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Corporate Tax

Portugal

Trends and Developments

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Trends and Developments

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The COVID-19 pandemic made the year of 2020 a turning point for the entire world and so all countries are now placing great expectations on 2021, which obviously impacts the legislative tax options of Portugal.

New Concept of Permanent Establishment

The Portuguese State Budget for 2021 has brought substantial amendments to the concept of permanent establishment, namely, widening the domestic concept in order to bring it closer to recent developments at OECD level. Although, in general, these amendments mostly aim to align the domestic concept of permanent establishment – as foreseen in the Corporate Income Tax Code (the "CIT Code") – with the concept currently embedded in the OECD Model Tax Convention and with Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI), interestingly, the Portuguese legislator took the opportunity to go beyond the MLI and include a new form of permanent establishment (a "services permanent establishment") that deviates from the OECD standard and follows the United Nations Model Tax Convention.

It is clear that all amendments serve the purpose of extending Portuguese tax jurisdiction to activities that, up until 2020, were either not covered in the concept of permanent establishment or would fall under the carve-out for "preparatory and auxiliary activities". However, the material impact of such amendments is still to be ascertained, given that the effectiveness of the new provisions depends on their compatibility with the Portuguese double tax treaty network. In this regard, despite that some of these amendments result from the MLI, the fact is that Portugal ratified the MLI on 14 November 2019 (only deposited in February 2020) but made two important reservations regarding Articles 12 and 14 of the MLI.

All in all, the new provisions may be segmented into three categories.

Amendments in accordance with the MLI and not contending with the reservations made by Portugal

This category includes a new concept of a person closely related to an enterprise and the extension of the permanent establishment to activities that were formally deemed merely ancillary (the specific activity exemptions). Both amendments are now in force without the need for further action.

Amendments made in accordance with the MLI, which fall within the reservations made by Portugal

These amendments should not have a direct effect pursuant to the MLI (due to the reservation) and contend with the current wording of several double tax treaties entered into by Portugal. This category includes the new provisions addressing commissionnaire arrangements and similar strategies, and an anti-avoidance rule tackling the splitting up of contracts. This category is unlikely to enter into effect without bilateral renegotiation of the double tax treaties.

Amendments that are not related to the MLI

This is specifically the case for the new services permanent establishment concept. The CIT Code now encompasses within the concept of permanent establishment the provision of services (including consultancy services) by a non-resident company in Portuguese territory. To trigger the existence of a permanent establishment, the provision of services should last for more than 183 days within a 12-months period, irrespective of whether the services are provided by employees of the non-resident entity, or people hired for said purpose.

It is the authors' view that this new type of permanent establishment is inspired by the United Nations Model Tax Convention; however, it brings additional challenges from an interpretative standpoint due to the fact that there is no experience, guidance and virtually no case law on this matter, but also since most of the double tax treaties entered into by Portugal are based on the OECD Model Tax Convention and therefore the new domestic rule is most likely incompatible with most of the tax treaties signed by Portugal.

Additional Challenge of Identifying the Relevant Taxpayer

The concept of a person closely related to an enterprise raises one additional challenge, since the CIT Code does not clarify which should be the relevant taxpayer when several entities are considered closely related. One should bear in mind that neither the CIT Code nor the Portuguese tax authorities have yet implemented a clear methodology for the attribution of profits to permanent establishments. Therefore, provided a permanent establishment is created out of the activities of several "closely related enterprises", it is not clear which entity (if not all) shall be deemed to have a permanent establishment and, ultimately, how the allocation of profits should be made in respect of the activities carried out by each entity.

The coming into force of these amendments represents a significant challenge for taxpayers, as well as for tax authorities and tax courts. In particular, the interplay between domestic provisions and double tax treaties, together with the effects of the MLI, will certainly lead to legal uncertainty and potentially an increase of tax litigation in this regard.

DAC6 Directive

Portugal had a very long transposition process of Council Directive (EU) 2018/822 (DAC6).

Having information transparency and fairness in taxation as a political target, DAC6 sets forth new mandatory disclosure rules regarding cross-border tax mechanisms that meet at least one of the specified hallmarks. The transposition of DAC6 throughout the EU has been affected by several difficulties, not only from a technical standpoint – due to the complexity of the hallmarks and the impacts it has on all taxpayers and (tax) intermediaries in terms of compliance costs – but also due to the fact that the transposition occurred in the context of the COVID-19 pandemic. Following a significant delay in transposing DAC6 into domestic legislation, Portugal has also delayed substantially the approval of the official reporting forms (published in the official gazette on 29 December 2020) and the publishing of the official guidelines issued by Portuguese tax authorities on the matter (released only by the end of January 2021).

In addition, Portugal has decided to extend the territorial reach of this regime to purely domestic transactions, as well as the scope of the reporting obligations to virtually all main taxes, including Value Added Tax.

The fact that, apart from Poland, no other EU member state has followed this approach implies that there is very little guidance for the correct interpretation and application of the new rules, despite that the same are now fully in force, requiring a significant tax compliance effort for both taxpayers and intermediaries, and possibly implying material consequences in the event of incomplete or late filing of the reporting forms, given the tax penalties specifically set forth in this case.

Portugal is also in a peculiar position as regards professional privilege. Whilst DAC6 itself foresees specific rules to safeguard legal professional privilege, Portuguese legislation has taken a deviating path from all other EU member states, setting forth the exact same rules for intermediaries covered by legal or contractual privilege. This implies that intermediaries covered by a confidentiality clause in their service contracts may claim to be on the same footing as lawyers or other professions that are bound to professional privilege by law.

This option may itself prove to be in breach of DAC6, given that under the Directive's rules, intermediaries subject to a contractual privilege would still be primarily liable for any reporting obligations, contrary to the Portuguese rules. Moreover, the Portuguese regime does not dismiss intermediaries from an obligation to report the mechanisms to Portuguese tax authorities; rather, intermediaries subject to professional privilege are secondarily liable for the reporting obligation (if the taxpayer opts not to do so), leading to the disclosure of the identity of taxpayers in the reporting forms, in breach of the legal privilege and professional ethics rules. In light thereof, the Portuguese domestic legislation has been much criticised and it is as yet uncertain how Portuguese courts (ultimately the Constitutional Court) will address this matter.

COVID-19

In spite of the new pandemic wave, 2021 is expected to be a turning point with regard to the COVID-19 situation, where countries all over Europe start recovering from the impact on economic and social structures, and investors regain confidence to do business as usual.

Several tax measures were adopted in the course of 2020, mostly focused on postponing the impact of tax payments (deferring payment deadlines) and allowing an extended period for carrying forward tax losses. This will likely continue in 2021, and new tax measures are expected to foster the economic recovery in a – much expected – post-pandemic period.

VAT

From a VAT standpoint, 2021 was expected to bring two main developments.

On one hand, in August 2020, Portugal transposed Council Directive (EU) 2018/1910 of 4 December 2018, and has established a set of VAT simplifying measures applicable to intra-community transactions of goods – the quick fixes.

In fact, there are four types of in-force quick fixes:

- a harmonisation of the VAT treatment of intra-community chain transactions;
- a simplification of the rules applicable to consignment sales;
- an obligation to validate on the VAT Information Exchange System (VIES) the VAT identification number of the buyer as a conditio sine qua non to be VAT exempt in such transactions; and
- the setting out of a list of necessary documentation for a VAT exemption, which has been in force since January 2020.

The practical effects of these new rules should start to materialise in 2021.

On the other hand, Portugal was expected to add a new requisite for invoicing, so that invoices include a quick response (QR) code. The new rules were already set out in 2019, but their application was postponed initially for 2020 and, due to the COVID-19 pandemic, the measure was again postponed till 2022. That notwithstanding, electronic means of commerce are booming in the pandemic period and although companies benefit from this additional implementation period, it is likely that companies will start a smooth transition in the course of 2021, adapting their invoicing software to the new QR code requirement.

Outlook for 2021

There are no doubts that 2021 will be a challenging year on many levels, especially from a tax standpoint, not only because of the aspects referred to above but also due to the need for constant adaptation to the exceptional measures required by the pandemic. One may not disregard that alongside the legal frameworks in force, the tax function of companies is also affected by the fact that tax authorities are (also) working remotely and facing the struggle of quickly adapting to a new reality. During certain periods of 2020, and once again under the current lockdown in early 2021, judicial proceedings and tax enforcement procedures have been suspended, while tax inspections have been either suspended or primarily made by email or electronic communication. The tax authorities are improving their ability to interact with taxpayers in an efficient manner, but COVID-19 has naturally created additional difficulties regarding tax procedural matters. It is, however, expected that when things go back to a new normality, there will be a huge budgetary pressure to collect more taxes and it is likely that tax litigation may increase.

Together with temporary tax measures, it should be pointed out that starting from 2021, a new financial incentives plan is in force (Portugal 2030), focused on eight pillars:

- innovation and knowledge;
- qualification, training and employment;
- demographic sustainability;
- energy and climate change;
- the economy of the sea;
- competitiveness and territorial cohesion in the coastal areas;
- competitiveness and territorial cohesion in the countryside areas; and
- agriculture and forestry.

The incentive packages will be complemented with the financial package negotiated by member states under the EU's response to COVID-19, and new tax incentives will most likely be designed during the course of 2021 to help the economic recovery and lead stakeholders to focus on the economic sectors and priorities mentioned above.

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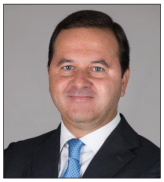

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