

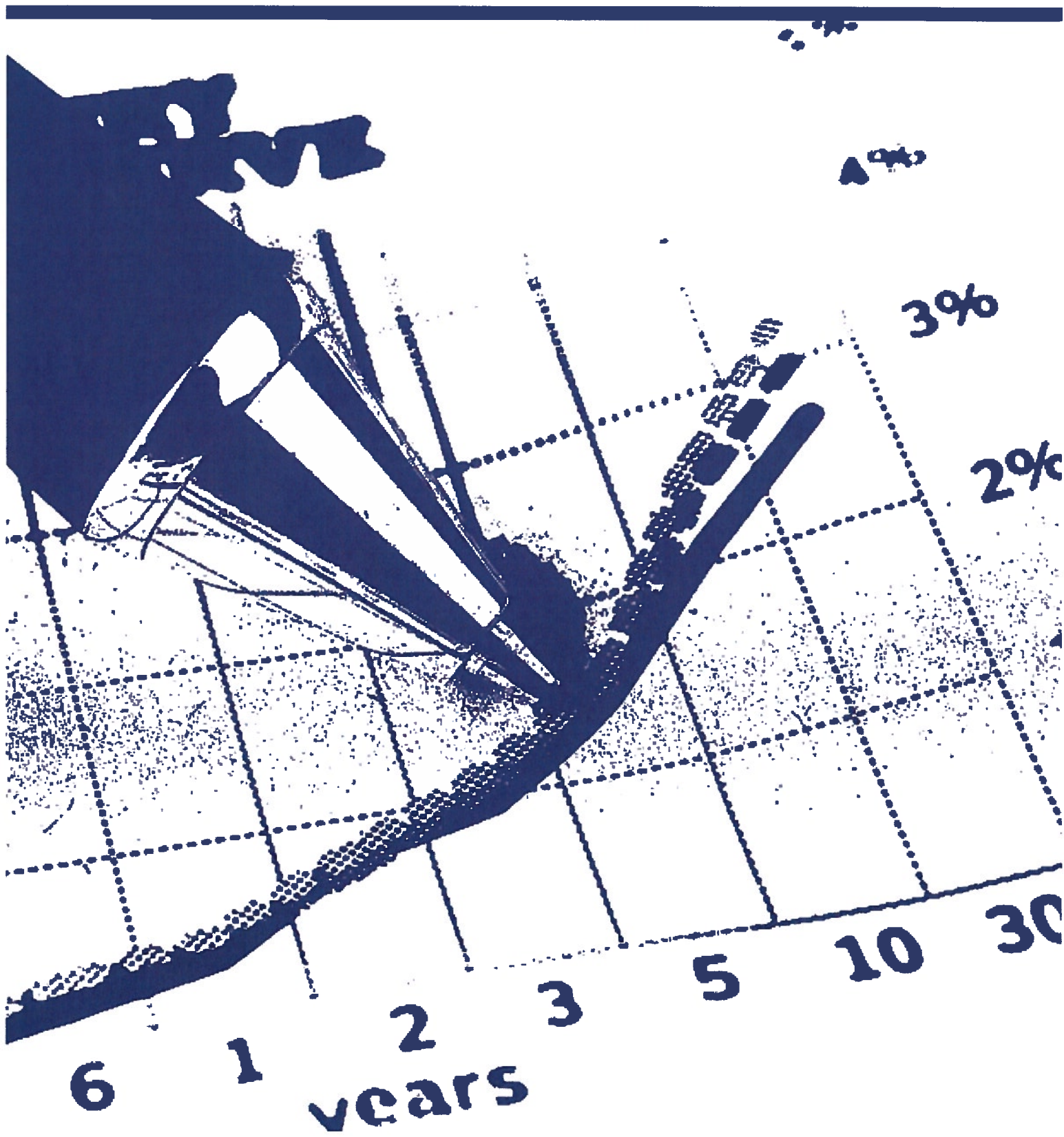


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The Portuguese State Budget for 2016

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Ordinarily, the Portuguese Annual State Budget (the 'State Budget') is published by the end of December, to enter into force on 1 January the following year. This year, however, there was some delay due to general elections, and so the State Budget only entered into force on 31 March 2016.

As is usual, the State Budget introduces immediate adjustments, while also paving the way through legislative authorisations for further amendments. These are now expected to occur later during the year.

The State Budget has been criticised for its strategy, which aims to increase uncertain tax revenues (ie, excise duties, motor vehicle taxes and stamp duty), rather than reducing public spending. This has added to doubts about its impact on the mandatory public debt reduction effort and compliance with European Union budgetary rules.

This article focuses on the amendments to the Portuguese tax system, notably the Portuguese Corporate Income Tax Code, introduced in the State Budget in the areas of corporate income tax and stamp duty, which may be relevant from an international business perspective. The article also considers a specific anti-avoidance rule that has recently been introduced to the law, in connection with the participation exemption regime for dividends.

Corporate income tax

Inbound dividends

For the inbound dividends exemption (ie, dividends received by a Portuguese parent company), the State Budget reduces the minimum holding period required for the shareholding from 24 months to one year. On the other hand, the State Budget increases the minimum percentage in capital or voting rights required to qualify for the exemption from the minimum of five per cent to ten per cent.

The new ten per cent minimum shareholding (in shares or voting rights)

criterion is effective from the entry into force of the State Budget and also applies to existing shareholdings. Accordingly, the new minimum shareholding period will be counted from the date of acquisition of the ten per cent in shares or voting rights, which may pre-date the enabling legislation.

Outbound dividends

The aforementioned amendments to the requirements for the participation exemption on inbound dividends are also applicable to outbound dividends (ie, dividends distributed by a Portuguese company to its shareholder abroad). Therefore, from the enactment of the State Budget, the minimum holding period to benefit from the withholding tax exemption on dividends distribution is also one year, subject to a minimum participation of ten per cent in shares or voting rights of the Portuguese entity.

Capital gains

One of the main features of the 2014 corporate income tax reform was the introduction of a participation exemption regime for capital gains on the sale of shares. The original rules provided for an exemption for a minimum five per cent participation held for at least two years. The State Budget also amends this participation exemption, consistent with the dividend participation amendments, now requiring a ten per cent participation with a minimum one year holding period.

Specific anti-abuse rule for dividends

This is another amendment to the Portuguese Corporate Income Tax Code that was introduced in February 2016. It is noteworthy because it is related to the participation exemption regime for dividends, derived from the implementation of EU Council Directive 2015/121/EU (27 January 2015) on the common system of taxation applicable to parent companies and subsidiaries of different EU Member States.

The amendment marks the introduction of a specific anti-abuse rule applicable to the following regimes set on the Portuguese Corporate Income Tax Code: i) withholding tax exemption regime on payment of dividends distributed by a Portuguese subsidiary to its non-resident parent company; and ii) participation exemption on the distribution of dividends.

The new anti-avoidance rule prevents application of the exemption regime for dividends to non-genuine arrangements set with the main purpose, or one of the main purposes, of obtaining a tax advantage contrary to the purpose of eliminating double taxation on the income or dividends mentioned above. The law defines 'non-genuine arrangements' as 'arrangements that are not carried out for valid economic reasons or that do not reflect economic substance'.

Country-by-country reporting

Following the current international trend, country-by-country reporting – as set by the final version of the Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting Action Plan – has been introduced by the State Budget in the Portuguese Corporate Income Tax Code as a new annual compliance procedure.

Therefore, given the clear intent of enhancing the tracking of profit allocation and economic substance of multinational groups, entities belonging to a multinational group will have to file a return for each tax period with relevant financial and tax information divided by the country or jurisdiction in which it operates. In particular, the country-by-country report will contain an overview of aggregate information per country regarding revenues, profits (or losses) before tax, income tax paid, tangible assets and number of employees.

This filing obligation will be applicable to entities that: i) own or control, directly or indirectly, one or more entities in different

countries; ii) derive business income equal or over €750m in the previous year; and iii) are not controlled by any entities resident in Portugal that are obliged to file this new country-by-country tax return. The filing deadline will be 12 months after the end of the financial reporting year. The form of the new tax return has not yet been released by the government.

Stamp duty

Operations involving credit institutions

The current stamp duty exemption on transactions performed between credit institutions is clarified as applicable only to bank guarantees and financial operations with the purpose of granting credit, and only if such transactions are carried out by a financial institution within the ordinary course of its activity.

This amendment may give rise to litigation, given its retroactive application, as it is set out in the State Budget that the amendment is made for clarification purposes, impacting operations not connected with the granting of credit made within the statute of limitation period (four years) for the tax authorities to make additional tax assessments.

Shareholder loan agreements

The stamp duty exemption on shareholder loan agreements (*suprimentos*) will now only be applicable in cases where they are entered into by shareholders with a stake of at least ten per cent held for at least one year, reflecting the same criteria proposed for the participation exemption regime for outbound and inbound dividends and, therefore, harmonising these conditions of eligibility.

The proposed amendment is expected to have a relevant impact on financing operations and will presumably result in companies opting to obtain more financing through equity, rather than through debt.