

THE OECD TAX-BENEFIT MODEL FOR ICELAND

Description of policy rules for 2020



THE OECD TAX-BENEFIT MODEL FOR ICELAND

Description of policy rules for 2020

Reference contact at the OECD: Olga Rastrigina (Tax-Benefit.Models@oecd.org)

National team: Óttar Snædal, Ministry of Finance and Economic Affairs, Iceland.

This version : October 2020 – via <http://www.oecd.org/els/benefits-and-wages.htm>

This work is published on the responsibility of the Director of the OECD Directorate for Employment, Labour and Social Affairs. The opinions expressed and arguments employed herein do not necessarily reflect the official views of the Organisation or of the governments of its member countries.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

© OECD 2020

You can copy, download or print OECD content for your own use, and you can include excerpts from OECD publications, databases and multimedia products in your own documents, presentations, blogs, websites and teaching materials, provided that suitable acknowledgment of the source and copyright owner is given. All requests for public or commercial use and translation rights should be submitted to rights@oecd.org. Requests for permission to photocopy portions of this material for public or commercial use shall be addressed directly to the Copyright Clearance Center (CCC) at info@copyright.com or the Centre français d'exploitation du droit de copie (CFC) at contact@cfcopies.com.



Directorate for Employment, Labour and Social Affairs, Jobs and Income Division

www.oecd.org/social/benefits-and-wages

Table of contents

<i>Preface</i>	4
<i>The OECD tax-benefit model for Iceland: Policy rules in 2020</i>	5
1. Reference wages and other reference amounts	5
2. Unemployment benefits	5
2.1. Unemployment insurance benefit (Atvinnuleysisdagpeningar)	5
3. Social assistance and housing benefits	8
3.1. Municipality financial assistance (Fjárhagsaðstoð sveitarfélaga)	8
3.2. Housing benefits (Húsnæðisbætur)	11
4. Family benefits	14
4.1. Family benefit (Barnabætur)	14
4.2. Lone parent mother/fatherhood allowance (Mæðralaun/Feðralaun)	15
5. Net costs of Early Childhood Education and Care	19
5.1. Gross childcare fees	19
5.2. Fee discounts and free provision	20
5.3. Child-care benefits for formal centre-based care	20
5.4. Child care allowance for children not using child care centers	20
5.5. Tax concessions for childcare expenditures	21
6. In-work benefits	21
7. Social security contributions and payroll taxes	22
7.1. Social security contributions (Tryggingagjald)	22
8. Taxes	24
8.1. Personal income tax (Tekjuskattur einstaklinga)	24
9. Sickness benefits	26
9.1. Sickness cash benefits (Sjúkradagpeningar)	26
9.2. Sick leave by employer (Veikindaréttur)	27
10. Short-time work schemes	29
10.1. Unemployment benefit due to reduced employment ratio (Hlutabætur)	29
11. Selected output from the OECD tax-benefit model (TaxBEN)	31
<i>Annex: Other benefits and direct taxes</i>	33
Mortgage interest rebate (Vaxtabætur)	33
Subsidy for child-care with day-care parents (Niðurgreiðsla vegna barna hjá dagforeldrum)	33

Preface

The [OECD Tax-Benefit model \(TaxBEN\)](#) incorporates detailed policy rules for tax liabilities and benefit entitlements as they apply to individual families across OECD member countries. Its main use is to calculate the amount of taxes that people are liable to pay, and the government transfers they are likely to receive, in different family and labour-market situations. The model includes legal policy rules that are relevant for people of **working age** (from 18 years old until the statutory retirement age) and their dependent children. Income tax liabilities and benefit entitlements are calculated for a broad set of *stylised* families (“vignettes”, e.g. a married couple of 40 years old adults with two children aged 4 and 6 respectively). Model users are free to change many of these characteristics, including the age and number of children, activity status of adult members, hours of work, current and past earnings levels, unemployment duration, social contribution records, and housing-related costs. The model has been updated annually since the early 2000s for most OECD countries.

TaxBEN’s policy scope includes the main taxes on employment income (earnings), social contributions paid by individuals and by employers, as well as the main cash and near-cash benefit programmes, including unemployment benefits, family benefits, guaranteed minimum-income benefits, cash housing benefits, and employment-conditional benefits. Disability benefits and support for non-parental childcare are included for a sub-set of countries and years. The most important policy areas that are outside the scope of the model include taxes on wealth (e.g. taxes on immovable and unmovable properties, including local taxes), indirect taxes (e.g. VAT), early-retirement benefits, sickness benefits and in-kind transfers (e.g. free school meals, subsidised transport and free health care).

This report describes the taxes and benefits that are included in the model and focuses on the rules that are relevant for family, individual and labour-market circumstances that are within its scope. The **Annex** provides information on other cash benefits and taxes on employment incomes that can be relevant for some members of the working-age population, but which are not included in the TaxBEN model.

Reading notes and further details on the scope and content of this report

- The **reference date** for policy rules described in this report is **1 January 2020**.
- **Guidelines for completing and updating this report** are provided [here](#).
- Further information on the model, model results, and references to reports and analytical uses is available on the [project website](#). A [methodology](#) document provides a full description of the assumptions underlying the model as well as the model choices that users can make. The symbol  in the text provides a link to a glossary of technical terms.
- Section titles provide the names of taxes and benefits as they are known in the country: first, direct translation into English, then (in brackets) the name in the national language.
- In order to facilitate transparency between the policy descriptions and the associated code in the model, the variable names are indicated in the text in square brackets using the following format: **[variable name]**, for instance: **[AW]** for the average wage.
- COVID-related measures are provided in **blue font**. These measures have been introduced after the reference policy date, 1 January 2020, and are not included in the model.
- Sickness benefits and Short-time work schemes described in Sections 9 and 10 are not included in the model.

The OECD tax-benefit model for Iceland: Policy rules in 2020

1. Reference wages and other reference amounts

Average wage **[AW]**: The OECD tax-benefit model uses Secretariat estimates of the average full-time wage (available [here](#))¹. If Secretariat estimates are not available yet, the model uses wage projections obtained by applying forecasted wage growth² to the latest available wage estimate.

Iceland has no statutory minimum wage **[MIN]**.

2. Unemployment benefits

2.1. Unemployment insurance benefit (*Atvinnuleysisdagpeningar*)

Code in the OECD tax-benefit model:³ **[UI_p; UI_s]**

This is an unemployment insurance benefit. It is contributory, not means-tested and taxable.



2.1.1. Eligibility conditions

Age: In order to qualify for unemployment benefits, one has to be between 18 and 70 years old.

Contribution/employment history: An employee must have worked for at least 3 months of the preceding 12 months to qualify for any unemployment insurance benefit (i.e. 25% of the full benefit). In order to qualify for the full benefit, he must have worked for the last 12 months. For full-time workers with employment record in between 3 and 12 months, the benefit will increase linearly from 25% to 100% of the full benefit. Part-timers qualify for proportionally reduced benefits.

Behavioural requirements and related eligibility conditions: A person must be willing and available to work, and must be resident of and settled in Iceland. A person must have been registered unemployed for at least three days. TaxBEN assumes that these compulsory conditions are satisfied when simulating unemployment benefits.⁴

¹ Average Wages are estimated by the [Centre for Tax Policy and Administration](#) at the OECD. For more information on methodology see the latest [Taxing Wages publication](#).

² Wage growth projections are based on [OECD Economic Outlook](#) and [EU economic forecasts](#) (for non-OECD countries).

³ The variable names ending with “_p” refer to the first adult (so-called “principal” adult) whereas those ending with “_s” are related to the spouse.

⁴ Details on behavioural requirements and sanction provisions for unemployment benefits are reported in regularly updated companion reports, see [Immervoll and Knotz \(2018\)](#), [Langenbacher \(2015\)](#) and [Venn \(2011\)](#).

2.1.2. Benefit amount

Benefits are paid in proportion to the number of hours worked in insured employment in the previous 12 months:

- The full benefit amount is ISK 289 510 per month.
- The minimum benefit amount is ISK 72 375 per month (25% of full benefits).
- Since 2006, benefits are linked to previous employment income to an extent. After having received the general benefit amount for two weeks the recipient is entitled to 70% of his employment income (average income in the 6-month period ending two months prior to unemployment), subject to a maximum of ISK 456 404 monthly, and for 65 days (three months) only. After that, he will continue to receive the general benefits only, for the remainder of his entitlement period. The earning-related benefit cannot be below the amount of the flat benefits that a person is eligible to.
- Parents receive a family supplement of ISK 11 580 per month (4% of full benefits) per dependent child below 18 years of age. These supplements apply to both the flat benefit as well as the earnings-related benefit. In case of earnings-related benefit it means that the amount with supplements for children can exceed the maximum of ISK 456 404 monthly.

On 26 August 2020, as a response to the Covid crisis, the period of income-related unemployment benefit was temporarily extended to 130 days (six months) until 1 October 2021. The total duration of the unemployment benefit remained the same.

2.1.3. Benefit duration

Benefits are paid for a maximum of 30 months since 1 January 2015 (36 months before that).

2.1.4. Means test

The benefit is not means-tested.

2.1.5. Tax treatment

Benefits are subject to general income tax and the employee's non-tax compulsory pension payments (4%). The Unemployment Fund pays the employer's non-tax compulsory pension payment (11.5% since July 1 2018) on behalf of the benefit recipient (*not covered by the model*). In addition, if taxable income (which includes unemployment insurance benefit) exceeds the threshold, the fees to the Construction Fund for the Elderly and the Treasury are also paid by the benefit recipient.

2.1.6. Interactions with other components of the tax-benefit system

Individuals receiving health insurance benefits because of a work-related accident (*slysadagpeningar*) are not eligible for unemployment benefits for the duration of receiving said benefits.

Individuals receiving maternity/paternity leave payments (*fæðingarorlofsgreiðslur*) are not eligible for unemployment benefits for the duration of receiving said payments.

For those receiving old age or disability pension payments, the unemployment insurance benefits are reduced by half of the total amount (old age or disability pension payment plus unemployment insurance benefits) that is above the sum of the full unemployment insurance benefits and the deduction-exemption threshold of the pension system.

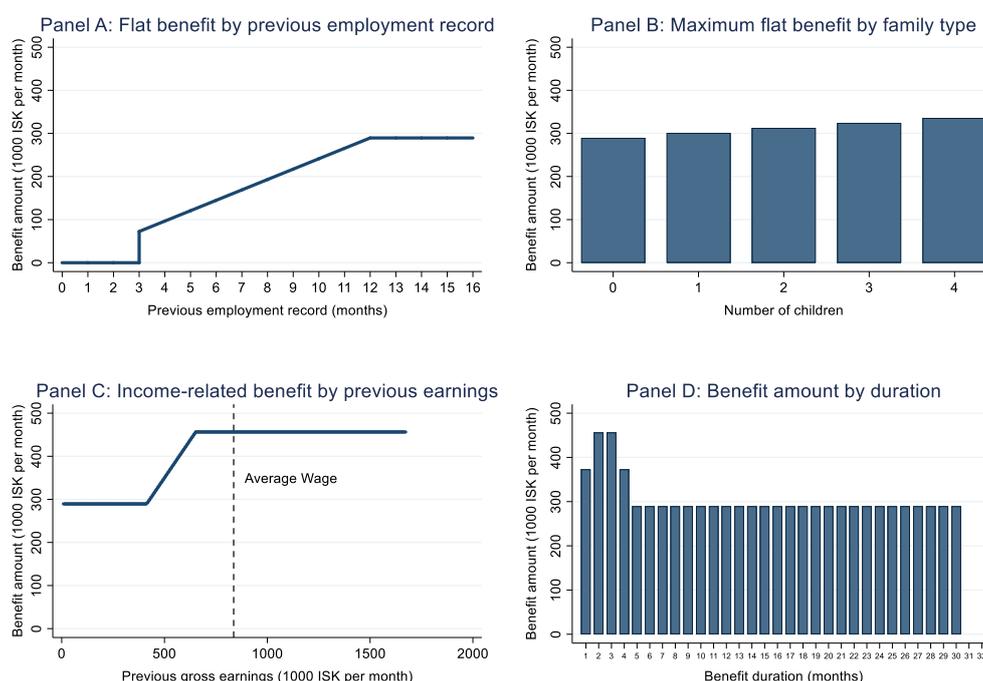
(None of these three cases is covered by the model because relevant benefits/pensions are not simulated.)

2.1.7. Combining benefit receipt and employment/starting a new job

If a recipient has occasional employment for one or two days at a time, benefit is reduced in proportion to the number of hours worked.

Figure 1. Unemployment benefit

40-year old single person



Note: Benefit rules do not depend on whether a person is single or lives in a couple. However, there are supplements for children (shown in Panel B). Other panels (Panels A, C and D) show benefit amount for a single person without children. Panels B, C, and D assume long and continues previous employment record. Panel A shows a flat benefit amount by previous employment record. Flat benefit is paid in the first two weeks of benefit receipt and after the end of the income-related benefit (approx. 3 months). Panel B shows the maximum flat benefit amount by number of children (under 18 years old). Panel C shows income-related benefit amount by previous gross earnings. Income-related benefit is paid for approx. 3 months after the initial “waiting period” of two weeks. Panel D shows benefit amount by duration for a person with previous earnings at the average wage. In the first and fourth month of benefit receipt, the amount is a weighted average of the flat amount (paid for two weeks) and income-related amount (paid for another two weeks).
Source: OECD Tax-Benefit Model.

3. Social assistance and housing benefits

Municipality financial assistance (*Fjárhagsaðstoð sveitarfélaga*) is available from local governments for those without other resources (see Section **Error! Reference source not found.**). There are also two schemes for housing benefits: one for tenants and one for home owners. Housing benefit (*Húsnæðisbætur*) is available to households renting accommodation as long as no household member owns any other real estate. This benefit is simulated in the model (see Section 0). Home owners can receive interest rebates to offset their mortgage payments. Mortgage interest rebate is not simulated in the model (see description in the Annex).

3.1. Municipality financial assistance (*Fjárhagsaðstoð sveitarfélaga*)

Code in the OECD tax-benefit model: **[SA]**

This is a non-contributory benefit, means-tested and taxable. Benefit amounts differ regionally. In the model the rules for the capital, Reykjavik, are simulated.

3.1.1. Eligibility conditions

Municipalities are required by law to assist individuals who cannot provide for themselves and those they are legal guardians of. During the process of reviewing an application for financial aid the municipality will collect information on the individual's eligibility for benefits from the central government and the social security system. The municipality can then reject the applications of those who qualify, fully or partially, for benefits from the central government and the social security system if their needs will be met by said benefits.

3.1.2. Benefit amount

Financial assistance is the difference between the needs (the applicable amount) and the claiming household's resources. The applicable amount for Reykjavik is shown below.

Household type	Applicable amount: recommended minimum monthly rate (ISK)
Single persons	207 709
Couples	322 334
Individual, living with parents (<i>not covered by the model</i>)	103 854
Individual, cohabiting (<i>not covered by the model</i>)	175 006

An individual, living with parents, who himself supports a child, is entitled to ISK 175 006 monthly (*not covered by the model*). There are no other regular allowances for dependent children. Recipients who have received benefits for at least three months are entitled to a December bonus of 25% of their regular monthly assistance.

Additional support may be provided to beneficiaries of assistance to meet various expenses, such as funeral costs, dental bills, education etc. (*not covered by the model*)

Parents may be entitled to additional support, up to ISK 16 671 per child monthly, to pay for child care, school meals or activities directed at the child's well-being. This support is

granted on an individual basis, subject to revision after each 6-month period. They may also receive ISK 16 154 twice, in August and December, towards expenses at beginning of school and Christmas. (*not covered by the model*)

3.1.3. *Benefit duration*

Social assistance is granted on the basis of a decision, with a base period of either 3 or 6 months. After 6 months, assistance may continue, following consultation and an assessment of eligibility. No general absolute duration limit applies.

3.1.4. *Means test*

There are no earning disregards. The tested resources include all gross family income. Excluded is income of children and all benefits paid in respect of children such as child support and family benefits, as well as mortgage interest rebates and housing benefits. The exemption is the lone parent benefit, which is included as family income in the same way as labour income, unemployment benefits, capital income, etc.

3.1.5. *Tax treatment*

Subject to general income tax. In addition, if taxable income (which includes municipality financial assistance) exceeds the threshold, the fees to the Construction Fund for the Elderly and the Treasury are also paid by the benefit recipient.

3.1.6. *Interaction with other components of the tax-benefit system*

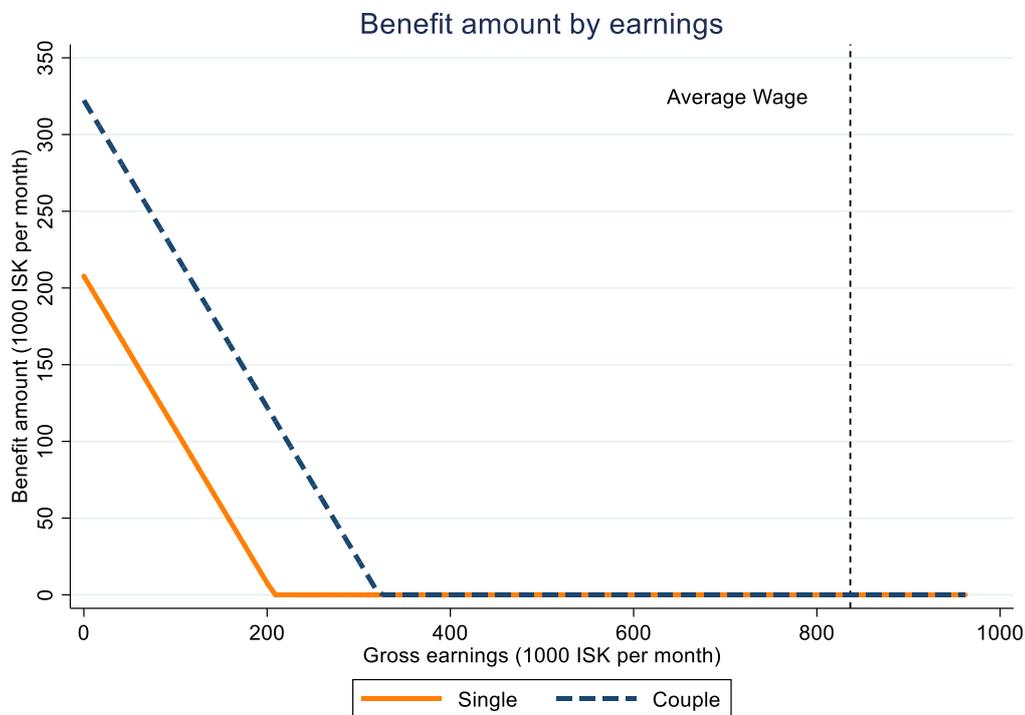
All other benefits, with the exception of income of children and all benefits paid in respect of children such as child support and family benefits, as well as mortgage interest rebates and housing benefits, are wholly deducted from the applicable amount. An exemption in regard to benefits paid in respect of children is the lone parent benefit, which is wholly deducted from the applicable amount.

3.1.7. *Combining benefit receipt and employment/starting a new job*

Employment does not affect eligibility, but employment income affects the aid amount as described above. If the applicant is employed part-time, with income below the applicable amount, they will be required to register with an employment agency and seek full-time employment in order to receive aid.

Figure 2. Municipality financial assistance

40-year old single person and couple with or without children



Note: Results assume no receipt unemployment benefit, lone parent benefit as well as other benefits, which are usually included in the means test for municipality financial assistance. Discretionary supplements for children are not included, thus the benefit amount depends only on whether a person is single or lives in a couple. The figure shows the reduction in benefit amount as one adult starts working. The benefit is reduced by 1 ISK for every gross ISK earned. Residence in the municipality of Reykjavik is assumed.

Source: OECD Tax-Benefit Model.

3.2. *Housing benefits (Húsnæðisbætur)*

Code in the OECD tax-benefit model: [\[HB\]](#)

A new housing benefit replaced the rent benefit as of 1 January 2017.

This is a non-contributory benefit, means-tested and not taxable.

The central government finances and administers the housing benefit system.

3.2.1. *Eligibility conditions*

Housing benefits are available to tenants with a certified rental agreement of at least 3 months' duration. The rented accommodation must be a self-contained unit (e.g. rooms in dormitories on campuses are excluded).

3.2.2. *Benefit amount*

Number of dwellers	Annual full benefit amount (ISK)	Annual income threshold (ISK)
1	389 520	4 020 975
2	515 172	5 318 064
3	603 132	6 226 026
4 or more	653 388	6 744 861

The benefit is reduced if income surpasses the thresholds (see Section 3.2.4.)

The rent benefit can never be more than 75% of the actual rent.

3.2.3. *Benefit duration*

As long as the eligibility conditions hold. When a recipient becomes ineligible they will not receive payment of housing benefits for the month during which they became ineligible. If a household member turns 18 during the benefit duration the recipient shall get said household member's approval for the necessary gathering of their information and data pertaining to housing benefits. Housing benefit payments can be withheld by the government for 60 days from the first day of the calendar month following the month in which said household member turned 18 if such approval is not received. If the administrative offices have not received said household member's approval within that 60-day grace period, the household has voided their right to housing benefits for the time period. The rights to housing benefits are furthermore demarcated by the end-date of the certified rental agreement.

3.2.4. *Means test*

Housing benefits are targeted to low-income tenants and are therefore subject to an income test. The benefit amount is reduced by 11% of income (i.e. the taxable income of all non-studying household members 18 years or older) that surpasses the income threshold. The taxable income (covered by the model) includes earnings, unemployment benefits, lone parent benefit, and municipality financial support.

After accounting for deductions due to the income-test the benefits are subject to a net wealth test. The post-income-test amount is reduced proportionally starting at a combined net wealth threshold of ISK 8 000 000 for all household members and reaching zero at ISK 12 800 000. Thus, if the combined net wealth of a household is ISK 10 400 000 (at the

halfway point between the net wealth threshold and the zero-benefit point of ISK 12 800 000) the post-income-test amount is reduced by 50%. (*net wealth is assumed to be zero in the model*).

3.2.5. *Tax treatment*

Benefits are not taxable.

3.2.6. *Interaction with other components of the tax-benefit system*

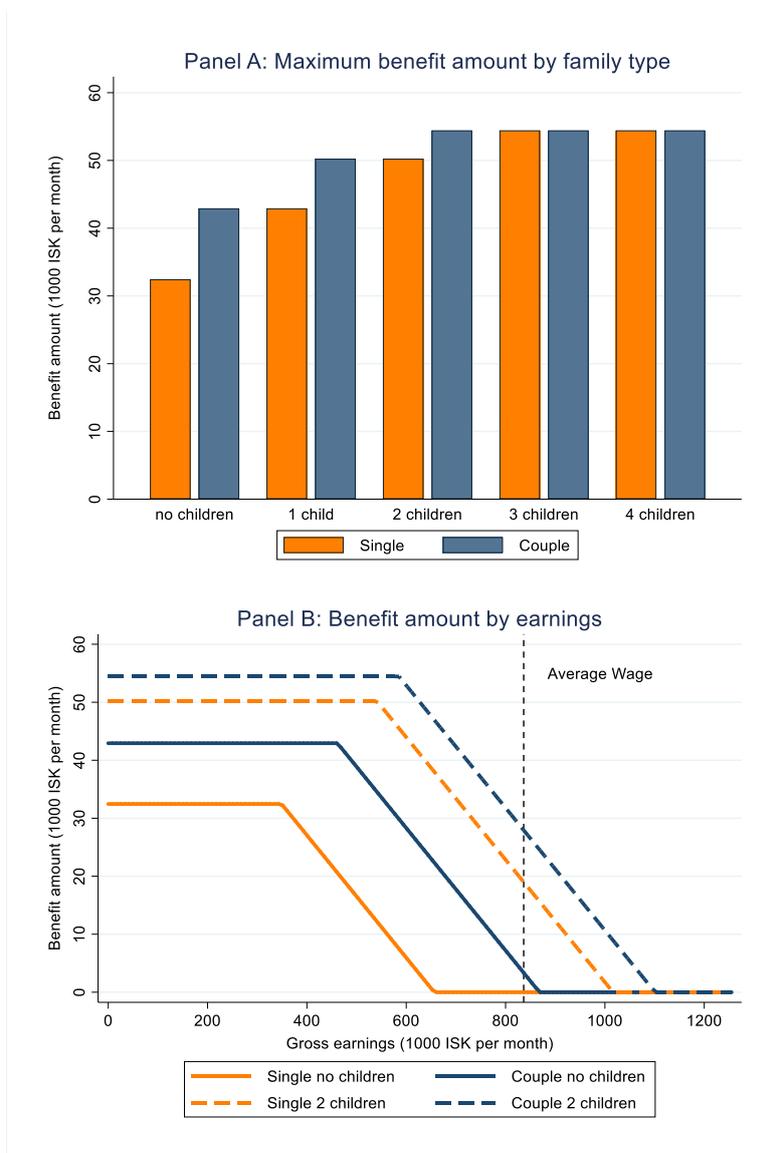
Housing benefits do not interact with other components of the tax-benefit system.

3.2.7. *Combining benefit receipt and employment/starting a new job*

Benefit receipt is unaffected by employment status.

Figure 3. Housing benefit

40-year old single or couple with or without children



Note: Results assume no receipt of unemployment benefits, financial municipality assistance, lone parent benefit or other benefits, which are usually included in the means test for housing benefit. Rent is assumed to be 20% of average wage for all family types. Panel A shows maximum benefit amount for a jobless family with no income. Panel B shows the reduction in benefit amount if one adult starts working.
Source: OECD Tax-Benefit Model.

4. Family benefits

4.1. Family benefit (*Barnabætur*)

Code in the OECD tax-benefit model: [\[FB_I\]](#)

This is a non-contributory benefit, means-tested and not taxable.

4.1.1. Eligibility conditions

To have a dependent child under 18 years of age.

4.1.2. Benefit amount

The benefit amount per child and income limits depend on the household type:

Household type	Amounts paid in 2020 (based on income received in 2019), ISK/year
Benefit amounts:	
Children under 18	
- First child	234 500
- Each additional child	279 200
Additional benefit for children under 7	
- For each child under 7	140 000
Benefits for single parents	
- First child	390 700
- Each additional child	400 800
Special child benefit supplement ¹	
- Per child, if households receive other child benefits	42 000
- Per child, if other child benefits are fully curtailed	30 000
Income threshold for benefit curtailment	
For couples	7 800 000
For single parent	3 900 000
Curtailment of benefits	
For one child	4%
For two children	6%
For three children or more	8%
For additional benefit for children under 7	4% per child
Additional curtailment for high income² (introduced in 2019)	1.5%
Threshold for couples	11 000 000
Threshold for single parents	5 500 000

¹ A temporary measure in response to the Covid crisis. This is a one-off universal supplementary child benefit payment, transferred to families with children under 18 on 1 June 2020.

² Additional curtailment is not applied to additional benefits for parents of children under 7.

Note that child benefits paid in 2020 are based on information from 2019 tax returns. However, in the model benefits paid in 2020 are simulated based on income in 2020.

4.1.3. *Benefit duration*

As long as the eligibility conditions hold.

4.1.4. *Means test*

The general benefit for parents with one child is reduced by 4% of income above the income limit, by 6% for parents with 2 children and by 8% for parents with 3 or more children. The additional benefit for children under 7 years of age is reduced by 4% of income above the limit (benefit is reduced for each child, i.e. the curtailment rate is multiplied by the number of children under 7). See income thresholds in table in Section 4.1.2.).

The income definition for the means test includes the following sources of income covered in this report: employment income less non-tax compulsory payments to the pension fund, lone parent motherhood/fatherhood allowance, unemployment benefit and municipality financial assistance.

4.1.5. *Tax treatment*

The benefit is not taxable.

4.1.6. *Interaction with other components of the tax-benefit system*

Benefit does not interact with other components of the tax-benefit system.

4.1.7. *Combining benefit receipt and employment/starting a new job*

Benefit receipt is unaffected by employment status.

4.2. *Lone parent mother/fatherhood allowance (Mæðralaun/Feðralaun)*

Code in the OECD tax-benefit model: [\[LPB\]](#)

This is a non-contributory benefit, not means-tested and taxable.

4.2.1. *Eligibility conditions*

Lone parents with two or more children (under 18 years of age) are entitled to additional benefits from the Social Security Administration.

4.2.2. *Benefit amount*

The benefit amount depends on the number of children:

Number of children	Benefit amount per year (ISK)
2 children	123 552
3 children	321 228

Additional amounts are paid to lone parents with disabled children (*not covered by the model*).

4.2.3. *Benefit duration*

As long as eligibility conditions hold.

4.2.4. *Means test* 

The benefit is not income tested.

4.2.5. *Tax treatment*

Subject to general income tax.

4.2.6. *Interaction with other components of the tax-benefit system* 

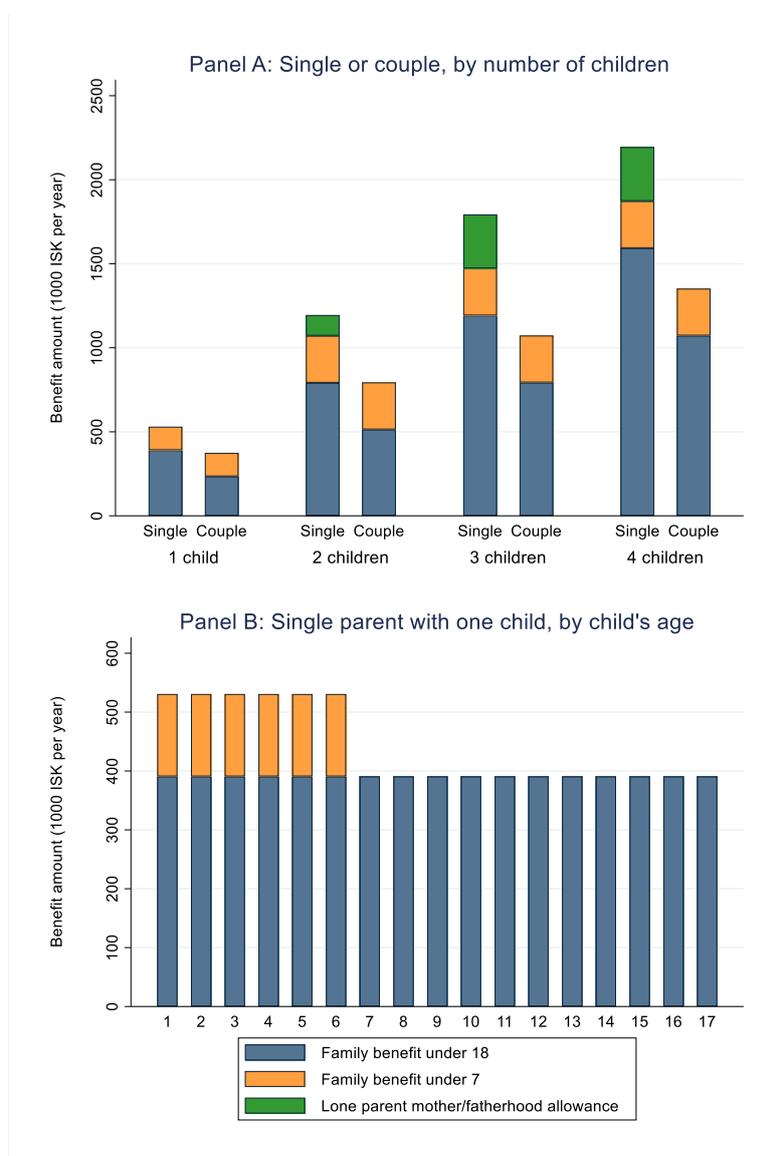
The benefit does not interact with other components of the tax-benefit system.

4.2.7. *Combining benefit receipt and employment/starting a new job*

Benefit receipt is unaffected by employment status.

Figure 4. Maximum amounts of family benefits

40-year old single person or couple with children

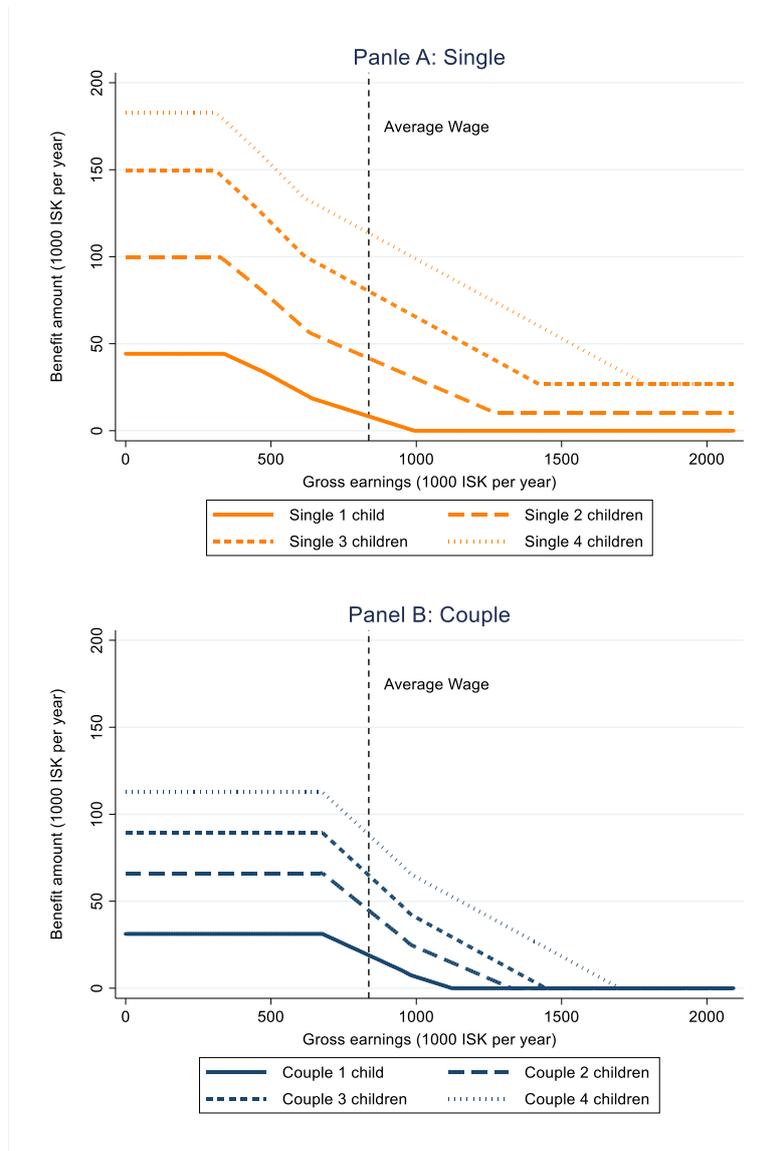


Note: The figure shows maximum family benefit amounts for a jobless family with no income. In Panel A, children's ages are 4, 6, 8, and 10. In Panel B, child's age varies from 1 to 17 years old.

Source: OECD Tax-Benefit Model.

Figure 5. Family benefits by earnings

40-year old single person or couple with children



Note: The figure shows the total amount of family benefits (family benefit under 18 and under 7 years old, and lone parent mother/fatherhood allowance) and how they are reduced if one adult starts working. The second adult in a couple is assumed to be out of work. The family receives only earnings from work and family benefits. The amounts of lone parent mother/fatherhood allowance does not depend on earnings. Other benefits are reduced gradually to zero as earnings increase. Children are 4, 6, 8, and 10 years old.

Source: OECD Tax-Benefit Model.

5. Net costs of Early Childhood Education and Care

The **reference date** for the policy rules described in this section is **1 January 2020**.

Pre-schools are available to all children who have not reached the age at which compulsory school begins, i.e. in autumn of the year in which the child turns six. However, few pre-schools accept children less than one year old, and the youngest children are usually about two years of age. Before that they may be cared for by day-care parents.⁵

5.1. Gross childcare fees

Code in the OECD tax-benefit model: [\[ICcc_cost\]](#)

Local municipalities pay for the construction and the operation of pre-primary schools. Parents contribute a substantial amount towards operating costs at the pre-primary level. The share that the parents contribute varies from one municipality to another. In most municipalities, reduced rates are available to lone parents and students and some offer reduction to parents who have two or more children attending schools at the pre-primary level. Overall, parents contribute about a sixth of the operating costs of pre-primary schools.

Most of the pre-schools are public but there are a number of “independently run pre-schools”. Many of them are able to accept children earlier than the public system. These schools are also subsidized by municipalities, but receive a lower stipend than public pre-schools. To accommodate for this, these independently run pre-schools are allowed to charge a 15% higher fee than the public pre-schools.

In the model, it is assumed that a child attends a public pre-school in Reykjavík.

The fee of Reykjavík public pre-schools is divided into two categories:

- I. No discount. Applies for married parents and parents who live together.
- II. Discount fee. Applies for families where both parents are students; for lone parents; one or both parents are disabled; employees of Reykjavik Preschools.

To qualify for category II, studying parents must study full-time. This category is also for full-time students in junior college and vocational schools. Evening classes are not valid.

Tuition fee for each category and meal fee in 2019 are the following:

Daily duration	Tuition fee		Meal fee	Total fee	
	Category I	Category II	Category I & II	Category I	Category II
4.0 hours	7 628	3 164	2 280	9 908	5 444
4.5 hours	8 582	3 560	2 280	10 862	5 840

⁵ In the model, it is assumed that also one-year-old children can attend pre-schools. However, in practice, the majority of 1-year olds are within the municipality subsidized “day-care parent” system (see information on the subsidy for child-care with day-care parents in Annex). Day-care parents set their fees individually (*not covered in this report*). Reykjavík city officials expect to be able to guarantee pre-schools for one-year-olds by the end of 2023.

5.0 hours	9 535	3 955	9 080	18 615	13 035
5.5 hours	10 489	4 351	9 080	19 569	13 431
6.0 hours	11 442	4 746	9 080	20 522	13 826
6.5 hours	12 396	5 142	9 080	21 476	14 222
7.0 hours	13 349	5 537	11 360	24 709	16 897
7.5 hours	14 303	5 933	11 360	25 663	17 293
8.0 hours	15 256	6 328	11 360	26 616	17 688
8.5 hours	18 777	7 780	11 360	30 137	19 140
9.0 hours	25 799	10 688	11 360	37 159	22 048
9.5 hours	32 821	13 596	11 360	44 181	24 956

In the model, the childcare full-time fee is modelled assuming 8 hours of childcare, and the part-time fee – assuming 4 hours.

5.1.1. Discounts for part-time usage

Pre-schools operated by municipalities offer part-time or full-time care. The fees are determined based on the hours (see the table above).

5.2. Fee discounts and free provision

Parents with more than one child are entitled to 75% discount of tuition fee for the second child and 100% discount for the third child (and any subsequent child). Parents must pay full meal fee for every child. This discount rule applies equally for children in a pre-school who have siblings in a family day-care or in a private pre-school.

5.3. Child-care benefits for formal centre-based care

Code in the OECD tax-benefit model: [\[cc_benefit\]](#)

Reykjavík and many other municipalities subsidise child-care with day-care parents (*Niðurgreiðsla vegna barna hjá dagforeldrum*). Day-care parents are certified to operate child-care services in their homes. They set their fees individually. This benefit is not simulated in the model because it is assumed that preschool childcare is available. The description of the subsidy for day-care parents can be found in Appendix.

5.4. Child care allowance for children not using child care centers

In 2013, benefits to parents who care for their children at home in the period beginning 6 months after the child is born until the child enters pre-school (cash-for-care) have been abolished in most or all municipalities where this type of benefit was formerly available. This trend is explained by the tight financial situation of municipalities and surging demand for social assistance that they are required to provide, whereas cash-for-care is optional for them. Reykjavík, the largest municipality, abolished cash-for-care in April 2011.

No legislation exists on cash-for-care. Generally, cash-for-care is available only if no formal centre-based childcare is used. The receiving parents may be employed or not. The benefit is not means-tested and not taxable. If used by the recipient towards paying for child

care, it is taxable with the caregiver, usually a family member. The benefit amount may vary significantly between municipalities.

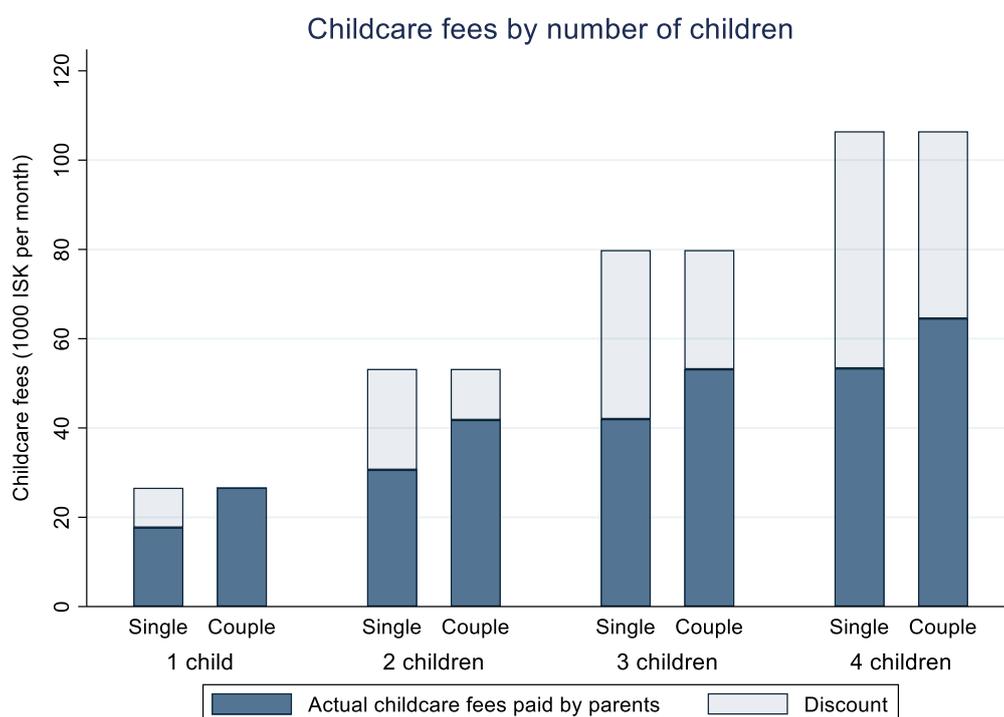
This benefit is not simulated in the model.

5.5. Tax concessions for childcare expenditures

There are no tax concessions for childcare expenditures in Iceland.

Figure 6. Childcare fees paid by parents

40-year old single person or couple with children



Note: Results assume that a family resides in Reykjavík. Childcare fees do not depend on family income, but there are discounts based on family composition (for single parents and siblings). Both parents are working full time and use childcare for all children for the full day (8 hours per day). Children are 2, 3, 4, and 5 years old.

Source: OECD Tax-Benefit Model.

6. In-work benefits

There are no in-work benefits in Iceland.

7. Social security contributions and payroll taxes

7.1. Social security contributions (*Tryggingagjald*)

Variable names: [SOCSEC_p, SC_NTCP_p, SOCSEC_s, SC_NTCP_s, SSCR_p, SSCR_NTCP_p, SSCR_s, SSCR_NTCP_s]

Individuals with an annual taxable income of more than ISK 1 870 828 in 2020 pay two fixed annual fees: to the Construction Fund for the Elderly and to the Treasury, intended to finance the National Broadcasting Service. These fees are payable in the following year and decided in the end of 2020 during the 2021 budget process. The fee for the Construction Fund for the Elderly is ISK 12 034 in 2020 (paid in 2021). The fee for the National Broadcasting Service is ISK 18 300 in 2020 (paid in 2021). Individuals younger than 16 years old and 70 years or older are exempt as well as old-age pensioners or disabled residing in old-age, nursing homes or special care establishments. Both fees are payable in the following year (2021). Nevertheless, in the model these fees are simulated in the income reference year (not in the year when they are actually paid).⁶

Employers pay a social security contribution on their total payroll cost to the Treasury. The rate for 2020 is 6.25% (6.50% in 2019). The proceeds go towards – but do not fully finance – the central government’s costs of old age, disability, health care and childbirth leave, the remainder of the cost coming from general tax revenue.

In addition to the social contribution, there are two mandatory fees levied on the social security contribution base: the Promote Iceland Market Fee⁷ and the Wage Guarantee Fund Fee⁸, 0.05% each.

Furthermore, a new financial activities tax was introduced in 2012, which requires financial and insurance companies to pay an additional payroll tax (*fjársluskattur*). The rate for 2018 is 5.5%. This tax is not part of the model.

Pension funds: Individuals aged 16-70 years with taxable income must be members of a pension fund and contribute 4% of their wages, generally deducted on a withholding basis. The employer counter-contributes at least another 11.5% (since 1 July 2018). Both contributions are deductible from income before tax.

From 1 July 2014, employees can contribute up to 4% to a pension fund on an optional basis. This contribution is also tax-exempt. If an employee chooses to take this option, the employer will generally match the employee’s contribution by 2% of the employee’s wages. These optional contributions are not simulated in the model.

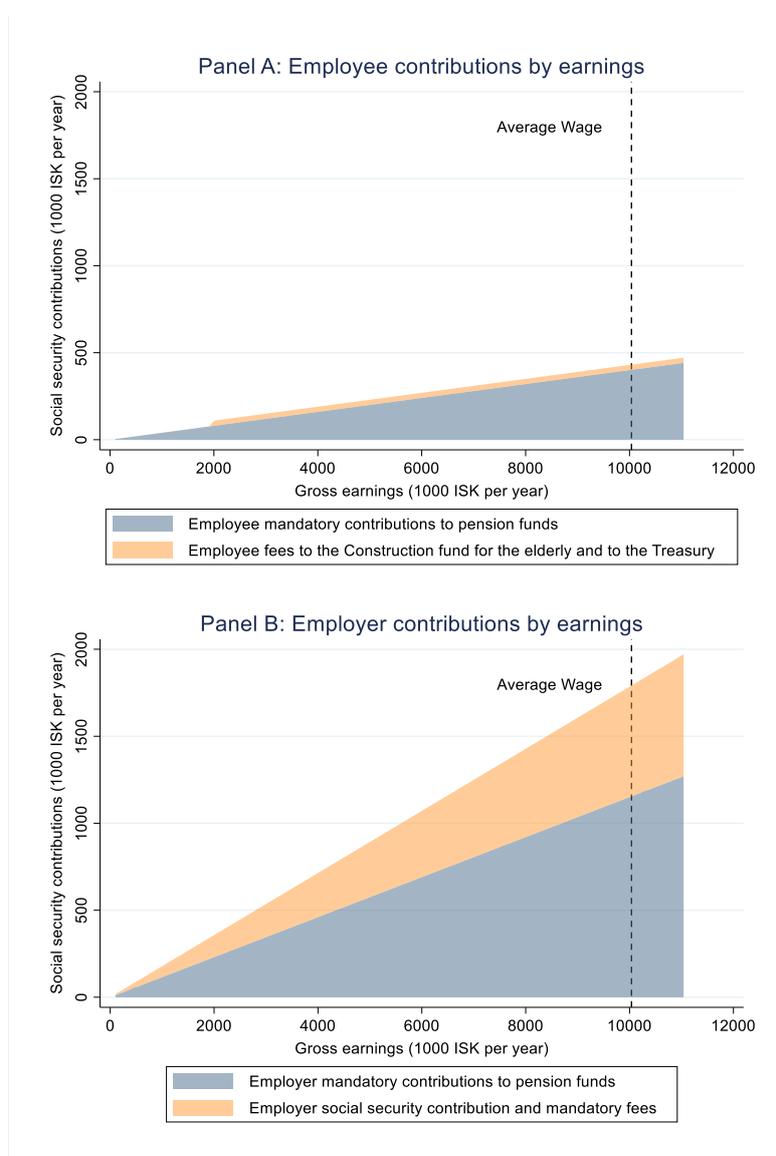
⁶ Since the fees are determined in the end of the year, the preliminary model for 2020 includes the fees of 2019 (paid in 2020) and the final version includes the fees of 2020 (paid in 2021).

⁷ The market fee goes to “Promote Iceland”, a public-private partnership established to improve the competitiveness of Icelandic companies in foreign markets and to stimulate economic growth through increased export.

⁸ The Wage Guarantee Fund guarantees payments to employees and pension funds in respect of their outstanding claims in the event of an employer’s insolvency.

Figure 7. Social security contributions

40-year old single person without children



Note: Social security contributions are paid on individual earnings and do not depend on family structure. A person receives only earnings from work and does not receive municipality financial assistance or other taxable benefits, which are included in the taxable income. Results include non-tax compulsory payments to pension funds. Employer mandatory fees include the Promote Iceland Market Fee and the Wage Guarantee Fund Fee.

Source: OECD Tax-Benefit Model.

8. Taxes

Iceland has a dual income tax system. Personal income tax for central and local government is collected together on a withheld basis. Income is taxed on an individual basis, except for capital income of married couples which is taxed jointly (*not covered by the model*).

Due to Covid, a payment deferral scheme was introduced for monthly pay-as-you-go payments of withheld central and local PIT and social security contributions on previous month wages. Employers may defer 50% of the payable amount in March 2020. Employers hard-hit by COVID-19 may also defer 100% of the monthly payable amount up to three times in the nine-month period April-December 2020. Deferred amounts are due for payment in January 2021.

8.1. Personal income tax (*Tekjuskattur einstaklinga*)

Code in the OECD tax-benefit model: `[FT_p; FT_s]`

This section describes both central government and local government income taxes.

8.1.1. Tax allowances

Tax allowance for pension contributions: Since January 2000, the compulsory payment by employees to pension funds, amounting to 4% of wages, is deductible. In addition, since 1 July 2014, a voluntary payment of up to 4% of wages may also be deducted (*not covered by the model*).

Work-related expenses: earnings-related transportation costs (net of fringe benefits) are deductible up to a certain limit (*not covered by the model*).

8.1.2. Tax base

Taxable income in the model includes wages, unemployment benefits, municipality financial assistance and lone parent mother/fatherhood allowance. Tax base is taxable income minus tax allowances. The tax base is the same for the central and local government tax. In the model in case of couples, municipality financial assistance is allocated to the partner with the lower taxable income.

8.1.3. Income tax schedule

In 2020, the central government personal income tax was reformed into a triple-rate system. In 2020, the tax schedule is the following:

- the bottom rate of 20.60% applies to personal income up to ISK 336 916 per month;
- the middle rate of 22.75% applies to income ranging from ISK 336 916 up to ISK 945 873
- the top rate is 31.80% for income above ISK 945 087.

The local government personal income tax is single rated. It varies between municipalities from 12.44% to 14.52%. The average rate of 14.44% is used in the model.

In general, the tax unit is the individual. A special rule applies for principal's taxable income in the highest bracket (above ISK 11 350 476 annually, i.e. ISK 945 873 monthly), if the spouse's taxable income is below ISK 11 350 476. A part of the principal's income above ISK 11 350 476 is then taxed in the middle bracket. The part is determined as half of the amount by which the spouse's income is below ISK 11 350 476, subject to a

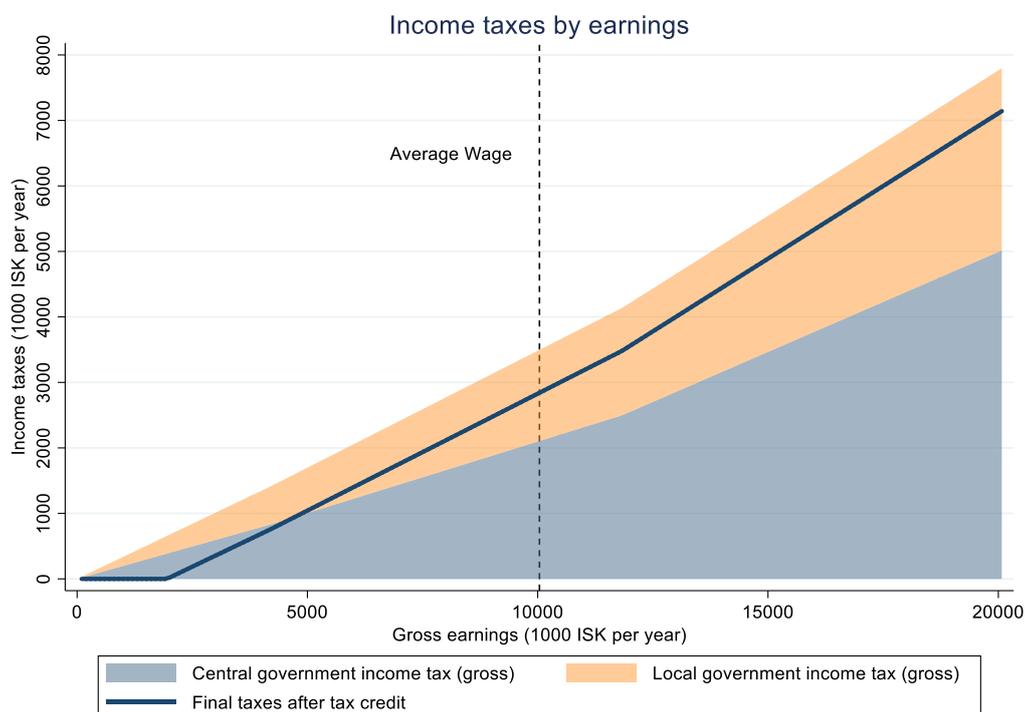
maximum of ISK 3 653 738 (half the amount of personal income that can be taxed in the middle bracket).

8.1.4. Tax credits

Basic tax credit is ISK 655 538 per earner annually. The credit is subtracted from central and local government taxes; unused portions are not refundable. Married couples may utilise up to 100% of each spouse's unutilised portion of his/her basic tax credit.

Figure 8. Income tax

40-year old single person without children



Note: A person has no other sources of income but earnings from work. Gross taxes are taxes before the basic tax credit. Final taxes are total taxes after subtraction of the basic tax credit (non-refundable). Income tax is calculated at the individual level and does not depend on family structure (with the exception of married couples under certain conditions, not shown in the figure).

Source: OECD Tax-Benefit Model.

9. Sickness benefits

Section 9.1. describes a state tax-financed sickness benefit. Section 9.2. provides information on mandatory continued payment of wages by the employer in case of employee temporary sickness.

Sickness benefits are not included in the model.

9.1. Sickness cash benefits (*Sjúkradagpeningar*)

This is a tax-financed protection scheme for employees and self-employed (*self-employed are not covered in the model*). The benefit is non-contributory, non-means-tested and taxable.

There is no statutory benefits in case of caring for a sick family member, but collective agreements may provide for the continued payment of wages and salaries in that case (*not covered in the model*).

9.1.1. Eligibility conditions

All employees and self-employed persons are eligible. Specific rules apply for homeworkers and students. Generally, it is required to have 2 months of work prior to illness and 6 months of residency for new residents from outside the EEA. Citizens of EEA countries can become eligible the day they gain legal residency in Iceland. A physician should certify incapacity for work due to illness.

Other eligibility conditions are:

- 18 years old or older (16-17 years olds may receive benefits in certain cases);
- A person cannot receive old-age or invalidity benefits at the same time;
- Incapacity for work due to illness should last for at least 21 days;
- A person must cease gainful employment;
- A person must not receive wages, including wages during sickness from employer based on collective agreements. (However, a person may continue receiving benefits from his or her labour union).

Sickness cash benefits is granted only after wages have ceased.

Unemployed persons insured in the unemployment benefits scheme that are no longer on the labour market because of illness or accident can keep their entitlement rights in the unemployment scheme for up to 6 months.

9.1.2. Benefit amount

Sickness cash benefits is a flat-rate benefit. For persons who have to give up full-time gainful employment the amount is ISK 1 873 per day (paid 7 days per week). In the case of part-time work, the sickness benefit is half of that: ISK 937 per day. Daily supplement for dependent children is ISK 514 per day for each child under the age of 18 (both parents can receive this supplement if they both are sick).

The payment starts on the 15th day of certified work incapacity, provided that no wages/sick pay are received, and the work incapacity has lasted longer than 21 days. If the incapacity lasts less than 21 days, than no benefit is received.

The benefits adjusted annually in accordance with the State Budget.

9.1.3. *Benefit duration*

There is a waiting period of 14 days. The waiting period begins on the day when a physician confirms incapacity for work. The maximum duration of the benefit is 52 weeks over 24 months. However, for employees the benefit starts only after the employer stopped paying wages/sick pay (which may be longer than 14 days).

9.1.4. *Means test*

The benefit is not means-tested.

9.1.5. *Tax treatment*

The benefit is subject to taxation. General taxation rules apply. There are no special exemptions. There are no contributions from general sickness cash benefits.

9.1.6. *Interaction with other components of the tax-benefit system*

A person cannot receive sickness benefits and old-age or invalidity benefits at the same time. Sickness benefit is included in the means test for other benefits.

9.1.7. *Combining benefit receipt and employment/starting a new job*

In general, it is not possible to combine benefit receipt and employment/wages.

The exception is if a person, who is entitled to the full sickness cash benefits (i.e. worked full time before becoming sick), starts working half time or less while regaining health. In this case, a person is entitled to half sickness cash benefits for up to three months.

9.2. *Sick leave by employer (Veikindaréttur)*

Employers are obliged to continue payment of wages and salaries during a limited period of time in case of temporary sickness of an employee.

9.2.1. *Eligibility conditions*

All workers are eligible for sick leave, but the duration depends on length of employment and varies between collective agreements.

9.2.2. *Benefit amount*

A worker is entitled to full wages during sick leave.

9.2.3. *Benefit duration*

According to the statutory rules, for each month worked an employee is entitled to wages for two days of sick leave. After one year of employment for the same employer a worker is entitled to no less than one month of sick leave. After three years, under the same conditions, employees are entitled to two months of sick leave and after five years, no less than three months of paid sick leave.

Collective agreements can provide longer duration. The exact duration depends on individual agreements. All employers and employees in occupations/sectors subject to

collective agreements are eligible to these provisions, regardless of union membership status. The two major unions for private sector employees account for almost half of the private sector. Employers receive no refund of wages or salaries from the health insurance.

9.2.4. Means test

Not means-tested.

9.2.5. Tax treatment

The wages paid by employer due to sickness are subject to general taxation rule. Contributions are also paid in the same way as from wages.

9.2.6. Interaction with other components of the tax-benefit system

The payments interact with other components of the tax-benefit system in the same way as normal wages.

9.2.7. Combining benefit receipt and employment/starting a new job

It is not possible to combine these payments with employment.

10. Short-time work schemes

10.1. Unemployment benefit due to reduced employment ratio (Hlutabætur)

This is a new partial unemployment scheme to cover employees seeing a reduction in their working hours due to a temporary contraction in the employer's activities because of the effect of Covid-19. The scheme was introduced on 15 March 2020 and expires on 31 December 2020.

This benefit is not included in the model.

10.1.1. Eligibility conditions

The scheme applies to both employees and self-employed individuals (*self-employed are not covered in the model*).

It is possible to start using the scheme since the day the employment ratio of an employee was reduced. The employees, who have to reduce their employment ratio, apply for payments from The Directorate of Labour. The employer submits a confirmation of reduced employment ratio and information regarding the employee's intended wages.

An employer is not allowed to claim work contributions from an employee in excess of the remaining employment rate when the employment rate has been reduced.

The employee's employment ratio has to be reduced by at least 20% but not below 50% of the usual average employee's employment.

In accordance with this provision, unemployment benefit may be granted to an employee even if this employee does not fully fulfil eligibility conditions for the standard unemployment benefit (see Section 2.1.1.). There are for example no requirements of minimum employment for the same employer and no special reduction for part-time employees.

10.1.2. Benefit amount

The new legislation provides entitlement to the payment of unemployment benefits (see Section 2.1.) alongside wages due to reduced employment ratio related to temporary contraction in the employer's activities. The wages received for the reduced employment ratio do not deplete the unemployment benefits.

Unemployment benefit payments are equal to the income-related unemployment benefit (i.e. they depend on the previous employee wage) in proportion to the reduced employment rate and cannot exceed ISK 342 303. For example, if an employee moves from 75% to 50% of full-time employment they will receive 50% of the wage-indexed unemployment benefits and 50% of full wages. This benefit amount is paid for the whole duration of the payment. The wages from the employer and total unemployment benefit may never exceed the amount of ISK 700 000 per month and shall not exceed 90% of the average total gross wage of the employee. The average total gross wage is calculated over a three-month period before the employee's employment ratio has been reduced. The total amount of wages from the employer for the reduced employment rate and unemployment benefits should equal at least total gross wage of the employee up to ISK 400 000 per month (for a person who was in full-time employment before the reduction in employment).

10.1.3. Benefit duration

The scheme is valid from 15 March 2020 to 31 December 2020

10.1.4. Means test

Not means-tested.

10.1.5. Tax treatment

The wages paid by employer are subject to the general taxation and contribution rules (see Sections 0 and 0). Unemployment benefits are subject to taxation rules and contribution rules described in Section 2.1.5.

10.1.6. Interaction with other components of the tax-benefit system

The payments interact with other components of the tax-benefit system in the same way as normal wages and unemployment benefits.

10.1.7. Combining benefit receipt and employment/starting a new job

The scheme is intended to combine payments of unemployment benefits alongside wages. It is not possible to start employment with another employer while being in the scheme.

11. Selected output from the OECD tax-benefit model (TaxBEN)

This section shows selected output of the TaxBEN model for Iceland 2020. TaxBEN by default produces the following output: net household incomes (**black line**) and its subcomponents (**coloured stacked areas**) for selected family and individual circumstances.

The model and the related web calculator is accessible from the [project website](#). The figure shows outputs for four scenarios:

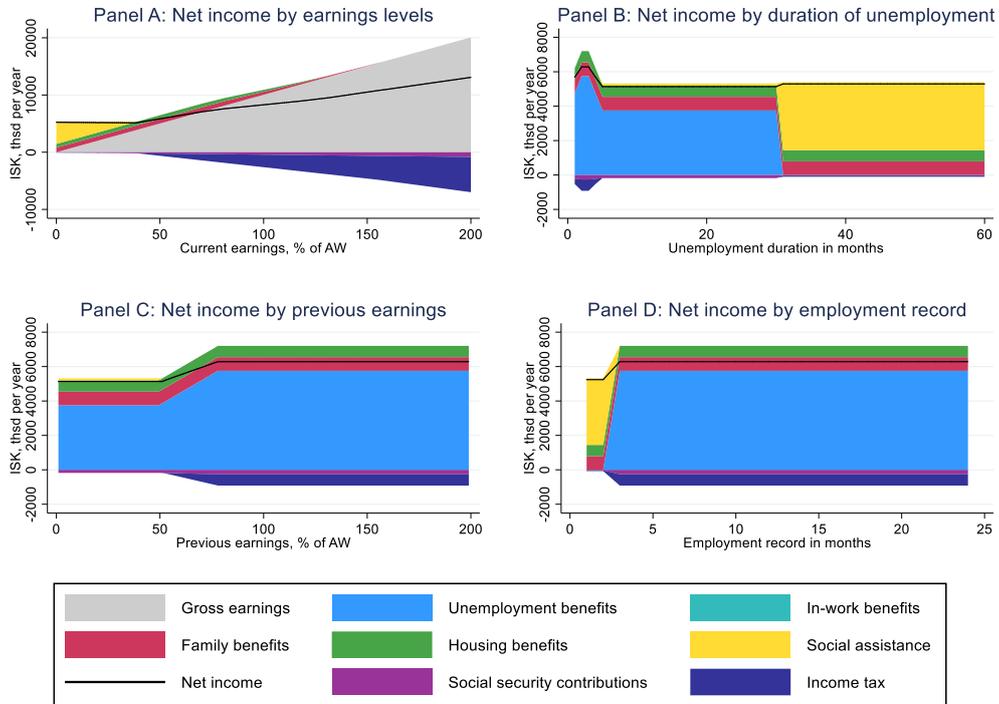
- By percentage of the average wage (**Panel A**);
- By unemployment duration (in months) for a jobseeker claiming unemployment benefits (**Panel B**);
- By previous gross earnings levels for a jobseeker claiming unemployment benefits (**Panel C**);
- By previous employment record, for a jobseeker claiming unemployment benefits (**Panel D**).

The stacked areas shows the following household income components: **GROSS** = gross earnings; **SSC** = social security contributions; **IT** = income tax; **FB** = family benefits; **HB** = housing benefits; **SA** = social assistance; **IW** = in-work benefits. Note that each component may contain more than one benefit or tax.

Results refer to a two-adult family with two children. Adults are both 40 years old whereas children are 4 and 6 years old respectively. Social assistance and housing benefit supplements are assumed to be available in all the four scenarios provided that the necessary income and eligibility requirements are met. Where receipt of social assistance or other benefits is subject to activity tests (such as active job-search or being available for work), these requirements are assumed to be met.

Figure 9. Selected output from the OECD tax-benefit model

40-year old couple with two children



Note: In Panel A, the first adult is employed full-time and full-year. The second adult is out of work and not eligible for unemployment benefits, e.g. because they have expired (the same is assumed for the first adult when earnings are zero). In Panels B to D, the first adult is out of work and claiming unemployment benefits, whereas the second adult is out of work and not eligible to unemployment benefits. Previous earnings of the first adult equal to the Average Wage. In Panels B and C, the first adult is assumed to have a ‘long’ employment record of 264 consecutive months before the job loss. Panels C and D refer to the 2nd month of unemployment benefit receipt.

Source: OECD Tax-Benefit Model.

Annex: Other benefits and direct taxes

This section provides a brief description of other cash benefits and taxes on employment incomes in Iceland that are relevant for some members of the population below the statutory retirement age, but which are not included in the OECD tax-benefit model.

Mortgage interest rebate (Vaxtabætur)

Mortgage interest rebate is open to all homeowners with mortgage payments but is subject to limits on net assets, total mortgage liabilities and a maximum interest payment amount. The cost of mortgage interest rebate is borne by central government. The programme is part of the tax system and is administered through tax authorities.

The rebate is based on interest paid on a home purchase loan. The following constraints apply to interest rebates paid in 2020, based on tax returns for 2019:

- They cannot exceed 7% of the remaining debt balance incurred in buying a home for one's own use.
- The maximum amount of interest payments that qualify for an interest rebate calculation is ISK 840 000 for an individual, ISK 1 050 000 for a lone parent and ISK 1 260 000 for a couple.
- 8.5% of taxable income is subtracted from the interest expense.
- The rebates begin to be curtailed at a net worth threshold of ISK 5 million for a single individual and lone parent and at ISK 8 million for a couple and are eliminated altogether at a 60% higher amount.
- The maximum amounts of interest rebates are ISK 420 000 for an individual, ISK 525 000 for a lone parent and ISK 630 000 for a couple.

In 2012, an additional condition was introduced to this scheme: the rebate is not paid to those who have not actually paid their due interest on mortgage debt of the preceding year.

Subsidy for child-care with day-care parents (Niðurgreiðsla vegna barna hjá dagforeldrum)

Reykjavík and many other municipalities subsidise child-care with day-care parents. Day-care parents are certified to operate child-care services in their homes. They set their fees individually.

Generally, the conditions for receiving a subsidy are that parents are unable to place their children in pre-schools or day-care centres, usually due to waiting lists, and therefore place them with day-care parents. Subsidy is granted from the time when the child is nine months old, but for lone parents and studying parents from the age of six months.

Subsidies vary from one municipality to another. The following subsidy applies in Reykjavík. (Categories I and II are the same as explained in Section 5.1.). A minimum subsidy applies if a parent pays for 4 hours of care. The subsidy for the 2nd child is 75% of the amount granted for the first child, however for the third child (and any subsequent child) the same subsidy is granted as for the first child.

Subsidy of day-care parent services (ISK per month), from 1 January, 2020						
Daily duration	Category I			Category II		
	Subsidy for one child	Addition for second child	Addition for third child	Subsidy for one child	Addition for second child	Addition for third child
4.0 hours	32 458	24 344	32 458	44 444	33 335	44 444
4.5 hours	36 515	27 386	36 515	49 999	37 502	49 999
5.0 hours	40 573	29 687	40 573	55 554	41 669	55 554
5.5 hours	44 630	33 472	44 630	61 110	45 836	61 110
6.0 hours	48 687	36 515	48 687	66 665	50 003	66 665
6.5 hours	52 744	39 558	52 744	72 221	54 169	72 221
7.0 hours	56 802	42 601	56 802	77 776	58 336	77 776
7.5 hours	60 859	45 644	60 859	83 332	62 503	83 332
8.0 hours	64 916	48 687	64 916	88 887	66 670	88 887
8.5 hours	66 945	50 209	66 945	93 015	69 767	93 015
9.0 hours	66 945	50 209	66 945	95 736	71 807	95 736

Provided a contract is in place with an approved day-care parent, subsidy begins when the child is 9 months old (6 months old for single parents and couples where both parents are students) and formally will end as the child enters elementary school at the age of six. In practice, however, most children start kindergarten around the age of two and will then no longer be eligible for the subsidy.

Subsidy is available to all parents, regardless of income. Subsidy is not subject to income tax. Subsidy does not interact with other benefits. Benefit receipt is unaffected by employment status.