MINISTRY OF FINANCE
ICELAND

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Principal tax rates 2006

This paper describes the principal tax rates applicable to individuals and companies in 2006 as well as tax rate changes for subsequent years.

1. Personal income taxation

Iceland's personal income tax structure is such that all personal income in 2006 (other than capital income, see below) is taxed at a PAYE rate of 36.72 per cent, 23.75 % of which goes to the Treasury and 12.97 % to the municipalities. There is a basic annual tax credit which amounted to 329,948 krónur a year in 2004, increasing to 339,846 krónur a year in 2005 and to 348,343 krónur in 2006. An unused tax credit is fully transferable between spouses.

Tax rates[1] since 1991 have been as follows:

	Central gov't general tax rate	Municipal tax rate	Total tax rate	Central gov't surtax
1991	32.80	6.99	39.79	
1992	32.80	7.05	39.85	
1993	34.30	7.04	41.34	
1994	33.15	8.69	41.84	5.00
1995	33.15	8.78	41.93	5.00
1996[1]	33.15	8.79	41.94	5.00
1997, Jan-Apr	30.41	11.57	41.98	5.00
1997, May-Dec	29.31	11.57	40.88	5.00
1998	27.41	11.61	39.02	7.00
1999	26.41	11.93	38.34	7.00
2000	26.41	11.96	38.37	7.00
2001	26.08	12.68	38.76	7.00
2002	25.75	12.79	38.54	7.00
2003	25.75	12.80	38.55	7.00
2004	25.75	12.83	38.58	5.00
2005	24.75	12.98	37.73	4.00
2006	23.75	12.97	36.72	2.00
2007	22.75	12.98	35.73	0

1) As of the beginning of 1997, the financing and operation of elementary schools were transferred from the central government to the municipalities. In order to finance the operation of the schools at the municipal level, the central government reduced its tax rate by 2.84 percentage points and the municipalities increased their rate by the same percentage points.

In addition, tax legislation was amended at the end of 2004 to the effect that the central government income tax was reduced to 24.75% in 2005 (as shown in table above), to 23.75% in 2006 and to 21.75% in 2007. By the middle of 2006, it was decided to rescind 1

[1] The central government general tax and the municipal tax are collected together on a PAYE basis and the rates are shown as applicable in the year of collection. The central government surtax rate is shown in the year of assessment, i.e. assessment in any given year is based on the previous year's income.

percentage point of the cut in the central government income tax in 2007 and bring the tax to 22.75%. The municipal income tax remains, as yet, unchanged.

Incomes in 2005 in excess of 4,191,686 krónur for an individual and double that for a couple are subject to a surtax of 2 per cent, payable in 2006. This will be the last year that a surtax is imposed. As of the end of 2006, the surtax expires.

Seamen get a special tax reduction of 768 krónur per day in 2005 and 787 per day in 2006. The PAYE personal income tax comprises both the central government and municipal income tax[2]. It excludes the social security tax, which is levied on employers (see below).

In addition to the above, each individual pays a flat tax of 6,075 krónur per year to the Elderly's Construction Fund, a central government fund used to finance the construction and operation of nursing homes and care centres for the elderly. Persons under the age of 16 and more than 70 years old are exempt from this levy, as well as those with an income below 900,732 krónur in 2005.

As noted above, the central government income tax rate is reduced by 1%, both in 2005 and 2006 and further 2 per cent in 2007. Child allowances (see below) will be raised at the same time.

The personal income tax is levied on gross income excluding income from capital (for the capital income tax, see below), with a number of minor exceptions. Employee contributions to pension funds are deductible. Such contractual contributions normally comprise 4 per cent of gross pay, to which the employer adds a contribution, normally 6-7 per cent[3] which also is deductible as an operating expense on the business side. In addition, the employee can save up to 4 per cent as a supplementary pension saving on a voluntary basis and deduct the contribution from taxable income.

Interest rebates are granted by the central government for interest expenses incurred from home purchase loans. Such rebates are subject to debt, income and net wealth ceilings. Maximum rebates in 2006 are: 169,541 krónur for a single individual, 218,042 krónur for a single parent and 280,372 krónur for a couple [4].

Child benefits are granted for each child, subject to income thresholds. The amendments to tax legislation that came into effect at the end of 2004 included a schedule for raising child benefits. In 2004-2007 they are as follows (in krónur per year):

	2004	**2005**	**2006**	**2007**
For all children under the age of 7[1]	36,308	37,397	46,747	56,096
Children under the age of 16 in 2005:				
First child...	123,254	126,952	139,647	139,647
Each additional child................................	146,713	151,114	166,226	166,226
Benefits for single parents:				

[2] The PAYE tax collection rate is the same for the whole country. Municipalities, however, have different municipal tax rates. An average of municipal income taxes is collected through the PAYE system. Actual tax settlements take place in the following year after a tax return has been filed and the actual tax has been assessed.

[3] In many cases the employer contribution is considerably higher. For central government employees it is 11.5 per cent and for airline pilots and similar professions with a shorter working life it is even higher.

[4] The following constraints apply to interest rebates: (1) They can not exceed 5 per cent of the remaining debt balance incurred in buying a home for one's own use. (2) The maximum amount of interest payments that qualify for an interest rebate calculation is 494,782 krónur for an individual, 649,544 krónur for a single parent and 804,304 for a couple. (3) Six per cent of taxable income is subtracted from the interest expense. (4) The rebates begin to be curtailed at a net worth threshold of 3,721,542 krónur for a single individual and 6,169,097 krónur for a couple and are eliminated altogether at a 60 per cent higher amount.

First child	205,288	211,447	232,591	232,591
Each additional child	210,854	216,902	238,592	238,592
Income threshold for benefit curtailment:				
For couples	1,444,139	1,487,463	1,859,329	2,231,195
For a single parent	722,070	743,732	929,665	1,115,598
Curtailment of benefits:				
For one child	3%	3%	3%	2%
For two children	7%	7%	7%	6%
For three children or more	9%	9%	9%	8%

1. These benefits are not linked to income.

The income taxation of rent subsidies supplied by municipalities to low-income tenants was abolished as of the beginning of 2002.

The tax treatment of stock options was introduced into tax legislation in 2001 as a result of the fact that a number of companies had begun to reward their employees with options to buy stock at a defined price as a part of the employees' total emolument package. Profits from stock options are now defined as capital gains, subject to a 10 per cent tax, whereas previously they were defined as ordinary income, subject to the common personal income tax rate. The exercise of stock options is subject to certain conditions, the chief being: (1) Stock options must be available to all employees; (2) A minimum of twelve months must pass between the conclusion of a stock option contract until it is exercised. (3) The exercise price must not be lower than the average trading price for the last ten trading days before the option is exercised. (4) The employee must own the stock for no less than two years after purchase. (5) The annual stock option must not exceed 600,000 krónur at the exercise price.

2. Taxes on capital income and net wealth

A uniform tax on capital income was introduced at the beginning of 1997. This change represented a complete overhaul of the former system. Before, there were large discrepancies between taxation of different forms of saving with distorting effects on the saver's choice. Interest income was tax-exempt, while most other capital income was subject to personal income tax. Starting in 1997, a general 10% withholding tax is levied on interest income and capital gains, which eliminates the discrepancy between various forms of capital income. Thus, all capital income, such as interest income, dividends, capital gains and rental income is subject to a uniform tax of 10% . The capital income tax is withheld at source for both businesses and individuals, as applicable. Individuals pay no further tax on capital income, whereas capital income incurred by businesses is taxed as ordinary corporate profits with the withholding capital income tax being offset against the corporate income tax.

The net wealth tax was abolished at the end of 2005 and will not be imposed in 2006. The last net wealth tax assessment took place in 2005 on the basis of net wealth and the end of 2004.

3. The social security tax

A social security tax rate of 5.79% is paid by the employer on top of personal wage income paid to the employee. The tax is allocated as follows:

General charge..	4.99%
of which to:..	
Standards Council..	0.007%
Icepro Committee...	0.001%
Childbirth Leave Fund...	1.080%
Financing social security expenditures........	3,902%
Unemployment insurance..	0.650%
Fund for covering wage claims on bankrupt employers..	0.100%
Marketing levy for financing the Export Council..............	0.050%
Total	**5.790%**
Suppl. charge for fishermen's accident insurance..........	0.650%
Total, incl. suppl charge	**6.44%**

4. Corporate taxation

As of the beginning of 2002, Iceland's corporate income tax was lowered from 30 per cent to 18 per cent. Partnerships with unlimited liability that file for taxes as distinct legal entities had their tax rate lowered from 38 per cent to 26 per cent[5]. The reduction in the tax rates apply to the 2002 income year, the tax for which is assessed in October 2003 and comes up for payment thereafter. As with the net wealth tax on individuals, the corporate net wealth tax is 0.6 per cent in 2005, based on net assets at the end of 2004. As of the end of 2005, the corporate net wealth tax is abolished.

As of 2002, the so-called inflation accounting system was abolished and replaced by conventional historical accounting. Inflation accounting has been in effect for a number of years due to the fact that inflation was at one time quite substantial and accounting methods had to reflect that fact. For the past decade, however, inflation has been in the single figures and the need for inflation adjustments in company accounts was diminished. Furthermore, international accounting standards are generally based on historical cost, and Icelandic standards are therefore being brought into conformity with international norms. As of 2002, Icelandic firms are allowed to keep their books and draw up their accounts in foreign currency. Their tax liability continues to be in krónur.

[5] In fact, the income taxation of corporations and partnerships is about the same. If a corporation has an income of, say, 100, it pays 18 in income tax. If it chooses to use the entire remainder, 82, as dividends, it pays a further 8.2 (i.e. 10 per cent of 82) as capital income tax, for a total of 26.2 (18+8.2) per cent. A partnership pays a total of 26 per cent on an income of 100 up front and is not subject to a further capital income tax.

The table below shows the corporate and partnership taxation rate since 1989 (in per cent):

	Corporations	Partnerships
1989	50	50
1990	45	45
1991	45	45
1992	39	41
1993	33	41
1994	33	41
1995	33	41
1996	33	41
1997	33	41
1998	30	38
1999	30	38
2000	30	38
2001	30	38
2002	18	26
2003	18	26
2004	18	26
2005	18	26
2006	18	26

Since March 1999, so-called international trading companies, having established a venue in Iceland, are subject to a 5 per cent income tax. This refers to companies that exclusively trade in goods and services outside Iceland. In December 2003, legislation was passed to abolish the tax benefit for international trading companies as of the beginning of 2008.

In 2002, a number of changes in the corporate income tax system took place in order to make it more flexible and in line with that of other European countries. The carry-forward provision for net losses was extended from eight to ten years. Depreciation rules were amended so that straight-line depreciation on machinery, equipment, vehicles, ships, aircraft and other non-fixed assets is replaced with remaining-balance depreciation and the rates were sharply increased.

	Previous rates		New rates	
	Min.	Max.	Min.	Max.
Ships, ship equipment, passenger vehicles	5	10	10	20
Aircraft and related equipment	5	10	10	20
Industrial machinery and equipment	5	15	10	30
Office equipment	10	20	20	35
Earthmoving and construction equipment,				
other vehicles and transport equipment and				
other non-fixed assets	10	20	20	35

Other assets are depreciated on a straight-line basis. Their main depreciation rates remain unchanged and are as follows:

	Min.	Max.
Residential, office and commercial buildings	1	3
Industrial and farm buildings	3	6
Piers and glass hothouses	6	8
Drill holes, electric overhead wires,		
removable work camps	7.5	10
Acquired intellectual property rights	15	20
Goodwill purchased	10	20

5. The value added tax

There is a general value added tax of 24.5 per cent on domestic goods and services. Exports of goods and services and several other transactions are zero-rated. A lower tax rate, 14%, applies to the following transactions: Most foodstuffs, newspapers, periodicals, books, subscription to radio and television, geothermal hot water, electricity, fuel oil used for heating, and hotel room rentals. As a general rule, all transactions are taxable except where exemptions are specified. The most common categories of exemption are health services, social services, education, libraries and art, sports, passenger transport, postal services, rental of property and parking spaces, insurance and banking services.

6. Motor vehicle taxation

The system of taxing motor vehicles and fuel is explained in a separate document that may be accessed here.