FOCUS MATTERS.

ADVOGADOS

February 2014

Portuguese CIT Reform 2014

Recently enacted Law 2/ 2014 of 16 January 2014 introduces major changes to the Portuguese Corporate Income Tax (CIT) Code.

The reforms are designed to simplify and modernize the taxation of companies, to stimulate investment and and improve the competitiveness of the Portuguese tax system in the international context.

The reforms adopted essentially reflect the measures proposed in July 2013 by the Commission for CIT reform, with some changes resulting from agreement reached among the major political parties. These include the reduced rate of 17% for small and medium enterprises (SMEs), the introduction of a new tier of state tax applicable to profits exceeding €35,000,000 and the extension to two years of the holding period of relevant shares for the application of the exemption regimes for dividends and capital gains.

While maintaining the overall structure of the current tax system, the new Law introduces significant changes to most articles of the CIT Code – in which the reduction of the tax rate is just the most noteworthy. The CIT reform brings in innovative solutions, similar to those prevailing in the most competitive tax systems within Europe, including the introduction of a participation exemption regime applicable to dividends and capital gains on qualifying holdings, a universal exemption on the outbound dividends from qualifying participations and a special tax regime for income from industrial property (patent box).

The changes apply to taxable periods beginning on or after 01 January 2014 and, also, to taxable events occurring after that date.

Tax rate

In a very welcome move, accepting the proposal of the Commission for CIT reform, the general corporate tax rate for 2014 has been reduced to 23%.

A new 17% rate will apply to the first €15,000 of taxable income for taxpayers qualifying as SMEs as provided by EU Commission Recommendation 2003/361/EC. The general rate will apply to profits in excess of €15,000.

State Surtax ("*Derrama estadual*")

A new tax bracket has been introduced for taxable profits in excess of € 35,000,000, and additional tax at a rate of 7% will be imposed on such profits.

Participation exemption for dividends and capital gains

From 01 January 2014, profits and reserves distributed to Portuguese domiciled companies by their subsidiaries and the capital gains and losses arising from the sale of shareholdings in such subsidiaries will be excluded from the former's taxable base (not

contributing to its taxable profits and losses), provided that:

- the Portuguese company holds at least 5% of the share capital or voting rights of the subsidiary;
- the shareholding has been held for the 24 months prior to the distribution or transfer of the shares (or is maintained for that period, in the case of distribution of profits);
- the company distributing dividends or reserves is subject to and not exempt from (i) Portuguese CIT or (ii) similar tax referred to in the Parent-Subsidiary Directive or (iii) similar tax provided that the applicable rate is not lower than 60% of the Portuguese standard CIT rate, unless:
  - at least 75% of the profits derive from an agricultural, industrial or commercial activity, or from the rendering of services, which are not predominantly targeted to the Portuguese market;
  - the activity of the non-resident entity does not generate passive income;
  - the entity distributing the profits or the reserves or in which a shareholding is sold does not have residence and is not domiciled in a jurisdiction with a more favorable tax regime.
- The company distributing the dividends or reserves or whose capital is subject to sale is not domiciled in countries or territories subject to a tax regime clearly more favorable ("tax havens")
- The profits or reserves do not qualify as deductible costs in the distributing entity.

Under the same universal principle of double taxation relief, companies with a registered office or effective center of management in Portugal may now exclude from their taxable base earnings and losses attributable to permanent establishments located outside Portugal, provided that the following conditions are met:

- the permanent establishment is subject and not exempt from a rate of tax not less than 60% of the corporate income tax rate in the state of its location;
- the permanent establishment is not located in a tax haven.

Where companies opt to use this regime, the option is required to be maintained for a minimum period of three years.

Taxation of outbound reserves and dividends

Outbound dividends distributed by Portuguese domiciled companies as from 01 January 2014 will benefit from a CIT withholding tax exemption, providing that the company receiving the dividends:

- is resident in a Member State of the EU or European Economic Area (EEA) or a country with which Portugal has concluded a Double Tax Treaty which includes provision for administrative cooperation in the field of taxation similar to that existing in the EU;
- is subject and not exempt from a tax mentioned in the EU Parent-Subsidiary Directive, or a tax that is similar to CIT tax, in other cases, provided that the applicable tax rate is not less than 60% (13,8%) of the corporate income tax rate;
- has held, directly or indirectly, for a 24 month period prior to the distribution, a participation of at least 5% of the share capital or voting rights of the company.

Loss carry-forward period

The period which tax losses may be carried forward is extended from 5 to 12 years (only for losses arising from 01 January 2014).

Tax losses carried forward may be deducted against up to 70% of the taxable profits (currently deduction is allowed against 75% of taxable profits).

Deductibility of net financial costs

The threshold for deducting net financial costs is reduced from € 3,000,000 to € 1,000,000, even though the alternative limit of 30% of the EBITDA remains unchanged.
In the case of group taxation, the representative company may opt to apply this limitation on the basis of the group's net financial expenses.

Special taxation regime for income from IP rights (patent box)

Income arising from the sale or temporary use of patents and industrial designs will be 50% exempt, provided that:

- the industrial property rights have resulted from research and development activities conducted or contracted by the taxpayer;
- the assignee uses the industrial property rights in the pursuit of an activity of a commercial, industrial or agricultural nature;
- the transferee of the rights does not use them for the delivery of goods or services that create tax deductible expenses in the transferor company or in a company with which the transferor is grouped, whenever a special relationship is deemed to exist;
- the assignee is not resident in a tax haven.

This regime applies to patents and industrial designs registered on or after 01 January 2014.

Tax "amortisation and depreciation" of intangible assets

Intangible assets without a fixed lifecycle may now be depreciated over a 20 year period (5% per year) counting from the initial record of the asset in the company's books. This regime applies to the following intangible assets:

- industrial property such as trademarks, licenses, production processes, models and other similar rights acquired for consideration and without a fixed lifecycle;
- goodwill arising from business restructuring transactions (but excluding goodwill arising from share transactions).

The regime applies to intangible assets acquired on or after 01 January 2014.

Group taxation regime

The relevant percentage direct or indirect shareholding necessary for the special tax regime for company groups to apply is reduced from 90% to 75%.
Companies indirectly held, through an EU or EEA resident company, are now eligible for the regime.

Exit tax: Transfer of residence

Tax liability resulting from the transfer of residence of a Portuguese resident company can now be deferred where the transfer is made to an EU or EEA member state, provided that certain conditions are met.

Tax neutrality regime applicable to corporate restructurings

The scope of transactions that may qualify under the tax neutrality regime has been substantially extended to include the following:

- mergers in which the totality of the share capital of the companies involved is already owned by the same person;
- reverse-mergers where all the share capital of the companies is wholly held by the same person;
- spin-off transactions where at least one branch of activity is split and integrated into the company that holds the whole of the share capital of the divided company;
- spin-off transactions where at least one branch of activity is split and integrated

in another company, where the whole of the share capital of both companies is held by the same shareholder;
- spin-off transactions where at least one branch of activity is split and integrated in another company, where the whole of the share capital of the beneficiary company is held by the divided company.

Simplified tax regime

Companies having gross annual income (turnover) during the previous tax year not exceeding € 200,000 may elect to be taxed under a simplified taxation regime, if the following requirements are met:

- the total balance sheet for the immediately preceding tax period does not exceed € 500,000;
- the entity is not legally subject to statutory audit ;
- No more than 20% of its share capital is held, directly or indirectly, by entities that do not meet the above conditions relating to turnover, balance sheet and statutory audit;
- the entity adopts the standard accounting system for micro-entities;
- the entity has not waived the application of the regime in the previous three years.

Under the simplified regime the taxable profit is determined by applying the following coefficients:

- 4% of the income from sales of goods and services rendered by hotels, restaurants and similar activities;
- 75% of income derived from the performance of professional activities;
- 10% of income derived from other operating services and subsidies;
- 30% of income derived from non-operating subsidies;
- 95% of income derived from the assignment or temporary use of industrial property or the provision of know-how;
- 100% of the acquisition value of net worth increases obtained free of charge.

Eligible entities which choose to apply the regime do not have to comply with the obligation to make special payments on account and the tax regime for deductible expenses.

Liquidation of companies

Liquidation proceeds are considered capital gains or capital losses (instead of investment income). These capital gains may be eligible for the participation exemption regime.

Simplification of tax obligations

A set of simplification rules relating to ancillary obligations has been introduced.
For its practical relevance and impact, it is worth noting that, in order to apply the withholding tax exemption or reimbursement of tax withheld under a Double Tax Treaty, the non-resident entity receiving the outbound payments may now submit the official form (Form 21-RFI) without certification as long as this form is attached to a certificate of tax residence issued by the competent tax authorities of its residence State.

CONTACTS

www.srslegal.pt

_LISBON
R. Dom Francisco Manuel de Melo, n.º 21
1070-085 Lisbon
T. +351 21 313 2000
F. +351 21 313 2001

_FUNCHAL
Av. Zarco, n.º 2, 2.º
9000-069 Funchal
T. +351 291 20 2260
F. +351 291 20 2261

_OPORTO (*)
R. Tenente Valadim, n.º 215
4100-479 Oporto
T. +351 22 543 2610
F. +351 22 543 2611

1_

2_

3_

4_

5_

1_PAULA ROSADO PEREIRA
PARTNER
T. +35121 313 2088
paula.pereira@srslegal.pt

2_ JOSÉ PEDROSO DE MELO
MANAGING ASSOCIATE
T. +35121313 2040
jose.melo@srslegal.pt

3_ MARIA DA GRAÇA MARTINS
SENIOR ASSOCIATE
T. +35121 313 2019
graca.martins@srslegal.pt

4_ MAGDA FELICIANO
SENIOR ASSOCIATE
T. +35121 313 2066
magda.feliciano@srslegal.pt

5_ JOÃO MARICOTO MONTEIRO
OF COUNSEL
T. +35121 313 2000
joao.monteiro@srslegal.pt

The Curriculum of the contacts may be consulted at www.srslegal.pt

Sociedade
Rebelo de Sousa
& Advogados
Associados, RL

In Association with_
(*) ALC & Associados
_ANGOLA
_BRAZIL
_MOZAMBIQUE