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Corporate Tax 2023

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Portugal: Trends and Developments

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Trends and Developments

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Corporate Tax in Portugal: an Introduction

2022 brought meaningful tax-related changes at both national and international levels, such as:

- increased global pressure for the implementation of tax regimes that cover crypto-assets;
- advances in the common ground between OECD countries regarding Pillar Two of the Global Anti-Base Erosion (GloBE) Model Rules at the international level;
- relevant national tax policies, such as material changes to the Portuguese Patent Box regime; and
- specific tax rules for remote working employment relationships.

In the context of the global economic recovery following the scaling down of the COVID-19 pandemic, a new socio-economic crisis with global effects has arisen, stemming from the armed conflict in Ukraine. Tax policies are once again being subjected to significant changes, and are regarded as a tool to mitigate the negative social and economic effects of the current international context. The Portuguese State Budget Law for 2023 has recently been approved, including relevant changes that will be analysed in this article, along with national and international case law that has future impacts for companies liable to tax in Portugal.

New tax loss regime

The Portuguese State Budget Law for 2023, approved by Law No 24-D/2022 of 30 December 2022, has established a new regime for the utilisation of tax losses reported by corporate

taxpayers in previous tax periods, which can be offset against the taxable income obtained by the same company in future periods.

Under the previous legal regime, tax losses reported by a company liable to Corporate Income Tax (CIT) in Portugal in a given tax period could be offset against the taxable income that the same company obtained in future periods. This option was available for five years for most companies, and for 12 years for companies that qualified as a micro, small or medium enterprise under Portuguese Decree-Law No 237/2007. The amounts offset against the taxable income of each year could not exceed 70% of said taxable income, and losses in excess of this limit could still be carried forward to future tax periods.

The most relevant change introduced by the Portuguese State Budget Law for 2023 in this regard is that tax losses obtained by a company that is liable to CIT can be offset against the taxable income of future periods without any temporal limit. In addition, under the new regime, tax losses that are offset against the taxable income of a given tax period cannot exceed 65% of said taxable income, while losses in excess may still be offset in future tax periods.

Regardless of the 5% decrease in the threshold that limits the deduction of tax losses to the taxable income in each period, the new regime will allow companies to retain the right to offset tax losses indefinitely, averting the possibility of significant tax losses incurred by companies that

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are liable to CIT, for not being possibly fully offset during the five or 12-year limit that was previously applicable.

The new regime will be applicable to tax losses obtained by companies in tax periods starting after 1 January 2023, as well as tax losses obtained in previous tax periods, which could still be offset in 2023 under the previous tax loss deduction regime.

The time period and the deduction threshold changes were not the only relevant changes introduced by the Portuguese State Law for 2023 in regards to the tax loss regime. The previous regime contained a clause through which tax losses obtained in previous tax periods ceased to be deductible to the taxable income of a given period if, in the period in which the loss originated, there was a change of more than 50% of the shareholder structure or the voting rights of the entity in question (with certain exceptions, such as changes from direct to indirect shareholding or changes resulting from operations covered by the tax neutrality regime).

While the new regime still foresees a limit to the possibility of tax losses being offset if there is a change in the shareholding structure or voting rights in the company that is greater than 50%, this limitation will not be applicable in any scenario where the operation through which said change took place has economic substance and was not carried out for tax purposes, or mainly for tax purposes.

With this change, the Portuguese CIT Code will depart from the previous formalistic approach to the limitations on the deductions of tax losses obtained in previous tax periods, establishing new material criteria rooted in the substance and economic reasoning of the operations through

which the shareholding structure of the taxpayers undergoes major changes. However, this change also implies that the taxpayer will be burdened with having to prove that the operations in question were carried out with sound economic reasons and that obtaining a tax advantage was not one of the main motives for said operations. If the taxpayer is not able to prove the economic substance of operations that led to a major change in its shareholding structure, the right to offset tax losses to future taxable income may be lost.

The aforementioned anti-abuse provision is also applicable to corporate groups that are subject to the special tax consolidation regime established in the Portuguese CIT Code, when offsetting tax losses of a company against the consolidated taxable income of the group that will be liable to CIT in Portugal, if there was a change of the dominant company of the group or if said company acquired the dominant company of a different group during the tax period in which the loss originated. In that scenario, the dominant company of the group will also have to demonstrate that the operation that originated the changes in question was concluded for valid economic reasons.

Withholding tax of foreign funds (Allianz GI Fonds case law)

Under the current national law, foreign Collective Investment Vehicles (CIVs) that invest in Portuguese companies are subject to CIT through withholding tax levied on dividends that are distributed by the companies in which the investment was concluded. CIV that are domiciled in Portuguese territory benefit from a CIT exemption on dividends; therefore, no withholding tax is levied on dividends received, which poses a clear disadvantage for foreign CIVs and has gen-

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erated controversy between such entities and the Portuguese tax authorities.

Due to this legal framework, foreign CIVs have regularly challenged the legality of the withholding tax mechanism that is being enforced in regards to Portuguese sourced dividends, which has also been known to happen in different EU member states with similar tax regimes on this matter.

After various tax disputes arose due to the different treatment of domestic and foreign CIVs in this regard, the European Court of Justice (ECJ) has been requested to rule on a question presented by the national tax courts, in order to decide if this difference in treatment should be qualified as a discriminatory treatment that is inadmissible under European law, namely by being an unjustified restriction of the freedom of movement of capitals between EU member states, which is one of the four fundamental freedoms established under European law, having a broad application spectrum that also covers capital flows between third countries and EU member states.

The ECJ decided on the matter in case C-545/19 (also known as the Allianz GI Fonds case), issued on 17 March 2022, stating that the current regime established under Portuguese law is not compatible with European law since the difference in the tax treatment of the dividends received by foreign and domestic CIVs is not applicable to “objectively comparable situations”, and therefore has no legal justification. For the purposes of EU law, such difference in treatment would only be acceptable if it was justified by the need to preserve the coherence of the Portuguese tax law or to ensure the appropriate allocation of taxing rights between EU member states, which is not the case.

At the immediate level, the Allianz GI Fonds decision will have a direct impact on a multitude of tax disputes that are currently being settled by the national tax courts, where withholding tax levied on dividends received by a foreign CIV has been challenged, many of which were suspended pending an ECJ ruling on the matter. Previous tax disputes that had already been settled – in which Portuguese tax courts had decided the withholding tax in question was contradictory to the EU law, based on previous decisions of the ECJ – are also impacted by the settlement of the question that remained controversial after the issuance of such decisions.

The effects of the Allianz GI Fonds decision will also have impacts beyond the Portuguese boundaries, as it clarifies the ECJ’s decisive understanding on the matter, which will pave the way for a change in similar regimes enforced in other EU member states, affecting CIVs that have invested in the countries in question.

In the aftermath of the ECJ’s ruling, the Portuguese law was expected to be updated in order to remove the discriminatory regime. However, in similar instances where Portuguese law had to be amended due to incompatibilities with European law, changes were not immediate, which appears to also be the case with the withholding tax regime applicable to foreign CIVs.

Foreign CIVs that have been subject to withholding tax on Portuguese sourced dividends received in the past can request the refund of the amounts withheld in the previous two years, through a formal appeal submitted to the Portuguese tax authorities. Alternatively, Portuguese law also foresees a mechanism through which foreign CIVs in this situation may request the Portuguese tax authorities to review the collection of the amounts withheld, which has the

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advantage of allowing the return of the amounts withheld in the previous four years.

GloBE – Pillar Two

In 2021, OECD countries reached a consensus on the implementation of significant changes to the global international tax policy, mainly through the approval of Pillars One and Two of the GloBE Model Rules.

The main premise of Pillar One is the proper allocation of taxing rights between jurisdictions where multinational enterprises (MNEs) with significant turnover and profitability are present, in order to ensure taxing rights for the jurisdictions where economic value for the MNE is created. Pillar Two focuses on establishing and ensuring that a minimum tax of 15% is levied on the income of MNEs that have global income surpassing EUR750 million.

While both initiatives have been widely discussed in the international tax community, Pillar Two and the establishment of a minimum CIT applicable to MNEs that achieve a certain level of profitability have recently, faced some reluctance from OECD member countries. This has motivated additional discussions and prevented the implementation of an EU Directive that already aimed to establish such minimum tax, since the Directive needed to be approved by a unanimous decision of the member states, which was not achieved.

Regardless of the proposal for the Directive not being approved, a political consensus has recently been reached in the EU regarding how the minimum corporate tax for MNEs should be implemented, in order to ensure the elimination of CIT competition within the EU and mitigate the risks of erosion of the tax base of EU member states and ensure that large MNEs are sub-

ject to a minimum level of taxation. In light of said consensus, the formal legislative process of the EU institutions may resume its course.

As such, the Directive that establishes the minimum corporate tax for MNEs is expected to be approved in the near future. EU member states may face some difficulties with the adaptation of internal legislation for the domestic implementation of said Directive, especially considering the short timeframe assumed by the OECD countries: the relevant legislation must be approved in 2023 for implementation in 2024.

The Directive will include specific rules in order to ensure that covered MNEs are subject to a minimum CIT of 15% in each jurisdiction where they have a significant economic presence, with the possibility of entities of an MNE that are not located in said jurisdictions also being subject to tax if the minimum tax level is deemed not to be achieved, according to the rules that will determine the effective tax rate to which the MNE was subjected in each jurisdiction.

In light of the recent developments, 2023 will be a crucial year for MNEs, which will need to adapt to the new complex legislation and regulations, and to the minimum CIT, although it is expected that the first tax returns and compliance obligations associated with the implementation of Pillar Two will only need to be filed and submitted from 2026 onwards.

Temporary solidarity contributions (windfall profits tax)

After widespread discussion on whether a tax on extraordinary profits derived from entities that operate commercially in the energy sector should be implemented, due to the inflation wave that has recently been felt in Europe and its impact on energy prices, Portuguese Law

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No 24-B/2022 was approved on 30 December 2022 and introduced a temporary solidarity contribution for such entities. The law in question also approved a contribution to be levied on the extraordinary profits of entities that operate in the food distribution sector, which is an unexpected novelty in the Portuguese tax landscape.

The justification provided for the implementation of such contributions for entities in the energy sector stems from EU Regulation 2022/1854, which addressed the necessity for the member states to implement policies to mitigate the rampant rise in energy prices, suggesting the implementation of a windfall profits tax.

Since the inflation phenomenon that originated this concern has also impacted prices of essential commodities such as food, a similar contribution was also implemented for food distribution entities, which is not rooted in European legislation. According to the law that approved both contributions, revenues generated through the application of both contributions will be used to finance anti-inflation measures, which will be implemented by the Portuguese government to assist those who are most impacted by the increase in the price of essential goods.

The solidarity contribution for the energy sector will be levied on entities that operate in the following subsectors:

- crude oil;
- natural gas;
- coal; and
- refinery.

Entities will be deemed to operate in these sectors if 37.5% of their turnover is derived from the extracting, mining or refining of oil or the fabrication of related products.

Law No 24-B/2022 was not clear in regards to the entities that would be covered by the solidarity contribution in the food distribution sector, but the approval of Ministerial Decree No 312-E/2022 established the specific activities to which this contribution is applicable, which essentially consist of food and beverage retail.

The solidarity contributions will only be levied in regards to the extraordinary profits obtained by the covered entities in 2022 and 2023, which will consist of the taxable income that exceeds, in at least 20%, the average taxable income obtained by said entities in the period between 2018 and 2021. In both cases, the contribution rate will be 33%.

Due to the fact that the contributions in question will already be applicable to tax periods starting in 2022, and that the law through which they were implemented was approved on 30 December 2022, doubts are arising as to whether this constitutes an unconstitutional retroactive effect of the law, which violates the legitimate expectations of Portuguese taxpayers.

This matter is expected to be brought to the Portuguese Constitutional Court in the near future.

Simplification of tax benefits applicable to companies liable to CIT in Portugal

The Portuguese Tax Benefits Code previously contained two tax benefits that were applicable to companies: the Deduction for Retained and Reinvested Profits regime and the Conventional Equity Remuneration regime. Both have been revoked by the State Budget Law for 2023 and will be condensed into a new regime: the Incentive to the Capitalisation of Companies (ICE) regime.

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The new regime will be applicable to tax periods starting after 1 January 2023 and will consist of a possible deduction in the taxable base of companies that are domiciled in Portugal, in the amount of 4.5% of registered net capital increases.

The capital increases that are eligible for this purpose are as follows:

- cash contributions in the context of the incorporation of companies or capital increases of the beneficiary;
- in-kind contributions that consist in the conversion of credits to equity;
- premiums on the issuance of shares; and
- accounting profits of a tax period that consist of retained earnings or, directly, reserves or capital increases.

The net capital increases will consist of the eligible capital increases after offsetting cash or in-kind outputs in favour of shareholders, as remuneration of equity or capital decrease, or as a distribution of the company's assets, and distributions of reserves or retained earnings. The calculation of the deduction will be based on the net capital increases obtained in the tax period in question and the nine previous tax periods.

For the purposes of the application of this regime, only net capital increases of tax periods starting after 1 January 2023 will be eligible.

The deduction resulting from this regime cannot exceed EUR2 million or 30% of the company's earnings before interest, taxes, depreciation and amortisation (EBITDA).

The ICE cannot be applied in regards to a certain tax period if, in the same tax period or one of the previous five periods, the same benefit has

been applied to companies that have a shareholding position in the company in question or to companies in which the applying company has a shareholder position.

Environment, social and governance (ESG)

In light of the ever-growing ESG concerns on a global scale, and in an effort to ensure a more sustainable future, countries are regarding tax policies as tools that may contribute to companies' adoption of ESG-compliant behaviours and policies.

ESG base values have been the main motivator of policies such as the taxation of environmentally irresponsible behaviours (also known as green taxes) and the implementation of tax benefits or breaks to encourage a reduction in harmful emissions, and incentives for the upskilling of employees and the development of a circular economy.

As such, companies are expected to start looking into alternative ways of conducting business and investments, and alternative employment practices, as a form of strategy with tax impacts on their overall profitability.

Due to the dissemination of ESG-related concerns, the pressure for the adoption of behaviours and policies that defend the inherent values of this movement is also expected to be reflected in consumer preference or investor options, which will ultimately be an additional motivation for companies to adapt their business.

In the near future, it is expected that ESG-driven policies will be reflected in international and national legislation that will affect not only tax, but also several other core business level such as financing, governance, employment and supply chains.

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Outlook for 2023

The implementation of the Recovery and Resilience Plan (RRP) for Portugal will continue in 2023, and the European Commission is expected to approve an extension of the deadline for the implementation of the investments and reforms contained within the RRP, beyond the original deadline of 2026. As such, the national economy is expected to be impacted by the EUR13.9 billion in grants and EUR2.7 billion in loans that will be granted in future years.

The Portuguese political landscape has recently been controverted and impacted by media events, but the trend of Portugal having an investor-friendly environment is expected to continue, aided by the recent approval of the Digital Nomad Visa programme. The Digital Nomad Visa will be applicable to individuals who remotely work for entities that are domiciled abroad, either as an employee or as service providers.

The Portuguese State Budget Law for 2023 has also approved the tax regime applicable to income derived from crypto-assets by individuals, which was previously not subject to taxation in the majority of cases. In the wake of the establishment of crypto-assets as a growing component of the global economy, the application of this regime will also have significant implications for the development of the Portuguese digital economy.

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