

General information on Taxation of occupational retirement funds

The taxation of pension fund contributions, pension fund assets and pension in Iceland is based upon the so-called EET method of taxation (i.e. “exempt, exempt, tax”). This method stipulates the following:

- a. Pension fund payments are exempt from taxation.
- b. Pension fund earnings are exempt from capital income tax.
- c. Pension fund benefit payments are taxed as any other earned income.

Pension fund payments.

According to items (4) and (5) of sub-paragraph A of paragraph 1 of Article 30 of the Income Tax Act No. 90/2003, the pension fund payments of employees and self-employed persons are deductible from taxable income, cf. Act No. 129/1997. The maximum deduction due to mandatory insurance amounts to 4% of the employee’s contribution base. The counter contribution from the employer is generally 8% and forms a deductible cost for the employer and at the same time, the employee will be exempted from taxation. The combined pension fund contribution is therefore generally 12% unless otherwise has been especially agreed during collective bargaining. It must also be mentioned that employees who have limited tax liability in Iceland must also pay pension fund contributions, and they are allowed tax deductions in the same manner as other employees. Employees in the EEA earn pension fund entitlements in Iceland as if they were Icelandic. Employees in the EEA may, on the other hand, continue to make pension fund payments into pension funds in their own country if they are temporarily employed in Iceland and furnish a special E-101 form from their home country stating that they have the entitlements provided by the national insurance legislation of the home country. On the other hand, the rules that apply to employees arriving from countries outside the EEA stipulate that such employees may have their pension fund contributions returned upon departure, namely the employee’s contribution and the employer’s contribution respectively, but must then pay tax on the returned pension fund contributions. In addition, an employee must pay up to a 4% pension fund contribution, in addition to the mandatory contribution, that is deductible from the taxable income, provided that the pension fund contribution be used for acquiring pension rights in a private supplementary pension scheme (supplementary pensions savings). Furthermore, an employer may pay a 2% reciprocal contribution for the employee’s supplementary contribution, with the same rules applying to this counter-contribution as apply to the mandatory insurance.

Taxation of pension.

The taxation of pension savings is subject to requirements that provide that pension rights acquired pursuant to Act No. 129/1997 on mandatory insurance of pension rights and the activities of pension funds are taxed as any other wage income upon the payment of pension benefits, provided that the pension fund payments were tax deductible. This applies equally to the payment of pension fund benefits from mandatory insurance and

supplementary insurance schemes and payments from those private pension funds that are subject to the Pensions Act.

Taxation position of occupational retirement funds in the meaning of the Directive.

No special rules apply to the taxation of the pension of persons who are residing abroad but who have paid into an Icelandic pension fund recognised as such. This concerns general tax liability according to item 1, sub-paragraph A of Article 7 of Act No. 90/2003, cf. also item 5 of Article 28 of the same Act. Double taxation treaties between Iceland and the state in question could, however, supersede this taxation of benefit payments, as according to these treaties, benefit payments are, as a general rule, subject to taxation in the country of residence of the beneficiary. Concurrent with this bill, another legislative bill for the proposed amendment of the Income Tax Act has been presented, which eliminates all doubt concerning the tax treatment of benefit payments from occupational retirement funds in the meaning of the Directive. According to that legislative bill, payments from such funds are, for taxation purposes, treated in the same way as benefit payments from general pension funds. It must be mentioned that taxation of pension benefit payments varies according to the national laws of those countries with which the Icelandic Government has entered into double taxation treaties, but in many instances, such payments are not taxed when they are disbursed and no deductions are allowed when pension fund contributions are paid.

Selected provisions, regarding taxation of occupational retirement funds, from Act No 90/2003 on Income tax:

Article 4, point 6:

These parties do not pay income tax:

6. Pension funds operating according to Section III of the Act on mandatory insurance of pension rights and the activities of pension funds and occupational retirement funds that are authorised to receive pension fund contributions for the earning of retirement pension rights.

Article 28, point 5:

Notwithstanding the provisions of this Section, the following will not be considered as earnings:

5. The contribution of the employer for the acquisition of pension rights in accordance with the Act on mandatory insurance of pension rights and the activities of pension funds and the Act on occupational retirement funds. However, the contribution of the employer for the earning of pension rights shall be considered taxable earnings if the pension fund payments from the employer or from a self-employed person, in addition to earlier earned pension rights and future pension rights, create a right to receive a retirement

pension that exceeds the average pay that previously formed the basis for contributions during the previous five years when taken into consideration that the pension will be received in equal payments from the age of 65.

When assessing earned rights, the earned rights held in the defined benefit accounts of pension funds according to the articles of association of each separate pension fund must be added together, taking into consideration that retirement would commence at the age of 65. Rights that are earned through individual retirement accounts or through occupational retirement pension provision in accordance with the Act on occupational retirement funds should also be totalled, and these rights should then be converted, taking into consideration that pension be disbursed in equal payments over a period of 17 years from the age of 65.

When assessing the future right to receive pension, the assessment should be based on the continuation of the payment of a pension fund contribution of 12%, based on the average wages of the previous five years, into a defined benefit account until the age of 65 and on the premise that these payments will create pension rights that would amount to 1.2% of the said average wages for each single year. When calculating the rights earned through an individual retirement account or rights to occupational retirement pension according to the Act on occupational pension funds, it should be based on interest rates of 3.5%.

Article 30(1), point 4

The following shall be deducted from the income of persons listed in Section II of this Act who are not connected with business operations or self-employed:

4. The employee's pension fund payments for the earning of pension rights according to the Act on mandatory insurance of pension rights and on the activities of pension funds, up to a maximum of 4% of the contribution base. In addition, up to 4% of the contribution base according to the decision of pension fund members for pension fund payments to pension funds to increase the pension rights of parties according to paragraph 3 of Article 8 of the Act on mandatory insurance of pension rights and on the activities of pension funds, or to occupational retirement pension funds according to the Act on occupational retirement funds. The precondition for deductions according to this sub-paragraph is that pension fund payments are paid on a regular basis. Up to a maximum of 4% of the contribution base for the pension fund payments of people who run their own business or are self-employed, aimed at the earning of pension rights according to the Act on the mandatory insurance of pension rights and on the activities of pension funds. In addition, up to 4% of the contribution base according to the decision of pension fund members for pension fund payments paid to pension funds in order to increase the pension rights of parties according to paragraph 3 of Article 8 of the Act on the mandatory insurance of pension rights, or to occupational retirement pension funds according to the Act on occupational retirement funds. The precondition for deductions according to this sub-paragraph is that pension fund payments are paid on a regular basis.