Thinking beyond borders: Management of extended business travellers - Iceland

February 2024

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Key message

Residents are taxed on worldwide income whereas non-residents are generally taxed on Icelandic- sourced income only.

A person´s liability to Icelandic tax is determined by residence status for taxation purposes and the source of income derived by that individual. Income tax is levied at progressive rates on an individual´s taxable income for the year, which is calculated by subtracting allowable deductions from the total assessable income.

1 Key message

Extended business travellers are likely to be taxed on employment income relating to their Icelandic workdays.

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Income tax

2 Income Tax

2.1 Liability for income tax

A person's liability to Icelandic income tax is determined by their residence status. A person can be resident or a non-resident for Icelandic tax purposes.

For Icelandic tax purposes the term 'resident' generally refers to an individual who is domiciled in Iceland or is staying in the country/jurisdiction for a period exceeding 183 days during any 12-month period. Short stays abroad for leisure or holidays will not be considered as an interruption of the 183-day period. The general rule is that a person who is a resident of Iceland is assessable on their worldwide income.

A non-resident of Iceland is generally someone who spends less than 183 days in the country/jurisdiction in any 12-month period. Non-residents are generally assessable on income derived directly or indirectly from sources in Iceland. Extended business travellers are likely to be considered non-resident of Iceland for tax purposes unless they enter into Iceland with the intention of remaining for more than 6 months.

The tax liability ends as soon as the individual leaves Iceland. However, former residents, on the grounds of domicile, remain subject to unlimited tax liability for 3 years after leaving Iceland, unless they prove they have become subject to taxation in another country/jurisdiction.

2.2 Definition of source

Employment income is generally treated as Icelandic-sourced when the individual performs the services while physically located in Iceland and performs the services for an Icelandic employer or a foreign employer´s permanent establishment (PE).

2.3 Tax trigger points

Technically, there is no minimum threshold/number of days that exempts the employee from the requirements to file an Icelandic tax return, nor pay tax in Iceland. To the extent that the individual qualifies in accordance with the dependent personal services article of the applicable tax treaty, there will be no tax liability. The treaty exemption will not apply if an Icelandic entity is the individual's economic employer. It should be noted that the Icelandic employer approach is neither clear nor developed in Iceland.

2.4 Types of taxable income

In Iceland, taxable income is divided into three categories.

- Category A: all income received by an individual in money or money's worth.
- Category B: income from a business or an independent economic activity; therefore, does not apply to an employee.
- Category C: capital income.

For the extended business traveller, category A will most likely apply (i.e., all types of compensation and benefits received by the employee for services rendered constitute taxable income, regardless of where paid). Typical items of an expatriate compensation package, which are fully taxable, include the following:

- salary payments bonus payments
- school tuition reimbursements for children provision of a car from the employer

- cost-of-living allowances.
- housing allowance and housing provided employer's contributions to a pension plan provision of domestic assistance reimbursement of moving expenses.
- the benefit of loans at reduced or zero interest rates provided by the employer round sum expenses allowances.
- home leave.

2.5 Tax rates

Individuals pay national income tax and municipal income tax on taxable income.

Taxable employment income is taxed at progressive tax rates ranging from 31.45 percent to 46.25 percent for assessment year 2024. These rates are inclusive of the municipal income tax, on average 14.67 percent (ranging from 12.44 percent to 14.74 percent).

For income year 2024 (assessment year 2025), earnings are taxed at 31.48 percent on the first 5,353,632 Icelandic krona (ISK) of taxable income, 37.98 percent on taxable income between ISK 5,353,632 – ISK 15,030,012 and 46.28 percent on the remainder.

Remuneration of non-residents for managerial, accounting or committee work is subject to a national tax rate of 20 percent. In addition, a municipal tax of average 14.93 percent is levied (20 percent plus 14.93 percent equals 34.93 percent collectively).

Entertainers, and those with a fixed salary, pay income tax at 20 percent plus the 14.93 percent on earnings, but are not able to claim any deductions and can, in lieu thereof, enjoy the revenues from such activity.

2.6 Personal tax credit

All individual taxpayers (except children under the age of 16) are entitled to a personal tax credit against the computed income from all income categories. This credit amounts to ISK 779,112 for income year 2024 (assessment year 2025). If the credit surpasses the tax, the excess will be applied by the State Treasury to settle the municipal tax payable. Any part of a single person's credit remaining thereafter will be cancelled.

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Social Security

3 Social Security

3.1 Liability for social security

In the case of salaries paid to employees, social security contributions are payable by employers and self-employed persons. Social security contributions are imposed on all employees and self- employed person´s remuneration (for example salaries, benefits, and the employer´s part of premiums to the pension funds). The contributions are partly used to finance the social security system. For income year 2024 the general rate is 6.35 percent. An additional 0.65 percent is payable with respect to sailors. If an employee has a foreign A1 certificate the social security contribution is 0.425 percent.

Pension fund

The Icelandic pension system consists of mandatory occupational pension funds and optional private pension funds.

Both employees and employers are required to pay premiums into the mandatory occupational pension funds. Collectively, the minimum payment is 15.5 percent of gross salary. The employees' part is usually 4 percent which is deductible from the employment income tax base. Employers provide a minimum 11.5 percent in addition to the employees' contribution. Self-employed persons pay both the employee´s and employer´s part of the pension fee.

Payments to pension funds are deductible from tax base for up to 4 percent of total salary for the mandatory occupational pension fund, and for up to 4 percent of total salary for payments to the optional private pension funds. Deduction from tax base due to payments to pension funds can therefore total 8 percent.

Social security number

An employee of a foreign company who arrives in Iceland for work purposes must apply for an Icelandic social security number with the National Registry. The social security number is used extensively in Iceland in businesses, universities and in the banking system. The number is also a prerequisite before applying for a tax card.

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Compliance obligations

4 Compliance obligations

4.1 Employee compliance obligations

Payment for taxes on employment income, benefits, or presumptive wages takes place through monthly payroll withholding at source (that is Pay-As-You-Earn (PAYE)) system.

An individual must file a tax return if they have received any income in the tax year in Iceland.

The tax year is the same as the calendar year.

The Internal Revenue Directorate annually decides the last day of filing individual income tax return. Traditionally it is on 14 March, following the tax year-end. An actual tax assessment should be issued by 31 May the same year. If the withholding tax paid is higher than the assessment, the employee will receive a refund. If the withholding tax is lower than the assessment, the difference will be collected.

All foreign citizens and stateless individuals, who have a residence permit in Iceland for a specific time, are obligated to file tax returns before leaving the country/jurisdiction.

4.2 Employer reporting and withholding requirements

Withholdings from employment income are covered under the PAYE system. An employer has a monthly reporting obligation, as well as a withholding obligation related to income while performing work in Iceland.

In addition, employers are obligated to pay a payroll tax (social security tax of 6.35 percent).

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Immigration

5 Immigration

5.1 Work permit/visa requirements

A residence permit is needed for a foreign citizen intending to stay for longer than 3 months in Iceland. European Economic Area (EEA)/European Free Trade Association (EFTA) nationals may stay and work in Iceland for up to 3 months without any permit and stay in Iceland for up to 6 months if they are looking for employment. The type of residence permit required will depend on the purpose of the individual's entry into Iceland.

Citizens of the Nordic countries/jurisdictions do not need a residence permit to stay in Iceland. Employees from certain countries/jurisdictions must apply for a visa before entering Iceland.

5.2 Local data privacy requirements

Iceland has data privacy laws.

5.3 Non-deductible costs for assignees

Non-deductible costs for assignees include contributions by an employer to non-Icelandic pension funds.

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Other issues

6 Other issues

6.1 Double taxation treaties

In addition to Icelandic domestic regulations, Iceland has entered into double taxation treaties with more than 40 countries/jurisdictions to prevent double taxation and allowing cooperation between Iceland and overseas tax authorities when it comes to enforcing their respective law.

6.2 Permanent establishment implications

There is a risk that a PE could be created as a result of extended business travel to Iceland, depending on the type of services performed and the level of authority the employee has when performing services in Iceland.

6.3 Indirect taxes

Iceland imposes value-added tax (VAT) on most goods and services. VAT registered businesses do not bear the final VAT costs. They can charge VAT on the supplies that they make (output VAT) and recover VAT on purchases that they have made (input VAT).

Currently there are two types of VAT: the standard rate (24 percent) applies for goods and services, and the reduced rate (11 percent) for groceries, accommodation, CDs, and printed material.

Foreign enterprises with business in Iceland can apply for and collect VAT reimbursements. A VAT registration number in Iceland is a prerequisite for a reimbursement. This can be done through an Icelandic agent.

6.4 Transfer pricing

The transfer pricing provision is based on the arm's length principle. If prices are not in accordance with the principle, they shall be adjusted using the transfer pricing guidelines issued by the OECD. Related party definition extends to direct or indirect ownership and/or control of legal entities as well as individuals which are considered related by family.

Companies which total revenue or assets in the beginning of the year or at year end exceeds ISK1,000 million are obligated to keep documentation about the nature and extent of transactions with related parties, the nature of the relationship and the basis of price decided. The document obligation referrers to the guidelines issued by the OECD.

The documentation obligation does not apply to transactions between related parties that are domiciled in Iceland.

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