European Tax Newsalert

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Portugal

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Portugal 2012 Budget Act

The Portuguese Parliament approved the 2012 Budget Act on November 30, 2011. The measures will be effective January 1, 2012.

This newsalert summarizes the relevant tax issues for U.S. entities operating in Portugal.

Corporate Tax

Elimination of the lower corporate income tax bracket

The Act revoked the 12.5% corporate tax rate, currently applicable to taxable profit up to 12,500 euros. Effective January 1, 2012, a single corporate tax rate of 25% applies to taxable profits.

The Act also eliminated the lower rate applicable to inland regions (between 10% and 15%).

Increase in the state surcharge

The state surcharge will increase for the 2012 and 2013 fiscal years. Currently, a single 2.5% rate applies to taxable profits in excess of two million euros. With the proposed changes, two tax brackets now apply:

- 3% for amounts greater than 1.5 million euros but less than 10 million euros,
- and 5% for amounts over 10 million euros.

Withholding tax

The withholding tax rate on dividends, interest and other investment income not specifically taxed under a different rate, will increase from 21.5% to 25% for non-resident entities with no permanent establishment ("PE") in Portugal. This rate does not cover royalty income, know-how, technical assistance or leasing payments which will continue to be taxed at 15%.

A new 30% rate will apply to Portuguese-sourced capital income (namely, dividends, interest, and royalties) when derived by non-resident entities that do not have a PE in Portugal and that are resident in a country, territory or region subject to a more favorable tax regime (i.e., tax havens listed by the Portuguese government).

Deduction of tax losses

The 2012 state budget extends the tax-loss carry forward period from four to five years. This will apply only to tax losses assessed in periods beginning on or after January 1, 2012. However, prior year tax losses may no longer fully offset taxable profits. The utilization of such tax losses will be limited to 75% of the taxable profit assessed in the relevant fiscal year. This measure will be effective January 1, 2012, but applies to all tax losses brought forward.

Madeira International Business Centre ("MIBC")

The Act revoked the exemption granted to shareholders of entities licensed under the MIBC regime with respect to the interest on shareholders loans and dividends.

Effective January 1, 2012, dividends and interest payable to shareholders by entities licensed under the MIBC will be subject to a 25% withholding tax (or 30%, if black-listed by the Portuguese government). There is an exception when the EU Parent Subsidiary Directive exemption or a tax treaty limitation applies.

Mutual funds – taxation of capital gains

The tax rate applicable to the capital gains derived by mutual funds will increase from 10% to 21.5%.

Payments to non-residents subject to a more favorable tax regime

Payments to non-resident entities subject to a more favorable tax regime, where the taxable person has or should have had knowledge about the ultimate beneficiary, will not be deductible for tax purposes. There is an exception when the taxpayer demonstrates that such charges relate to genuine transactions and are not abnormal or excessive.

Such knowledge is presumed when special relations exist between the taxpayer and the entities subject to the favorable tax regime or between the taxpayer and the legal representative, fiduciary or intermediary.

Attribution of profits to non-resident entities subject to a more favorable tax regime - a Controlled Foreign Company ("CFC") regime

Profits or income from an indirect holding, if held by a legal representative, fiduciary or intermediary, will now be attributed to the Portuguese entity under the CFC regime.

Nevertheless, the CFC regime will no longer apply to entities resident in the European Union ("EU") or in the European Economic Area ("EEA') when the incorporation and operation of such controlled entities has valid economic reasons and the controlled entity develops agricultural, commercial, industrial or services activities.

In addition, Portuguese entities will no longer be able to carry forward tax credits for international double taxation that are not used in a tax year due to insufficient taxable income.

Tax year

Taxpayers are no longer required to maintain a tax year different from the civil year for a minimum period of five years when a taxpayer joins a group of companies with consolidated financial statements, and the holding company chooses a different tax period.

Capital Gains realized by non-residents

The domestic tax exemption for capital gains from transfers of shares, other securities, autonomous warrants or certain derivatives will not apply where:

(i) the seller is domiciled in a black-listed jurisdiction,

(ii) the company, whose shares are being sold, has assets more than 50% of which comprise, directly or indirectly, real estate in Portugal; or

(iii) the non-resident is held, directly or indirectly, more than 25% by Portuguese residents.

Special tax regime applicable to debt securities issued by non-resident entities

The Act continues to exempt income from debt securities representing public and non-public debt issued by non-residents. The exemption will apply provided the income is considered earned in the Portuguese territory, under Portuguese tax rules, and paid by the Portuguese State as a guarantor of the obligations undertaken by the entities in which it, and other EU member states, own a participation interest. This exemption applies to effective beneficiaries that fulfill the requirements stated in the legal diploma of the debt securities regime.

Investment and R&D support tax benefits

The Act extends investment support and R&D benefits (“RFAI” and “SIFIDE”) to cover expenses incurred during the 2012 fiscal year.

Other Changes

Non habitual residents

Employment income and income from business and professional activities, obtained by qualified non-habitual residents who carry out high value activities, will now be liable to a 20%withholding tax. This may impact multinational company managers who are seconded to Portuguese group companies.

Real estate taxes

The Act increases the Real Estate Transfer Tax ("RETT") rate for real estate acquired by entities domiciled in black-listed jurisdictions from 8% to 10%.

In addition, the Act increases the tax rate on real estate held by entities domiciled in black-listed jurisdictions from (up to) 5% to 7.5%.

Tax amnesty (“RERT III”)

The Act also introduces a new tax amnesty that encourages the declaration of assets located abroad until December 31, 2010, and subjects the corresponding values to a flat rate of 7.5%. The amnesty does not require actual repatriation of the assets. Portuguese taxpayers must make this declaration by June 30, 2012.

Absent this declaration, and where omissions or inaccuracies exist, the tax due is subject to a 60% increase.

Tax Litigation

Terms for transactions with blacklisted jurisdictions

The Act increases the time limit for tax corrections involving blacklisted jurisdictions from four to 12 years and increases the term for tax collection from eight to 15 years.

Anti-avoidance rules

The legislation increases the period for the tax authorities to process tax assessments under the anti-avoidance rules from three to four years (12 years if black listed jurisdictions are involved). The tax authorities will also have more flexibility in the procedure for providing proof.

Rulings

For urgent ruling requests sent to the tax authorities, the Act extends the response deadline to 120 days (currently 60 days) to issue a binding opinion. In addition, the maximum ruling fee will increase from 10,200 to 25,500 euros.

For non-urgent rulings, the Act extends the response deadline from 90 to 150 days.

For more information, please do not hesitate to contact:

Your tax services team in the US

Daniel Landaluce	*+ (1) 646 471 7762*	*daniel.landaluce@us.pwc.com*

Your tax services team in Portugal

Jaime Esteves	*+ (351) 225 433 212*	*jaime.esteves@pt.pwc*
Jorge Figueiredo	*+ (351) 213 599 636*	*jorge.figueiredo@pt.pwc.com*
Leendert Verschoor	*+ (351) 213 599 631*	*leendert.verschoor@pt.pwc.com*
Catarina Gonçalves	*+ (351) 225 433 121*	*catarina.goncalves@pt.pwc.com*
Catarina Nunes	*+ (351) 213 599 621*	*catarina.nunes@pt.pwc.com*