International Tax

Portugal Tax Alert

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Corporate tax reform proposed

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On 15 October 2013, the Portuguese government presented to parliament a draft law to reform the corporate tax code (draft reform law), together with the draft state budget for 2014. The draft reform law is based on the recommendations of the 10-member Commission on Corporate Tax Reform appointed by the Prime Minister in February 2013 and is designed to promote "sustainable economic development based on private investment and internationalization of the economy."

The proposals included in the draft reform law that are likely to be of the most interest to international investors are set out below.

Reduction of combined corporate tax and surcharge rates

The 25% corporate tax rate currently is increased by a municipal surcharge of 1.5% and a state surcharge of 3% on profits between EUR 1.5 million and EUR 7.5 million and 5% on profits exceeding EUR 7.5 million, resulting in a maximum combined rate of 31.5%. It is proposed to gradually reduce the corporate tax rate as from 1 January 2014 as follows:

Year	Corporate tax rate	Max. combined rate
2014	23%	29.5%
2015	21%	27.5%

The corporate tax rate would be further reduced to between 17% and 19% in 2016, and the municipal and state surcharges would be phased out in 2018.

Participation exemption

Following the recommendation of the Commission, the draft reform law would extend the benefits of participation exemption regime for dividends and capital gains arising from shareholdings that have been held for an uninterrupted period of at least 12 months. The current participation exemption applies to dividends arising from shareholdings of at least 10% in Portuguese or EU/EEA countries and the participation exemption on capital gains applies only to regulated holding companies (SGPSs) and venture capital companies (SCRs) provided certain requirements are met.

Under the proposal, dividends would be exempt if a Portuguese company holds, directly or indirectly, at least 5% (reduced from the current 10%, but increased from the 2% proposed by the Commission) of the capital or voting rights of the payer company. The participation exemption would be available for all shareholdings of 5% or more, including those in a non-EU company, provided the payer company is not tax resident or domiciled in a tax haven. In addition, for shareholdings of 5% or more, a credit for underlying tax would be granted to the Portuguese company where one or more of the conditions to benefit from the participation exemption are not satisfied. The participation exemption would replace the tax privileges currently available only to SGPSs and SCRs.

Dividends paid by a Portuguese company to a company resident in the EU or in a jurisdiction that has concluded a tax cooperation agreement similar to the agreements with EU member states also would be exempt if the 5% participation requirement is met and the recipient is subject to (and not exempt from) a tax equivalent to the Portuguese corporate tax at a rate that is at least 60% of the Portuguese corporate tax rate (however, if this last condition is not satisfied, it still would be possible to benefit from the exemption if other conditions are satisfied).

Capital gains derived by nonresident companies from the sale of shares in a Portuguese company already are exempt if specific requirements are met, and would continue to remain so.

Foreign branch exemption

The draft reform law would allow a Portuguese company to elect not to take into account the profits and losses of its foreign permanent establishment (PE) provided the PE is subject to a tax in its country of residence that is equivalent to the Portuguese corporate tax at a nominal rate that is at least 60% of the Portuguese corporate tax rate. This option would not be available to PEs located in countries on Portugal's black list or where losses of a foreign branch previously were offset against profits taxable in Portugal, up to the amount of losses utilized.

Foreign tax credit

According to the draft reform law, the limitation on the amount of a foreign tax credit would be determined on a per-country basis (currently, it is determined by reference to each individual receipt up to the corresponding corporate tax due in Portugal on the relevant net profits). It is also proposed to introduce a five-year carryforward period in which to offset excess foreign tax credits (under existing rules, the credit must be used in the year to which the foreign income relates).

Tax loss carryforwards

The draft reform law proposes to extend the loss carryforward period from the current five years to 12 years (rather than the 15 years proposed by the Commission) and allowing loss carryforwards to be used following a merger without the need for prior approval by the Finance Ministry. In addition, the current 75% limit on the amount by which tax losses carried forward can reduce taxable income would be reduced to 70%.

Withholding tax on interest

The government did not include the Commission's recommendation to abolish the withholding tax on interest on loans paid to credit institutions and shareholders resident in an EU/EEA member state. However, the draft reform law would eliminate the obligation to withhold tax from interest on shareholders' loans made by Portuguese-resident entities that hold (directly or indirectly through subsidiaries) more than 10% of the voting share capital of the payer company for at least one year before the payment.

Exit tax rules on transfer of residence

The draft reform law would amend Portugal's exit tax rules that apply where a company transfers its residence from Portugal to another EU/EEA country in order to align the rules with EU law. Instead of immediate payment of tax upon migration, three options would be available: immediate payment; payment in five installments; or deferral of tax payment until the year following the effective disposal of thee company or transfer of residence to another jurisdiction (the latter two options would be subject to interest). These rules also would apply to Portuguese PEs of nonresident companies.

Transfer pricing rules

Under current rules, one of the definitions of a related party for transfer pricing purposes is where one entity participates directly or indirectly in at least 10% of the share capital or voting rights of another entity. The draft reform law would raise the 10% participation to 20%. Although not included in the draft reform law, the Commission proposed that the net turnover level above which additional transfer pricing documentation requirements would be triggered should be raised from EUR 3 million to EUR 5 million; it is still possible that the Minister of Finance will adopt this recommendation by amending the relevant ministerial order.

The scope of the transfer pricing rules would be extended to dealings between the head office of a Portuguese company and its PE abroad.

Unilateral advance pricing agreements (APAs) would be permitted (currently, it is only possible to obtain a bilateral APA).

Tax deductibility of financing expenses

The draft reform law would further tighten Portugal's thin capitalization rules. Specifically, the deductibility of net financial expenses would be limited to the higher of the following: (i) EUR 1 million (currently EUR 3 million); or (ii) 30% of EBITDA (according to the draft reform law, a redefined EBITDA would be considered for this purpose). A group of companies reporting under the tax group regime would have the option to apply the relevant threshold at the group level. Securitization companies, Portuguese branches of credit and other financial institutions and insurance companies with their head office outside the EU would be excluded from the application of the restriction on the deduction of interest expense.

Tax groups

The draft reform law would reduce the minimum percentage holding for purposes of the tax group regime from 90% to 75% and would allow eligible companies held through EU/EEA-resident companies to be part of a tax group in Portugal.

Black-list countries

Following the Commission's recommendation, the draft budget law would introduce general criteria for a jurisdiction or territory to be included on Portugal's black-list jurisdictions. The criteria are as follows:

- The absence of a tax on income equivalent to the Portuguese corporate tax or a tax rate lower than 60% of the Portuguese corporate tax rate;
- Significant departure from the generally accepted rules (by OECD member countries) for determining taxable income;
- Existence of more favorable incentives or similar measures leading to a substantial reduction in taxation; and
- Absence of exchange of information arrangements (based on law or existing practice).

As recommended by the Commission, the black list would be updated on a regular basis, taking into account the findings of the OECD global forum on tax havens. It also would be possible for a jurisdiction appearing on the black list to request that Portugal review its inclusion and remove it from the list in appropriate cases.

Patent box regime

The draft reform law would provide for the introduction of a 50% exemption from corporate tax for companies exploiting patents, industrial designs or models. The patent box regime would apply to assets registered as from 1 January 2014. A tax deduction spread over a 20-year period also would be granted for the acquisition cost of intangibles with no time limit on their use (currently, a deduction is allowed only if the intangible depreciates in value over time and amortization is approved by the tax authorities).

Simplification of certain tax obligations

The draft reform law would introduce simplified tax reporting for small companies, i.e. companies with annual turnover not exceeding EUR 200,000 and total assets not exceeding EUR 500,000. Such companies would be able to opt to compute their taxable profits using a simplified method if they satisfy certain conditions. The formulae to determine the taxable profit would be as follows:

- For hotels, restaurants and similar catering businesses: 4% of turnover;
- For professional services companies: 75% of fees;
- For companies providing other services: 10% of fees and operating subsidies received;
- For companies receiving income from the transfer or grant of temporary rights to use intellectual or industrial property, or from the provision of information regarding experience acquired in the industrial, commercial or scientific sector: 95% of the amounts received;
- For rental income, income from capital or net capital gains and other increases in net worth, as defined for income tax and capital gains tax purposes: 95% of the relevant amounts; and
- For increases in net worth acquired free of charge: 100% of the increase.

In the first and second year of taxation under this regime, only 50% and 75%, of the taxable profit derived from the sale of goods and the rendering of services, respectively, would be taxable. Participants also would be exempt from the special tax prepayment and the autonomous (penalty) tax on certain expenses.

The draft reform law follows the Commission's recommendations to simplify and harmonize other compliance obligations, such as eliminating the requirement to obtain advance approval from the tax authorities in certain cases (e.g. using a tax year different from the calendar year or using methods or rates of depreciation or amortization different from those set out in legislation or regulations). Instead, the taxpayer would only have to report the action to the authorities.

The formalities to obtain benefits under Portugal's tax treaties would be simplified significantly. As an alternative to the current requirement to obtain a specific form that has been approved by the Portuguese tax authorities, a nonresident would be permitted to submit a certificate of residence that has been certified by the tax authorities of the income recipient's country of residence, which would constitute sufficient proof of residence to obtain treaty benefits.

Other proposals

The budget law for 2014 and the draft reform law contain various other measures aimed at clarifying and simplifying tax legislation or ensuring compliance with EU law, relating to the following:

- The tax deductibility of expenses;
- Tax treatment of capital gains and losses that do not fall within the scope of the participation exemption;
- Harmonization of tax and accounting rules, namely with respect to deferred payment purchases, impairments, bad debts, subsidies, depreciation, amortization and losses on noncurrent assets, among other items;
- Consolidation of rules governing tax-neutral concentrations, the development of rules for non-tax-neutral reorganizations and clarification of certain tax aspects of concentrations;
- Transactions to which the Portuguese tax neutrality regime applies, e.g. reverse mergers and various types of mergers not resulting in the issuance of shares;
- Tax benefits;
- Stamp tax exemption on short-term intercompany loans; and
- Authorization to review the rules governing collective investment vehicles and the special regime for debt instruments.

Conclusion

The draft reform law and the draft budget law for 2014 implement most of the corporate tax reform measures recommended by the Commission and would bring about many long-awaited changes that would positively influence the climate for inbound and outbound investment, increase the international competitiveness of Portugal and raise the country's ranking among OECD member states in terms of fiscal policy.

The proposed legislation will now be considered by parliament. If approved and signed by the president, the new rules will apply as from 1 January 2014.