Portugal

Recovery of corporate investment in Portugal

Paulo Núncio and João Miguel Fernandes of Morais Leitão consider whether Portugal's extraordinary tax credit will boost corporate investment in Portugal.

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MORAIS LEITÃO

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CFEI II applies to business investments until June 30 2021

The whole world plummeted into an unexpected pandemic crisis in 2020. For the purpose of relaunching Portugal's economy and mitigating the negative effects of COVID-19, EU member states are putting in place the final approval procedures for a recovery plan which is expected to amount to a total investment of approximately €1.8 trillion (approximately $2.1 trillion) to help rebuild Europe in a post-COVID-19 environment.

In its turn, the Portuguese government has approved a supplementary state budget for 2020 aimed at not only adapting the state budget under implementation in relation to COVID-19 but also to approve further tax measures.

As a result, the Extraordinary Tax Credit for Investment II (CFEI II), a temporary tax incentive, was approved and applies to business investments until June 30 2021.

CFEI II

The purpose of CFEI II is to mitigate the shelving of envisaged investments and incentivise companies to invest. The super-credit tax regime (CFEI I) was successfully implemented in 2013 and contributed positively to the economic recovery of Portugal in the following years.

This tax incentive consists of a corporate income tax (CIT) credit for 20% of the investment made in assets allocated to the company's activity, up to 70% of CIT collection, provided that the overall amount of eligible expenses does not exceed €5 million. This credit may be deductible against the CIT collection for an additional period of five years in certain circumstances.

As a rule, any companies liable to CIT that develop a commercial, industrial, or agricultural activity are eligible to benefit from this tax incentive.

For the purposes of this regime, eligible investments are the ones made on fixed tangible assets and biological assets other than consumables, newly acquired and put into use until the end of 2021. Also, eligible investments are the ones made on some intangible assets subject to depreciation (namely patents, trademarks, licenses, or other assimilated rights).

Eligible investments must be held for a minimum period of five years. In addition, the transfer of any eligible investments under the scope of a restructuring transaction benefiting from tax neutrality must be approved by the Minister of Finance.

Deductions shall be grounded in documents that must include in detail the relevant investment, amount, and other relevant data. In a scenario of non-compliance with the rules on the eligibility of the investments, the taxpayer must refund the missing amount of tax, accrued with compensatory interest increased by 15%.

This regime has a broad nature that should contribute to its successful implementation among potential investors, stimulating the recovery of corporate investment in Portugal.

However, as result of the 2021 state budget, since January 1 2021 large companies can only benefit from CFEI II if the average number of employees remains the same before and during the application of this incentive.

This restriction raises several legal issues and may have a negative impact on the successful application of this tax incentive, considering that it changes the eligibility rules for CFEI II during its application period and represents a red flag to tax certainty for potential investors.

There are strong arguments to sustain that this limitation should not apply to large companies that were eligible for the CFEI II in 2020 even in a scenario where the relevant investments are only made in 2021.

In addition, the application of this restriction to large companies can be challenged on the grounds of a potential violation of the Portuguese constitution, namely the breach of the constitutional principles of proportionality and equality.

Finally, considering that a consistent economy recovery must be based on a substantial business investment increase, it would be advisable to extend this tax incentive from June 30 until, at least, the end of the current financial year, in order to cover all corporate investments made in Portugal in 2021.

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