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Corporate Income Tax Reform Efforts in Portugal

by Francisco Cabral Matos

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Since January 1, Portugal has a new set of rules concerning corporate taxation. The corporate income tax (CIT) reform is a milestone in the Portuguese government's tax policy for the current term, which ends in 2015.

The essential aim of the CIT reform was to raise the competitiveness of the Portuguese tax system, foster investment in the country, and reinstate Portugal's position as a preferred gateway to Portuguese-speaking emerging markets. This goal was accomplished by reducing the nominal CIT rate, broadening the participation exemption regime to a worldwide basis, extending the carryforward of tax losses, and simplifying several compliance obligations.

Notably, the new participation exemption is now applicable to all Portuguese companies and, to some extent, to Portuguese permanent establishments of foreign companies, and applies symmetrically to inbound and outbound flows.

The CIT reform was discussed, negotiated, and enacted because of a broad political consensus between the governing coalition and the opposition Socialist party, giving investors greater confidence as to its implementation and stability in the coming years.

Simultaneously, the State Budget Law for 2014 was also approved by the parliament and sets out some additional changes to Portuguese tax law that may complement the advantages of the CIT reform.

CIT Reform: A Step Forward

The CIT reform sets out a reduction of the general CIT rate from 25 percent to 23 percent, effective immediately.

For small and medium-size enterprises there is a new dual rate system, which taxes a first bracket (taxable income of up to €15,000) at a reduced CIT rate of 17 percent. Conversely, highly profitable companies are subject to a new state surcharge bracket, which taxes profits in excess of €35 million at a rate of 7 percent.

Surprisingly, along with the legal provisions enacted by the CIT reform, there is a statement[1] of intentions according to which the general CIT rate should be progressively reduced up to 19 percent or 17 percent in 2016, subject to the:

> results achieved by the CIT Reform, the assessment of the country's economic and financial progress and the (expected) reform of the Value Added Tax and Personal Income Tax systems.

Contrary to the initial proposal, and as a result of the parliamentary negotiations, the CIT reform does not foresee the elimination of municipal and state surcharges by 2018.

Participation Exemption Regime

Portugal faced a significant competitive disadvantage compared to other European jurisdictions, as the former participation exemption regime would only apply

[1]The statement is not legally binding.