Recent tax reforms attract investors to Portugal

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For several years Portugal faced difficulties in attracting foreign direct investment, partially due to the complexity of its legal and tax system, with direct impact on compliance costs and on the level of legal (un)certainty for foreign investors. In fact, government bureaucracy and taxation have been on top of the list of concerns reported by investors.

To counteract those inefficiencies, several measures have been put forward in the last few years with a very positive impact in the attractiveness of the Portuguese economy. Back in 2006, the Government launched a countrywide program appropriately designated "SIMPLEX" focusing "the whole Public Administration on the provision of a quick and effective response to the needs of both citizens and businesses". SIMPLEX was a milestone in the transition of Portuguese Public Administration to the electronic era, as since then most of the basic public services are available online and, in many cases, in both Portuguese and English language.

The Portuguese effort is proving to be effective and the recent financial crisis helped to point out the positive effect of the recent reforms: not only has the Portuguese economy been holding steady through the period of financial crisis, but the country has also been improving its rankings in terms of economic competitiveness. According to the Global Competitiveness Report 2014-2015 released last September 2, amongst 144 countries, Portugal is ranking 11th in availability of latest technologies, 8th in availability of scientists and engineers, 4th in quality of management schools, ultimately reaching the 36th position in the overall ranking – an astonishing increase from 51st in 2013.

Just recently, a series of tax reforms has been launched to foster tax competitiveness. This article gives you a general overview of the most relevant tax developments.

I. Corporate Income Tax Reform

As of January 1, 2014, Portugal enacted a major Corporate Income Tax reform, which placed the Portuguese tax system at an international level playing field, alongside the most relevant European countries. The goal of the CIT Reform was to reinstate Portugal's position in the European context, namely as a preferred gateway to Portuguese speaking and emerging countries. In order to achieve that goal, Portugal chose for chirurgical changes – safeguarding legal certainty and stability to the extent possible – such as a progressive reduction of the nominal CIT rate (expected to be of 19% to 17% in 2017), the broadening of the *participation exemption* regime to a worldwide basis, the extension of the carry-forward of tax losses for up to 12 years and the simplification of several compliance obligations.

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The most emblematic change refers to the new participation exemption regime, which grants a full exemption to dividends received in connection with, and capital gains derived from the sale of, participations representing at least 5 per cent. Of the subsidiary's share capital or voting rights, and held for a minimum period of two years. This regime applies to subsidiaries established worldwide, with certain limitations when it comes to entities established in blacklisted jurisdictions. The participation exemption is also applicable to foreign permanent establishments of Portuguese companies, safeguarding the possibility of a switch over from the exemption to the credit method. In this case, the new rules allow for an indirect foreign tax credit for income taxes borne by underlying subsidiaries. Notably, the participation exemption also applies to dividends paid abroad, both for European parent companies (along the lines of the Parent-Subsidiary Directive) and to parent companies established in third Countries that have double tax treaties in force with Portugal, which is not so common in continental Europe countries.

II. Non-habitual Tax Residents' Regime

Since 2010, Portugal is also looking for high-value individuals, by offering a special tax regime applicable to any person that transfers the tax residence to Portugal. Any individual may apply to this regime as long as such person was not resident for tax purposes in Portugal in any of the five years prior to the transfer of residence. With no additional requirements, the applicant is granted a full tax exemption on passive income sourced outside Portugal (such as pensions, interest, dividends and rents) even if the funds are transferred to, remitted to and/or used in Portugal. In addition to that, the applicant may benefit from a tax exemption or a reduced flat rate of 23.5 per cent. On active income (employment income or professional services' income) provided some requirements are complied with.

This regime is attracting several individuals, not only as a consequence of the tax benefits granted, but also due to the simplicity of the Portuguese personal income tax system. In fact, there are no specific limitations on the transfer of funds (no exchange controls), no minimum tax payable in Portugal, no wealth tax and even donations and inheritance may be tax free provided the beneficiaries are close relatives of the donor (spouses, children or parents)

III. Personal Income Tax Reform

Following to the Corporate Income Tax Reform in 2014, a Personal Income Tax Reform is expected for early 2015. Among other changes, the draft tax reform released this summer includes amendments addressing international / cross-border matters. On the one hand, there are some changes to the concept of "tax resident" and a new "split year residence" for individuals arriving or leaving Portugal throughout the calendar year. There is also a completely new set of rules regarding the taxation of fiduciary structures, such as trusts. This regime is quite innovative in Portugal (a civil law country that does not fully recognize trusts for legal and/or tax purposes), due to the fact that to date there are no provisions on the (non) recognition and taxation of trusts, settlors and beneficiaries.

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