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22 October 2012

Portugal – Amendments to Tax Laws for 2012 and Draft Budget Law for 2013

Main tax issues

A significant tax hike

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General

The Portuguese Parliament approved on 19 October 2012 several amendments to Portuguese tax laws (the "**2012 Amendment**"). Additionally, the Government tabled the Draft Budget Law for 2013 (the "**2013 Draft Budget**"), which also contains significant amendments to Portuguese tax laws. This Newsletter aims to sum up the proposed changes to Portuguese tax laws that are more likely to affect foreign entities investing and trading in Portugal.

Corporate Income Tax

Limitation to the deductibility of financing costs

The 2013 Draft Budget replaces the thin capitalisation regime with a set of rules restricting the deductibility of financing costs, inspired in similar rules recently entered into force in Spain and other European countries, such as France and Finland.

Specifically, the deductibility is denied in respect of the portion of the net financing costs incurred by companies subject to Corporate Income Tax (except for finance and insurance companies) that exceed the higher of the following caps: i) € 3,000,000 and ii) 30% of EBITDA (this percentage will be introduced gradually, being reduced by 10 percentage points each year, from 70% in 2013 to 30% from 2017 onwards).

There will be a "current account" between the non-deductible portion of the financing costs and the difference between the deductible part of financing costs and the 30% cap of the EBITDA. On the one hand, the amount which is not deductible in a given fiscal year (due to both the above caps having been exceeded) may be deducted in the subsequent five fiscal years (subject in each year to those same caps). On the other hand, any "unused" portion corresponding to the difference between the financing costs deducted and the amount corresponding to the 30% cap of the EBITDA that the taxpayer might have deducted may also be used in the following five fiscal years.

Unlike the equivalent Spanish rules, the Portuguese rules will apply on an individual basis even if a group of companies applies the tax consolidation regime. This may encourage groups of companies to consider strategies of internal reallocation of debt financing.

Tax rates for non-residents corporate entities

Both the 2012 Amendment and the 2013 Draft Budget provide for an increase of the tax rates applicable to various categories of income derived by non--resident corporate entities, namely:

- Income derived from intellectual or industrial property, imparting of know-how and the use or grant of use of agricultural, industrial, commercial or scientific equipment;
- Intermediation fees and several types of service fees deemed to arise within the Portuguese territory; and
- Property rental income.

Specifically, the 2012 Amendment increases the withholding tax rates on the above categories of income from 15% to 25% (to be applied from the entry into force of the 2012 Amendment until the end of the year), although keeping the final rate at 15% (without any reference to any refund mechanism), and the 2013 Draft Budget (presumably to apply from 1 January 2013 onwards) aligns the withholding and the final tax rates at 25%.

State Surcharge

The 2013 Draft Budget reduces from € 10,000,000 to € 7,500,000 the threshold of taxable profit to which the State Surcharge of 5% applies (accordingly, the 3% rate will apply to taxable profits from € 1,500,000 up to, but excluding, € 7,500,000).

Tax benefits and other taxes

Other benefits

According to the 2013 Draft Budget, some tax benefits which have been enacted in previous Budget Laws should be maintained, such as the following:

- The exemption from Stamp Tax is to be renewed and applicable to all “repo” transactions of securities or other related rights which take place in the stock market and also to “repo” and assignments by way of security by financial institutions and intermediated by central counterparties;
- The exemption for earnings obtained by non-resident financial institutions on “repo” transactions of securities carried out with resident credit institutions, as long as those earnings are not attributable to a Portuguese permanent establishment of the non--resident financial institution, will remain in place;

- Investment income arising from *Schuldscheindarlehen* contracts entered into with the Portuguese Republic will remain exempt from Portuguese income tax, provided the creditor is a non-resident entity without a Portuguese permanent establishment the income may be attributable to.

Delegating provisions

The 2013 Draft Budget includes an authorisation for the Government to prepare and subsequently enact a significant set of measures, of which the following should be the most relevant for non-resident investors:

- The Portuguese version of the "Financial Transaction Tax" will in principle apply to a wide range of financial transactions in the secondary market, notably transfers of shares, bonds, money market instruments, units in investment funds, structured products and derivatives, as well as entering into or amending derivative transactions. The 2013 Draft Budget also provides for the creation of special regime to be applied to high-frequency trading, with the purpose of "*curbing and correcting some speculative interventions in the market*".

  The delegation to the Government is very vague, allowing the Government to determine "*in a clear manner, all the elements defining the chargeable event*", to provide for objective exemptions ("*such as issues of shares and bonds, obligations in respect to international institutions and transactions where Central Banks are involved*"), subjective exemptions and also the rules to compute the tax due. The 2013 Draft Budget only specifies the maximum caps which under no circumstances the law to be enacted by the Government may exceed:

  - Up to 0.1% on high-frequency transactions;
  - Up to 0.3% on transactions involving derivatives as well as on the "*the remaining transactions subject to the new tax in general*".

  Due to the ambiguity of numerous expressions used in the delegating provisions and also due to the fact that the core elements defining the chargeable event are left to the Government's purview, both the delegation provisions and the tax itself are prone to be challenged from the point of view the compliance with the Constitution's principles and rules on taxing powers.

- An amendment to the regime provided in the Corporate Income Tax Code applicable to the event of transfer of tax residence and cessation of activity, as a result of the decision of the Court of Justice in case no. C-38/10 ("Portuguese exit taxes"), authorising to create "*rules necessary to prohibit the unlawful use of the regime by acts or contracts executed in order to avoid taxation*".

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Approval and entry into force

The 2012 Amendment should be published in the Official Gazette and enter into force in the near future.

The 2013 Draft Budget will be voted by Parliament on 27 November of 2012. If approved, the amendments to the tax laws contained therein should, in general, become effective on 1 January 2013.

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This publication is intended merely to highlight issues and not to be comprehensive, nor to provide legal advice. Should you have any questions on issues reported here or on other areas of law, please contact one of your regular contacts, or contact the editors.

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