2014

AVCONEWS #30

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CORPORATE TAX ALERT: IS PORTUGAL THE NEW NETHERLANDS?

Portugal has been showing some impressive efforts on its way to financial recovery while slowly but steadily reaping the rewards. Portuguese companies are exporting more than ever and, according to government officials, exports should reach 41% of Portuguese GDP in 2013 (against 28% in 2011). But is this enough? Clearly not.

In an effort to boost companies already doing well in foreign markets (specifically in lusophone countries such as Angola, Brazil or Mozambique) the Portuguese Government has leaded and the Parliament passed, an ambitious corporate tax[1] reform. The reform is expected to help companies take their business to another level, from exports to investment.

How will this be achieved? The reform has nine major points which we will discuss in detail:

1.- Corporate tax rate: the general rate now stands at 25% but it has been lowered to 23% in 2014, and is expected to be cut even further: an extra 2% in 2015 and another 2% to 4% in 2016. So at the end of the line the rate could be 17%.

2.- Intermediate rate for smes: from this year small and medium enterprises will benefit from a special intermediate rate of 17% for the first taxable € 15,000.

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1 Corporate tax is known in Portugal as "Imposto sobre o Rendimento das Pessoas Colectivas" - IRC

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3.- Participation exemption: one of the key aspects of the reform, all inbound and outbound dividends will be tax exempt provided that the following conditions are met:

For inbound dividends:

a) A minimum participation of 5% is required;
b) The participation must be held uninterruptedly for 24 months prior to distribution of dividends;
c) The parent company must not be subject to tax transparency regime;
d) The subsidiary must be subject to corporate tax as per Directive 2011/96/UE, of November 30, or to tax akin to Portuguese IRC provided that the rate is at least 60% of the 23% rate;
e) The subsidiary must not be domiciled in a tax haven or offshore territory as defined by the Portuguese Government.

For outbound dividends:

a) The parent company must be domiciled in an EU/ EEA country or one that has a DTT with Portugal;
b) The parent company must be subject to corporate tax akin to Portuguese IRC. When the parent company is domiciled in a territory with a DTT the local corporate tax rate should be at least 60% of the 23% rate;
c) The parent company must hold at least a participation of 5%;
d) The participation must be held uninterruptedly for a period of 24 months prior to distribution.

Dividends paid from resident entities to branches in the EU/ EEA will also benefit from this regime as long as conditions a) to c) are met.

4.- Capital gains: also exempt if the participations meet the same conditions as per inbound dividends;

5.- Tax loss carryforwards: tax losses can be set-off for a 12-year period. However, compensation for each period can only go as far as 70% of taxable profits.

6.- Tax deduction when reinvesting profits: smes that reinvest their profits will qualify for a 10% deduction.

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7.- Patent box: only 50% of income derived from licensing patents or industrial designs will be taxed as long as four conditions are met:

a) IP rights must be the result of R&D activities executed by or contracted by the company;
b) The licensee uses the IP rights in a commercial, industrial or agricultural activity;
c) The results of use of IP rights by the licensee must not materialize in the delivery of goods or rendering of services which may be tax-deductible for the licensor;
d) The licensee is not resident in a tax haven or offshore territory.

8.- Income from permanent establishments: Portuguese companies with permanent establishments may choose not to include said income as long as:

a) The permanent establishment is subject to corporate tax akin to Portuguese IRC. When it is domiciled in a territory with a DTT the local corporate tax rate should be at least 60% of the 23% rate;
b) The permanent establishment is not resident in a tax haven or offshore territory.

9.- Less red tape: the number of procedures associated nowadays with preparing, reporting and filing corporate tax is 68. The reform will cut over 20 procedures.

In conclusion, even if the Portuguese legislator has not gone as far as it could have (indeed the preliminary project was even more ambitious) the reform is an invaluable asset for Portuguese companies seeking internationalization. And, more importantly, it raises Portugal's tax competitiveness big time, which will surely allow for major exposure to international investors.

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