In the current economic scenario, any corporate tax regime plays a big role in the promotion of economic growth and the Portuguese regime is no exception, even though it can generate important distortions in investment decisions

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I. ABSTRACT

Nowadays, Portugal has a robust corporate tax regime which has been in force for over 20 years, and which has been contaminated by recurrent changes to the tax legislation, specifically tailored amendments and the recent need to raise tax revenues.

Notwithstanding, the time has come to make an end-to-end revision of the current corporate tax regime, considering the need to revise and simplify the taxation of companies thus promoting investment – be it domestic, inbound or outbound –, the need to revise and simplify the current regime of ancillary obligations imposed on taxpayers thus reducing some of the existing bureaucracy and the need to restructure the current international tax policy followed by Portugal in its relations with other countries and its positioning in a globalized economy, namely as regards the negotiation and conclusion of double taxation agreements.

With the above mentioned objectives in mind, a special commission (the “Reform Commission”) was appointed by the Portuguese Government to study the necessary changes and put forward a proposal of revision of the Corporate Income Tax Code and related legislation, which conclusions have been presented on 30 July 2013.

Please find below a summary of the most relevant proposals.

II. REDUCTION OF STATUTORY TAX RATES

Tax rates are typically perceived as the ultimate proxy for how burdensome a given tax system is.

Even though the effective tax burden relies on a myriad of other elements, as acknowledged by the Reform Commission, the most visible proposal entails the reduction of the statutory tax rates and the extinction of the existing (municipal and national) surtaxes, progressively, until 2018.

Accordingly, the proposal is that the aggregated statutory tax rate is reduced, progressively and on a yearly basis, from 31.5% in 2013 (4th higher in the European Union) to 19% in 2018, with the surtaxes being completely repealed.

III. (RE)INTRODUCTION OF A SPECIAL TAXATION REGIME FOR SMALL BUSINESSES

Considering that Portuguese business sector is mainly composed of small and medium enterprises, the Reform Commission has put forward a proposal to reintroduce (a previous system had been repealed in 2010) a simplified tax system applicable to small businesses.

According to the proposal this is an optional regime applicable to entities which comply with all of the following:
i) maximum turnover of € 150,000 in the previous year;
ii) balance sheet not exceeding € 500,000 in the previous year;
iii) Are not statutorily subject to statutory audit;
iv) At least 80% of its share capital is held, directly or indirectly, by entities which fulfill the above mentioned requirements;
v) Adoption of the accounting regime applicable to micro-entities;
vi) Have not opted-out of the regime in any of the 3 previous years.

In order to provide for the additional costs incurred in by start-ups, the taxable basis referred to above are reduced in 50% and 25%, respectively, in the first and second years of activity.

In accordance with this regime, the corporate income tax rate will be applied on:
i) 4% of the sales made and services rendered in the hotel and restaurant industry;
ii) 75% of the income obtained by specific professional activities;
iii) 10% of the remaining income obtained from the provision of services;
iv) 95% of royalty income (as defined in the proposal), capital gains and other gains;
v) 100% of other gains accrued gratuitously.

Moreover, in order to simplify the taxation system of small enterprises, and cater for the specific difficulties of these entities, the Reform Commission proposes that they are not subject to any autonomous taxation (tributações autónomas) or to the special payment on account.

IV. SIMPLIFICATION OF ANCILLARY TAX OBLIGATIONS

Acknowledging that the existing ancillary tax obligations pose an excessive compliance burden on taxpayers, thus discouraging investment in Portugal, the Reform Commission proposes to cut some of the current red tape.

With this concern in mind, the proposal suggests that most of the situations which required previous acceptance agreement by the tax authorities can now be completed with a mere communication (which still needs to be justified). As regards this situation, the proposal includes, for instance, the procedure to adopt different depreciation rates, or to adopt a particular tax year.

In addition, the Reform Commission also proposes that certain ancillary tax obligations are simplified, namely those concerning to the group taxation regime, the transfer pricing regime, the deduction of the tax losses regime, as well as the regime for the relief of economic double taxation.

V. REDUCTION OF TAX LITIGATION

Even though some improvements have been introduced in the tax judiciary system in Portugal, the length of tax litigation procedures is still a negative aspect of the Portuguese tax system.

In order to resolve some of the issues that traditionally give rise to massive litigation, the Reform Commission proposes to review the concept of deductible costs for tax purposes as well as that of impairments due to bad debts.

Another area of recurrent litigation is that of the application of double tax treaties, namely regarding the requirement that the proof of residence in the other contracting state is submitted in a particular fashion. Considering the existing case-law the Reform Commission proposes that even though the existing procedure is preferable, other proofing methods are also accepted by the tax authorities.

The Reform Commission finishes this analysis with a recommendation that the tax authorities review their positioning as regards its traditional pro-litigation stance.

VI. HARMONIZATION OF ACCOUNTING AND TAXATION RULES

Another area that is a regular source of interpretation and application issues is that of the impact of the accounting rules in the taxation rules.

In fact, even though the taxable income of companies is based on the accounting result, the corporate income tax rules introduce several distortions, which the Reform Commission suggests to abolish by adapting the tax rules to the accounting rules.

In particular, the concepts that are at stake in this situation are those of depreciations, impairments, provisions and intangible assets.

VII. DEFINITION OF A NEW INTERNATIONAL TAX POLICY

Bearing in mind one of the main goals of the reform – promote inbound and outbound investment – the redefinition of the international tax policy is of the essence to achieve such objectives.

In this respect, the proposals of the Reform Commission entail the negotiation of new double tax treaties and the renegotiation of existing ones, namely repositioning Portugal in the current economic context, revising the tax rates applicable to non-residents and developing the introduction of anti-abuse measures in its double tax treaties (such as limitation on benefits clauses).

Another proposal – of great importance – is the introduction of a generic participation exemption regime, thus replacing the existing short-scoped holding regime.

Under this new regime, which qualifies as one of the most attractive in Europe, a participation exemption for dividends and capital gains is provided for in case of holdings of, at least, 2%.

However, unlike many of the participation exemptions regimes in Europe, the proposed regime has a broad scope of application thus positioning Portugal as a go-to platform for investments to and from Europe.

Moreover, a 5-year carry-forward period for international tax credits is now proposed.

Additionally, to promote outbound investments, a new exemption regime is proposed to income generated by foreign permanent establishments of resident companies.

VIII. REDUCTION OF LIMITATION ON TAX LOSSES DEDUCTION

Another very important proposal is that regarding the extension of the carry-forward period for tax losses.

Considering other existing regimes in Europe, the Reform Commission proposes to extend the current 5-year carry-forward period, to a 15-year period, which is a substantial benefit for companies operating in Portugal as compared to the current regime.

Also worth of note is the proposal of revoking the current regime under which the tax losses can no longer be carried-forward if there is a substantial change in the holding of the company or in its activity.

IX. SIMPLIFICATION OF TRANSFER PRICING RULES

In order to ease the tax compliance burden on taxpayers, the Reform Commission proposes to increase the threshold for the transfer pricing rules to apply.

As such, instead of the previous threshold of a 10% holding, the proposal sets the minimum holding for transfer pricing rules to apply at 20%.

X. SIMPLIFICATION OF GROUP TAXATION RULES

On the other hand, the Reform Commission proposes to reduce the threshold for eligibility for the group taxation regime already in place, while adapting the current regime to the case-law of the European Court of Justice.

In accordance, the eligibility holding threshold is reduced from 90% to 75%, thus allowing for the creation of taxable groups in more situations, which is deemed to be more in accordance with the economic reality.

On top of that, some penalties for non-communication of minor changes to the group were abolished, as the Reform Commission considered them to be excessive and inappropriate.

XI. SIMPLIFICATION OF TAX NEUTRALITY REGIME

As regards the tax neutrality regime, the Reform Commission proposes to introduce a new list of operations covered by such regime.

In fact, in view of the current list of operations covered by the tax neutrality regime, several disputes have taken place as to whether or not similar operations that were not expressly covered by the list could benefit from the regime.

In face of the long list of case-law on the matter, both from national courts as well as from the European Court of Justice, the Reform Commission proposes to broaden the scope of this regime to those operations which have already been analyzed by said case-law.

On the other hand, the Reform Commission also clarified the regime applicable to reorganization operations (such as mergers or divisions) when the tax neutrality regime is not applicable, thus solving interpretation problems that the current regime entails.

XII. CONCLUSIONS

As it can be seen from the analysis carried out above, the proposals put forward by the Reform Commission are bold although important to promote the economic growth of the Portuguese market and of the Portuguese companies.

In any case, it is important to stress that these are just proposals which are going to be subject to a period of public discussion, after which the Reform Commission will submitted them to the Portuguese Government for discussion and approval under the applicable legislative procedure.

This said, even though these proposals are expected to be included in the corporate income tax code, the exact content of that new regime is not totally clear yet.

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