Tax on Inbound Investment

Contributing editors
Peter Maher and Lew Steinberg

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GETTING THE DEAL THROUGH

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Peter Maher and Lew Steinberg

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Acquisitions (from the buyer's perspective)

1 Tax treatment of different acquisitions

What are the differences in tax treatment between an acquisition of stock in a company and the acquisition of business assets and liabilities?

The acquisition of stock in a company in principle has no tax impact on the buyer. The only exception is in the acquisition of 75 per cent or more shareholdings in limited liability companies with the capital divided in quotas and general or limited partnerships that own real estate. In this case it is considered that the transaction is assimilated to a direct acquisition of the real estate that is subject to real estate transfer tax. The tax rate of real estate transfer tax is: 6.5 per cent rate for urban property, 5 per cent for rural land and 10 per cent if the acquirer is a company resident in a blacklisted jurisdiction. This tax is not due in the acquisition of stock in limited liability companies with the capital divided in shares. It is possible to convert a limited liability company with the capital divided in quotas into a limited liability company with the capital divided in shares before the acquisition of 75 per cent or more shareholdings to avoid this tax in case the company has immoveable property. Portuguese tax law has a General Anti-Avoidance Rule (GAAR). As far as we are aware, the Portuguese tax authorities have never applied the GAAR in this situation (conversion of a limited liability company with the capital divided in quotas into a limited liability company with the capital divided before the acquisition of the shareholding).

The acquisition of business assets and liabilities may be made through an acquisition of distinct assets and liabilities or through a transfer of business as a going concern if the assets and liabilities acquired qualify as an enterprise or a business (ie, if the assets and liabilities have enough autonomy to generate profit on their own).

The acquisition of distinct assets and liabilities is generally subject to VAT. The current standard VAT rate is 23 per cent.

The acquisition of a business through a transfer of business as a going concern is not subject to VAT, but may be subject to stamp duty at the rate of 5 per cent. There is a certain degree of uncertainty in the tax treatment of this deal. We know that there is an internal opinion from the tax authorities defending that a transfer of business as a going concern is only subject to stamp duty if, together with the business, a lease of immoveable property is also transferred to the buyer. Accordingly, some authors and practitioners maintain that if there is no lease agreement of immoveable property associated with the acquisition of the business, no stamp duty shall be paid. There is also some degree of uncertainty in relation to the tax base of the stamp duty. While some maintain that the tax base is the goodwill acquired as shown in the accounts of the buyer, others consider that the tax base is the price paid.

In case one of the assets is immoveable property, in principle no VAT is due as the acquisition of immoveable property may be VAT exempted, but real estate transfer tax at the abovementioned rates is due. The tax base for the real estate transfer tax is the higher of either the property tax value as shown in the tax certificate of the property and the agreed price. In the acquisition of immoveable property, stamp duty is also due at the rate of 0.8 per cent on the higher of either the property tax value as shown in the tax certificate of the property and the agreed price.

2 Step-up in basis

In what circumstances does a purchaser get a step-up in basis in the business assets of the target company? Can goodwill and other intangibles be depreciated for tax purposes in the event of the purchase of those assets, and the purchase of stock in a company owning those assets?

In principle, it is not possible to have a step-up in the business assets of the target company. In exceptional cases the law may allow for revaluations relevant for tax purposes.

Goodwill acquired in a concentration of activities and other intangibles may be depreciated for tax purposes in a 20-year period, provided such goodwill and intangibles are recognised in the company's accounts.

In the event of a purchase of stock in a company, goodwill depreciation is not allowed for tax purposes.

3 Domicile of acquisition company

Is it preferable for an acquisition to be executed by an acquisition company established in or out of your jurisdiction?

Provided the acquisition company is not located in a blacklisted tax jurisdiction (in which case it is not recommended because it is generally not tax efficient), it should not matter whether the holding company is in Portugal or abroad as Portugal has a competitive participation exemption regime for dividends and capital gains.

4 Company mergers and share exchanges

Are company mergers or share exchanges common forms of acquisition?

Company mergers and share exchanges are both common operations and are used either to acquire target companies or to perform intragroup reorganisations (the latter operations are most common).

The Portuguese Corporate Income Tax Code foresees a tax neutrality regime (deriving from the transposition of the EU Tax Merger Directive to domestic law) for both operations. The special tax neutrality regime may be applied to these operations provided that they are executed between companies resident in Portugal and companies resident in another EU member state.

5 Tax benefits in issuing stock

Is there a tax benefit to the acquirer in issuing stock as consideration rather than cash?

There is no tax benefit to the acquirer in issuing stock as consideration rather than cash.

6 Transaction taxes

Are documentary taxes payable on the acquisition of stock or business assets and, if so, what are the rates and who is accountable? Are any other transaction taxes payable?

Please see question 1.

7 Net operating losses, other tax attributes and insolvency proceedings

Are net operating losses, tax credits or other types of deferred tax asset subject to any limitations after a change of control of the target or in any other circumstances? If not, are there techniques for preserving them? Are acquisitions or reorganisations of bankrupt or insolvent companies subject to any special rules or tax regimes?

The right to carry-forward the tax losses is lost in cases where there is a change of control of the target. Notwithstanding, the Ministry of Finance may authorise the preservation of existing tax losses if the taxpayer presents a writ to the tax authorities and demonstrates the economic interest of the operation. Such writ has to be presented within 30 days after the change of control has occurred.

The tax-neutral regime applicable to corporate reorganisations allows for the maintenance of: the net operating losses generated in previous tax years, tax benefits and net financial costs thresholds yet to be deducted to be transferred to the acquiring company, provided certain conditions are met.

In relation to bankrupt or insolvent companies there are the following tax benefits:

- exemption of corporate income tax on the capital gains made by the insolvent in some circumstances;
- exemption of corporate income tax on increases in equity due to debt forgiveness;
- exemption of stamp duty on the extension of the maturity of loans;
- exemption of stamp duty on financial operations and on transfer of businesses as a going concern;
- exemption of stamp duty on the issuance of letters of credit; and
- exemption of real estate transfer tax on the acquisition of immoveable property in certain circumstances.

8 Interest relief

Does an acquisition company get interest relief for borrowings to acquire the target? Are there restrictions on deductibility where the lender is foreign, a related party, or both? Can withholding taxes on interest payments be easily avoided? Is debt pushdown easily achieved? In particular, are there capitalisation rules that prevent the pushdown of excessive debt?

Interest may be deductible provided that said interest refers to a loan incurred for obtaining income subject to corporate income tax. Nevertheless, the deduction of annual interest expenses is limited to the highest of the following amounts: €1 million or 30 per cent of the company's earnings before interest, taxes, depreciation and amortisation.

The amount of financial expenses not deductible as a consequence of exceeding the aforementioned limits may be carried forward and deducted in the following five years (but always taking into consideration the applicable limits in each year).

In case the buyer is a related party, the interest paid has to be at arm's length.

As a rule, the payment of interest is subject to withholding tax at the rate of 25 per cent, which may be reduced by the application of a double tax treaty. There is an exemption of withholding tax on the payment of interest to banks resident in Portugal. As this exemption does not apply to non-resident banks it has recently been judged against European Union Law by the Court of Justice of the European Union. A change in the law is expected in the medium term. There is an exemption for interest paid by resident banks to non-resident banks. An exemption of withholding tax on the payment of interest may also be requested to the Ministry of Finance in case of foreign loans obtained by companies that provide public services.

Debt pushdown may be achieved for instance by reverse mergers or by sale of credits. This matter has been subject to controversy between the tax authorities and taxpayers, therefore it is recommended to consult a tax adviser before implementing such structure.

9 Protections for acquisitions

What forms of protection are generally sought for stock and business asset acquisitions? How are they documented? How are any payments made following a claim under a warranty or indemnity treated from a tax perspective? Are they subject to withholding taxes or taxable in the hands of the recipient?

Warranties, indemnity clauses and deed of tax covenants are common mainly for stock and business assets acquisitions made by foreign buyers. In purely domestic transactions it is less common to use these types of clauses. Accordingly, it is more common to see these types of clauses in share and purchase agreements subject to foreign law. Only the indemnities related to those events whose risk may not be insured are deductible for tax purposes. From the perspective of the recipient, the indemnity is considered an income relevant for the determination of the taxable profit subject to corporate income tax.

Post-acquisition planning

10 Restructuring

What post-acquisition restructuring, if any, is typically carried out and why?

It is not common to see a standard or typical post-acquisition restructuring. In some circumstances there may be mergers mainly to avoid having two corporate entities or exchange of shares to obtain a simpler corporate structure or to facilitate the flow of dividends.

11 Spin-offs

Can tax neutral spin-offs of businesses be executed and, if so, can the net operating losses of the spun-off business be preserved? Is it possible to achieve a spin-off without triggering transfer taxes?

The special tax-neutral regime regarding corporate reorganisations that, among others, allows the preservation of tax losses in some circumstances may also be applicable to spin-offs, provided the following specific requirements are met:

- the companies to be subject to a spin-off are resident in Portugal and are subject to and not exempt from corporate income tax therein, or are resident in another EU member state;
- the spin-off is performed due to valid economic reasons and is not executed with a main or sole tax related purpose; and
- the depreciation and amortisation methods, as well as the inventory adjustments, impairment losses and provision regime previously used by the acquired company should be maintained for tax purposes.

A spin-off may also be executed without triggering transfer taxes (namely property transfer tax and stamp duty, when there is immoveable property to be transmitted). In order to benefit from these exemptions, the company has to submit a special request to the Minister of Finance, stating the economic advantages of the operation.

12 Migration of residence

Is it possible to migrate the residence of the acquisition company or target company from your jurisdiction without tax consequences?

The Portuguese exit taxes have been subject to discussion through the years and some cases even reached the Court of Justice of the European Union, although mainly on a personal income tax perspective.

Currently, the change of residence of a company resident in Portugal triggers a corporate income tax liability. The taxable income is assessed on the year in which the company changes its residence to a location outside of Portugal.

Should the company opt for migration to another EU member state or to a country within the EEA (provided the country has exchange of information obligations with Portugal similar to those established within the EU), the corporate income tax assessed by the positive balance of the market value and the tax value of the company's assets may be settled in the following terms:

- immediately, for the whole amount or through instalments;
- in the year following the one in which the company changed residence; or
- in up to five annual partial payments, each corresponding to one-fifth of the tax assessed: these payments starting on the year following the change of residence to a jurisdiction outside of Portugal.

Interest will be due whenever the company chooses one of the deferred payment possibilities (starting on the date from which the immediate payment should have been carried out until the effective payment of the total due amount) and, additionally, the Portuguese tax authorities may request a bank guarantee corresponding to 125 per cent of the tax due.

13 Interest and dividend payments

Are interest and dividend payments made out of your jurisdiction subject to withholding taxes and, if so, at what rates? Are there domestic exemptions from these withholdings or are they treaty-dependent?

In broad terms, interest and dividend payments made by Portuguese resident companies to non-resident companies without a permanent establishment in Portugal to whom the income is attributed are subject to final withholding tax at a rate of 25 per cent.

Notwithstanding, the withholding tax rates applicable to interest and dividend payments may be reduced through the application of a double tax treaty.

Therefore, assuming that the entities are able to comply with the requirements to trigger the application of the applicable double tax treaty (usually through the filing and certification of a specific formulary), the beneficiary may benefit from rates for interest and dividend payments that usually range between 5 and 15 per cent.

Furthermore, dividends or interest payments, whenever the requirements set by the EU Parent-Subsidiary Directive and the EU Interest and Royalties Directive (respectively) are met, are exempt of withholding tax.

There is also an exemption of withholding tax for dividends paid to entities resident in a country with whom Portugal has in force a double tax treaty provided the beneficiary is subject and not exempt to a tax similar to the Portuguese corporate income tax, the tax rate of such tax is not less than 12.6 per cent, the shareholding in the Portuguese company is not less than 10 per cent of the share capital or the voting rights of the Portuguese company and was uninterruptedly held in the year prior to distribution. To benefit from this exemption, the beneficiary of the dividends has to present to the Portuguese subsidiary before dividends are distributed a declaration confirmed and certified by its tax authorities stating that it is resident in a country with whom Portugal has in force a double tax treaty, it is subject and not exempt to a tax similar to the Portuguese corporate income tax and the tax rate of such tax is not less than 12.6 per cent.

Finally, we highlight the anti-abuse rule which foresees that interest and dividend payments are subject to withholding tax at a 35 per cent rate, if the beneficiary is resident in a blacklisted jurisdiction.

14 Tax-efficient extraction of profits

What other tax-efficient means are adopted for extracting profits from your jurisdiction?

In case there is a shareholder loan outstanding, the reimbursement of the capital borrowed to the Portuguese subsidiary is not subject to tax.

Disposals (from the seller's perspective)

15 Disposals

How are disposals most commonly carried out – a disposal of the business assets, the stock in the local company or stock in the foreign holding company?

The three options are commonly pursued depending on the circumstances. From a buyer's perspective the disposal of the business assets may be of advantage in case the local company has tax liabilities or litigation pending, although in some situations the tax authorities have a privilege or guarantee over the assets sold.

From the seller's perspective, a sale of stock may be preferable because it may benefit from the participation exemption on capital gains.

16 Disposals of stock

Where the disposal is of stock in the local company by a non-resident company, will gains on disposal be exempt from tax? Are there special rules dealing with the disposal of stock in real property, energy and natural resource companies?

In the first place it is important to determine if there is a double tax treaty in force with the state of residence of the seller because such convention may exclude the competence of Portugal to tax such gain.

The majority of the double tax treaties signed by Portugal provide that the capital gains arising from the disposal of shares should be taxed at the jurisdiction where the transferor is resident. This tax allocation may differ if the disposal is of shares in companies whose assets are mainly composed of real estate located in Portugal.

Otherwise, there is also an exemption foreseen in the law for capital gains made by non-resident entities on the sale of shares, provided the following conditions are met:

- no more than 25 per cent of the non-resident company is owned, directly or indirectly, by Portuguese resident entities, with the exception of the following cases, whenever the requirements below are met, regarding the non-resident company:
- the beneficiary entity of the capital gain is resident in an EU member state, in a state of the EEA that is bound to administrative cooperation in tax matters in terms equivalent to the administrative cooperation available in the EU, or in a third state with which Portugal has celebrated a double tax treaty that foresees exchange of information agreement in tax matters;
- the beneficiary entity of the capital gain is subject and not exempt from tax in accordance with article 2 of the Directive 2011/96/EU or

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another tax similar to corporate income tax, provided the applicable rate is not lower than 12.6 per cent;
- the beneficiary entity of the capital gain has a direct or indirect 10 per cent shareholding or voting rights for a period of one year on the Portuguese resident entity;
- the transfer of shares is not considered as part of an artificial arrangement with the main or single purpose of obtaining a fiscal advantage;
- the non-resident does not have as its place of residence a blacklisted jurisdiction; and
- the capital gains do not arise from the transfer for consideration of shares or other moveable assets in a Portuguese company of which the assets primarily consist (more than 50 per cent) of immoveable property located in Portugal or in a Portuguese holding company that controls such a company.

Finally, there are no specific tax rules applicable to energy and natural resources companies.

17 Avoiding and deferring tax

If a gain is taxable on the disposal either of the shares in the local company or of the business assets by the local company, are there any methods for deferring or avoiding the tax?

A tax rollover regime of up to 50 per cent of the capital gains arising from the disposal of business assets may be used, through the application of the reinvestment regime. In general terms, the sale proceeds shall be used on the acquisition, production or construction of other tangible or intangible assets. The reinvestment operation must comply with the arm's-length principle and the assets shall be subsequently held by the acquirer for at least one year.

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