International Tax

Iceland Tax Alert

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Legislation proposed to ease capital controls, introduce "stability tax"

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Iceland's government presented two bills into parliament on 10 June 2015 that aim to provide the foundation for a comprehensive strategy to liberalize the controls that currently restrict the flow of capital out of the country. As part of this strategy, the government plans to introduce a one-time "stability tax" on the assets of failed banks. Parliament is expected to approve both bills in the near future.

According to a press release issued by the Ministry of Finance, the public interest requires that the capital controls be lifted without jeopardizing Iceland's economic and financial stability. The objectives of the current liberalization strategy are based on the fundamental principle that the controls must be lifted in stages to avoid upsetting the balance of the economy and imposing additional financial burdens on the Treasury or the Icelandic people.

To reinforce the government's plans to lift the capital controls and to safeguard the Icelandic currency (ISK) and prevent a potential risk of capital exodus, the parliament passed a bill on 6 June 2015 that amends the Foreign Exchange Act to impose more restrictive rules in certain situations. The main changes include limits on foreign exchange transactions of failed banks and companies that were established in connection with the conclusion of "composition agreements," and a prohibition against administering loans to entities within the same group.

Once the proposed capital control measures are passed, existing controls on corporations, pension funds and individuals will be relaxed to encourage foreign investment in Iceland and strengthen the competitiveness of the country.

Background

Capital controls were introduced following the collapse of several major Icelandic commercial and savings banks during the 2008 financial crisis, to halt the flight of capital out of the country. According to the government, the total value of the underlying assets of the defaulting banks, which led to the imposition of capital controls, is about ISK 1,200 billion:

- ISK 500 billion worth of assets of failed banks;
- ISK 400 billion in foreign-denominated claims; and
- About ISK 300 billion held offshore by nonresidents.

The government aims to prevent these assets from flowing into the foreign exchange market and adversely affecting Iceland's balance of payments. The proposed solution is twofold: to impose stability conditions and to introduce a stability tax on failed banks.

Stability conditions

The proposed stability measures are designed to address (and mitigate) the potential adverse effects that could arise from the winding up of the assets of Icelandic banks that failed during the 2008 financial crisis—specifically, to ensure that these procedures do not pose a threat to the monetary, exchange rate and financial stability of Iceland.

If the failed banks conclude composition agreements by the end of 2015, they would be able to obtain authorization to transfer funds outside Iceland provided they fulfill stability conditions (detailed information on the conditions has not yet been released). The conditions would be mandatory and nonnegotiable, entailing a special stability contribution that consists of six segments. If all of the stability conditions are not fulfilled before the end of 2015, the stability tax (described below) would be imposed.

In this regard, a bill to amend the Act on Financial Undertakings has been presented to the parliament that would simplify the rules that currently apply to the execution of composition agreements. The bill also includes provisions that would require that a district court judge approve a bank's “composition proposal” (scheme of arrangements), unless the Central Bank of Iceland has determined that the proposal does not jeopardize the monetary, exchange rate or financial stability of the country.

Stability tax

The proposed stability tax would impose a one-time 39% tax on failed commercial or savings banks, based on their assessed value as of 31 December 2015, unless the banks are able to reach composition agreements with their creditors by the end of 2015, in which case the banks would be able to avoid payment of the stability tax (provided the financial stability conditions referred to above are fulfilled). If the prescribed requirements are not met, the banks would be required to pay the stability tax, which would be levied on 15 April 2016 and would have to be paid in full before 31 August 2016. Once the tax is paid, conditioned authorization would be granted to transfer funds out of Iceland.

Currency auction for holders of offshore ISK

Although not included in the proposed bills, the government’s liberalization strategy includes a measure that would allow certain foreign creditors to participate in currency auctions, exchange their debt for longer term government bonds denominated in Icelandic kronur or euros or transfer the debt to “locked” non-interest bearing accounts. Creditors that that bid on foreign currency in exchange for their ISK would be subject to a premium to compensate for the necessary costs of releasing them from the restrictions of the capital controls.