Brief Outlines On The Portuguese Corporate Income Tax Reform And Other Investor-Friendly Tax Measures Recently Enacted

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In this article the Authors will bring to the readers' attention the major amendments brought about by the corporate income tax reform that took place in Portugal and some new measures introduced by the Budget Bill for 2014.

After a lively discussion among the tax community in the second half of 2013, the Government has put in place for the taxable year of 2014 onwards a corporate income tax reform with the purpose, among others, of promoting international investment and simplifying red tape. The original draft of this reform was very audacious, aiming at competing with other major European tax jurisdictions to attract foreign investment; however the version finally approved by the Parliament was far more unpretentious. In any case this reform has the merit of having been agreed by the major political parties and therefore it is foreseeable that it will be maintained stable for the years to come.

In a nutshell the main topics of the corporate income tax reform are:

(1) **Reduction of the nominal corporate income tax rate** from 25 percent to 23 percent in 2014 (and a subsequent evaluation to determine if it is feasible to decrease to 21 percent in 2015 and in a range between 17 percent and 19 percent in 2016).

(2) Introduction of a reduced rate of 17 percent for the first EUR15,000 slice of taxable income for small and medium sized companies (if *de minimis* EU criteria are complied with).

(3) Institution of an optional simplified tax scheme for small companies (being considered as such those with a gross annual income not exceeding EUR200,000 and total net assets not exceeding EUR500,000).

(4) **Extension of the tax losses carry forward period to 15 years** (formerly 5 years) and subject to a relaxed annual limit of the taxable income – currently 70 percent (formerly 75 percent).

(5) Introduction of a five-year carry-forward period for using the credit for international double taxation (formerly no carry-forward was available).

(6) **Exemption of foreign-sourced income from permanent establishments** of resident

companies (for at least three years and for all permanent establishments in the same jurisdiction).

(7) Simplification of the certification process to benefit from reduced rates of withholding tax regarding entities resident in a country with which Portugal has entered into a Double Tax Convention.

(8) Reduction of the shareholding required to form a tax group to 75 percent (formerly 90 percent) and relaxation of the non-qualifying entities criteria.

(9) Widen the scope of group restructuring transactions that may be performed on a tax-neutral basis, clarifying the application of this regime to several restructuring operations (*e.g.* reverse mergers).

(10) Enlargement of the tax transparency regime to include a greater number of professional services companies.

(11) **Participation exemption for foreign dividends** (EU and non-EU) received from qualifying shareholding (at least 5 percent) held uninterruptedly for at least two years.

(12) **Withholding tax exemption for dividends paid to nonresident shareholders** (EU and non-EU), with shareholdings of at least 5 percent held uninterruptedly for at least two years.

(13) **Participation exemption for capital gains derived from the sale of shares**. The shares sold have to represent at least 5 percent of the share capital or voting rights of the subsidiary and held uninterruptedly for at least two years. Capital losses meeting the same conditions are not deductible. Capital gains derived by nonresidents remain exempt regardless of the holding period and percentage held.

(14) **Introduction of a "patent box" regime for certain intangible property (IP) income**: only 50 percent of eligible income will be subject to tax with a full deduction for related expenses (if certain requirements are complied with).

(15) Relaxation of the definition of associated enterprises for transfer pricing purposes by increasing the shareholding threshold to 20 percent (formerly 10 percent).

(16) Relaxation of the threshold (income higher than EUR5m while previous was EUR3m) used to require the fulfillment of transfer pricing documentation.

On January 1, 2014 also entered into force the Portuguese **Budget Bill for 2014** where a range of business tax friendly changes can also be found. Among those, the most relevant are:

(a) enlargement of the threshold to EUR200,000 (formerly EUR150,000) under which individual taxpayers earning business income may benefit from a simplified tax scheme for personal income tax purposes;

(b) maintenance of the International Business Center of Madeira regime (corporate income tax rate of 5 percent) for entities licensed until June 30th, 2014, and the regime is preserved until the end of 2020 (subject to

the foreseeable approval of the European Commission);

(c) introduction of a partial allowance for corporate equity scheme for small and medium sized companies whereby up to 10 percent of the non-distributed profits are deductible to the company's tax base, provided the non-distributed profits are reinvested in certain assets.