group consolidation may not be extended to a non-resident subsidiary of a resident parent company and relief for overseas subsidiaries is therefore not allowed.

4.6 Is tax imposed at a different rate upon distributed, as opposed to retained, profits?

Tax is not imposed at a different rate upon distributed, as opposed to retained, profits in Iceland.

4.7 Are companies subject to any other national taxes (excluding those dealt with in "Transaction Taxes") - e.g. tax on the occupation of property?

A company employing employees is subject to paying an 8.65% social security tax that is levied on all wages. Municipal real estate tax is levied on commercial real estate and varies from one municipality to another, but is generally around 1.7% for the property's value. Other minor taxes are the farmers' charge (1.2%) levied on farming, and the industrial charge (0.8%), which is levied on the turnover of industrial companies.

4.8 Are there any local taxes not dealt with in answers to other questions?

There is a tax levied on financial institutions, at the rate of 0.041%. The tax base is the year and total debt of the taxable person.

5 Capital Gains

5.1 Is there a special set of rules for taxing capital gains and losses?

The corporate income tax is levied on the worldwide income of businesses, which includes general business profits and capital gains. Furthermore, Icelandic tax law provides a possibility of no capital gains taxation on disposal of shares held by a company shareholder as it may be able to get a full deduction against the capital gains income. However, such deduction is permitted only to the extent that carryover losses have first been settled. Such deduction is furthermore contingent upon the disposing company shareholder holding at least 10% of the issued share capital of the relevant company at the date of the disposal. Should the abovementioned condition be satisfied, the company shareholder should be entitled to a deduction against the capital gain, with the only exception being that the shares sold may not be shares in a low tax jurisdiction company. If the shares are held by an individual then an 18% tax is applicable on the capital gain.

5.2 If so, is the rate of tax imposed upon capital gains different from the rate imposed upon business profits?

The same 18% rate of corporate income tax applies to both business profits and capital gains, although the effective rate for capital gains from shares may be 0% if the companies are entitled to a full deduction against the capital gains income; see question 5.1.

5.3 Is there a participation exemption?

No, but net taxation is achieved by providing a deductible expense; see questions 5.1 and 5.2.

5.4 Is there any special relief for reinvestment?

Reinvestment relief was abolished for the 2008 income year when capital gains on the disposal of shares held by corporate shareholders were effectively not taxed. Reinvestment of companies in real estate and permanent operational assets can be used to defer taxation on income from the sale of such assets.

6 Local Branch or Subsidiary?

6.1 What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

There are no taxes imposed on the formation of a subsidiary. There is a stamp duty on the issuance of shares in public limited liability companies.

6.2 Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

No, there are no significant taxes or fees that would be incurred by a locally-formed subsidiary but would not be incurred by a branch of a non-resident company.

6.3 How would the taxable profits of a local branch be determined?

The tax base is income allocated to the branch minus the deductible cost allocated to the branch; however there are no specific rules on how to allocate income to branches and very little practice. The tax rate is 20% if the company is: (i) a public limited company; (ii) a private limited company; or (iii) a limited partnership. Other legal entities are subject to a tax rate of 36%.

6.4 Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

There is no branch profit tax in Iceland.

6.5 Would a branch benefit from tax treaty provisions, or some of them?

A foreign branch would only benefit from tax treaty provisions in Iceland's treaty with its country of residence.

6.6 Would any withholding tax or other tax be imposed as the result of a remittance of profits by the branch?

No withholding tax would be imposed as the result of a remittance of profits by the branch.

7 Overseas Profits

7.1 Does Iceland tax profits earned in overseas branches?

Yes, unless exempted by a tax treaty.

7.2 Is tax imposed on the receipt of dividends by a local company from a non-resident company?

Only if the non-resident company is not taxed in a similar manner as the local company and in principle the same conditions apply as to capital gains (see section 5).

7.3 Does Iceland have “controlled foreign company” rules and if so when do these apply?

The tax authorities can request information about the business of foreign branches or foreign subsidiaries of an Icelandic company.

8 Anti-avoidance

8.1 Does Iceland have a general anti-avoidance rule?

No, there is not.

8.2 Is there a requirement to make special disclosure of avoidance schemes?

No, there is not.



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Bjarnfreður Ólafsson joined LOGOS in 2006 as a partner in the Tax Department from Taxis Law Firm, which he co-founded in 1999. His practice covers all direct taxes, international tax and value-added tax. He has extensive experience in corporate finance, mergers and acquisition, and corporate restructuring. Bjarnfreður Ólafsson has written various articles and papers on foreign and domestic business law. He is the co-author of the Commissioner of the Inland Revenue's handbook on VAT (1998). He served as an independent director on the board of Iceland's largest bank, Kaupthing Bank, since 2003. He holds an LL.M degree from the University of Miami and is a member of the Icelandic Bar Association.

LOGOS
LEGAL SERVICES
SINCE 1907

Times have changed since Sveinn Björnsson, the future first President of Iceland, established his law firm in 1907. However, the basic principles upon which Björnsson built his success remain. In today's business environment integrity, professionalism and experience are still the guiding lights of LOGOS legal services, making it the leading law firm in Iceland.

In recent times Icelandic business has been growing fast, inside and outside of the borders. LOGOS has been growing with, and alongside those businesses. Our international affairs are now also operated from our London and Copenhagen offices, providing our full range of services and expertise. These services are already being put to good use by our clients, including some of the country's largest companies seeking their fortune abroad as well as prestigious international clients looking for insights, legal advice, and assistance in gaining a firm foothold in the unique Icelandic business arena.

This step is also important for a knowledge-driven law firm. The London and Copenhagen offices offer our staff fresh challenges and opportunities to enhance their extensive experience and post-graduate expertise that bring them to the podium, as scholars and lectures, in several universities in Iceland.

Not so many years ago no-one would have believed that an Icelandic law firm could have such an impressive presence in London and Copenhagen. I, however think that this demonstrates the unique strength of LOGOS, and that it would have made Mr. Björnsson extremely proud.

The competitive edge of LOGOS is the result of the systematic recruitment of the finest crop of professionals. LOGOS also commits itself to the sharing of information, knowledge and experience within the firm, allowing people to grow to their maximum potential. Dynamic workgroups are active in several fields of law, taking on important internal work, driving innovation and ultimately sharing knowledge and result.

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