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LEGAL FLASH | TAX

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LAW NO. 2/2014, OF JANUARY 16 | CORPORATE INCOME TAX REFORM

On January 16, 2014, the Law approving the Corporate Income Tax ("CIT") Reform - Law No. 2/2014 – was published in the Portuguese Official Gazette ("Diário da República"). The amendments introduced by this Law apply to tax periods beginning or to taxable events occurring on or after January 1, 2014.

The main amendments introduced by Law No. 2/2014 are herein referred and, for ease of reference, segregated as follows:

(i) New Regimes
(ii) Most Relevant Measures
(iii) Other Measures

I. NEW REGIMES

"PARTICIPATION EXEMPTION"

A "participation exemption" regime is introduced and generally applies to all CIT resident taxpayers that are not subject to the tax transparency regime, both for purposes of eliminating double economic taxation on distributed profits and reserves and regarding capital gains and capital losses arising from the sale of shares or other equity instruments.

Inbound – Qualified Participation

A minimum shareholding of 5% of the subsidiary’s share capital or voting rights (previously, 10%), held either directly or indirectly, is required.

For purposes of distributed profits and reserves, the referred qualified participation must be uninterruptedly held for a period of 24 months prior to the distribution (previously, a 12-month period) or, if it is held for a lower period, it should be kept uninterruptedly during the time period required to complete said 24 months. Regarding capital gains and capital losses, the qualified participation is only of relevance in respect to the shareholding selling date, being the 24-month holding period determined by reference to the shareholdings being sold.

Inbound – Subsidiary

Regarding the subsidiary, which may in no case be resident or domiciled in a country, territory or region subject to a clearly more favorable tax regime included in the list approved by the Ministerial Order of the Finance Minister, the same should be subject to and not exempt from CIT (or special tax on gambling), to a tax referred to in Article 2 of Directive No. 2011/96/UE, of the Council, of November 30, 2011 ("Parent-Subsidiary Directive"), or to a tax identical or of a similar nature to the CIT whose applicable rate is not lower than 60% of the standard CIT rate. The requirement for liability to tax may be waived depending on the nature of the activity undertaken or on the patrimony of the subsidiary.

Inbound – Regime

Provided that the above requirements are met, the profits and reserves distributed to and the capital gains/capital losses obtained by CIT taxpayers resident in the Portuguese territory shall not be included in their taxable income.

For purposes of this new regime, the concept of profits or reserves includes capital repayments resulting from the amortization of shareholdings without a share capital reduction and also the fraction of taxable income allocated to shareholders that corresponds to profit distributed to entities subject to the tax transparency regime.

Capital gains/capital losses are, however, expressly excluded from this regime, being therefore included in the taxpayer’s taxable income, whenever the value of the properties held by the subsidiary represent, directly or indirectly, more than 50% of its assets (except if the properties are allocated to an agricultural, commercial or industrial activity other than the purchase and sale of real estate, in which case the new regime applies).

The regime also applies to profits, reserves and capital gains/losses attributable to a Portuguese permanent establishment of an EU Member State or EEA resident entity, in this last case subject to cooperation obligations identical to those of the EU, provided that the requirements and conditions set forth in Article 2 of the Parent-Subsidiary Directive or equivalent requirements and conditions, if it is an EEA's resident, are met.

The regime also applies to profits, reserves and capital gains/losses attributable to permanent establishments of entities resident in other States, not included in blacklisted jurisdictions, with which Portugal has signed an Agreement for the Avoidance of Double Taxation providing for administrative cooperation regarding taxation equivalent to the cooperation provided within the EU and that in said State are subject to and not exempt from a tax of identical or similar nature to CIT.

If an entity holds a qualified participation during 24 months prior to the distribution (or keeps it for the necessary time to complete the 24-month period) but the other requirements of the "participation exemption" regime are not met, the Portuguese resident taxpayer may choose to apply for new tax credit regime for eliminating international economic double taxation.

Outbound – Profits and Reserves

Regarding non-resident CIT taxpayers, the "participation exemption" regime in the form of exemption will apply to profits and reserves distributed by Portuguese resident entities that are subject to and not exempt from CIT (or special tax on gambling) and not subject to the tax transparency regime, provided that the other requirements related to the qualified participation and the beneficiary entity are complied with.

Outbound – Qualified Participation

A qualified participation is of at least 5% of the subsidiary's share capital or voting rights, uninterruptedly held, either directly or indirectly, for 24 months prior to the distribution date (or held uninterruptedly during the time required to complete said period, in which case the law provides for the reimbursement of the tax withheld on the profits or reserves that have been meanwhile distributed).

Outbound – Beneficiary Entity

The beneficiary entity should be a resident (i) in another EU Member State, (ii) in an EEA Member State bound to administrative cooperation in the tax area equivalent to that established in the EU, or, (iii) in a State with which Portugal has signed an Agreement for the Avoidance of Double Taxation providing for administrative cooperation regarding taxation equivalent to the cooperation within the EU.

The beneficiary entity should also be subject to and not exempt from a tax referred to in Article 2 of the Parent-Subsidiary Directive or to a tax of identical or similar nature to

CIT, being also required that for entities outside the EU or EEA that the applicable tax rate is not lower than 60% of the standard CIT rate. If all the other requirements are met, this regime also applies to permanent establishments of the aforementioned entities that are located in other EU or EEA Member States.

Outbound – Capital gains

The new "participation exemption" regime does not refer to capital gains obtained by non-resident entities upon disposal of shares. However, such capital gains continue to benefit from income tax exemption regime currently foreseen in Article 27 of the Tax Benefits Statute.

Transitional Regime

The new regime applies to the positive balance of capital gains and losses obtained prior to January 1, 2001 that hitherto were under a "suspended taxation" status;

When determining the percentage of the subsidiary's properties value on the total balance–sheet value, only the properties acquired after January 1, 2014, should be accounted for. Thus, the new regime may apply to the capital gains and losses derived from the sale of shareholdings of a company whose properties represent more than 50% of its assets, if said properties have been purchased before the CIT Reform Law entered into force;

The minimum shareholding period also applies to the shareholdings already held at the moment the CIT Reform Law entered into force, being computed for purposes of the 24-month period the holding period already elapsed until such date.

SIMPLIFIED TAXATION REGIME

Portuguese resident taxpayers may now opt for a simplified regime for determining the taxable income, to the extent that they are not tax exempt or subject to a special taxation regime, carry out primarily an agricultural, commercial or industrial activity and that meet cumulatively the following requirements:

- Have obtained, in the previous tax year, a gross annual income lower or equal to EUR 200,000.00 and a total balance–sheet value of less than EUR 500,000.00;
- Are not legally bound to statutory audit;
- The share capital is not held, directly or indirectly, in more than 20% by entities that do not comply with the above-mentioned requirements, except if such entities are venture capital companies or venture capital investors;

- Adopt the accounting standardized system applicable to micro entities, as set out in Decree-Law No. 36-A/2011, of March 9;

- Have not waived the application of the simplified regime in the previous three years, with reference to the date in which the regime starts applying.

The simplified taxation regime ceases to apply when the respective requirements are no longer met or when the taxpayer waives its application or fails to fulfill the issuance and communication of invoices obligations provided for, respectively, in the VAT Code and Article 3(1) of the Decree-Law No. 198/2012, of August 24.

The effects of the termination or waiver of the simplified taxation regime are produced with reference to the first day of the tax period in which one of the above requirements is not met or the waiver is communicated.

For purposes of applying the simplified taxation regime, the relevant taxable income results from the use of the following coefficients:

a) 0.04 of the sales of goods and the supply of services rendered by hotels and similar activities, restaurants, catering and beverage services;

b) 0.75 of the professional activities specifically provided for in the list referred to in Article 151 of the Personal Income Tax Code;

c) 0.10 of the income derived from other supplies of services and of the amount of operational subsidies received;

d) 0.30 of the non-operating subsidies received;

e) 0.95 of the income derived from contracts providing for the temporary assignment or use of intellectual or industrial property or the provision of industrial, commercial or scientific know how, other capital income, real estate rental income, the positive balance of capital gains and losses and of other patrimonial increases;

f) 1.00 of the acquisition value of the gratuitous patrimonial increases.

The taxable income cannot be lower than 60% of the annual value of the minimum monthly wage. Moreover, this limit and the coefficients above mentioned in a) and c) are reduced by 50% and 25% in the tax period of commencement of activity and in the following tax period, respectively.

As for the entities operating in retail fuel, tobacco, vehicles subject to Motor Vehicle Tax ("ISV") and alcohol and alcoholic beverages sectors, the taxable income does not comprise the amounts corresponding to the Excise Duties ("IEC") and the ISV.

As regards the purchase and sale of real estate, taxpayers under this regime should comply with the rules laid down in Article 64 of the CIT Code, i.e., should adopt fair market prices, which may not be lower than the fiscal value that was considered for purposes of Real Estate Transfer Tax ("IMT") assessment or which would have been used for such purposes if indeed IMT had been due.

Taxpayers covered by the simplified taxation regime that opt to apply the capital gains reinvestment rollover regime set forth in Article 48 of the CIT Code, but fail to make the required reinvestment within the due deadlines will have to add to their taxable income the difference (or the proportion) not previously included in the taxpayer's taxable income, increased by 15%.

Taxpayers under this regime may deduct to their taxable income the tax credit for international double taxation (ordinary tax credit) and withholding taxes not compensated or reimbursed under the applicable law.

Finally, taxpayers choosing to apply this regime are exempted from the special payment on account ("PEC") and certain expenses, such as representation expenses, daily allowances and travel costs in their own vehicle incurred on duty and not charged to clients, severance payments, bonuses and other variable income paid to board members, will be excluded from autonomous taxation. In regard to the autonomous taxation due on other type of expenses, the increase of 10% over the autonomous taxation rates whenever the taxpayer has tax losses shall not apply to these taxpayers.

Tax Regime for Patent and Other Industrial Property Rights– "Patent Box"

A new specific tax regime is introduced on income derived from the assignment or temporary use of patents and industrial designs or models, which provides for a CIT exemption on 50% of such income, provided that the following requirements are cumulatively met:

- The industrial property rights are the result of research and development activities undertaken or contracted by the taxpayer;

- The transferee uses the industrial property rights in a commercial, industrial or agricultural activity;

- The proceeds of the use of the industrial property rights by the transferee do not result in the delivery of goods or services that give rise to tax deductible expenses at the level of the transferor or of a company with which it forms part of a tax group, whenever any of the entities and the transferee are qualified as related parties;

- The transferee is not an entity resident in a country, territory or region with a clearly more favorable tax regime.

For the purpose of eliminating international double taxation, when such income derives from outside of Portugal the computation of the corresponding ordinary tax credit will also take into account only 50% of such income.

Finally, it should be noted that the "Patent Box" regime applies only to patents and industrial designs or models registered on or after January 1, 2014.

TAX REGIME APPLICABLE TO PERMANENT ESTABLISHMENTS ABROAD

This new regime allows taxpayers with head office or place of effective management in Portugal to opt for excluding from their taxable income the profits and losses attributable to a foreign permanent establishment provided that:

- The profits attributable to the permanent establishment are subject to and not exempt from a tax referred to in the Parent-Subsidiary Directive or a tax identical or similar in nature to CIT whose rate applicable to such profits is not lower than 60% of the standard CIT rate; and

- The permanent establishment is not located in a country, territory or region with a clearly more favorable tax regime.

This regime does not apply to the profits attributable to the permanent establishment, up to the amount of the losses attributable to the same that have been considered for purposes of the computation of the taxable income of the taxpayer in the prior 12 taxation periods.

If the taxpayer opts for this regime, the same should cover all of the taxpayer's permanent establishments in the same territory and be applied for at least 3 years.

Whenever this regime ceases to apply, the following rules should be considered:

- Tax losses of the permanent establishment shall not be included in the taxpayer's taxable income up to the amount of the taxable profits attributable to the permanent establishment that were not accounted for in the taxpayer's taxable profit of the last 12 tax periods

- In case of transformation of the permanent establishment into a company, the profits and reserves distributed by the new company, as well as the capital gains from the sale of shareholdings and from the winding-up of said company, will not benefit from the "participation exemption" regime up to the amount of the permanent establishment's profits that have not been accounted for the taxable income of the taxpayer in Portugal in the prior 12 tax periods.

DEDUCTIBILITY OF NON-AMORTIZABLE INTANGIBLE ASSETS

A new regime is introduced allowing a 20-year tax deduction (annual 5% rate) of the acquisition cost borne with certain types of intangible assets provided they have been acquired on or after 1 January 2014.

This regime is applicable to industrial property elements such as brands, licenses, production processes, models or other similar rights onerously acquired and that do not have a limited useful life period. The same is also applicable to *goodwill* acquired within the context of a corporate restructuring process.

However, this new regime does not apply to (i) assets acquired within the context of corporate restructurings that benefit from the tax neutrality regime, to (ii) *goodwill* arising from shareholdings and to (iii) assets acquired to entities resident in a country, territory or region with a clearly more favorable tax regime.

INTERNATIONAL DOUBLE TAXATION - UNDERLYING TAX CREDIT

Taxpayers may now opt for an underlying tax credit when distributed profits and reserves by a non-Portuguese resident entity have been included in the taxpayer's taxable amount and the requirements for the application of the "participation exemption" regime are not verified.

In this context, taxpayers may choose to deduct to the tax due part of the income tax paid abroad by its own subsidiary, provided that the profits and reserves distributed by the subsidiary do not qualify for purposes of the "participation exemption" regime.

II. MOST RELEVANT MEASURES

RATES

The general CIT rate is reduced to 23% in 2014 and a reduced 17% rate applies to the first EUR 15,000 of the taxable income of taxpayers who, directly and primarily, carry on an agricultural, commercial or industrial activity and qualify as a small or medium enterprise under the annex of Decree-Law no. 372/2007, of November 6th.

It is set as a goal to reduce the general CIT rate to 21% in 2015 and to establish said rate within a range between 17% and 19% in 2016. These are however programmatic measures whose enforcement will depend, for instance, on an evaluation of the results achieved with the Reform, on the evolution of the economic situation of the country and shall be considered simultaneously with the recast of the Value Added Tax and of the Personal Income Tax, particularly as regards the reduction of the respective tax rates.

A new State Surcharge rate of 7% applicable to the taxable profit over EUR 35,000,000 is introduced.

TAX LOSSES CARRY-FORWARD

The carry-forward period for tax losses is extended to 12 years. This period applies to tax losses incurred in the tax periods starting on or after January 1st, 2014.

However, offset of tax losses may not exceed 70% of each tax period's taxable profit. This threshold applies to the offset of tax losses against the taxable profits from the tax periods starting on or after January 1st, 2014.

The restriction on the offset of tax losses when the company's business scope or activity is changed was eliminated.

However, the restriction on the offset of tax losses still applies when more than 50% of the share capital ownership or voting rights changes (except if the offset is duly authorized by the Minister of Finance), save in the following cases:

- Changes from direct to indirect ownership and vice-versa;
- Changes arising from transactions to which the tax neutrality regime applies;
- Changes arising upon death of the previous shareholder;
- The acquirer holds, uninterruptedly, directly or indirectly, more than 20% of the share capital or the majority of the voting rights of the company since the beginning of the tax period to which the losses respect;
- The acquirer is an employee or member of the governing bodies of the company, at least since the beginning of the tax period in which the tax losses were incurred.

SPECIAL PAYMENT ON ACCOUNT ("PEC")

The deduction of PECs is extended until the sixth tax period following the one which the PEC respects to. If it is not possible to fully deduct the PECs by the end of this period, reimbursement may be requested without the need for conducting inspection work, as hitherto was required.

Taxpayers under the simplified taxation regime are not subject to PEC. However, if the simplified taxation regime ceases to apply due to non-compliance with any of the requirements relating to the annual value of income or total balance sheet, taxpayers must pay the corresponding PEC until the end of the 3rd month of the following tax period.

AUTONOMOUS TAXATION

The autonomous taxation rates applicable to expenses incurred with light passenger vehicles, mopeds or motorcycles, excluding electric vehicles, are changed as follows:

- 10% for vehicles with an acquisition cost lower than EUR 25,000;
- 27.5% for vehicles with an acquisition cost equal or higher than EUR 25,000 and lower than EUR 35,000;
- 35% for vehicles with an acquisition cost equal or higher than EUR 35,000.

Certain expenses borne by taxpayers who adopt the simplified taxation regime, as well as expenses attributable to permanent establishments located outside the Portuguese territory, which relate to the activities carried on by said permanent establishments, are excluded from autonomous taxation.

Furthermore, expenses incurred with light passenger vehicles, mopeds or motorcycles, are excluded from autonomous taxation when a written agreement between the employee and the employer grants the employee a specific vehicle, thus triggering Personal Income Tax.

LIMITATION ON THE DEDUCTION OF NET FINANCIAL COSTS

The limit on the deduction of net financial costs is reduced to EUR 1,000,000. The alternative limit of 30% of the earnings before depreciation, net financing costs and taxes ("EBITDA") remains unchanged.

Net financing costs not deductible within the subsequent five tax periods as well as the difference between the costs incurred and 30% of EBITDA may only be deducted after the net financing costs of the tax period at stake are considered. Older net financing costs shall be carried forward immediately afterwards.

However, this carry forward mechanism no longer applies if there is a change in the ownership of more than 50% of the share capital or of the majority of voting rights of the taxpayer, unless the exceptions for the carry-forward of losses apply or an authorization of the Minister of Finance is obtained.

If the tax unit regime applies, the dominant company may choose to apply this regime to the group's net financing costs, when determining the group's taxable profit. This option should be communicated to the Tax Authorities and the regime must be in force for a minimum period of 3 years.

When applying this regime, a specific concept of EBITDA must be considered, which although based on the accounting concept, is adapted for tax purposes by the following items:

- Gains and losses arising from fair value changes that are disregarded when determining the taxable profit;

- Impairment losses and reversals of non-depreciable or non-amortizable investments;

- Gains and losses resulting from the application of the equity method or, as regards joint ventures which are taxable persons for CIT purposes, the proportional consolidation method;

- Income or expenses regarding participations to which the "participation exemption" regime applies;

- Income or expenses attributable to a permanent establishment outside the Portuguese territory regarding which the option for not computing its taxable income at the level of the Portuguese head-office was made;

- The extraordinary contribution on the energy sector.

The non-application of the abovementioned rules extends to securitization companies and to Portuguese branches of credit institutions and to other financial institutions or insurance companies with head office in third countries (*i.e.* outside the EU).

Transfer of residence abroad – Exit Tax

Taxation upon the transfer abroad of residence of entities with its head office or place of effective management in Portugal is maintained. As previously, tax is levied on the difference between the market value and the relevant tax value of the assets, even if not expressly accounted for, as at the date of termination of the activity.

Nevertheless, further to the judgment of the European Union Court of Justice in Process C-38/10, which concerned an action brought by the European Commission against the Portuguese State, deferred payment of the CIT is now allowed when a company transfers its residence from Portugal to the territory of another EU Member State or EEA Member State (provided that in the latter case the rules regarding the administrative cooperation in exchange of information and assistance in the collection of taxes equivalent to those established in the EU are set forth).

Thus, as an alternative to the immediate payment of the total amount of tax assessed on the income statement of the period of cessation of activity, CIT payment may be deferred as per one of the following options:

- With respect to each of the assets considered in determining the tax due, to the year following its extinction, transmission, detachment of the entities' activity or transfer by any title, either material or legal, to a territory or country outside the EU or the EEA, as regards the part of the tax which would correspond to the tax result of each asset individually considered; or

- In 5 annual installments, in the same amount, beginning in the tax period in which the residence is transferred abroad.

The option for any of the deferred payment methods shall be made in the income statement of the tax period in which the cessation occurs. Said option gives rise to interest at the rate set forth for default interest, and may also demand the rendering of a bank guarantee corresponding to the amount of tax due plus 25%, under the conditions to be prescribed by order of the Minister of Finance.

As set forth prior to the Reform, the non-taxation of the transfer abroad of residence of a company relating to the assets that remain connected with a permanent establishment in Portuguese territory is unchanged.

The new payment rules above referred to do also apply in case of cessation of activity of the permanent establishment in the Portuguese territory of a non-resident entity or of transfer abroad of assets allocated to a permanent establishment located herein.

Finally, we highlight the repeal of article 85 of the CIT Code which provided for the taxation of the shareholders of the company transferring its residence abroad, who therefore are no longer subject to taxation.

DEDUCTIBILITY OF CAPITAL LOSSES ON SHARES

When the "participation exemption" regime does not apply, the negative difference between the realized capital gains and capital losses and other losses relating to shares is fully deductible for tax purposes, unless when related to shares of companies resident in a country, region or territory with a clearly more favorable tax regime.

MERGERS, DEMERGERS, TRANSFER OF ASSETS AND EXCHANGES OF SHARES (TAX NEUTRALITY)

The following reorganization operations taking place as from January 1st, 2014, are now expressly included in the tax neutrality regime:

- Mergers without attribution of shares to the shareholder of the merged company, when all the shares representing the share capital of the companies involved are owned by the same shareholder;

- "Reverse Mergers" when all the shares representing the capital of the receiving company are owned by the merged company;

- Demerger-mergers, when at least one branch of activity is spin-off and transferred to the company which holds all the shares representing the share capital of the company subject to the spin-off;

- Demerger-merger, when at least one branch of activity of the demerged company is spin-off and merged into another existing company whose capital is entirely owned by the same shareholder;

- Demerger, when at least one branch of activity of the demerged company is transferred to a company whose capital is entirely owned by the demerged company.

As a general rule, tax losses within this kind of operations are now automatically transferred, i.e., it is no longer required authorization of the Minister of Finance for such purpose. However, the transfer of tax losses resulting from a merger involving all companies' part of a tax unit regime still depends on the authorization of the Minister of Finance.

On the other hand, it is expressly set forth for most situations that the deduction of transferred losses is limited to the proportion of the value of the net assets of the transferor company in the value of the net assets of the other entities involved in the operation.

It is established that the tax benefits of the merged companies are transferred to the recipient company, provided that the latter meets the necessary requirements for such transfer and the tax neutrality regime is applicable.

Similarly, tax benefits may also be transferred within demergers and transfers of assets provided that authorization from the Minister of Finance is granted for such purpose.

Additionally, it is stated that the amounts in excess which are not carried forward and the amounts which are not used related to the limitation on the deductibility of net financing costs rule by the merged companies may be taken into account for determining the taxable profit of the beneficiary company of a tax neutral merger.

III. Other Measures

Tax Transparency

The concept of professional partnership is extended to include those which income arises in more than 75% of the combined or isolated performance of listed professional activities, as defined by article 151 of the Personal Income Tax Code, provided that (i) the respective number of partners is not higher than 5, (ii) none of the partners is a public law entity and (iii) at least 75% of the respective share capital is held by professionals carrying out the listed activities, total or partially, through the professional partnership.

It is expressly foreseen that entities that carry out a shareholding management activity and that hold participations that comply with the requirements of the "participation exemption" regime are excluded from the concept of pure (passive) asset management entities, and therefore do not qualify for the tax transparency regime.

Tax Unit Regime

For purposes of applying the tax unit regime, the minimum percentage in the share capital of the participated entities is reduced to 75%, provided that such shareholding continues to grant more than 50% of the voting rights.

This new shareholding percentage can be indirectly achieved through an EU Member State or EEA resident company, provided that, in this last case, exists an obligation to administratively cooperate in tax matters identical to the one established within the EU.

When the dominant company of the group loses that status and becomes a participated company of another Portuguese resident entity that qualifies as dominant company for purposes of the tax unit regime, the latter may choose to continue to apply the tax unit regime.

Specific rules are introduced in respect of the carry forward of tax losses whenever changes occur at the level of the Group's dominant company, notably in case the dominant company becomes a participated company of another already existing Group.

Finally, it is set forth that the lack of communication in due time of changes in the Group's composition no longer determines the automatic cancellation of the tax unit regime.

Winding-up of Companies

The liquidation proceeds attributed to shareholders, deducted from the acquisition cost of the participations and other equity instruments, are from now on always qualified for tax purposes as a capital gain or capital loss.

When a capital gain results from a company's winding-up it may benefit from the "participation exemption" regime, being therefore excluded from taxation provided that the necessary requirements are met.

When a capital loss results from a company's winding-up it may be tax deductible, but only on the amount exceeding that resulting from the sum of the used tax losses within the scope of the tax unit regime and the distributed profits and reserves of the wounded-up company that have benefit from the "participation exemption" regime.

Capital losses arising from a company's winding-up will not however be tax deductible if the wounded-up company is resident in a country, territory or region with a clearly more favorable tax regime or when the participations have been held for less than 4 years.

Finally, the amount of the capital loss deducted for tax purposes should be added to the taxable profit, increased by 15%, at the level of the shareholders of the wounded-up company, whenever they start undertaking the same activity that was performed by the wounded-up company in the 4 taxable years following the winding-up.

TRANSFER PRICING

The concept of related entities is amended, namely through the increase of the percentage in the share capital of a company from 10% to 20% for purposes of qualification as related entities.

The cases of significant dependency between two entities within the carrying out of a business activity are now limited to the ones resulting from a legal obligation.

Transfer pricing rules are now expressly applicable to operations carried out between Portuguese resident entities and their foreign permanent establishments as well as to the ones carried out between those foreign permanent establishments.

MERGERS, DEMERGERS, TRANSFER OF ASSETS AND EXCHANGE OF SHARES (NON-TAX NEUTRAL)

A set of rules is introduced aiming at clarifying the Corporate Income Tax regime applicable to mergers, demergers, transfer of assets and exchange of shares that are not covered by the tax neutrality regime, notably in respect to income qualification and computation of the income liable to taxation, both at the level of the entities involved in these operations and at the level of the respective shareholders.

Shareholdings Valuation Criteria

It is set forth that the valuation criterion to be used on the onerous transfer of shareholdings of the same nature and that grant identical rights is the *"first in first out"* (FIFO) criterion.

Notwithstanding, taxpayers may opt to apply the average weighted cost criterion, in which case the acquisition value of the shareholdings cannot be updated by the monetary coefficients foreseen in article 47 of the Corporate Income Tax Code, and to the extent that this alternative criterion applies to all shareholdings belonging to the same portfolio and is used for a minimum 3-year period.

International double taxation – Ordinary Tax Credit

The ordinary tax credit to avoid international juridical double taxation is now assessed by country, taking into account the total amount of income arising in respect to each country, with the exception of income attributable to foreign permanent establishments of Portuguese resident entities, in which case the computation is made on an individual basis.

The amount of the tax credit that cannot be deducted on the tax period in which it was generated due to lack of tax due may once again be deducted within the following 5 taxable years.

Ancillary Obligations

Some ancillary obligations have been simplified, notably by replacing the need to obtain previous authorizations from the Portuguese tax authorities for mere communications, as it is the case for instance of adopting a tax period different from the calendar year and the use of depreciation or amortization rates lower than the minimum rates.

The necessary formalities for waiving or reducing the domestic applicable withholding tax or the reimbursement of the tax withheld in respect to income obtained by non-Portuguese resident entities, pursuant to the provisions of the Agreements on the Avoidance of Double Taxation, any other International Law agreements or applicable Portuguese legislation, have been simplified.

In fact, it is now allowed the submission of the RFI-forms accompanied by a document issued by the tax authorities of the State of Residence of the beneficiary of the income confirming the latter's tax residence in the period at stake as well as the liability to income tax in such State, as an alternative to submission of such RFI-Forms duly certified by the referred tax authorities.

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