dateline Portugal

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PERSONAL INCOME TAX REFORM: UPDATE ON THE NEW RESIDENCE RULES

2014 proved to be a year like no other for highly awaited Portuguese tax reform. It got off to a good start with corporate income tax reform, designed to increase competitiveness and the internationalization of companies incorporated in Portugal. Other legal changes quickly followed: enactment of environmental tax legislation, personal income tax (PIT) reform, and changes to the Tax Investment Code. The main changes to the Tax Investment Code aim to promote and reinforce competitiveness and investment. These include a corporate tax credit of up to 25% on certain capital expenditure. Start-ups may even be exempt from corporate income tax for the first three years of business if they make certain capital expenditure. In addition, the property tax exemption or reduction period has been extended to ten years while investment in less favored areas is entitled to an increase of up to 10% in tax benefits, such as a corporate income tax credit and property and stamp tax exemptions. [1]

The PIT reform is intended to simplify the tax code and promote social and geographical mobility. It deemed itself family oriented, which had a direct impact on the new residence rules established therein.

The criteria for determining resident status for tax purposes in Portugal were amended. The first criterion is still that an individual must remain in the country for more than 183 days, consecutive or otherwise, but a requirement was added that the days must be in a 12-month period beginning or ending in the relevant tax year.

The second alternative criterion is that an individual who has remained in Portugal for a shorter period will also be considered resident if he maintains an accommodation under conditions that indicate his intention to occupy and keep it as a habitual abode in Portuguese territory on any day of the 12-month period beginning or ending in the relevant tax year. Prior to the reform, this criterion was met only if the individual had an accommodation on December 31 of the relevant year.

The new law also clarifies how days of presence are calculated for purposes of qualifying as a tax resident. Thus, a day of presence is considered any given day, complete or otherwise, that includes an overnight stay in Portuguese territory.

Further, individuals who qualify are considered residents in Portugal from the moment of their entry into Portuguese territory, allowing for partial residence during the first year (e.g., to address situations where an individual moves to a different country in the middle of the calendar year). This provides good tax planning opportunities. This rule does not apply when an individual has ceased to be resident in Portugal in the previous year and becomes a resident again in the following year. In these situations, the individual will be considered resident

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1 See "Portugal 2015 Budget, Green Taxation Reform, Investment Tax Benefits," *PwC In & Out*, 26 JOIT 24 (January 2015).

during the entire year and not just when he enters Portuguese territory.

On the other hand, the loss of resident status comes into effect on the last day of presence in Portuguese territory unless two conditions occur: (1) in the year of leaving, the individual remained in Portugal for more than 183 days, consecutive or otherwise; and (2) after leaving, he received income during that year that would have been taxable in Portugal had he not left the country. This rule is not applied if the income is taxed in another EU member state or European Economic Area country with a fiscal cooperation and exchange-of-information agreement, or taxed in a state where the applicable rate is no less than 60% of the applicable PIT rate if the individual had maintained his residence in Portuguese territory.

Portuguese citizens who have relocated their residence to a tax haven are taxed as if residing in Portugal for five years, but this rule ceases to apply when these individuals become tax residents in a state that is not a blacklisted tax haven. The rule under which all members of a family unit follow the resident status of the household head was eliminated.

The reform also introduced individual-based taxation, although spouses living together may opt for joint taxation as a family unit. Previously, compulsory joint taxation for spouses and life partners was the general rule, but this proved inadequate and did not address current family dynamics and the position of cross-border workers.

The new rules are expected to clarify what were otherwise controversial subjects, bridging the gap between the understanding of the tax authorities and taxpayers. Only time will tell if the new regime accomplishes what it set out to do, keeping up with an increasingly globalized economy. ●

Branch Rule

Continued from page 33) tax base (Step 3). The hypothetical ERT equals the hypothetical tax in the CFC's country of incorporation or the manufacturing jurisdiction (Step 4) divided by the hypothetical tax base (Step 3).

Footnote 18 of the AM says: "If the hypothetical tax base is subject to a single statutory rate, the [hypothetical ERT] will equal the statutory rate. If, however, the hypothetical tax base is subject to graduated tax rates, the [hypothetical ERT] will be a weighted average of the applicable tax rates."

Although the AM speaks only to "statutory" and "graduated' tax rates in computing the hypothetical ERT, tax ruling or tax incentive rates that would apply under the taxpayer's actual facts should also be considered, as indicated above regarding Step 4. This reflects the interplay between Step 4 and Step 5. In Step 4, the hypothetical tax equals the product of the hypothetical tax base and the applicable statutory rate(s). In Step 5, the hypothetical ERT is calculated by dividing the product of the hypothetical tax base and the applicable statutory rate(s) by the hypothetical tax base, essentially reversing Step 4. If Steps 4 and 5 are performed without adjusting for other tax attributes (such as graduated rates and tax credits), or special incentive tax rates discussed above, the hypothetical ERT in the CFC's country of incorporation or the manufacturing jurisdiction will simply equal that jurisdiction's applicable statutory rate.

Under the facts of the AM, the actual ERT is 5.27%, and the hypothetical ERT is 20%. See Exhibit 3. The actual ERT is less than 90% of, and at least five percentage points lower than, the hypothetical ERT, so there is tax rate disparity with respect to the Product X commission income earned through DE.

EXHIBIT 3
Actual and Hypothetical ERT Calculations

Actual tax paid in the sales jurisdiction (Step 2)	€4x = 5.71% actual ERT
Hypothetical tax base (Step 3)	€70x
Hypothetical tax in the CFC's country of incorporation or the manufacturing jurisdiction (Step 4)	€14x = 20% Hypothetical ERT
Hypothetical tax base (Step 3)	€70x

The methodology in the AM assures that the hypothetical ERT equals the applicable statutory rate in the CFC's country or incorporation or the manufacturing jurisdiction (subject to the impact of graduated rates and tax credits), while the actual ERT incorporates the various tax preferences available in the sales jurisdiction. Both Country A and Country B impose 20% tax rates on net sales income, but the 50% exclusion that Country A allows reduces the actual ERT by more than ten percentage points and thereby creates tax rate disparity with Country B.

Observations—Step 5. The AM provides detailed guidance only on the application of the tax rate disparity test. That tax rate disparity is found does not result in FBCSI in all cases. Once tax rate disparity is found, a separate set of special rules must be applied to determine whether the branch, or the remainder of the CFC, has FBCSI under the branch

6 In addition, neither the Regulations nor the AM specifies whether the "entire" income includes or excludes the income of sales or manufacturing branches located in other countries. In any case, inclusion of other income of the CFC (whether only the hypothetical jurisdiction income or all of the income of the CFC) could potentially dilute the impact of deductions and other reductions that are not specifically allocable against the TRD gross income under the laws of the hypothetical jurisdiction for purposes of determining the hypothetical tax determined in Step 4. This could affect the determination of tax rate disparity.

7 See Reg. 1.954-3(b)(2)(ii).