

**Act No. 86/2007**  
**on the taxation of merchant ship operations, as amended by Act No. 61/2008**

**Article 1**

Limited liability companies and private limited companies, subject to taxation pursuant to Item 1 of Paragraph 1 of Article 2 of the Income Tax Act No. 90/2003, and which operate merchant ships registered on the Icelandic International Ship Register (IIS), may decide to pay taxes on their merchant ship operations in accordance with this Act instead of Act No. 90/2003.

A merchant ship, pursuant to this Act, means any ship of 100 gross tonnage and over, which is used commercially for the carriage of cargo and/or passengers in international trade and for the carriage of cargo in domestic trade in Iceland.

**Article 2**

The Directorate of Taxes shall be sent a written notification of the decision pursuant to Article 1 before the beginning of the first income year to which the taxation is to apply. The taxation shall apply for at least three years. If the ship operator decides, after three years, to return to general taxation pursuant to the Income Tax Act, the Directorate of Taxes shall be notified in writing before the beginning of the income year. A ship operator may not select taxation pursuant to this Act again until three years after the return to general taxation.

In the event of a merger of two or more companies that have selected taxation in accordance with this Act, the minimum term shall be based on the company that has been subject to such taxation for the shortest period. In the event that one of the merged companies has not been subject to taxation pursuant to this Act, the merged company shall be taxed in accordance with the Act for at least three years from the date of the merger. The three-year minimum term also applies to the division of companies.

A ship operator choosing taxation pursuant to this Act shall not be permitted joint taxation pursuant to Article 55 of the Income Tax Act.

**Article 3**

Merchant ship operations pursuant to this Act includes the transport of cargo or passengers for commercial purposes between destinations by means of:

- a. merchant ships owned by the ship operator,
- b. merchant ships hired without crew (bareboat charter), and
- c. merchant ships hired with a crew (time charter).

Merchant ship operation includes the hiring of the merchant ship that the charterer uses for the transport of cargo or passengers. Merchant ship operation does not include the

hiring of merchant ships without crew (bareboat charter) for longer periods than three years.

The following are considered operational elements in merchant ship operation pursuant to this Act:

1. the use of containers for cargo transport,
2. the operation of loading, unloading and maintenance facilities,
3. operation of ticket sales and passenger terminals,
4. the operation of offices and management facilities, and
5. sale of consumer products on board merchant ships.

Taxation pursuant to this Act includes the operation of all the merchant ships of a ship operator that meets the requirements for registration on the Icelandic International Ship Register.

If a ship operator operates a merchant ship in joint ownership with another entity, the taxation shall apply to the operator's share in the operation of such merchant ship.

#### **Article 4**

Activities other than the operation of ships which meet the requirements of Articles 1 and 3 are not subject to special taxation pursuant to this Act. If a ship operator operating merchant ships is also engaged in other activities, the income of such activities shall be taxed in accordance with the Income Tax Act. If a merchant ship has been permanently laid up, its use is not considered merchant ship operation. Merchant ship operation does not include the use of merchant ships in e.g.:

1. preparatory research, the search and processing of carbohydrate compounds or of other natural resources,
2. fishing operations and the processing of the catch,
3. the construction of harbours or other installations, the laying of cables on the sea bed, mineral extraction and processing,
4. diving operations,
5. piloting and salvage operations,
6. educational and pedagogic activities or other social activities,
7. activities relating to museums,
8. sports, entertainment and leisure activities, including whale watching,
9. carriage of passengers between Icelandic ports that are not ports of call on international voyages.

#### **Article 5**

If an operator offers joint cargo transport services using the operator's own merchant ship and means of transport owned by another cargo carrier, the ship operator shall be taxed for the total services according to this Act. If an operator engages in transport with

another means of transport than a merchant ship, this part of the transport shall not be taxed pursuant to this Act but shall be taxed pursuant to the Income Tax Act. The division of sale prices between operational activities shall be based on general market prices.

### **Article 6**

The base for taxation for merchant ship operations is determined by the size of the ships operated, irrespective of profit. The tax base is determined by the following basic amounts for each 100 net tons (NT) of each ship for each started 24 hours, whether the ship is in operation or not:

1. 25,000 NT or less: 30 ISK per 100 NT.
2. 25,001 NT or more: 10 ISK per 100 NT.

No deductions are permitted from the tax base, pursuant to Paragraph 1.

Taxes shall amount to 15% of the tax base.

### **Article 7**

Ship operators paying taxes in accordance with this Act shall maintain the income and costs of merchant ship operation separate from income and costs of other activities in their accounts and annual financial statements.

### **Article 8**

Interest, depreciation and exchange rate gains, cf. Article 8 of the Income Tax Act, shall be divided between the merchant ship operation and other activities in proportion to the book value of assets used in merchant ship operation, on one hand, and for other uses, on the other hand.

### **Article 9**

Operation costs of merchant ships, including other costs that only, or primarily, involve the acquisition of income in merchant ship operation, cannot be deducted from the income of the ship operator subject to taxation according to the provisions of the Income Tax Act.

In the event that costs, other than financial costs, relate at the same time to the acquisition of income in merchant ship operation and the acquisition of other income, other than capital gains, the cost shall be divided in proportion to the income. The deductibility of

the proportion of the costs that are thus considered to relate to the acquisition of other income shall be governed by the provisions of the Income Tax Act.

In the event that interest expenses, depreciation and exchange rate losses pursuant to Article 49 of the Income Tax Act relate at the same time to the acquisition of income in merchant ship operation and the acquisition of other income, such financial costs shall be divided in proportion to the book value of assets used in merchant ship operation, on one hand, and for other uses, on the other hand. The deductibility of the proportion of the costs that are thus considered to relate to the acquisition of income other than merchant ship operation shall be governed by the provisions of the Income Tax Act.

#### **Article 10**

In the event that income belonging to merchant ship operation pursuant to Article 8 amounts to a greater amount than costs that belong to the merchant ship operation pursuant to Paragraph 3 of Article 9, the difference shall be taxed in accordance with the provisions of the Income Tax Act.

#### **Article 11**

Losses from merchant ship operation are not deductible from income from the other activities of a ship operator, neither in the year when the losses occurred nor in subsequent years.

In the event, prior to the taxation pursuant to this Act, that losses have occurred in complex operation, i.e. merchant ship operation and other activities, such losses shall be divided between operating activities in proportion to the book value of assets for use in merchant ship operation on one hand, and for other uses, on the other hand.

#### **Article 12**

Depreciation shall be calculated annually in accordance with the provisions of the Income Tax Act and shall be entered into the accounts for the reduction of the base price of operating assets, but not, however, in the year when the asset is sold or its use ends. Depreciation shall annually amount to the average depreciation in the asset category in question pursuant to Article 37 of the Income Tax Act.

#### **Article 13**

Profits from the sale of permanent operating assets in merchant ship operation shall be determined and taxed in the same manner as the taxation of depreciable assets in accordance with the provisions of the Income Tax Act, taking into account the reduction

of the base price pursuant to Article 12. The crediting of sales profits may be postponed and entered into the accounts for the reduction of the base price of permanent operating assets in merchant ship operation purchased in the next two operating years. In the event that no such purchases are made within the stated time limit, the sales profits shall be accounted with the income of the second year from the date that it formed. The provisions of this Article cover profits from the sale of permanent operating assets in merchant ship operation that have been postponed during the last two operating years before the selection of taxation method pursuant to this Act.

#### **Article 14**

On the division of income and costs, the prices and business terms shall be based on what is commonly the norm in transactions between independent parties. In the event that a ship operator does not comply, the tax director shall correct the income and costs in accordance with Article 57 of the Income Tax Act.

#### **Article 15**

The levying and collection of taxes pursuant to this Act shall be governed by the provisions of the Income Tax Act, cf. Chapters IX-XIV.

#### **Article 16**

Limited liability companies and private limited companies subject to taxation pursuant to Item 1 of Paragraph 1 of Article 2 of Act No 90/2003 on Income Tax, and which operate merchant ships, cf. Article 3, registered in the Icelandic International Ship Register (IIS), shall receive a subsidy which corresponds to 90% of the correctly determined amount of income tax and municipal income tax in withholding taxes on the wages of the crew of the merchant ships in question, having taken into account personal tax allowances and seamen's allowances. The withholding tax shall, in other respects, be so disposed of that 5% shall be paid to the Treasury and 5% shall be paid to the municipality of the crewmember in question. This disposal shall replace the disposal of withholding tax and division according to the Act on Withholding Tax, the Income Tax Act and the Act on Municipal Revenue Base.

The Minister of Finance shall, by means of a regulation, specify the implementation of payments pursuant to Paragraph 1, including the form of subsidy applications, payment times and balancing against unpaid public levies.

#### **Article 17**

This Act shall enter into effect on 1 January 2008.

### Interim provisions

If a ship operator has utilised the authorisation provided in Article 1 of Act No. 48/2006, then income for which taxation was postponed shall be taxed according to the provisions of the Act on Income Tax even if the ship operator has subsequently chosen taxation in accordance with this Act.

Done at Reykjavik, 30 March 2007.

[Entered into force on 1 January 2008]