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LÖGMENN · REYKJAVÍK

LEGAL BRIEFING FOR INTERNATIONAL CLIENTS

Taxation in Iceland

The tax system, key rates and rules, and how tax disputes are fought and won — a legal guide for international businesses and investors.

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2026 Edition

INTRODUCTION

A Simple System with Sharp Edges

Iceland's tax system is comparatively simple: a flat corporate rate, a two-rate VAT, no net wealth tax and a broad treaty network. But the system has sharp edges — payroll and pension charges that surprise foreign employers, withholding taxes that must be actively reclaimed, and public levies whose constitutional limits Icelandic courts police strictly. MAGNA's lawyers have litigated leading cases on exactly those limits, recovering unlawfully collected charges for major companies with full default interest. This briefing covers both the map and the minefields.

~20%	24% / 11%	22%	40+
flat corporate income tax on limited companies	standard / reduced VAT rates	tax on capital income of individuals	double-taxation treaties in force

Contents

PART I — THE SYSTEM

Administration, Rulings and Treaties

- **One administration.** Iceland Revenue and Customs (Skatturinn) administers all national taxes, customs and the company and VAT registers; tax investigations are handled by its investigative arm. The system is electronic, efficient and assessment is based on self-reporting with subsequent review.
- **Legal framework.** The Income Tax Act No. 90/2003 is the core statute, supplemented by the VAT Act No. 50/1988, the Withholding Acts and sector-specific levies. Under the constitutional principle of legality (40. and 77. gr.), taxes may only be imposed by statute — the basis of a robust line of case-law striking down charges that overstep.
- **Binding rulings.** Taxpayers may obtain binding advance rulings (bindandi álit) from Skatturinn on the tax consequences of contemplated transactions — a valuable de-risking tool for inbound structures, reorganisations and financing.
- **Appeals.** Reassessments may be appealed to the independent Internal Revenue Board (yfirskattanefnd) and from there to the courts; taxpayers may also bring suit directly. Repayment of overpaid or unlawfully levied tax carries interest, and default interest where liability was contested.
- **Treaties and the EEA.** Iceland has a network of more than forty double-taxation treaties (including all major trading partners) and is bound by EEA rules prohibiting discriminatory taxation of cross-border activity — both regularly decisive in structuring and in disputes.

Key point for foreign groups

Icelandic withholding taxes on dividends, interest and royalties are levied first and relieved afterwards: treaty and EEA reductions are often applied through refund claims rather than automatically at source. Building the reclaim process into transaction planning avoids trapped cash.

PART II — BUSINESS TAXATION

Companies, VAT and Payroll

Corporate income tax

- **Rate.** Limited companies pay a flat corporate income tax of approximately 20% (a temporary one-point increase has applied to recent income years — confirm the current rate); other entity forms are taxed at higher rates.
- **Dividends and gains.** Dividends received by Icelandic companies and gains on shares are effectively exempt through a deduction mechanism, making Iceland workable for holding structures within the EEA.
- **Financing.** Interest is generally deductible, subject to an interest-limitation rule for intra-group financing and transfer-pricing scrutiny; documentation duties apply to larger groups under the arm's-length rule of the Income Tax Act.
- **Losses** may be carried forward for ten years; reorganisations (mergers, divisions, share exchanges) can be implemented tax-neutrally where statutory conditions are met.

VAT and indirect taxes

- **VAT** — 24% standard, 11% reduced (food, accommodation, books and more). Registration is mandatory above a low turnover threshold; exports and defined international services are zero-rated, and voluntary registration of commercial leases allows input-VAT recovery on real estate.
- **Excise and sector levies** — various product charges, accommodation tax and sector fees apply; their statutory basis deserves scrutiny — see Part IV.

Employer charges

- Employers withhold employees' income tax at source, pay **social security tax** of roughly 6.3–6.4% of gross wages and mandatory **pension contributions** (customarily 11.5% employer share) — together adding materially to headline salary costs and frequently underestimated by foreign employers.

PART III — INDIVIDUALS

Personal and Cross-Border Taxation

- **Residents** are taxed on worldwide income: employment income at progressive combined state and municipal rates (roughly 31–46% across three brackets), capital income (interest, dividends, gains, rent) at a flat 22%.
- **Foreign experts.** Qualifying foreign specialists recruited to work in Iceland may benefit from a statutory regime under which 25% of employment income is excluded from the tax base for the first three years — a significant incentive for relocating key staff.
- **Non-residents** are taxed on Icelandic-source income (employment exercised in Iceland, Icelandic real estate, dividends and more) subject to treaty relief; short-term postings are frequently protected by the dependent-services articles of the treaties.
- **Social security.** EEA coordination rules and A1 certificates determine where contributions are due for mobile employees — reviewing this alongside payroll registration avoids double charges.
- **No net wealth tax** applies; inheritance tax is levied at 10% above a modest exemption, and Iceland does not levy a separate gift tax (gifts are taxed as income in defined cases).

Arriving executives — a short checklist

1 Confirm residency start date and apply for the foreign-expert regime within the deadline.
2 Coordinate social-security position (A1) before the first payroll run.
3 Review equity compensation: option and RSU taxation follows Icelandic timing rules once resident.
4 Check treaty tie-breakers for dual-residence years and exit-year planning on departure.

PART IV — DISPUTES

Audits, Appeals and Constitutional Limits

The dispute path

- **Audit and reassessment.** Skatturinn may generally reassess the past six income years (shorter where full and accurate information was disclosed in the return); reassessments typically carry a surcharge, which can be contested or remitted.
- **Administrative appeal.** Appeals lie to the independent Internal Revenue Board (yfirskattanefnd), which decides in written proceedings; its rulings are published and form a substantial body of precedent.
- **Courts.** Taxpayers can bring reassessments and refusals before the District Courts and onwards to the Landsréttur Court of Appeal and the Supreme Court; tax cases against the State are common and taxpayers regularly prevail.
- **Criminal exposure.** Serious matters may be referred for criminal investigation; early, coordinated defence of the tax and criminal tracks is essential.

Constitutional limits on taxes and charges

Under the Icelandic Constitution, no tax may be imposed, changed or abolished except by statute, and taxation powers cannot be delegated to ministers or agencies. Icelandic courts enforce these limits strictly: charges levied without an adequate statutory basis — including customs-related fees, sector levies and service charges out of proportion to cost — have repeatedly been struck down, with the State ordered to repay what was unlawfully collected, with interest. For businesses facing novel or escalating levies, a constitutional challenge is a realistic remedy, not a theoretical one.

PART V — SELECTED EXPERIENCE

Recovering Unlawful Charges from the State

MAGNA's lawyers have litigated leading Icelandic cases on the constitutional limits of taxes and public charges. The publicly reported matters below illustrate the practice.*

Tax and public-charges litigation

- **Hagar v the Icelandic State** — Supreme Court Case No. 667/2016 (judgment of 18 January 2018): acted for Hagar, Iceland's largest retail group, in proceedings against the State concerning unlawfully levied customs charges, raising constitutional limits on taxation.
- **Innnes v the Icelandic State** — Supreme Court Case No. 666/2016 (judgment of 18 January 2018): parallel proceedings for the consumer-goods importer Innnes on the same statutory and constitutional grounds.
- **Repayment with default interest** — in the same litigation line, run for several leading trading companies including Sælkeradreifing, the courts confirmed the companies' right to repayment of unlawfully collected charges from the State with full default interest — precedent of direct value to any business overpaying contested levies.
- **Administrative and constitutional litigation** — a broad practice challenging administrative decisions, levies and service charges before yfirskattanefnd, the regulatory appeal boards and the courts.

Related sector experience

- **Corporate and M&A tax coordination** — structuring Icelandic acquisitions, holding vehicles and reorganisations together with clients' tax advisers — see our companion briefing, *Doing Business in Iceland*.
- **Real estate** — stamp duty, VAT registration of leases and property-tax questions in transactions — see *Acquiring Real Estate in Iceland as a Foreign Entity*.

References available

Detailed case references and CVs of the responsible partners are available on request; client-specific matters are disclosed only with the client's consent.

* Certain matters were handled by MAGNA's partners at the firm's predecessor offices (Lögmenn Höfðabakka and Málflutningsstofa Reykjavíkur), which merged to form MAGNA Lögmenn in 2019.

PART VI — HOW WE CAN ASSIST

Your Icelandic Legal Partner

MAGNA Legal (MAGNA Lögmenn) advises international clients across the full life cycle of an Icelandic investment — from first market analysis to operations, expansion and exit. We work in English and Icelandic and coordinate seamlessly with foreign counsel, tax advisers and technical consultants.

Tax Disputes & Litigation

Audit defence; appeals to yfirskattanefnd; court proceedings against the State; constitutional challenges to taxes and charges; repayment claims with interest.

Transactions & Structuring

Tax aspects of acquisitions, financings and reorganisations; binding-ruling applications; withholding-tax relief and reclaims; coordination with international tax advisers.

Employment & Mobility

Payroll and employer-charge compliance; the foreign-expert regime; cross-border postings and social-security coordination; equity compensation.

VAT & Indirect Taxes

VAT registration and zero-rating; voluntary registration of commercial leases; excise and sector levies; customs classification and valuation disputes.

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