Portuguese tax reform would lower tax rate and widen application of the participation exemption

August 27, 2013

In brief

The Portuguese government has appointed a think tank to consider a comprehensive corporate income tax (CIT) reform package. This package would simplify the CIT regime and promote Portugal's tax competitiveness, with the intention of attracting and retaining investment.

Following a public discussion period, we expect the measures to enter into force in January 2014.

US multinational corporations (US MNCs) with Portuguese subsidiaries, operations in Europe or emerging markets (particularly Portuguese-speaking countries), or Portuguese research and development (R&D) activities should consider the potential impact of the proposed tax changes.

In detail

Overview of the proposals

The package would:

a) decrease the nominal tax rate (currently 25%), by 2 percentage points per year, until it reaches a value between 17 and 19% by 2018. The package also would abolish state and municipal surcharges over the same period

b) extend the tax loss carryforward period to 15 years (currently 5 years)

c) introduce a 5 year carryforward period for using international double taxation credits (no carryforward currently is available)

d) reduce the shareholding required to form a tax group to 75% and relax the non-qualifying entities criteria

e) provide a participation exemption for dividends received from qualifying shareholdings of at least 2%, including from countries outside the European Union (EU) (subject to anti-avoidance restrictions)

f) provide a withholding tax exemption for dividends paid to non-resident shareholders, including residents outside the EU with shareholdings of at least 2% (currently 10%)

g) provide a participation exemption for capital gains arising from shares held for a minimum period of 12 months, regardless of the percentage held. Capital losses meeting the same conditions would not be deductible. Capital gains derived by non-residents would remain exempt regardless of the holding period

h) exclude from taxable income foreign-sourced income derived from permanent establishments

i) introduce a 'patent box' regime for certain intangible property (IP) income: only 50% of eligible income would be subject to tax, with a full deduction for related expenses

j) provide a tax amortization rate of 5% for intangible assets not subject to depreciation

k) simplify certification processes (e.g., claims for the elimination or reduction in withholding taxes for entities resident in a treaty country)

l) reduce the amount of net deductible financial expenses to 1 million euros (currently 3 million euros). Companies taxed under a tax group regime could elect to apply the deduction limit to the tax group.

m) clarify the tax deductibility of expenses by linking them with the company's activity

n) list the documentation requirements for deductible expenses

o) widen the scope of group restructuring transactions that may be performed on a tax-neutral basis. The package also would clarify the tax treatment of group restructuring transactions when not performed under the tax-neutral regime

p) increase the special payment on account

q) relax the definition of related parties for transfer pricing (TP) purposes -- by increasing the shareholding threshold from 10% to 20% -- and reduce other conditions that subject parties to the TP rules

r) require transfer pricing documentation only for companies with income higher than 5 million euros (currently 3 million euros) and define individual and overall de minimis thresholds for inclusion in the documentation file

s) provide an optional simplified tax scheme for small companies (income not exceeding 150,000 euros and total assets not exceeding 500,000 euros) that would eliminate special payments on account and reduce the number of expenses subject to flat rate taxation.

The takeaway

The proposed CIT reform would affect all US MNCs operating in Portugal. The proposed changes also aim to enhance the benefits of using Portugal as a holding location (particularly as a hub for investments in Portuguese-speaking countries) as well as to boost R&D activity.

The proposed measures are subject to public discussion, and ultimately require Portuguese government and Parliament approval. However, we expect the approved measures to be presented in October 2013 and may enter into force on January 1, 2014.

Let's talk

For a deeper discussion, please contact:

International Tax Services, United States

Daniel Landaluce
+1 646 471-7762
daniel.landaluce@us.pwc.com

Arturo Soriano
+1 646 471 8771
arturo.soriano@us.pwc.com

International Tax Services, Portugal

Jaime Esteves
+351 225 433 212
jaime.esteves@pt.pwc.com

Catarina Gonçalves
+351 225 433 121
catarina.goncalves@pt.pwc.com

Leendert Verschoor
+351 213 599 642
leendert.verschoor@pt.pwc.com

Jorge Figueiredo
+351 213 599 636
jorge.figueiredo@pt.pwc.com

Catarina Nunes
+351 213 599 621
catarina.nunes@pt.pwc.com

Rosa Branca Areias
+351 225 433 197
rosa.areias@pt.pwc.com

Laura Rosa Araújo
+351 225 433 240
laura.rosa.araujo@pt.pwc.com