R&D Tax Incentives: Iceland, 2020

Design of R&D tax relief provisions

Iceland provides R&D tax relief through a volume-based, payable (refundable) R&D tax credit with a headline rate of 35% for SMEs and 25% for large firms in 2020 (previously 20% for SMEs and large firms).

Table 1. Main design features of R&D tax incentives in Iceland, 2020

		R&D tax credit
Type of instrument		Volume-based
Eligible expenditures†		Current, capital
Headline rates (%)		35 (SMEs), 25 (large firms)
Refund		Immediate
Carry-over (years)		No
Thresholds & ceilings	Floor (R&D expenditure)	ISK 1 million per project
	Ceiling (R&D expenditure)	ISK* 1100 million (including ISK 200 million for subcontracted/collaborative R&D)

*100 ISK= 0.6218 EUR, Q3 2020.

Note: For more details, see OECD R&D Tax Incentive Compendium and Eligibility of current and capital expenditure for R&D tax relief

Source: OECD, R&D Tax Incentives Database, http://oe.cd/rdtax, March 2021.

Key features:

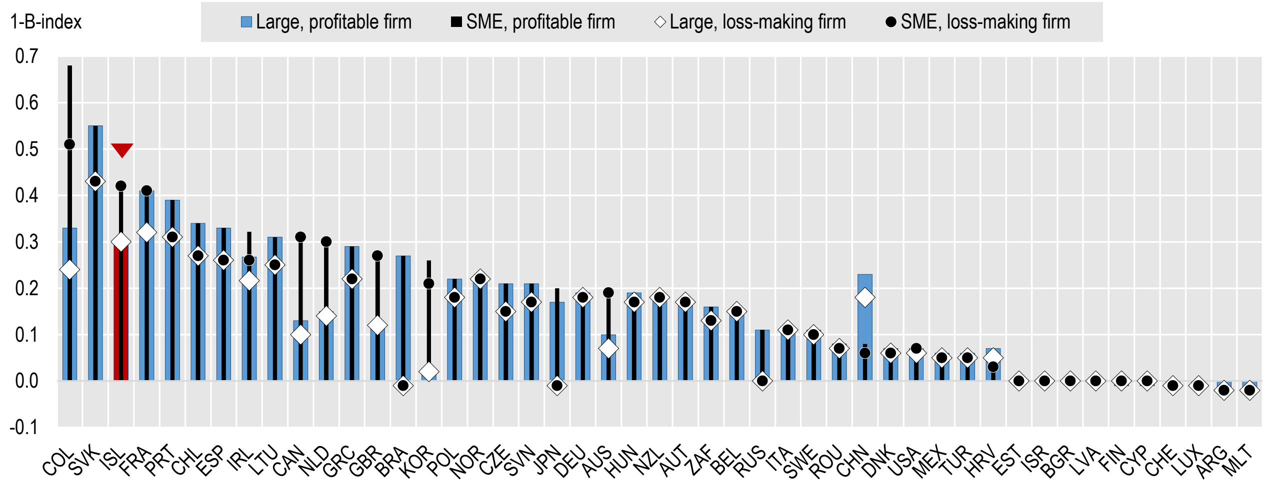
- In the case of insufficient tax liability, firms are entitled to an immediate refund of unused credits.
- As of 2020, an upper ceiling of ISK 1100 million (previously ISK 600 million) applies to qualifying R&D expenditures. This includes an allowance of ISK 200 million for purchased or collaborative R&D (previously ISK 300 million).
- Furthermore, a minimum level (floor) of ISK 1 million applies to R&D projects.

Generosity of R&D tax support in 2020

Differences in the design of R&D tax incentives drive significant variation in the expected generosity of tax relief per additional unit of R&D investment. In 2020, the marginal tax subsidy rate for profit-making (loss-making) SMEs in **Iceland** is estimated at 0.42 (0.42), well above the OECD median of 0.20 (0.18). The implied R&D tax subsidy rate for large enterprises is equal to 0.3 (0.3) in the profit (loss)-making scenario and likewise well above the OECD median of 0.17 (0.15).

Figure 1. Implied tax subsidy rates on R&D expenditures: Iceland, 2020

1-B-Index, by firm size and profit scenario



Note: Implied marginal tax subsidy rates, presented for different firm size and profitability scenarios, are calculated based on headline tax credit/allowance rates (see methodology and country-specific notes), providing an upper bound value of the generosity of R&D tax support, not reflecting the effect of thresholds and ceilings that may limit the amount of qualifying R&D expenditure or value of tax relief.

Source: OECD, R&D Tax Incentives Database, http://oe.cd/rdtax, March 2021.

Recent developments in R&D tax relief provisions

Regular reforms of R&D tax incentives lead to continuous changes in the availability, scope and generosity of R&D tax incentives. Such reforms relate to the launch of new tax incentives, the R&D definition adopted for tax purposes, changes in tax credit and allowance rates, adjustments of thresholds or upper ceilings on qualifying R&D expenditure or tax relief amounts, or changes in the terms and availability of refunds.

In 2020, changes in the availability and scope of R&D tax incentives represented the most frequent type of policy reform (OECD, 2020), along with adjustments to the headline R&D tax credit/allowance rates and adjustments of thresholds or upper ceilings on qualifying R&D expenditure or tax relief amounts. In response to the COVID-19 pandemic, several countries increased the generosity of R&D tax relief or introduced modifications to the administration of R&D tax incentives to facilitate and accelerate R&D funding.

In 2020, **Iceland** undertook **two changes** in its R&D tax relief provisions:

- The total ceiling on payments to individual parties has been increased from ISK 900 to 1100 million. This includes an allowance for purchased external R&D-work up to ISK 200 million (previously ISK 300 million).
- The rate of the volume-based R&D tax credit has been increased from 20% to 35% for SMEs and from 20% to 25% for large companies.

Both policy changes, applying in 2020 and 2021, were taken **in response to the COVID-19 crisis**.

Trends in the generosity of R&D tax support

Since the introduction of a refundable R&D tax credit in 2011, the generosity of R&D tax incentives has practically remained unchanged in **Iceland** until the year 2019.

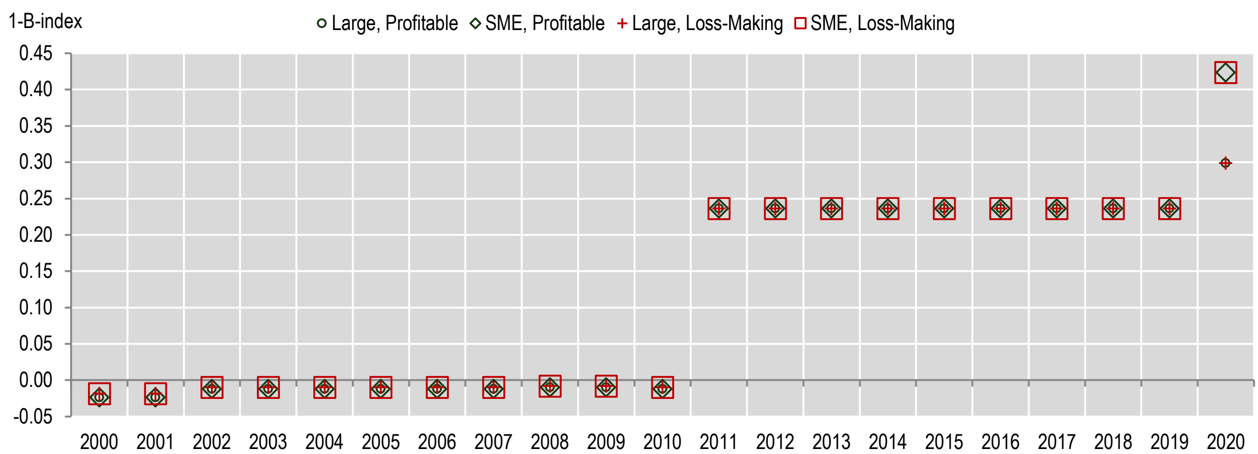
The sharp increase in the implied R&D tax subsidy rate for SMEs and large firms in 2020 can be attributed to the increase of headline tax credit rates. **Iceland** raised the R&D tax credit rate of SMEs from 20% to 35%, leading to an increase in the tax subsidy rate estimated for SMEs from 0.24 to 0.42 in both profit scenarios.

The increase in the tax credit rate for large firms from 20% to 25% led to a correspondingly smaller increase in the implied R&D tax subsidy rate for large firms from 0.24 in 2019 to 0.30 in both profit scenarios.

Throughout the 2011-20 period, marginal tax subsidy rates for SMEs and large firms do not vary by profit scenario due to the refundable nature of the R&D tax credit.

Figure 2. Implied tax subsidy rates on R&D expenditures: Iceland, 2000-20

1-B-Index, by firm size and profit scenario



Note: Implied marginal tax subsidy rates, presented for different firm size and profitability scenarios, are calculated based on headline tax credit/allowance rates (see methodology and country-specific notes), providing an upper bound value of the generosity of R&D tax support, not reflecting the effect of thresholds and ceilings that may limit the amount of qualifying R&D expenditure or value of tax relief.

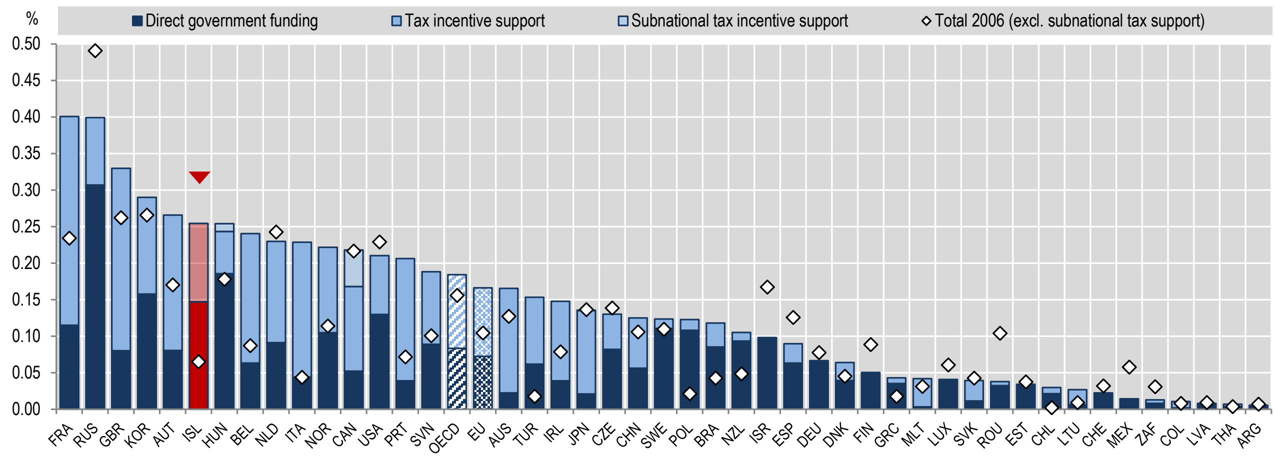
Source: OECD, R&D Tax Incentives Database, http://oe.cd/rdtax, March 2021.

Policy support for business R&D: the policy mix

In 2018, **Iceland** is placed above the OECD average in terms of total government support to business R&D as a percentage of GDP, at a rate equivalent to 0.25% of GDP.

Figure 3. Direct government funding of business R&D and tax incentives for R&D, 2018 (nearest year)

As a percentage of GDP



Note: Data on subnational tax support are only available for a group of countries.

Source: OECD, R&D Tax Incentives Database, http://oe.cd/rdtax, March 2021.

Key points:

- From 2006 to 2018, total government support for BERD as a percentage of GDP increased in **Iceland** by 0.19 percentage point (pp), while the OECD average increased by 0.03 pp.
- During this period, business R&D intensity in **Iceland** declined from 1.52% to 1.29%
- In 2018, R&D tax incentives accounted for 42% of total government support for BERD in **Iceland**.

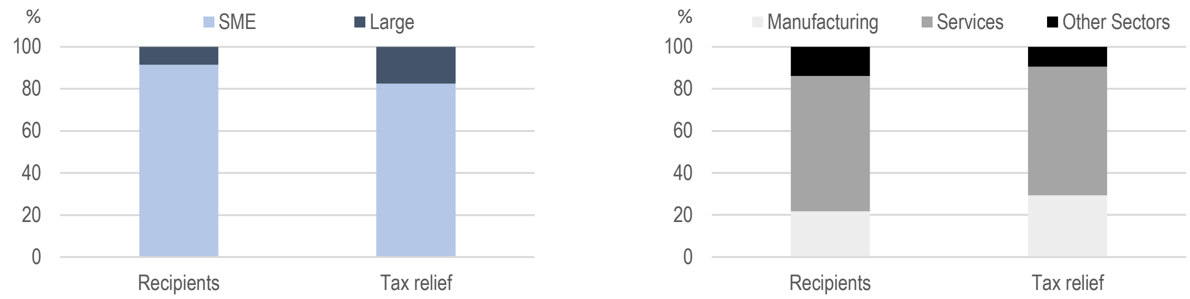
Distribution of R&D tax relief recipients and government tax relief for R&D

The distribution of R&D tax relief recipients and government tax relief for R&D expenditures (GTARD) provide insights into what types of firms claim and benefit from tax relief.

Figure 4. Number of R&D tax relief recipients and value of government tax relief for R&D, 2018

By firm size*, share in percent

By industry**, share in percent



Note: Figures refer to the R&D tax credit. *SMEs are defined as firms with 1-249 employees and follow the EU criteria in terms of number of employees, turnover and balance sheet total. **Economic activity is defined based on the Icelandic industry classification (ISAT 2008).

Source: OECD, R&D Tax Incentives Database, http://oe.cd/rdtax, March 2021.

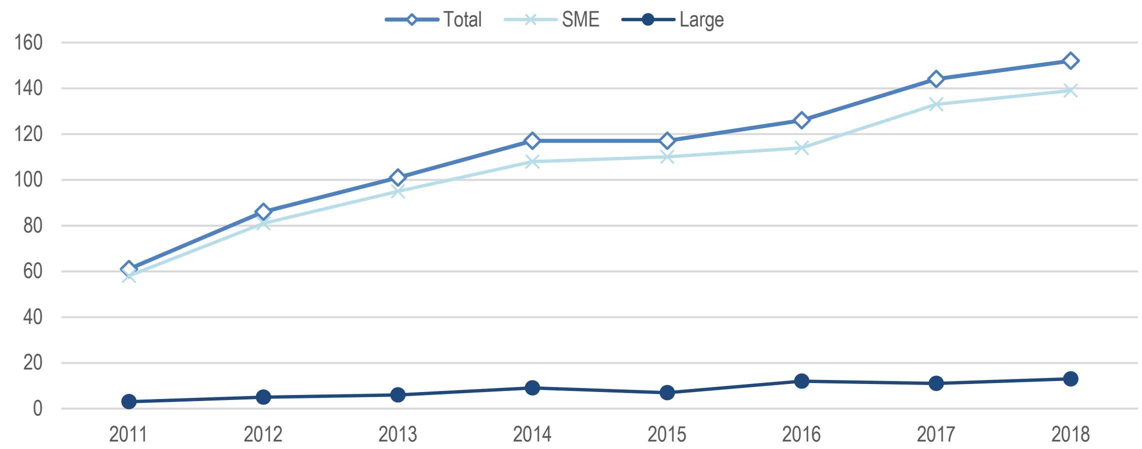
Key points:

- In **Iceland**, SMEs accounted for 91% of R&D tax relief recipients in 2018, while the share of R&D tax support accounted for by SMEs amounted to around 83% in this year. 17% of R&D tax benefits were allocated to large firms, comprising 9% of the population of R&D tax relief recipients in 2018.
- In 2018, firms in services represented around 64% of R&D tax relief recipients in **Iceland**, followed by firms in manufacturing with a share of 22%. The share of R&D tax benefits accounted for by the latter amounted to 29% in that year, while this share amounted to 61% in the case of firms in services.

Trends in the uptake of R&D tax incentives

Over the period 2011-2018, the number of R&D tax relief recipients increased in **Iceland**, reaching around 150 in 2018. Most of this increase is attributable to SMEs. Throughout these years, the number of SMEs receiving R&D tax support more than doubled from close to 60 to almost 140, while the number of large firms receiving tax support increased by a factor of 4 but remained comparatively smaller, with close to 15 recipients in 2018. Over the 2011-18 period, SMEs accounted for more than 90% of R&D tax relief recipients in **Iceland**.

Figure 5. Number of R&D tax relief recipients, Iceland, 2011-2018



Note: Figures refer to the R&D tax credit.

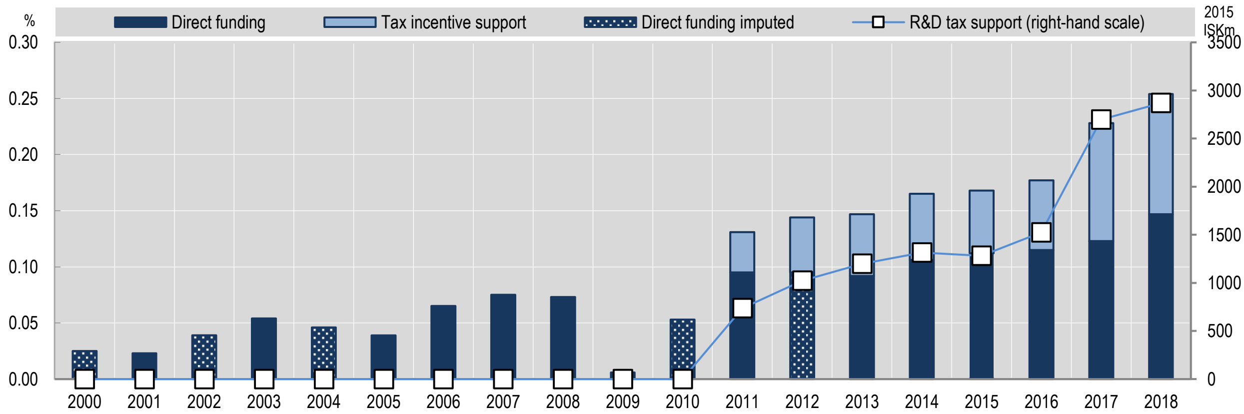
Source: OECD, R&D Tax Incentives Database, http://oe.cd/rdtax, March 2021.

Trends in government support for business R&D

Since the introduction of R&D tax support in 2011, the importance of R&D tax incentives has increased in **Iceland**, both in absolute and relative terms.

Figure 6. Direct funding of business R&D and tax incentives for R&D, Iceland, 2000-18

As a percentage of GDP, 2015 prices (right-hand scale)



Source: OECD, R&D Tax Incentives Database, http://oe.cd/rdtax, March 2021.

- The cost of tax government tax relief for R&D rose (in 2015 prices) from ISK 735 million in 2011 to ISK 2 869 million in 2018 following the 2016 increase in the upper ceilings on qualifying R&D from ISK 100 million to ISK 300 million, and purchased or collaborative R&D from ISK 150 million to ISK 450 million.
- As percentage of GDP, R&D tax support increased from 0.04% to 0.11% over this period.
- Direct funding of BERD increased from 0.10% to 0.15% of GDP between 2011 and 2018.
- The share of tax incentives in total government support increased from 27% in 2011 to 42% in 2018.

Please cite this note as: OECD (2021). “R&D Tax Incentives: Iceland, 2020”, www.oecd.org/sti/rd-tax-stats-iceland.pdf, Directorate for Science, Technology and Innovation, March 2021.