

CUATRECASAS, GONÇALVES PEREIRA



LEGAL FLASH | TAX

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Draft State Budget Law for 2016

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DRAFT STATE BUDGET LAW FOR 2016

The Government presented to the Parliament the Draft State Budget Law for 2016 (Draft Law nr. 12/XIII, hereafter "Draft SB 2016"). The initial version presented on February 5 was replaced by a new version on February 10. From among the tax measures proposed, we highlight those with greater impact on the activity of businesses operating in Portugal.

I PERSONAL INCOME TAX ("PIT")

Income brackets

The limits of the first three brackets of the PIT's general rates schedule are increased by 0.5%, with no modification of the applicable rates.

Deductions of losses

The carry forward period for losses within Category B (*Business and Professional Income*) decreases from twelve to five years, taking effect with reference to the losses incurred from January 1, 2017, onwards.

Income splitting mechanism - Marital quotient

The family quotient is eliminated and the marital quotient that was in force until 2014 is reintroduced. Thus, assessment of the PIT due of married taxpayers, who are not judicially separated of people and assets, as well as of couples living under civil union, is determined by applying the quotient of two, in case there is an option for joint taxation.

Deductions per descendants and ascendants

The annual allowed deduction to the PIT due increases from €350.00 to €550.00 per each descendant. The annual allowed deduction increases from €325.00 to € 525.00 per each ascendant cohabiting with the taxpayer. In case of handicapped descendants or of handicapped ascendants not earning income exceeding the value of the minimum pension of the social security general regime, cohabiting with the taxpayer, the amount of the annual allowed deduction increases to €1,187.50 per descendant or ascendant.

Healthcare, training and education expenses abroad

Taxpayers are now allowed to deduct healthcare, training and education expenses incurred outside of the Portuguese territory even if incurred outside of the European Union ("EU") or of the European Economic Area ("EEA").

PIT Assessment

Tax Authorities should summarize the basis of the PIT assessment, being required to include in the respective notification a reference to the applicable tax law provisions, to the qualification and quantification of the taxable events and of the operations undertaken to assess the taxable basis and determine the PIT due. Tax Authorities are now also required to disclose the PIT assessment's relevant information, notably that related to the allowed deductions to the tax due.

Legislative authorizations

The Government is authorized to legislate, among other, on the following matters:

- Implementation of a new online registration system for non-habitual tax residents;
- Anticipation to the end of January of the deadline to file Standard Form "Modelo 37". This form should notably be filed by credit institutions, habitational cooperatives, insurance companies, leasing companies as well as companies managing complementary regimes such as pension funds and retirement-savings plans.

II CORPORATE INCOME TAX ("CIT")

Participation exemption regime

Non-taxation of profits, reserves and of capital gains or losses obtained with the onerous transfer of parts of capital or other equity instruments will require a minimum shareholding of 10% (currently, 5%) and a minimum holding period of one year (currently, 24 months).

The non-applicability of the participation exemption regime regarding capital gains and losses derived from the onerous transfer of shares when the value of real estate represents more than 50% of the company's assets is now also applicable to the onerous transfer of other equity instruments associated with the shares, such as supplementary capital contributions (*prestações suplementares*).

The new minimum holding percentage (10%) and period (one year) are also applicable in order so that the withholding tax exemption on dividends and reserves made available by Portuguese resident companies to non-resident entities may apply.

These changes to the participation exemption regime apply to shares held prior to the entry into force of the State Budget for 2016, and the new relevant shareholding period shall be counted from the acquisition date of the 10% shareholding.

Tax losses carry forward

The tax losses carry forward period is reduced from twelve to five years. This new carry forward period applies to tax losses incurred in tax periods starting from January 1, 2017 onwards.

Profits and losses of permanent establishments located outside of Portugal

The optional regime providing for non-taxation of profits and losses attributable to permanent establishments located outside of the Portuguese territory is adjusted in line with the reduction of the tax losses carry forward period referred to above.

Transfer abroad of residence or of the assets of local permanent establishment

The participation exemption regime is now expressly applicable (provided that the necessary requirements are met) to the gains or losses related to parts of capital assessed upon transfer of a company's tax residence to other Member State of the EU or of the EEA with an agreement for administrative cooperation with Portugal.

The same applies in the assessment of the taxable income of a Portuguese permanent establishment ("PE") of a non-resident entity upon termination of its activity in Portugal or in case of transfer abroad of the patrimony allocated to the PE.

Tax credit for international economic double taxation

The minimum shareholding percentage and period required to apply a credit for the avoidance of international economic double taxation, in those cases where the participation exemption is not applicable, are changed to 10% (currently 5%) and one year (currently 24 months), respectively.

These changes apply to shares held prior to the entry into force of the State Budget for 2016, and the new relevant shareholding period shall be counted from the acquisition date of the 10% shareholding.

Tax Unit Regime (*Regime Especial dos Grupos de Sociedades* "RETGS")

In case the option to waive from a CIT rate lower than the standard rate of 21% is exercised in order so that one company may be included in the RETGS, it is now required that such option is maintained for a minimum period of three years.

Profit obtained within the previous Tax Unit Regime pending taxation

Taxation shall be now levied over profits still pending taxation as at December 31, 2015, which arose from transactions within economic Groups that were subject to CIT under the previous Tax Unit Regime (*Regime de Tributação pelo Lucro Consolidado* "RTLCL"), and that benefited from a taxation deferral pursuant to the transitional regime to the current Tax Unit Regime (RETGS), as per Law nr. 30-G/2000, of December 31.

Said profits shall now be subject to CIT, in equal parts, during the tax period starting in or after January 1, 2016, and in the two following tax periods.

An autonomous advanced payment, equal to one third of the total CIT to be paid over the referred three-year period, shall be done during July 2016, or during the seventh month of the 2016's tax period for tax payers adopting a tax period different from the calendar year. This payment will be deductible against the 2016 CIT due.

Entities not mainly engaged in a business undertaking

The CIT rate applicable to these entities is reduced from 21.5% to 21%.

The carry forward period for tax losses and capital losses is reduced from twelve to five years regarding tax losses and capital losses assessed in tax periods starting from January 1, 2017 onwards.

Autonomous taxation

In case of failure to comply with the conditions set forth so that no autonomous taxation is levied over bonuses and other variable remuneration paid to managers or members of the board, the amount of the autonomous taxation not assessed should be added to the CIT of the year in which the non-compliance occurs.

If the Tax Unit regime applies (RETGS), the 10% increase of the autonomous taxation rate levied in case tax losses are assessed is applicable by reference to the tax result of the Group.

Obligation to present an income statement

It is clarified that non-resident entities without a PE in Portugal, obtaining only herein exempt income or income liable to final withholding taxation are not obliged to file the annual CIT tax return.

Tax documents and accounting obligations

The period during which tax and accounting documents should be kept for inspection is reduced from twelve to ten years, concerning taxation periods initiating from January 1, 2017.

Multinational Groups' financial and tax information

Resident entities forming part of multinational groups become subject to a country-by-country reporting obligation.

Legislative authorizations

The Government is authorized to legislate on the following matters:

- (i) Revocation of the current *patent box* regime, and introduction of a new regime applicable to the income derived from patents and other intellectual property rights.
- (ii) Introduction of new rules regarding the CIT Special Payment on Account (*Pagamento Especial por Conta "PEC"*) due by companies included in a Tax Unit (RETGS).
- (iii) Introduction of an optional regime to reevaluate in 2016 fixed assets and investment properties.

III VALUE ADDED TAX ("VAT")

Waiving the VAT Exemption on medical and health care services

With the Draft SB 2016, private institutions may opt for the waiving of the VAT exemption on medical and health care services (and operations related thereto) provided that the latter services do not result from agreements entered into with the Portuguese State within the scope of the Public health care system.

List I annexed to the VAT Code - amendment

The following amendments to the List I annexed to the VAT Code – transactions subjected to reduced rate of VAT (currently 6%) – are proposed:

Paragraph	Current version	Draft SB 2016
1.1.5	Bread and similar products such as breadsticks,	Bread

	bread-nurse, loaves and rusks	
1.6.5	-	Live, fresh or dried algae
1.11	Juices and nectars of fruits or vegetables	Juices and nectars of fruits and algae or vegetables and oat drink, rice and almond drinks without alcohol
3.7	Live plants of forest and fruit species	Live plants of forest and fruit species and algae

List II annexed to the VAT Code - amendment

It is proposed that from July 1, 2016 onwards the intermediate VAT rate (13%) would apply to ready-to-eat meals under a ready-to-eat and take away mode, as well as to home delivery of meals and to food and beverage services. However, alcoholic beverages, soft drinks, juices, nectars, carbonated or sparkling water will remain excluded from the intermediate VAT rate (i.e., current standard VAT rate of 23% will continue to apply to these products).

On the other hand, canned meat will be taxed at the standard rate (23%) rather than being taxed at the intermediate rate (13%).

Legislative Authorisations

The Draft SB 2016 also includes several VAT legislative authorisations granting the Government powers to rule on the following:

- (i) Limitation of the moment when the right to deduct VAT may be exercised, in the sense that right to deduct VAT may only take place in the period in which the relevant input invoice was received or, at the latest, in the subsequent tax period.
- (ii) Amendment of invoicing requirements regarding transactions performed by taxpayers covered by the small retailers' regime.
- (iii) Amendment of the payment methods of VAT due on intra-EU acquisitions of new means of transports.
- (iv) Amendment to procedures to be followed in the application of the exemptions regarding supplies of goods to certain international organizations and under diplomatic arrangements, as well as to exemption on the dispatch of goods from Portugal to destinations outside European Union by a non-resident or non-established in the European Union territory.

IV MUNICIPAL PROPERTY TAX (“IMI”) AND PROPERTY TRANSFER TAX (“IMT”)

Property Fiscal Value (*Valor Patrimonial Tributário* “VPT”)

The VPT of urban properties used for activities of commercial, industrial or services’ nature is now updated on a triennial basis, by reference to the currency devaluation coefficient of the last year in which the VPT of said properties was updated.

By reference to December 31st, 2016, the VPT of the commercial, industrial or services’ urban properties that have been updated between 2012 and 2015 is extraordinarily increase in 2.25%.

The commercial, industrial or service’s urban properties for which the VPT’s general calculation formula is inadequate are now assessed according to the rules provided for properties classified as “Others”, *i.e.*, under the method of the cost added of the land’s value.

Safeguard regime for urban properties used as main permanent dwellings

The IMI of the urban properties used as taxpayers’ main and permanent dwelling cannot exceed last years’ IMI assessment, added by the higher of the following values: €75.00; or a third of the difference between the IMI resulting from the current VPT and the IMI that would result from the previous assessment, if no exemptions would apply.

The safeguard regime is not applicable in case of modification of the IMI’s taxpayer in the year to which the tax refers to, with the exception of cases where that change results from the transmission of the properties free of charge for the benefit of the former taxpayers’ spouse, descendants and/or ascendants.

IMI on properties used as main permanent dwelling of taxpayers responsible for dependents

The assessment of the requirements to the reduction of the IMI rates, to be decided by the city councils concerning the properties used as main permanent dwelling of taxpayers with dependents, is automatically effected by the Tax Authorities.

The relevant household composition for this purpose is the one verified in the last day of the year before that to which the IMI refers.

Exemptions

The properties included or to be integrated in open-end and closed-end real estate investment funds, pension funds and retirement-savings funds will no longer benefit from the halving of the IMI and IMT's rates.

The IMI and the IMT's exemption regime applicable to properties placed in "business location areas" is expanded provided that those properties are acquired or concluded until December 31, 2016.

An IMT exemption will apply to real estate investment funds whose participation units are fully held by the State, the Autonomous Regions of Madeira and Azores, the local government and the public associations and federations of municipalities.

Closed-end real estate investment funds

The acquisition of participation units in privately placed closed-end real estate investment funds, as well as the redemption, increase or decrease of capital or other operations in which, one of the holders, or two of the holders if married or living under civil union, become holder(s) of, at least, 75% of the participation units representative of the fund's assets, would be liable to IMT.

The transfer of real estate in the act of subscription of participation units in privately placed closed-end real estate investment funds is now subject to IMT. In this case, the taxable value of the transaction corresponds to the higher of the following amounts: the property's VPT; or the value of the investment for which the taxpayers participate in the real estate investment fund.

In case of dissolution of the real estate investment fund, if the properties remain to belong to unit holders that have already been taxed, the IMT is computed by reference to the difference between the value of the assets acquired and the value according to which the IMT was previously assessed.

Acquisition of shares and equity

In situations where IMT is due by virtue of the acquisition of shares or equity, and because of that acquisition the shareholders are reduced to two married persons, the matrimonial property scheme is now irrelevant. This regime also applies where the sole two shareholders are living under civil union.

Legislative authorizations

The Draft SB 2016 also authorizes the Government to introduce several legislative amendments for IMI purposes, from which we highlight the following:

- Levelling of the quality and comfort coefficients concerning the location and the operability of both the real estate used for housing and that used for commerce, industry and services;
- Reduction of the time limits for the lodging of appeals and judicial claims, which would then be calculated from the end of the deadline set for the voluntary payment of IMI's first or single instalment.
- Suspension of the IMI assessment while the tax services have not decided the application of the IMI exemption concerning properties used as main permanent dwellings.

V STAMP DUTY

Repo transactions

It is expressly foreseen that repo transactions are subject to Stamp Duty whenever the first acquirer or the first seller are domiciled in Portugal, being the first acquirer the corresponding taxpayer.

If the first acquirer is not domiciled in Portugal, the corresponding taxpayers would be (i) central counterparties, credit institutions, financial companies or other legally equivalent entities and any other financial institutions domiciled in Portugal that have intermediated the repo transaction, or, (ii) the first seller domiciled in Portugal, if such intermediation has not occurred.

Lease and sublease

For lease and sublease agreements with more than one lessor and sub-lessors, the taxpayer is the one submitting the communication statement to the Portuguese tax authorities related with the beginning of the lease and/or sublease agreement or, when such statement is presented by an authorized third party, the lessor or sub-lessor that firstly appears identified as such in the communication statement.

It is expressly foreseen that regarding a lease or sublease agreement of a real estate part of an undivided estate or a common area of a real estate under horizontal property, the taxpayer is the head of the undivided estate and the condominium represented by its administrator, respectively.

Shareholder loans

Shareholder loans made by stakeholders holding less than 10% of the company's share capital or holding such shareholding for less than one year will be subject to Stamp Duty, no longer benefiting from the current exemption.

Guarantees and financial transactions

It is now clarified that Stamp Duty exemption on interest and commissions charged, guarantees granted and credit granted between credit institutions, financial companies, venture capital companies and financial institutions only applies to guarantees and financial transactions aimed directly at the granting of credit within the scope of the activity carried out by the referred institutions and companies.

Guarantees in favour of the State or Social Security Institutions

The Stamp Duty exemption for guarantees in favour of the State or Social Security Institutions granted within the scope of debt payment made in instalments and prorogation of guarantees is now expressly foreseen in the Stamp Duty Code.

Card payment transactions fees

Fees related with card payment transactions are expressly included in the concept of "*other commissions and fees for financial services*", being therefore subject to Stamp Duty taxation at a 4% rate.

Disincentive to consumer credit

An increase of 50% in the Stamp Duty rates applicable to consumer credit transactions related to tax events occurred until December 31, 2018 is expressly foreseen.

Legislative authorisations

Authorization is granted to the Government to rule on the following matters, amongst others:

- (i) Set out the criteria for establishing the taxable value of the real estate acquired by means of special adverse possession;
- (ii) Regarding gratuitous transfer of participations in non-listed companies, foresee the application of a 4% spread over the relevant interest rate for purposes of computing the capitalization factor used for establishing the participations taxable value;
- (iii) To broaden the Stamp Duty payment control obligation on gratuitous transfers to the ones related to any kind of stakes, deposit of securities, public debt bonds and certificates and deposits of cash and equivalent monetary values (currently this obligation only applies to deposit withdrawals).

VI EXCISE TAXES (“IEC”), VEHICLE TAX (“ISV”) AND ROAD TAX (“IUC”)

IEC

There is a general increase of the tax rates applicable to products liable to excise duties.

In particular, regarding to excise duty on tobacco, the specific rate imposed on cigarettes will be increased from €88.20 per 1000 to €90.85 per 1000, while the *ad valorem* element will remain unaltered (*i.e.*, 17%).

The minimum excise duty applicable on cigarettes will be computed by subtracting from the minimum reference value (*i.e.*, which corresponds to 104% of the duty resulting from applying the standard rates of the excise duty on tobacco, plus VAT, of the cigarettes of the Most Popular Price Category of the year to which corresponds the special tax stamp in force) the VAT amount included in the retail sale price thereof.

The excise rate applicable to cigarettes produced and released for consumption in the Autonomous Region of Azores would also increase, being the specific rate set at EUR 18.50 and the *ad valorem* element at 42% (currently the rates are €16.30 and 38%, respectively).

The minimum excise duty applicable to cigars shall be €400 per 1000 instead of €60.00.

The specific rate applicable to smoking tobacco, snuff, chewing and heated tobacco is increased from €0.075/g to €0.078/g. The minimum excise duty applicable to these products cannot be less than €0.169/g.

Finally, the rate applicable to fine-cut tobacco increases from €0.135/g to €0.169/g.

ISV

The tax incentive to end-of-life vehicle renovation granted on the purchase of electrical vehicles, hybrids *plug in* and electric quadricycles remains in force until December 31, 2017.

From January 1, 2017, the values of that tax incentive are reduced by 50%.

IUC

The Draft SB 2016 foresees that entities engaged in a leasing and/or long-term rental of cars activity are no longer required to report to the Tax Authority the tax identification of the users of these vehicles.

Worth of noticing is also the legislative authorisation granted to the Government, whereby the latter is allowed to clarify that the taxable persons for IUC purposes are those individuals or legal persons governed by public or private law in the name of which the ownership of vehicles is registered.

In addition, another legislative authorisation is granted allowing the Government to establish the conditions under which the deregistration of vehicles can be officially promoted by the Tax Authority when the vehicles are registered under the name of extinct legal entities and when the vehicles are registered more than one year under the name of taxpayers who have died, where there are no known heirs or legatees or when the known heirs have renounced to the inheritance.

VII TAX BENEFITS

Taxation of income paid by Portuguese collective investment undertakings (“CIU”)

It is expressly foreseen that income distributed by CIU or deriving from the redemption of CIU units obtained by unitholders resident for tax purposes in countries, territories or regions with a more favourable tax regime are liable to Portuguese income tax at an increased rate of 35%.

The 35% rate applies also to income paid or made available to accounts opened in the name of one or more unitholders, although on behalf of third parties, except if the effective beneficial owner of the income is identified.

Furthermore, the application of the most favourable income taxation regime to non-Portuguese resident unitholders (exemption on income arising from Securities CIU and 10% rate on income arising from Real Estate CIU) is broadened to cover non-Portuguese resident unitholders held in more than 25% by a Portuguese resident entity or individual, provided the unitholders are entities residing in another EU Member State or EEA country that has entered into an agreement with the Portuguese State for administrative cooperation in the field of taxation or with which a Double Tax Treaty has been entered into foreseeing a clause of exchange of tax information.

Capital gains on the sale of securities obtained by non-Portuguese residents

Portuguese income tax exemption on capital gains arising from the sale of shares and other securities obtained by non-Portuguese residents will apply to non-Portuguese residents held in more than 25% by a Portuguese resident entity, provided the former are entities residing in another EU Member State or EEA country that has entered into an agreement with the Portuguese State for administrative cooperation in the field of taxation or with which a Double Tax Treaty has been entered into foreseeing a clause of exchange of tax information and that all the other requirements set forth in the law for the exemption to apply are duly met.

Termination of tax incentives on real estate

Application of the immediate termination of the IMI exemption on real estate that is no longer allocated for the purposes set forth in the exemption rule is broadened to cover also:

- (i) Corporate public entities responsible for the schools public network, in relation to real estate or part thereof allocated direct or indirectly to the achievement of their goals;
- (ii) Real estate exclusively allocated to water public supply, urban wastewater sewerage and urban waste management.

IMI exemption on real estate with reduced VPT

The IMI exemption on real estate with reduced patrimonial value owned by taxpayers with lower income will also apply to the real estate in which the taxpayer has allocated his/her corresponding tax domicile.

Legislative authorizations

Regarding tax benefits, authorization has been granted to the Government to rule on the possibility of expenses incurred with the acquisition in Portugal of fuel for the supply of goods and passengers transport vehicles and taxi benefiting from a maximum increase of 120% on the corresponding deduction as costs for purposes of computing the taxable profit of the Corporate Income and Personal Income taxpayers having organized accounting.

VIII TAX JUSTICE

General Tax Law (“LGT”)

Review of taxable acts

The current provision establishing that a fault in self-assessment of taxes is alike to a fault imputable to the Tax Authorities is repealed. Potential adjustments in favour of the taxpayer in relation to self-assessed taxes may only be made by reference to the previous two years.

Tax Procedural Code (“CPPT”)

Evaluation of Guarantees

Several criteria are introduced to evaluate guarantees granted in tax enforcement proceedings, with the exception of bank guarantees, deposit and guarantee-insurance.

Waiver of guarantees in payments up to 12 instalments

It is introduced the possibility to waive the granting of a guarantee in the context of the payment in instalments of (non-suspended) tax debts demandable in a tax enforcement proceeding, provided that a request for such waiver is presented by the debtor together with a request for payment on instalments, the payment plan is authorized with a maximum of 12 instalments, and if, during the life of the payment plan, the debtor complies with all the below requirements:

- i. Paying the instalments stipulated in due time;
- ii. Not to assign, lease, dispose or encumber in any way his/her patrimonial assets, safeguarding any act that is indispensable to the professional activity of the individual or that is set forth in the corporate object of the entity; and
- iii. Settle new debts that may be coercively collected through tax enforcement proceedings.

During the period of waiver of the guarantee, the applicable interest rate will correspond to twice the interest arrears rate applicable to tax debts (currently 5.168%).

This waiver regime is applicable to requests for payment in instalments submitted until December 31, 2016.

VIII OTHER AMENDMENTS

Contribution over the banking sector

Portuguese branches of EU credit institutions are now subject to this contribution.

The maximum rate applicable over the value of liabilities deducted of own funds and qualifying deposits is increased from 0.085% to 0.11%.

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