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PRACTITIONERS' CORNER

Portugal's New Tax Rules for Investment Companies

by Paula Rosado Pereira

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Portugal has a new tax regime for undertakings for collective investment (UCI) and their investors. This tax reform, to enter into force July 1, will completely alter Portugal's model of taxing UCIs by adhering to the exit taxation method.

Decree-Law No. 7/2015 of January 13 introduced a new tax regime for Portuguese undertakings for collective investment (UCI), which enters into force July 1. The tax regime applicable to UCI investors is also subject to substantial changes, as noted below.

Framework of the Tax Reform

One of the main objectives of the reform of the UCI tax regime is to strengthen the fiscal competitiveness of Portuguese UCIs in international markets so that they are capable of attracting foreign and, ideally, domestic investors, retaining capital within Portugal.

The current tax treatment of UCIs is not competitive internationally and has had a negative effect on their ability to attract foreign investment. Some portions of the current regime have a negative effect on a UCI's performance indicators.

Also, the current regime creates economic double taxation of income paid by UCIs to nonresident investors, since UCIs are unable to obtain foreign tax credits. Therefore, despite the tax exemption applicable to nonresident investors on the payment of income by Portuguese UCIs, the regime is still not attractive.

The new UCI regime adopts the exit taxation method, following a major trend in investment vehicles' tax regimes in other European Union member states. As such, the main level of taxation of income switches from the UCI to the investors.

Under the new tax regime, the income obtained by UCIs is not, in principle, subject to withholding tax. Major categories of such income are completely excluded from tax, which strongly contributes to the tax competitiveness of the UCI. Therefore, in the new regime investors will predominantly be taxed on the income obtained at the UCI level.

The new regime is applicable to the following types of UCIs:

- securities investment funds (*fundos de investimento mobiliário*);
- real estate investment funds (*fundos de investimento imobiliário*);
- securities investment companies (*sociedades de investimento mobiliário*); and
- real estate investment companies (*sociedades de investimento imobiliário*).

The real estate urban rehabilitation investment fund, the forest real estate investment fund, and the real estate investment fund for rental purposes are not subject to major changes under the new tax regime.

Taxation Under the New Regime

The new tax regime applies to income obtained on or after July 1. UCIs must follow a comprehensive transitory regime to facilitate the move to the new tax regime.

Under the new regime, UCIs are taxed in accordance with the corporate income tax rules. A UCI's taxable profit is determined based on the net profit for the financial year.

Income obtained by UCIs is not subject to withholding tax, which is consistent with the broad exclusion

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from taxation from which UCIs benefit. In fact, the following income is not considered in computing the taxable profit of UCIs:

- investment income;
- capital gains; and
- rental income.

These types of income, however, are taxable if they originate in entities resident or domiciled in jurisdictions included on Portugal's blacklist set forth by Ministerial Order No. 292/2011.

Also not considered when computing the taxable profit of UCIs are the costs incurred in connection with income excluded from tax (investment income, capital gains, and rental income), as well as nondeductible expenses under the corporate income tax (CIT) code and income and expenses relative to management fees and other commissions earned by UCIs.

The UCI's taxable profit is subject to taxation at the general corporate income tax rate of 21 percent. UCIs are also subject to the autonomous tax rates set forth in article 88 of the CIT code.

On the other hand, UCIs are exempt from the municipal surcharge (*derrama municipal*) and state surcharge (*derrama estadual*), thus benefiting from another tax advantage.

Note that UCIs are subject to the CIT rules and may now benefit from the CIT's general regime for reporting tax losses, which allows those losses to be carried forward for up to 12 tax years.

Mergers, demergers, or subscriptions in kind between UCIs can benefit from the tax neutrality regime in the CIT code. This allows tax-efficient restructuring operations or the transfer of assets between investment vehicles.

UCIs are subject to ancillary obligations foreseen in the corporate income tax code; for example, UCIs must submit tax returns and maintain organized accounts.

Stamp Duty

The new tax regime creates a new tax liability for UCIs that are now subject to a specific stamp duty taxation that is levied on the UCI's global net asset value. UCIs that invest exclusively in monetary market instruments and deposits are subject to stamp duty at a rate of 0.0025 percent. Other UCIs, including real estate investment funds and companies, are subject at a rate of 0.0125 percent. The stamp duty is determined through self-assessment and is due quarterly.

Taxation of Investors

Generally, the tax treatment of income distributed by UCIs incorporated in Portugal and operating under Portuguese law or of income derived from the redemption or disposal of units or shares in these UCIs depends on the investor's residence and the type of UCI.

Resident Investors' Income

When an investor is an individual resident in Portugal for tax purposes, the income paid by UCIs and the income arising out of the redemption of units or shares is subject to withholding tax at the rate of 28 percent. This is a final withholding, which settles the investor's tax obligation, provided that the income in question is obtained outside the scope of a commercial, industrial, or agricultural activity.

Income earned by a corporate entity tax resident in Portugal is subject to withholding tax at a rate of 25 percent. This withholding tax is like a payment on account of the final tax due, except if investors benefit from a corporate income tax exemption that excludes investment income, in which case the withholding tax is final.

Nonresident Investors' Income

Investors nonresident in Portugal, both individuals and corporate entities, are exempt from personal income tax and corporate income tax, respectively, on income distributed by Portuguese UCIs and on capital gains resulting from the redemption of units or shares or from the winding up of investment funds or companies.

This tax exemption is applicable if the nonresident investors give evidence of such status and if they do not have a permanent establishment in Portuguese territory to which the income in question might be attributable.

Investors nonresident in Portugal who receive income distributed from units or shares in real estate investment UCIs or derived from their redemption are taxed at a rate of 10 percent.

Income derived from real estate investment UCIs, including capital gains resulting from their redemption or liquidation, is considered income from immovable property obtained in Portugal. This qualification is particularly relevant when one applies income tax treaties entered into between Portugal and other states, because, in principle, under an income tax treaty the right to tax immovable property income is attributed to the source state.

Nonresident investors cannot benefit from the above mentioned exemption or reduced rate regimes in the following cases:

- when they have not provided evidence of their nonresident status;
- when they are resident in a jurisdiction included in the Portuguese blacklist set forth by Ministerial Order No. 292/2011; or
- when they are entities directly or indirectly held in more than 25 percent of their share capital by entities or individuals that are resident in Portugal.

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In these cases, nonresident investors are subject to a final withholding tax of 25 percent (for corporate entities), 28 percent (for individuals), or 35 percent (for investors from blacklisted jurisdictions).

The proof of nonresidency must be provided to the paying agent up to the deadline for the delivery of the tax to the treasury (20th of the month following the payment of the income).

Nonresident investors that have not provided evidence of their nonresidency on time and that were, therefore, subject to higher taxation as residents may request the reimbursement of the excessive tax paid within a two-year period from the end of the year in which the taxable event occurred.

Conclusions

The new tax regime constitutes an important step in strengthening the fiscal competitiveness of the UCIs established and operating in Portugal. The adoption of the exit taxation method brings the tax rules applicable to Portuguese UCIs and their investors closer to those in force in most EU countries, enabling a better comparability of the performances of Portuguese and international UCIs.

This is expected to increase the potential of Portuguese UCIs to attract foreign investors, an objective also served through a favorable tax regime for nonresident investors, which are tax exempt on income obtained from the UCIs (except for income arising out of real estate investment UCIs, to which a 10 percent taxation is applicable).

The tax reform carried out at the level of UCIs and their investors has been generally well received by the investment sector. The major point of controversy is the new stamp duty liability over a UCI's global net asset value. ◆

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Richard Collier comments on the OECD's recent proposals on the dependent and independent agent provisions, which he notes will lead to a material lowering of the permanent establishment threshold.

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