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Portugal: Trends and Developments

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Trends and Developments

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PORTUGAL TRENDS AND DEVELOPMENTS

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Corporate Tax in Portugal: an Introduction

The year 2023 was an impactful year for the Portuguese economy, which, in line with the international trends, suffered the effects of the increase of interest rates and inflation, resulting in some relevant changes of the national tax policies.

Despite all these factors and changes, Portugal's debt-to-GDP ratio fell to 98.7% and a favourable budgetary situation was registered, along with the deleveraging of private sector debt and strengthening of the banking sector.

Although in a very challenging political landscape, the Portuguese State Budget Law for 2024 was approved and relevant tax measures were introduced. Below are highlighted some of such measures along with important national and international case law that may impact companies/entities liable to Portuguese taxation.

Reduced Corporate Income Tax (CIT) rate for start-ups

The Portuguese State Budget Law for 2024, approved by Law No 82/2023 of 29 December, as from 1 January 2024, introduced a reduced CIT rate of 12.5% for entities qualified as start-ups under the so-called "Start-ups Law" (Law 21/2021 of 25 May).

Notwithstanding the criticism around the limited benefit that is granted, it is expected that this measure, aimed at supporting new and developing start-ups, will foster innovation and entrepreneurship to create a sustainable and favourable environment for economic growth.

This reduced rate applies to companies meeting new standards, such as:

- carrying out business for a period of less than ten years;
- employing less than 250 employees;
- having an annual turnover not exceeding EUR50 million;
- the company should not result from a corporate reorganisation (eg, demerger) of a non-qualifying company; and
- the company should not be held, in more than 50%, by a non-qualifying company.

New start-ups must also meet the conditions of being an innovative company with high growth potential, completing at least one round of venture capital financing or receiving investment from the Portuguese Development Bank. The new reduced rate is subject to European rules on de minimis aid.

It should be noted that small and medium-sized businesses and small/mid-cap companies would already benefit from a reduced rate of 17% on the first EUR50,000 of taxable income.

Pillar Two implementation

In December 2022, the new Council Directive on ensuring a global minimum level of taxation for multinational groups in the European Union (EU) was approved. EU Countries were given until 31 December 2023 to transpose and adapt its national legislation to these new rules.

Portugal has already failed the deadline to transpose the Directive risking being fined by the EU institutions. However, in practical terms, since the payment of the 2024 CIT to be assessed CIT will not be due before 2025, the Portuguese Government can still implement the Directive in the course of 2024.

Therefore, it is expected that until the end of this year, Pillar Two will be implemented, even though a full overview of the terms of such implementation is not yet known.

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Raising of financing for non-resident investors: Portuguese Special Debt Securities Regime gets increased attention

Under the Portuguese Special Debt Securities Regime (Decree-Law No. 193/2005 of 7 November), interest and capital gains derived from Portuguese public and private debt securities are exempt from Portuguese income tax when obtained by non-resident investors without a permanent establishment in Portugal, provided that some pre-defined conditions and formalities are met.

The main conditions and formalities for the Portuguese Debt Securities Exemption Regime to be applicable are:

- Bonds shall be integrated in:
  (a) a centralised system for securities managed by an entity resident for tax purposes in Portugal (which is the case of CSD managed by Interbolsa);
  (b) an international clearing system operated by a managing entity established in a member state of EU other than Portugal (such as Euroclear or Clearstream, Luxembourg) or in an European Economic Area state provided, in this case, that such state is bound to cooperate with Portugal under an administrative cooperation arrangement in tax matters similar to the exchange of information schemes in relation to tax matters existing within the EU member states; or
  (c) integrated in other centralised systems not covered above in relation to which Portuguese Government expressly authorises the application of this regime.
- Beneficiaries shall be central banks or governmental agencies, international bodies recognised by the Portuguese state, or any other entities without headquarters, effective management or a permanent establishment in the Portuguese territory to which the relevant income is attributable. In the latter case, the special regime will not apply if these entities are domiciled in a blacklisted jurisdiction, unless such jurisdictions have a double tax treaty or a tax information exchange agreement in force with Portugal.
- Beneficiaries shall evidence the non-residence status.

Market players have coped well with the requirements above over the past years, with a high number of new issues coming into market every year. Although the regime has been in force for more than 15 years, it has been raising increased attention as it might mitigate the risk a withholding tax waiver is challenged based on EU Law, given recent developments in the international tax outlook.

The concept of beneficial owner has been subject to an increased scrutiny within the EU (including Portugal) following the recent case law of the European Court of Justice (ECJ) – habitually referred to as the “Danish Cases” (C-116/16 and C-117/16) – which developed a conservative approach to the concept of beneficial owner under the terms of the EU Interest and Royalties Directive. This case law challenges the concept of beneficial ownership in lending structures relying on back-to-back structures, where interest payments flow to an entity that would not be able to claim this benefit (namely a non-EU resident company). Additionally, according to the proposed Anti-Tax Avoidance Directive 3 (so-called “ATAD 3” or “Unshell Directive”), “shell companies” will not be eligible for tax residence certificates.

Funding structures falling under the Portuguese Special Debt Securities Regime should fall out

of said discussions given that the withholding tax exemption results from a domestic tax regime that clearly encompasses non-resident (and non-EU) lenders. Thus, to the extent the conditions and formalities identified above are complied with, no withholding tax should apply in Portugal.

In this regard, it is interesting to note that the Portuguese Special Debt Securities Regime allows for other forms of non-residence certification beyond the traditional certificate of residence, depending on the nature of the investor. By way of example, if the investor is an investment fund or other type of collective investment undertaking domiciled in any OECD country or any country with which Portugal has signed a double tax treaty or TIEA, certification shall be provided by means of a declaration issued by the entity which is responsible for its registration or supervision or by the tax authorities, confirming its legal existence and the law of its incorporation.

ECJ rules that commissions charged in the context of the issuance of bonds fall within the scope of the Council Directive concerning Indirect Taxes on the raising of Capital

Apart from the above Portuguese income tax, bond loans should not be subject to Stamp Duty (SD) in line with a restriction provided for by the EU Directive concerning indirect taxes on the raising of capital (Directive 2008/7/EC) (as opposed to straight bank loans, where SD would be due over the principal amount at a rate of up to 0.6%).

However, SD may be levied on the security package (if any) at a maximum 0.6% rate over the maximum secured amount. Further, SD is usually due at a 4% rate on commissions for financial services.

On 19 July 2023 the ECJ issued a ruling on Case C-335/22, stating that Article 5(2)(a) of the Council Directive concerning indirect taxes on the raising of capital ("Directive 2008/7/EC") must be interpreted as precluding national legislation which provides for the imposition of SD to fees for financial intermediation services provided by a bank in connection with the placement of securities (bonds and commercial paper), regardless of whether the provision of such financial services is a legal requirement or merely optional.

On the same day, the same panel of judges issued a ruling on Case C-416/22 stating that the same article of Directive 2008/7/EC must be interpreted as precluding national legislation which provides for the imposition of SD to fees for financial intermediation services provided by a bank in connection with:

- the offer for the cash purchase of securities;
- the placement and subscription of securities; and
- the public offer for subscription of shares, regardless of whether the provision of such financial services is a legal requirement or merely optional.

In previous case C-656/21 the ECJ had emphasised that in light of the objectives pursued by Directive 2008/7/EC, a broad interpretation of Article 5 is required, as to ensure the practical effects aimed by the prohibitions it lays down are achieved. Thus, the prohibition to tax shall apply whenever taxation is imposed on a transaction forming part of another overall transaction that relates to the raising of capital even if the underlying transaction itself would not (at least directly) be covered as it is not expressly mentioned in the Directive.

These decisions may provide a basis for recovering SD imposed on commissions charged by financial institutions in bond issuances and other capital-raising operations over the last four years. Furthermore, they may have a broader impact as they could potentially extend to the taxation of security created to guarantee obligations arising from bond issuances and other capital-raising operations.

Regarding to the specific question of SD on guarantees in the context of a bond issuance, the issue has been brought before national courts and recently a Portuguese Arbitration Court has referred to the ECJ the question on whether those guarantees are covered by the prohibition laid down under Directive 2008/7/EC.

It will be interesting to monitor these developments as Portugal may be closer to having a zero SD taxation in the overall capital-raising operation, significantly reducing the cost of capital raised in debt issuances.

Withholding tax of foreign funds (AllianzGI-Fonds AEVN case law) – the story continues (and the law remains unchanged)

Under the current national law, foreign collective investment vehicles (CIVs) investing in Portugal are subject to withholding tax on dividends paid by Portuguese companies, which results in a clear disadvantage compared to resident CIVs which are not subject to corporate income tax on same dividends.

In light of this discrimination, several CIVs have been challenging the WHT to Portuguese sourced dividends based on the breach of EU Law (in line with litigation in other member states). These cases have been brought before Portuguese Tax Arbitration Courts by several CIVs that have claimed for the application of a full exemption (pari passu with Portuguese CIVs).

This litigation was initially filed before Tax Arbitration Courts in Portugal, one of which requested a preliminary ruling on whether the difference in treatment was in breach of the Free Movement of Capital and, therefore, incompatible with EU Law.

In the well-known case C-545/19 of 17 March 2022 (AllianzGI-Fonds AEVN) the ECJ confirmed that the Portuguese withholding taxation on dividends paid to non-resident CIVs is incompatible with EU Law, in line with the arguments that were presented at the mentioned proceeding before the Portuguese Tax Arbitration Court.

Following the ECJ decision, several cases has been brought before Portuguese Tax Courts by foreign (mostly EU) CIVs, leading to a full WHT refund.

The impact of this decision goes beyond national borders, paving the way for the elimination of withholding tax on dividends received by CIVs throughout Europe.

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 WHT regime applicable to CIVs.

Foreign CIVs that have been subject to WHT 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 authori-

ties. Alternatively, Portuguese law also foresees a mechanism through which foreign collective investment undertakings in this situation may request the Portuguese tax authorities to review the collection of the amounts withheld, which has the advantage of allowing the return of the amounts withheld in the previous four years. As the ECJ decision is based on the Free Movement of Capital, the withholding tax recovery should also be possible to third countries CIVs.

The "Mais Habitação" Programme (new affordable housing measures)

The so-called "Mais Habitação" Programme was approved with the aim of promoting access to affordable housing in Portugal. This Programme is part of an investment of EUR2.7 billion in the sector in Portugal from the Recovery and Resilience Plan (PRR). The funds will be used to support the implementation of "Mais Habitação" initiatives, alongside other housing-related investments.

As part of this legislative package, relevant tax incentives were approved for properties covered by the specific Affordable Rental Programme, such as:

- Exemption from Municipal Property Transfer Tax (MPTT) applicable to the acquisition of land for construction of urban buildings or units, provided that they are allocated to the Affordable Rental Programme and the licensing process is initiated within two years as from the acquisition date.
- Exemption from MPTT and Municipal Property Tax (MPT) for a period of three years (with a renovation option for another five years) applicable to the acquisition and ownership of urban buildings or units acquired or built to be allocated to the Affordable Rental Programme.
- A reduced VAT rate of 6%, applicable to construction or rehabilitation works for properties under the Affordable Rental Programme, provided that at least 70%, or the totality of the property, in case of full ownership or unit, is allocated to the Affordable Lease Programme, recognised by IHRU (*Instituto da Habitação e da Reabilitação Urbana*).

Personal Income Tax (PIT) and CIT exemptions applies, until 31 December 2029, to rental income arising from properties transferred from local lodging to residential lease agreements, provided certain conditions are met.

In the opposite way, entities exploring local lodgings are subject to a 15% rate extraordinary contribution and should submit a tax declaration (that will be approved) and pay the extraordinary contribution, until 20 June of the year following the taxable event.

Additionally, a CIT exemption (and a PIT) will apply to the capital gains arising from the sale of properties for residential purposes to the State, Autonomous Regions, Public Business Entities or to Municipalities.

It should be also highlighted the reduction of the three-years period to a one-year period in which properties acquired for resale purposes have to be resold in order to maintain the MPPT exemption (or, when MPPT has been paid at the time of the acquisition, to request the refund).

Finally, the 6% reduced VAT rate of 6% continues to apply only to urban rehabilitation works of properties located within urban rehabilitation areas or within the scope of re-qualification and rehabilitation operations of recognised national public interest, being excluded from the new rule new construction rehabilitation works in urban rehabilitation.

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Sectorial contributions
The several sectorial contributions that have been in place over the past years will generally remain in force (in addition to the new extraordinary contribution on local accommodation envisaged in the "Mais Habitação" Programme), thereby anticipating the perpetuation of the tax litigation associated with them.

Contribution over very light plastic bags and single-use packages
Since 2015, as one of the measures created by the Portuguese Government to tackle climate change and as part of a set of green tax measures, a special contribution was created over light plastic bags produced, imported, and acquired in the Portuguese territory.

As a continuation of the progressive implementation of green tax measures, the State Budget Law for 2024 extended the said contribution to very light plastic bags, these being the ones acquired in bulk sales of bakery products and fresh fruit and vegetables, which will be subject to a fixed contribution of EUR0.04 for each very light plastic bag.

Also, with the same goal mentioned above for light plastic bags, and as part of a process of progressively introducing contributions over non-reusable plastic products, in 2021, a contribution was created over plastic and aluminum (and both) single use packages acquired for the supply of meals as ready-to-eat, take away, and delivery, sales. This contribution amounted to EUR0.30 per package.

However, the implementation of the contribution of plastic and aluminum packages was constantly postponed and never entered into force. Now, the State Budget Law for 2024 revoked the Law that created such contribution and replaced it with a new contribution and regime applied over single-use packages, including composite packaging, purchased for takeaway or home delivery ready-to-eat meals, as well as single-use packages for ready-to-eat meals sold in points of sale to the final consumer.

The contribution amounts to a fixed contribution of EUR0.10 per package and should be imposed over the final consumer. However, the Law also establishes a minimum price of sale of single-use packages that should be imposed by the seller to the consumer. Therefore, single-use packages must be sold to the final consumer at a minimum price of EUR0.30.

Tax incentive for the capitalisation of companies
In 2023, a new tax incentive for the capitalisation of companies was introduced. Under its rules, companies may deduct to the taxable income 4.5% of eligible net equity increases. For that purpose, "eligible net equity increases" is computed by reference to the sum of the values calculated in the tax period the incentive relates to and in each of the nine previous tax periods.

From 2023 onwards, with the aim of adapting this tax incentive to the current economic context and recent increase of the reference interest rates – in line with the mechanism provided for in the proposal of Debt-Equity Bias Reduction Allowance Directive (DEBRA) presented by the European Commission in 2022 – the deduction to the taxable income will be computed based on a variable rate, corresponding to the average of the 12-month Euribor over the tax period in question, plus a spread of 1.5%, applicable to "eligible net equity increases" corresponding to the sum of the values calculated in the tax year the incentive relates to and in each of the six previous tax periods.

Furthermore, the definition of "eligible net equity increases" shall include, amongst others, any share capital contributions in cash, equity increases, conversion of loans into equity, and the allocation of distributable accounting profits to retained earnings or directly to reserves or equity increases.

Extraordinary energy sector contribution

The extraordinary energy sector contribution started to be charged in 2014 over companies acting in the national energy sector, as an extraordinary measure to finance the promotion of systemic sustainability of the energy sector measures, by setting up a fund to improve the reduction of tariff debt and finance social and environmental policies in the energy sector.

The general tax rate is of 0.85% – although different rates are applicable in special cases – and the taxable basis of the contribution is, in a nutshell, the fixed assets and intangibles of the company.

Ten years after the creation of this "extraordinary" measure, new changes have been introduced to its regime, that will be applicable from 2024 onwards.

Operators transporting crude oil and derivative products will only be subject to this extraordinary contribution when such activity represents more than 50% of its total annual turnover, which is an interesting new criterion introduced in the regime, since, until now, no connection has been made to the turnover of the entities subject to this contribution.

Moreover, the changes to the regime also include an exclusion from the tax basis of the contribution assets related to the promotion of sustainable investment. As such, with the intervention of the Portuguese Environment Agency, assets that, according to the European Regime for the Promotion of Sustainable Investment, reveal a substantial role to one of the following purposes, are to be excluded from the tax basis of this extraordinary contribution:

- climate change mitigation;
- climate change adaptation;
- sustainable use and protection of water and marine resources;
- transition to a circular economy;
- pollution prevention and control; or
- protection and restoration of biodiversity and ecosystems.

Outlook for 2024

In a challenging economic context, with a downward revision of the 2024 real GDP projected by the IMF at 1.5%, as well as with the March extraordinary legislative election – that can lead to relevant changes of the current Portuguese political landscape – the need of ensuring the successful implementation of the Recovery and Resilience Plan (RRP) until 2026 is expected to prevail and confirm the aimed continued stability and investor-friendly environment offered by Portugal during the last decade.

The fact of having an approved 2024 State Budget Law in a resigning government scenario, and even if a potential supplementary State Budget Law can be a reality, the path of introducing or even improving tax incentives (eg, "Start-ups" CIT reduced rate, tax incentive for the capitalisation of companies), are very good signs, both for national and foreign investors, that the Portuguese corporate taxation framework is still attractive.

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