



International Tax

Iceland Tax Alert

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New law updates króna-denominated assets subject to restrictions

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Iceland's parliament passed a law on 22 May 2016, effective as from that date, which further defines and updates the króna-denominated assets that are subject to special restrictions. The law is part of the government's capital account liberalization strategy for a phased lifting of controls, which aims to prevent negative impacts on the economy or the imposition of additional burdens on the treasury or the population (for prior coverage, see the [tax alert dated 12 June 2015](#)). The law sets out which assets constitute "króna assets" subject to restrictions, the applicable restrictions and the exemptions that apply to such assets. The law contains extensive restrictions that potentially could affect nonresident holders of offshore króna. Such holders can participate in foreign currency auctions scheduled to take place in June 2016; otherwise, they may be subject to the restrictions.

Overview of new measures

The following are the main features of the new law:

The law contains a more detailed definition of the term "offshore króna" than previously was the case. Offshore króna encompasses the following:

- a) Deposits denominated in Icelandic króna and held by the following parties with "deposit-money" banks in Iceland, irrespective of whether the deposits are the actual property of the party or whether the party holds the deposit in custody for another legal entity or an individual:
 - Foreign legal entities that have an operating license or that carry out legally defined activities in financial markets, their branches and subsidiaries owned by them; and
 - Other foreign institutional investors that invest in financial instruments, including parties that engage in securitization or other financing activities.
- b) Funds held in a custodial deposit account in the name of the payer, in an escrow account with a deposit-money bank in the name of the owner or its representative or in the form of specified assets of a creditor in the custody of the payer, provided they have been paid for the benefit of a nonresident entity that has, or has had, a claim against a legal entity that has undergone winding-up or insolvency proceedings or has undergone restructuring via a composition agreement.

- c) Icelandic treasury bonds and bills issued in Icelandic króna or bearing a state guarantee, and owned or held in custody by a party falling under item a).
- d) Unit share certificates owned or held in custody by a party falling under item a) and issued in Icelandic króna, in mutual, investment and institutional investment funds that invest, directly or indirectly, in financial instruments issued by Iceland's treasury or bearing a state guarantee.
- e) Shares, bonds and any type of debt instrument issued in Icelandic króna by resident entities that underwent restructuring on the basis of a composition agreement according to the Act on Bankruptcy, etc., after 28 November 2008, and owned by nonresident legal entities as a result of a conversion of claims in which they invested after that date. The same applies to a reinvestment of the proceeds from such assets that have been sold, in whole or in part.
- f) Shares, bonds and any type of debt instrument issued in Icelandic króna by resident entities, if the investment took place after 28 November 2008 and payment was remitted, directly or indirectly, by withdrawal from an account in Icelandic króna with a foreign financial institution.
- g) Unit share certificates owned or held in custody by a party falling under item a) and issued in Icelandic króna, in mutual, investment and institutional investment funds that, among other things, invest, directly or indirectly, in financial instruments issued in Icelandic króna by entities other than Iceland's treasury or those enjoying a state guarantee, deposits, cash and derivatives.
- h) Sales proceeds or other payments due to assets falling under items c)-g) that accrue during the period from the entry into force of the law until 1 September 2016.

The following offshore króna-denominated assets are exempt from the provisions of the law:

- a) Offshore króna assets owned by governments, central banks and international institutions of which Iceland is a member.
- b) Offshore króna assets deriving from payments of premiums according to contractual agreements in domestic currency concerning supplemental insurance for the acquisition of personal pension savings and concerning investment plan insurance, single-premium life insurance and regular savings on the basis of the exemptions for foreign insurance companies and foreign pension custodians from the restrictions in certain provisions of the Foreign Exchange Act.
- c) Offshore króna assets held by foreign electronic money institutions and used in accordance with these institutions' exemptions from the restrictions in certain provisions of the Foreign Exchange Act, for the purpose of engaging in payment intermediation in Iceland.
- d) Offshore króna assets deriving from investments made after 28 November 2008, i.e. under the new investment scheme, but not including direct or indirect investments in derivatives contracts and claims against entities that are in winding up or insolvency proceedings or that have concluded winding up or insolvency proceedings via a composition agreement that entails a distribution of assets to creditors.
- e) Offshore króna assets deriving from participation in Iceland's central bank auctions during the period from 28 June 2011 through 10 February 2015.
- f) Offshore króna assets deriving from the satisfaction, by parties falling under article 2 of the Act on a Stability Tax at the time that act entered into force, of claims under a composition agreement.
- g) Offshore króna assets that derive from nonresidents' claims against

residents on the basis of a composition agreement pursuant to the Act on Bankruptcy, etc., if the Central Bank of Iceland has granted an exemption from the restrictions in the Foreign Exchange Act for distributions of foreign currency.

- h) Offshore króna assets that are the basis for foreign exchange transactions with the Central Bank of Iceland at the reference exchange rate (set at ISK 220 per EUR 1).
- i) Offshore króna assets that are the basis for foreign exchange transactions in the 2016 foreign currency auction of the Central Bank of Iceland, at the auction exchange rate, for an amount equal to the market value of the offshore króna assets, so that settlement of the transaction takes place with delivery by the owner of the assets of an amount equal to the market value of the offshore króna assets, less the product of the market value of the offshore króna assets and a percentage of the central bank's official central exchange rate for the Icelandic króna against the euro on 20 May 2016 and the auction exchange rate.

Requirements for offshore holders

Offshore króna-denominated assets held as deposits will be transferred to restricted deposit accounts with domestic deposit-money banks or the Central Bank of Iceland, in the case of foreign securities depositories, upon request. The same applies to payments deriving from other assets included within the scope of offshore króna assets.

Offshore króna assets in the form of electronically registered securities held in custody with domestic and foreign financial institutions will be transferred to administrative accounts with the Central Bank of Iceland in the name of the custodian concerned.

Financial institutions and securities custodians are required to transfer the offshore króna assets no later than 1 September 2016, subject to per diem fines. In addition, deposit institutions are required to allocate an amount equal to the total balance of restricted accounts held by them for investment in Central Bank of Iceland certificates of deposit, i.e. the reserve requirement. The certificates of deposit will bear 0.5% interest, which will be reviewed by the central bank every 12 months.

Withdrawals from restricted accounts generally are prohibited, except in the following instances:

- a) Temporary authorizations for withdrawal:
 - For foreign exchange transactions with the Central Bank of Iceland at the reference exchange rate, until 1 November 2016.
 - For illiquid offshore króna assets, provided the owner has paid to the central bank the difference, calculated in euro, between the value of the assets according to the reference exchange rate and the value of the assets according to the official central exchange rate of the króna versus the euro on 20 May 2016. The authorization will remain in effect until 1 November 2016. If an owner of offshore króna-denominated assets exercises its authorization, the assets underlying those transactions will be exempt from the restrictions in the law, upon receipt of confirmation by the central bank.
- b) Unlimited authorizations for withdrawal:
 - For the purchase of special certificates of deposit issued by the central bank.
 - For transfers between accounts subject to special restrictions.

- For withdrawals of amounts not to exceed ISK 1 million per calendar year, provided it can be demonstrated that the deposit actually is owned, and has continuously been owned, by an individual.
- For accrued interest, indexation of interest and dividend payments.

Central bank authority/foreign exchange act

The central bank is entrusted with the implementation of the new law and is granted broad authority to gather information and to apply certain measures, such as per diem fines and administrative fines.

Analogous amendments have been made to the Foreign Exchange Act and the Act on Electronic Registration of Title to Securities. For example, these changes include a provision that prohibits lending in króna between group companies unless the loan complies with the general requirements in the Foreign Exchange Act relating to borrowing and lending.

The central bank will publish details of the planned currency auction where all offshore króna owners will be given the opportunity to exchange their offshore króna for euro, thus avoiding the limitations imposed by the law. The auction is expected to be held in June 2016.

Comments

The law will impact both residents and nonresidents holding offshore króna-denominated assets. If holders decide not to participate in the upcoming auction in June, the assets will be subject to stringent restrictions, with the only realistic option being to invest in Central Bank of Iceland certificates of deposit bearing a 0.5% rate of interest.

Legal entities and individuals that hold offshore króna assets should consider consulting their tax and/or legal advisors in regards to the upcoming auction or to obtain further information on the new law.

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